

## Press Release

27 February 2009

### Strong operational performance underpins growth

#### Serco Group plc – 2008 Annual Results

	2008	2007	% change
Revenue	£3,124m	£2,811m	11.1%
Adjusted profit before tax	£145.3m	£123.2m	17.9%
Profit before tax	£136.1m	£114.6m	18.8%
Adjusted earnings per share	22.20p	18.57p	19.5%
Earnings per share	20.49p	16.98p	20.7%
Dividend per share	5.00p	4.25p	17.6%
Group free cash flow	£94.2m	£97.6m	(3.5)%

#### Strong operational performance and increasing capabilities in growing markets

- Signed contracts valued at £3.2bn
- Win rates of one in two for new bids and 90% of rebids
- Organic growth broadly spread across markets and sectors
- Significant progress in developing new markets
- SI International integration on track

#### Robust financial performance and secure funding

- Strong revenue growth of 11.1%
- Adjusted profit before tax margin increase of 30bps
- Good cash generation: Group free cash flow of £94.2m
- £900m of committed debt funding: £64m repayable in 2010 with over 60% maturing from 2013

#### Substantial order book and continued high revenue visibility

- Order book of £16.3bn at 31 December 2008
- Continued high visibility of 90% of planned revenue for 2009, 76% for 2010 and 65% for 2011

#### Growth prospects increasing: expect continued strong performance

- Challenging global economic environment fuelling opportunities for efficient delivery of essential services in existing and new markets
- Flexible and agile business model, £26bn pipeline of opportunities and new markets support expectation of continued strong performance
- Consistent with previous guidance, expect revenue of approximately £5bn and an improvement in Adjusted operating profit margin of around one per cent to approximately 6.3% by the end of 2012\*

Christopher Hyman, Chief Executive of Serco Group plc, said: "In 2008, we delivered strong operational and financial performance. We continued to grow our existing business and further strengthened our capabilities in existing and new markets. While the global economic environment seems likely to remain challenging, we have a substantial order book that gives us high visibility on our future revenues, together with increasing growth prospects. The ability of our business to respond quickly in directing our resources at the best opportunities across the portfolio and addressing our customers' needs supports our ability to deliver continued strong performance."

\* excluding material acquisitions, disposals and currency effects. Detailed guidance for 2009 reflecting the benefit of SI International is given in the "Outlook and guidance" section on page 5-6 of this announcement.

Note: Adjusted operating profit, Adjusted profit before tax and Adjusted earnings per share shown above are before amortisation of acquired intangibles as shown on the face of the Group's income statement and the accompanying notes. 2008 Adjusted operating profit was £165.2m (2007: £142.0m). Group free cash flow is free cash flow from subsidiaries and dividends received from joint ventures and is reconciled in Section 3 of the Finance Review.

**For further information please contact Serco Group plc: +44 (0) 1256 745 900**

Charles King, Head of Investor Relations

Dominic Cheetham, Corporate Communications Director

[www.serco.com](http://www.serco.com)

### **Presentation**

A presentation for investors and analysts will be held at JP Morgan Cazenove, 20 Moorgate, London EC2R 6DA at 8.30 am today.

## Overview

### Strong operational performance underpins growth

In 2008, we delivered strong operational and financial performance while continuing to increase our presence in existing markets and enter new markets. We were successful in expanding the scope and scale of existing contracts, both on rebids and during the contract term, and won a number of significant contracts in new markets with strong growth opportunities. At the same time, we invested in improving our capabilities, systems and structures across the business. In an economic environment that seems likely to remain challenging, our expectation of continued strong performance is underpinned by our continued high revenue visibility, our agility and flexibility in addressing our customers' needs and our ability to direct our resources at the best opportunities.

We grew revenue by 11.1% to £3,123.5m, Adjusted profit before tax (Adjusted PBT) rose by 17.9% to £145.3m and Adjusted earnings per share grew 19.5% to 22.20p. Our margins increased, with Adjusted PBT margin up 30 basis points to 4.7%. Profit before tax rose by 18.8% to £136.1m and earnings per share were 20.7% higher at 20.49p.

Our policy is to increase the total dividend each year broadly in line with the increase in underlying earnings. The Board has proposed a final dividend of 3.52p per share, representing an increase on the 2007 final dividend of 16.6%, and bringing the total dividend for the year to 5.00p, growth of 17.6%. The final dividend will be paid, subject to shareholder approval, on 20 May 2009 to shareholders on the register on 6 March 2009.

Our cash performance continues to be strong, with Group free cash flow of £94.2m. Group recourse net debt increased to £524.5m (2007: £137.9m) principally as a result of the SI International acquisition. We agreed new committed bank facilities during the year to fund the purchase of SI International and refinance our existing debt. These facilities have a long maturity profile, with the earliest maturity of £64m in September 2010 and over 60% maturing in 2013 and beyond. This brings our total available committed debt funding to £900m. Together with our ongoing focus on releasing cash from investments, this leaves us with a strong funding position.

The strength of our business model and the commitment of our people means that we continue to deliver quality service to our customers, which was again reflected in our contract win rates. During 2008, we maintained our win rates at over 90% on rebids and one in two new bids, and in total we won over 200 contracts valued at £3.2bn across a wide range of our markets.

We expanded our presence in existing markets, both through new contracts and expanding the scope and scale of existing contracts. Among larger wins, in the UK we won two contracts to deliver a range of innovative environmental services for the London Borough of Hammersmith & Fulham and Milton Keynes

Council valued respectively at £140m and £160m over a maximum of 14 years, and we renewed our education and children's services contract with Walsall Council, which is now valued at £345m over a longer term of 12 years. We were also awarded a facilities management contract to manage 29 of Deloitte's office facilities and buildings valued at £50m over 5 years.

In defence, we continued to expand our services to the military in the UK and overseas. In the UK, we expanded our contract, valued at £76m over its maximum ten year term, to provide the Naval Air Command with engineering and aircraft support services at Yeovilton and Culdrose air stations. In Australia, Serco Sodexo Defence Services, a Serco joint venture, renewed its contract to provide garrison support services at six defence bases in the Northern Territory and was awarded a similar contract for the North Queensland region. The total value of both contracts to Serco is AUS\$362m. In the US, we won a rebid to deliver Aviation Technical Maintenance and Support Services to the US Navy, which has a potential value of US\$167m over five years and significantly increases the support we provide to the Space and Naval Warfare Systems Center Atlantic.

In 2008, we also invested in the development of a number of new markets. In the local authority market, we signed our first local authority strategic partnership, valued at £265m over ten years, with Glasgow City Council. We continue to pursue similar opportunities with other local authorities. In April, we signed our first light rail contract in the Middle East with an agreement, valued at £500m, to operate and maintain the Dubai Metro, leveraging the transport capabilities we have developed in the UK and positioning us well for further opportunities in the region. Our implementation plan for the Metro is on schedule ahead of the start of the service in September this year.

During the year, we continued to invest to support our strong growth: this means ensuring that we have the best people, capabilities, systems and business structures to meet our customers' needs and pursue the higher-value opportunities available to us. For example, during the year, we began the roll-out of our Business Academy, providing our people with online access to the latest tools, thinking, approaches, and techniques. At the end of July we reorganised the central IT services team within our technology business in order to better align our capabilities with developing market needs such as in security and resilience, and to improve efficiency and simplify structures. In the future, we will also leverage our new capabilities in India to support these and related areas. We also completed the roll-out of our SAP system in the UK and the Asia Pacific business, and are now implementing it in the Middle East and anticipate starting that process in North America later this year.

At the end of the year, we completed the acquisition of SI International, a provider of information services, technology, and network solutions to the US government, for US\$524m, including assumption of debt. In 2008, SI International had revenue of US\$575.5m and underlying Adjusted operating profit of US\$36.7m.

SI International creates a strong foundation for growth and the delivery of higher value services in the US government services market, by giving us scale and increased resources to bid on larger US government

contracts, broader customer relationships, and access to higher growth areas and increased capabilities. Since the year end, we have made good progress in integrating SI International with our existing North American business. Reaction from our customers has been favourable, and there are early positive signs that our integrated teams can apply our enhanced capabilities across our enlarged customer base.

We also entered the Indian market through the acquisition in December of a majority shareholding in InfoVision, a leading business process outsourcing (BPO) business serving the domestic Indian market, for £14.8m, and have invested in enhancing our presence and launching the Serco brand in that market.

In January 2009, we announced that we had formed a partnership with the Guy's and St Thomas' NHS Foundation Trust to improve the Trust's pathology services and target pathology market in the UK and overseas. In the UK, pathology is a significant market, valued at around £2.5bn. The 50:50 joint venture – the first of its kind - is branded as GSTS Pathology and will operate and enhance the Trust's existing pathology capabilities under a ten-year contract valued at around £250m to Serco, which started on 1 February 2009.

In the nuclear market, while we were disappointed that our consortium did not win the Sellafield nuclear decommissioning contract, we have seen growth in our nuclear assurance business which is well placed to take advantage of increasing nuclear opportunities in the UK and overseas.

