CAPITA

**31 January 2018**

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**Update on Capita's transformation, capital structure, funding and trading outlook**

Capita plc ("Capita") today provides an update on the outlook for trading, dividend policy, funding and actions being taken to improve the performance of the Group over the medium-to-long term.

**Key points**

- Capita has commenced a multi-year transformation programme and is committed to delivering a strategic review of the Group during 2018 - building blocks exist to create a great business.
- Substantial opportunity to improve cost competitiveness over the medium term.
- Decision taken to strengthen the balance sheet, targeting a leverage ratio of 1-2x net debt to EBITDA.
- Non-core disposal programme over next two years.
- Dividend suspended until Company generating sustainable free cash flow.
- Rights issue planned in 2018. Precise quantum to be determined as part of the transformation programme. Standby underwriting in place for up to £700m.
- 2017 trading in line with our expectations. 2018 underlying pre-tax profits, before significant new contracts and restructuring costs, expected to be between £270m and £300m.

Jonathan Lewis, Chief Executive Officer of Capita, said:

"In my first two months I have begun a thorough review of Capita – its structure, its leadership, its contracts and its financial position. There is a lot to be excited about: talented people, a blue-chip customer base, great technology and the ability to deliver value adding services.

We have completed the budgeting process for 2018 from which we have set a prudent plan. Since our December update, we have also decided to invest in people, sales and our transformation programme for the long-term benefit of the Group.

However, significant change is required for Capita's next stage of development. We are now too widely spread across multiple markets and services, making it more challenging to maintain a competitive advantage in every business and to deliver world class services to our clients every time.

Capita has underinvested in the business and there has been too much emphasis on acquisitions to drive growth. As our markets have evolved, the Group has not responded consistently to new customer demands. Since December, we have continued to experience delays in decision making and weakness in new sales.

Today, Capita is too complex, it is driven by a short-term focus and lacks operational discipline and financial flexibility.

Capita needs to change its approach. I have initiated a transformation programme, appointed a Chief Transformation Officer and formed a new executive committee to drive this change. I believe that this transformation programme can significantly improve the performance of Capita.

An immediate priority is to strengthen the balance sheet through a combination of cost savings, non-core disposals and new equity. My initial review of our cost base highlights that over the next few years there is significant scope for cost efficiencies across a number of areas but also the need to spend more where there has been underinvestment. We have identified a small number of quality businesses that do not fit with our core skills for which there will be better owners and a process to maximise value will commence shortly.

Cost savings and non-core disposals alone will not be enough. We have also taken the significant decision to suspend the dividend and seek equity.

We have the building blocks to create a great business; one that consistently delights its customers, has operational discipline and generates sustainable cash flow. My team and I are now working hard putting in place the plan to deliver it."

**Capita transformation programme and strategy**

Subsequent to Jonathan Lewis' appointment, we have initiated a transformation programme, encompassing strategy, cost competitiveness, sales, IT and our capital structure, to improve the performance of Capita over the medium-to-long term.

As part of the programme we are developing a multi-year strategy, the outcome of which is expected to be announced later in the year. Early findings include that Capita has many strengths which can be built on, such as strong market positions in the UK, long term relationships with blue chip customers, good technology capabilities which can be leveraged to take advantage of the secular growth in digital solutions and talented committed people.

However, Capita also has a number of weaknesses that we need to address. It is too complex, placed too great an emphasis upon short term performance, underinvested in infrastructure, over-relied upon acquisitions for growth and has limited financial flexibility, which has constrained its ability to invest for the long term benefit of the business. We need to address these challenges in order to move forward.

**Cost competitiveness and re-engineering sales**
We have identified significant multi-year opportunities to reduce costs and improve operational efficiency. These include reductions in general and administrative expenses, which are higher than our peers, centralising more procurement, standardising and investing in our processes and systems and increasing the use of offshoring and automation. We will provide more detail on these cost savings during the course of this year. Over the medium term, we intend to use some of the benefit from any further efficiency savings to improve our competitiveness and capability.

We have reallocated our previously centralised business development capability to the divisions, bringing it closer to the markets we serve. This reduces complexity and increases accountability, in relation to the bidding, implementation and management of contracts, as we seek to improve sales performance.

**Disposals**
As part of the transformation programme, we intend to simplify Capita and increase the focus of our resources on a smaller number of markets with the best prospects and where the Group has the capability and potential to create value. We have already identified a small number of businesses that are considered non-core to the Group, including ParkingEye and Constructionline, and a disposal programme for these businesses will commence shortly. The Group intends to use the proceeds from disposals to reduce indebtedness in the short term and to invest in the remaining core areas of the Group over time. The impact of the disposals, both in value and forgone EBITDA, has not been included in any 2018 pre-tax profit forecasts.

