Capita Transcription - 18 August 2020

Jon Lewis:
Good morning. And a warm welcome to everyone and thank you for your interest in Capita and our 2020 half year results presentation. Of course, before we begin today's formal material, I draw your attention to the legal text on slide two.

I'd like to start today by paying tribute to our extraordinary colleagues and the dedication they have shown throughout the COVID 19 crisis. Our people have consistently gone above and beyond for our clients, their customers, citizens and each other, often in the face of risk and operational challenges. Ninety five percent of our colleagues have continued to deliver for our stakeholders through the pandemic some as key workers in the field. Some in the office, while thousands of others have been balancing the demands of family life while working from home. The professionalism and unwavering commitment of our colleagues has allowed us to navigate through these exceptionally challenging times and make me very proud to be the CEO leading this business. I want to publicly thank colleagues for their support and commitment.

This has been a very challenging six months for Capita, our colleagues and for many other companies. Throughout the first half we have continued to make progress with the transformation, focusing on improving client services, retaining existing contracts and reducing costs through restructuring and efficiency programmes. In the extraordinary circumstances created by COVID 19, we have taken decisive action to ensure the well-being of colleagues, sustain service delivery to our clients and protect the business. We've had very positive feedback from our clients in the private and public sectors. And at this point, I would like to extend a thank you to them. Our clients have been collaborative and supportive and we have in turn demonstrated agility and responsiveness as a strategic partner. This has deepened relationships and clients are now acknowledging a different Capita and one that has outperformed a number of our competitors with respect to service continuity through the pandemic. However, COVID 19 has hit during a typical year for Capita and our short term focus is rightly shifting and targeting revenue growth and sustainable free cash flow to managing our way through the economic challenges that it has created.

Moving on to the financials. And Patrick, of course, we'll go into these in more detail. Both revenue and profit have reduced partly as expected and partly due to COVID. We've acted to manage our costs in cash, which means the free cash flow has increased, liquidity is strong and net debt is down. And we were compliant with our lending covenants on the 30th of June. We came into 2020 with plans well advanced to dispose of the specialist services portfolio and refinance some of our debt. COVID, of course, has delayed both several of the specialist services businesses have been significantly impacted by the crisis so this disposal process is now on hold. On the back of the book for you now as we did in 2019. We quickly recalibrated our disposals programme and brought forward the disposal of Eclipse and our educational software solution, as communicated on June the 19th. As we accelerate the simplification and strengthening of Capita, you can expect us to announce further one more disposal in the coming months, and proceeds from these will be used as a priority to ensure we have sustainable levels of debt and that we meet our pensions liability. For the remainder of the year, we expect COVID to continue to impact revenue negatively, particularly our transactional and volume related work. We anticipate revenues in the second half to be broadly flat with those in the first. We continue to take cost and cash action, which, when combined with holiday accrual reversal, would benefit the second half. And based on our current planning assumptions, we expect to meet our covenant at the full year.

Now, this is a familiar slide to many of you and serves as a quick reminder of our strategy, which is underpinned by three imperatives to simplify, to strengthen and to succeed. We've got the work we've done over the past two years. All three. We do not believe we could have delivered as effective an operational response to COVID as we have. We have a management team who are now established in their positions and are taking clear, decisive action on operations, growth and cost. They're also being supported in those actions by strong functional leadership and superior insights generated by our investment in platforms like Salesforce and Workday. And our commitment and investments in contract delivery has been rewarded by both renewals, increases in scope and new work. 400 million of the revenues we booked in the first half came in the form of growth opportunities from existing clients. But we are still behind our 2018 schedule. And the impact of COVID means we now have to prioritise a stronger balance sheet while sustaining cash while sustainable sorry, free cash flow generation is still one to two years away. Let me now pass you on to Patrick, to go through the numbers.

Patrick Butcher:
Thank you, John. May I add my welcome to that offered by John. These are unusual and uncertain times and they provide a very particular backdrop for our half year results. As John said, 2020 was always going to be a key proving year for Capita. In March, we explained that the transformation was going to take longer and cost more than had been expected at the outset. Since 2018 we had invested heavily in our growth capability and were ready for the year ahead. And we were expecting revenue growth for the first time in several years. In March we knew that our balance sheet was in need of attention and our plans for asset disposals and a public market fund issue were well advanced and then COVID 19 struck. As soon as it was clear that the virus was likely to come to the UK, bringing unprecedented and unpredictable economic effects, we took action and started planning further steps that might be necessary as the crisis develops. We've described this process in previous market updates. However, it is important to remember going through these results, the sheer scale of change that we were forced to make to maximise the chances of successfully navigating the crisis. At this point I would like to remind you that from now on we will be presenting our results on an IFRS16 basis. The key impacts of this change, which we have explained previously, are higher debt and slightly lower PDT.

