FY22 Results Presentation – Transcript

Jon Lewis – *Capita – Chief Executive Officer*

Thank you. Good morning, everyone, and thanks for joining us. I'm joined this morning, of course, by Tim Weller, our CFO, and also members of the executive team who are in the audience here who would be very happy to chat with anyone afterwards.

As usual, I take a moment to refer you to our disclaimer.

Capita today is a leading provider of business process services driven by data, technology and people. Put simply, we help our clients realise improvements in productivity and customer experience. We achieve this by combining our deep understanding of their business operations with an increasingly competitive array of digital solutions. 2022 was an important year for us, which I'm pleased to report a turnaround in our underlying financial performance, demonstrating the financial benefits of our strategy to focus on the two core markets we serve best.

We delivered accelerated growth during the year with four percent revenue growth in the second half after one percent in the first. Our competitive solutions mean we are winning in all our markets and verticals and as I will show later, we cemented our reputation for delivery with our clients, which is further aiding our growth ambitions.

Our top line growth benefited profit before tax, swinging from a loss of £123 million in 2021 to a profit of £74 million in 2022. Profit before tax was also enhanced by an improving revenue mix, cost savings from the restructuring program and non-recurrence of the related cost. And with the high growth rate achieved, we also delivered positive free cash flow as expected.

Through the sale of our portfolio businesses and Pay360 we realised just over 485 million in the year materially strengthening our balance sheet at the end of the year pre IFRS 16 net financial debt was just 85 million.

Now, of course, none of this would be possible without the commitment of our colleagues, many of whom are with us today. As a services company, a highly engaged, motivated and flexible workforce is fundamental to meeting our clients' expectations. And I am pleased to report that our employee Net Promoter Score improved 15 points in 2022 year on year.

Our strong client relationships, long term contracts, are increasingly competitive solutions, our engaged colleagues, and our track record for delivery means we have a resilient business, one well-positioned in the current uncertain economic environment.

It is perhaps helpful to reflect on where we are on our overall journey. Following four years of significant transformational activity, which we call complete this time last year, 2022 was a year of stabilisation in which we focused on embedding our strategy and its related operating model, ultimately delivering, of course, the results I've just spoken of. 2022 was, in many ways, a pivotal year for us as a company in which we ensured that we had the platform in place by which to accelerate our financial performance. And while there remain opportunities for cost efficiency, for example, through further simplification of our processes and reducing our employee attrition rates, it is top line growth that we are now most focused on and the operating leverage that that will provide. For this reason, we are selectively investing in digital solutions, have improved sales incentives and processes, and are increasingly focused on new client opportunities. And helpfully, over 50 percent of our weighted pipeline in 2023 represents opportunities with new clients or growth on existing accounts. Improving conversion rates on these is key to accelerating our overall revenue rate. I'll come back to this later but let me now hand over to Tim to talk you through the numbers to. Tim.

Tim Weller – *Capita – Chief Financial Officer*

Thanks, Jon. Morning, everyone. As Jon just said, we've seen a turnaround in financial performance and we significantly strengthened the balance sheet. As mentioned on this slide and consistent with prior presentations, our results are presented on an adjusted basis unless stated otherwise. As we noted at the half year, we've restricted the adjustments we make to those resulting from business exits, the amortisation and impairment of intangibles of goodwill and certain fair value adjustments. We simplified our financial reporting and are no longer calling out significant restructuring costs and contract & litigation related provisions as below the line items. The comparatives have been represented on the same basis and we provide a reconciliation to the previously reported numbers in the appendix to the presentation.

Turning to the next slide for our financial highlights. We've seen revenue growth accelerating across the year from one percent in the first half to four percent in the second, resulting in full year growth of 2.4 percent. We saw a stabilisation of revenues in the experience division with stronger growth in the Public Service and Portfolio divisions. We've seen significant improvements in operating profit, profit before tax and EBITDA reflecting this revenue growth, efficiency delivery and the completion of the group's restructuring programme in 2021. We delivered positive free cash flow as expected. And we've also seen a 91 percent improvement in free cash flow after capital lease payments. This reflects our increased operating profit, improves cash conversion, reduced level of pension contributions and the final COVID 19 related VAT repayment.

The growth in free cash flow, coupled with disposal proceeds realised in the year contributed to the 45 percent reduction in net debt. With our net financial debt pre IFRS 16 reducing substantially to 85 million. Overall, the groups are a turnaround in financial performance in 2022 with a step up in revenue growth, a step change in profit, and positive free cash flow.

Now turning to the divisional performance and Public Service on Slide 7. The divisions are accelerating revenue growth across the year with second half growth of four percent and full year growth of 2.5 percent. This was underpinned by new wins such as the Northern Ireland Teachers I.T. Refresh contract, annualisation of the Royal Navy Training contract, a full test cycle under the STA contract, and growth in central government contracts offset by revenue reductions in some Local Public Service contracts.

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Operating profit fell by 1.8 percent, reflecting the mix of work and reduce margin on the Army recruitment contract as it moved into the next phase of service delivery, partially offset by the impact of revenue growth, a benefit from the 2021 conclusion of the Electronic Monitoring Transformation programme and the cessation of restructuring spend.

Cash generated by operations saw a step from £67 million to £95 million, reflecting the working capital benefit of contracts moving into operational phase and a step down in deferred VAT repayments offset by contract provision utilization.

Moving on to Experience, on the next slide, we saw a stabilisation in revenue and a step change in profit. Revenue was impacted by significant prior year contract losses, offset by new wins, including those in International and Scottish Power. There were no material new contract losses in 2022, resulting in a much improved revenue trajectory compared with a 10 percent decline seen in 2021. Operating profit was adversely affected by the flow through of prior contract losses. But even so, the result was up by almost £30 million on 2021, which is impacted by restructuring costs and closed book life and pensions provisions.