**Capital structure, dividend and proposed future raising of equity**
Capita's transformation programme includes an assessment of the appropriate financial leverage for the Group over the medium term, to ensure that we have a sustainable capital base to support our customers and operations, increase investment in the business and deliver our future strategy. Whilst the outcome of the programme has yet to be finalised, the Board's preliminary view is that the appropriate leverage for Capita over the medium term should be between 1.0 and 2.0 times net debt to EBITDA and that the Group should target an investment grade credit rating.

Given the short term outlook and level of indebtedness, the Board has decided upon a number of actions. Firstly, we are pursuing "self-help" options, including the aforementioned cost actions and non-core disposals. Secondly, the Board is not recommending the payment of a final dividend. Finally, the Board is planning to raise equity by way of a rights issue during this year. The precise quantum has yet to be determined and the Company has entered into a standby underwriting agreement for up to £700m with Citi Global Markets Limited and Goldman Sachs International.

**Trading in line with expectations in 2017**
Although market conditions remained challenging, underlying trading across our divisions in the second half of 2017 was in line with our expectations.

**2018 outlook**
We have now completed the budgeting process for 2018 from which we have set a prudent plan. Since our December update, we have also decided to invest in people, sales and our transformation programme for the long-term benefit of the Group.

Following that update, when we highlighted a higher level of attrition than expected, we have continued to experience delays in decision making and weakness in new sales. The divisional plans indicate that there is likely to be a significant negative impact upon profits from contract and volume attrition, the dropping out of one-off items including contract and supplier-related profits which were reported in 2017 and increases in some cost items, including depreciation and adoption of the General Data Protection Regulation. These headwinds are particularly expected to impact upon the financial performance of the Private Sector Partnerships, in both Insurance Services and Customer Management, Public Services Partnerships and IT Services divisions.

We do not expect to offset the above headwinds through the full year benefit of last year's cost actions and new business. A more fundamental approach to cost competitiveness is required. As a result, we expect the Group's underlying pre-tax profits, before significant new contracts and restructuring costs, to be between £270m and £300m in the full year to December 2018.

**Leverage**

We expect net debt at the 2017 year-end to be in the region of £1.15bn and leverage (including contingent obligations under bonds and guarantees) to be around 2.25 times, after the receipt of proceeds from the disposal of our Capita Asset Services businesses, partial normalisation of seasonal cash management and a reduction of deferred income in the second half of the year. We expect our receivables financing balance to be £110m at 31 December 2017.

Looking forward, we expect a free cash outflow this year, which will be impacted by a number of known non-underlying payments and working capital items. We expect around £215m spend in relation to known commitments, including £66m cash costs on the Connaught settlement, around £50m in relation to the separation of Capita Asset Services (including a pension contribution), contingent considerations, historic litigation and restructuring costs. In addition, we expect a £130m cash outflow from the final normalisation of seasonal cash management, and a £130m cash outflow on continued reduction in deferred income, reflecting the ongoing low level of new business.

**Pensions**

We are currently undertaking a triennial review of the pension scheme. Our current expectation is that the actuarial deficit after this review will be significantly below the last disclosed IAS19 deficit of £381m at 30 June 2017. In addition to our annual contribution, we are committed to an additional contribution of £21m in 2018. We will seek to reduce the remaining deficit as a priority.

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This announcement contains inside information for the purposes of article 7 of EU Regulation 596/2014.

**<u>Analyst & investor conference call:</u>**

Jonathan Lewis, CEO and Nick Greatorex CFO will host a conference call at 07:45 UK time today.

**Date and time:** 7.45-08.30AM, 31 January 2018

**Participant dial in details**

**Tel:** +44 (0) 20 3003 2666/0808 109 0700

Password: **Capita**

Participant names and company names will be collected as they dial in.

This call will be available on a seven day replay: Tel: 0208 196 1998 PIN: 5808520#

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LEI no. CMIGEWPLHL4M7ZV0IZ88.

**Forthcoming events**
The date for Capita's final results is to be confirmed.

**Cautionary statements**

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There are a number of factors which could cause actual results to differ materially from those expressed or implied in forward-looking statements. Among the factors that could cause actual results to differ materially from those described in the forward-looking statements are: increased competition; the loss of or damage to one or more key customer relationships; changes in the economies, political situations and markets in which Capita operates; currency fluctuations; changes in interest and tax rates; changes in laws, regulations or regulatory policies; the failure to retain key management; or the key timing and success of future opportunities or major investment projects.

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