H1 23 Results Presentation Transcript

***Jon Lewis** – Capita – Chief Executive Officer*

Good morning, everyone. Thanks for joining us in August when most people are away on holiday, I think. I'm joined by Tim, our CFO, as well as a number of members of the executive management team, who will be here after the formal presentation, and you are very welcome to engage with them.

As usual, our disclaimer which I ask you to refer to.

Okay, 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. As expected, the first half of 2023 demonstrated the financial benefits of our strategy of doing precisely what I just described in our two core markets, Capita Public Services, and Capita Experience. Overall, we delivered accelerated revenue growth in the first six months with 6 percent growth after less than 1 percent disclosed in the first half of ‘22 and 4 percent in the second half of ‘22. This is the fourth successive period of growth and the fastest growth rate this business has delivered for many years.

Our competitive solutions mean we are winning in our chosen markets and our order book is strong. In addition, our strong sustained reputation for operational delivery is further supporting our growth ambitions of mid-single digit over the medium term. Our top line growth benefitted profit before tax from 25 million in ‘22 to 33 million in ’23, up 34 percent. Profit before tax was also enhanced by the Deferred Income release and a commercial settlement in the Experience division. Partly offsetting these was the 10 percent salary increase we gave to our lowest paid colleagues earlier this year, in line with our real living wage commitments. This increase, which along with other initiatives, I will cover later has helped reduce employee attrition by more than 3 percent on a 12-month rolling basis and improved our employee Net Promoter Score by plus five points -- plus 14 points, sorry.

We have continued to make good progress on our disposal program, we've realized 50 million net proceeds in the year to date, and of that 50 million just 5 million net proceeds in the year, in H1, with the remainder of the proceeds being received in the second half. And we continue to make good progress on the disposal of the remaining assets we have two or three to complete over the coming months. Our liquidity remains strong in June we extended the revolving credit facility to 2026 and then in July issued just over 100 million pounds in U.S. private placement notes. This diversifies our funding base and extends our debt maturity profile. On balance, a good performance in H1 demonstrates that the foundations we have created are delivering an acceleration in our financial results. There's more to do to reduce costs, including delivery of the 40 million pounds reduction plan we've announced today, as well as improving as a result of that and other actions of free cash flow. 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 that is well positioned for the future.

I'll come back to this later. But let me now hand it over to Tim to talk us through the numbers. Tim.

***Tim Weller** – Capita – Chief Financial Officer*

Thanks, Jon. Morning, everyone, apologies for the slightly slow walk across there. I'm having a bit of a challenge to my Achilles at the moment, inappropriate sports with 60-year-old is squash.

As Jon's just said, we've seen revenue growth across all divisions and half on half growth of 6 percent for the group as a whole. As mentioned on this slide, and consistent with prior presentations, our results are shown on an adjusted basis unless stated otherwise. As announced in May, we've incurred exceptional costs in resolving the cyber incident and these have been excluded from adjusted profits. Following feedback from investors, we've revised the definition of our free cash flow measures and these are now presented after deducting the capital element of lease payments and receipts. The comparators have been re-presented on the same basis.

Turning to the next slide for our financial highlights. We've seen revenue growth of 6 percent compared with the first half of 2022. This reflected underlined growth, as well as two specific factors in the Experience division being the beneficial impact of the early termination of our old contract and the commencement of our new contract with Virgin Media O2 and a commercial settlement in the closed book life and pensions business. We've seen an improvement in operating profit, profit for tax, and EBITDA, reflecting the growth in revenue and in particular the VMO2 contract transition and the commercial settlement in Experience. There's been a decrease in cash generated by operations, from operations as expected, driven by the non-cash nature of Deferred Income releases, timing of the cash received from the commercial settlement, the previously announced furlough repayment, and the cash costs of the cyber incident. The increase in free cash outflow reflects the reduction in cash generated from operations together with the increase in technology related to capital expenditure, which we flagged at the full year results.

Now turning to the divisional performance and Public Service on the next slide, the division saw revenue growth of 2.4 percent with good growth in the core business areas. This is underpinned by scope increases on the Royal Navy training contract, and increased volumes on the Personal Independence Payments contract offset by contract hand backs within Local Public Services and a step down in revenues in Northern Ireland, where the first half of 2022 saw a benefit from the teacher's laptop contract. The divisional profit margin reduced by 1.2 percent as the beneficial impact of the revenue growth that was offset by increased IT spend on certain contracts, including Primary Care Support England, as well as incremental property costs in our intelligent communications business as we moved operating locations. Cash conversion was broadly in line with the prior period. The 4.4 percent increase in order book reflects wins such as the extension to the British Army recruiting contract, which has been renewed for another two years plus an option for a further one, the City of London Police contract and expanded scope on Transport for London.

Moving on to Experience on the next slide. The divisions strong revenue growth was driven by the accelerated Deferred Income release and the new contract revenue following the renewal of our contract with Virgin Media O2 and a commercial settlement in the closed book life and pensions business. The benefits from VMO2 and the closed book life and pension settlement represent an acceleration of revenue from future periods, and we would therefore expect a lower rate of revenue growth in the second half. Operating profit reflected the VMO2 contract transition, and the closed book life and pension settlement offset by flow through of prior contract losses, including Carphone Warehouse, the Co-operative bank and continued attrition in the remaining life and pensions contracts. The reduction in cash conversion reflects the non-cash nature of the VMO2 Deferred Income release and the close book life and pensions agreement where we anticipate cash settlement beyond the current calendar year. The reduction in the orderbook was principally due to the new 366-million-pound VMO2 contract being a framework agreement which under accounting rules no longer ticks the box for inclusion in the order book.

