Chief Financial Officer's review

We are simplifying and strengthening

I joined the Board in January this year, and have spent time meeting our people, clients, suppliers, shareholders and other stakeholders to gain a better understanding of the business. What has struck me most is the importance to our clients and customers of the services we provide and the commitment of our people to creating better outcomes.

In 2018 we developed and started to deliver on the strategy – simplify, strengthen and succeed – as part of which we launched a multi-year transformation plan, started to simplify Capita and progressed work to make our cost base more competitive. We strengthened the balance sheet by raising new equity and disposing of some non-core businesses. We delivered adjusted profit[1] in line with the January 2018 trading update and remain on track with work to deliver our 2020 financial targets.

We revised our non-statutory reporting measures to improve transparency and make it easier for the readers of our Annual Report to understand the Group's financial performance. Capita is a large and complex set of businesses, has recently implemented IFRS 15, with IFRS 16 to come, and is at the end of the first year of a three-year business transformation. As a result of these factors, work will be done during 2019 to identify additional improvements to the clarity and transparency of the presentation of our financial performance, position and prospects.

As part of our plan to strengthen the balance sheet, we launched a rights issue on 23 April, which received shareholder approval on 9 May and successfully completed later that month. The rights issue raised £701m gross proceeds and £663m after expenses, with a take-up rate of 97.3%.

£408m was raised from non-core disposals in 2018, ahead of the target of £300m. This included £157m from the disposal of Supplier Assessment Services, including Constructionline, £232m from the disposal of ParkingEye, and an aggregate £19m from the disposal of a number of small businesses.

"What has struck me most is the importance to our clients and customers of the services we provide and the commitment of our people to creating better outcomes."

Patrick Butcher, Chief Financial Officer

We also strengthened Executive Committee oversight of financial reporting, including enhanced monthly performance reviews, with clearer financial and operational KPIs at business, division and business unit level, and new governance committees. These include: the Contract Review Committee, set up to review proposed new and amended customer contracts prior to making formal bids; and the Investment Review Committee to approve investment cases and budgetary release for division, function and transformation investment proposals.

1 Refer to alternative performance measures on pages 197–198.

Chief Financial Officer's review continued

Summary of financial performance

Financial highlights

	Adjusted[1] results – continuing operations			Reported results – continuing operations		
	Adjusted[1] 2018 £m	Adjusted[1] 2017 £m	Adjusted[1] YOY change %	**Reported 2018 £m**	Reported 2017 £m	Reported YOY change %
Revenue	**3,867.6**	4,091.8	(5)	**3,918.4**	4,234.6	(7)
Operating profit/(loss)	**335.3**	447.5	(25)	**34.9**	(420.1)	+(108)
Profit/(loss) before tax	**282.1**	383.1	(26)	**272.6**	(513.1)	+(153)
Earnings/(loss) per share	**16.37p**	27.99p	(42)	**17.99p**	(48.82)p	+(137)
Total dividend per share	**–p**	11.1p	(100)	**–p**	11.1p	(100)
Free cash flow[2]	**(82.5)**	75.4	(209)	**(260.5)**	66.6	(491)

1 Refer to the alternative performance measures on pages 197–198. Further details of our performance are contained in our consolidated income statement and in notes 3, 4 and 6 to the consolidated financial statements.
2 The Group has represented and restated its 2017 cash flow statement. Refer to note 29 of the consolidated financial statements for details.

Adjusted profit[1] was in line with the January 2018 trading update. Revenue declined year-on-year, due to the limited benefit from contract wins being outweighed by contract losses and scope and volume changes in a number of divisions. The decline in profit was largely due to revenue decreases from contract losses and volume and scope changes, and the non-repeat of a supplier settlement and the impact of the reshaping of the Defence Infrastructure Organisation (DIO) contract in 2017. This was partially off-set by savings achieved from the cost-out programme, along with the full-year benefit of restructuring begun in prior periods, and certain one-off items in 2018, including contract-related profits that arose on the earlier than planned terminations of contracts.

Reported profit was affected by a number of items, including the costs of the transformation plan and the amortisation and impairment of acquired intangibles and goodwill. An explanation of the major items contributing to 2018 financial performance is provided later in my report.

