Serco Investor Pack

Serco Group plc

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Strategy overview

Our strategy: be a focused B2G business

1. Be a superb provider of public services by becoming the best managed company in the sector

2. Focus on 5 pillars across 4 geographies: Defence, Justice & Immigration, Transport, Health and Citizen Services, delivered in UK & Europe, North America, Middle East and Asia Pacific

3. Exit non-core businesses

The Elevator Speech

"We are a leading provider of public services.

Our customers are governments or others operating in the public sector.

We gain scale, expertise and diversification by operating internationally across five sectors.

We will succeed and be differentiated by being the best managed business in the sector."

‘Four Forces’ creating long term structural growth in the market

Growing costs: healthcare, ageing population and infrastructure

Voters unwilling to tolerate higher taxation

Public Policy

Rising expectations of service quality

Need to balance public income and expenditure, and reduce debt

Fierce pressure on governments to deliver more, and better, for less

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Our strategy: be a focused B2G business

1. Be a superb provider of public services by becoming the best managed company in the sector

- Improve cost competitiveness
- Strengthen BD and risk management
- Drive operational excellence: management information systems and continuous improvement
- People: build talent and capabilities

2. Focus on five pillars in four regions

- Defence, Justice & Immigration, Transport, Health and Citizen Services; delivered in UK & Europe, North America, Middle East and Asia Pacific
- Structural drivers of growth
- Strong existing positions
- Reduced volatility through segment and regional diversification
- Ability to build international scale

3. Exit non-core businesses

- Private Sector BPO
- Great Southern Rail in Australia
- Leisure and Environmental Services in the UK (subsequently retained)

The plan in a nutshell

Our Ambition
To be a superb provider of public services by being the best managed business in our sector

2014 **Stabilise**

- Hire new management
- Identify issues
- Develop strategy and implementation plan
- Undertake Contract and Balance Sheet Review
- Stabilise morale
- Roll out corporate renewal

2015-17 **Transform**

- Strengthen balance sheet
- Rebuild confidence and trust
- Improve risk management
- Rationalise portfolio
- Mitigate loss-making contracts
- Strengthen sector propositions
- Re-build business development and pipeline
- Build differentiated capability
- Improve execution and cost efficiency

2018-20 **Grow**

- Harvest benefits of transformation
- Leverage scale and capability
- Build out geographical footprint
- Move into new sub-segments
- Continuously review portfolio

Planned Outcome

Chosen sectors will grow at c.5-7%

Industry margins in our sectors c.5-6%

We believe our performance can match this

Executing the Strategy – 2015 achievements

A superb provider of Public Services

The best run business in our sector

Theme	**Winning good business**	**Executing brilliantly**	**A place people are proud to work**	**Profitable and sustainable**
2015 Delivery	**Rebuild our pipeline**	**Build capability & efficiency**	**Energise our people**	**Strengthen financial performance**
	• Started to develop sector propositions • Created new Centres of Excellence – Transport, Health, J&I • Pipeline starts to grow	• Upgraded systems infrastructure and management information • Improved bidding and DPR processes • Implemented some more cost efficient structures	• Built confidence in our strategy • Improved talent management and hired some great people • Increased staff engagement	• Refinanced • Reduced debt • Mitigated some loss-making contracts • Reduced total costs • Beat our budgets

Executing the Strategy – 2016 actions

A superb provider of Public Services

The best run business in our sector

	Winning good business	Executing brilliantly	A place people are proud to work	Profitable and sustainable
Theme	**Winning good business**	**Executing brilliantly**	**A place people are proud to work**	**Profitable and sustainable**
2016 Focus	**Rebuild our pipeline**	**Build capability & efficiency**	**Energise our people**	**Strengthen financial performance**
	• Build effectiveness of our CoEs • Grow pipeline in key markets • Position to win key bids and re-bids • Ready to deliver growth in 2018 and beyond	• Deliver operationally • Improve performance of onerous contracts • Develop Continuous Improvement • Increase cost efficiency • Improve quality of shared services	• Launch Values • Make "Serco & Proud of it" come alive • Introduce Management Programme • Rebuild confidence / sense of momentum	• Drive down overheads and other non-direct support costs • Identify and understand risks and manage them well • Minimise cash outflow • Make our budgets

Historical context to 2014/15 Strategy Review

Historically, Serco's strategy had been to grow through diversification

The decade to 2010 was a time of bold expansion for Serco, with a series of acquisitions and strong organic growth. Double digit revenue and earnings CAGR.

From 2008, conditions in core markets became tougher

- Sharp public expenditure cuts in the UK and US in response to global financial crisis; growing sophistication of government contracting, with emphasis on risk transfer; increasing competition attracted by growth rates and margins

In response to this, in 2010 Serco adopted a strategy to further diversify

- Build a Business Process Outsourcing (BPO) capability in the private-sector, to be achieved largely through acquisition
- Apply skills and assets acquired from private sector BPO into the public sector; leverage Serco footprint, distribution, brand and infrastructure to add value to private sector BPO acquisitions
- Continue to grow revenues in the public sector market despite hardening conditions
- Improve the operating efficiency of the business: implement a global SAP platform with a shared services model for IT, Finance and HR

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2010 strategy had not worked as anticipated

Conception

- Serco was not able to add enough value to the private sector BPO businesses it acquired
- Serco's sales and marketing engine was unsuited to selling to private sector clients
- Public sector not as receptive as expected to private sector practices - eg offshoring, whole department outsourcing

Execution

- Poor integration of private-sector BPO acquisitions
- Insufficiently robust controls on bidding and risk management in some contracts; internal focus on revenue growth rather than risk and returns on capital
- Poorly executed moves into new segments - e.g. clinical healthcare and asylum seeker housing in UK
- Poor implementation of centralised shared services and weak reporting environment

Events

- Electronic Monitoring (EM) and prisoner escorting (PECS) contracts debacle in 2013
- Major contracts reduced in volume or margin, lost on re-bid or taken in-house
- Impact of volatility in the number of Illegal Maritime Arrivals (IMAs) in Australia
- Threat of sequestration in US prejudiced long-term projects

Serco faced a number of specific challenges, which are also opportunities

Need to build a solid platform

- Constrained balance sheet
- Loss-making contracts
- Need to strengthen Group-wide reporting and management information

Inefficient processes

- Opportunity to reduce the cost base and make better use of economies of scale

Need to position for growth

- Need to improve business development and risk management
- Need to build talent and capability

Our challenges were in our control and resolvable over time

Strategy Review criteria and objectives

CRITERIA - Strategy with greatest opportunity for value creation

- Balancing risk and reward
- Playing to our strengths
- Preference for markets with underlying structural growth
- Preference for simplicity and clarity

OBJECTIVE - Deliver long-term value to all stakeholders

- To shareholders: sustainable increases in value with an appropriate risk/reward profile
- To customers: excellent, reliable and innovative services
- To colleagues: rewarding careers; interesting and worthwhile work

Strategy Review – our reasons for confidence at the outset

We have a strong core business providing public services

- £3bn of core revenues; present in the largest public sector services markets
- Trusted supplier of critical services across a broad range of activities
- We are well-placed to provide what the public sector needs
- Customers value what we do, and how we do it

Our challenges are within our power to resolve

- People, people, people
- Management, management, management

By resolving those challenges we can deliver growth and increase value

- To shareholders: growing and sustainable value
- To customers: innovative, reliable services which deliver more and better for less
- To colleagues: rewarding and interesting careers

The secret of success

- Accurate analysis of the current position – we think we have done it
- A good strategy – we think we have got it
- Executed immaculately – we think we can do it

But . . . it will take time, progress will not be smooth, and we will need to adapt to events and keep portfolio under review

What we do

Focus on five sectors across four regions

FY15 revenue excluding private sector BPO, including share of JVs

£m Sector	UK & Europe	Americas	Middle East	Asia Pacific		
Defence	680	279	34	76	**£1,069m**	27%
Justice & Immigration	250			279	**£529m**	14%
Transport	496	93	181	67	**£837m**	21%
Health	324		8	84	**£416m**	11%
Citizen Services	629	322	68	44	**£1,063m**	27%
Total	**£2,379m** 61%	**£694m** 18%	**£291m** 7%	**£550m** 14%	**£3,914m**	

- Strong
- Foundation
- Exploring

Note: Revenue reflects £3,177m for Continuing Operations only (therefore excluding the discontinued £338m Global Services division, consisting of private sector BPO operations) and adjusted to include Serco's share of joint ventures revenue of £737m.

Defence: What we do

2015 Revenue

£1,069m
inc JV

% Service Line Split (approx.)

Base & op. support	Engineering, equipment & information	Maritime services	Whole enterprise transformation
30	15	25	30

% Group Revenue

27

What we do	Example contracts
Base and operational support Full service life cycle support to military bases, operations, acquisitions and programmes	• Defence Academy Campus Integrator (UK) • RAF Valley (UK) • Price fighter (US)
Engineering, equipment and information services Engineering, installation and maintenance of complex systems and networks	• Skynet 5 (UK) • Sea Enterprise (US)
Maritime services Operations, installations and maintenance support to military vessels	• Future Provision of Marine Services (UK) • Armidale Class Patrol Boats (Aus) • Consolidated Afloat Networks and Enterprise Services (US)
Whole enterprise transformation Management and transformation of public sector enterprises on behalf of government departments	• Atomic Weapons Establishment (UK) • Defence Business Services (UK)

Note: Revenue numbers extracted from management information, have not been audited and include Serco's share of joint ventures.