Cash flow improved as a result of improvements in working capital across the division during 2022, with 2021 cash flows impacted by deferred VAT repayments, restructuring spend, and contract related provisions.

On the next slide, we provide the reconciliation between adjusted and reported PBT. Adjusted profit has improved by roughly £200 million, principally reflecting a step up in profitability in the Experience and Portfolio divisions and a step down in central group costs following the cessation of restructuring in 2021. We also completed a number of disposals from our portfolio division and sold the Pay360 business, which previously sat with the Experience division, realising disposal gains of £167 million. The benefit of this was offset by a non-cash goodwill impairment charge of £169 million. In respect of a number of the businesses remaining in the Portfolio division at year end, in recognition of our current expectation of the outcome of the disposal processes underway.

The next slide sets out the detail behind the substantial improvement we've delivered in cash flow in the year and the drivers behind the step reduction in net debt achieved by year end. EBITDA increased 67 percent, reflecting the improvement in adjusted profit I talked about earlier. We saw a significant improvement in operating cash flow, reflecting a number of our contracts moving from transformation to operational phases. We also increased the utilisation of receivables financing over the year as with prevailing interest rates, it's become an economically appealing lever to pull.

Pension deficit contributions reduced by £44 million as the group reverted to the £30 million of regular annual deficit contributions set as part of the 2020 triennial funding agreement with the pension scheme trustees. During the year we completed the disposal of eight businesses realising net cash proceeds of £388 million. We saw a substantial reduction in net debt of £397 million, reflecting the group's positive free cash flow generation, as well as proceeds of the disposals, an ongoing programme of leased property estate assets.

Turning to the next slide, which shows the Group's liquidity position. The group was undrawn on its revolving credit facility at year end, compared with £40 million drawn of the 2021 full year. As we noted at the half year in July, we extended the RCF to August 2024. Private placement loan notes of £227 million were repaid during the year, with additional £39 million repaid to date in 2023. As you can see from the chart at the bottom the slide in each of the last three years, we've repaid over £200 million of debt, which has broken the back of the group's refinancing challenge. Given our robust liquidity position and cash flow generation capacity, the group's future debt maturity profile no longer represents anything like the challenge it was just three years ago.

Building on this theme, on the slide, we take a look back at what's been achieved over the last few years in terms of balance sheet strengthening. Since the start of 2018, we've realised proceeds totalling around £1.3 billion from the successful non-core disposal program. These proceeds have contributed towards the repayment of around £1.7 billion of debt in the same time period. Our ongoing property rationalisation programme has delivered a £45 million per annum saving on net cash payments for lease liabilities, and this has been supplemented by incremental savings through reduced energy usage, capital investment and other property running costs. Our pension deficit is reduced substantially with payments of around £350 million into the group's main defined benefit pension scheme since 2018, with the overall pension now in an accounting surplus position. As I previously outlined, we extended of the RCF in July for initial 12 months and with net financial debt pre IFRS 16 of only £85 million, our leverage is now well within the Group’s medium term target envelope.

Moving to the next slide. In 2022, we received net disposal proceeds of £388 million for the Portfolio programme and the exit of Experience’s Pay360 business. We've now launched processes for all of the remaining pillars within the portfolio and are focused on maximizing proceeds, targeting the sale of these businesses by half year, depending on market conditions.

The next slide shows the key areas where we've delivered significant efficiencies over the year. Firstly, improving operational performance and project execution on our major contracts continues to be a rich source of cost reduction for capital and its customers. We're very focused on disciplined contract management and maximizing the benefit of our demand led resourcing model to meet the peaks and troughs in client trading cycles.

The delivery functions in our two core divisions are running continuous improvement programs, working with our centralised TSS Energy Function to maximize the efficiency benefits of digitisation and standardise tools and processes. We continuing to drive cost optimisation through expanding our delivery capabilities and resources in Poland, South Africa and India to improve the flexibility of our client offer.

Finally, as I mentioned previously, our property rationalisation program continues to deliver cost savings with 137 properties vacated since 2019. Going forward, in addition to each of these areas, we will target further cost savings from areas such as legal entity rationalisation, reducing employee attrition across the group, and moving to a lead central overhead structure.

Now turning to the next slide for guidance on our outlook from a financial perspective. Just to be clear, the guides on this slide is for Core Capita, which excludes the remaining Portfolio businesses. In the appendix of this presentation, we provided a bridge between the overall group results of 2022 and the pro forma results for Core Capita. We expect to see further acceleration of revenue growth in 2023. And over the medium term, we'll continue to target mid-single digit revenue growth in line with the guidance we gave at the half year. On EBIT margin, we're targeting to at least double the 2.9 percent margin delivered in 2022 over the medium term. We expect 2023 operating cash flow conversion to reduce slightly from that seen in 2022, which benefits from a step up in usage of our non-recourse invoice discounting facility. Overall, we expect cash generated by operations in 2023 to be broadly in line with that delivered in 2022 with more significant growth over the medium term as pension deficit contributions step down and we see the cash flow benefit from revenue growth and margin improvement. We're planning an increase in capital expenditure in 2023 to between £50 million and £60 million as we invest in digitisation and technology improvements in both divisions.

Notwithstanding this increase in technology investment, we expect to see continued reductions in debt in 2023 from completion of the Portfolio disposal programme and further property estate rationalisation. Over the next few years. We currently anticipate running with the relatively low level of net financial debt will leverage well within the group's medium term target range. Overall, we are well positioned to deliver sustainable growth over the medium term. And so with that, I'm back to Jon.

Jon Lewis – *Capita – Chief Executive Officer*

Thank you, Tim. As you know, our purpose creating better outcomes is at the very heart of everything we do at Capita and is one of our corporate priorities. It's a key part of how we run the business. This has now been formally recognised through the creation of an ESG committee of the board, which ensures environmental, social and governance considerations are integral to everything we do, including executive compensation. This is quite a detailed snapshot of some of the things we've achieved around ESG in 2022, which I'll let you read at your leisure. But I want to emphasise a couple of things that are important in the context of our business. Firstly, our performance on the prompt supplier payment, the engagement of small to medium enterprises in our solutions, tur commitment to the real living wage, the importance we place on equality, diversity and inclusion, and our commitment to net zero by 2035 provide us with a very strong social value score, particularly important as we look to win more work with government.