As expected, we had a reported free cash outflow in 2018, before rights issue and disposal proceeds. This reflects the cash outflow from the final elimination of period-end cash management activity, the continued reduction in deferred income and spend in relation to known commitments, including the Connaught settlement, the separation of Capita Asset Services (including a pension contribution), and restructuring costs and professional fees in support of the transformation plan. We also fully phased out the non-recourse trade receivables financing which was expected in 2019 and made agreed deficit reduction payments into our main defined benefit pension scheme.

Net debt at 31 December 2018 was £466.1m (2017: £1,117.0m), reflecting the completion of the rights issue, the receipt of the proceeds from disposals and the free cash outflow highlighted above. The Board's view is that the appropriate leverage ratio for Capita over the medium term should be between 1.0 and 2.0 times adjusted net debt to adjusted EBITDA[1] (prior to the adoption of IFRS 16). At 31 December 2018, our adjusted net debt to adjusted EBITDA[1] covenant ratio was 1.2 times (2017: 2.2 times).

Changes to non-statutory reporting

We have simplified our non-statutory reporting measures to improve understanding of the Group's financial performance. Historically, the Group separated underlying, non-underlying results (comprising business exits and specific items) and reported these on the face of the income statement. In the notes, underlying results before significant new contracts and restructuring were disclosed.

There are a number of items that influence the profit reported in any one year. These can lead to significant differences between reported profit and the generation of free cash flow, including:

- IFRS 15 and the timing of reported profits compared to the receipt of cash. Under IFRS 15, revenue is more evenly distributed over the life of contracts, with the timing of profits re-profiled. There are typically lower profits in the early years on contracts, with significant restructuring costs or higher operating costs prior to transformation, with a compensating increase in profits in later years. Typically, cash receipts are aligned to when the costs are incurred. This results in income being deferred and released as we continue to deliver against our obligation to provide services and solutions to our clients. Further reporting improvements are being considered to make the impact of this more transparent.
- Contract terminations which can lead to major gains or losses in the year of termination, and where cash inflows/outflows have occurred in prior years.
- Additional pension contributions to address pension deficits are not reflected in our adjusted[1] or reported profit, in accordance with IAS 19, but will reflect a significant future cash commitment, totalling £176m to 2021, as described below.

To provide better understanding of our financials, we will continue to provide guidance on our sustainable free cash flow targets, with disclosures where the Company has committed to future cash outflows, as was done in relation to the cash contributions to the Group's defined benefit schemes.

The revised presentation provides reported results on the face of the income statement, with a footnote detailing adjusted results, and a note to the accounts providing a reconciliation between reported and adjusted results (note 3 to the consolidated financial statements). Those items which relate to the ordinary course of the Group's operating activities remain within the adjusted results. In the Directors' judgement, a number of items need to be disclosed separately by virtue of their nature, size and/or incidence, in order for users of the financial statements to obtain a proper understanding of the financial information and the underlying performance of the business. Accordingly, our presentation of the performance of the divisions does not comment on these adjustments, as they do not impact our consideration of in-year performance. We have treated items consistently with the approach adopted at the time of the rights issue in 2018. We will be giving consideration to further improvements in 2019.

1 Refer to alternative performance measures on pages 197–198.

New organisational structure

In April, a new organisational structure was put in place at Capita, with six divisions: Software, People Solutions, Customer Management, Government Services, IT & Networks and Specialist Services. The businesses within Specialist Services are mostly stand-alone and are being managed on a portfolio basis to maximise value. These divisions are supported by a common set of Group capabilities and functions, which have been strengthened. The Group's segmental reporting has been modified to align with management's view of divisional performance, and the 2017 disclosures represented to provide comparability.

2018 financial performance

The major items contributing to 2018 performance are detailed in the following summary of financial performance.

Revenue

Adjusted revenue[1], excluding results from businesses exited in both years, was £3,867.6m (2017: £4,091.8m), an organic decline of 5%.

This was due to the limited benefit from contract wins being outweighed by contract losses and scope and volume changes in Government Services, Customer Management and Specialist Services, including the re-shaping of our DIO contract with the Ministry of Defence, and Home Office escorting, on which we chose not to re-bid. There was also a decline in transactional revenue in People Solutions and IT & Networks.

Adjusted revenue[1] year-on-year	£m
2017	4,092
Contract wins	25
Contract losses	(172)
Scope and volume changes	(61)
Transactional business	(62)
One-offs	48
Other	(2)
2018	**3,868**

Reported revenue decreased by 7% to £3,918.4m (2017: £4,234.6m).