Justice & Immigration: What we do

2015 Revenue

£529m

% Service Line Split (approx.)

Immigration	Justice
45	55

% Group Revenue

14

What we do

Justice services
Prison operations, rehabilitation programmes and prisoner escorting services

Immigration services
Detention centre management, transport and support services for immigrants and asylum seekers

Example contracts

Justice services:

- Thameside (UK)
- Auckland South (NZ)
- Dovegate (UK)
- Acacia (Aus)
- Wandoo Youth Reintegration (Aus)
- Doncaster (UK)
- Western Australia Custodial Services
- Prisoner Escorting & Custody Services (UK)

Immigration services:

- COMPASS asylum seeker accommodation (UK)
- Yarl's Wood immigration removal centre (UK)
- DIBP onshore immigration detention centres (Aus)

Note: Revenue numbers extracted from management information, have not been audited and include Serco's share of joint ventures.

Transport: What we do

2015 Revenue

£837m
inc JV

% Service Line Split (approx.)

Rail and ferry services	Road and traffic fleet	Air Traffic control
70	20	10

% Group Revenue

21

What we do	Example contracts
Rail and ferry services Full service management of light and heavy rail systems	• Dubai Metro • Mersey Rail (UK) • Caledonian Sleeper (UK) • Northern Isles Ferries (UK) • Previous operator of DLR and NR (UK)
Road traffic and fleet management Delivery of traffic and transport management services	• Georgia DoT (US) • Hong Kong transport operations • London Cycle Hire Scheme (UK)
Air Traffic Control Full service delivery of aircraft navigation services	• Dubai • Sharjah • Baghdad • FAA Towers (US) • Scatsca (UK)

Note: Revenue numbers extracted from management information, have not been audited and include Serco's share of joint ventures.

Health: What we do

2015 Revenue

£416m

% Service Line Split (approx.)

45	35	20
Non-clinical support	Processing, patient admin and care coordination	Specialist clinical support

% Group Revenue

11

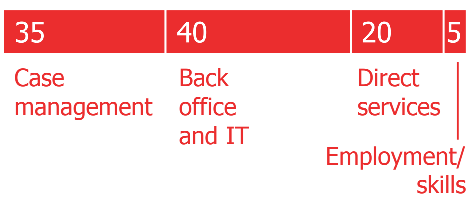
What we do	Example contracts
Non-clinical support services Full service offering covering all non-clinical aspects of support to acute hospitals	• Norfolk & Norwich hospital (UK) • Fiona Stanley hospital (Australia) • Forth Valley hospital (UK) • East Kent hospitals (UK) • Dr. Sulaiman Al Habib Hospitals (Saudi Arabia)
Specialist clinical support Clinical support in pathology and legacy contracts in exited clinical health market	• Guys & St. Thomas' Pathology JV (UK)
Processing, patient administration and care coordination Management of patient journey and experience alongside BPO in Healthcare environment and procurement support	• Anglia Support Partnership (UK) • NHS Trust procurement support (UK)

Note: Revenue numbers extracted from management information, have not been audited and include Serco's share of joint ventures.

Citizen Services: What we do

2015 Revenue

% Service Line Split (approx.)



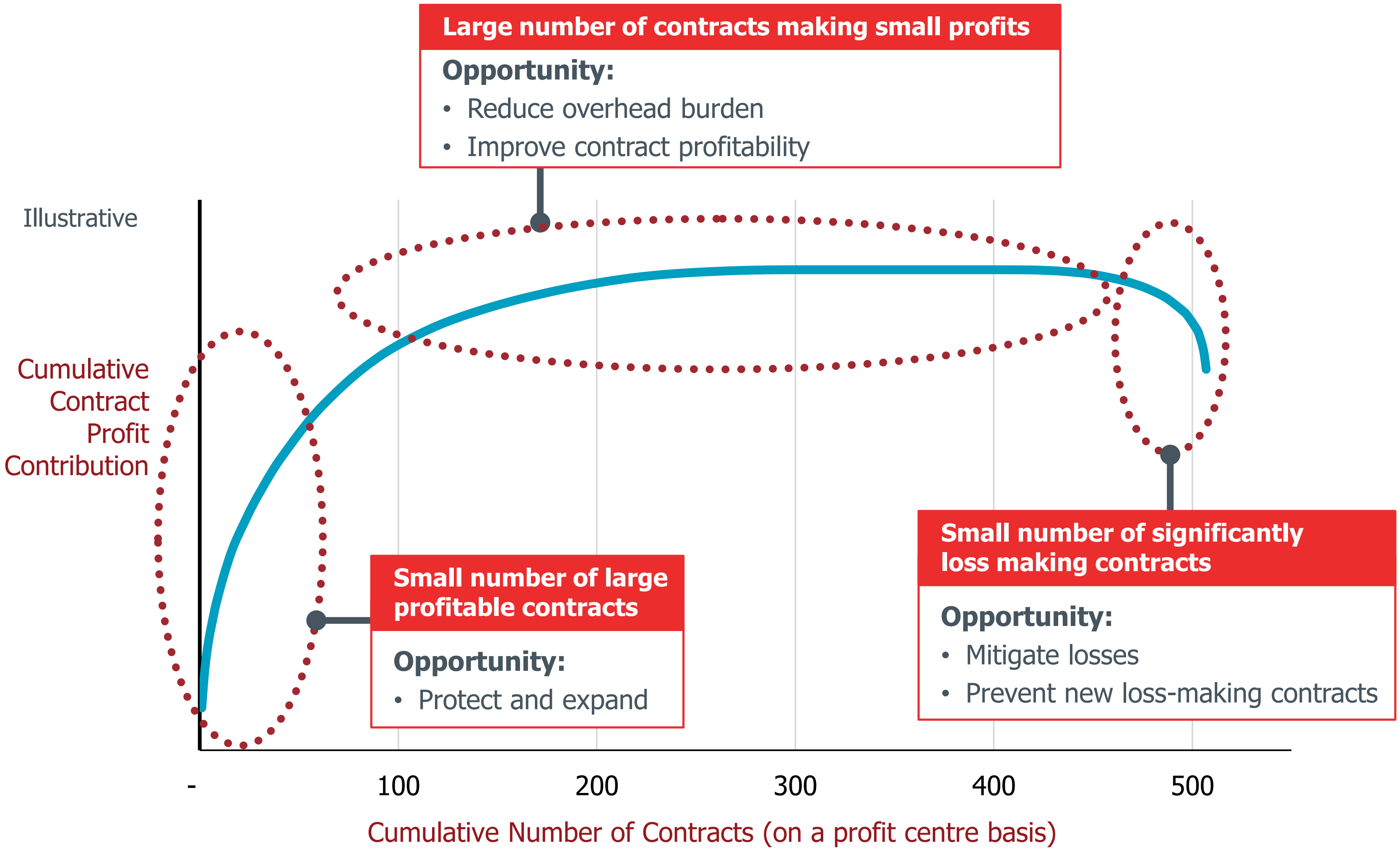
% Group Revenue

What we do	Example contracts
Case management Front & middle office case management services for Government programmes	• Centers for Medicare and Medicaid Services (US) • Child Maintenance Group (UK) • UCAS contact centre (UK)
Back office and IT support Internal process management of records, data and employee service	• Glasgow Access (UK) • Service Center Operations Support Services II and Federal Retirement Thrift Investment Board (US) • Australian Tax Office
Employment and skills services Providing better outcomes for jobseekers and apprentices	• Work Programme (UK)
Other direct services Environmental, leisure and other facilities management services	• Sandwell environmental services (UK) • Melbourne Parks and Gardens (Aus) • Sport England (UK)

Note: Revenue numbers extracted from management information, have not been audited and include Serco's share of joint ventures.

