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SERCO GROUP PLC
Preliminary results for the year ended 31 December 2004

	2004	2003	
Turnover	£1,637m	£1,556m	up 5.2%
Profit before tax pre-amortisation	£73.9m	£67.0m	up 10.3%
Earnings per share pre-amortisation	12.20p	11.03p	up 10.6%
Profit before tax	£57.4m	£52.9m	up 8.6%
Earnings per share	8.37p	7.75p	up 8.1%
Dividend per share	2.63p	2.34p	up 12.4%

Continued strong sales, profit and cash growth

- Underlying turnover (excluding disposals and contracts exited) up 14.0%
- Underlying profit before tax, amortisation and 2003 exceptionals up 16.4%
- Recommended final dividend of 1.82p, giving a total of 2.63p for the year, up 12.4%
- Group EBITDA to cash conversion of 94.9% (2003 – 80.7%)
- Free cash flow of £55.8m (2003 – £47m)

Strong organic growth

- 82% of the increase in underlying turnover came from growth in existing contracts and new wins
- Continued win rates of over 90% on rebids and over 50% on new bids
- Contracts won valued at £4.1bn, including £2bn share of Northern Rail franchise, Electronic Monitoring and FAA Air Traffic Control Towers

Acquisitions strengthen our capabilities where we see strong organic growth opportunities

- ITNET plc – one of the UK's leading suppliers of IT and business process outsourcing services to local authorities, with expected 2004 sales of £209m
- Resource Consultants Inc (RCI) – supplier to US federal government of business process management and IT services, with expected 2004 sales US\$293m
- ITNET acquisition completed in February 2005. RCI expected to complete in March 2005

High visibility of future earnings

- Record forward order book of £12.7bn at year end
- 91% of 2005 planned turnover secured, 76% for 2006, 64% for 2007
- Bids worth £4.7bn submitted and under evaluation
- Strong start to 2005 with new wins of £0.4bn and contracts at preferred bidder valued at £0.9bn
- Over £16bn of further potential opportunities identified

Note: EBITDA is earnings before interest, tax, depreciation and intangible amortisation. Free cash flow is reconciled in Section 3 of the finance review.

Executive Chairman Kevin Beeston said:

"Today's results demonstrate once again how Serco's focus on customer service and relationships is building a strong business around the world. Underlying Group turnover and profit have grown by 14% and 16% – principally through high levels of organic growth. The drive for better value for money public services around the globe puts Serco in an excellent position to continue its strong growth, further enhanced by our recently completed acquisition of ITNET in the UK and the planned acquisition of RCI in the US."

– Ends –

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INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

Serco has today issued a separate stock exchange announcement providing an update on its transition to IFRS.

WEBCAST

A webcast of the results presentation will also be available on www.serco.com from 1800hrs (GMT) on the day of announcement. To pre-register for viewing please visit:
<http://www.axisto.com/webcast/media/serco/010305/index.htm>

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Dominic Cheetham – Corporate Communications Director
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Chairman's statement

2004 was another very good year for Serco, and 2005 has started in excellent fashion too.

Our ability to achieve continued strong growth is rooted in a number of factors that are fundamental to Serco. These include our broad range of markets and services, our good reputation and the commitment and professionalism of our staff. We work in partnership with clients and stakeholders to deliver value for money and real service improvements.

As in the past, more than half our sales growth was achieved by expanding the scale and scope of existing contracts. This organic growth remains the primary focus for our business. We can only deliver it through high levels of customer satisfaction and a proactive and thoughtful approach to deepening our customer relationships and services.

We continued to strengthen our cash position and maintained our outstanding earnings visibility. By the end of 2004 we had achieved preferred bidder status on £0.9bn of contracts and had secured 91% of our planned revenues for 2005, 76% for 2006 and 64% for 2007. Over the year our forward order book rose from £10.3bn to £12.7bn, substantially boosted by our largest-ever contract win – the Northern Rail franchise, valued at some £2bn to Serco. Other wins included a £300m seven-year contract to provide court escort and custody services. Successful rebids included our air traffic control contract with the US Federal Aviation Administration (FAA) and multi-activity contracts with the UK's Royal Air Force and Naval Air Command. In fact, our defence business had its best year ever, with a good combination of organic growth and new business wins. And we further strengthened our position in the growing justice and national security markets.

To continue building our capabilities in areas where we see strong organic growth opportunities, in December we announced two significant acquisitions that will bring additional skills and capabilities in the UK and US, currently the world's largest public service outsourcing markets.

ITNET plc is a leading supplier of IT services, business process management and consulting to UK local authorities and private sector companies.

Resource Consultants Inc (RCI) supplies business process management, IT services, supply chain management, systems engineering and consulting to the US federal government, primarily in defence. We expect this acquisition to complete during March 2005.

We expect both acquisitions to be earnings enhancing in 2005 and to further increase our ability to develop in current and emerging markets.

People

Ultimately, Serco's continued success stems from the achievements of dedicated, passionate people. Through the annual Chairman's Recognition Awards we acknowledge those individuals and teams who make exceptional contributions. Their stories emphasise how – day in, day out – the people of Serco are bringing service to life.

Leaders of the UK's major companies have recognised our employees' efforts by rating Serco as the UK's most admired support services company, and the sixth most admired company in the UK, in the *Management Today* 2004 annual survey. This recognition from peers and analysts is a tribute to the effort and commitment of everyone in the company. We congratulate and thank them all.

Financial performance

Sales and profit

Turnover grew 5.2% to £1,636.8m. After adjusting for the effect of disposals and contracts exited, underlying turnover growth was 14.0%.