## **Outlook and Guidance**

While the global economic environment seems likely to remain challenging, we have a substantial order book that gives us high visibility on our future revenues together with increasing growth prospects. Our long-term contracts and substantial order book continue to provide excellent visibility over our revenues, over 90% of which come from government. Including a £1bn benefit from SI International, we had a substantial order book of £16.3bn as at 31 December 2008, and we had identified 90% of planned revenue for 2009, 76% for 2010 and 65% for 2011.

Constrained government budgets drive demand for efficiency and cost-effectiveness in the delivery of public services, especially as governments balance their investment in providing economic stimulus with the requirement to control national debt. Our strong capabilities mean that we are well positioned to provide relevant support in existing markets and to leverage our expertise through exporting proven models to new areas. With growing markets and capabilities, our pipeline now stands at a substantial £26bn, including SI International's pipeline of over £2bn.

With our substantial order book, excellent revenue visibility, and our ability to direct our resources flexibly to pursue the best opportunities, we remain confident that our business will continue to perform strongly. We expect increasing demand for our skills to support robust revenue growth, and see good opportunities to

improve our margins, through our focus on managing our contract portfolio, enhancing our efficiency, and bidding selectively for higher-value work.

Given the confidence this gives us over the medium term, we are guiding to revenue and margin by the end of 2012. In future, reflecting the operational drivers of our margin improvement and in line with market practice, we will give our margin guidance at the operating profit margin level.

Accordingly, and consistent with our previous guidance, our projections are that our revenue will increase to approximately £5bn and our Adjusted operating profit margin to approximately 6.3% by the end of 2012, excluding material acquisitions, disposals and currency effects.

In 2009, we expect to deliver double-digit revenue growth and a 30bps increase in our Adjusted PBT margin, excluding SI International. The addition of SI International is anticipated to increase our 2009 revenue growth by approximately 10%. Including the benefit of SI International, we expect our Adjusted operating profit margin of 5.3% in 2008 to increase by approximately 40 bps in 2009. This 2009 guidance excludes material currency effects.

## **Operating Review**

### **Civil Government**

In civil government, our work encompasses sectors including home affairs, healthcare, local government, education and children's services and the corporate sector, providing a broad range of integrated facilities management, IT and business process outsourcing (BPO) support and consulting services. In the US, the acquisition of SI International has added new records management and IT capabilities which we provide to a number of civil government agencies.

Civil government revenue grew by 18.4% to £1,127m, representing 36% of Group revenue (2007: 34%).

### **Home Affairs**

The UK Government is responding to increasing prisoner numbers with investment in building new prison facilities and increasing the capacity of existing prisons. Serco is playing an important role in maximising the impact of this investment.

Construction has begun of new houseblock accommodation at HMP Dovegate and HMP Lowdham Grange, adding 260 new places to each prison, and increasing the combined operating income of both contracts by over £100m over their lives. The pressures on the prison system are also increasing demand for associated services, including growth in our court escorting and electronic monitoring services as authorities look to alternative approaches to prison sentences for the management of offenders.

We received positive inspection reports on Yarl's Wood Immigration Removal Centre by HM Chief Inspector of Prisons, and Hassockfield Secure Training Centre by Ofsted, which commended our people on the high quality of the care they provide and further reinforced our reputation for the provision of specialist care for children and young people in secure accommodation.

### **ICT and BPO**

The demand for innovative, flexible approaches to working and people management, combined with the requirement to achieve value for money and the requirement for Local Authorities to achieve year on year efficiencies is leading to new opportunities for our IT and BPO management services.

In December we acquired a 60% shareholding in InfoVision, the third largest BPO company serving the Indian domestic market, enabling further development of InfoVision's BPO business, and broadening our existing customer offering. We have agreed to acquire the remaining 40% of InfoVision in two tranches over the next two years. We see strong opportunities for growth, both in BPO, and as a provider of services to the public as the Indian market develops.

We have made a successful start to our landmark £265m partnership with Glasgow City Council to transform land, property and information and communications technology (ICT) services. During the first nine months of the contract, we have surveyed close to 500 properties, opened a new datacentre, merged five service desks into one and delivered some £9m of transition projects to time, cost and quality. The transfer of some 280 seconded staff into the joint venture has taken place and we have already reorganised the ICT function to improve service delivery

Following our success in Glasgow, we signed a new contract with Derby City Council and Derby Homes to provide IT management and support. The new partnership is designed to support innovative approaches to office and home working, alongside reducing the council's carbon footprint, and securing cash efficiencies for both Derby City Council and Derby Homes. The contract is valued at £19m over seven years.

Our contract with the [businesslink.gov](http://businesslink.gov) services supporting SMEs has been extended to cover the development of online business support. This extra work, with an additional value of £14m per annum, follows positive reviews of our performance on the contract by the National Audit Office. We have continued to develop our business support work across a number of the UK's regions, with a £2m, four-year contract to support the South East's businesses through a customer relationship management system, additional funding of £9m to support rural enterprise in Devon, Cornwall and Somerset, and a contract for the London Development Agency for its Competefor procurement portal to match buyers and potential suppliers in the 2012 Olympic Games supply chain which has recently secured additional funding of £1.8m.

### ***Integrated services***

We saw good growth in 2008 in our integrated services business which provides facilities management services to both public and private sector customers, and environmental services for local authorities, all of whom are looking to reduce overall expenditure and improve service levels. We were pleased that in the year our work with the Norfolk and Norwich Health Trust was commended in the Department of Health's 'Deep Clean to Keep Clean' Report, which quotes Serco as an example of best practice in collaborative working.

Our innovative approach to environmental services includes introducing electric vehicles and more efficient route planning to reduce councils' carbon footprints, synchronising street cleansing, recycling and refuse collections, and actively promoting recycling. During the year, we won contracts with the London Borough of Hammersmith and Fulham, at a value of £140m over a maximum of 14 years, and Milton Keynes Council, with a value of £160m over the same term. We have also won a contract to maintain parks and sports grounds for the London Borough of Newham, with a value of £30m over 10 years.

We also secured a new £50m, five-year facilities management contract with Deloitte, which covers cleaning, security, maintenance, helpdesk facilities and the disposal of confidential waste, and also won further

corporate facilities management contracts for Coca-Cola, Volkswagen and Wyeth Medica, with a combined value of around £20m per annum.

The signing of a £20m, ten-year contract covering fire and rescue services at Cardiff International Airport further secures our strong position in the UK's airport facilities management market, adding to existing contracts with Birmingham and Filton airports. The new contract covers primary fire and rescue response, adverse weather response, training and maintenance.

### ***Education and Children's Services***

During the year, we renewed and extended our contract with Walsall Council to provide education and children's services. The award of the new contract, which is valued at around £345m is for a longer term of 12 years, reflecting the success we had achieved under the previous contract. Under the new contract, we are working with the Council to ensure that children and young people achieve the best possible educational outcomes, and also to provide support to the most vulnerable children and their families.

Our contract to provide support for the national roll-out of Children's Centres under Sure Start's Together for Children programme has been extended following strong performance under our innovative 'field force' model. Our approach delivered the target of 2,500 rolled out centres ahead of schedule, and we delivered a further 400 centres under the term of the initial contract. Under the contract extension, worth £15m over two years, the total number of centres will be increased to 3,500 by 2010.

Our success under Together for Children contributed to us winning a separate, new contract under the Aiming High for Disabled Children programme as Together for Disabled Children, with a value of £5.5m over two years. In both these national programmes we are proud to lead contracts fully involving voluntary sector organisations in delivery.

This year has seen two major landmarks in our success in Education. Our primary school results across Walsall and Bradford were ranked the first and seventh (respectively) most improved councils for primary school achievement nationally between 2001 and 2008, and our transformation of Children's Services at Stoke was recognised by Ofsted in the 2008 Annual Performance Assessment referring to "significant and rapid progress made" since our appointment.

### ***Healthcare***

Excellent service delivery and an innovative approach to improving performance are the foundation of our growth across the Healthcare sector.

Serco Occupational Health has increased our presence in this fast-growing sector and added new capabilities in managed healthcare services. The business has won new contracts and extended current business across both public and private sector employers. Serco is now the third largest provider of occupational health in the UK.

The extension for a further two years of our out-of-hours doctors' service contract for Cornwall and the Isles of Scilly follows consistent outperformance of national targets as recognised by the Healthcare Commission and positive feedback from users of the service. The contract extension is worth £14.5m.

We have signed a new three-year contract with Doncaster Primary Care Trust to provide nursing and related services to HMP Lindholme, HMP Moorlands and Lindholme Immigration Removal Centre. With a value of £4m, the contract brings to 16 the number of prisons and immigration centres for which we provide health services.

### ***Consulting***

Serco's consulting business continued to increase its scale and scope during the year, expanding its high-value, strategic and advisory level work. Examples include NHS Connecting for Health, the Rural Payments Agency and our work for Department for Environment, Food and Rural Affairs (DEFRA) Animal Health where we are working on a major business reform programme. Serco's consultancy team continues to perform strongly and our presence on the programme has been expanded to developing DEFRA's capability and managing external relationships with suppliers.

Home affairs continues to represent a growing market, with new wins including the Metropolitan Police, Greater Manchester Police and the Home Office. Other strong markets for Consulting include Scottish government and education.