Operating profit

Adjusted operating profit[1] decreased by 25.1% to £335.3m (2017: £447.5m), as a consequence of the revenue decline year-on-year, due to the limited benefit from contract wins being outweighed by contract losses and scope and volume changes in Government Services, Customer Management and Specialist Services, a decline in People Solutions margin, the re-shaping of the DIO contract in Government Services and a one-off supplier settlement in the prior year in IT & Networks. These were partially off-set by cost savings achieved from the transformation plan announced earlier in 2018 along with the full-year benefits of restructuring begun in prior years, and one-off contract-related profits of £6m on Prudential and £9m on Marsh that arose on the earlier than planned terminations of contracts in Specialist Services.

These contract profits arose as a result of the Group's revenue recognition policy under IFRS 15, where revenue is deferred over the expected life of a contract. Where a contract is terminated early, all deferred revenue is pulled forward and recognised in the year of termination. Similarly, any associated contract-specific assets that were being amortised over the expected life of the contract are written off in the year of termination, unless there are alternative uses on other contracts.

Adjusted operating margin[1] was 8.7% (2017: 10.9%). We continue to target double digit adjusted EBIT margins in 2020.

Adjusted operating profit[1] is before charging a number of specific items detailed further below.

The table below provides a reconciliation for 2018 and 2017 between reported and adjusted profit[1].

Reported operating profit for the year was £34.9m (2017: loss £420.1m). Further detail of the specific items charged in arriving at reported operating profit for 2018 is provided in the notes to the financial statements.

The Group's policy is to disclose significant restructuring separately so users of the financial statements can more clearly understand the financial performance of the business. As announced in 2018, the Board has launched a multi-year transformation plan to support the objectives of simplifying and strengthening Capita. The plan includes restructuring, property rationalisation, procurement centralisation, finance transformation and operational excellence. Activities are designed to improve the cost competitiveness of the Group and secure Capita's position in the markets it serves.

Adjusted[1] to reported profit bridge	Operating profit 2018 £m	Operating profit 2017 £m	Profit before tax 2018 £m	Profit before tax 2017 £m
Adjusted[1]	**335.3**	447.5	**282.1**	383.1
Amortisation and impairment of acquired intangibles	**(143.5)**	(138.3)	**(143.5)**	(138.3)
Impairment of goodwill	**(33.8)**	(551.6)	**(33.8)**	(551.6)
Impairment of other non-current assets	**–**	(63.5)	**–**	(63.5)
Impairment of Life & Pensions assets	**–**	(61.2)	**–**	(61.2)
Impairment of loans and investments	**(1.6)**	(9.0)	**(1.6)**	(9.0)
Litigation and claims	**1.8**	(30.0)	**1.8**	(30.0)
GMP and retirement age equalisation	**(5.4)**	–	**(5.4)**	–
Net finance costs	**–**	–	**(18.8)**	2.1
Contingent consideration movements (and acquisition costs in 2017)	**5.0**	0.8	**5.0**	0.8
Business exit – trading	**16.8**	16.8	**16.8**	16.7
Business exit – non-trading expenses	**(29.7)**	(13.7)	**(29.7)**	(13.7)
Business exit – (gain)/loss on disposals	**–**	–	**309.7**	(30.6)
Significant restructuring	**(110.0)**	(17.9)	**(110.0)**	(17.9)
Reported	**34.9**	(420.1)	**272.6**	(513.1)

1 Refer to alternative performance measures on pages 197–198.

Chief Financial Officer's review continued

In prior years, the Board disclosed profit before 'significant new contracts and restructuring'. This altered the previous presentation of significant restructuring. We have further simplified our reporting and now exclude significant restructuring costs from adjusted operating profit[1]. The Board recognises that this reflects a change in presentation but, given the critical nature of the multi-year transformation plan, concluded that this new presentation met the objectives of simplifying the Group's structure. The Board also considered other items that impact the reported results and the consolidated financial statements presented in note 7 to the consolidated financial statements that have a material impact on in-year performance. This policy will remain under review by the Audit and Risk Committee and the costs will be reported over the life of the plan. The costs incurred in 2018 totalled £110.0m and full details are set out in note 3 to the consolidated financial statements. An update will be provided at the next reporting period at 30 June 2019.