Pre-tax profit rose 10.3% to £73.9m before intangible amortisation and 8.6% to £57.4m after intangible amortisation. The previous year's profit figure benefited from exceptional items with a net profit of £3.6m; excluding these, the underlying profit growth before intangible amortisation was 16.4%.

Earnings per share rose 10.6% to 12.20p before intangible amortisation and 8.1% to 8.37p after intangible amortisation.

Cash performance

Our cash performance continues to strengthen. Free cash generation increased to £55.8m, compared with £47.0m in 2003. Conversion of Group EBITDA (earnings before interest, tax, depreciation and intangible amortisation) into cash was 95%, ahead of the previous year's 81%. This is a significant achievement in a rapidly growing business.

Dividend

The recommended final dividend of 1.82p per share gives a total for the year of 2.63p – an increase of 12.4% over 2003. It will be paid on 11 May to shareholders on the register on 11 March 2005.

Strategy

Organic growth

Organic growth is Serco's primary strategic aim – and it delivered 82% of our underlying turnover increase in 2004. The majority (61%) came from extending the duration or scope of existing contracts and a further 21% came from new business wins. We aim to leverage the value of every new contract win. By working in partnership with clients and stakeholders to deliver value for money and real service improvements, we create opportunities to broaden and deepen our relationships.

In 2004, for example, we were awarded an extended court escort contract valued at £300m over seven years: double the size of the original contract. We also maintained our 90% success rate in rebids, including our contract to manage the UK's National Physical Laboratory, valued at over £500m, our US\$118m air traffic control contract in the US and the £55m contract at RAF Northolt and Uxbridge.

Our strategy is to remain focused on areas with the right scope for growth through service delivery. In line with this strategy, we disposed of a number of smaller asset management contracts in Australia and New Zealand. In the UK, as agreed with Network Rail, we ended our rail maintenance contract for the East Midlands zone in January 2004.

Acquisitions

In tandem with our strong organic growth, we make acquisitions to gain capabilities or market access as a foundation for future organic development.

In the UK, the business transformation and local government outsourcing markets are set to grow by 50% by 2007 and we have sought to increase our present capabilities. The ITNET acquisition strengthens our offering to local government and brings expertise in business process management, an important element in the broader outsourcing contracts that we are increasingly pursuing. ITNET's consulting expertise, through French Thornton, complements our own growing consultancy business, which is helping to stimulate favourable change in our key markets. We also see opportunities to strengthen our service offering to markets such as health, justice, transport and defence, both in the UK and overseas.

The US is the world's largest service contracting market and the announced acquisition of RCI deepens our access to federal government, where demand for outsourced services is accelerating. RCI has strong customer relationships in defence, which accounts for more than 75% of federal spending on services and is an area where we have much to offer. In the North American market, RCI's federal focus complements our existing customer base, which is largely civil agencies, and state and local governments. And RCI's significant business process management and IT service capabilities complement our existing change management and service delivery resources.



International strategy

Our international strategy remains clear. As markets develop, we leverage our skills from one geographic market into another. In turn, increased diversity across borders and markets helps reduce risk. In 2004 we continued to transfer skills and capabilities around the globe, notably in defence, aerospace, prison services and road traffic management.

Consistent values

To deliver the service, relationships and growth we aspire to, it is essential to develop and nurture consistent values and principles. Our four governing principles – to foster an entrepreneurial culture, enable our people to excel, deliver our promises, and build trust and respect – are embedded in all our policies and processes.

Operational highlights

Bringing service to life

Around the globe, people are experiencing a quality of service from Serco that makes a genuine difference to their lives.

Our rail businesses had a particularly good year in 2004. Merseyrail continued to set new performance standards and the Docklands Light Railway carried record numbers of passengers. In Australia, our iconic train The Ghan also carried record passenger numbers and ran its longest-ever trains on the world's first North-South transcontinental service. In England, with our partner NedRailways, we successfully phased-in the combination of two previously separate operations to launch the new Northern Rail franchise, which is already improving punctuality and modernising ticketing systems.

In other UK markets, pupils in Walsall are receiving significantly improved education thanks to the partnership between Serco's Education Walsall and the borough's council. An official inspection described the improvements as 'spectacular'. The young people in our care at Ashfield Young Offenders Institution near Bristol are receiving significantly improved education and support to reduce reoffending, thanks to a dramatic 15-month turnaround programme praised by the Chief Inspector of Prisons.

An MoD customer survey rated Serco among the best of its 'key suppliers'.

In the US, our focus on safety and service to pilots was recognised with a second award from the FAA, for which we now operate 54 air traffic control towers.

In Asia Pacific, the first of 12 new patrol boats being supplied by our joint venture was launched. We are also currently installing a traffic information and management system which will benefit commuters on the Shenzhen corridor, linking Hong Kong with mainland China.

Strong start to 2005

While still focused on growing the scope and scale of our existing services, we continue to win a broad range of new work.

In the UK we have signed the £400m Defence Academy Campus Integrator contract, which runs for nearly 24 years, to join the MoD's three existing postgraduate education colleges into an international academic centre of excellence for senior military and civilian personnel. We already manage one of the three colleges on the Defence Academy campus – the Joint Services Command and Staff College.

In the United Arab Emirates (UAE) we have entered into an agreement to form a joint venture to provide facilities management services to the UAE University's new campus in Al Ain for a minimum period of 10 years.



Market development

Our vision to be the leading company in our chosen markets requires us to be a thought leader, proactively helping to shape the way our markets develop. Serco Government Consulting is bringing our expertise to the leading edge of public policy and service development by contributing strategic and operational expertise across a range of UK government departments. In the past year it has worked with the BBC, Department for Constitutional Affairs, Department for Environment, Food and Rural Affairs, Department of Health, Office of the Deputy Prime Minister and a number of local authorities.