As government looks to find efficiencies in the procurement of external consultancy services, our position as an approved supplier on the Office of Government Commerce's buying.solutions Catalist framework is also leading to an increased number of new project opportunities.

### **Defence**

We are a major provider of operational support services to the armed forces of the UK, US, Canada, Germany and Australia. We provide training, engineering and operational support, maintain strategic defence assets, and deliver cost analysis, human resources, systems engineering, safety assurance and risk management services. We are well placed to help our customers by improving efficiency and reducing costs, through providing advice and consultancy to achieve greater efficiencies while improving operational availability, and implementing the delivery of services to improve operational capability.

Defence revenue grew by 9.1% to £786m, representing 25% of Group revenue (2007: 26%).

### ***United Kingdom***

We are actively engaged with the Ministry of Defence at the highest levels to help them meet their operational challenges with a focus on improving the availability of people and equipment to the front line and ensuring that military staff are able to focus on core operational tasks.

We provide training, engineering and operational support to the Royal Air Force and the aviation arms of the British Army and Royal Navy. We also support the Royal Navy's three main UK bases, operate and maintain key strategic defence assets such as secure satellite communications and the UK's Defence Academy, and provide systems engineering, safety assurance and risk management services.

We continued to broaden our contribution to improving the capability of the UK's military air operations in 2008, both through engineering support in the UK and deployed operations in theatres of conflict. During the year, over 50 Serco employees supporting the No 32 (The Royal) Squadron and the Skynet 5 secure military satellite systems were awarded military service medals for their work in operational theatres.

The potential for growth stemming from our successful track record in support to operations is shown in a number of new air support contracts won during 2008. These include the 10-year £68m 'surface finish' contract covering 16 RAF sites including the Falkland Islands, taking Serco's military aviation support to over 16 different aircraft types and a maintenance contract for the RAF glider fleet valued at £6m over a maximum of seven years.

Following successful rebids, we were also awarded the £9m, five-year contract to provide air traffic control, engineering and flight planning at the British Army Air Corps' Wattisham base and an £8.5m contract with the US Air Force Europe to provide support services at three of its UK operating bases.

In addition to contracts directly awarded by the Ministry of Defence, we are benefiting from an increasing range of opportunities with other private sector providers. BAE Systems appointed Serco to the £8m, five-year maintenance and supply contract for improving efficiency and aircraft availability amongst the VC10 aircraft fleet that BAE Systems operates at Brize Norton. We already support the RAF Tristar fleet at the base.

### ***North America***

We provide information services, technology and network solutions, and enterprise management, engineering, logistics, economic cost analysis and human resources services to the US military. The

acquisition of SI International at the end of the year has significantly expanded our capabilities and broadened our customer base. We now serve all branches of the US armed forces.

Increasing demand for high-quality personnel support services is reflected in the award of a number of contracts. These included a contract to provide psychological health services at five US Navy regional commands, valued at approximately US\$6m over two years.

We also renewed our contract valued at up to US\$32m over two years with the US Army Career and Alumni Program to provide career counselling and won a new contract to support the provision of advocacy services to soldiers and family members who are victims of domestic violence and sexual assault, through a one-year, US\$10m contract with a second-year option. We will also provide support services for families of Active Army, National Guard and Reserve Soldiers under a US\$5.6m extension to our US Army's Integrated Family Support Network contract and were awarded a contract worth US\$11m annually over a base year plus one option year, to develop the MyArmyLifeToo web portal, which provides timely and relevant information to Army families.

We successfully rebid for the Casualty Support Services Contract awarded by the US Army Casualty and Mortuary Affairs Operations Center, which includes manning the operations center for Army casualty support, receiving casualty reports and providing information and assistance to next-of-kin. The initial value of the contract is US\$9m for the first year, with the potential to increase to US\$44.5m if all options are exercised.

We also won, with our partner Summit Marketing, a contract for the Freedom Team Salute recognition and commendation program, which has an estimated value of US\$21m to Serco over two years.

The award of the Aviation Technical Maintenance and Support Services contract by US Navy SPAWAR Systems Center Charleston, with a potential value of US\$167m over five years, reaffirms our track record in delivering high quality air traffic control and integrated technical and maintenance aviation services, and strengthens our 11 year partnership with SPAWAR.

With greater budget constraints and increased demand for operational resources being deployed in the field, emphasis is being placed on cost analysis and procurement. During the year, we rebid successfully for the Price Fighters cost analysis contract supporting the US Navy's weapons procurement program. The contract is valued at approximately US\$41m for a base year plus four option years. We were also awarded a one-year US\$2.3m contract to provide cost analysis support to the multi-national coalition forces in Iraq.

We were awarded a US\$18.5m contract by the US Space and Naval Warfare Systems Command for the production and delivery of Navigation Sensor System Interface (NAVSSI) components and ongoing production engineering support services. The NAVSSI system collects and processes data for weapons, combat support and other on-board information systems. The five-year contract combines purchases for the

US Navy and the governments of Australia and Spain. We were also part of a team awarded contracts under the Project Management Support Services programme, with an overall value to Serco estimated at US\$25m over five years.

### **Middle East and Asia Pacific**

In the Middle East, as previously reported, we were disappointed to be informed in February 2008 that the Oman Ministry of Defence no longer wished to proceed with its project to develop a military training college.

We provide training, logistics and operational support services to the Australian Department of Defence and we have successfully built a presence on every defence base in Australia, providing a firm foundation for organic growth.

Our joint venture in Australia, Serco Sodexho Defence Services, was awarded the Integrated Base Services Contract for the North Queensland region, adding to its earlier success in winning the Base Services Contract for the Northern Territory. The combined value of the two contracts is AUS\$362m over nine years.

### **Transport**

We are a major provider of transport services to the UK and markets in Australia, the Middle East and US. We operate heavy and light rail systems, are a leader in the development of integrated traffic management systems, and are one of the world's largest private sector suppliers of air traffic control services.

Transport revenue grew by 2.4% to £671m, representing 22% of Group revenue (2007: 23%). Excluding the effect of the ending of our contracts to operate the Manchester Metrolink and Copenhagen Metro in 2007, revenue growth was 8% reflecting strong performance across this segment.

During the last year, our transport operations continued to leverage skills developed in the UK to win significant new business in the Middle East and further develop our presence in US markets.

### ***Heavy rail***

Northern Rail and Merseyrail, Serco's two joint ventures with NedRailways, continued to deliver good growth in 2008, supported by innovation and excellent service delivery, and have made a good start to 2009. These joint ventures have revenue or profit sharing agreements, and stable subsidies which account for over 60% of revenue.

Northern Rail was named as 'Train operator of the year' and 'Rail business of the year' at the HSBC Rail Business Awards during 2008. The new hourly service Northern has introduced between Leeds and Nottingham links these two important centres, directly, for the first time in 25 years and along with the expansion to a half-hour service on its Leeds-Sheffield route will further improve performance and enhance the passenger experience.

Merseyrail has received the highest score for passenger satisfaction in the latest National Passenger Survey for any train operating company outside London as well as achieving the UK's first fully secure rail network by the Department of Transport as all of its 66 stations have been awarded Secure Station status. Serco Docklands was awarded Secure Station status for its stations in 2007.

Our Australian rail operation, Great Southern Rail, has made appropriate adjustments to service schedules and operations after a weaker tourist market began to impact on passenger numbers during the second half of the year. Sales of the Ghan service's premium Platinum cabins, launched in September, have performed well. In August, we learned we had not been selected to run the trains in Melbourne, Australia.

We continue to pursue opportunities for monitoring and maintaining infrastructure. Serco was awarded two contracts this year, one by Network Rail, extending our existing track monitoring and rail grinding contract, valued at £20m over one year with a possible one year extension, and one by Virgin Trains to upgrade property and stations on the West Coast route valued at £5.5m over a maximum four-year term.

### ***Light rail***

Docklands Light Railway (DLR) continued to perform strongly in 2008. The construction work to extend the railway's capacity from two-carriage to three-carriage trains is proceeding on schedule, and the £180m extension to the line serving Woolwich Arsenal was opened early in January 2009.

Our expertise in light rail systems puts us in an excellent position to meet growing demand for these services, particularly in the Middle East.

Signed in April 2008, our contract with the Dubai Government Roads and Transport Authority (RTA) to operate and maintain the first two lines of the new Dubai Metro has a value of £500m over 12½ years. The launch of the driverless metro system is creating considerable local interest, and is expected to lead to further opportunities in the region through the extension of the Dubai Metro network, further transport systems in Dubai, and the adoption of similar rail systems in other Emirates. Our implementation plan, which includes the recruitment of over 3000 employees, is proceeding to schedule, ahead of the formal start of the operating contract in September 2009.

Our broad transport capabilities meant that we were also able to win further business with the RTA during the year. These included a £3.5m contract to implement ten key projects under the Bus Master Plan for

Dubai and a £2m contract to deliver a real-time journey planner system, which is accessible online, over mobile phones and through a customer service centre.