There were in fact a number of public sector contract wins in 2022, in which we were commended for our social value score, and we continue to aspire to be the UK government's most progressive purpose led strategic supplier. Of course, our ESG credentials are also an important factor in our ability to attract talent. We see from our recruitment programme and our employee surveys that people increasingly want to work for companies committed to being responsible businesses, manifested through deeds and not just words.

With the highest levels of inflation in many decades, we are supporting colleagues through the cost of living crisis, biasing our salary increases this year to our lower earning colleagues. We remain committed to being a real living wage employer in the UK and adopting a fair pay approach in other geographies.

And lastly, we've cemented our reputation for delivery with our clients, which is further aiding our growth ambitions of course. Our customer Net Promoter Score was up six points year on year to plus 35 points, a highly competitive performance amongst our peers. As already mentioned, a highly engaged and motivated workforce is vital for any services business and following the disappointing reduction in our employee Net Promoter score in 2021, you'll remember directly related to the significant restructuring that took place that year, we undertook specific measures in 2022 to address this. This included a significant ramp up in employee communications, including our Be Brilliant Be You campaign, investment in training and development, and ensuring we had a competitive employee value proposition. As a result of these measures are employee net promoter score, employee engagement, and wellness scores all improved materially year on year.

According to the Institute of Employment Studies we are experiencing one of the tightest labour markets since records began. Given our ability to attract and retain the talent required to deliver, our strategy remains a key risk and cost. We continue to invest in recruitment capacity and attrition reduction. Our recruitment engine met demand in the second half of 2022 for the first time since the pandemic and continues to do so. Revenue is no longer being lost due to a lack of delivery capacity, and we now focus on improving fit to roll, a key factor in reducing attrition.

For the group as a whole, voluntary turnover was unchanged at 30 percent for the year, but the underlying performance is more nuanced. It did reduce towards the back end of the year and we have made great progress in reducing attrition in Capita Public Services and TSS. But in Experience, as with many other peer companies in the customer management sector, there are still pockets of the business -- essentially four contracts in our case -- where attrition remains challenging. Given the material burden, margin burden, attrition places on the business, reducing what we call cost of churn is a core area of focus in 2023 with defined management targets which drive executive compensation.

Now, one mitigating factor to attrition is the continued benefits of our virtual approach, virtual first approach to flexible working. It is a differentiator in terms of recruitment and retention, as other employers are encouraging staff to return to the office. It is also -- it also allows us to access talent from disadvantaged groups and the so-called economically inactive. And in 2022, 85 percent of employees gave our virtual first policy, a reason to stay with Capita. More interestingly, amongst colleagues embracing hybrid working, we see materially less sickness and absenteeism, attrition is half that of office-based staff, and hold and handling times and our customer management operations are lower for homeworkers than office based staff. In other words, a virtual first model has improved our colleague’s productivity and reduced our property costs.

As mentioned in one of my introductory slides, top line growth will be the primary driver of accelerated financial performance going forward. This will come from a combination of renewals, often with expanded scope, as we have seen in the current Functional Assessment Services tender for the Department of Works and Pensions, growth on account as we have very effectively executed on our TFL Transport for London account the last few years, and new clients exemplified by Scottish Power and the HMRC wins in 2022.

Starting at the bottom of the triangle on this slide, our renewal rate in 2022 remained pretty strong at 97 percent, testimony to the ongoing competitiveness of our offerings and the quality of service we deliver. Our growth in account win rate was 75 percent and our new client win rate was 11 percent. This was a decent overall performance, particularly in the second half of 2022, but we're challenging ourselves to do better in 2023. An appropriate setting of sales targets and their associated incentive schemes is core to achieving this. For example, sales compensation and all deals greater than £25 million is based on net margin and for example, on a deal of £100 million, the multiplier is one on renewals, 1.25 for growth and 1.5 for new clients. In otherwise we're incentivising ourselves organization to win growth on account and new clients. And in life contract performance and net margin hurdles have to be met for the second sales compensation payment to be made.

We also placed particular emphasis in 2022 on building new client pipeline for 2023, which if we combined with growth on account represents more than 50 percent of the opportunity set we have this year, the highest it has been in at least seven years. Now we have a habit of emphasising the larger, more binary, longer sales cycle contract opportunities. But it's worth remembering that we also deliver growth from a healthy mix of smaller transactional engagements. Through our market vertical structure we're getting far better at originating the sub £10 million TCV opportunities and in 2022 over 40 percent of the TCV won, around £1.16 billion was driven by deals of this size and with this much shorter sales cycle.

As you can see on this slide, in 2022, we won contracts with a total value of nearly £2.9 billion. An 18 percent reduction on 2021 as a result of contract phasing in Capita public service, something I'll come back to later on. But as focused as we are on growth, it is not at the expense of contract alignment to strategy, deliverability at the price bid, of balance between margin and execution risk. Our contract review committee, which we've talked about many times, which Tim and I sit on, remains a core and integral part of our governance model. We are not going to repeat the mistakes of the past.

Throughout our journey, we have talked about the need to migrate our contract portfolio from the more commoditised BPO space into the business process services arena. As this slide illustrates, we're taking both existing clients on this journey, as well as winning new work firmly in the BPS space. Capitalising on this digitalisation shift is strategically key for us with our capabilities in this space, improving our competitiveness, making us more sticky with those clients, and ultimately driving margin improvements. We achieve this by combining the deep market insights and client needs provided by our market vertical client partners with the technical capabilities of our 4,200 person strong Technology and Software Solutions organisation.