Creating a strong financial base in FY14/15

Contract portfolio background: 2014 profit contribution



FY14 Contract and Balance Sheet Review

Total impact of Contract & Balance Sheet Review broadly in line with November 2014 expectations

All charges represent necessary revisions to accounting estimates rather than errors arising from prior years

- Review undertaken in H2 2014 with support of EY
- Risk-based review of contracts and balance sheets across Serco
  - 19 full scope reviews
  - 114 specific scope reviews
- Outcome broadly in line with November 2014 guidance of 'around £1.5bn'
- Onerous contract Provisions (OCPs), impairments and other balance sheet charges total £1.3bn of review items
  - Separate exceptional items for DLR pension settlement and GSR impairments and charges; these total £0.1bn and were included within our previous guidance
- Key line item within the review items are the OCPs due to their future cash flow impact

FY14 Review items

Total impact of Contract & Balance Sheet Review broadly in line with November 2014 expectations

OCPs represent the estimated cumulative future losses for 2015 to end of contract, and are the major element of the charge with a future cash flow impact

£m	Onerous contract losses and related impairments	Other impairments and charges	**Total charge to operating profit**
Items charged to Trading Loss:			
OCPs for future year contract losses	(433)	-	(433)
Intangible fixed asset impairments and write-downs	(9)	(18)	(26)
Property, plant and equipment impairments	(19)	(3)	(22)
Impairment of receivables and other assets	(87)	(62)	(149)
Other provisions and accruals	(10)	(105)	(115)
Total items charged to Trading Loss	**(558)**	**(188)**	**(745)**
Impairment of intangibles arising on acquisition	(6)	(6)	(12)
Total items charged to loss before exceptionals	**(564)**	**(194)**	**(758)**
Exceptional items:			
UK clinical health OCP	(14)	-	(14)
UK clinical health other charges	(2)	-	(2)
Other provision for legal claims	-	(20)	(20)
Impairment of Global Services re held for sale	-	(39)	(39)
Impairment of goodwill	-	(466)	(466)
Total items charged to exceptionals	**(16)**	**(525)**	**(541)**
Total charge to operating loss	**(580)**	**(719)**	**(1,299)**

FY14 OCPs and related charges

£447m Onerous Contract Provisions (OCPs) represent the estimated cumulative future losses for 2015 to end of contract, and have a future cash flow impact

£133m of related impairments and charges, non-cash

£m	Onerous contract provisions for future year contract losses	Related impairments and charges	**Total charge to operating profit**
Items charged to Trading Loss:			
ACPB	(136)	(60)	(196)
COMPASS	(112)	(3)	(115)
FPMS	(50)	(15)	(65)
PECS	(14)	(13)	(27)
Ashfield	(15)	(4)	(19)
Five largest	**(327)**	**(95)**	**(422)**
Other	(106)	(29)	(135)
Total items charged to Trading Loss	**(433)**	**(124)**	**(558)**
ACPB - Impairment of intangibles arising on acquisition	-	(6)	(6)
Total onerous contracts charged to operating loss before exceptional items	**(433)**	**(130)**	**(564)**
UK clinical health exceptional charges	(14)	(2)	(16)
Total onerous contract charges to operating loss	**(447)**	**(133)**	**(580)**

Background to capital structure strategy

- Capital structure medium term leverage target of 1-2x net debt to EBITDA (based on covenant definition) to ensure strength and flexibility to delivery turnaround
- Increased need for a strong balance sheet given
  - Clear message from our customers that they are looking for Serco to emerge with a very strong funding position
  - Greater outflow and risks related to OCP contracts (£139m projected outflow in 2015)
- Starting point: net debt per covenant definition of £658m at 31 December 2014, but
  - Greater cash outflow anticipated for 2015, driven by OCP'd contracts and further unwind of year-end net debt versus average net debt; net cash outflow pre rights issue and any disposals of £150-200m
- 2015 assessment therefore based on £800m+ average net debt
- EBITDA per covenant definition of ~£160m forecast for 2015
- Proposed rights issue net proceeds of £530m necessary to appropriately reduce leverage to around 2x target
- Proceeds from planned disposals, together with medium term recovery in profitability and cash conversion, expected to further reduce leverage to the lower end of target range
- Strong capital structure from which to build Serco's future

Refinancing completed in March 2015

- Negotiations with private placement noteholders and lending banks completed in March 2015
  - Maintained 100% support
  - Extended RCF maturity from 2017 to 2019 + 1 year extension option
  - Maintained private placement maturity profile out to 2024
  - Make whole payments, arrangement fees and other costs of ~£30m
  - Debt agreement contingent was on successful completion of the rights issue
  - December 2014 covenant test on a rights issue pro forma basis, excluding review items
- Limited increase in pricing
  - Blended note coupon ~5% (from ~4%)
  - RCF all-in drawn rate ~2.6% (from ~2.5%)
- Two key financial covenants unchanged and with increased flexibility
  - Net debt/EBITDA <3.5 times
  - EBITDA/Interest cover >3 times
  - EBITDA continues to follow statutory profit definition, ie includes the credit to the income statement from OCP utilisation; net borrowings will though reflect the cash outflow on OCP-related contracts
  - Flexibility increase includes any future OCP has charge spread aligned with cash profile

Rights issue completed in April 2015

Size

- Gross proceeds of approximately £555m, net proceeds of £530m
- Fully underwritten

Structure

- Shareholders granted transferable subscription entitlements ("Rights")
- Applications made to the UKLA and to the LSE for the New Ordinary Shares (nil and fully paid) to be admitted to the premium listing segment of the Official List and to trading on the LSE main market for listed securities respectively

Terms

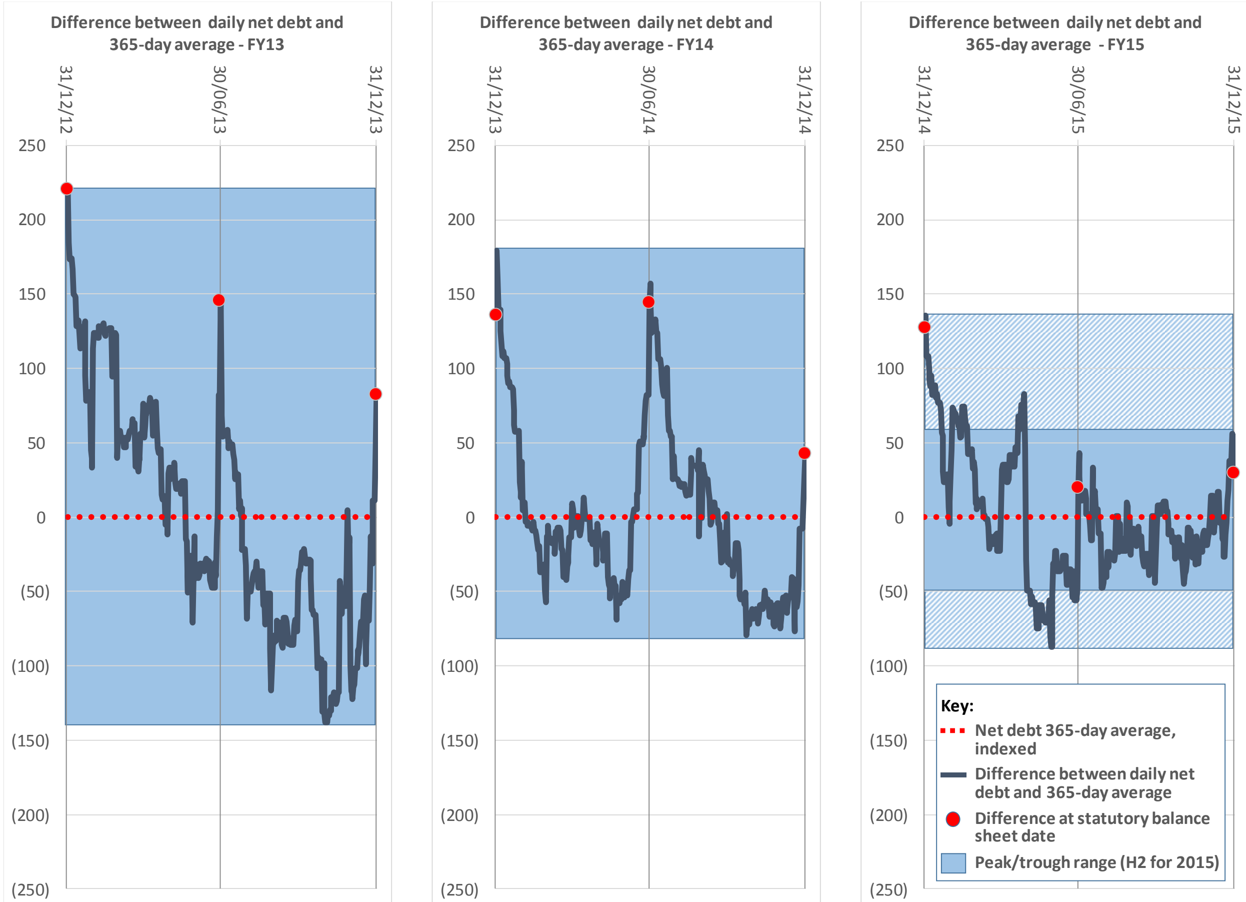
- 1 for 1 issue of new shares at 101p per share
- Discount to Theoretical Ex-Rights Price ("TERP") of 34.3% based on closing price of 206p of Serco's Ordinary Shares on the LSE at 11 March 2015
- Shareholder general meeting approval of 99.93%

Cash management normalisation

Previous cash management now largely unwound, removing optical benefit at the open/mid/closing statutory dates and narrowing the in-year cash cycle swings

For FY13, the 3-point statutory average net debt was £149m better than the 365-day average

By not repeating previous actions this had reduced to £108m for FY14, £59m for FY15 and £34m for 2H15



The impact of net proceeds from the May 2014 Placing, the April 2015 Rights Issue and refinancing, and the December 2015 BPO disposal are all removed from the net debt average used in the above charts.