### ***Traffic management***

Reducing congestion is a priority issue in the UK, with the Highways Agency increasing its investment in the area and emphasis growing on the skills required to manage motorways and road infrastructure effectively. We are taking a leading role in developing innovative solutions through traffic management systems, with several new contract wins during 2008. We signed a first-year trial contract with the UK's Department for Transport (DfT) to undertake a feasibility and strategy study on Time-Distance-Place (TDP) road charging. TDP systems track vehicle movements and offer road authorities the option of varying costs to motorists depending on where and when they use their vehicles. We also won a ground breaking contract with BAA to maintain the traffic system at Heathrow Airport, which has the potential to be replicated around the world.

In the US, Serco secured a US\$23m contract to install and manage a new smart parking system for San Francisco, as well as a separate US\$8m, two-year extension to our parking meter counting and collection contract.

In Hong Kong, we have renewed our contracts to operate the Aberdeen tunnel and maintain the Shenzhen road corridor between Hong Kong and mainland China. Under a further contract, Serco will supply the latest technology in traffic light enforcement to the Hong Kong Transport Department. In total, these contracts are valued at approximately £23m.

### ***Civil Marine***

Serco's expertise in the provision of marine services to the Royal Navy led to Transport for London awarding us a new £11m, 18-month contract to operate the Woolwich Ferry, opening up further opportunities in the civil marine market. The free ferry service carries over a million vehicles and two million passengers a year, and provides an important link to the DLR.

### ***Air Traffic Control***

In Middle East air traffic control services, we rebid successfully on our contract to provide air traffic control and electronic engineering services for the United Arab Emirates' Area Control Centre in Abu Dhabi. The contract, with the General Civil Aviation Authority, is worth £28m over three years.

## Science

Serco manages science-based organisations and develops and applies scientific knowledge for wealth creation. Technology, innovation and people management are at the heart of our offering in this market.

Science revenue grew by 11.7% to £540m, representing 17% of Group revenue (2007: 17%).

We continued to see strong performance from our joint venture to manage and operate the UK's Atomic Weapons Establishment (AWE). The construction phase of the new Orion building finished as scheduled in March 2008, with the project due for completion in 2010. AWE has also commenced the planning phase for Project Mensa, the construction of a replacement warhead assembly and disassembly facility at the Burghfield site.

In December 2008, BNFL sold its one-third shareholding in AWE Management Limited (AWEML) to the California-based company, Jacobs Engineering. We retain our one-third stake in AWEML in an equal partnership alongside Lockheed Martin and Jacobs Engineering.

The annual RoSPA awards once again recognised AWE's excellent health, safety and environmental performance, with the award of the Astor Trophy for excellence in occupational health, the International Dilmun Environmental Award and the sectoral award for outstanding performance in health and safety.

We have been responsible for managing the work of the National Physical Laboratory (NPL) since 1995, supporting its mission to apply scientific knowledge for economic and quality of life benefits. NPL has won business in the environment sector, including air monitoring projects with DEFRA, and in the security and defence sector. In addition, the Nobel Peace Prize Committee recognised the important work of NPL in supporting its peace prize winners and our diversity and educational outreach were rewarded with the 'Investor in WISE' award from Women into Science, Engineering and Construction (WISE).

Our nuclear assurance business, which is focused on enhancing the performance of nuclear reactors that generate electricity or power nuclear submarines, has continued to perform well during the year.

We were appointed as one of a team of partners to provide engineering and technical support to British Energy's nuclear power stations, worth up to £30m to the partners over the next five years, and are well placed to grow the business as nuclear new build programmes get underway in the UK and overseas.

The business has also completed the main stage of its extensive refurbishment of its nuclear laboratory and support complex in Cheshire. These facilities, which include nuclear corrosion and high temperature laboratories, strengthen Serco's world class capabilities in nuclear safety, assurance and regulatory support.

## Market opportunities

Our customers, principally national and local governments, are increasingly under pressure to reduce budgets and to maximise the effectiveness of their available resources given the current challenging economic environment. At the same time, they continue to face rising demand from their citizens to improve the delivery of existing public services, and growing challenges in areas such as climate change, migration, security, economic development, ageing populations and congestion.

These pressures are increasing demand from our customers to reduce the costs of public services and address these broader challenges. We are well positioned to help them given our strong capabilities across a broad range of markets, our proven track record in delivering people-led change and excellent service, and our ability to create innovative solutions.

The strong opportunities for the private sector in delivering better value for money services, both in the UK and overseas, were confirmed in the independent review of the public services industry conducted for the UK government by Dr DeAnne Julius. The review, which was published in July 2008, concluded that the UK has the most developed public services industry in the world, valued at £79bn, and saw strong potential for this to grow further in the UK and for these skills to be exported into new markets.

The role of the private sector in delivering efficiencies was further confirmed in UK government's Operational Efficiency Review, announced in July 2008, and due to report this year. The Review identifies five work streams, including collaborative procurement, back office and IT functions, asset management, property and local initiatives and empowerment, and is seeking to draw on the best of public and private sector experience to deliver billions of pounds of savings across these areas. The further development of Competitive Neutrality, as set out in the UK's Budget in 2008, should also increasingly mean that there will be equality between the public sector and private sector or voluntary agencies when bidding for contracts.

Looking at prospects across the business, we continue to see strong opportunities in home affairs. Rising prison populations are increasing the demand for prison places and innovative approaches to offender management, providing Serco with opportunities to expand its work in the sector in the UK and Australia. At the same time, border security issues have increased the pressure on places at immigration control centres, and the demand for proven, consistent approaches to managing these facilities, and associated services such as escorting.

In the US, the incoming administration's focus on countering cybersecurity threats, improving information sharing among agencies, modernising healthcare management, and increasing the need for logistics services with the anticipated drawdown of combat troops and the lengthening life expectancies of existing military platforms provide growing areas of opportunity for the expanded capabilities of our North American business.

Ageing populations are adding significantly to the pressures on health services and increasing the need to use existing resources efficiently. The groundbreaking partnership between Serco and Guy's and St Thomas' NHS Foundation Trust establishes a new model to target the significant national pathology market, which is valued at £2.5 billion and is growing at 8% to 10% annually, and international opportunities. Similarly, the acquisition of Grosvenor has given us new opportunities in the fast-growing market for occupational health services for public, private and not-for-profit organisations.

The economic downturn is increasing the focus on developing new solutions to increase employment by encouraging entrepreneurialism and support people in returning to work. We see further opportunities to support small and medium-sized enterprises through initiatives such as Businesslink and our work with the UK's regional development agencies, and expect new opportunities under the government's Flexible New Deal initiative following the publication of the Green Paper on welfare reform in July 2008.

Local authorities in the UK face a range of challenges in balancing the requirement to achieve a 3% annual efficiency gain (as required by the 2007 Comprehensive Spending Review) with the demand for more responsive public services and their key role in enabling the delivery of national policy such as the Every Child Matters agenda. Serco has pioneered an innovative approach to service transformation in our partnership with Glasgow City Council, and we see good opportunities to provide similar services to other local authorities. We also see a strong pipeline in providing our innovative environmental services to local authorities.

Traffic congestion is a growing threat to economic growth, public health and the wider environment in most regions of the world. Responsive, dependable traffic management and reliable, cost-effective public transport systems both play vital roles in the solution. We see further opportunities to grow our presence in light rail, both in Dubai as the new Metro network expands, and in other countries, including in the UK and continental Europe. Serco's expertise in traffic management is also in growing demand as the UK Highways Agency increases its investment in this area, and as other countries look to import the expertise in integrating systems and data to maximise efficiency of the road network developed in the UK.

We recognise the financial and operational pressures affecting our defence customers, and are using our expertise to help them achieve more within existing resource levels. In the UK, we remain in constant dialogue at senior levels as to how we can contribute to through life capability management, and continue to innovate to help our customers at a local level. In the US, we now serve every branch of the military and see strong opportunities to grow in key areas such as personnel support services, procurement, engineering and logistics, and program management. We also see opportunities to deploy our skills in selected other markets overseas.

We have also identified good growth opportunities in the Indian market where we launched Serco BPO following the acquisition of InfoVision's business process outsourcing capabilities in December. Rising

incomes are creating an increasing demand from consumers for services and consequently a growing use of third parties to deliver them. The outsourced domestic BPO services market is expected to grow in value to around US\$1.8bn over the next five years and there is early evidence that there will be demand for process outsourcing within the Indian public services market.

### ***People***

We continue to be focused on our values – our Governing Principles as we call them – to ensure that we operate in the best interests of all our stakeholders in the short, medium and long-term. By combining a strong public service ethos with commercial acumen, we seek to create a working environment that is attractive and rewarding for employees, and gives customers the confidence they need to entrust their requirement to deliver excellent service to us. That environment helps Serco people all around the world give of their best, whether improving the education a child receives, helping pilots and commuters arrive safely at their destinations, supporting front line military personnel, or assisting businesses in their plans to grow and prosper.

The quality and dedication of our people is reflected in the many awards we receive around the world. Some examples in 2008 include the many employees who received military service medals for their work in operational theatres supporting the No 32 (The Royal) Squadron and the Skynet 5 secure military satellite communications systems both in Iraq and Afghanistan. At Merseyrail and Northern Rail, employees' dedication to service has been recognised at an industry level: Merseyrail has achieved a high rating of 90% customer satisfaction and Northern Rail was recognised as the Rail Operator of the Year, having continued to improve reliability and service quality. Among many other awards, we were again recognised by our peers as the UK's Most Admired Support Services company, for the fifth year in a row.