So for example, under our revised contract with Barnett Counsel signed in 2022, some of the BPO elements went back in-house, but we kept the more digitally enabled parts co-designed and developed new digital solutions with citizen staff and partners to drive improved responsiveness, productivity and end user experience. This is translated into a 50 percent increase in digital transactions for the council, an increase of online satisfaction by 13 percent, and a reduction in the number of phone calls by 30 percent over the last three years. It's a great proof point for what we can do for our public sector clients.

Contracts won in the BPS space often leverage existing Capita IP, by delivering, for example, a mortgage origination platform for virgin money by building on our proprietary Omiga software. Much of our software development is undertaken in our digital development centre in India, part of the technology and software services organisation where we have seen continued improvement in in the velocity of release cycles. And technology partners Microsoft, Salesforce, Palantir, Amazon and others are also playing an increasingly important role as we standardise our technology stack and go to market together, these global technology players see us as a vehicle by which to increase their share in the segments we serve, often leveraging our presence on government framework agreements.

So let me now spend a few minutes on each of our core divisions, highlighting their growth potential, market resilience, core strengths, and our strategy to generate more value from them. According to Tech Market View, Capita Public Service is the number one strategic supplier of both software and IT services and business process services to the UK government, with around 10 percent share of a market that's worth around £13.9 billion, While the market as a whole is predicted to grow at around 5 percent per annum, subsectors, particularly those in the digital arena, are growing at more than double this. Based on 30 years of experience, we focus on and are structured around those market verticals with the healthiest growth rates and where we can leverage our specialist knowledge and insights. These five market verticals are justice, central government and transport, defence, fire and security, local public services, health and welfare, and education and learning. And we believe we are largely insulated from UK public sector budgetary pressures due to government spend in our core market verticals being nationally critical activity. I'd sight army recruitment and personal independence payments as examples of that. And we're also part of the solution, of course, as government focuses on the digitalisation of services with its associated cost benefits.

As you'll no doubt be aware, the UK Government published its Roadmap for Digital and Data in '22, outlining its spend of up to 8 billion by 2025 on digital transformation. Based on our investment in and operational delivery on a number of contracts such as HMRC automation and the Turing Grants Scheme, the UK Government for the first time now regards us as a digital services provider alongside our more traditional complex outsourcing credentials. We are one of a small handful of strategic suppliers to government with credentials in both categories.

Capita Public Services reputation for delivery is now cemented and we have strong client relationships as reflected in the nine point improvement in the customer Net Promoter score to plus 33 achieved in 2022. Now we saw a 50 percent reduction in TCV sold in CPS last year to £1.2 billion as a function of two things. Firstly, the non-repeat of the very large 925 million Royal Navy Training contract, Project Selborne, as many of you will remember in 2021. And second, the contract tender slippage a function of UK politics in the middle of 2022, resulting in the closing dates of contracts with a total TCV value of more than £2.5 billion moving from the second half of 2022 into the first half of 2023. It's important to remember that these have not been lost. They've simply moved to the right. We have over £1 billion of this TCV to be awarded in Q1 of this year and we have already been informed that we are the winning bidder on 25 percent of this.

As a result of the government's outsourcing playbook commitments, we now have better insight to contracts that will be tendered over the next several years by analysing the services and technology required to deliver these, we have mapped a series of scalable and repeatable solutions based on a common tech stack that would underpin two or more of these future contract opportunities. And we're using our proven model of consult, transform, and deliver with increasing integration of technology, digitalisation and partnerships. And we're starting to invest in a controlled and very disciplined manner in a selection of these propositions ahead of time to improve bid quality, price competitiveness, and the margin potential of our tenders -- tender responses.

Good examples of such propositions would be the automation and digitisation of records or the BPaaS business processes as a service solution for medical assessments. These digital Lego blocks, as I call them, will be increasingly important to our ability to win and deliver appropriate margins from this business. And mark an important strategic shift in our approach to government bids. Historically, each major contract Army recruitment, for example, was bid with a unique tech stack and a unique set of processes. This significantly increased cost, both at the bid and execution phases, increased execution risk, limited the transferability of resources, and ultimately stymied the margin potential on that contract or those contracts.

This next slide illustrates the much more balanced portfolio of contracts across the renewals, growth on account, and new client spectrum division is built over the last year or so. Our renewals performance was strong at 91 percent, with all renewals securing improved financial and commercial terms. A previous slide showed that 94 percent service delivery on KPIs for the Division, a performance that has helped us win expanded scopes with Transport for London and the Royal Navy Training contract, which we've delivered every aspect of on time, on spec and on budget. As a result, we've continued to be awarded new scopes under this contract and the TCV now exceeds £1.03 billion.

In May last year, we were appointed as HMRC as new automation partner to develop, deploy, and support Robotic Process Robotic, process automation and other automation tools in order to simplify processes and drive operational efficiency. Now, in part due to contract slippage, but also down to improved origination, the division's weighted pipeline in 2023 is now £1.2 billion. It's a healthy balance of renewals, growth with existing clients, and new client opportunities, and we expect this to deliver accelerated growth in 2023. Capita Experience is a full service customer management solutions provider led by data, enabled by technology and powered by our people. It is the number one customer services company in the UK and Ireland, in the top five in Europe, and we have a blue chip client base with high customer loyalty in four key segments -- financial services, technology, media and telco, energy and utilities, and retail. We service clients in four geographic markets the UK, Ireland, Switzerland and Germany from those markets and also substantial delivery centres in Poland, India and South Africa.

Capita Experience has five competitive, repeatable and scalable market offerings. Customer experience transformation, customer experience delivery, collections, customer acquisition and retention, and pensions administration. The global customer experience market is worth more than £277 billion, with the outsourced element predicted to grow at around 5 percent per annum. Although, like the public sector – public services sector subsectors are expected to grow significantly faster. It's also worth remembering that globally, only around one third of customer management services are outsourced today, creating plenty of additional opportunity as solutions become more technically sophisticated and clients need more external support. Within that large growing market, Capita experienced won £1.4 billion of work last year, a 71 percent increase on 2021, taking its book to bill ratio to the highest level in several years.