In addition, the Serco Institute researches trends in competition and contracting and is stimulating debate worldwide on how governments can provide better public services.

Corporate responsibility

We are responsible for providing services that are essential to everyday life. For those working at the heart of society, corporate responsibility has to be second nature. At Serco it is. It underpins the culture and values that help distinguish us in our markets and is an explicit part of the Serco Management System that shapes the way we run our business. Our Corporate Assurance Group, which oversees our approach to corporate responsibility, reports directly to the Group Board and takes an integrated view of all aspects of our corporate governance, risk management, health and safety, and social responsibility.

In 2004 our investment in community initiatives totalled £0.8m in cash and in kind, representing 1.4% of pre-tax profit.

Our staff have begun a coordinated effort in 2005 to support the victims of the tsunami that devastated so many lives. In an effort that has united people across the company in fundraising and volunteering, by mid-February employees had already raised £73,000 to match Serco's £100,000 donation to the Disasters Emergency Committee. We look forward to reporting progress in this area during the year.

Our second corporate responsibility report will be published in March. It explains more about our values and objectives, and details many of our initiatives. It will be available both in printed form and on our website at www.serco.com/corporate_responsibility.

Corporate governance

Our commitment to effective governance embraces the whole organisation through the Serco Management System. Group Board members have continued to engage with employees, customers and investors to develop a deep and consistent understanding of our operational and strategic performance and to see at first hand how we are perceived by stakeholders.

In 2004, each Group Board meeting was held at a different Serco location to help Board members maintain their understanding of this rapidly expanding business. In addition, our Senior Independent Director attended meetings with institutional investors and all Board members attended the AGM. For the third successive year, all Directors participated in a formal Board appraisal process and the results and actions were discussed by the full Board. Full details of Serco's governance arrangements are described in the corporate governance report within the Annual Review and Accounts.

Board developments

In March 2004 Iestyn Williams retired as an Executive Director, and in April Rhidian Jones retired as a Non-Executive Director. Both became Directors of the newly-created Serco in 1987 after the buyout of RCA's UK business. We thank them for their significant contribution, commitment and guidance over the years. In addition to their other Board responsibilities, in April, DeAnne Julius took over the role of Senior Independent Director and David Richardson became Chairman of the Audit Committee. In February 2005 Joanne Roberts was appointed as Company Secretary – succeeding Julia Cavanagh, who has become



Finance Director of our Government Services division. We thank Julia for her contribution over six years as Company Secretary.

Executive team developments

In light of our two acquisitions we have reorganised and expanded our executive team, which reports to the Group Board for Serco's direction, organisation, performance and governance.

Two members of our executive team have taken on additional responsibilities. Strategic Projects Director Ian Downie has become Chief Executive of the ITNET business. And Chief Development Officer Steve Cuthill has relocated to the US to become Chairman of Serco North America and to take responsibility for integrating the RCI acquisition once it has been completed.

In addition, we have strengthened the executive team with Grant Rumbles, formerly Chief Executive of Serco Continental Europe & Middle East, as Group Operations Director; Clive Barton, formerly Chief Operating Officer of Serco Solutions, as Group Marketing Director; and Bridget Blow, formerly ITNET Chief Executive, as Group Technology Director.

Outlook

Across the world, governments and commercial organisations are increasingly seeking to deliver better services and gain greater value for money.

In the past year we have taken important steps towards our vision: to be the leading service company in our chosen markets. Our service delivery record and customer relationships help maintain and grow our business base. The acquisitions of ITNET and RCI strengthen our position in key markets and our major contract wins provide further scope for development. With our management further strengthened we believe that we have a better platform than ever for delivering continued strong growth.



Finance Review

1. Financial performance

Analysis of the Group's financial performance in 2004 is shown in Figure 1.

Figure 1: Profit and loss account

Year to 31 December	2004 £m	2003 £m	Increase
Total turnover	1,636.8	1,555.5	5.2%
Group turnover	1,381.4	1,324.3	
Joint venture turnover	255.4	231.2	
Gross profit	190.9	180.8	5.5%
Administration expenses	(139.7)	(138.5)	
Exceptional items (net)	-	3.6	
Joint venture profit	24.8	24.0	
Net Group interest	(2.1)	(2.9)	
Profit before intangible amortisation and tax	73.9	67.0	10.3%
Intangible amortisation	(16.5)	(14.1)	
Profit before tax	57.4	52.9	8.6%
Tax	(20.4)	(19.1)	
Profit after tax	37.0	33.8	
Minority interest	(1.0)	(0.5)	
Profit for the financial year	36.0	33.3	
Effective tax rate	35.5%	36.1%	
Average number of shares	430.1m	429.9m	
Earnings per share before intangible amortisation	12.20p	11.03p	10.6%
Earnings per share after intangible amortisation	8.37p	7.75p	8.1%
Dividend per share	2.63p	2.34p	12.4%

1.1 Turnover

Total turnover for the year to 31 December 2004 increased by 5.2% to £1,636.8m. After adjusting for the effect of disposals and contracts exited (see 6.1 Disposals), turnover grew by 14.0%.

Turnover for 2004 includes an incremental contribution of £35m from Premier Custodial Group (PCG) following the acquisition of the remaining 50% in July 2003. From this date the results of PCG have been included in Group turnover.

Gross margin on Group turnover, representing the average contract margin across the portfolio, has increased to 13.8% (2003 - 13.7%).

1.2 Exceptional items

There were no exceptional items in 2004. During 2003 there were three exceptional items resulting in a net profit of £3.6m.