As usual this first slide summarises the key financial metrics for the group. Revenue is down five percent due to known and expected contract losses and four percent due to COVID. As a result, profit is also lower. The reduction being exacerbated by lower margins on some contract renewals and partly offset by cost savings, including those actions taken specifically in response to COVID 19. From March onwards, we have had a near obsessive focus on cash conservation, working hard to stay close to our plans so that we could accurately forecast receipts producing day cash collection reports that planning for the risk of customers paying later or not paying at all. In fact, customers have in the main been very supportive and as a result, net debt is lower 257 million and our available liquidity has been increased to seven hundred and four million at the 30th of June. However, we have maintained our commitments to paying suppliers on time and in the first half our payment performance averaged 95 percent within 60 days. I have separated out the pre-COVID revenue effects to remind you that our plans to drive revenue this year was both ambitious and fundamental to our planned success. This was the half year in which the full effects of the local governments contract comebacks were felt. These and other losses, such as the systems and the Defence Infrastructure Organisation, were only partially offset by new wins. The majority of revenue growth was previously expected in the second half. But Capita has a resilient base of long term private and public sector contracts, providing software and services on which our plants and their customers rely. Therefore, the main impact of COVID 19, has been on our transactional businesses such as travel and events, resourcing and Face-To-Face training, as well as those framework contracts that are volume based, such as the payment services software we use to collect the congestion charge. We have, however, seen some good wins as we have responded to support government efforts to deal with this crisis, including NHS call centre work and support for the DWP.

Turning to cost saving. We use a structured and disciplined approach to identifying and executing on cost reduction. The approach works using horizontal workstream such as property automation while driving delivery and culpability through the division. On a recurring cumulative basis from 2018 to the end of 2020, our prospect is expected to be some 317 million pounds lower than it otherwise would have been. At the onset of COVID, we set a target of 100 million pounds of savings through incremental action and we are on track to achieve this, although it is too early to tell exactly how much of these will recur into 2021. This slide highlights the volatility in the profit and loss accounts, some of which is technical in nature, so I'll take my time to walk you through it. It is another reminder of why we are continuing to improve our disclosure on cash from trading operations as another measure that helps follow the underlying performance of the business. And we are providing more analysis on divisional movement. Contract wins increased profit by eighteen point eight million in the first half, including six million of start up loss on the DFRP contract, which was signalled and resolved. One of the features of our rigorous recording of growth cost reductions is that it highlights the need for continued focus on indirect semi fixed and fixed costs. There will always be an inherent delay in reducing these costs in response to a revenue reduction. As managers we will want to avoid leaving capability that might be required if and when revenue bounces back. This has been starkly highlighted in Q2 when in some sectors such as travel, we saw the fastest ever peacetime contraction in activity. Put simply, people just stopped travelling. For example, in Capita, we spent four million on travel in January and only 200,000 in June, a ninety five per cent reduction. Of course, while this is a loss of income in our travel and events business, on the other side of the equation, this is reflected as a cost saving. We have separated the cost savings to show the impact of those that were planned in response to known revenue losses and those that were implemented as part of our COVID response. Other costs are made up of deflection, which includes a commitment to the real living wage depreciation and the run costs of new systems. The net impact of all of these changes would have seen profits of around seventy million, which, given an expected second half waiting to revenue and cost savings, would have been brought in line with our expectations. However, the big unexpected item is the noncash holiday pay accrual, which has several compounding factors. In the past, we have not been able to accurately assess the level of holiday pay across the company. The recent investment, as John mentioned, in the new HR system Workday, gives us total visibility across the group. In the first half of the year, the number of days of holiday taken has been reduced as a result of the lockdown. This will change in the second half. And finally, as part of our credit response, we have offered senior management additional holiday entitlements in return for salary reductions. The accrual itself will not repeat in H2 and will reverse by around 10-15 million, depending on the actual amounts of leave taken.