Capita

Our market offerings and capabilities are aligned to the market trends and client demand. And this slide shows how our adoption of technology is positioning as well as the market expands its adoption of agent augmentation, self-service. and automation solutions. AI and data analytics are playing an increasingly important role in accelerating agent productivity and customer problem solving as clients find that customers demand ever higher levels of service. Such customer expectations are themselves a catalyst for growth.

On our Scottish Power contract, we quickly mobilized nearly 400 Capita agents early last year with our assisted customer conversations technology and AI based innovation. The tool provides real time feedback to our customer service agents using data analytics, driving a more personalized and efficient customer service outcome. Scottish Power are delighted with the services we are providing. Overall, our assisted customer conversation technology has helped clients with 58 million minutes of conversations in 2022. And we're using related technology on our chat platforms where on a number of accounts 70 percent of the chats have been fully contained and closed with our artificial intelligence solution.

Clients are also looking to utilise omni channel offerings with increased multi-lingual capabilities and capacity, with agents working remotely both on, near, and offshore. For example, our Virgin Media O2 contract is delivered across the UK, South Africa and India, with different services provided across each geography. Now we expect to make greater use of our operations in India and South Africa as we continue to grow this business.

Our propositions are competitive and attractive, and we won work in each of our market verticals in Capita Experience in 2022. Our telecoms clients are among the biggest in Europe and we renewed contracts with EE and Freenet. We anticipate doing the same here in the UK in Q1 with Virgin Media O2. As expected, during 2022, there were multiple wins within the financial services sector, including new clients Allianz, Santander and very recently this year, Commerzbank reflecting our strength in this vertical in particular. The challenging economic landscape poses an opportunity for Experience, particularly within our financial services and energy utilities industries as institutions in these sectors have a role to play in helping vulnerable customers through periods of economic uncertainty. Here, human intervention is required to ensure our clients meet their regulatory obligations to their customers. Our 99 percent renewal rate speaks to the high levels of operational delivery for our clients, and Experience has a weighted pipeline of around £1 billion this year.

So in summary, 2022 was another year of execution against our commitments. We now have strong operational momentum and a platform in place by which to accelerate our financial performance. We're growing. We're profitable. We've generated free cash flow and we have a solid balance sheet. And on completion of the disposal program later this year, we will have the minimum net financial debt. We have strong market share positions in growing markets with increasingly competitive offerings, a reputation for delivery, and much of our contract portfolio is protected from inflationary pressures. We therefore targeting accelerated revenue growth in 2023.

And as we continue to improve our efficiency and benefit from the operating leverage provided by revenue growth, we're targeting core Capita EBIT margins of at least double the 2.9 percent we delivered in '22 over the medium term as Tim presented. We will maintain a prudent approach to our capital structure with net financial debt to EBITDA at or below one times.

As I think I always say at this forum, there is clearly more to do, particularly on margins. But in these uncertain times, we have a resilient platform with which to deliver improving returns. Thank you. And we would be very happy to take your questions.

Male Speaker:
Mics on the way

Paul Sullivan:
Great. Thanks. It's Paul Sullivan from Barclays. I'm going to be greedy into four if that's okay. Firstly –

Jon Lewis – *Capita – Chief Executive Officer*

Let me grab my pen, Paul. Sorry.

Paul Sullivan:
How should we -- how should we think about margins this year? And so the range of outcomes and the key determinants of that and the sort of the phasing to doubling by, I guess 2025? How should we think about that? Secondly, how do how do you think AI changes the economics of Experience? And then thirdly, given dare I say it, you're going to be awash with cash on a financial basis by the end of the year, how do we think about capital structure and do you think there's scope for or do you want M&A to come back onto the agenda? And then just finally, for me, it looks like the auditors have removed the material uncertainty clause from the going concern. Is that indeed, material? Thank you.

Jon Lewis – *Capita – Chief Executive Officer*

They seem to be rather biased to our CFO. So margins, Tim needs to take the credit for the removal of the MU. Tim, if you could cover that and then the balance sheet and then I'll come back to talk about AI and economics and perhaps maybe make some other comments on the other questions as well. Tim.

Tim Weller – *Capita – Chief Financial Officer*

Okay. So on margins, the guidance was given to more than doubling is over the medium term. You know me, a bit sporty if I said we're going to be doubling by 2023. So I'd like to take the full time out to end this planning period in 2025 to get to that doubling. And that is clearly what we're saying. Reflecting the fact that we are going to be making both Capex and OPEX investments in this technology journey, do not expect a big step up in margin in 2023 is the guidance we're giving. Having said that, reflecting the improvement we have seen in particular in Capita experiences underlying financial performance in 2022, the mathematical result of that will be that there should be some margin improvement in 2023. So I'm being deliciously vague and not saying what the actual answer is, but it should be a little bit better than it currently is.

Awash with cash. Capital structure. I think Jon's official phrases is de minimis net financial debt. And you can do that maths when you start off with net finance.

Jon Lewis – *Capita – Chief Executive Officer*

Some of us are old enough to have done Latin in school.

Tim Weller – *Capita – Chief Financial Officer*

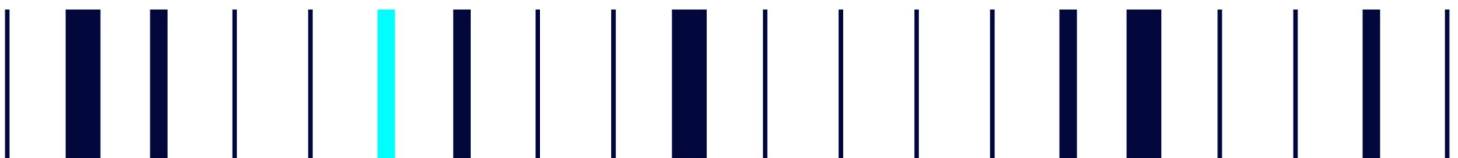
When you start off with a net financial debt of 85 million, you reflect the number of Portfolio businesses left to be sold. It would be disappointing if genuinely, it is anything more than de minimis net financial debt at that particular point in time.