The impairment and amortisation of acquired intangibles, including goodwill, amounted to £177.3m (2017: £689.9m). The amortisation of acquired intangibles, and any impairment charges, are reported separately, due to the size of the annual charges and because the performance of the acquired businesses is assessed through the adjusted operating profit[1] which, for internal purposes, excludes any amounts associated with the acquired intangible assets. During the year, impairment charges were recorded in relation to businesses of £95.5m (2017: £565.6m). As noted in 'divisional performance' on pages 21–33, the local government market for large BPO contracts is declining, with a significant drop-off in the number and size of opportunities coming to market and existing clients choosing to end contracts early and take services back in-house. These events and circumstances led to the recognition of the goodwill impairment charge of £33.8m, as set out in note 15 to the consolidated financial statements.

The Board has considered the appropriate guidance and FRC thematic review on alternative performance measures and concluded that it is appropriate to exclude the above items in arriving at adjusted profit before tax[1].

Finance costs

The adjusted interest charge[1] in 2018, excluding the fair value movement on mark-to-market fixed rate swaps, was £53.2m (2017: £64.4m), reflecting the benefit from the repayment of debt following the rights issue and disposals. Interest cover was 8.2 times for the year (2017: 8.6 times).

Profit before tax

Adjusted profit before tax[1] decreased by 26% to £282.1m (2017: £383.1m). Reported profit before tax increased by 153% to £272.6m (2017: loss £513.1m). Both reported and adjusted profit[1] in 2017 were impacted by significant impairment.

Discontinued operations

The disposal of the Capita Asset Services businesses in 2017 was treated as a discontinued operation as stipulated by IFRS 5. The profit on the disposal of these businesses was £445.4m. This profit is specific to the disposed businesses and is therefore excluded from both the adjusted[1] and reported results of the continuing operations. Adjustments in 2018 to provisions related to this disposal are also disclosed as discontinued.

Taxation

The income tax charge of £27.4m on adjusted profit[1] resulted in an adjusted tax rate of 9.7% (2017: income tax charge of £65.8m and adjusted tax rate 17.2%). This is a reduction year-on-year as a result of deferred tax credits arising from a re-assessment of the recognition of deferred tax assets and true-ups of positions to filed tax returns, together with an unremitted earnings charge, as detailed further in note 10 to the consolidated financial statements. It is expected that the adjusted tax rate will return to a level closer to the UK tax rate of 19% in 2019.

The income tax credit of £0.9m on reported profit resulted in a tax rate of (0.3%) (2017: income tax credit of £14.0m and tax rate (2.7)%). The reported tax rate will generally vary from the adjusted tax rate year-on-year due to the items excluded from adjusted profit[1] in a period, for example non-taxable profits/losses on disposals or non-deductible impairment of certain acquired intangible assets.

Capita has an open and positive working relationship with HMRC, has a designated customer compliance manager, and is committed to prompt disclosure and transparency in all dealings with HMRC and overseas tax authorities. The Group does not have a complex tax structure, nor does it pursue aggressive tax avoidance activities. The Group has a low-risk rating from HMRC. The Group has operations in a number of countries outside the UK. All Capita operations in non-UK jurisdictions are trading operations and pay the appropriate local taxes on these activities. Further detail, regarding the tax strategy, can be found on the Policies and Principles area of the Capita website (capita.com/about-us/policies-and-principles).

In total, Capita contributed £164.3m (2016: £204.8m) in taxes from its UK operations in the year. This consisted of a net refund of £37.5m (2017: £12.7m) of UK corporation tax; £16.0m (2017: £21.4m) in irrecoverable VAT payments; £143.1m (2017: £155.5m) in employer NIC; and £42.7m (2017: £40.6m) in other levies including business rates, import duties, the apprenticeship levy and environmental taxes. Additionally, the Group collected and remitted to the UK Government £360.5m (2017: £409.9m) of VAT and £333.3m (2017: £367.7m) of Capita employee PAYE and NIC. Capita entities in overseas jurisdictions paid £4.6m (2017: £6.4m) of tax on local profits.

Earnings per share

Adjusted basic earnings per share[1] for continuing operations decreased by 42% to 16.37p (2017: 27.99p) as a result of the performance explained above.

The reported basic earnings per share for continuing operations was 17.99p (2017: loss 48.82p).

Dividend

The Board is not recommending the payment of a final dividend (2017: £nil). 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 when the Group is generating sufficient sustainable free cash flow.

1 Refer to alternative performance measures on pages 197–198.

Cash flow

Adjusted free cash flow[2] from continuing operations was an outflow of £82.5m (2017: inflow £75.4m). The Group has represented and restated its 2017 cash flow statement – refer to note 29 of the consolidated financial statements for details.