On the next slide, we provide the reconciliation between adjusted and reported PBT. The 8.4 million or 34 percent increase in adjusted PBT was driven by revenue growth and the contract benefits outlined on previous slides. We completed the disposal of our resourcing and security watchdog businesses from the Portfolio division in May. And the business exits charge 34.7 million includes disposal related losses and impairments trading in the disposed businesses up to the point of exit and transaction related costs. We incurred a non-cash goodwill impairment charge of 42.2 million in respect of a number of businesses remaining in the Portfolio division at the half year, in recognition of our current expectation of the outcome of the disposal processes underway. As announced previously, the exceptional costs relating to the cyber incident have been excluded from adjusted profit. These costs comprise specialist professional fees, recovery and remediation costs and investment to reinforce Capita's cyber security environment. A charge of 21.8 million has been recognised in the half year. This excludes any potential insurance receipts, as these had not met -- yet met the criteria for recognition of the half year. The expected cost of the cyber incident net a potential insurance receives is now between 20 and 25 million, an increase from the 15 to 20 million we estimated in the early stages of the forensic data review process.

The next slide sets out the details behind the increase in free cash outflow in the period. EBITDA increased by 10 percent reflecting the improvement in profit offset by the reduction in depreciation, amortisation, and impairment charges, which is driven by a lower level of capital investments in prior periods and the ongoing rationalization of the property portfolio, which decreases the right of use asset depreciation charge. The period-on-period reduction in cash generated from operations reflects the non-cash nature of the commercial settlement in the Experience division, hand backs and Local Public Services, the 9 million direct cash flow impact of the cyber incident, and the repayment of the 2021 furlough related income, which we've announced previously. Capital expenditure reflects increased digitization and technology investment in both divisions, which we highlighted in our year-end results announcement. The reduction in net capital lease payment has been driven by the ongoing property rationalization process. Free cash flow, excluding business exits in the six months was an outflow of 53.4 million with the increased outflow reflecting the reduction in cash from operations and increased capital investment.

Just a quick aside on pension contributions, in addition to the 50 million of regular deficit contributions shown separately on the slide, which are paid in line with the 2021 triennial valuation, we also made disposal related accelerated contributions of 15.6 million, which were included when within other cash flows at the foot of the slide. These have contributed to the improved funding position from year end with a scheme now showing an accounting surplus of 50.6 million. Net debt was reduced by 166 million year-on-year principally as a result of the impact of the portfolio disposal program and continued reduction in our leased property estate.

Moving to the next slide. We received net cash disposal proceeds for the People pillar, 4.5 million in the half year, with deferred proceeds at 6.7 million expected in the second half. During June 2023, we agreed the sale of our Software, Page One and Enforcement businesses and all three of the sales completed on 31st of July 2023, realizing net cash disposal proceeds of around 45 million. Including this last trio, in aggregate, the completed disposals outlined on this slide have generated net proceeds of around 438 million in 2022 and 2023 to date with more to come over the next few months from the FERA and Travel processes, each of which is well advanced.

Turning to the next slide, which shows the group's liquidity position.

In June 2023, we extended the maturity of the group's revolving credit facility out to 31st December 2026, a 28-month extension of RCF maturity from the original expiry date. And in July, we issued 102 million pounds worth of U.S. private placement loan notes and are shortly expecting to early settle around 30 million of Euro PPN debt maturities, which previously fell due in 2027. The U.S. private placement enables us to reduce the level of periodic drawings under the RCF which we typically see arising from the inherent cash flow dynamics of our contracting business. And whilst the average interest rate of 9.45 percent on the new issuance is significantly higher than the rate on debt issued in previous periods, it reflects current market conditions, and is broadly comparable with the rate we would be paying on RCF drawings at this point in time. As a result of the RCF extension, and the new PPN issuance, we diversified our funding mix, extended the average period and maturity of our debt, and reduced our exposure to market volatility. Both events demonstrate debt investors' confidence in Capita's financial resilience. As you can see, during the last six months, we've transformed our funding position and have no need for any further refinancing for a significant period.

Now turning to the next slide for guidance on our outlook from a financial perspective, just to be clear, the guidance on this slide is the core Capita, which excludes the remaining Portfolio businesses. In the appendix in this presentation, we provided a bridge between the overall group results for half year 2023 and the pro forma results for core Capita. As noted earlier, we expect a lower rate of revenue growth in Experience in the second half, but accelerated growth in Public Service from contract extensions, new wins and increases in the scope on existing contracts. Overall, we continue to expect to deliver accelerated revenue growth for the full year for the group as a whole.

We expect EBITDA to increase against full-year 2022 due to both revenue growth and efficiency gains. We see further EBITDA upside in 2024 and beyond from the 40 million of cost savings, which we expect to deliver through the group and divisional overhead and operating efficiency initiatives highlighted by Jon. Free cash flow in the second half is expected to be broadly in line with H1, as the year-on-year benefit of improved EBITDA is anticipated to be offset by the balance of cash spend on the cyber incident and continuation of our capital expenditure run rate, which on a full year basis, we still expect to be between 50 and 60 million for the full year. We expect further reduction in net debt in the second half as we complete the portfolio disposal program and as we continue to focus on rationalising our property estate. Looking to 2024 and beyond, we would expect continuing improvement in free cash flow reflecting a greater level of cash back profits, delivery of cost efficiencies, and the lower level of deficit contributions arriving from the much-improved funding position of the pension scheme. This underpins the expectation set out in today's announcement of a reintroduction of dividend payments in the next couple of years with a modest initial payout.