We were also delighted to celebrate the achievement of those teams and individuals nominated by their colleagues to receive a "Pulse" award, which is Serco's way of recognising their efforts in ensuring that we live our governing principles and support those around us and in our wider community. Our people's strong commitment, which we find all over Serco, is the real bedrock of our growth.

As 2008 came to a close, approximately 13,000 people joined the Serco family through the acquisitions of SI International in the United States and InfoVision in India. We chose these companies very carefully, based on the growing markets they operate in, the skills and capabilities they have and, critically, the values that their people demonstrate. We are delighted to welcome them to the Group.

## Risk Management

Our business, results and financial condition could be affected by a broad range of risks and uncertainties. The Group risk register identifies the principal risks facing the business, including those that are managed directly at a Group level. The Group risk register is updated at least quarterly, reviewed six-monthly by the Risk Oversight Group and discussed at quarterly Board meetings.

During 2008, the risk management process has been incorporated in to an over-arching resilience management framework that incorporates risk, security, business continuity and crisis management. The resilience management framework is supported by a set of top-level requirements, more detailed process descriptions and guidance and tools to support the implementation of the framework across the Group.

Active risks are ranked by importance and grouped under the following six headings:

- **Strategic** – covering threats to the long-term deliverability of the Group's strategy. Principal risks include loss of competitive position and risks associated with acquisitions.
- **Financial/Commercial** – covering threats to the short- to medium-term performance. Principal risks include the loss of key contracts, failure to meet financial business plans, availability of funding, pension fund liabilities and delays or cost over-runs in major transition programmes.
- **Compliance** – covering compliance with all relevant legislation and regulations. Principal risks include legal action resulting from compliance failures, loss or compromise of personal data and unethical behaviour by Directors or members of staff.
- **Safety and Security** – covering threats to the safety of staff, sub-contractors, members of the public and the environment and the security of the Group's assets and staff. Risks include the responsibility for a major accident or incident where public safety is concerned, environmental pollution, assaults on staff in the course of their duties, loss of sensitive information and crime, fraud and terrorism.
- **Operational** – covering threats to the continuity of business operations. Principal risks include the failure of information systems, loss of key infrastructure and the recruitment and retention of key staff.
- **Management** – covering possible internal failures of managers or management systems. Principal risks include failures of internal controls and management systems.

For the Group, the most significant risks relate to the strategy and safety areas. Social, environmental and ethical issues, while recognised within a number of the Group's risks, do not represent significant threats to the Group's strategy at present. Reputational and emerging risks are kept under active review and the Board informed of changes. Emerging risks cover longer-term risks that could represent a threat to the Group's activities but which are not yet sufficiently defined to be included as active risks. Examples of these risks include financial market instability, influenza pandemic, climate change and changes in key markets.

## Finance Review

### 1. Financial performance

Serco's strong performance in 2008 is reflected in our financial results, with double-digit revenue growth and a further increase in margins. We generated good cash flow, and have a strong funding position.

Serco's income statement for the period is summarised in Figure 1 below. This includes the results of joint ventures which are proportionately consolidated.

**Figure 1: Income statement**

<b>Year ended 31 December</b>	<b>2008 £m</b>	<b>2007 £m</b>	<b>Increase</b>
Revenue	<b>3,123.5</b>	2,810.7	11.1%
Gross profit	<b>456.8</b>	406.2	12.5%
Administrative expenses	<b>(291.6)</b>	(264.2)	
Adjusted operating profit	<b>165.2</b>	142.0	16.3%
Investment revenue and finance costs	<b>(19.9)</b>	(18.8)	
Adjusted profit before tax	<b>145.3</b>	123.2	17.9%
Amortisation of acquired intangibles	<b>(9.2)</b>	(8.6)	
Profit before tax	<b>136.1</b>	114.6	18.8%
Tax	<b>(36.5)</b>	(32.2)	
Profit for the year	<b>99.6</b>	82.4	20.9%
Effective tax rate	<b>26.8%</b>	28.1%	
Adjusted earnings per share	<b>22.20p</b>	18.57p	19.5%
Earnings per share	<b>20.49p</b>	16.98p	20.7%
Dividend per share	<b>5.00p</b>	4.25p	17.6%

#### 1.1 Revenue

Revenue grew by 11.1% to £3,123.5m, benefiting from the growth of existing contracts and the contribution of new wins. Underlying revenue growth, which excludes the effects of changes to currency exchange rates, acquisitions, disposals and significant contract divestments, was 10.3%.

#### 1.2 Gross margin

Gross margin – the average contract margin across our portfolio – was 14.6%, a small increase of 0.1% on 2007.

#### 1.3 Investment revenue and finance costs

Investment revenue and finance costs totalled a net cost of £19.9m (2007: £18.8m). A reduction in the Group's underlying borrowing costs was offset by an increase in the net pension funding cost charged to the income statement.

#### **1.4 Profit before tax**

Adjusted profit before tax was £145.3m, an increase of 17.9%. This represented a margin of 4.7%, up from 4.4% on 2007. Profit before tax increased by 18.8% to £136.1m.

#### **1.5 Tax**

The tax charge of £36.5m (2007: £32.2m) represents an effective tax rate of 26.8%, compared with 28.1% in 2007. The decrease in the effective tax rate principally reflects the fall in the UK corporation tax rate from 30% to 28% in April 2008.

#### **1.6 Earnings per share (EPS)**

Adjusted EPS rose by 19.5% to 22.20p. EPS grew by 20.7% to 20.49p.

EPS and Adjusted EPS are calculated on an average number of shares in issue of 485.7m during the year (2007: 482.4m). The increase in the average number of shares in issue resulted from the exercise of employees' share options.

### **2. Dividend**

Serco's policy is to increase the total dividend each year broadly in line with the increase in underlying earnings. The Board has proposed a final dividend of 3.52p per share, representing an increase on the 2007 final dividend of 16.6%, and bringing the total dividend for the year to 5.00p, a growth of 17.6%. The final dividend will be paid on 20 May 2009 to shareholders on the register on 6 March 2009.

### **3. Cash flow**

The Group generated a free cash inflow of £94.2m, £3.4m lower than in 2007. The free cash flow in 2007 benefited from a low working capital movement and a lower level of cash tax.

Figure 2 analyses the cash flow. As in previous years, we have designed the analysis to show the actual cash performance of the Group – being the cash flows generated by subsidiaries plus the dividends received from joint ventures. It therefore differs from the consolidated cash flow on page 31, which proportionately consolidates the cash flows of joint ventures. The adjustment line in Figure 2 reconciles the movement in Group cash to the consolidated cash flow.

**Figure 2: Cash flow**

<b>Year ended 31 December</b>	<b>2008 £m</b>	<b>2007 £m</b>
Operating profit excluding joint ventures	<b>107.8</b>	92.2
Non cash items	<b>39.4</b>	47.6
Group EBITDA	<b>147.2</b>	139.8
Working capital movement	<b>(21.6)</b>	(0.2)
Group operating cash flow	<b>125.6</b>	139.6
Interest	<b>(25.0)</b>	(25.6)
Tax	<b>(11.8)</b>	(5.4)
Net expenditure on tangible and intangible assets	<b>(31.8)</b>	(47.9)
Dividends from joint ventures	<b>37.2</b>	36.9
<b>Group free cash flow</b>	<b>94.2</b>	97.6
Disposal of business undertakings	<b>1.9</b>	3.3
Acquisition of subsidiaries	<b>(322.2)</b>	(7.4)
Financing	<b>289.0</b>	(71.0)
Special pension contribution	<b>-</b>	(51.0)
Dividends paid	<b>(21.6)</b>	(17.9)
Group net increase/(decrease) in cash and cash equivalents	<b>41.3</b>	(46.4)
Adjustment to include joint venture cash impacts	<b>2.8</b>	6.7
Net increase/(decrease) in cash and cash equivalents	<b>44.1</b>	(39.7)

Note: Group EBITDA is earnings from subsidiaries (excluding joint ventures) before interest, tax, depreciation, intangible amortisation and other non cash items.

### 3.1 Group operating cash flow

Group operating cash flow of £125.6m (2007: £139.6m) represents a conversion of Group EBITDA into cash of 85% (2007: 100%). The strong levels of organic growth in the business require working capital investment and this is reflected in the 2008 movement of £21.6m.

### 3.2 Interest

Net interest paid was £25.0m, compared to £25.6m in 2007.

### 3.3 Tax

Tax paid was £11.8m (2007: £5.4m). Tax paid in 2007 and the first half of 2008 was lower than expected as a result of the tax relief on the special pension contributions made in 2006 and 2007. The increase in 2008 reflected that there was no further tax relief available in the second half of the year on these contributions.

Cash tax is below the equivalent charge in the income statement as a result of accelerated capital allowances and other timing differences.