The Group's free cash flow was affected by the aforementioned decline in profit and a £372.4m working capital outflow from continuing operations. The change in working capital reflected the final elimination of period-end cash management activity, having historically optimised the working capital position at the end of reporting periods, and a £110m outflow from the phasing-out of non-recourse trade receivables financing. Deferred income declined due to limited new large contract wins, termination of contracts and a change in mix of licence sales in our Software division. Net capital expenditure on continuing operations was £139.9m in 2018 (2017: £110.2m), mainly attributable to an increase of investments in systems and infrastructure.

We continue to expect to deliver at least £200m of sustainable free cash flow in 2020, before exceptional and restructuring charges, and the pension deficit recovery payments set out below.

Reported free cash flow was an outflow of £260.5m (2017: inflow £66.6m). This reflected spend in relation to known commitments, including the Connaught settlement, the separation of Capita Asset Services, pension contributions, (which the Directors consider to be debt like in nature), restructuring costs, professional fees, contingent and deferred consideration, litigation and other items.

Net debt

Net debt at 31 December 2018 was £466.1m (2017: £1,117.0m), reflecting the completion of the rights issue and the receipt of the proceeds from the disposal of Supplier Assessment Services, including Constructionline, and ParkingEye, which were partially offset by the free cash outflow.

At 31 December 2018, the Group had £1,108.0m of private placement notes which mature over the period up to 2027. In addition, the Group has £100.0m of bank debt which matures in 2019, and an undrawn £600m revolving credit facility of which £81m matures in August 2020 and £519m in August 2021.

The Board's view is that the appropriate leverage ratio for Capita over the medium term should be between 1.0 and 2.0 times adjusted net debt to adjusted EBITDA[1] (prior to the adoption of IFRS 16). At 31 December 2018, the Group's adjusted net debt to adjusted EBITDA[1] covenant ratio was 1.2 times (2017: 2.2 times) and interest cover[1] was 8.2 times (2017: 8.6 times).

At each reporting date, the calculation of the Group's debt covenants is assessed, both for that period and subsequent ones. These covenants are calculated based on the adjusted[1] performance of the Group, in that they exclude exceptional items. The Group has been consistent with previous years in its treatments of these items.

Adjusted operating profit to adjusted free cash flow[2]	2018 £m	2017 £m
Adjusted operating profit[1]	**335.3**	447.5
Add back: Depreciation	**59.1**	56.4
Add back: Amortisation of intangible assets	**27.9**	15.4
Add back: Impairment of property plant and equipment	**6.1**	–
Adjusted EBITDA	**428.4**	519.3
Working capital:	**(372.4)**	(263.2)
Non-recourse receivables financing cleared	**(110.0)**	(23.6)
Full normalisation of period-end cash management	**(126.3)**	(85.0)
Deferred income	**(243.4)**	(75.2)
Accrued income	**24.8**	(52.2)
Other movements in working capital	**82.5**	(27.2)
Interest	**(39.0)**	(54.2)
Taxation	**26.6**	9.5
Capital expenditure	**(139.9)**	(110.2)
Provision movements and non-cash items	**13.8**	(25.8)
Adjusted free cash flow[2]	**(82.5)**	75.4

Adjusted to reported free cash flow	2018 £m	2017 £m
Adjusted	**(82.5)**	75.4
Pension deficit contributions	**(46.9)**	–
Significant restructuring	**(100.8)**	(45.0)
Business exits	**(6.6)**	19.5
Other	**(23.7)**	16.7
Reported	**(260.5)**	66.6

Capital management

The Group's policy is to hold cash and undrawn committed facilities at a level sufficient to fund the Group's operations and its medium-term plans. The Group holds cash and undrawn committed facilities to enable the Group to manage its liquidity risk. At 31 December 2018, the Group held cash and cash equivalents net of overdrafts of £642.7m, and had available to it a committed Revolving Credit Facility of £600m.

The Group agreed comprehensive amendments with the holders of its US private placement notes, euro fixed rate bearer notes and the Schuldschein loan to address certain issues which arose from the early adoption of IFRS 15 and the Group's strategy of disposal of certain non-core businesses. The amendments established a robust framework supporting the new corporate strategy. Further details of the terms of the amendments are set out in note 26 to the consolidated financial statements.