This slide provides the breakdown between the divisional operating profits of one hundred and twenty two point seven million, which is 75 million lower year on year, and the group support services, which have increased by 13 million together, making up the PBT decline of 88 million. As is our practice, we have excluded certain items from our adjusted results. These items are lower than last year because of the gain on the sale of Eclipse and lower restructuring costs. I will discuss the divisional performance in a moment but I've provided further analysis on the makeup of the group support services costs in the table on the right. We have taken action to reduce the negative impact of all three of these categories in the second half by around 25 million. This table shows the composition of numbers by division as a reminder, in anticipation of the disposal programme, certain business units were moved out of an into specialist services. Some details of these changes were included in our pre-close trading update and more details are available on our website. I have, for the first time, included specific slides on each division. This is part of the programme to provide more granularity and transparency in our results. In future, more of the discussion will be focused at the divisional level. For today, I'm going to skip through these at pace, but would be happy to take questions at the end.

Software is the only division to show revenue growth. However, the sharp reduction in payment services revenue in Q2 has had a significant impact on margins. Despite this, the software division contribute seventy seven million pounds of free cash flow. Only five million down on H1 2019. People solutions, some contract losses, and COVID impacts on transactional revenues have hit revenue and margins. The speed with which transactional revenue fell off in Q2 meant that the management team were unable to respond quickly enough, resulting in a 30 per cent fall in margins. Plans are in place to tackle this in the second half. In customer management revenue has held up well, despite volume declines in existing contracts with new work from current plans from some public sector contracts arising from the pandemic. The contractual payment of six million and inflationary pressures, such as the introduction of the real living wage, reduced profits by 12 million. Cash conversion however was improved by timing differences on accrued income, some of which will reverse in the second half. The law sign posted reduction in local government contracts came through this half. There were also COVID impacts on transactional businesses such as Entrust, which amongst other services arranges Outward Bound activities, which, as you can imagine, did not take place this year. The margin impact of these were offset by cost reductions with only the six million pound year one first half, year one loss of DFRP falling to the bottom line. Cash from operations improved by 24 million, benefiting from favourable working capital movements on Local Government, DFRP and STA.

The technology Solutions Division has been hardest hit by margin erosion as some high margin legacy contracts roll off and higher depreciation from investments and other contracts flow through. There has been some offset from higher activity levels through COVID as clients have reorganised their operating models. However, improved contractual working capital and lower capex have mitigated the impact on free cash flow. The specialist services division is much reduced with, for example, the life and pensions business and tax loss having been moved out. And it has suffered from a significant COVID impact. Again, the speed and scale of revenue shrinkage have meant that management has not been able to respond quickly enough that each business is being reviewed and will be structured to be fit for the future.

I've combined all the cashflow information onto a single slide. I covered the contractual working capital from capital expenditure movements in the divisional slides, adjusted free cash flows and improved, as Jon mentioned, with the figure, including 77 million of accelerated customer receipts. We taken action across almost every line of the cash flow and summarised some of these on next page. Together with the COVID cost actions referred to earlier, so you can see on a single slide the impacts of the actions we have taken. During a period when we saw dramatic economic contraction, we focussed on conserving as much cash as possible to protect against unknown risks. This took the form of cost reductions and cash management activities. This slide shows that the cost actions have delivered 57 million of P&L benefits, with more to come in H2. And those that are not P&L focused generated 304 million of cash in H1. It also explains our current expectations on which will reverse and when.

For the first time we are presenting net debt, including the impact of IFRS 16. The table on the right shows how this builds up and confirms that the bulk of the reduction was in financial debt rather than lease debt. On a like for like pre IFRS basis headline net debt to EBITDA was inside our target range of one to two times at one point nine times. The board has not formally reviewed the target range, but taking account IFRS 16, the range would increase arithmetically to around one point seven to two point seven times and we were at two point seven times. We will keep our leverage target under review as the economic services develop, circumstances develop and our balance sheet strengthens following the asset disposals. We were compliant with all debt covenants at the 30th of June.

As described earlier, we have been very focussed on conserving cash and maximising liquidity. This has resulted in improved liquidity as we enter the second half. We have since added a further 56 million through an additional backstop facility. One hundred and fifty million original facility naturally reduced on the sale of Eclipse. These two facilities fall away pound for pound on the execution of disposals or a successful refinancing of our near term maturity. Liquidity will fall in H2 as some of the H1 actions unwind. However, we are actively developing further short term mitigations in case they should be required.