1.3 Profit before tax

Profit before tax and intangible amortisation increased by 10.3% to £73.9m, representing a net margin on turnover of 4.5% (2003 - 4.3%). Profit before tax, intangible amortisation and the contribution from exceptional items in 2003 grew by 16.4%.

Profit before tax and after intangible amortisation increased by 8.6% to £57.4m.

1.4 Intangible amortisation

Intangible amortisation, arising primarily from goodwill, was £16.5m in 2004 (2003 - £14.1m). The increase results largely from the acquisitions of the remaining 50% of PCG in July 2003 and the Ontario Driver Examination Services (DES) franchise which commenced operation in September 2003.



1.5 Tax

The tax charge of £20.4m (2003 - £19.1m) represents an effective rate of 35.5% (2003 - 36.1%). The small decrease in the rate is primarily due to changes in the geographical mix of profits.

1.6 Earnings per share

As a result of the above, earnings per share before intangible amortisation increased by 10.6% to 12.20p. Earnings per share after intangible amortisation grew by 8.1% to 8.37p.

2. Dividends

The proposed final dividend of 1.82p per share gives a total dividend for 2004 of 2.63p, a 12.4% increase on 2003.

3. Cash flow

Free cash flow for 2004 was £55.8m (2003 - £47.0m). Further analysis is shown in Figure 2.

Figure 2: Cash flow

Year to 31 December	2004 £m	2003 £m
Operating profit before exceptional item	34.7	28.2
Exceptional item: reorganisation costs	-	(4.5)
Operating profit	34.7	23.7
Non-cash items	36.9	33.8
Group EBITDA	71.6	57.5
Working capital movement	(3.6)	(11.1)
Operating cash flow	68.0	46.4
Dividends from joint ventures	14.2	12.6
Interest and taxation	(5.2)	(7.8)
Exceptional item: GSR sale and leaseback	-	5.8
Capital expenditure	(19.3)	(21.8)
Disposal of assets	-	8.9
Other items	(1.9)	2.9
Free cash flow	55.8	47.0
Exceptional item: Norfolk and Norwich refinancing	-	4.1
Acquisitions/disposals	(9.0)	(96.6)
Other financing	(7.8)	109.5
Dividends paid	(10.4)	(9.5)
Non-recourse debt financed assets	(25.2)	47.0
Net cash flow	3.4	101.5

3.1 Operating cash flow

There was an operating cash inflow for the year of £68.0m (2003 - £46.4m), an increase of 47%. This represents a conversion of 196% (2003 - 196%) of operating profit and 95% (2003 - 81%) of Group EBITDA into cash.

The improvement in conversion rates is particularly notable given that our strong level of organic growth brings an accompanying demand for working capital, typically equivalent to a month's incremental turnover each year.

3.2 Dividends from joint ventures

Dividends received from joint ventures during 2004 of £14.2m (2003 - £12.6m) represent an 85% (2003 - 78%) conversion of profit after tax of joint ventures into cash.

3.3 Interest and taxation

The 2004 outflow of £5.2m (2003 - £7.8m) benefited from the Group being able to utilise tax losses of subsidiaries that were previously joint venture companies.

3.4 Capital expenditure

Capital expenditure for the year, excluding investment in PFI Special Purpose Companies (SPCs), was £19.3m (2003 - £21.8m). This expenditure represented 1.4% of Group turnover, and is broadly similar to prior years.



3.5 Acquisitions / disposals

The 2004 net outflow of £9.0m primarily relates to the acquisition of shares in ITNET plc prior to 31 December 2004 for £13.7m and the disposal of businesses in Australia and New Zealand for £3.2m. Further details are in section 6.

3.6 Non-recourse debt financed assets

The £25.2m outflow relates to the net movement on expenditure on PFI assets under construction, non-recourse loans and other PFI balance movements. Further analysis is provided in Figure 3.

Figure 3: Non-recourse debt financed assets

Year to 31 December	2004 £m	2003 £m
<i>Change in PFI balances</i>		
PFI debtor	6.9	3.7
Assets in the course of construction	(16.3)	(33.0)
Non-recourse debt	(12.8)	26.6
	(22.2)	(2.7)
<i>Change in other balances</i>		
Non-recourse debt: Ontario Driver Examination Services	(3.0)	49.7
Non-recourse debt financed assets	(25.2)	47.0

The movements on the PFI balances are the result of timing differences between loan repayment/draw-down and asset spend/recovery. Over the lifetime of each PFI contract, we expect these movements to offset each other. Included within the change in PFI balances is £8.7m of equity and subordinated debt invested into the Traffic Information Services (TIS) PFI SPC in January 2004.

4. Net debt

At 31 December 2004 net recourse debt was £14.8 m (2003 - £22.3m). Further analysis is provided in Figure 4.

Figure 4: Net debt

As at 31 December	2004 £m	2003 £m
Closing cash	173.9	170.9
Long term loans	(167.4)	(165.3)
Other loans and finance leases	(21.3)	(27.9)
Recourse net debt	(14.8)	(22.3)
Non-recourse debt	(256.4)	(357.0)
Total net debt	(271.2)	(379.3)

Non-recourse debt (see 7. PFIs) represents long term loans secured on the contracts of PFI and other concessions, and not any other assets of the Group. The loans are excluded from all of our credit agreement and other covenants calculations, therefore having no impact on the Group's ability to borrow.

Non-recourse debt, utilised to fund PFI assets and the acquisition of the DES franchise, reduced during the year to £256.4m (2003 - £357.0m), largely due to Laser (see 7. PFIs) and the scheduled part repayment of other debt.