Strategic focus on sustainable shareholder value creation - key to re-establishing a strong base from which to rebuild

- Quality core - a more focused business with a clear strategic direction
  - While some challenging market conditions and outlook for 2015-2017, customer demand and Serco's strong positioning should support a market-driven return to growth and recovery in margins over the longer term
  - Additional self-help on cost efficiencies a key component of margin recovery
- Loss-making contracts a key management focus and will have a reducing drag
  - Income statement impact neutralised by OCP
  - Balance sheet OCP 'liability' reduces each year
  - Cash performance improves with performance recovery and/or run-off
- Established a clear focus on ROIC, risk-adjusted for internal hurdles
- Exit of non-core businesses to support focus on B2G strategy implementation
- Sustainable financing, capital structure and cash management established

Path to longer term recovery of good growth, at the right margin, driven by an unwavering focus on appropriate risk/return metrics

Latest performance: HY16

HY16: Performance ahead of our expectations

Trading better

- Underlying Trading Profit up 9% at £51.0m (£49.6m constant currency)
- Trading Profit up 14% at £71.7m
- Good progress on loss-making contracts: OCP utilisation £22m lower than HY15, and a net £17m release from reduction in estimates of future losses and liabilities

Progress on wins and pipeline

- £0.9bn signed contracts; £9.7bn order book; pipeline increase to £7.3bn, up £0.8bn in period and £2.3bn year-on-year

Strong balance sheet

- Leverage steady at 0.75x EBITDA; sharply improved Trading Cash Flow, inflow of £19m versus outflow of £50m

Good progress on putting strategy into action

- Costs down by ~£550m on an annualised basis, and in proportion with revenue reduction
- Improved systems, employee engagement and customer relationships

Guidance increased

- 2016: ~£3.0bn Revenue and Underlying Trading Profit of not less than £80m; increase reflects a continued slightly better trading performance and FX benefit
- 2017: View not materially changed on a constant currency basis

HY16 highlights & lowlights

Highlights

- Better trading performance than we expected; outlook for 2016 increased
- Cost savings running ahead of plan; ~£550m annualised reduction and in proportion with revenue
- Losses on OCP contracts reducing; £22m lower utilisation in H1, and estimates of future losses and liabilities reduced by £17m
- £0.9bn order intake; pipeline reloaded and increased to £7.3bn
- Attracting strong talent into the business
- Progress on systems, employee engagement and customer relationships
- Ahead of plan for UK private sector BPO exit
- Strong Balance Sheet: better net debt and leverage outlook
- Pension surplus increases by £20m

Lowlights

- Significant proportion of better than expected performance in H1 due to items that will not repeat
- H2 profits will be much lower than H1
- Low level of new work bid and won in period; low win rate on larger bids
- Pipeline not yet strong enough to return us to growth at current conversion rates
- Pressure on ad hoc, project and volume-related work
- Several contracts still operational 'hotspots': Doncaster prison, Lincolnshire CC, Ontario DES
- Brexit

UK Central Government

HY16 Revenue

£349m
(£17m)
constant FX
(5%)

% Group Revenue

23

Underlying Trading Profit

£33.4m
+£8.7m
constant FX
+35%

Sectors

Defence, Justice & Immigration, Transport

- **Organic revenue decline:** -5%. Transfer of DSTL and DBS, end of two other small defence contracts, end of EM support; only partially offset from growth elsewhere (Sleeper and COMPASS).
- **UTP margin up:** 9.6%, or 5.9% JV-adjusted. Strong AWE and Northern Rail contributions; contract attrition more than offset by other cost efficiencies.
- **OCPs:** £18m utilisation, in line with expectations. Releases on FPMS (operational improvements), Ashfield (re-pricing) and YJB (transfer).
- **Contracts awards:** ~£70m. Mainly smaller rebids/extensions. CalMac ferries unsuccessful.
- **FY16 outlook and future rebids:** ~£70m/10% revenue decline for FY. H2 profit pressure from JV reductions. 8 major rebids/extensions 2016-18, ~30% of revenue base.
- **Pipeline:** Defence Fire & Risk Management Organisation; other Defence prospects and longer term Justice potential.

UK & Europe, Local and Regional Government

HY16 Revenue

£377m
(£90m)
constant FX
(19%)

% Group Revenue

25

Underlying Trading Profit

£2.7m
+£0.6m
constant FX
+29%

Sectors

Health, Citizen Services including Enviro and Leisure

- **Organic revenue sharp decline:** -19%. Successful exit of loss-making contracts: Suffolk Community Healthcare, NCS. Reducing scale of CMG and other scope reductions; limited growth elsewhere.
- **UTP margin broadly flat:** 0.7%. Contract attrition broadly offset by other cost efficiencies.
- **OCPs:** £13m utilisation, slightly better than expectations.
- **Contract awards:** ~£200m. Rebid/extensions for Anglia Support Partnership, Woking enviro, Public Health England; new wins and rebids for European Space Agency; Camden enviro unsuccessful.
- **FY16 outlook and future rebids:** ~£200m/25% revenue decline for FY. H2 revenue pressure from changes to healthcare procurement contracts, with annualisation impact in FY17. 7 major rebids/extensions 2016-18, ~15% of revenue base.
- **Pipeline:** Additional Enviro Services and Health FM bids included.

AsPac

HY16 Revenue

£285m
+£5m
constant FX
+2%

% Group Revenue

19

Underlying Trading Profit

£7.6m
(£0.2m)
constant FX
(3%)

Sectors

Justice, Immigration, Defence, Health, Citizen Services, Transport

- **Organic revenue growth:** +6%. Increases in ACPB, expansion of Acacia prison; immigration services broadly flat.
- **UTP margin broadly flat:** 2.7%. Cost efficiencies broadly offset by other cost and margin pressures.
- **OCPs:** £8m utilisation, in line with expectations.
- **Contracts awards:** ~£500m. 'Icebreaker' initial ~£160m TCV; Acacia Prison and South Queensland Correctional Facility extensions worth ~£200m.
- **FY16 outlook and future rebids:** broadly flat at constant FX, ~£50m/10% revenue growth with currency benefit. 10 major rebids/extensions 2016-18, ~30% of revenue base.
- **Pipeline**: New prison opportunities in NSW; offshore immigration not included in pipeline; look to develop other prospects in Justice, Citizen Services, Defence, Transport and non-clinical health.

Middle East

HY16 Revenue

£154m
+£2m
constant FX
+2%

% Group Revenue

10

Underlying Trading Profit

£9.7m
(£0.9m)
constant FX
(9%)

Sectors

Transport, Defence, Health, Citizen Services

- **Organic revenue broadly flat:** +2%; some growth from annualisation of Saudi rail contract and volumes in defence logistics; scope reduction on Dubai ANS and a small number of other operations.
- **UTP margin modest pressure:** 6.3%; benefits from volume growth and cost efficiencies, offset by attrition and investment in BD/bidding.
- **OCPs:** No material existing or new OCPs.
- **Contracts awards:** Only Baghdad ATC and other smaller extensions decided in the period.
- **FY16 outlook and future rebids:** broadly flat at constant FX, ~£30m/10% revenue growth with currency benefit. 7 major rebids/extensions 2016-18, ~35% of revenue base.
- **Pipeline:** Three major rail/tram opportunities with 2017 decisions due; added further opportunities in defence training, non-clinical Health FM support.

Americas

HY16 Revenue

£329m

(£45m)
constant FX
(12%)

% Group Revenue

Underlying Trading Profit

£19.6m

(£7.2m)
constant FX
(28%)

Sectors

Defence, Citizen Services, Transport

- **Organic revenue decline:** -12%. End to National Benefits Centre; hand-back of VDOT; some reduced work areas on Affordable Care Act (ACA) and certain other operations. Limited growth elsewhere.
- **UTP margin down:** 6.0%. Contract attrition and some cost timing impacts, partially offset by favourable FX and cost efficiencies.
- **OCPs:** £5m utilisation, slightly lower than expectations. Upward revision to Ontario DES IT systems implementation.
- **Contract awards:** >£150m. New work USAF radar upgrades and LADOT transport support; Navy task orders totalling >$60m.
- **FY16 outlook and future rebids:** ~£70m/10% revenue decline at constant FX, largely offset by currency benefit. 3 major rebids/extensions 2016-18, ~40% of revenue base; skewed by ACA due for rebid in 2018.
- **Pipeline:** DoS Passport Support Services; significant increase in Navy support opportunities; further transport, Citizen Services and immigration added.

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Global Services (discontinued operations)

HY16 Revenue

£25m
(£152m)
constant FX
(86%)

% Group Revenue

<2

Underlying Trading Profit

(£4.2m)
(£6.3m)
constant FX
n/a

Sectors

Private Sector Business Process Outsourcing

- **Exit substantially concluded:** Sale of majority of offshore operations completed on 31 December 2015; one of two smaller Middle East operations completed in HY16; exit of remaining UK onshore operations progressing well. Revenue decline as expected.
- **UTP loss from residual contract losses and 'stranded' costs:** Running ahead of plans to mitigate due to transfer of contracts and property liabilities. Further reduction in loss run-rate expected in H2; no material residual effect beyond.
- **OCPs:** £3m utilisation, in line with expectations. No material remaining OCP balance.
- **Two contracts remaining:** Continue to consider options.