And finally a look to the future. As Jon will cover in his next section, there are many reasons to be positive about the future. However, the economic landscape remains uncertain, with the potential return of lockdown restrictions as a result of the second wave. We are not therefore providing detailed guidance. However, based on the modelling we have done before, the impact of this or any further disposals, we expect revenue to be flat to slightly down in H2 on H1, and nine to ten percent down for the full year. Further cost savings and the non recurrent and partial reversal of the holiday pay accrual will be tailwinds to H2 profit. The other one, H1 cash management actions will return net debt towards 2019 levels pending the impact of any further mitigation. And now, I will hand you back to Jon.

Jon Lewis:
Thank you. In this next section of the presentation, I will provide more details on our response to COVID 19 as well as our overall transformation. I've already stated COVID has been a huge

challenge and we took an action very early, setting up a pandemic planning team. We did this in February to coordinate our response to the crisis. Our focus was as following; the welfare of colleagues, which remains paramount. Sustaining service delivery to our clients, enabling them to continue to trade while protecting our revenue and managing costs and husbanding cash, given the unprecedented uncertainty. Using a programmatic approach, the programmatic approach outlined on the slide, we've been able to keep colleagues safe and establish operational stability while minimising the revenue impact. As previously stated, ninety five percent of our colleagues have remained engaged in serving our clients through the crisis. Which is why COVID impacted revenues by just four percent. We very quickly adapted our delivery models and today 50,000 of our colleagues are now working remotely. Nearly 60 percent of our office facilities remain closed. While there is strict evaluation and enforcement of safety measures in offices that remain open. We have communicated to colleagues who remain able to work from home that we will not reopen their office facilities until the New Year.

COVID 19 has taught us a great deal about how we can evolve to a hybrid working operating model and through our new-norm workstream, we are actively leveraging these learnings to reimagine our future property footprint and technology solutions. At the services company, we're only as good as our ability to deliver or exceed our contractual commitments. In this example from our customer management business, you can see that over the course of a couple of weeks, we've not only moved a large number of existing colleagues to working remotely, but recruited an additional 3,000 people who also work remotely to deliver on new government contracts. We have recently served a one millionth customer on a government contract that only started three months ago. Customer satisfaction has actually increased over the period, as has productivity facts that have not gone, gone unnoticed by our clients, both public and private. To combat the impact on revenue, we also took swift and decisive action to protect profits and preserve cash, as Patrick has outlined. At the end of March, we set out 100 million saving programme over and above our ongoing cost transformation savings, and we are on track to deliver with 57 million secured in the first half. We have reduced discretionary spend to the bare minimum, in particular on travel, marketing and professional service fees. We've taken difficult decisions to make significant savings in people costs, such as furlough for some of our colleagues, salary cuts, the withdrawal of this year's bonus scheme. And a shift from using external contractors to using reallocated internal resources. We have made property savings to date of around four million from temporarily shutting 168 about two hundred ninety four office properties. We have recently started to target another round of cost savings in group and functional cost centres. We are now making on working on making these savings sustainable as we look at addressing new behaviours, and new ways of working. For example, we have already decided to permanently close 25 of the properties around the country, specifically reducing our central London footprint and leveraging our regional centres. This alone will deliver property savings by 2022 of around 20 million.

The transformation of Capita, as we stated in March, is taking longer and costing more than we originally thought. But we are making progress. We have re-established a reputation for operational delivery, earning the right to target revenue growth with the resulting profit and cash margin uplift. We've made good progress on fixing our more challenging contracts. And at the most senior levels our public sector stakeholders have been particularly complimentary about the speed with which we have done this and met contractual obligations. You will be familiar with the three large underperforming contracts that we have highlighted before, and profit and cash on these is now significantly improved. The next step is to execute what I call grinding up the margins. And there are three elements to this. First, leading out the operating model on our existing contract portfolio to drive productivity and efficiency. Second, we are taking a more rigorous approach to contract extension and renewal, ensuring improved commercial terms when in the public sector and when in the public sector adherence to the outsourcing playbook. And third, we're ensuring that the scope, margin and risk profile of new contracts aligns with our strategic ambition and that they meet our targeted economic hurdles.

