

CHAIRMAN'S INTRODUCTION



“2017 has been a difficult year of unprecedented change for Capita. Against a challenging backdrop in many of our markets, we began to address the underlying problems preventing Capita and its people from achieving their full potential. We have strengthened our leadership and governance, undertaken a strategic review and have launched a fully underwritten Rights Issue to position Capita well for the future.”

SIR IAN POWELL, CHAIRMAN

It is apparent that Capita remains a systemically important business to the UK, with important services and strong market positions. Every day, our committed and talented people continue to fulfil our core mission – improving the efficiency and productivity of our clients. However, over the years, the business has become too complex, expanded beyond its core skills and failed to keep pace with a rapidly changing marketplace.

Shortly after I took up the Chair position on 1 January last year, it became apparent that there were three critical areas requiring immediate attention – Leadership, Strategy and Governance – each of which we as a Board have either addressed or are in the process of addressing.

LEADERSHIP

A critical first step was to steer the Company in a new direction under fresh leadership. We announced in early March 2017 that Andy Parker would stand down as Chief Executive Officer (CEO) later in the year, formally leaving Capita on 15 September 2017. At which time, Nick Greatorex, Chief Financial Officer (CFO), became Interim CEO until 30 November. Following a thorough executive search process, we welcomed Dr Jonathan (Jon) Lewis as our new CEO on 1 December 2017.

With his extensive technology background and strong track record in turnaround situations, Jon brings the skills, experience and energy required to lead Capita on its new course. He joined from Amec Foster Wheeler plc, where he served as CEO following an impressive career with Halliburton in the US.

Jon has the credibility, knowledge, values and behaviours required to lead the transformation of this significant UK services business, accountable not just to our clients, investors and people but also to the wider community.

STRATEGY

Capita has lacked a clear strategy and operated with a short-term focus. This focus has resulted in short-term decisions to pursue near-term growth and in-year profitability at the expense of planning for long-term sustainability. Capita has taken on too many low-margin/high risk contracts and has amassed too much debt in support of acquisition-led growth. At the same time, it has under-invested in its infrastructure (especially in those functions that provide the oversight that a business of Capita's complexity requires) and as a result has made insufficient investments in financial and operational controls for a business of its scale. Crucially, a long-term strategy with aligned objectives were not in evidence when I became Chairman. Until new leadership was in place, it was inappropriate to undertake a full strategy review, however the preliminary work to facilitate such a review was put in place.

A strategic review of the business, its markets and purpose has been completed as part of the new strategy Jon is implementing. Capita's objective is to become a more focused and predictable, client-centric company, generating sustainable free cash flow. The Board believes that changes to its operating model under its new strategy will deliver enhanced performance through increased simplification, efficiency, standardisation and focus.

Given the breadth of Capita's activities and the complexity of our structure, this is necessarily an extensive exercise involving employees at all levels. The new strategy is detailed by Jon in his Chief Executive Officer's review on pages 6–12.

The changes necessary will require both cost savings and investment, a reappraisal of areas that were overlooked in the past and the implementation of a multi-year plan. To support this strategy, a fully underwritten Rights Issue has been launched to ensure Capita has the balance sheet to support its clients and operations. The proceeds of the Rights Issue will be used to support the delivery of Capita's new strategy; invest in the business and reduce indebtedness.

GOVERNANCE

We have worked to improve the Group's governance, rebalance the Board and bring it in line with current good practice. Prior to my joining the Board in September 2016, it comprised five Executive Directors and five Non-Executive Directors. Today, we have two Executive Directors – the CEO and CFO

– and six Non-Executive Directors. Whilst we will continue to review the constitution of the Board, we believe that this is a more appropriate Board structure to facilitate debate and challenge as the business undergoes its strategic transformation.

On behalf of the Board, I would like to thank Andy Parker who left on 15 September 2017 and Vic Gysin and Chris Sellers, who left in recent months – all of them having made meaningful contributions over many years of service. We also thank Paul Bowtell, who left Capita last May after seven years as a Non-Executive Director and Chair of the Audit and Risk Committee.

We are delighted to welcome Baroness Lucy Neville-Rolfe to the Board as a Non-Executive Director with effect from 6 December 2017. A backbencher in the House of Lords and former Government minister, Lucy brings extensive private and public sector experience from her time on the Boards of Tesco plc, ITV plc and Metro AG.

We are also delighted that Matthew Lester joined the Board in March 2017, taking over as Chair of the Audit and Risk Committee on 1 June. He was formerly CFO of Royal Mail plc and is a Non-Executive Director of Man Group plc and Barclays Bank plc. Finally, I would like to thank Nick Greatorex for his contribution during the year as Interim CEO.

