17 December 2024

Trading and operating update

Capita plc (â€œCapitaâ€) Â Â

Good margin progression in 2024. Further focus on operating model delivers additional cost savings and underpins our Group medium-term targets

Summary:

- Outlook for adjusted operating profit unchanged for 2024, with adjusted operating profit margin up c.50bps, largely driven by cost reduction initiatives
- Adjusted revenue[1] was c.8% lower in the eleven months ended 30 November 2024, owing to exiting lower margin service lines and the impact of prior year headwinds. Good momentum on cost savings target of Â£160m, with Â£140m annualised savings, now actioned
- Experience of live projects and data capture creates significant opportunity to use more AI and generative AI in our service offerings, enabling cost savings target to be raised to up to Â£250m by December 2025
- Increased employersâ€™ National Insurance Contributions to have an annual cost of c.Â£20m with cost savings expected to mitigate these costs over the medium-term
- Expect a free cash outflow[2] of Â£120m-Â£140m in 2024 as a result of lower revenues and a more sustainable approach to working capital management. Majority of the up to Â£50m additional cash restructuring costs to deliver additional savings, expected to impact 1H25 free cash flow. We expect positive and consistent free cash flow[2] from the end of 2025
- Progress exiting managed for value businesses. Completion of Capita One disposal in September 2024, c.Â£180m net proceeds received, providing funding optionality. 2024 year-end net financial debt to adjusted EBITDA, pre IFRS 16, expected to be <1.0x
- The Board is increasingly confident in delivering its 6-8% medium-term operating margin target

Strategic priorities

As outlined at the Groupâ€™s Capital Markets Day in June, the first priority of the ongoing transformation is improving the operating margin of the Group, which in turn will deliver free cash flow[2] and adjusted revenue growth as we become more cost competitive.

Significant opportunities continue to be identified to fundamentally improve our operating model and drive cost efficiencies throughout the organisation, with the increasing use of AI and generative AI at the heart of this transformation. Consequently, the accelerating momentum of the current cost reduction programme has increased our confidence in the level of efficiencies that can be delivered, enabling us to increase our cost reduction target from Â£160m to up to Â£250m. Voluntary employee attrition of around 21% contributes to these savings, reduces the need for redundancies and the Group can ensure that it can rebalance new hires, incremental training of our colleagues and investment in key growth areas, particularly within the Contact Centre business. By combining people, processes and technology to develop repeatable scalable products we can drive efficiencies for our clients and make us more competitive. The progressive adoption of AI in the delivery of our client solutions will enable us to continue to focus on efficiencies in the future on a â€œbusiness as usualâ€ basis.

Increasing our operating cash conversion and a return to positive free cash flow[2] is our next priority. Though the total cash cost of delivering the cost reduction targets will impact free cash flow by c.Â£50m in 2024 and up to Â£50m further in 2025, the combination of improving profitability, and the absence of pension deficit payments (from H2 2024 onwards) will contribute to positive and consistent free cash flow[2] from the end of 2025.

We are increasingly focused on leveraging our domain expertise with technology solutions provided by our hyperscaler partners to deliver profitable revenue growth in the medium-term. The use of AI is already enabling us to deliver significant productivity and service quality improvements for our early adopting Contact Centre and Local Government customers, where those early clients have seen average handling time reductions of around 20%. We are also seeing some encouraging early successes on winning new contracts due to our enhanced service offering. Looking forward, we have opportunities which deliver AI solutions with the hyperscalers worth more than Â£5bn within the pipeline.

In 2024, we have accelerated the exit from lower margin activities, including the sale of our Mortgages Asset Services business which we expect to complete in Q2 2025 as detailed in yesterdayâ€™s news release. We will continue to exit those activities that are either low margin or where we have a limited right to win and as a result, we expect a broadly flat revenue performance in 2025.

Financial performance

Adjusted revenue[1] was c.8% lower in the eleven months ended 30 November 2024.

Capita Public Service adjusted revenue[1] reduced 0.9%, in the eleven months to 30 November 2024, driven by the continued impact of previously announced contract losses in 2023, the cessation of some lower margin services, and delayed mobilisations of two contracts in 2023 which impacted current year revenue and profit and will benefit 2025. These factors offset additional volumes in our contract with Transport for London and the benefit from indexation. Looking ahead, we have strong alignment with the UK Governmentâ€™s priorities as outlined in the recent budget, particularly in areas such as Healthcare and Defence.

Capita Experience adjusted revenue[1] reduced 16.3% in the eleven months to 30 November 2024.Â The Contact Centre[3] business declined 18.5% reflecting the one-off benefit from the Virgin Media O2 contract transition in the prior year, the impact of prior year contract losses with the Co-operative Bank in 2023 and lower volumes on a Telecommunications contract, which we expect to remain subdued in 2025.

Pension Solutions[3] grew 6.7% reflecting volume growth across a number of clients, including PIC and Rothesay and the benefit from indexation.

Regulated Services[3], including closed book Life & Pensions, saw revenues decline 25.8% as expected reflecting the one-off benefit from the prior year commercial settlement, the impact of contract exits and volume reductions as we resolve legacy issues and look to exit this business segment.

Financial guidance

For 2024, we expect to deliver a high-single digit adjusted revenue decline, after adjusting for disposals including Capita One, with improved margins driving an unchanged operating profit outlook. In 2025, we expect additional savings to offset the Â£16m of in-year incremental employersâ€™ National Insurance Contributions costs (Â£20m on an annualised basis), and to deliver further margin improvement and modest profit growth.Â The up to Â£50m additional cash restructuring costs to deliver the up to Â£250m upgraded cost savings target are expected to mainly impact 1H25 free cash flow.

Adolfo Hernandez, Chief Executive Officer, said: â€œAs we head towards the end of my first year as CEO of Capita, I am very encouraged by the progress we have made against our strategic priorities, despite the impact of prior year headwinds being larger than originally expected.Â Our focus is on becoming a better business, â€œgetting smaller to get stronger and fitter to then growâ€ and being more selective in not pursuing and exiting existing lower margin contracts. Consequently, revenue is expected to be high single-digits lower in 2024. However, we are encouraged by the customer reaction to our suite of AI solutions developed with the hyperscalers which will help to drive profitable revenue momentum from 2025 onwards.

We have implemented a significant proportion of our efficiency programme, and today have outlined further savings which will result in further improvement to operating profit margins. We have made good progress with the managed for value businesses including the sale of Capita One in September and we look forward to 2025 with expectations of continued progress with positive and consistent free cash flow[2] from the end of 2025.

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THIS ANNOUNCEMENT CONTAINS INSIDE INFORMATION

Notes:

1. Adjusted revenue = revenue on a like-for-like basis, as outlined in the Groupâ€™s alternative performance measures note.
2. Free cash flow, before the impact of business exits.
3. Following a review of the Groupâ€™s offerings, moving forwards, Capita Experience will be reported as three segments â€“ reflecting the different market sectors and end product offerings. These are, Contact Centre, Pension Solutions and Regulated Services which includes closed book Life & Pensions. We will provide full comparative 2023 data ahead of the Groupâ€™s year end results.

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About Capita

Capita is a leading provider of business process services, driven by data, technology and people. Capita is a modern outsourcer, helping clients across the public and private sectors run complex business processes more efficiently, creating better consumer experiences. Operating across 8 countries, Capita's 41,000 colleagues support primarily UK and European clients with people-based services underpinned by market-leading technology. We play an integral role in society - our work matters to the lives of the millions of people who rely on us every day. Capita is quoted on the London Stock Exchange (CPI.L). Further information can be found at: http://www.capita.com

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