So, with that, I'll hand it back to Jon.

***Jon Lewis** – Capita – Chief Executive Officer*

I think I need to stop you playing squash ahead of the results, Tim.

Thank you. You may remember the left-hand side of this slide from March, where we highlighted our focus on top line growth. This being the primary driver of accelerated financial performance going forward. And we've made material progress against each of these enablers of accelerated growth in the first half. We've built a strong track record in contract renewals over the last three years with renewals in the high 90 percent range and Capita Public Services achieving 100 percent renewals in the first half of this year. But we're increasingly focused on new client opportunities. And here we saw more than a quadrupling of our win rate in the period. I'm pleased to announce we won 1.4 billion pounds in TCV in the first six months slightly below the first half over the period compared to last year. But if we compare year to date, with the signing of the Disabled Students Allowance scheme or DSA, and our selection as the preferred bidder for two expanded scopes, around the Functional Assessment Service for the DWP, we are over 50 percent ahead of where we were this point last year delivering one of the strongest TCV performances in many years. We also won 650 million pounds in in-year revenue, up 22 percent year on year and the best in-year revenue growth performance of any six-month period for many years. Our improving win rates combined with our strong order book bodes well for full year growth and onwards.

Now, one of the areas I am proud of during my time at Capita is becoming a purpose led company it has probably been the single biggest lever of cultural and reputational change through the introduction of initiatives such as the real living wage, having employees on the board, signing up to the fair tax market, a good business charter, net zero by 2035, to name but a few. Being purpose led is our licence to operate and has created a company that clients want to contract with and that colleagues are proud to work for. During the first half, we continued to make further progress on these responsible business initiatives, of which a few I mentioned on this slide, and which I will let you read at your leisure. Again, there have been a number of significant public sector contract wins in '23 DSA being one, in which we were commended for our social value score. And we continue to aspire to be the U.K. government's most progressive purpose led strategic supplier credentials that will serve us well, irrespective of the political party in power. Our ESG credentials are also an important factor in our ability to attract talent. We see from our recruitment programs and employee service that people increasingly want to work for companies committed to being responsible businesses, this being manifested through deeds and not just words.

Now part of our responsibility to our employees and customers is also around data security, a responsibility we take very seriously. The cyber incident we experienced at the end of March was therefore a very challenging period for us. But I am very proud of how the organization responded to this criminal attack from our very early detection and containment, through to the rapid restoration of services. Strong business as usual service delivery, the securing of exfiltrated data and on communication -- ongoing communication with stakeholders. We have and continue to fulfill all obligations to the regulators, and we will update stakeholders for any material changes.

As a purpose-led business we have also been extremely thorough in our responsibility to Capita and inform anyone whose data was exfiltrated. This has involved significant resources over many months. But our forensic analysis, as Tim has alluded to, is now close to completion. There is no evidence that anyone's personal data has been compromised, something we continue to monitor on the dark web daily, and the incident has not had a material impact on contract awards, as you can see. And in fact, the overwhelming feedback from both the U.K. government and commercial customers has been one of thanks, appreciation, and a deeply positive impression of how we handled the incident. Government departments have collectively awarded us more than 1 billion pounds in TCV since the incident. I should also share that we've been approached by a number of Whitehall departments executive teams, chairs CEOs to share learnings on how we manage the crisis. Cyber is a risk a bit like safety, mitigating the risk is in everyone's interests, and cyber knowledge should not be used for competitive advantage. We will be sharing our Cyber Incident Management playbook with third parties, partners, clients, and competitors alike, a commitment that the U.K. Government has been -- has commended us for. Cyber was and remains the biggest risk to most businesses, and increasingly so, so we've redoubled our efforts to ensure we are secure by accelerating an already established multiyear multi-million-pound cyber security investment program. And our cyber preparedness will be verified annually by one of the big four audit firms, and we will publish the results.

Let me now turn to colleagues. I'm extremely pleased with the strong 14-point improvement in our employee Net Promoter Score measured after the cyber incident. Our investment in recruiting effectiveness and a broader focus on our employee value proposition are delivering a marked reduction in attrition across all areas of the business and that trend has continued into July. Excluding the Experience business where higher attrition is a characteristic of the business model, the government's attrition level -- the group's attrition level, sorry, is in the high teens down from the low 20s. Attrition in Experience is also similarly down almost three percentage points to the low 30s, where it is negatively skewed by a small handful of contracts. Our recruitment engine continues to meet demand. In fact, we hired over 11,000 people in the first half of which 1000 are in India in anticipation of expanding contract volumes from Virgin Media O2.

Despite this progress, we're not complacent, pay growth in the U.K. remains strong, and there continue to be cost-saving opportunities associated with further reductions in attrition. And as a growing company, we will continue to maximise efficiency by using an expanding number of delivery centers overseas, wherever and whenever we can. One mitigating factor to attrition continues to be the continued benefit of our virtual first approach to flexible working across the entire organisation. It is a key differentiator in terms of recruiting and retention as many other employers increasingly encourage staff to return to offices. As I've shared previously, we've also seen materially less sickness and absenteeism amongst colleagues embracing virtual working, in the first half this dropped by 1.7 percent on major contracts in Capita Experience driving a helpful improvement in productivity. And as Tim has highlighted, there are material costs and balance sheet benefits from the associated reduction in our property footprint, which is ongoing.