In addition to Figure 4, non-recourse debt of £51.4m (2003 - £55.2m) is included in joint venture gross liabilities.

5. Pensions

For 2004 we have continued to apply the transitional rules and disclosures for the implementation of FRS 17 *Retirement Benefits*. This requires the market values of the assets and liabilities for defined benefit schemes to be calculated and disclosed in a note, discussed in more detail in Note 32 to the Annual Review and Accounts.

In summary, at 31 December 2004, there was a net deficit on an FRS 17 basis in relation to the defined benefit scheme of £75.6m (2003 - £69.7m), and an asset base of £380.8m (2003 - £350.4m). Long term employer and employee contributions were increased in 2003 and have remained at the same level to address the level of deficit in the scheme.



6. Acquisitions / disposals

6.1 Disposals

In line with our intention to focus the business on areas with the greatest potential for growth and profitability, we announced in April 2004 the disposal of a number of small and medium sized contracts in Australia and New Zealand. The annual turnover of these contracts was approximately £38m. The disposals were completed by August 2004.

The above disposals, together with 2003's disposal of a number of our Swedish contracts and the exiting of our rail maintenance contract with Network Rail in January 2004, have reduced annualised turnover by £140m.

6.2 Acquisitions

Also during December 2004, we invested £13.7m in the shares of ITNET plc, a company in which we acquired a controlling interest during February 2005. (See 10. Post balance sheet events).

7. PFIs

At the end of 2004 the Group was involved in 11 PFI projects, with 10 equity investments and 11 operating contracts. These contracts contribute £3.2bn to the Group's order book of £12.7bn. During 2004 PFIs contributed £194m (2003 - £133.4m) to turnover and £14.6m (2003 - £11.9m) to gross profit.

At the end of 2004 we had invested £24.0m of equity and subordinated debt into our SPCs. Cumulatively, as at 31 December 2004, we had generated £26.9m cash from these investments, representing a net inflow to the Group of £3.0m.

During October 2004, we stopped accounting for Laser (the National Physical Laboratory PFI SPC) as a subsidiary due to the discussions surrounding the transfer of control of the PFI asset to the DTI. This has removed the non-recourse debt and corresponding PFI debtor from the balance sheet.

8. Treasury

8.1 Treasury management

The Group's treasury function is responsible for managing the Group's exposure to treasury risk, and operates within a defined set of policies and procedures reviewed and approved by the Board.

8.2 Credit facilities and liquidity management

The Group's liquidity during 2004 was principally provided by a £140m revolving credit facility, which was undrawn at year-end, and two private debt placements.

The £140m facility was replaced in January 2005 by a five-year £450m term loan and revolving credit facility. The £450m facility is to fund the acquisitions of ITNET plc and RCI Holding Corporation and is also available to fund the Group's day-to-day liquidity requirements.

The £450m facility is unsecured, with covenants and obligations typical of these types of arrangement, which are consistent with our previous facilities.

The Group continues to service two private placements which include sterling and US dollar tranches. The first, for £43.2m, was taken out in 1997 and matures in 2007. The second, for £117m, was taken out in 2003 and amortises from 2011 to 2015.

8.3 Foreign exchange risk

The Group does not currently hedge the sterling equivalent of the net assets of its overseas operations as the net asset value of these businesses does not represent a significant proportion of the market value of the Group. Foreign exchange gains and losses therefore do not represent a material risk to the consolidated net asset value of the Group.

The foreign exchange exposure on the US dollar tranches of the private placements has been fully hedged into sterling in accordance with the risk profile set out above.

The nature of the Group's business in general does not involve a significant amount of cross-border trade. Consequently the Group is not exposed to substantial foreign currency transaction risk as sales and costs are approximately matched within overseas operations. Material transactional exposures of individual business units are hedged by forward foreign exchange contracts.



Central funding of individual business units gives rise to monetary assets and liabilities centrally and in the business units. Where the asset or liability is denominated in a currency that is not the operating currency of the business unit involved, and a foreign exchange risk would otherwise result, the foreign currency exposure arising is hedged by forward foreign exchange contracts.

8.4 Interest rate risk

The Group's exposure to interest rate fluctuations on its borrowing and deposits is selectively managed, using interest rate swaps.

8.5 Credit risk

The Group monitors the credit quality of counterparties and limits credit exposures accordingly.

9. International Financial Reporting Standards (IFRS)

Serco Group plc will adopt IFRS for accounting periods beginning on 1 January 2005. The Group's interim financial statements for the six months ending 30 June 2005 will be the first under IFRS.

The Group is well positioned to ensure compliance within the required timescale. Reporting systems and procedures have been enhanced to support the new reporting requirements and the Group's IFRS accounting policies are being developed. In addition, IFRS training programmes have been provided to ensure that IFRS knowledge is embedded throughout the organisation.

A number of areas of difference between IFRS and UK GAAP, which may impact the Group's reported results and financial position, have been identified. These include goodwill and intangible assets, financial instruments, share based payment, employee benefits including pensions, joint ventures and taxation. Areas that may require additional disclosure include segment reporting, service concessions and joint ventures.

The key points arising from the adoption of IFRS are:

- The Group's underlying performance, cash flow and ability to pay dividends will be unaffected.
- The impact on year-on-year earnings growth after transition is likely to be minimal.
- The fair value concept may introduce volatility into the balance sheet, largely due to the inclusion of financial instruments and actuarial gains and losses on defined benefit pension schemes
- On transition, the Group's profit before tax will be principally affected by non-amortisation of goodwill, partially offset by a charge for share based payment.
- On transition, net assets will reduce principally through recognition of actuarial losses on defined benefit pension schemes.