In last year's Annual Report, I highlighted diversity as an area of both Board and wider leadership focus for the future. Ensuring that all of our people have the opportunity to fulfil their potential is an essential element of a successful organisation, both commercially and as a responsible and supportive employer. It is also the right thing to do. We have made some progress in this area in 2017 but not enough. Under our new leadership, we look forward to redoubling our diversity efforts at all levels, especially in senior leadership positions, as the transformation plan takes shape.

I am grateful to all Capita people, who have shown great resilience and commitment throughout an uncertain period. Jon, the Board and I are determined to give all our employees a sound basis for a stable and happy career within Capita, focused on delivering outstanding services to our clients and their customers.

PERFORMANCE

Market conditions remained challenging in 2017, new business wins were weak and we experienced some operational difficulties. Despite these challenging trading conditions, progress was made in a number of important areas, notably the disposal of the Capita Asset Services businesses valued at £888m to Link Group, early adoption of the new IFRS 15 revenue recognition standard, progress on a series of cost initiatives, the hiring of Jon Lewis

as our new CEO and the commencement of the strategic review. We reported underlying profits before tax of £383.0m for 2017 and underlying profits before tax and before significant new contracts and restructuring costs of £400.9m, in line with our expectations for underlying trading.

Our reported operating loss for the year was £420.1m (2016: £16.1m), including a charge for specific items of £852.8m (2016: £353.5m). The significant increase in 2017 arises from the impairment of goodwill, intangible assets, and other non-current assets as at 31 December 2017. The impairment of goodwill and intangible assets amounted to £565.6m. The continued operational and external challenges faced by the Group, which became apparent following the conclusion of the 2018 business planning process, have led to a significant deterioration in new business opportunities from previous positions. In addition, the Group has experienced contract terminations and attrition as highlighted in the divisional performance reviews and the strategic review has identified areas that need to be addressed to rebuild and reposition Capita. These events and circumstances have led to the recognition of the impairment charge. Nick Greatorex will cover our detailed financial performance in his Chief Financial Officer's review on pages 15–22.

On 31 January 2018, we provided an update on the outlook for trading in 2018. In our update, we highlighted a number of headwinds, the need for investment and a transformation plan for the long-term benefit of the business, which is detailed in the Chief Executive Officer's review on pages 6–12.

BALANCE SHEET AND CAPITAL STRUCTURE

We have carried out an assessment of the appropriate financial leverage over the medium term, to provide a sustainable capital base to support our clients and operations, increase investment in the business and deliver its future strategy.

The Board has determined that the appropriate financial leverage for the Company is between 1.0x and 2.0x adjusted net debt to adjusted EBITDA prior to the adoption of IFRS 16, (compared to its existing leverage ratio of 2.27x adjusted net debt to adjusted EBITDA as at 31 December 2017), which the Board believes is the appropriate financial leverage for companies of similar size and with similar operations to Capita.

As announced on 31 January 2018, Capita intends, as a matter of good corporate responsibility, to reduce the remaining pension deficit in its defined benefit scheme. The current actuarial deficit is supported by an asset backed funding arrangement, the estimated value of which is £69m, and which is not included in the last disclosed IAS 19

deficit of £407m as at 31 December 2017. The triennial actuarial valuation of the scheme as at 31 March 2017 is due to be completed by 30 June 2018. In addition to Capita's current annual contributions, further contributions totalling £21.5m were paid in January 2018. Capita is fully committed to addressing the remainder of the deficit in the medium term.

In addition, we currently expect to achieve proceeds of approximately £300m from non-core disposals in 2018. We further intend to review the diversity of funding on our balance sheet over the next two years.

DIVIDEND

Given the short-term outlook and level of indebtedness, the Board did not recommend the payment of a final dividend in respect of 2017. However, the Board recognises the importance of regular dividend payments to investors in forming part of their total shareholder return, and will consider the payment of dividends once Capita is generating sufficient sustainable free cash flow.

THE WAY AHEAD

Capita is a key part of the UK corporate landscape, both in its own right and as the provider of essential services to businesses and public-sector institutions in every sector of the economy.

Scale has been critical to our offering. It has enabled us to achieve crucial efficiencies for our clients but it has also created its own operational difficulties that we must now address. From leadership and strategy to business mix and capital structure, we are assessing every aspect of the business.

Inevitably this is a difficult time for Capita's people, clients and shareholders. Our people are central to everything we do, and I want to thank them for their continued hard work, energy and commitment. The multi-year transformation process being led by Jon and his team will lead to a more sustainable, focused business operating with strong values to deliver great services to our clients. The Board and I are fully committed to the Rights Issue and the new strategy underpinned by the multi-year transformation plan to strengthen and simplify the business and deliver future success for the company, our employees, shareholders and clients.