Capital structure, M&A. What we've consistently said about capital structure is when we have completed disposal program and in the presentation we talk about targeting that to be achieved by half year. We will then set out what we expect our long-term capital structure and shareholder remuneration policy to be. So I'd expect to be giving an update on that at the half year. I presume you want to pick up on any suggestions around M&A.

On the removal of the material uncertainty, on going concern quantification. It's wrong to say I take the credit for that. The reality is it is the performance of this business that has got us there. So we have seen a step down in financial leverage through the successful portfolio disposal programme, a material diminution in the pension scheme deficit we have to fund. Importantly, a turnaround in the financial performance of the group, which clearly you roll forward into future expectations in a going concern assessment. And that going concern assessment. You are not allowed to take of take account of the things outside your control, which would in this case be the portfolio disposal programme. So without completing that portfolio disposal program, the directors have concluded that we are a going concern in all cases, including a severe but plausible downside. And the auditors will not be drawing attention to anything around that in the order of what you will see in a few weeks' time when we publish our accounts.

Jon Lewis – *Capita – Chief Executive Officer*

Modest as ever. M&A is not on the cards until we've determined what our long-term capital structure is. Have we started looking at some small bolt on opportunities that have protected IP as a means of accelerating our strategy to being a sort of full-service BPS provider in the two markets we serve? Yes, but we won't sort of pull the cord on any of that until we've finalized our capital structure. And then the economics and AI. We're delivering more value and we're de-commoditising what we're able to do versus some of our competitors. And that ultimately speaks to higher net margin on those contracts. And if we look at the work I mentioned, some of the companies we've been awarded work from in CE in my prepared remarks, the margins on those contracts, many of which have much richer digital content then -- and a more commoditised customer management service offerings. You know, those margins are in the high single digit, and we have a couple that are in the low double digit range. And that's, as you know, Paul, completely aligned with strategy. We want to get out of the commoditised BPO space, whether it's public or whether it's CE and have high value offerings that reflect where the growth is in the markets and reflect where we can earn high margins long term. In contrast to some of our traditional outsourcers.



David Brockton:
Good morning. It's David Brockton from Numis. Just two from the please. Firstly, in respect to the win rate, I mean clearly over the last year and two years the focus has been on renewals and securing those and you've done very well at that. As we look forward, you touched on some of the changes to compensation structure. I just wondered if you could sort of elaborate on when those were implemented. Are you starting to see an improvement in the win rate for new work and where you think that should be? That's the first set of questions. The second question just relates to if you can give a bit more, I guess, visibility on how you form the guidance for 2023 in respect of revenue growth. When you look at the book to bill in Public Service, it's lower yet you're expecting growth there. Yet when you look at Experience, the book to bill was higher yet you're expecting stability. I just want if you just help me understand your thought process there. Thank you.

Jon Lewis – *Capita – Chief Executive Officer*

Okay let's start with win rates. I'll make a couple of comments on growth given the order book and Tim might want to add to that as well. I think the first thing we should recognise is that our contract portfolio can be quite lumpy in terms of wins and they can massively shift the percentage win rates in different categories. So by way of example, our new business win rate went from 59 percent in 2021 to 11 percent in 2022, purely as a function of project Selborne, a £925 million new win contract in the prior year. We aspire to new client win rates of high teens to low twenties that would be competitive to, you know, our competitors in the space. And I think you can anticipate that we will sort of grind that percentage up over the course of 2023, 2024 and into 2025. You're right, our renewal rate remains very strong. And I think we're now at the point where we can perhaps negotiate a little bit harder on some of those renewals. I have -- I think you've heard me say before David -- never operated in a B2B business with renewal rates that high. We deliberately wanted to achieve that because through the early years of the transformation, we didn't want to attrit any more revenue than we had to. I think as we build the growth on account and new client opportunities, we could afford, quite frankly, to lose a couple of those renewals if we didn't believe that the returns were where we -- where they should be for the type of work we're doing, the risk we're engaging in and so forth.

In terms of commission structure, it was implemented this year and I think, you know, the next question is, well, you know, why do you believe you can grow? Given what's happened to your order book? Well, that is a key factor. We have, through Kathy Quashie our chief growth officer, completely transformed the discipline focus operation structure associated with ourselves operations. People know what their target is. There's overage. We have clarity on who's going to close what. We are prioritising commission, as I mentioned in the prepared remarks for growth and account, a new client, which tend to come at a high margin because you're ready, you know, the new client is building on -- sorry, the growth in account is building on an existing cost base, of course.

And then to your last point about guidance, I think we need to remember that the order book of Core Capita is flat year on year. The nine percent reduction is associated with removal of Portfolio. Of course, it's flat at 6.1 billion, which is not a bad achievement given £2.5 billion of opportunity slipped from 2022 into 2023. And that is very biased to Capita Public Services. The deal in CE there was of course Virgin Media O2 and we feel pretty well positioned on a billion of that for awarding Q1. We may not get it all, but we certainly have put in some pretty competitive bids on that government scope in particular. We will renew VMO2 too as well, which I, you know, contributes to that number.

I think the other point one should remember is a stat we've not shared before, which is, you know, the £1.16 billion in TCV we closed last year on deals are less than £10 million, short sale cycles, growth and account, leveraging our understanding of client needs. And I didn't say this, but they -- in new clients become a steppingstone to bigger things. Of course, we get into a client with a small opportunity from which we then hope to grow on the back of the quality of service we deliver.