The Group's analysis of the effect of IFRS is ongoing. In addition, the interpretation of standards is evolving so further changes may arise, notably in accounting for pension schemes and service concessions, including PFIs.

10. Post balance sheet events

During December 2004, Serco made a recommended offer to acquire all of the issued and to be issued share capital of ITNET plc, a UK listed company. The acquisition of ITNET was declared unconditional in all respects on 3 February 2005. On 17 February 2005, Serco announced that it had acquired, or contracted to acquire, more than nine tenths in value of ITNET's shares and that Serco intended to compulsorily acquire the outstanding ITNET shares.

Also during December 2004, Serco made an offer to purchase RCI Holding Corporation, an American private company. The process of obtaining US government approvals is continuing, and we expect to reach completion during March 2005.

Consolidated Profit and Loss Account

For the year ended 31 December 2004

	Note	2004 Group £'000	2004 Joint Ventures £'000	2004 Total £'000	2003 Group £'000	2003 Joint Ventures £'000	2003 Total £'000
Turnover: Group and share of joint ventures - continuing operations	2	1,381,417	255,440	1,636,857	1,324,271	231,255	1,555,526
Less: Share of joint ventures	2	-	(255,440)	(255,440)	-	(231,255)	(231,255)
Group turnover	2	1,381,417	-	1,381,417	1,324,271	-	1,324,271
Cost of sales		(1,190,531)	-	(1,190,531)	(1,143,418)	-	(1,143,418)
Gross profit		190,886	-	190,886	180,853	-	180,853
Administrative expenses		(156,204)	-	(156,204)	(157,144)	-	(157,144)
Amortisation of intangible assets		(16,476)	-	(16,476)	(14,131)	-	(14,131)
Other administrative expenses		(139,728)	-	(139,728)	(138,516)	-	(138,516)
Exceptional item: reorganisation costs		-	-	-	(4,497)	-	(4,497)
Operating profit-continuing operations		34,682	-	34,682	23,709	-	23,709
Exceptional item: GSR sale and leaseback		-	-	-	3,977	-	3,977
Share of operating profit in joint ventures		-	25,437	25,437	-	22,700	22,700
Interest receivable and similar income		31,171	4,111	35,282	16,760	11,397	28,157
Group		31,171	-	31,171	12,691	-	12,691
Exceptional item: Norfolk and Norwich refinancing		-	-	-	4,069	-	4,069
Share of joint ventures		-	4,111	4,111	-	11,397	11,397
Interest payable and similar charges		(33,259)	(4,760)	(38,019)	(15,609)	(10,080)	(25,689)
Group		(33,259)	-	(33,259)	(15,609)	-	(15,609)
Share of joint ventures		-	(4,760)	(4,760)	-	(10,080)	(10,080)
Profit on ordinary activities before taxation		32,594	24,788	57,382	28,837	24,017	52,854
Taxation on profit on ordinary activities				(20,371)			(19,103)
Profit on ordinary activities after taxation				37,011			33,751
Share of joint venture minority interest				(577)			(198)
Minority interest				(413)			(255)
Profit for the financial year				36,021			33,298
Equity dividends				(11,810)			(10,050)
Retained profit for the financial year				24,211			23,248

Earnings per Ordinary Share (EPS) of 2p each

3

Basic EPS, after amortisation of intangible assets	8.37p	7.75p
Basic EPS, before amortisation of intangible assets	12.20p	11.03p
Diluted EPS, after amortisation of intangible assets	8.27p	7.74p
Diluted EPS, before amortisation of intangible assets	12.06p	11.02p

The basis of preparation of this statement is set out in Note 1.



Consolidated Balance Sheet

As at 31 December 2004

	Note	2004 £'000	2003 £'000
Fixed Assets			
Intangible assets		215,157	222,950
Tangible assets		79,537	77,398
Investments in joint ventures		27,196	24,886
Share of gross assets		195,475	151,460
Share of gross liabilities		(168,279)	(126,574)
Other investments		13,712	-
		335,602	325,234
Current assets			
Stocks		36,204	39,543
Debtors: Amounts due within one year	4	293,608	278,931
Debtors: Amounts due after more than one year	4	333,615	419,589
Cash at bank and in hand		173,886	170,888
		837,313	908,951
Creditors: Amounts falling due within one year			
Trade creditors		76,886	81,335
Other creditors including taxation and social security		114,179	90,892
Accruals and deferred income		192,032	177,866
Proposed dividend		8,330	6,958
		391,427	357,051
Net current assets		445,886	551,900
Total assets less current liabilities			
		781,488	877,134
Creditors: Amounts falling due after more than one year		415,088	539,798
Provisions for liabilities and charges		61,981	56,526
Net assets		304,419	280,810
Capital and reserves			
Called up share capital		8,707	8,697
Share premium account		191,510	190,791
Capital redemption reserve		143	143
ESOP reserve		(15,815)	(16,949)
Profit and loss account		119,874	98,128
Equity shareholders' funds	5	304,419	280,810

This preliminary announcement was approved by the Board of Directors on 1 March 2005 and signed on behalf of the Board:

Kevin Beeston Executive Chairman

Andrew Jenner Finance Director



Consolidated Cash Flow Statement

For the year ended 31 December 2004

	2004 £'000	2003 £'000
Operating profit	34,682	23,709
Depreciation and amortisation of intangible assets	35,790	32,532
Movement in ESOP investment	1,134	1,258
Net increase in working capital	(3,642)	(11,111)
Net cash inflow from operating activities before PFI asset expenditure	67,964	46,388
Movement in PFI debtor *	6,902	3,680
Expenditure on PFI assets under construction *	(16,278)	(33,001)
Net cash inflow from operating activities after PFI asset expenditure	58,588	17,067
Dividends received from joint ventures	14,239	12,630
Returns on investments and servicing of finance		
Interest received	31,033	5,652
Interest paid	(34,767)	(6,054)
Exceptional item: Norfolk and Norwich refinancing	-	4,069
Net cash (outflow)/inflow from returns on investments and servicing of finance	(3,734)	3,667
Taxation		
Tax paid	(1,479)	(7,354)
Capital expenditure and financial investment		
Purchase of tangible fixed assets	(19,257)	(21,835)
Sale of tangible fixed assets	51	8,878
Exceptional item: GSR sale and leaseback	-	5,761
Net cashflows with joint ventures	(1,960)	2,969
Net cash outflow from capital expenditure and financial investment	(21,166)	(4,227)
Acquisitions and disposals		
Acquisitions †	(13,890)	(107,463)
Net cash acquired with acquisitions	-	12,843
Net overdraft/(cash) redeemed upon disposal	16	(3,141)
Subscription for shares in joint ventures	-	(3,354)
Proceeds from disposal of subsidiary and business undertakings	3,159	4,471
Proceeds from reduction in investment in joint ventures	1,763	-
Net cash outflow from acquisitions and disposals	(8,952)	(96,644)
Equity dividends paid		
Dividends paid	(10,438)	(9,529)
Net cash outflow from equity dividends paid	(10,438)	(9,529)
Net cash inflow/(outflow) before financing	27,058	(84,390)
Financing		
Issue of ordinary share capital	729	-
(Decrease)/increase in other loans	(782)	115,793
(Decrease)/increase in non-recourse debt financing	(15,798)	76,285
Capital element of finance lease repayments	(7,782)	(6,188)
Net cash (outflow)/inflow from financing	(23,633)	185,890
Increase in cash in the year	3,425	101,500
Balance at 1 January	170,888	69,388
Non-cash movements	(427)	-
Balance at 31 December	173,886	170,888

* PFI assets and debtor financed by non-recourse loans.

† Includes investment of £13,712,000 in respect of ITNET prior to the acquisition offer becoming unconditional.



Consolidated Statement of Total Recognised Gains and Losses

For the year ended 31 December 2004

	2004 £'000	2003 £'000
Profit for the financial year	36,021	33,298
Currency translation differences on foreign currency net investments	(2,714)	6,654
Total recognised gains and losses for the year	33,307	39,952



Notes to the Preliminary Announcement

For the year ended 31 December 2004

Basis of preparation – preliminary announcement

The basis of preparation of this preliminary announcement is set out in note 1.

The financial information in this announcement, which was approved by the board of directors on 1 March 2005, does not constitute the company's statutory accounts for the years ended 31 December 2004 or 2003, but is derived from these accounts. Statutory accounts for 2003 have been delivered to the Registrar of Companies and those for 2004 will be delivered following the company's annual general meeting. The auditors have reported on these accounts; their reports were unqualified and did not contain statements under S237 (2) or (3) Companies Act 1985.

1. Accounting policies

This preliminary announcement has been prepared in accordance with applicable UK accounting standards. These have all been applied consistently throughout the year, and the preceding year.



2. Segmental Report

Classes of Business

	Group £'000	Joint Ventures £'000	Total £'000
2004			
Turnover			
Civil government	540,634	6,498	547,132
Defence	320,598	165,907	486,505
Transport	279,049	83,035	362,084
Science	115,972	-	115,972
Private sector	125,164	-	125,164
Total	1,381,417	255,440	1,636,857
Profit before taxation and other costs			
Civil government	24,374	656	25,030
Defence	23,389	17,620	41,009
Transport	16,125	7,161	23,286
Science	10,439	-	10,439
Private sector	3,081	-	3,081
Total	77,408	25,437	102,845
Other costs			
Common costs			(26,250)
Amortisation of intangible assets			(16,476)
Net interest - group			(2,088)
Net interest - joint ventures			(649)
Profit on ordinary activities before taxation			57,382
Net assets			
Civil Government			66,228
Defence			67,378
Transport			58,108
Science			60,399
Private sector			31,131
Total			283,244
Unallocated assets			21,175
Total			304,419



2. Segmental Report (continued)

Classes of Business	Group £'000	Joint Ventures £'000	Total £'000
2003			
Turnover			
Civil government	444,875	42,897	487,772
Defence	252,469	151,496	403,965
Transport	385,793	36,862	422,655
Science	111,004	-	111,004
Private sector	130,130	-	130,130
Total	1,324,271	231,255	1,555,526
Profit before taxation and other costs/income			
Civil government	17,025	4,195	21,220
Defence	17,878	15,968	33,846
Transport	18,976	2,537	21,513
Science	11,619	-	11,619
Private sector	8,697	-	8,697
Total	74,195	22,700	96,895
Other (costs)/income			
Common costs			(31,858)
Exceptional items – reorganisation costs and GSR sale and leaseback			(520)
Amortisation of intangible assets			(14,131)
Net interest - group			(2,918)
Exceptional item - Norfolk and Norwich refinancing			4,069
Net interest - joint ventures			1,317
Profit on ordinary activities before taxation			52,854
Net assets			
Civil Government			43,749
Defence			53,127
Transport			59,173
Science			64,508
Private sector			32,436
Total			252,993
Unallocated assets			27,817
Total			280,810