Capita

I'd now like to say a little bit more about growth. The overall trend on renewals, expanding existing scopes, and new clients remains positive. Starting at the bottom of the triangle on this slide, our renewal rate in 1H 23 at 69 percent was impacted by the loss of one single contract, teachers' pensions, which we lost on price. This was offset by the 100 percent retention rate in Capita Public. In total, more than 750 contracts were renewed in the first half. The pension administration contract we lost would not have met our contract risk versus returns criteria at a materially lower price. A loss is a loss but is encouraging that we now have a sufficient pipeline to realise a few losses and still deliver healthy revenue growth as we continue to push on pricing. And as I've shared previously, we still need to push harder on pricing, especially in the current high inflationary environment. On the whole, we've done a pretty good job at managing pricing on our larger value contracts. But we've more work to do on the more transactional work, and we have a program in place to achieve this.

Our win rate for expanding existing scopes was 61 percent after 75 percent in '22, again a function of pushing harder on price. But our new client win rate of 46 percent is a strong improvement over the 11 percent we realised in '22, and again speaks to the competitiveness of our offerings. Overall, we won 1.4 billion pounds in TCV in H1, and since the end of June we've secured an additional 800 million in TCV, including signing the Disabled Students Allowance scheme and being named preferred bidder on two lots of the Functional Assessment Service. In addition to these larger, more binary longer sales cycle contract opportunities, we continue to deliver growth through a healthy mix of smaller transaction engagements. In fact, we signed over 8,500 contracts with TCV at or below a million. And this helped us to deliver the previously mentioned 650 million pounds in year revenue in H1, as I mentioned earlier, up 22 percent and the best performance in years. So, a decent overall growth performance and the result of placing particular emphasis on building new client pipeline in '23 and '24. Of course, it also, as I have said previously, speaks to our competitiveness.

This next slide shows some of the key contract wins in the first half together with some of the main opportunities in H2. In Capita Public Services strong operational performance has helped us to win expanded scopes with Transport for London, and a new scope with the City of London Police and we've extended a significant contract with the Ministry of Defense for the British army. In the Experience division, our telecoms clients are amongst the biggest in Europe and we renewed our contract with Virgin Media O2 as expected. There were also multiple wins within the Financial Services vertical including new clients Santander and Commerzbank. Looking to H2, Capita Public Services, as mentioned, has been selected as preferred bidder on FAS and recently signed the DSA contract. Other renewals we have bid on include the Ministry of Justice electronic monitoring scheme, and the Gas Safe register for -- for the Health and Safety Executive. Our Capita Experience in the second half are in the Retail, Financial Services, and Telecoms sector. But as focused as we are on growth, it is not at the expense of contract alignment to strategy deliverability at the price bid, or balance between margin and execution risk. Our contract review committee, which Tim and I continue to sit on, remains a core and integral part of our governance model. And as I've said before, we are not going to repeat the mistakes of the past.

Let me now provide a short update on the two divisions. Capita Public Service is the number one strategic supplier of both software and IT services and business process services to the U.K. Government with around 10 percent share of a market that's worth roughly 14 billion annually. The division’s reputation for delivery is now firmly cemented. This is evidence for example, through our contract with the Standards and Testing Agency in which we manage a testing cycle involving more than 3 million exam scripts, a complex logistics process involving schools, Parcel force, our scanning center in Darlington, and several 1000 exam markers, in which a core KPI is to deliver 99.9 percent of exam scripts marked on time. This is an exceptionally difficult and complex process in which we delivered 99.93.

Another example would be the Department of Work and Pensions Personal Independence Payment contract, PIP, which we have now run for 10 years, and which hit a major milestone last month passing the 2 million assessment mark. When you include the Department for Communities’ contract in Northern Ireland, which started in 2016, we've now helped over 2.4 million people across the U.K. get access to essential funding and support while living with a long-term health condition or disability. There is no doubt that our strong performance on both these contracts helped our successful bid for the FAS contract that begins in the autumn of ’24.

94 percent of delivery KPIs in the first half for the division were green, a delivery performance that continues to sustain strong net Client promoter scores and trusted client relationships. This undoubtedly contributed to the 100 percent renewals rate I referred to earlier on. All of which by the way was secured with improved financial and commercial terms. Capita Public Services closed 760 million pounds in TCV in the period with a further 240 million pounds signed in July for DSA. And I've already mentioned the preferred bidder on two FAS contracts, which will add a further 565 million. The divisions book to bill ratio as of the 30th of June was 1x. But with the DSA signing, this is right -- this rises to 1.3 and of course will rise further when we sign the FAS contract in September.

Revenue growth in Capita Public Service is dependent upon an understanding of the U.K. government's key priorities. Government's increasing reliance on the private sector for policy delivery, a strong track record on the part of the strategic supplier, and competitive bids with an increasingly large digital content. All of these factors are embedded and trending positively, and we are increasingly well positioned to benefit from them. This is the core reason why our total unweighted pipeline for Capita Public Services is substantial at over 7 billion pounds. Of that 7 billion we have 29 strategic deals worth over 2.9 billion that are targeted for 2024. The largest opportunities are coming from Central Government, specifically in the Ministry of Defense, the Department for Education, and NHS England.

Some near-term examples are listed on this slide. One is within our Health, Welfare, and Education vertical where we are piloting midlife MOTs for the southwest of England as part of the government's Health and Career Guidance scheme. As part of the increasing investment in defence, we're also supporting the U.K. Government by modernising the delivery of Royal Navy training and of course improving defences fire and rescue capabilities.