Let me touch on each of these in a bit more detail. We were never going to be able to grow this business unless we addressed existing contract delivery and associated reputational issues. A priority, therefore, was to ensure delivery against the existing contractual commitments This has clearly taken more time and cost more money than we originally foresaw. However, we have now achieve this objective. And I would like to thank our colleagues for the huge contribution they have made to making this happen. The cost of poor quality. A key metric is materially improved and our KPI performance across the business is the highest it has been through the transformation. One of the reasons why we have a high renewal rate and why we have been able to grow our revenues with existing clients. As one senior civil servant stated recently, Capita is now seen as a very committed and dependable strategic supplier that delivers against its contractual obligations. Cash burn associated with legacy contracts is reduced significantly and we have reduced the number of cash negative contracts amongst our largest thirteen by over a half in the last three years. With more work to do. But we de-risked a major part of the legacy contract portfolio. And our focus on an investment in programme management has meant that our execution on new scopes of work has not been plagued by execution and cost overrun issues of the past. The Ministry of Defence, for example, is delighted with our execution on the Defence, Fire and Rescue Project where even COVID related issues have failed to delay the programme and importantly, we are delivering on the best contract margins.

In summary, our operational muscle fundamental to our business model, is far more evolved than it was two years ago. And this investment on our part is starting to pay dividends and revenue generation. We spoke in March about a focus on account management and execution of transport for London. And this clearly helped in their recent decision to award us the 355 million congestion charge and ULEZ extension. Patrick mentioned the cumulative cash savings generated by our ongoing transformation programme, giving us the opportunity to raise margin and cash generation through the leaning out of our operating model. We're organising the business more effectively, consolidating and eliminating layers of overhead and increasing the use of shared service centres. For example, we continue to consolidate our software development capabilities into a simple single function, our digital development centre with common state of the art development tools and processes. We're also progressing the consolidation of internal I.T. support into a single shared service function with significant cost benefit. We're also using technology to drive efficiencies and examples would be the use of robotic process automation internally on embossing processing, financial reporting and issuance of contracts of employment and of course, externally on things like Pensions Administration for our PCSE contract with NHS England.

On the back about work to better define our market offerings, what we call our client value propositions, we're also building a growing pipeline of opportunities that reflect our strategic intent to deliver consulting, transformation and digitally enabled services. This has resulted in us winning more of the right sort of work as evidenced on this slide. Work that reflects our strategic and margin objectives. These contracts have an increasingly strong digital content. Typically leveraging our investment in proprietary digital platforms such as our Amiga platform in the mortgage origination space of third party solutions such as Microsoft, Microsoft's Azure platform in the work we're doing for TFL to migrate their solutions to the cloud. Our customer experience contracts are increasingly benefiting from our leverage of the Amazon Connect and AWS platforms, technology that was key to the execution of COVID related contracts for government. We're also leveraging our consulting expertise to pre position for higher value scopes of work. This has been an extremely difficult time to build a consulting business, but I'm pleased with the growth this business is demonstrating this year. Consulting is also starting to deliver on its goal of engaging capital at much more senior levels within our client base, as evidenced by the strategic nature of engagements we have won in both the private and public sectors.

In summary, we have won some sizeable contracts this year but just as importantly, they speak to strategic direction, marketing objectives, and we believe they will be significantly lower risk over their term due to the improved governance we have put in place. Now, before we talk about the performance of the software division, I should remind you of our plans for our software portfolio. As announced in June, we're now aligning software solutions and future development activities to our transformation and digitally enabled services strategic objectives. And we continue to work to prepare our standalone commercial off the shelf software businesses for disposal. The Eclipse legal software business has now being sold. And the process to dispose of our Education Software Solutions business was launched at the end of July. It remains on track. ESS, this is an excellent business and we are encouraged by the interest it is receiving. And we will announce further software disposals over the coming months as we accelerate the simplification of the portfolio. I want to emphasise, however, that software platforms and digital components that support our digitally enabled services remain deeply strategic and core. We have over 80 different software tools, services and platforms distributed across our divisions. Examples include Capita One for government customers, the Hartlink Pensions Platform in People Solutions, our Revenue Benefits Platform in Government Services and our regulated mortgage software in customer management. And we continue to invest in such platforms. Our new digital grants distribution solution is a great example of how we can combine our digital capabilities with our deep understanding of the benefits and grants distribution market to deliver a more efficient and flexible solution. We develop the solution on the Salesforce platform in just six months and we have just signed our first high profile anchored client. This solution also highlights how we can use our domain expertise gained from years of outsourcing activity to build differentiated solutions on third party platforms.