2. Segmental Report (continued)

Geographical segments

2004	Group £'000	Joint Ventures £'000	Total £'000
Turnover			
United Kingdom	1,006,310	196,030	1,202,340
Rest of Europe and Middle East	180,612	6,051	186,663
Asia Pacific	105,556	47,747	153,303
North America	88,939	5,612	94,551
Total	1,381,417	255,440	1,636,857
Profit before taxation and other costs			
United Kingdom	51,986	21,989	73,975
Rest of Europe and Middle East	13,200	496	13,696
Asia Pacific	3,386	2,630	6,016
North America	8,836	322	9,158
Total	77,408	25,437	102,845
Other costs			
Common costs			(26,250)
Amortisation of intangible assets			(16,476)
Net interest - group			(2,088)
Net interest - joint ventures			(649)
Profit on ordinary activities before taxation			57,382
Net assets			
United Kingdom			172,650
Rest of Europe and Middle East			42,352
Asia Pacific			41,252
North America			26,990
Total			283,244
Unallocated assets			21,175
Total			304,419

Note: Turnover is shown by geographical origin. Turnover analysed by geographical destination is not materially different.



2. Segmental Report (continued)

Geographical segments

	Group £'000	Joint Ventures £'000	Total £'000
2003			
Turnover			
United Kingdom	950,098	174,723	1,124,821
Rest of Europe and Middle East	185,936	8,355	194,291
Asia Pacific	109,627	43,251	152,878
North America	78,610	4,926	83,536
Total	1,324,271	231,255	1,555,526
Profit before taxation and other costs/income			
United Kingdom	43,017	19,274	62,291
Rest of Europe and Middle East	14,414	227	14,641
Asia Pacific	6,982	2,831	9,813
North America	9,782	368	10,150
Total	74,195	22,700	96,895
Other (costs)/income			
Common costs			(31,858)
Exceptional items – reorganisation costs and GSR sale and leaseback			(520)
Amortisation of intangible assets			(14,131)
Net interest - group			(2,918)
Exceptional item - Norfolk and Norwich refinancing			4,069
Net interest - joint ventures			1,317
Profit on ordinary activities before taxation			52,854
Net assets			
United Kingdom			142,166
Rest of Europe and Middle East			41,670
Asia Pacific			42,553
North America			26,604
Total			252,993
Unallocated assets			27,817
Total			280,810

Note: Turnover is shown by geographical origin. Turnover analysed by geographical destination is not materially different.



3. Earnings per Ordinary Share

Basic and diluted earnings per Ordinary Share have been calculated in accordance with Financial Reporting Standard 14 (FRS 14) – Earnings Per Share. Earnings per share is shown both before and after amortisation of intangible assets to assist in the understanding of the impact of FRS 10 on the Group Accounts.

	2004 £'000	2003 £'000
Weighted number of shares in issue	430,127,262	429,878,711
Weighted average number of dilutive share options	5,276,198	412,330
Total number of shares for calculating diluted earnings per share	435,403,460	430,291,041

	2004		2003	
	Earnings £'000	Per share amount pence	Earnings £'000	Per share amount pence
Basic earnings	36,021	8.37	33,298	7.75
Amortisation of intangible assets	16,476	3.83	14,131	3.28
Earnings before amortisation of intangible assets	52,497	12.20	47,429	11.03
Diluted earnings	36,021	8.27	33,298	7.74
Diluted earnings before amortisation of intangible assets	52,497	12.06	47,429	11.02



4. Debtors

	2004 £'000	2003 £'000
a) Amounts due within one year:		
Amounts recoverable on contracts	194,261	198,687
Other debtors	39,399	32,572
Corporation tax recoverable	1,784	1,670
Prepayments and accrued income	46,696	35,924
Amounts owed by joint ventures	6,078	2,600
PFI debtor *	5,390	7,478
	293,608	278,931
	2004 £'000	2003 £'000
b) Amounts due after more than one year:		
Amounts recoverable on contracts	27,972	22,043
Other debtors	16,064	21,780
Pensions prepayment	34,580	30,580
Amounts owed by joint ventures	2,934	8,869
PFI debtor *	181,816	260,780
PFI assets in the course of construction*	70,249	75,537
	333,615	419,589
Total debtors	627,223	698,520

* The PFI assets analysed above are funded by non-recourse loans of £208,905,000 (2003 - £307,239,000).



5. Reconciliation of movements in equity shareholders' funds

	2004 £'000	2003 £'000
Retained profit for the financial year	24,211	23,248
Goodwill previously written off released on sale of subsidiary	249	-
Currency translation differences on foreign currency net investments	(2,714)	6,654
New capital subscribed	729	-
Change in ESOP reserve	1,134	1,258
Net increase in equity shareholders' funds	23,609	31,160
Opening equity shareholders' funds	280,810	249,650
Closing equity shareholders' funds	304,419	280,810

6. Analysis of net debt

	Balance 1 January 2004 £'000	Disposals 2004 £'000	Cash flow movement during 2004 £'000	Exchange adjustments 2004 £'000	Non- cash changes 2004 £'000	Balance 31 December 2004 £'000
Cash at bank and in hand	170,888	-	3,425	(359)	(68)	173,886
Other loans due within one year	(4,473)	-	3,310	-	-	(1,163)
Other loans due after more than one year	(165,256)	397	(2,528)	11	-	(167,376)
Finance leases	(23,461)	1,369	7,782	(244)	(5,590)	(20,144)
Recourse net debt	(22,302)	1,766	11,989	(592)	(5,658)	(14,797)
Non-recourse debt	(356,979)	-	15,798	(740)	85,478	(256,443)
Net debt	(379,281)	1,766	27,787	(1,332)	79,820	(271,240)

Non-cash changes to non-recourse debt represents £85,478,000 in respect of the deconsolidation of Laser.