HY16 Financial Review

Income statement – Revenue and Trading Profit

Revenue excludes share of JV revenue, Trading Profit includes share of JV PAT

Underlying measure presented for consistency; includes the performance of discontinued operations, and strips out one-time items and multi-year Review impacts

£m	**HY16**	HY15	*FY15*
Revenue	1,493	1,613	*3,177*
Include: discontinued operations	25	177	*338*
Revenue including discontinued operations	**1,518**	**1,789**	***3,515***
Trading Profit	71.7	62.7	*137.6*
Exclude: Contract and Balance Sheet Review adj.	(17.0)	(5.5)	*(20.9)*
Exclude: one-time profit on contract termination	(3.5)	-	*(9.0)*
Exclude: Assets held for sale D&A benefit	(0.2)	(10.3)	*(11.7)*
Underlying Trading Profit (UTP)	**51.0**	**46.9**	***96.0***

- **Favourable currency impact in HY16: Revenue +£25m; Underlying Trading Profit +£1.4m**
- **Translational FX sensitivity:**
  - FY15 £:US$ av. rate of 1.53; 5c move = ~£30m Revenue, ~£2m Underlying Trading Profit (based on Americas + Middle East)
  - FY15 £:Aus$ av. rate of 2.04; 5c move = ~£15m Revenue, ~£0.3m Underlying Trading Profit (based on AsPac)
- **Estimated FY16 favourable currency impact: Revenue ~£165m; Underlying Trading Profit ~£8-9m**
  - Assumes FY16 £:US$ av. rate of 1.38 (HY 1.44; H2 1.32); FY16 £:Aus$ av. rate of 1.86 (HY 1.96; H2 1.76)

Revenue – divisional analysis

Organic decline driven by contract attrition in LRG (principally Suffolk Community Healthcare, NCS, Thurrock), Americas (National Benefits Centre, VDOT), and CG (DSTL)

Disposal impact driven principally by exit of Global Services private sector BPO, together with May 2015 sale of GSR in AsPac

Revenue - growth composition

£m	HY15 Reported Currency	Organic	(Disposed) /Acquired	FX	TOTAL	HY16 Reported Currency	HY16 Constant Currency	*FY15 Reported Currency*
UK CG	366	(5%)	-	-	(5%)	349	349	*742*
UK&E LRG	464	(19%)	-	-	(19%)	377	374	*906*
AsPac	281	+6%	(4%)	(1%)	+1%	285	286	*545*
Middle East	144	+2%	-	+5%	+7%	154	146	*291*
Americas	358	(12%)	-	+4%	(8%)	329	313	*693*
Continuing	**1,613**	**(8%)**	**(1%)**	**+2%**	**(7%)**	**1,493**	**1,468**	***3,177***
Global Services	177	-	(86%)	-	(86%)	25	25	*338*
Total	**1,789**	**(8%)**	**(8%)**	**+1%**	**(15%)**	**1,518**	**1,493**	***3,515***
HY16 v HY15		(£150m)	(£146m)	+£25m	(£271m)			

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Underlying Trading Profit – divisional analysis

UTP increase of £4.1m or £10.4m before impact of Global Services exit; this includes £1.4m FX benefit and £3.8m increase in JV profits; excluding these, the increase is £5.2m

Net impact of contract attrition therefore successfully offset by good progress on existing contract base and cost management

Underlying Trading Profit and margin

£m	HY16 UTP Constant Currency	HY16 UTP Reported Currency	HY16 UTP Margin	HY15 UTP Reported Currency	HY15 UTP Margin	Change Reported Currency	*FY15 UTP Reported Currency*	*FY15 UTP Margin*
UK CG	33.4	33.4	*9.6%*	24.7	*6.7%*	8.7	*53.1*	*7.2%*
UK&E LRG	2.7	2.7	*0.7%*	2.1	*0.5%*	0.6	*4.7*	*0.5%*
AsPac	7.6	7.6	*2.7%*	7.8	*2.8%*	(0.2)	*11.9*	*2.2%*
Middle East	9.1	9.7	*6.3%*	10.0	*6.9%*	(0.3)	*18.9*	*6.5%*
Americas	18.5	19.6	*6.0%*	25.7	*7.2%*	(6.1)	*44.3*	*6.4%*
Divisions continuing	**71.3**	**73.0**	***4.9%***	**70.3**	***4.4%***	**2.7**	***132.9***	***4.2%***
Corporate costs	(17.5)	(17.8)	*(1.2%)*	(25.5)	*(1.6%)*	7.7	*(51.2)*	*(1.6%)*
Total continuing	**53.8**	**55.2**	***3.7%***	**44.8**	***2.8%***	**10.4**	***81.7***	***2.6%***
Global Services	(4.2)	(4.2)	*(17.0%)*	2.1	*1.2%*	(6.3)	*14.3*	*4.2%*
Underlying	**49.6**	**51.0**	***3.4%***	**46.9**	***2.6%***	**4.1**	***96.0***	***2.7%***

- **Note: Margin enhancement of equity accounting**
  - If JV revenue of £294m was included and JV interest and tax cost of £3.7m excluded, HY16 Group margin would decrease from 3.4% to 3.0% (FY15: 2.7% to 2.4%)
  - Impact principally UK CG – HY16 margin would decrease from 9.6% to 5.9% (FY15: 7.2% to 4.1%)

OCPs and other Review adjustments

Commitment to report transparently the effect that the 2014 Contract & Balance Sheet Review has on future profits and cash flows

Overall adjustment for Review items results in a £17m benefit to Trading Profit in HY16

Guidance continues to be on the basis of Underlying Trading Profit (ie before any OCP or other Review adjustments, and other one-time items)

- FY14 total operating profit charge of £1,299m, of which £745m within Trading Profit
  - £433m of OCPs were the main items which impact future profits and cash flows (£447m inc. exceptionals)
  - £312m of other charges to Trading Profit, mainly contract-related, reflecting asset impairments, together with other charges to accruals and provisions
- HY16 overall adjustment a net £17m benefit to Trading Profit
  - Further good progress on reducing the OCP liabilities; no individual movement >£6m; largest releases relate to HMP Ashfield, FPMS and YJB; no new OCPs
  - OCP liability reduced to £239m at 30 June 2016
- HY16 OCP utilisation of £47m; anticipate ~£80m for FY16 as a whole
- Detailed table of provision movements and future OCP profile included at Appendix 11

Income statement

Income statement combines continuing and discontinued operations

Operating profit before exceptionals of £69.7m

Net finance costs reduced to £7.1m, driven by reduction in average net debt; includes a net pension credit of £2.3m reflecting strong pension funding position (accounting pre-tax net asset of £140m; actuarial deficit of £11m)

£m	**HY16**	HY15	*FY15*
Trading Profit	**71.7**	**62.7**	***137.6***
Amortisation and impairment of intangibles arising on acquisition	(2.0)	(2.9)	*(4.9)*
Operating profit before exceptionals	**69.7**	**59.8**	***132.7***
Net finance costs (NFC) before exceptionals	(7.1)	(18.6)	*(32.0)*
PBT before exceptionals	**62.6**	**41.2**	***100.7***
Tax on UTP and NFC before exceptionals	(3.6)	(14.6)	*(30.5)*
Tax on other non-underlying items	(0.2)	(1.2)	*(6.1)*
PAT before exceptionals	**58.8**	**25.4**	***64.1***
Exceptional items, net of tax	(12.4)	(117.1)	*(217.2)*
Profit/(loss) after tax	**46.4**	**(91.7)**	***(153.1)***

Tax

Effective tax rate of 8% due to high proportion of JV profits and pension deferred tax credit

Cash tax of £6.6m in line with estimate of ~£10m for full year

Estimated UK tax losses at 30 June 2016 of £765m with a potential value of £138m at 18% tax rate; only £11m currently recognised, with remainder being a contingent asset

- Tax of £3.6m on Underlying PBT of £43.9m, equivalent to an 8% effective tax rate (or ~20% before £4.4m pension deferred tax credit)
  - Calculation significantly affected by higher than expected JV profits representing ~40% of Underlying PBT in the period, but which are consolidated on an after tax basis
  - Tax charge on overseas profits blends to 30%+, driven by US and Australia local rates
  - Absence of deferred tax credit for losses in the UK
- FY16 anticipate rate of ~20-25%
  - Assumes continued absence of deferred tax credit in the UK
  - Assumes tax credit caused by pension movement in H1 does not change
- Future years' effective tax rate will be high until UK tax losses can be recognised based on IAS12 technical requirements
- Cash tax rate continues to be low
  - £6.6m paid in HY16; low rate includes the effect of losses on onerous contracts overseas as well as the UK, together with refunds and sale of losses to JV entities

Exceptional items

£6.6m restructuring, £0.9m external adviser costs re UK Government reviews; other exceptionals driven by non-cash adjustments, etc

The net cash impact of exceptionals was £32.4m in HY16, which includes the cash timing of exceptional charges taken in prior years such as the payments to the DLR pension scheme and the exit of residual UK private sector BPO operations