### 3.4 Net expenditure on tangible and intangible assets

Net expenditure on tangible and intangible assets in the year was £31.8m (2007: £47.9m). This comprised gross expenditure of £48.7m, representing 2.0% of revenue excluding joint ventures (2007: 2.2%), and disposals of £16.9m. The principal component of disposals was the sale and leaseback of a number of carriages on the Great Southern Railway in Australia. This follows similar transactions in previous years to

realise a further part of the substantial investment we have made in acquiring and successfully growing the business since 1999.

### **3.5 Dividends from joint ventures**

Dividends received from joint ventures totalled £37.2m (2007: £36.9m), a conversion rate of 84% (2007: 100%) of joint ventures' profit after tax and minority interest, excluding costs allocated by Group. This is in line with our expectation of a conversion rate in the range of 80-90%.

### **3.6 Disposal of business undertakings**

On 23 June 2008, the Group disposed of its equity stake in Kilmarnock Prison Services Ltd., in line with our strategy to realise cash from our equity and subordinated debt in private finance initiatives (PFI) projects. This disposal follows the sale of equity and subordinated debt in six PFI projects in 2006. Profit on disposal of the Kilmarnock stake was £2.7m, and the net cash inflow of £1.9m comprised gross sale proceeds of £6.2m offset principally by cash held within the entity to cover future debt repayments of £3.0m. We retain the operating contract for Kilmarnock prison.

### **3.7 Acquisition of subsidiaries**

Acquisition of subsidiaries principally comprises the acquisition of SI International, Inc. on 29 December 2008, a provider of information services, technology, and network solutions to the US Government, for £289.8m. The acquisition gave rise to goodwill of £305.2m. Intangible assets arising on the acquisition have been recognised at £51.8m and will be amortised on a straight-line basis over their expected lives. Given the proximity of the acquisition to the Group's year end, SI International, Inc. made no contribution to the Group's revenue, profit and operating cash flow in 2008.

Other acquisitions were InfoVision, an Indian business process outsourcing company, for which we paid £14.8m for an initial 60% shareholding in December 2008, and the Grosvenor Health Group, an occupational health service provider, acquired for £19.0m, in May 2008.

Fair values have been determined provisionally in respect of SI International, Inc. and InfoVision and may be subject to adjustment in the year.

### **3.8 Financing**

The movement in financing resulted primarily from a drawdown on our committed facilities to finance acquisitions made during the year.

#### 4. Net debt

Figure 3 analyses Serco's net debt.

**Figure 3: Net debt**

At	31 December 2008 £m	31 December 2007 £m
Group - cash and cash equivalents	199.8	138.1
Group - loans	(708.8)	(263.3)
Group - obligations under finance leases	(15.5)	(12.7)
<b>Group recourse net debt</b>	<b>(524.5)</b>	<b>(137.9)</b>
Joint venture recourse net cash	44.5	34.9
<b>Total recourse net debt</b>	<b>(480.0)</b>	<b>(103.0)</b>
Group non recourse debt	(34.1)	(59.3)
<b>Total net debt</b>	<b>(514.1)</b>	<b>(162.3)</b>

##### 4.1 Group recourse net debt

Group recourse net debt increased by £386.6m to £524.5m. The net impact of acquisitions in the year added £322.2m to net debt. Changes in currency exchange rates increased net debt by £32.3m. Group cash and cash equivalents rose to £199.8m, an increase of £61.7m, primarily reflecting periodic changes in working capital. Cash and cash equivalents includes encumbered cash of £10.4m (31 December 2007: £11.9m) which is cash securing credit obligations and customer advance payments.

##### 4.2 Group non recourse debt

The Group's debt is non recourse if no Group company other than the relevant borrower has an obligation to repay the debt under a guarantee or other arrangement. The debt is excluded from all of our credit agreements and other covenant calculations, and therefore has no impact on the Group's ability to borrow.

Group non recourse debt reduced by £25.2m to £34.1m, due to the disposal of our equity stake in Kilmarnock Prison Services Ltd. The remaining non recourse debt relates to our Driver Examination Services contract in Canada.

#### 5. Pensions

At 31 December 2008, the net liability included in the balance sheet arising from our defined benefit pension scheme obligations was £20.5m (31 December 2007: £52.2m), on an asset base of £1.2bn. The net liability has fallen principally as a result of changes in the RPI and discount rate assumptions used to value the scheme, partially offset by lower than expected equity returns in the year. Figure 4 provides further analysis.

**Figure 4: Defined benefit pension schemes**

At	31 December 2008 £m	31 December 2007 £m
Group schemes – non contract specific	<b>(0.7)</b>	(67.9)
Contract specific schemes:		
– reimbursable	<b>(89.6)</b>	(60.7)
– not certain to be reimbursable	<b>(24.4)</b>	(14.0)
Net retirement benefit liabilities	<b>(114.7)</b>	(142.6)
Intangible assets arising from rights to operate franchises and contracts	<b>14.4</b>	17.4
Reimbursable rights debtor	<b>89.6</b>	60.7
Deferred tax (liabilities)/assets	<b>(9.8)</b>	12.3
Net balance sheet liabilities	<b>(20.5)</b>	(52.2)

Serco has three main types of scheme which are accounted for as defined benefit pension schemes. Each type has its own accounting treatment under International Financial Reporting Standards. These are:

- Non contract specific – schemes which do not relate to specific contracts or franchises. For these schemes, we charge the actuarial gain or loss for the period to the consolidated statement of recognised income and expense (SORIE);
- Reimbursable – schemes where we have a right of full cost reimbursement and therefore include both the pension scheme deficit and offsetting reimbursable rights debtor in the balance sheet; and
- Not certain to be reimbursable – schemes relating to specific contracts or franchises, where the deficit will pass back to the customer or on to the next contractor at the end of the contract. For these schemes, we charge the actuarial gain or loss on our share of the deficit for the period to the SORIE, recognise a recoverable intangible asset on the balance sheet at the start of the contract or franchise and amortise the intangible asset to the income statement over the contract or franchise life.

Serco has limited commercial risk in relation to the contract specific schemes, due to either the right of cost reimbursement or because the deficit will, in general, pass back to the customer or on to the next contractor at the end of the contract. Among our non contract specific schemes, the largest is the Serco Pension and Life Assurance Scheme (SPLAS). At 31 December 2008, SPLAS had a surplus of £62.4m (31 December 2007: a deficit of £28.7m). This movement in the scheme position reflects the reduction in volatility afforded by the Liability Driven Investment (LDI) strategy introduced in 2007 and a change in inflation and discount rate assumptions.

Figure 5 shows the sensitivity of the liabilities of our pension schemes to changes in discount rates and to adjustments in the principal actuarial assumptions for the rate of inflation, members' salary increases and life expectancies.

**Figure 5: Pension assumptions and sensitivities**

	<b>Assumption</b>	<b>Change in assumption</b>	<b>Change in liability</b>
Discount rate	6.0%	+0.5% (0.5)%	(9)% +10%
Price inflation	2.6%	+0.5% (0.5)%	+7% (7)%
Salary inflation	3.1%	+0.5% (0.5)%	+3% (3)%
Longevity	20.3 – 24.4*	Increase by one year	+3%

\* Post retirement mortality range for male and female, current and future pensioners.

## 6. Treasury

In the year, the Group replaced its existing £400m bank credit facility with a new five-year £400m bank revolving credit facility which matures in September 2013. The Group also arranged a term loan and bilateral facility totalling US\$550m to fund the acquisition of SI International, Inc. The term loan and bilateral facility are repayable between September 2010 and September 2013. The facilities, which are syndicated with a group of 13 banks, are unsecured. As at 31 December 2008, £560m had been drawn down on these facilities.

Serco has also issued US private placement loan notes totalling £117m, which will be repaid evenly from 2011 to 2015.

In total, the Group has £900m of committed debt facilities available, giving significant headroom to fund working capital and other known requirements.

## 7. Going concern

The directors have acknowledged the guidance on going concern and financial reporting published by the Financial Reporting Council in November 2008. Whilst the current economic environment is uncertain, the Group is well placed to manage its business risks successfully, and has adequate resources to continue in operational existence for the foreseeable future, given that it has a balanced portfolio of principally long-term contracts, an order book of £16.3bn, over 90% of its revenues derived from governments, and substantial debt financing committed for the medium-term. As at 31 December 2008, the Group as a whole had revenue visibility of 90% for the next 12 month period based upon the order book. Visibility of planned 2010 and 2011 revenues are already 76% and 65% respectively. Accordingly, the Group has adopted the going concern basis in preparing the annual report and accounts.