Tim Weller – *Capita – Chief Financial Officer*

And if I can just add, picking up on that point about the smaller contracts and the cycle times. Revenue growth in a particular year, revenue isn't all about TCV win and how quickly that flows to some of the big complex contracts, you win it and it's takes, you know, a very long time before that actually starts playing through into revenue, recognizing you'll be transitioning potentially from one service provider to another. What we have in Capita Public in the second half of 2022 is momentum. So it grew four percent in the second half and that's why we continue to expect it to grow in revenue terms moving into 2023. The revenue growth in Capita Experience in the second half wasn't at the same level. And so that's one reason why we're expecting Public to outperform Experience in revenue growth in 2023. The other point in Experience is we continue to expect revenue attrition in respect of our life and pensions business in Capita Experience, which is going to naturally limit the actual revenues we deliver in '23.

Jon Lewis – *Capita – Chief Executive Officer*

Closed book Life and Pensions.

Male Speaker:
Chris.

Chris Bamberry:
Morning, Chris Bamberry. Peel Hunt. Four questions if I may. Going back to the new contract, new bids were unsuccessful. Are there any kind of recurring themes in terms of customer feedback on why you've been unsuccessful in Public or Experience? Secondly, what's your thoughts on the kind of central overheads this year, the kind that develops? Third to what your expectations for wage inflation this year? And finally, in your fixed cost contracts, can you give us a flavour how successful you are or otherwise in terms of improving pricing in those last year? Thank you.

Jon Lewis – *Capita – Chief Executive Officer*

Okay. Let me talk to new bids. I'll have Tim talk to overheads. I can talk to wage inflation. Tim, you may want to touch on fixed costs of – fixed cost contracts.

Let's start with wage inflation first. We allocated four percent in our '23 budget to wage inflation. We've since increased that between five and six. And we are biasing all of that budget to colleagues earning less than £120,000 a year. We will pay the 10.1 percent increase for the real living wage. Our attrition is greatest in our lowest earning colleagues, particularly in Capita Experience. So obviously a logical reason for continuing to pay the real living wage there. As I mentioned earlier on, we've asked people over 120 not to take a pay rise and all of ExCo volunteered to do to do the same.

In terms of new bids, I don't think Chris there's any one particular reason. At times it can be, you know, we were too greedy. Our price wasn't where it needed to be. I think the other thing one has to recognize with new clients is you don't know them as well, and you're often competing with an incumbent who has been there for many years. So simply deriving the relevant understanding of that client and their needs is much more challenging on a new client than it is on renewal. And that's why the renewal, that's why the renewal rates are so much higher than the new client rates. But as we continue to develop our stronger digital offerings, there is no doubt that is improving our capacity to win with new clients. And you know, we announced whenever it was -- well internally this week the Commerzbank deal as one example, a new client where we've got an opportunity based on a stronger digital content for the solutions we're providing than -- and I think it's more of the same that will ultimately deliver an acceleration in our win rate in the new client space.

Tim Weller – *Capita – Chief Financial Officer*

On the central overhead in the back of the pack in the pro forma calculation to strip out portfolio and leave you with core Capita. The central overhead factor, the Capita plc costs end up as £54 million for 2022. That is a pro forma. In the prepared remarks, we talked about the opportunities for further efficiency moving forward and clearly in our sights is that central overhead cost because that is a pro forma overhead. Is the overhead for the Capita that we were during the course of 2022. Clearly, as we are exiting the Portfolio business, we have the scope to shrink that central overhead further. We're not giving precise guidance on where it's going to end up, but you can expect it to be significantly lower than 54 million over the next couple of years as we drive that efficiency.

And then in terms of the fixed cost or the inflationary impacts on our contract portfolio, we have replicated once again in the appendices to the slides, the contract analysis we presented I think a couple of times now results announcements showing the split of our contract portfolio between those contracts that have indexation clauses built in and those that do not. Remembering that around two thirds of our contract portfolio does actually have the benefit of indexation clauses. And therefore what you are talking about in terms of exposure is on the remaining third. We have had a measure of success in that third in arguing and negotiating for incremental price rises. As Jon pointed out earlier, of course a significant amount of our in-year revenue is driven by contracts, small contracts before during the course of the year, and those are priced at current prices as opposed to historic prices. So actually, as we are going through the business development program with repricing in terms of new work. In terms of the upshot of all that in our order book at the end of the year versus the start of the year, we have an incremental £80 million as a result of the application of indexation clauses and other inflationary impacts.

Chris Banbury:
Thank you.

Jon Lewis – *Capita – Chief Executive Officer*

So, David, that's relevant to your question as well. The indexation tailwind we have and far fewer contract terminations. We have the lowest level of contract terminations coming into 2023 of any year in my six years of Capita.

Arthur Truslove:
Hi there, Arthur Truslove from Citi. So first question which is on the net debt. It sounds like you're on just over £80 million of net debt now on a financial basis, and you've got about £250 million of revenue to sell. So how conceivable is it that you end up in a net cash position? Second question is, I think from memory, the labour market was most tight around the end of 2021 from the experience you were having. Just wonder if you could comment on how that is progressing. And then thirdly, you know, once you finished getting rid of your non-core businesses and you've got your net debt down, is there any reason why you shouldn't introduce the regular dividend? Thank you.

Jon Lewis – *Capita – Chief Executive Officer*

Took a long time for the D-word to come up. [laughter]

Thank you. Let me talk about the labour market is probably best for Tim to talk to the other two. The labour market is still tight. And there is unquestionably hourly rate inflation. At the lower compensation levels of the labour market in the quite material. I mean, Tesco, who we compete with, quite frankly for some of the resources we have in our customer margin business, have just agreed to pay as a lowest salary £1 more than the real living wage. That puts stress on our ability to attract talent. That said, as I mentioned in our prepared remarks, we have managed to attract the people we need in the second half of last year and into this. But I think ultimately, and we're seeing this from our clients as well as we grow, I think you can expect that more of the resource associated with that growth will come from our centres in India, South Africa and Poland than the UK. And I'm always at pains to point out at this point that does not mean we are going to have redundancies in the UK. It's the growth that is going to lead to staffing more in our overseas operations than in the UK because of the tightness of the labour market.