In the first half, the software division has delivered a strong response to COVID. Ninety seven percent of our SLAs are being delivered and in excess of 97 percent of our software colleagues in the UK, Ireland and India are working from home with no drop in productivity. The division showed modest revenue growth year on year. Order intake has grown in the last six months, and we have got better going to market with products that have been invested in over the past two to three years. Key contract wins were our healthcare services solution with NHS Wales and our

Capital One cloud solution in local governments and our recent win for identity checking solution optimize verify, part of our Pay 360 family to a major insurance company is also encouraging for the second half.

The People Solutions Division has lagged the other division in this transformation, but is now making encouraging progress, investment in fixing contracts has resulted in superior client KPI performance, reduced service credit costs and significantly improved relationships, which in turn have resulted in much higher contract renewal rates in the first half than in the first two years of this transformation. And I expect the Pensions Administration business where we are the market leader here in the UK to be a good example of where we can grind margins up. We've earned the right to negotiate this with clients. We have invested more than 10 million over the last two years to address service delivery issues in this business, and KPIs has improved significantly. And we've been able to renegotiate commercials and extend scopes with a number of key clients. We've also identified scope to improve our growth and margin prospects as new business unit leaders get their feet under the table. And this is particularly true of our learning business. And we have identified market opportunities from COVID and pensions consulting, agile resourcing and digital ways of learning. We were also pleased to secure major wins from the Teachers Pension Scheme and Civil Service apprenticeships these being offset by losses in HR solutions and resources.

Our customer management division responded exceptionally well to the multi country COVID challenge, quickly moving 70 percent of colleagues to working from home, 98 percent of colleagues in the case of our operations in India. We were pleased to secure contracts, to deliver COVID work for the UK and Irish governments for NHS and DWP in particular, where our investment in digital platforms and the resultant services performance, we were able to deliver and this marked us out. This again positively impacted client receptions and opened up additional long term opportunities. We have been able to maintain high levels of service delivery, which is helped by low attrition rates and our commitment to pay not less than the real living wage from April 1st this year. High volumes in areas like financial services and utilities are helping us to drive the shift to digitalisation, encouraging our clients to embrace the deflection of voice calls to chat bots, apps and Web sites for quicker and cheaper resolution of customer need. We secured wins with Irish Water, a new client for us and for a UK retail bank, as well as a two year, framework extension from a major European telecoms client.

At the beginning of the year, government services restructured to focus on six primary segments. Examples being defence, education and transportation, where we can leverage our existing expertise and experience. This resultant client centric model has allowed the division to become an extremely effective interface with government, including winning and accessing work for other Capita divisions. The division responded very effectively to COVID, helping government to maintain critical national services. And to date this year we have been awarded 80 million in total contract value for government related COVID work. In addition to expected revenue reductions as a result of local government hand backs in 2019, COVID constraints did result in a temporary drop off, drop off of some transactional volumes in education and trust business, for example, and science and welfare affaire business. This has, however, been substantially mitigated by wins of new work. Despite the COVID constraints, we've also made strong progress with project execution highlights including on time delivery of technology and services on

Defence Fire and Rescue, and continued successful delivery of new services for transport for London. Overall, our investment in intense program delivery is paying dividends with an anticipated 30 per cent reduction in cost of quality in the division. An increase in cost and an increase in customer satisfaction. By the end of 2020. We expect to have all of our historically problematic programmes on a sound footing, delivering on their contract KPIs.