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Capita Experience is a full-service customer management solutions provider. We're led by data, it's enabled by technology, and we're powered by our people. It is the number one customer services company in the U.K. and Ireland and a top five in Europe. Within a large and growing market Capita Experience won 560 million pounds in TCV in the first half of the year and had a book to bill ratio of 0.9 and I will again emphasize Tim's point that did not include the Virgin Media O2 renewal. 93 percent of the division's delivery capability -- KPIs were green on the back of which secured additional scopes of work from a number of our strategic clients. This resulted in a particularly strong in year revenue performance, up over 70 percent on the same period last year.

Also, on the slide are just a few examples of where we have delivered for our clients. For example, in India, as mentioned in just a few months, we've recruited over 1000 additional employees in support of expanded scope with Virgin Media O2. For Marks & Spencer, the introduction of Gen AI solutions has resulted in the upfront resolution of a third more queries thereby reducing the number of interactions required to address customer needs. Capita Experience services clients in four geographic markets, the U.K., Ireland, Switzerland, Germany, from those markets, and delivery centers in Poland, India, Bulgaria, and South Africa. We have a blue-chip client base with high customer loyalty in four key industries, Financial Services, Technology, Media & Telco, Energy & Utilities and Retail.

On this slide, using data and projections provided by third party analysts, you can see that the market segments on which we are focused are the largest customer management markets in the U.K. and Europe. And they are predicted to grow by around 5 percent per annum between '22 and '26. And there are some common themes across the market solutions we provide to these segments in particular, the use of automation technologies for the more mundane lower value services versus the use of Gen AI as an agent augmentation solution for higher value services.

We are unashamedly pivoting our focus to the upper levels of the triangle on the right of the slide. The shift to more sophisticated digital solutions is improving our competitors as evidenced by our new win rates, new client win rate, making us more sticky as evidenced by our renewals and ultimately drives improved margins. Our partnerships with the hyper scalars are critical in this regard. And this year, there has been a significant step change in our relationships with Microsoft, ServiceNow, and Salesforce. Given our market position, they view Capita as a key go to market partner and there is investment and executive sponsorship of these partnerships at the most senior levels within those organisations. By combining their platforms with our deep sector process knowledge, and very importantly our proprietary data, we see numerous opportunities to drive productivity improvement and enhance customer journeys. I will share examples of these on the next slide.

Our partners Gen AI enabled platforms are particularly relevant in this regard. We are now -- we're not new to AI it underpins our chatbot technology we use in Capita Experience and the image recognition technology we're using Capita Public Services, but Gen AI has the potential to transform how we assist our colleagues in delighting our clients' customers by supporting agent's engagement with customers in real time summarising text, summarising solutions, call conversations, supporting colleagues with financial -- complex financial claims and automating aspects of complaints handling. Gen AI also has implications for how we manage our data. We've just hired a Chief Data Governance officer. And one of their key accountabilities will be the definition of and distinction between data that is proprietary to Capita, versus our clients. We will also reflect this in our contractual T's and C's. Data, of course, that is proprietary to Capita will be core to extending the large language models provided by our technology partners, providing us with distinct competitive capabilities around the very processes we execute for them.

We've taken a number of steps to accelerate this digitalisation strategy. First, we're providing colleagues with a Gen AI platform with which they can experiment. This is an important action. As I'm not sure any of us fully understand all the value adding applications, we need to get it into the hands of colleagues so that they can assess its potential and the tasks they currently undertake day to day. Second, we have committed to developing a number of Gen AI use cases in partnership with Microsoft. And those proof of concepts will be live by the end of this year. We're also exploring use cases with Salesforce and ServiceNow. And some examples of these are summarised on this slide. One is around medical screening assessments, a task we undertake on several contracts across the Capita Public Services. Today on one contract alone, the team manually screens and reads over 20,000 individual medical records per annum. We're currently implementing a Gen AI solution to automatically provide summary medical reports and early results are very encouraging, reducing the time it takes our medical professionals to perform this task by more than 50 percent. Other application -- another application is on a contract where we currently manually reply to over 40,000 customers per month who are challenging penalty charge notices. This is another very relevant application where we can use Gen AI to automate many of these responses, again realising a significant reduction in processing time. And finally, on one of our Financial Services contracts. Within the Experience division, the team has to transcribe more than 700,000 call recordings a year to enable a search again sector specific terminologies to categorise claims and process them. Using custom speech to text Gen AI. We've now compressed this process for many months to about a few weeks.

Now we recognize that Gen AI presents threats, and opportunities. First, we're embracing it rapidly so that we understand the competitive and business model implications. Gen AI represents, after all, an exciting opportunity to redouble our digitalisation efforts whilst improving margins. Second, we're working in partnership with the technology hyperscale as was mentioned to ensure access to leading technology with its associated secure data controls and management. And third, we will implement the technology in a responsible and ethical manner. Our vision is that Gen AI will augment our colleagues, enabling agents to focus on value added activities where a human, empathetic touch is essential.