Tim Weller – *Capita – Chief Financial Officer*

Net debt. There are clearly two measures of net debt. One is the accounting definition that includes capitalised leases and the other is net financial debt. At year end overall, net debt was £402 million and yes, there was £85 million of net financial debt. So if you starting with your £85 million of net financial debt, I think it would be disappointing if from the disposals we're talking about, we didn't realise more than £85 million. We're very coy about giving any kind of guidance in terms of proceeds for any particular transaction. But you've identified the amount of revenue that is in that in terms of the businesses to be sold and plaining it would be disappointing if we didn't achieve more than £85 million.

And then in terms of the D-word. Back to what I said before. We've been consistent in saying when we complete that portfolio disposal program is the appropriate moment to set out essentially a capital allocation or financial structure and distribution policy for this group moving forward. So that'll be something we come back to. If we do achieve the completion of the disposal program by the half year after the half year results announcement in August.

Female Speaker:
Some questions online.

Tim Weller – *Capita – Chief Financial Officer*

Of course.

Female Speaker:
I think they're all for Tim. Do you want them one at a time, or all in one go?

Tim Weller – *Capita – Chief Financial Officer*

Depends how many there are?

Female Speaker:
About five. So the first one -- they're all from Stian Husvaeg -- does the significant reduction in lease expenses in full year 2022 to reflect the new run rate? Or did you exit the year lower than the overall year reflects? And if so, can you provide some guidance on where the run rate is?

Tim Weller – *Capita – Chief Financial Officer*

So you've got two things about leases. You got the step down in lease liability, but also more personally the step down in capital lease rental payments, which came down from about £80 to £56 million between 2021 and 2022. The 80 number in 2021 was impacted by the pandemic and that they were deferred rentals from 2020 into 2021. And therefore the 80 had, if you like, a double count of rentals in that particular year in 2021. A more underlying decrease will be from high sixties to high fifties. And we do anticipate further reduction in rentals moving into 2023 and 2024, reflecting our ability to further trim our property estate.

Female Speaker:
Okay, Thank you. Then the next one is the expected acceleration in digital Capex investment for 2023. Should we consider this as a natural investment level to continue to develop digital capabilities and remain competitive?

Tim Weller – *Capita – Chief Financial Officer*

Yep. So the guidance we're giving is for Capex for the group as a whole, which includes an incremental amount in respect to digital investment to increase to £50 to £60 million for core Capita. That is an increase from around £36, £37 million in 2022. Yes, that would be our expected capital run rate moving forward. So kind of bubbling around a couple of percent of revenue, which is not out of line with what you would see in terms of investment by our competitors.

Female Speaker:
Thank you.

Jon Lewis – *Capita – Chief Executive Officer*

And just to build on that, Helen, I think it's important that we remember that we can do a lot more with that quantum of Capex today than we could five years ago when we were investing in tin and wire and data centers and we were developing solutions for our clients from scratch. We work very closely with the technology partners I mentioned in our prepared remarks, many of whom actually help us with the cost associated with the development of some of these platforms through a low-code no code approach. And we certainly aren't building tin and wire anymore. We are leveraging Azure, Amazon Web Services, etc. So it goes a lot further than it used to.

Capita

Female Speaker:
Thank you. Then the next question is does the acceleration in pension deficit contribution due to disposals mean that future pension contribution will be reduced? And how much do you foresee annual pension contributions to be going forward?

Tim Weller – *Capita – Chief Financial Officer*

Yeah. So at the moment we're running under the pension -- the agreed pension deficit contributions as part of the 2020 triennial and the pension year end is March triennial, which means that the next one is going to be in March 2023. So this month is the official start date for the next triennial. So if nothing else moves, the agreed payment profile under the previous agreement was £30 million the deficit contributions in 2023 and then £15 million per year in 2024, 2025 and 2026. The acceleration, absent any other moving parts as a result of the disposals, reduces the tail end 15 million in 2024, 2025 and 2026. However, I emphasize the point about absent any of the moving part and clearly a significant moving part is next triennial when we will both have a new valuation and then a new agreed funding schedule.

In the detail of the results announcement, you will see that in respect of pensions, the funding basis. So assuming the same assumptions as at the last triennial, we would be showing a £40 million surplus. So not only is the accounting surplus £40 million, coincidentally -- it is coincidentally -- the funding surplus, assuming the same basis of valuation at the last triennial, the 2020 would be also a £40 million surplus. However, over time, we and the trustees would like to move towards some form of self-sufficiency for this scheme and applying a sensible investment strategy and return expectation to move towards self-sufficiency. You'd expect that £40 million surplus to move to around a £50 million deficit. The £50 million deficit would obviously be covered by the already committed deficit payments. The £30 million in 2023 and £15 a year for the subsequent three years. Well, we haven't got anywhere near resolution of the triennial, I wouldn't expect the next valuation we go through to materially change what we're expecting in terms of deficit contributions going forward.

Female Speaker:
Thank you. I think you've answered the question, but there was a follow up from Andy Brooke at RBC basically saying, does that imply you think £15 million deficit reduction payments will end in 2024, 2025 and hence there'll be a boost to free cash flow? Think you're not committing on that?

Tim Weller – *Capita – Chief Financial Officer*

I'm not commenting on that because the -- we have to go through the process with the trustees. Clearly, we have called out the expectation of reducing deficit contributions moving forward as one of the contributors to the improvement in free cash flow moving forward.

Female Speaker:
I thank you. That's from all the questions online. Thank you.

Jon Lewis – *Capita – Chief Executive Officer*

Any other questions in the room? Thank you, everyone. Appreciate you coming.

Tim Weller – *Capita – Chief Financial Officer*

Thank you very much.