£m	**HY16**	HY15	*FY15*
Profit/(loss) on disposals inc. discontinued	(1.2)	(4.9)	*2.8*
Other exceptional operating items:			
Impairment of goodwill inc. discontinued	-	(65.4)	*(153.4)*
Impairment of other discontinued assets	4.3	(4.7)	*(14.9)*
Restructuring costs inc. discontinued	(6.6)	(9.5)	*(21.9)*
UK frontline clinical health contract provisions	-	-	*2.8*
Aborted transaction costs	0.3	-	*(1.7)*
Costs re UK Government reviews	(0.9)	(0.1)	*(1.2)*
Movement in indemnities provided on disposals	(7.8)	-	-
Other exceptional operating items	(10.7)	(79.7)	*(190.3)*
Exceptional operating items	**(11.9)**	**(84.6)**	***(187.5)***
Exceptional net finance costs inc. discontinued	(0.4)	(32.8)	*(32.8)*
Tax on exceptional items	(0.1)	0.3	*3.1*
Total exceptional items, net of tax	**(12.4)**	**(117.1)**	***(217.2)***
Memo: cash flow exceptionals	**(32.4)**	**(72.8)**	***(88.4)***

EPS and DPS

EPS combines continuing and discontinued operations

Underlying EPS reflects the Underlying Trading Profit measure, after deducting pre-exceptional net finance costs and related tax effects

As previously indicated, the Board has not declared an interim dividend; resumption will continue to depend on appraisal of financial performance and prevailing market outlook

	HY16	HY15	*FY15*
Weighted average share count for basic EPS	**1,088.8m**	**886.2m**	***986.5m***
Underlying EPS	**3.70p**	**1.57p**	***3.44p***
Impact of non-underlying items	1.70p	1.32p	*3.11p*
Statutory EPS before exceptional items	**5.40p**	**2.89p**	***6.55p***
Impact of exceptional items	(1.13p)	(13.21p)	*(22.02p)*
Statutory EPS	**4.27p**	**(10.32p)**	***(15.47p)***
DPS	**0p**	**0p**	***0p***

Free Cash Flow and Trading Cash Flow

Underlying cash profitability offset principally by the cash outflows on OCP contracts

Improvement to prior period reflects the significant working capital impact in 2015 of unwinding previous cash management, and in the latest period lower outflows for interest and capex

£m	**HY16**	HY15	*FY15*
Operating profit before exceptionals	**69.7**	**59.8**	***132.7***
Share of profit of joint ventures	(17.7)	(13.9)	*(37.0)*
Depreciation, amortisation and impairment	24.3	26.9	*71.5*
Working capital movement	(14.2)	(71.5)	*(22.6)*
Provisions movement	(77.8)	(53.3)	*(116.0)*
Other non-cash movements	29.0	18.9	*30.6*
Tax paid	(6.6)	(7.7)	*(2.7)*
Net cash inflow from operating activities	**6.7**	**(40.8)**	***56.5***
Dividends from joint ventures	19.7	15.8	*32.5*
Net interest paid	(10.5)	(19.6)	*(32.7)*
Net capital expenditure	(14.4)	(32.9)	*(72.5)*
Free Cash Flow	**1.5**	**(77.5)**	***(16.2)***
Add-back: tax, as above	6.6	7.7	*2.7*
Add-back: net interest, as above	10.5	19.6	*32.7*
Trading Cash Flow	**18.6**	**(50.2)**	***19.2***
Underlying Trading Profit	**51.0**	**46.9**	***96.0***
Trading cash conversion	***36%***	***n/a***	***20%***

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Free Cash Flow reconciliation to movement in net debt

Closing net debt of £120m; average net debt of £124m over the period and peak net debt of £170m

Cash exceptional items driven by timing of restructuring costs and DLR pension payment

Disposal proceeds reflect completion of one of the two Middle East private sector BPO businesses

Adverse post-Brexit FX impact from translation of US$357m USPP debt

£m	**HY16**	HY15	*FY15*
Free Cash Flow	**1.5**	**(77.5)**	***(16.2)***
Exceptional items	(32.4)	(72.8)	*(88.4)*
Net disposal/(acquisition) of subsidiaries	11.1	(4.5)	*184.9*
Net proceeds of rights issue	-	530.1	*530.3*
Purchase of own shares net of option proceeds	0.1	4.3	*4.4*
Movement in finance leases	-	(1.0)	*0.5*
Movement in non-recourse loans	-	24.0	*24.0*
Other movements on investment balances	0.4	(0.6)	*(1.9)*
Foreign exchange	(23.4)	(10.1)	*(32.9)*
Movement in net debt	**(42.7)**	**391.9**	***604.7***
Opening net debt	(77.5)	(682.2)	*(682.2)*
Closing net debt (inc. held for sale)	**(120.2)**	**(290.3)**	***(77.5)***

Net debt and leverage

Leverage ratio per covenant 0.5x; on a pro forma basis to remove EBITDA of the private sector BPO disposal and the benefit of non-underlying items, leverage would be 0.75x

Forecast net debt increase and EBITDA reduction in H2 would see leverage on an underlying basis of ~1x at the end of 2016

£m	**HY16**	HY15	*FY15*
Net debt (including held for sale)	(120.2)	(290.3)	*(77.5)*
Less: loan note, encumbered cash and other adjustments	(15.5)	(2.4)	*(14.2)*
Covenant adjustment for average FX rates	20.1	-	-
Net borrowings per covenant	**(115.6)**	**(292.7)**	***(91.7)***
EBITDA			
EBITDA per covenant (see Appendix 8)	217.7	176.3	*209.5*
Less: adjustment for EBITDA of BPO disposal	(18.7)	n/a	*(37.0)*
Less: adjustments for non-underlying items	(44.9)	(5.5)	*(29.9)*
EBITDA underlying pro forma	**154.1**	**170.8**	***142.6***
Leverage ratio per covenant (not to exceed 3.5x)	**0.53x**	**1.66x**	***0.44x***
Leverage ratio on underlying pro forma basis	**0.75x**	**1.71x**	***0.64x***

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Outlook and modelling assumptions

- 2016 Revenue ~£3.0bn (2015: £3.5bn)
  - Net contract attrition ~£0.4bn; BPO exit ~£0.3bn; updated estimate of favourable FX ~£0.2bn
- 2016 Underlying Trading Profit of not less than £80m (2015: £96m)
  - Previously described impact from contract attrition and BPO exit, partially offset by target of £50m cost savings which are tracking slightly ahead of plan; other non-recurring commercial issue resolutions, and updated estimate of favourable FX ~£8-9m
- 2016 Net Finance Costs (pre-exceptional) ~£15m (2015: £32m)
  - Lower average net debt and benefit of £117m repayment at par of USPP notes in February 2016
  - Net pension credit of ~£5m now included; reflects strong funding position
- 2016 underlying effective tax rate of ~20-25% (2015: 48%)
  - Rate reflects extent to which UK tax losses not recognised and higher international tax rates
  - The proportion of JV profits within the calculation has significantly lowered the rate in 2016 but the overall estimated tax charge and cash cost are both broadly unchanged at £10-15m
- Weighted average number of shares annualises to ~1.1bn (2015: 986.5m)
- 2016 closing net debt of ~£150m, underlying leverage of ~1x EBITDA
- Forecasts assume current FX rates continue for the rest of the year
- 2017: conditions remain uncertain; expect limited financial progress on the original expectation of ~£50m Underlying Trading Profit (before FX benefit, estimated at £10-12m)

Appendix

Appendix 1 – Notes and definitions

- Revenue is as defined under IFRS, which excludes Serco's share of revenue of its joint ventures. Revenue including that from discontinued operations is shown for consistency with previous guidance.
- Organic revenue growth is the change at constant currency in Revenue after adjusting to exclude the impact of any acquisitions or disposals.
- Trading Profit is defined as IFRS Operating Profit adjusted for (i) amortisation and impairment of intangibles arising on acquisition and (ii) exceptional items. Consistent with IFRS, it includes Serco's share of profit after interest and tax of its joint ventures. Underlying Trading Profit excludes Contract and Balance Sheet Review adjustments (principally Onerous Contract Provision (OCP) releases or charges), the beneficial treatment of depreciation and amortisation of assets held for sale, and other material one-time items such as the pension scheme settlement in the first half of 2016 and the profit on early termination of a UK local authority contract that occurred in the second half 2015. Trading Profit measures include discontinued operations for consistency with previous guidance.
- Underlying EPS reflects the Underlying Trading Profit measure after deducting pre-exceptional net finance costs (including those for discontinued operations) and related tax effects.
- Trading Cash Flow is the net cash flow from operating activities before exceptional items as shown on the face of the Group's Consolidated Cash Flow Statement and is stated after capital expenditure from tangible and intangible purchases less proceeds of tangible and intangible disposals, adding dividends we receive from joint ventures and adjusting to remove tax payments or receipts.
- Free Cash Flow is Trading Cash Flow after adjusting to add interest received, deduct interest paid, deduct tax payments, and add tax received.
- Change at constant currency for Revenue and Underlying Trading Profit is calculated by translating non-Sterling values for the periods to 30 June 2015 and 30 June 2016 into Sterling at the average exchange rate for the year ended 31 December 2015.
- Pre-tax ROIC is calculated as Trading Profit divided by the Invested Capital balance. Invested Capital assets are: goodwill and other intangible assets; property, plant and equipment; interests in joint ventures; trade and other receivables; and inventories. All other assets are excluded from Invested Capital, being: retirement benefit assets; tax assets; derivative financial instruments; and cash and cash equivalents. Of the total liabilities on the balance sheet, Invested Capital liabilities are trade and other payables. All other liabilities are excluded from Invested Capital being: retirement benefit obligations; tax liabilities; provisions; obligations under finance leases; derivative financial instruments; and loans. Assets and liabilities classified as held for sale are also included in Invested Capital.
- The order book reflects the estimated value of future revenue based on all existing signed contracts, excluding Serco's share of joint ventures. It excludes contracts at the preferred bidder stage and excludes the award of new Indefinite Delivery, Indefinite Quantity (IDIQ) contract vehicles and Multiple Award Contracts (MACs) where Serco are one of a number of companies able to bid for specific task orders issued under the IDIQ or MAC. The value of any task order is recognised within the order book when subsequently won.
- The pipeline of new bid decisions over the next two years is the aggregate value of potential new contracts that are anticipated to be bid in the near term, where annual revenue for each is estimated to be in excess of £10m and where the estimated total contract value of each is capped at £1bn.