Note 24 to the consolidated financial statements details the Group's future minimum rental payments under its lease arrangements which highlight gross commitments of £736.0m.

1 Refer to alternative performance measures on pages 197–198.
2 Refer to note 29 of the consolidated financial statements for details.

Chief Financial Officer's review continued

Pension

In November, the Group announced that it had agreed a deficit recovery plan with the Trustees of the Capita Pension and Life Assurance Scheme (the 'Scheme').

This pension deficit recovery plan is in line with the commitment made by the Group in January 2018 to reduce the deficit over the medium term as a priority. The actuarial deficit at 31 March 2017, the date of the last triennial valuation, was £185m, before the impact of the recent High Court ruling on Guaranteed Minimum Pension equalisation.

The agreed deficit recovery plan, with payments totalling £176m, aligns with the Group's transformation plan, reflects the higher than expected proceeds the Group received in 2018 from its disposal programme, and incorporates steps to continue to lower the level of investment risk in the Scheme, benefiting the Scheme and the Group.

The expected pension deficit recovery plan payment schedule is:

2018 £m	2019 £m	2020 £m	2021 £m	Total £m
42	71	59	4	176

The current deficit is supported by an asset-backed funding arrangement of c.£70.0m, the value of which is not included in the IAS 19 deficit of £219.0m at 31 December 2018 (31 December 2017: £406.8m). Refer to note 32 to the consolidated financial statements for further detail on the arrangement. In addition, further contributions totalling £21.5m were paid in January 2018, comprising £17.0m following the disposal of Capita Asset Services, and £4.5m following closure of the Scheme in 2017 to future accrual for the majority of members of the Scheme.

IFRS 16 Leases

IFRS 16 was effective for the Group from 1 January 2019 and replaced IAS 17 Leases. The standard will have a material impact for the Group as it introduces a single lessee accounting model and requires the recognition of assets and liabilities for all leases. Rental costs currently recognised in operating profit will be replaced by depreciation of the assets and net finance costs on the liability. The total cash outflow for lease payments will not change. However the payments related to the principal liability will be presented as cash outflows from financing activities, as opposed to the current treatment as cash outflow from operating activities.

At 31 December 2018, the Group held a significant number of operating leases for which the future minimum lease payments amount to £736.0m as disclosed in note 24 to the consolidated financial statements. On adoption of IFRS 16, the expected effect on the balance sheet is the recognition of an asset in the range of £579m to £591m, a liability in the range of £640m to £650m, and an increase in retained deficit in the range of £23m to £25m. The expected effect on the income statement for 2019 is an improvement in EBITDA of £130m to £135m, an improvement in operating profit of £19m to £21m as rental payments are replaced by a lower depreciation charge, and an increase in finance costs of £28m to £30m, resulting in a reduction in profit of £8m to £10m.

The above changes are expected to increase our leverage ratio by 0.6 times. However, the impact on our adjusted net debt to adjusted EBITDA[1] covenant ratio is expected to be neutral to positive as the Group covenants are on frozen GAAP, with the exception of the US private placement notes. The US private placement notes covenant test includes the income statement impact of IFRS 16, but not the balance sheet.

Due to the Group transformation plan, which includes a consolidation of Capita's properties, the Group's lease portfolio is expected to materially change over the next few years. Any changes to the lease portfolio will be accounted for when transacted. The costs arising from the property rationalisation programme will be excluded from adjusted[1] profit in line with the current Group policy.

The Group will continue to implement and refine procedures and processes to apply the new requirements of IFRS16. As a result of this ongoing work, it is possible that there may be some changes to the adoption impact outlined above, before the 30 June 2019 results are issued. However, at this time these are not expected to be material. Further detail of IFRS 16 is provided in note 2 to the consolidated financial statements.

Financial outlook

Capita is entering the second year of a major transformation and the successful delivery of this programme is critical to the future performance of the Group. We expect adjusted net finance costs to be in the region of £40m and adjusted profit before tax to be between £265m and £295m in 2019. We expect our headline net debt to EBITDA ratio to be in the top half of our stated range of 1.0 times to 2.0 times before adoption of IFRS 16.

Our 2020 targets of £175m initial cost savings, double-digit adjusted[1] EBIT margins and at least £200m of sustainable annual free cash flow, before exceptional and restructuring charges and additional pension contributions, remain unchanged.

1 Refer to alternative performance measures on pages 197–198.