Now before we move to Q&A, as many of you are aware, this will be my last results presentation as CEO of Capita, and I would like to thank all of you for your interest, support, and questions. Well, most of them anyway over the last several years. Capita today is a very different company to the one I joined in 2017 had more than 1.1 billion of net financial debt was an unintegrated portfolio of businesses trying to do too many things in too many markets, and with revenue attrition of more than 10 percent per annum in some years. More importantly, it had no strategy with which to survive. The business had been over-dividended for many years, was starved of investment, had a number of serious and very high-profile contract delivery issues, and a rather poor reputation. It also won a series of very large contracts that could not be delivered for the price bid. Furthermore, it lacked the risk management systems, controls, and governance appropriate to a FTSE company of this scale and importance to the U.K. The mechanisms by which to manage the business, frankly, were not in place. Over the last few years, collectively with colleagues, we've addressed all of these challenges and created a purpose led business with a very clear strategy, a transformed reputation, engaged colleagues, a robust balance sheet, and an accelerating financial performance. The foundations for ongoing success are in place. And I think probably the most -- the best example that evidences our transformation was the way colleagues handled the cyber incident back in March, we would not have been able to do that five years ago. It has been damned hard work by all involved. And I want to pay particular tribute to my colleagues past and present for enabling us to get to where we are today, and in particular, my partner of the last two years, Tim.

So, in conclusion, we have strong market share positions in growing markets with increasingly competitive offerings and a reputation for delivery. And we continue to have strong operational momentum. We're growing, we're profitable, we have a strong balance sheet, strong liquidity, and are on track to meet our revenue growth and margin expectations for 2023 and the medium term. And with that, thank you for your attention. And we would now be happy to take your questions.

***Arthur Truslove** – Citi*

A couple of questions from me, please. So, first question, just on the free cash flow. I think you said you mentioned it, you're expecting similar in the second half to the first half. And I think using the former definition of free cash flow is a slight downgrade. I think previously, you're expecting slightly positive. Now slightly negative, are you just able to explain, you know, kind of what's changed there in terms of that free cash flow expectation. The second question just on the, sort of, pension run off business, -- which is obviously costing you money each year, are you able to tell me sort of how that's been progressing? Sort of in total, since the full year, thank you very much.

***Tim Weller** – Capita – Chief Financial Officer*

Yep, on the free cash flow one. So, we had a free cash outflow and first half of 53 million. That compared to the 17 million outflow on the same basis last year. And the big things that have caused that one of them continues into the second half, which is the cash costs of the cyber incident. So, reflecting that, that's why your slight positive turns into a slight negative on the old definition, because you got the cyber costs going into our adjusted free cash flow number. I mean, the -- when you look at the trading performance, on free cash flow in the first half of the year versus the first half of last year, you strip out, the furlough repayment, you strip out cyber, you adjust for the step up in capex of 15 million, a half on half, the trading free cash flow reduction is about 7 million pounds, which is around one day's worth of cash flows in this business. So, you kind of need to look at it in context.

***Jon Lewis** – Capita – Chief Executive Officer*

There was a second question, I think.

***Arthur Truslove** – Citi:*

Yeah, so just in terms of you've obviously had the sort of pensions business that has been costing you money over time, and just wondered in general, how you were getting on kind of getting out of those arrangements, and how that changed since the full year.

Jon Lewis *–Capita – Chief Executive Officer*

So, you're referring, of course, to our closed book life and pensions business, which we have indicated we would like to exit over time, but on appropriate economic terms. It's probably not appropriate for me to say too much more other than we continue to have productive conversations with the two key clients in that space. And we hope to be able to make material progress in the resolution of those contracts by the end of this year. And that is something I have committed to the board to stay very close to over that period.

David Brockton *– Numis*

Good morning, it's David Brockton from Numis. Can I ask two? They're sort of related and partly related to the last question. In the Experience division, there have been several moving parts through the first half in terms of the DI release, and also the closed book life and pensions that you just touched on there. If you strip those out, can you just give an assessment of where you think you are in terms of the turnaround of that division and the, sort of, medium-term expectations you have for both growth and margins for that division? That's the first question.

The second question, again, relates to the, sort of, the DI release that you've had in the first half, I guess one could look forward to next year and think that creates a sort of a difficult headwind for further sort of trajectory of profits next year. Can you just touch on whether you've got visibility on your ability to sort of cover that reduction year on year and continue to grow profits next year? Thanks.

Jon Lewis *–Capita – Chief Executive Officer*

So, I'll let Tim address the second one. I'll speak to the first one. One of the things we debate is whether or not we should pull out to what we call Core Capita Experience from Capita Experience given the drag that the life and pensions business over time, not necessarily the first half, but over time creates. If you were to do that, I think you would find that Core Capita Experience is actually growing. And has actually a pretty strong pipeline for the remainder of the year to sustain that growth as well. We've got more pipelines to build for Capita Experience in the long term. But I'm very encouraged by the opportunities we see in Europe and Ireland, in particular for that business. And we have new leadership over that division as well. And I'm very pleased with the progress we're making in that regard.

Tim?

***Tim Weller** – Capita – Chief Financial Officer*

Yeah, so the impact of the VMO2 contract transition, coupled with the commercial settlement in closed book life, and pensions, each of those independently is in the teens of millions. So, if you adjust to strip that out of the 9 percent growth that Capita Experience shows in the first half, you broadly have its growth rate. So, 4 percent, 4.5 percent growth rate. And to be clear for the group as a whole, that would reduce our revenue growth rate from 6 percent to 4 percent. So, we're kind of still with both businesses, both the group as a whole and Capita Experience in that mid-single digit territory in terms of underlying growth, experience in the second half, isn't going to grow as fast as 9 percent in the first half. That -- I said that in the prepared remarks. Clearly, those are relatively significant in the context of a single half. And therefore, the first half of next year, it might be something that we'll be talking about this time next year, about the slower growth rate on a reported basis in Capita Experience. But the underlying growth in both divisions is in that mid-single digit territory.

***David Brockton** – Numis*

On the annualized cost savings that you touched on that you seek to target, can you just touch on to the phasing of that, and how you expect that to come through. Thank you.