Appendix 2 – Currency rates

	Average rates			Spot rates	Closing rates		
	HY16	HY15	FY15	21 Jul 2016	30 Jun 2016	31 Dec 2015	30 Jun 2015
£:US$	1.44	1.53	1.53	1.32	1.35	1.47	1.57
£:Aus$	1.96	1.95	2.04	1.76	1.81	2.02	2.04
£:Eur	1.30	1.35	1.38	1.20	1.21	1.36	1.41

- **Favourable currency impact in HY16: Revenue £25m; Underlying Trading Profit £1.4m**
- **Translational FX sensitivity:**
  - FY15 £:US$ av. rate of 1.53; 5c move = ~£30m Revenue, ~£2m Underlying Trading Profit (based on Americas + Middle East)
  - FY15 £:Aus$ av. rate of 2.04; 5c move = ~£15m Revenue, ~£0.3m Underlying Trading Profit (based on AsPac)
- **Estimated FY16 favourable currency impact: Revenue ~£165m; Underlying Trading Profit ~£8-9m**
  - Assumes £:US$ av. rate of 1.38 (HY 1.44; H2 1.32); £:Aus$ av. rate of 1.86 (HY 1.96; H2 1.76)

Appendix 3 – Focus on five sectors across four regions

HY16 revenue excluding private sector BPO, including share of JVs

£m Sector	UK & Europe	Americas	Middle East	Asia Pacific		
Defence	343	154	21	49	£567m	32%
Justice & Immigration	126			148	£274m	15%
Transport	177	45	92	18	£332m	19%
Health	143		16	42	£201m	11%
Citizen Services	228	130	25	30	£413m	23%
Total	£1,017m 57%	£329m 18%	£154m 9%	£287m 16%	£1,787m	

- Strong
- Foundation
- Exploring

Note: Revenue reflects £1,493m for Continuing Operations only (therefore excluding the discontinued £25m Global Services division, consisting of private sector BPO operations) and adjusted to include Serco's share of joint ventures revenue of £294m.

Appendix 4 – costs analysis

£m	FY14	FY15	Change	% Change	FY16e	Change	% Change
Revenue	3,955	3,515	(440)	(11%)	~3,000	~(515)	~(15%)
Underlying Trading Profit	113	96			80+		
Exclude: JVs	(30)	(37)			~(30)		
Underlying Trading Profit ex. JVs	83	59	(24)	(29%)	50+	~(9)	~(15%)
Implied total costs	**(3,872)**	**(3,456)**	**(416)**	**(11%)**	**~(2,950)**	**~(506)**	**~(15%)**
Include: costs offset by OCP utilisation*	(41)	(125)	84		~(80)	~(45)	
Total costs	**(3,913)**	**(3,581)**	**(332)**	**(8%)**	**~(3,030)**	**~(551)**	**~(15%)**

- Bigger cost challenge in 2016: revenue expected to reduce by around £0.5bn, or ~15%
- To achieve Underlying Trading Profit of not less than £80m, we need the total cost base to also reduce by around £0.5bn, or ~15%
  - Direct Cost of Sales will volume-adjust for contract attrition and disposal impact by ~£450m
  - Shared service and overheads need to volume adjust as much as possible ie ~£50m+, equivalent to 10%+ reduction

* FY14 reflects £2m OCP utilisation of previously established provisions together with £27m of in-year costs on the ACPB contract that were written off as part of the Contract and Balance Sheet Review and £12m of loss recognised within exceptionals for UK clinical health; FY15 reflects total OCP utilisation on both Trading (£114m) and exceptional (£11m) to reflect the total cost base.

Appendix 5 – Cost reduction: Shared Services and overheads

- FY16 total cost saving challenge of ~£700m
  - ~£650m direct Cost of Sales via attrition, disposal, etc
  - ~£50m+ via Shared Services and overheads, equivalent to 10%+ reduction
- Shared Services are central to Serco's operating model: ~£180m cost base, to reduce by ~£30m
  - IT, HR, Finance, Procurement, etc
  - Some of this is 'Cost of Sales' in nature eg purchases on behalf of contracts
  - Some areas are more volume related, eg hiring, processing, etc
  - Others more fixed in nature, eg IT systems
  - Major project to drive efficiencies to lower cost but also promote increased use of Shared Services
- Other overheads ~£290m, to reduce by ~£20m
  - For non-UK divisions, this includes their equivalent of local shared service infrastructure
  - Major project ongoing to standardise overhead charging approach
  - Overheads include ~£50m BD/bidding; focus will be on improving return rather than reducing
  - Corporate costs of ~£50m to reduce by ~£10m
  - Other divisional and BU overheads to reduce by ~£10m

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Appendix 6 – cash flow breakdown 1 & breakdown 2

£m	**HY16**	HY15	*FY15*
Breakdown 1 – depreciation, amortisation and impairment			
Depreciation	12.2	10.8	*28.9*
Amortisation (non-acquisition)	9.8	11.6	*24.1*
Depreciation and amortisation	**22.0**	**22.4**	***53.0***
Impairment of PPE	0.3	1.6	*2.1*
Impairment of intangibles	-	-	*11.5*
Amortisation of intangibles arising on acquisition	2.0	2.9	*4.9*
Total depreciation, amortisation and impairment before exceptional items	**24.3**	**26.9**	***71.5***
Breakdown 2 – other non-cash movements			
Share-based payment expense	4.9	4.1	*9.8*
Loss on disposal of PPE and intangible assets	0.4	0.8	*1.6*
Non-cash R&D expenditure	-	(0.3)	*0.1*
FX impact and other non-cash movements	23.7	14.3	*19.1*
Other non-cash movements	**29.0**	**18.9**	***30.6***

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Appendix 7 – cash flow breakdown 3

£m	**HY16**	HY15	*FY15*
Breakdown 3 – exceptional costs			
Finance costs re refinancing and early repayment	(0.3)	(31.3)	*(31.8)*
Restructuring, claims and costs related to Strategy Review	(8.3)	(20.0)	*(28.4)*
Break and exit costs re residual UK private sector BPO operations	(14.5)	-	-
Lease break costs on termination of GSR lease	-	(12.9)	*(12.9)*
UK frontline clinical health	(0.1)	(8.7)	*(11.7)*
Costs re DLR pension deficit settlement	(8.3)	(8.3)	*(8.3)*
Rights issue costs moved to reserves on completion	-	8.4	*8.4*
Aborted transaction costs	(0.1)	-	*(1.3)*
Costs associated with UK Government reviews	(0.8)	-	*(2.4)*
Exceptional items cash costs	**(32.4)**	**(72.8)**	***(88.4)***

Appendix 8 – leverage covenant calculation

£m	**HY16**	HY15	*FY15*
Trading Profit before FY14 Contract and Balance Sheet Review charge	146.6	107.1	*137.6*
Exclude: share of joint venture post-tax profits	(40.8)	(30.1)	*(37.0)*
Include: dividends from joint ventures	36.4	35.9	*32.5*
Add-back: DA including impairment (excluding acquisition intangibles)	64.9	57.0	*66.6*
Add-back: share-based payments charge	10.6	6.4	*9.8*
EBITDA per covenant	**217.7**	**176.3**	***209.5***
Recourse net debt (closing), including assets held for sale	(120.2)	(290.3)	*(77.5)*
Less: disposal vendor loan note, encumbered cash and other adjustments	(15.5)	(2.4)	*(14.2)*
Covenant adjustment for average FX rates	20.1	-	-
Net borrowings per covenant	**(115.6)**	**(292.7)**	***(91.7)***
Leverage ratio per covenant (not to exceed 3.5x)	**0.53x**	**1.66x**	***0.44x***