## Consolidated income statement

For the year ended 31 December 2008

	Note	2008 £m	2007 £m
<b>Continuing operations</b>			
Revenue	2	3,123.5	2,810.7
Cost of sales		(2,666.7)	(2,404.5)
<b>Gross profit</b>		<b>456.8</b>	406.2
Administrative expenses		(291.6)	(264.2)
Other expenses – amortisation of intangibles arising on acquisition		(9.2)	(8.6)
Total administrative expenses		(300.8)	(272.8)
<b>Operating profit</b>	2	<b>156.0</b>	133.4
Investment revenue	3	8.2	12.2
Finance costs	3	(28.1)	(31.0)
<b>Profit before tax</b>		<b>136.1</b>	114.6
Tax		(36.5)	(32.2)
<b>Profit for the year</b>		<b>99.6</b>	82.4
Attributable to:			
Equity holders of the parent		99.5	81.9
Minority interest		0.1	0.5
<b>Earnings per share (EPS)</b>			
Basic EPS	4	20.49p	16.98p
Diluted EPS	4	20.18p	16.74p

### Consolidated statement of recognised income and expense

For the year ended 31 December 2008

	Note	2008 £m	2007 £m
Net actuarial gain on defined benefit pension schemes	9	8.7	62.2
Actuarial gain/(loss) on reimbursable rights	9	50.6	(19.4)
Net exchange gain on translation of foreign operations	9	54.1	12.8
Net fair value gain on cash flow hedges during the year	9	14.2	9.0
Tax charge on items taken directly to equity	9	(21.3)	(11.5)
Recycling of cumulative net hedging reserve on disposal	9	(0.7)	-
<b>Net income recognised directly in equity</b>		<b>105.6</b>	53.1
<b>Profit for the year</b>		<b>99.6</b>	82.4
<b>Total recognised income and expense for the year</b>		<b>205.2</b>	135.5
Attributable to:			
Equity holders of the parent		205.1	134.9
Minority interest		0.1	0.6

## Consolidated balance sheet

At 31 December 2008

	Note	2008 £m	2007 £m
<b>Non-current assets</b>			
Goodwill	5	964.7	542.1
Other intangible assets		191.3	139.4
Property, plant and equipment		115.4	95.1
Trade and other receivables		121.1	104.6
Retirement benefit assets		62.4	-
Deferred tax assets		19.6	51.6
Derivative financial instruments		5.6	1.2
		<b>1,480.1</b>	<b>934.0</b>
<b>Current assets</b>			
Inventories		50.2	46.3
Trade and other receivables		719.5	573.6
Cash and cash equivalents		250.8	185.0
Derivative financial instruments		5.0	1.5
		<b>1,025.5</b>	<b>806.4</b>
<b>Total assets</b>		<b>2,505.6</b>	<b>1,740.4</b>
<b>Current liabilities</b>			
Trade and other payables		(754.7)	(670.0)
Current tax liabilities		(19.5)	(14.8)
Obligations under finance leases		(4.5)	(7.7)
Loans		(36.8)	(13.5)
Derivative financial instruments		(4.2)	(2.1)
		<b>(819.7)</b>	<b>(708.1)</b>
<b>Non-current liabilities</b>			
Trade and other payables		(35.5)	(13.3)
Obligations under finance leases		(12.7)	(8.7)
Loans		(710.9)	(317.4)
Derivative financial instruments		(0.4)	(11.2)
Retirement benefit obligations		(177.1)	(142.6)
Provisions		(38.1)	(18.6)
Deferred tax liabilities		(25.9)	(22.0)
		<b>(1,000.6)</b>	<b>(533.8)</b>
<b>Total liabilities</b>		<b>(1,820.3)</b>	<b>(1,241.9)</b>
<b>Net assets</b>		<b>685.3</b>	<b>498.5</b>
<b>Equity</b>			
Share capital		9.7	9.7
Share premium account		301.1	299.3
Capital redemption reserve		0.1	0.1
Retained earnings	9	339.8	260.6
Retirement benefit obligations reserve	9	(47.7)	(90.2)
Share-based payment reserve	9	40.0	34.6
Own shares reserve	9	(19.7)	(15.1)
Hedging and translation reserve	9	61.9	(1.8)
<b>Equity attributable to equity holders of the parent</b>		<b>685.2</b>	<b>497.2</b>
<b>Minority interest</b>	9	<b>0.1</b>	<b>1.3</b>
<b>Total equity</b>		<b>685.3</b>	<b>498.5</b>

## Consolidated cash flow statement

For the year ended 31 December 2008	Note	2008 £m	2007 £m
<b>Net cash inflow from operating activities</b>	7	<b>162.6</b>	134.1
<b>Investing activities</b>			
Interest received		7.3	10.3
Disposal of business undertakings		1.9	2.5
Proceeds from disposal of intangible assets		-	1.7
Proceeds from disposal of property, plant and equipment		17.5	2.9
Acquisition of subsidiaries, net of cash acquired		(322.2)	(9.1)
Purchase of other intangible assets		(20.4)	(30.6)
Purchase of property, plant and equipment		(32.6)	(26.2)
<b>Net cash outflow from investing activities</b>		<b>(348.5)</b>	(48.5)
<b>Financing activities</b>			
Interest paid		(30.3)	(34.2)
Dividends paid		(21.6)	(17.9)
Dividend paid to minority interest		-	(1.2)
Repayment of borrowings		(78.6)	(74.6)
Repayment of non recourse loans		(7.5)	(8.3)
New loan advances		397.4	2.2
Other financing		(17.0)	-
Capital element of finance lease repayments		(8.6)	(8.4)
Purchase of own shares for employee benefit trust (ESOP)		(9.2)	-
Proceeds from issue of share capital and exercise of share options		5.4	17.1
<b>Net cash inflow/(outflow) from financing activities</b>		<b>230.0</b>	(125.3)
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>44.1</b>	(39.7)
<b>Cash and cash equivalents at beginning of year</b>		<b>185.0</b>	217.9
Net exchange gain		21.7	6.8
<b>Cash and cash equivalents at end of year</b>	8	<b>250.8</b>	185.0

## Notes to the Results Announcement

### 1. General information

The basis of preparation of this results announcement is set out below.

The financial information in this announcement, which was approved by the Board of Directors on 26 February 2009, does not constitute the Company's statutory accounts for the years ended 31 December 2008 or 2007, but is derived from these accounts.

Statutory accounts for 2007 have been delivered to the Register of Companies and those for 2008 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) of the Companies Act 1985.

The results announcement has been prepared in accordance with International Financial Reporting Standards (IFRSs) adopted for use in the European Union. Whilst the financial information included in this results announcement has been prepared in accordance with IFRS, this announcement does not itself contain sufficient information to comply with IFRS. The Company expects to publish full financial statements that comply with IFRS in April 2009.

The financial statements have been prepared on the historical cost basis.

## 2. Segmental information

The Group manages its business on a market segment basis and these segments are the basis on which the Group reports its primary segment information.

<b>Market segments</b>	<b>Civil Government</b>	<b>Defence</b>	<b>Transport</b>	<b>Science</b>	<b>Total</b>
<b>For the year ended 31 December 2008</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Revenue</b>	<b>1,127.3</b>	<b>785.8</b>	<b>670.8</b>	<b>539.6</b>	<b>3,123.5</b>
<b>Result</b>					
Segment result	55.2	59.1	29.7	51.6	195.6
Corporate expenses					(39.6)
<b>Operating profit</b>					<b>156.0</b>
Investment revenue					8.2
Finance costs					(28.1)
<b>Profit before tax</b>					<b>136.1</b>
Tax					(36.5)
<b>Profit for the year</b>					<b>99.6</b>

	<b>Civil Government</b>	<b>Defence</b>	<b>Transport</b>	<b>Science</b>	<b>Total</b>
<b>For the year ended 31 December 2007</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Revenue</b>	<b>952.2</b>	<b>720.5</b>	<b>655.0</b>	<b>483.0</b>	<b>2,810.7</b>
<b>Result</b>					
Segment result	46.8	49.8	26.7	45.7	169.0
Corporate expenses					(35.6)
<b>Operating profit</b>					<b>133.4</b>
Investment revenue					12.2
Finance costs					(31.0)
<b>Profit before tax</b>					<b>114.6</b>
Tax					(32.2)
<b>Profit for the year</b>					<b>82.4</b>

<b>Geographical segments</b>	<b>United Kingdom</b>	<b>North America</b>	<b>Europe and Middle East</b>	<b>Asia Pacific and India</b>	<b>Total</b>
<b>For the year ended 31 December 2008</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Revenue</b>	<b>2,334.6</b>	<b>369.9</b>	<b>237.2</b>	<b>181.8</b>	<b>3,123.5</b>

	<b>United Kingdom</b>	<b>North America</b>	<b>Europe and Middle East</b>	<b>Asia Pacific and India</b>	<b>Total</b>
<b>For the year ended 31 December 2007</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Revenue</b>	<b>2,125.6</b>	<b>300.9</b>	<b>222.1</b>	<b>162.1</b>	<b>2,810.7</b>

### 3. Investment revenue and finance costs

For the year ended 31 December 2008	2008 £m	2007 £m
Net fair value adjustments on derivative financial instruments	0.3	0.3
Interest receivable by PFI companies	1.0	3.2
Interest receivable on other loans and deposits	6.9	5.5
Net interest receivable on retirement benefit obligations	-	3.2
<b>Investment revenue</b>	<b>8.2</b>	12.2
Interest payable on non recourse loans	(2.7)	(3.7)
Interest payable on obligations under finance leases	(1.3)	(1.0)
Interest payable on other loans	(23.5)	(26.3)
Net interest payable on retirement benefit obligations	(0.6)	-
<b>Finance costs</b>	<b>(28.1)</b>	(31.0)
<b>Net finance costs</b>	<b>(19.9)</b>	(18.8)

#### 4. Earnings per share

Basic and diluted earnings per ordinary share (EPS) have been calculated in accordance with IAS 33 'Earnings per Share'. EPS is shown both before and after amortisation of intangible assets arising on acquisition to assist in the understanding of the underlying performance of the business.