***Tim Weller** – Capita – Chief Financial Officer*

Yeah, what we said on the 40 million annualized cost savings, that will be a run rate to be delivered by the end of 2024. Clearly, we'll try and deliver as much as possible as we can to impact as much as we can in 2024. But that all up is a run rate at the end of the year. When we talked about the doubling at income target over the medium term, the results announcements previously, we said there were various different components, revenue growth, improving the revenue mix, increasing use of technology, and cost savings. And essentially, we've quantified a chunk of the deliverables that will get us there in terms of that doubling of the net margin in the group as a whole. That cost reduction comes out of group, divisional, overheads, operating costs. Group individual overheads currently run at around 11 percent of revenues. Taking 40 out of it would get us down into single digit percentages of revenues, which is more in line with our peers. But even then, there would still be more to go for in terms of efficiency.

***Jon Lewis** –Capita – Chief Executive Officer*

I mean, just a couple of comments to add to Tim's. David, I think we've been quite transparent, the last two or three reporting events in stating that as we complete the disposal of portfolio as we cement in place, the very controls the governance, the functional excellence that we've been building into the business the last five years, then there is less resource required to sustain that. And then of course, we've got the reduction in property footprint that Tim and I both talked about. So, you combine those together and there is line of sight to that quantum of cost saving, and perhaps more.

***James Rose** – Barclays*

Hi. It's James Rose from Barclays. Got two, please. The release talks to the difference between BPO work and digital transformation work within Capita. Could you talk about the bids in the pipeline? Does that also reflect a shift towards more digital transformation? And then secondly, when do you expect the group to return to positive free cash flow? And could you give us a -- remind us of the deltas to how we get there?

***Jon Lewis** – Capita – Chief Executive Officer*

A nice demarcation between Tim and I. Tim, for the second, me for the first.

***Tim Weller** – Capita – Chief Financial Officer*

I thought you'd want to do it the other way.

***Jon Lewis** –Capita – Chief Executive Officer*

Yeah [laughs]. I don't think -- I can't think of a single engagement we have had in the last 18-24 months in which there isn't digital content, we would not be winning work today. I mean, think about it in our personal lives, right, anything and everything we do involves digital capability in some form or another. So, all of the major contracts, whether it's Defence, Fire and Rescue, whether it's FAS. You know, I had a conversation with a permanent secretary in one of the government departments this week, where we are actively encouraging them to adopt more Gen AI more digital solutions to drive cost down for the taxpayer. So, it will be the exception, if we were to bid on anything that didn't have a slight -- a significant digital content.

Now, what's different today, compared to what Capita might have done 5-10 years ago, is that digital content doesn't require the huge investment in capex that it did back then. We're leveraging low code, no code platforms from, you know, the hyper scalars I mentioned earlier on ServiceNow, Salesforce, and Microsoft. And we can very quickly configure those with our deep understanding of our client's business processes, to the applications that our clients are seeking. And that's really how the application of tech, it's true of Gen AI as well, will shape the kinds of solutions we deliver going forwards. So, our ability to compete will be tightly aligned with our capacity to configure horizontal technologies to the business processes in the industry verticals and the government departments in which we operate. And as the single largest provider and manager of those processes today, surely, we have some competitive advantage there.

Capita

***Tim Weller** – Capita – Chief Financial Officer*

The route to free cash flow. First of all, I should just emphasize the point I said during the presentation, we're not tin eared, we've listened to the investment community. And we've changed our free cash flow definition. And that is now after deducting the capital element of lease payments. I think looking at most of the consensus numbers, on that basis, it's probably 2025 before most analysts are predicting this group to be in positive free cash flow territory, after those capital lease payments.

And then in terms of the things that will change between now and then. One thing that actually happened in the first half of the year which is a reasonable chunk of deferred income on one of our largest contracts; that's now been released. So, that was noncash back profits, and therefore the quality of our profits are improving moving forward as we are clearing out some of the legacy Deferred Income balances, so great level of cash back profits. A presumption we will not have a cyber incident on a recurring basis doing it that is impacting significantly on cash flows in the current half and the second half of the year. Pension contributions, the much stronger position of the pension scheme means that on a both accounting basis and the same actuarial funding basis as the last triennial in 2020, the scheme would be in about a 50-million-pound surplus. We're going through a triennial valuation at the moment, effective date of April 2023. That'll be completed towards the end of the current calendar year. We sort of know where the answer is going to be in terms of the funding valuation of that scheme, probably somewhere between 20 and 30 million pounds. That deficit would be covered by our preexisting contributions coupled with some further accelerated contributions we're going to be making as we complete the portfolio disposal program, and therefore by the time we get to 2025, I would expect a much-reduced level of pension deficit contributions.

And then finally, now we're including lease payments in our definition, the ongoing property rationalization program will reduce the cash costs of leases. All of those help you in this journey to a positive free cash flow, which in terms of our own timeframe is still over the medium term. But as most analysts are modeling on that basis 2025 is when you go through from negative to positive.

***James Rose** – Barclays*

Thank you.

***Chris Bamberry** – Peel Hunt*

Morning, Chris Bamberry. Three questions. You mentioned obviously expect CX to have lower growth in the second half of it the first half 9 percent. But how would you compare it to the kind of underlying 4 percent to 4.5 percent? Secondly, what was the net impact of cost inflation against indexation in the first half? And finally, are you seeing any evidence in any of your verticals in CX of slowdown? Thank you.