Appendix 9 – interest cover covenant calculation

£m	**HY16**	HY15	*FY15*
Statutory net finance costs	(20.5)	(38.1)	*(32.0)*
Exclude: net interest receivable on retirement benefit obligations	(4.7)	(4.1)	*(4.9)*
Exclude: movement in discount on other debtors	(0.6)	-	*(0.1)*
Add-back: interest payable on non-recourse loans	-	0.4	-
Add-back: movement in discount on provisions and deferred consideration	3.6	2.8	*5.6*
Add-back: costs related to refinancing	-	2.1	-
Net finance costs for covenant calculation	**(22.2)**	**(36.9)**	***(31.4)***
EBITDA per covenant (Appendix 8)	**217.7**	**176.3**	***209.5***
Interest cover per covenant (at least 3.0x)	**9.81x**	**4.78x**	***6.67x***

Appendix 10 – FY15 provisions movement

Overall provision movements in line with expectations

Contract and Balance Sheet Review OCPs charged in FY14 of £447m; OCPs reduced to £300m by end of FY15; movement included utilisation of £125m and £nil net charge/release

£m	**Total OCPs**	Other contract provisions	Held for sale Adj.	**Total contract provisions**	Employee, Property and other	**Total reported provisions**
31 December 2014	(447.1)	(4.9)	21.6	(430.4)	(147.5)	(577.9)
Charge – Trading	(91.8)	(10.1)	12.8	(89.1)	(33.7)	(122.8)
Charge – exceptional	-	-	-	-	(35.8)	(35.8)
Release – Trading	88.8	2.7	(1.3)	90.2	15.0	105.2
Release – exceptional	2.8	-	-	2.8	2.2	5.0
Utilised – Trading	114.1	16.6	(24.7)	106.0	33.3	139.3
Utilised – exceptional	10.8	-	-	10.8	-	10.8
Unwinding of discount	(5.5)	-	-	(5.5)	(0.1)	(5.6)
Disposals	6.5	0.4	(6.9)	-	-	-
FX	8.2	0.3	-	8.5	(2.8)	5.7
Transfer re trade payables	-	(4.5)	4.5	-	(15.9)	(15.9)
Assets held for sale	-	-	4.9	4.9	5.4	10.3
Reclassifications	13.3	(13.6)	-	(0.3)	0.3	-
31 December 2015	**(299.9)**	**(13.1)**	**10.9**	**(302.1)**	**(179.6)**	**(481.7)**

Appendix 11 – HY16 provisions movement and future profile

Overall provision movements in line with expectations

Contract and Balance Sheet Review OCPs originally charged in FY14 of £447m; liability now reduced to £239m

HY16 movement included utilisation of £47m and £13m net release

£m	**Total OCPs**	Other contract provisions	Held for sale Adj.	**Total contract provisions**	Employee, Property and other	**Total reported provisions**
31 December 2015	(299.9)	(13.1)	10.9	(302.1)	(179.6)	(481.7)
Charge – Trading	(4.4)	-	-	(4.4)	(12.9)	(17.3)
Charge – exceptional	-	-	-	-	(7.9)	(7.9)
Release – Trading	17.8	0.6	(0.7)	17.7	7.2	24.9
Release – exceptional	-	4.3	(4.3)	-	-	-
Utilised – Trading	47.3	0.5	(3.0)	44.8	12.2	57.0
Utilised – exceptional	-	-	-	-	-	-
Unwinding of discount	(0.8)	-	-	(0.8)	-	(0.8)
Disposals	-	-	-	-	-	-
FX	(7.0)	-	0.1	(6.9)	(6.9)	(13.8)
Transfer re working cap.	11.5	1.6	-	13.1	-	13.1
Assets held for sale	-	-	-	-	-	-
Reclassifications	(3.2)	5.5	(3.0)	(0.7)	0.7	-
30 June 2016	**(238.7)**	**(0.6)**	**-**	**(239.3)**	**(187.2)**	**(426.5)**

- Closing balance at 30 June 2016 of largest OCPs: COMPASS £82m; FPMS £39m; ACPB £37m; Lincolnshire £20m; Hong Kong £15m; PECS £10m; DES £9m; all others in aggregate £27m, or ~11% of total
- Utilisation phasing: 2016 ~£80m, 2017 ~£70m, 2018 ~£50m, 2019 ~£50m, 2020 ~£20m, 2020+ ~£20m
- Revenue base: 2016 ~£550m, 2017 ~£380m, 2018 ~£350m, 2019 ~£270m, 2020 ~£70m

Appendix 12 – Pensions

- Serco sponsor a number of defined benefit pension schemes
  - Non contract specific – not related to specific contracts or franchises, largest of which is main Group scheme (SPLAS)
  - Contract specific – related to specific contract or franchise where the deficit is expected to pass back to the customer or next contractor. Intangible asset is recognised at the start of the contract and amortised over the contract life
- Total net balance sheet asset (before tax) across defined benefit schemes as at 30 June 2016 of £140m (31 December 2015: £116m) on asset base of £1.5bn
- Over £1.3bn of £1.5bn assets allocated to conservative liability driven investments (LDIs)
- Main Group scheme (SPLAS) has an estimated actuarial deficit using prudent assumptions of approximately £11m (31 December 2015: £28m)
- Most recent triennial full actuarial valuation of SPLAS was a deficit of £24m as at 5 April 2012 (6 April 2009: deficit of £141m); no further one-off contributions were required. Valuation as at 5 April 2015 due to be released in Autumn 2016

Appendix 13 – Balance sheet summary

Goodwill increase reflects currency movements

Receivables increase and payables decrease driven by unwind of cash push

Loans reduction driven by rights issue and disposal proceeds

Provisions reduction driven by OCP utilisation

Held for sale reduction reflects impairment and disposals, together with the reclassification of Enviro and Leisure

£m	**HY16**	HY15	*FY15*
Goodwill	545.2	530.6	*509.9*
Other intangible assets	88.5	95.5	*89.8*
Property, plant and equipment	70.7	37.2	*73.2*
Trade and other receivables	608.1	603.3	*569.9*
Inventories	27.6	34.4	*26.4*
Interest in joint ventures	12.6	1.4	*13.8*
Invested capital assets (before assets held for sale)	**1,352.7**	**1,302.4**	***1,283.0***
Cash and cash equivalents	166.2	157.1	*323.6*
Other assets (tax, fin. instruments, ret. benefit assets)	230.1	193.5	*193.1*
Total assets (before assets held for sale)	**1,749.0**	**1,653.0**	***1,799.7***
Invested capital liabilities (trade & other payables)	**(569.2)**	**(611.4)**	***(567.1)***
Loans	(273.5)	(412.4)	*(381.9)*
Provisions	(426.5)	(492.5)	*(481.7)*
Other liabilities (finance leases, tax, financial instruments, ret. benefit liabilities)	(93.5)	(79.8)	*(94.2)*
Total liabilities (before liabilities held for sale)	**(1,362.7)**	**(1,596.1)**	***(1,524.9)***
Assets held for sale (net)	**14.1**	**307.2**	***7.3***
Net (liabilities)/assets	**400.4**	**364.1**	***282.1***

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Appendix 14 – Return on Invested Capital

Reviews significantly lowered Invested Capital, but also resulted in a Trading Loss for FY14 and HY15

Therefore ROIC based on Trading Loss after Reviews is a significant negative return for HY15

ROIC based on Underlying Trading Profit is ~11%

FY15 on pro forma basis to remove Trading Profit re BPO disposal and on closing IC would be ~10%

£m	**HY16**	HY15	*FY15*
Invested capital assets	1,352.7	1,302.4	*1,283.0*
Invested capital liabilities	(569.2)	(611.4)	*(567.1)*
Assets held for sale (net)	14.1	307.2	*7.3*
Invested Capital (IC)	**797.6**	**998.2**	***723.2***
Average IC (2pt; for HY15 uses 31 Dec and 30 Jun)	897.9	999.9	*862.4*
Trading Profit/(Loss)	71.7	62.7	*137.6*
Trading Profit/(Loss) for rolling 12m	146.6	(632.7)	*n/a*
Underlying Trading Profit	51.0	46.9	*96.0*
Underlying Trading for rolling 12m	100.1	115.0	*n/a*
Pre-tax ROIC:			
Trading Profit/(Loss) / Average IC	16.3%	(63.3%)	*16.0%*
Underlying Trading Profit / Average IC	11.1%	11.5%	*11.1%*

American Depository Receipt (ADR) program

Serco Group has recently upgraded to a sponsored Level 1 ADR program, for which Deutsche Bank act as the depositary bank and custodian

Ticker: SCGPY

Exchange: OTC

CUSIP: 81748L209

ISIN: US81748L2097

Ratio: 1 ADR : 1 Ordinary Share

ADR key benefits

- Convenient means of trading/holding foreign shares
- USD-denominated security – reducing custody costs
- Trade, clear and settle like other US securities
- Dividends (if declared by the Board) paid in USD
- Purchased or sold through US brokers

For assistance with converting Ordinary Shares into ADRs (or vice versa), please contact Deutsche Bank's ADR broker helpline:

New York: +1 212 250 9100 **London**: +44 207 547 6500 **Hong Kong**: +852 2203 7854

e-mail: adr@db.com ADR website: www.adr.db.com