The calculation of the basic and diluted EPS is based on the following data:

Number of shares	2008	2007
	Millions	Millions
Weighted average number of ordinary shares for the purpose of basic EPS	485.7	482.4
Effect of dilutive potential ordinary shares: share options	7.3	6.8
Weighted average number of ordinary shares for the purpose of diluted EPS	493.0	489.2

Earnings	2008		2007	
	Earnings £m	Per share amount Pence	Earnings £m	Per share amount Pence
Earnings for the purpose of basic EPS being net profit attributable to the equity holders of the parent	99.5	20.49	81.9	16.98
Add back:				
Amortisation of intangible assets arising on acquisition, net of tax of £0.9m (2007: £0.9m)	8.3	1.71	7.7	1.59
Adjusted earnings before amortisation of intangible assets arising on acquisition	107.8	22.20	89.6	18.57
Earnings for the purpose of basic EPS	99.5	20.49	81.9	16.98
Effect of dilutive potential ordinary shares	-	(0.31)	-	(0.24)
Diluted EPS	99.5	20.18	81.9	16.74

#### 5. Goodwill

	2008 £m
<b>Cost</b>	
At 1 January 2008	542.1
Additions during the year	367.6
Foreign exchange translation differences	55.0
<b>At 31 December 2008</b>	<b>964.7</b>

The additions to goodwill in the year were in relation to the acquisitions of SI International, Inc. (£305.2m), Amtech Private Limited (InfoVision) (£42.2m) and Grosvenor Health Limited (£20.2m). Details of the acquisition of SI International, Inc. are disclosed in note 6.

## 6. Acquisition of SI International, Inc.

On 29 December 2008, Serco acquired 100% of the issued share capital of SI International, Inc. for consideration of £295.8m in cash. SI International, Inc. is a provider of information services, technology and network solutions to the US Government.

Due to the completion of the transaction being so close to the Group's own year end, the fair values of SI International's assets, liabilities and contingent liabilities, have been determined provisionally.

This transaction was accounted for in accordance with IFRS 3 'Business Combinations'.

Net liabilities acquired were:

	Book value £m	Provisional fair value adjustments £m	Provisional fair value £m
Goodwill	182.5	(182.5)	-
Intangible assets	15.3	36.5	51.8
Property, plant and equipment	9.1	(3.8)	5.3
Trade and other receivables	93.8	(2.3)	91.5
Cash and cash equivalents	13.2	-	13.2
Trade and other payables	(64.3)	2.3	(62.0)
Loans	(69.9)	-	(69.9)
Deferred tax liabilities	(11.2)	(3.0)	(14.2)
Provisions	-	(25.1)	(25.1)
<b>Net liabilities acquired</b>	<b>168.5</b>	<b>(177.9)</b>	<b>(9.4)</b>
Goodwill			305.2
<b>Total consideration</b>			<b>295.8</b>
<b>Satisfied by</b>			
Purchase consideration			289.8
Directly attributable costs			6.0
<b>Total consideration</b>			<b>295.8</b>
<b>Net cash outflow arising on acquisition</b>			
Purchase consideration			(289.8)
Directly attributable costs*			(12.8)
Cash and cash equivalents acquired			13.2
			<b>(289.4)</b>

\* Directly attributable costs include £6.8m of acquisition costs incurred by SI International, Inc. but which were paid post acquisition. In accordance with IFRS 3, these costs have not been capitalised.

Provisions arising on the acquisition of SI International, Inc. relate principally to property and contracts.

Due to the proximity of the acquisition date of 29 December 2008 to the Group's year end, SI International, Inc., did not contribute to either the revenue or the profit before tax of the Group. If the acquisition had taken place at the start of the year, the Group's revenue and profit before tax would have been approximately £308.3m and £13.7m higher, respectively.

SI International, Inc. and Serco's existing North American business will be combined, and the combination will enhance Serco's ability to deliver integrated solutions to the US federal government services market. The goodwill arising on the acquisition of £305.2m is attributable to the anticipated profitability arising from new business and the anticipated future operating synergies from the combination.

## 7. Reconciliation of operating profit to net cash inflow from operating activities

	2008 £m	2007 £m
<b>Operating profit for the year</b>	<b>156.0</b>	133.4
Adjustments for:		
Share-based payment expense	7.0	5.0
Depreciation of property, plant and equipment	26.0	30.2
Amortisation of intangible assets	29.3	23.2
(Profit)/loss on disposal of property, plant and equipment	(4.6)	1.3
Profit on disposal of business undertakings	(2.7)	(0.7)
Movement in provisions	(9.0)	(4.3)
Gain on derivatives	(1.2)	(1.1)
<b>Operating cash inflow before movements in working capital</b>	<b>200.8</b>	187.0
Decrease in inventories	0.9	5.9
Decrease/(increase) in receivables	12.2	(99.9)
(Decrease)/increase in payables	(26.4)	108.6
Special contribution to defined benefit pension scheme	-	(51.0)
<b>Cash generated by operations</b>	<b>187.5</b>	150.6
Tax paid	(24.9)	(16.5)
<b>Net cash inflow from operating activities</b>	<b>162.6</b>	134.1

## 8. Analysis of net debt

	At 1 January 2008 £m	Cash flow £m	Acquisitions/ disposals £m	Exchange differences £m	Non cash movements £m	At 31 December 2008 £m
Cash and cash equivalents	185.0	33.0	11.1	21.7	-	250.8
Non recourse loans (related to PFI assets)	(22.5)	1.6	20.9	-	-	-
Other non recourse loans	(36.8)	5.9	-	(3.2)	-	(34.1)
Other loans	(271.6)	(318.8)	(72.9)	(50.3)	-	(713.6)
Obligations under finance leases	(16.4)	8.6	-	(0.5)	(8.9)	(17.2)
	<b>(162.3)</b>	<b>(269.7)</b>	<b>(40.9)</b>	<b>(32.3)</b>	<b>(8.9)</b>	<b>(514.1)</b>

Non cash movements in 2008 relate to finance leases.

## 9. Reserves

	Retained earnings £m	Retirement benefit obligations reserve £m	Share-based payment reserve £m	Own shares reserve £m	Hedging and translation reserve £m	Total £m	Minority interest £m
<b>At 1 January 2008</b>	260.6	(90.2)	34.6	(15.1)	(1.8)	188.1	1.3
Profit for the year attributable to equity holders of the parent	99.5	-	-	-	-	99.5	-
Profit for the year attributable to minority interest	-	-	-	-	-	-	0.1
Dividends paid	(21.6)	-	-	-	-	(21.6)	-
Net actuarial gain on defined benefit pension schemes	-	8.7	-	-	-	8.7	-
Actuarial gain on reimbursable rights	-	50.6	-	-	-	50.6	-
Credit in relation to share-based payment expense	-	-	7.0	-	-	7.0	-
Net exchange gain on translation of foreign operations	-	-	-	-	54.1	54.1	-
Net fair value gain on cash flow hedges during the year	-	-	-	-	14.2	14.2	-
Purchase of own shares for employee benefit trust (ESOP)	-	-	-	(9.2)	-	(9.2)	-
Exercise of share options	-	-	(1.0)	4.6	-	3.6	-
Tax charge on cash flow hedges	-	-	-	-	(3.9)	(3.9)*	-
Tax charge on items taken directly to equity	-	(16.8)	(0.6)	-	-	(17.4)*	-
Recycling of cumulative net hedging reserve on disposal	-	-	-	-	(0.7)	(0.7)	-
Acquisition of minority interest by joint venture	1.3	-	-	-	-	1.3	(1.3)
<b>At 31 December 2008</b>	<b>339.8</b>	<b>(47.7)</b>	<b>40.0</b>	<b>(19.7)</b>	<b>61.9</b>	<b>374.3</b>	<b>0.1</b>

\* In 2008, these amounts represent £21.3m of a net tax charge taken directly to equity in the SORIE (2007: £11.5m). The net movement of £21.3m consists of £22.2m of deferred tax and a credit of £0.9m relating to current tax.

## 10. Joint ventures

The Group's interest in joint ventures are reported in the consolidated financial statements using the proportionate consolidation method.

The effect of the Group's joint ventures on the consolidated income statement is as follows:

<b>For the year ended 31 December 2008</b>	<b>2008</b>	2007
	<b>£m</b>	£m
Revenue	<b>719.7</b>	680.1
Expenses	<b>(671.4)</b>	(638.9)
Operating profit	<b>48.3</b>	41.2
Investment revenue	<b>5.1</b>	4.9
Finance costs	<b>(0.7)</b>	(0.9)
Profit before tax	<b>52.7</b>	45.2
Tax	<b>(13.2)</b>	(12.1)
Profit for the year	<b>39.5</b>	33.1
Minority interest	-	(0.3)
Share of post-tax results of joint ventures	<b>39.5</b>	32.8

Operating profit is after allocating £4.7m (2007: £4.0m) of costs incurred by Group.