Jon Lewis *– Capita – Chief Executive Officer*

Let me deal with the latter question first. I'd refer to you Chris to the slide we showed the second CX slide we showed, which talked about the growth in the top five markets for CX in Europe, we're in four of those. And on average, those are growing at 5 percent per annum. So, we're not seeing any reduction or projected reduction in growth in those markets. And I think what's interesting is that many more of our clients will not -- do not have the experience around the application of Gen AI solutions, because they don't have the scale in order to do that internally. So, I think there might very well be incremental demand for our expertise around how we configure and implement some of these complex digital solutions to meet their specific business processes.

On indexation, I think we spoke to that in the sense that I'm very pleased with the progress and indexation we've delivered for our largest contracts. It's at CPI or RPI or some merge of and there are some caps on some, but we've done a pretty good job of getting after those contractually agreed indexation increases, and we've made some progress on others where we actually didn't have a contractual obligation on the part of the client to give us a pay rise -- price rise. Where we've got more work to do is on some of the annual revenue transactional work where we've got to look much harder at our rate cards, the discipline by which we're sticking to those rate cards and going after those smaller transactions of in the million to less category, where I believe we are still leaving money on the table.

Tim?

Tim Weller *– Capita – Chief Financial Officer*

Just picking up on that indexation point, there's a slide in the appendices to the packet slide 33. And coincidentally, the revenue impact in the first half of indexation is 33, 33 million increased revenues from the pure indexation clauses being exercised in the contracts that Jon was talking about. Just to refresh your memory about how those work, those typically take effect in March-April, in terms of the indexation clause price rises based on a probably November-December pricing index, and therefore, you've got two or three months of effect, and therefore there will be a greater benefit of that moving into the second half in terms of the benefits of indexation on our revenues versus the prior year.

In terms of the growth rates in the two businesses in the second half of the year, there's going to be a switch-around. So, expect Experience to grow more slowly because it won't have the one-off benefits we've seen from the accelerated revenue in respect to the commercial settlement and VMO2 that we saw in the first half. And Capita Public in terms of its business development successes, we'll see more benefit in the second half. So, the Public will grow more quickly, in the second half Experience will grow more slowly. With precision, the point about Experience had a good second half growth rate last year. And if you remember, it stepped up from a small negative in the first half of last year to around 4 percent growth in the second half of last year. And therefore, it's going to be challenged to have an underlying growth rate at that 4 or 5 percent we've seen in the first half, excluding the one offs. The group as a whole, we continue to expect to show accelerated revenue growth for the whole year versus the whole of last year.

***Chris Bamberry** – Peel Hunt*

Thank you.

***Jon Lewis** – Capita – Chief Executive Officer*

One other comment, Chris, on growth. You know both divisions are either growing out or exceeding the growth rate we built into our financial plan for the first half of this year. We had anticipated that CPS would do a little bit better than that. On the back of the Disabled Students Allowance award that got delayed about a quarter. And that's one of the reasons why we've not seen quite the rate of revenue growth in CPS in the first half we were hoping for. They delivered against plan, but we were hoping to do a little bit better than planned.

***Jon Lewis** – Capita – Chief Executive Officer*

There must be a few more. Come on.

***Helen Parris** – Capita – Director of Investor Relations*

I've got one online.

***Jon Lewis** – Capita – Chief Executive Officer*

Oh, yeah, go ahead.

***Helen Parris** – Capita – Director of Investor Relations*

Thank you. So, it is from -- sorry, on the screen. It's from Max Hymas basically asking confidence around the forecast for the cost related to the cyber incident.

***Tim Weller** – Capita – Chief Financial Officer*

Shall I do that? As Jon has said, we're drawing to an end in terms of the forensic exercise going through all of the exfiltrated data to identify who to communicate with, and therefore we've got a reasonably good handle on what the cost of the exercise will be just because we're getting towards the end of it. You would have spotted there is a range of 20 to 25 million. Being quite direct about it, the reason for that range is the insurance recovery, the potential insurance recovery, we got a view on what the cost will be, there will be a bit of a negotiation and a bit of loss adjustment, shall we say, in terms of how much we're likely to get back through insurance. But the 20 to 25 is our best estimate at this point in time when it's going to land after a little bit more spending, we see in the second half and reflect a view of the potential insurance recoveries.

***Helen Parris** – Capita – Director of Investor Relations*

Okay, I've got one more [laughs]. Bit of a cheeky one this but it seems a good one to end on. So, somebody called Lynn saying, Jon, knowing what you know now, would you still have taken the job at Capita?

[laughter]

***Jon Lewis** – Capita – Chief Executive Officer*

Yes. And here's why. I told a very senior city person this week actually, when we started this journey, there were an awful lot of pundits out there who said that this could not be achieved. We were so indebted. Our reputation was so bad. We'd been under invested in it for so many years, you needed to break the business up. And when we talked about all of the limitations and constraints, we actually euphemistically referred to it as the Gordian knot that we had to untie to get to where we are today. And through the hard work of colleagues, some great advisors, some of whom are in the room here, we get to where we are today. And I can quite honestly say that has been and will be the most professionally satisfying thing I will ever do in my life. Many people said it was impossible, it bloody nice to prove them wrong I can tell you. We got to where we are today the company has been saved. We have a strong basis and foundation for the future. And I'm very confident that under Adolfo's leadership, we will see sustained growth, free cash flow, and margin improvement, the base, the foundations of that to achieve that. Now, my job as a turnaround guy is done. I'm going to go and do something else.

Wasn't a cheeky question at all.

We're done? Thanks very much, everyone. Nice to meet you.

***Tim Weller –** Capita – Chief Financial Officer*

Thank you.

[end of transcript]