And as you can see on this slide, we have made particularly good progress in building our pipeline of opportunities with governments as we expect government in particular to invest more in digital solutions as part of the broader reform agenda. Technology solutions is a key component of Capita's future. With its strong network and I.T. services foundations and now its investment in future technologies. Our divisional reorganisation at the end of 2019 also included technology solutions absorbing the management of internal I.T.. This has been critical to our own capability of capture to move to working over the crisis. Deploying laptops at very short notice and quadrupling our VPN capability for example. Own customers remain loyal and retention rates are high. And we are seeing increasing demand for new digital capabilities such as private migration, cyber security and automation, while also continuing to deliver cost opportunities to consolidating service desks and individual business entities. As Patrick mentioned earlier, specialist services has been hard hit by COVID. Particularly reflecting the more transactional nature of some of the bigger businesses and in particular, travel and events and enforcement. We're tracking the recovery across all eleven distinct businesses, some of which are likely to recover well into next year. We're therefore taking the opportunity to restructure the businesses where we think the model needs to change, examples being travel and events as they come out of the crisis so that they come out of the crisis leaner and fitter for the future. This should allow them to maintain and even increase margins, even if revenue is lower and our plan is still that we will diversify businesses as and when appropriate. As Patrick highlighted due to COVID, we are taking decisive action to preserve cash in the short term with over 300 million of benefit in the first half. Some of this benefit is expected to unwind in the second half. As we face 500 million of further debt repayments over the next two years, we've taken action to strengthen the balance sheet. We've sold Eclipse and the proceeds from ESS will also be used to address debt and pension liabilities and reducing gearing. Additional non-core, non-strategic software disposals will be announced in coming months. And we will revisit the option to raise new debt and to dispose of the specialist services businesses when appropriate.

So in summary, it has been a challenging first half for Capita, with COVID emerging during a pivotal year of a complex company transformation. Our response has been robust and decisive, demonstrating our improved operational capability. We've looked after our colleagues, continue to deliver for our clients. We protected revenue in the process and we've executed a range of profit and cash management actions. But COVID has set back our expected return to growth and delayed our plans to reduce debt through disposals and refinancing, creating short term pressure on the balance sheet. We have therefore accelerated our simplification strategy, identifying a number of other disposals to address this pressure and provide future resilience. The board remains confident in our strategic goals, and we continue to make progress on the transformation.

Thank you for listening, and Patrick and I would now like to open it up for questions.

Operator:
Ladies and gentlemen, if you would like to ask a question, please, press star followed by one on your telephone keypad. If you change your mind, you can withdraw your question by pressing star two. Alternatively, if you've joined us by the web, you can press the request to speak flag icon. Our first question comes from Robert Plant from Panmure Gordon. Robert, please go ahead.

Robert Plant:
Thanks. Morning, John and Patrick. At the time of the June statement on the conference call, you said the guidance was flat sequentially for second half revenues. It's now flat to slightly down. Has the outlook deteriorated slightly since June? And if so, in which areas? Thank you.

Jon Lewis:
I'll give a broad response to that and then Patrick can get into some of the detail. We're being cautious. We're worried about a second wave. I think our assumptions on the economy are that it is going to be more a Nike swoosh than a V or even a symmetrical U. And given the dependency of some of our transactional businesses, in particular learning, enforcement, traveling, events, et cetera, on economic recovery, we've taken a more prudent view.

Patrick Butcher:
Yeah. This is a real specific highlight. If you remember I think we actually said that we expected revenue in the first half to be 10 percent down and it was nine percent down. And this is all in the roundings of small percentages. So revenue in the first half was a tiny bit better than we thought and therefore it's flat to slightly down. But the simple message is that revenue is broadly equal, 50/50 as is normally the case.

Robert Plant:
Great, thanks.

Operator:
Our next question comes from Sylvia Barker from JP Morgan. Sylvia, go ahead.

Sylvia Barker:
Hi. Good morning, everyone. Thank you for taking the question. Just a similar question to Rob's to start off with. So you also said that the margin guidance for H2 is a mid to high single digits margin. Obviously, the accruals will be moving around. Could you maybe kind of comment on that and if anything's changed? Then in the going concern statement, a bit of discussion around kind of certain circumstances where the headroom will be limited June 2021. Can you just clarify? Do some of these measures include kind of an option where you have sold ESS for 500 million plus and you still have limited headroom? Or does the ESS kind of disposal fully offset that? And then finally, just on the contingent liability that you've mentioned, is this related to past services with a contract that you still have with a customer -- do you still have contracts with or is it solely, kind of, in the past? Thank you.

Jon Lewis:
Sylvia, thanks very much for your questions. I'll let Patrick talk to you -- margins and contingent

liabilities in a minute. But I want to be crystal clear in the going concern. The disposal of ESS addresses the Covenant head room issue; the material uncertainty issue.

Patrick Butcher:
Yeah, I'm not quite sure where your high single digit margin number came from. I think consensus for the second half is about 128, 125. So that would call 90 million or so of PBT for the second half. And revenue flex, that would be sort of five and a half percent or so. So that's kind of what we're saying. We've talked through the moving parts first half to second half, the pay accrual disappears. A little bit of it reverses. We've got some more cost savings to come and then a few other moving parts. I think on the contingent liability in respect of past services, and we, as many companies do, we make wide use of this service from this particular supplier. They come and have done a detailed review. We -- as is the market practice, we will settle that liability by agreeing to buy more from them in the future. We expect that that agreement will be consistent with our forward plans. In other words, it's no net increase cost to us in the future; we're simply disposing it because it's a significant number.

Sylvia Barker:
Thanks very much.

Operator:
Our next question comes from Rory McKenzie from UBS. Rory, please go ahead.

Rory McKenzie:
Good morning, all. It's Rory here. Just three for me, please. Your contract renewal rate was running at 70 percent at the moment. You said that that's lower as your choosing not to renew some contracts. How long should we expect it to remain at this lower rate? Or can you quantify maybe the further contracts you might choose to exit? And I guess what's your midterm expectation for the renewal rates? And then secondly, on the contractual working capital inflow of 43 million that you saw in H1, is that largely just relating to the falling revenue or have there been any within contract improvements to be aware of in that? And I've got a second, but I think that -- after these.

Jon Lewis:
Rory, thanks for your questions; I'll deal with the first one and then Patrick can address the second. Look, I think investors should see the very disciplined way in which we're deciding whether or not we wish to renew contracts based on alignment to strategic intent and that likely margin and risk profile is a good thing. And we are now in a position where we're able to make those tradeoffs. You know, we've inherited a number of scopes of work that we probably don't want to continue to renew going forward. And I think being disciplined in what we decide, vis-à-vis scopes of work we want to undertake and importantly comprehending the risk profile associated with some of these things is part of achieving one of our strategic goals, which is more sustainable, long term delivery of free cash flow. That percentage will flex a little bit. It will probably come down a little bit further as we continue to wash out legacy contracts that we don't want to participate in. But over time, I would then expect it to climb again.

Patrick Butcher:

Turning to the contractual working capital, just to remind you that there are three components to contractual working capital: there is accrued income, deferred income, and what we called CFAs, contracts fulfillment assets. And so if you look at the inflow in June -- in the six months to June 2020, most of that is within the deferred income, and that was largely down to invoicing, timing differences in the way that the deferred income is realised. We expect that in the fall, over the second half of the year, that inflow of 44 million will reverse and become an outflow of about 60 to 70 million. That compares with our expectations of about a hundred, so there will be a reduced inflow there. Full year position is more to the point that you've made, which is about the revenue growth being deferred in the first half. The movements have much more to do with the timing of our invoicing as part of our cash management activities.

Jon Lewis:
Bethany, we'll take one more question, please.

Operator:
No problem. Then last question comes from James Rose from Barclays. James, please go ahead.

James Rose:
Morning. I'm wondering if we can talk about cash generation of the group, sort of putting COVID aside and the movements aside for one moment. Where do you think your standing versus where you imagined you'd be at the start of the year versus perhaps some of the targets you've talked about originally? And then bearing in mind some of the assets you're thinking of disposing of are some of the most cash backs in the group. I'd appreciate your comments on what you think the long term cash generation capability of the business is. And then secondly, it's coming back on that contract renewal point as well. Is it fair to say if that continues for the longer term, then Capita could still be a smaller group in revenue terms, but albeit higher margins? Thank you.

Jon Lewis:
Let me take the second one first. Absolutely. We are not wedded on a particular scale of revenue; are much more focused on sustainable free cash flow and margin improvement.

Patrick Butcher:
In terms of the cash flow for the year, as I pointed out on my slide, we've taken action on every single line of the cash flow. And that has meant that sort of unpacking to work out what it might have been had COVID not hit us is a little difficult. If you look at the bottom line, cash flow [unintelligible] movements. I think the main COVID thing that goes from this year to next year is the VAT deferral. I think we're hoping that by the end of the year, our position relative to our expectations will be improved by that VAT movement. Looking to the first half, I think we were as close as we could be to being where I thought we would be after adjusting for COVID. But there are, as I said, a lot of moving parts in the first half.

Jon Lewis:
Let's wrap it up there. We have a series of other calls we need to go on. Thanks very much, everyone, for your interest. We look forward to speaking to a number of you over the course in

the next few days. Thank you.