

Closed period update

13 December 2018

Serco Group plc

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Underlying Trading Profit to grow 30-40% in 2018, and to grow in line with consensus for 2019; upgrade to EPS forecasts for both 2018 and 2019; lower than expected leverage and net debt; continued strong order intake and a growing order book; successfully completed refinancing of banking facilities.

Serco Group plc ('Serco' or 'the Group'), the international service company, today provides its scheduled update on financial performance for 2018 and for the outlook for 2019. Serco will be in a closed period between 1 January 2019 and publication of the results for the 2018 financial year on Thursday 21 February 2019. Serco will be holding meetings with analysts today, during which no additional material information will be disclosed.

Highlights

- 2018 Underlying Trading Profit to grow 30-40% to be within the range of £90-95m, an outcome in line with guidance that was revised upwards in late September; closing net debt to be lower than previously expected at around £200m, with leverage improving to 1.2-1.3x.
- 2019 outlook in line with market expectations of continued progress; this includes revenue of £2.8-2.9bn and Underlying Trading Profit growth of mid-single digits to be within the range of £95-100m.
- Underlying EPS for both 2018 and 2019 likely to be a further 5-10% ahead of current consensus, principally as a result of a lower effective tax rate.
- £250m of Revolving Credit Facility with banking syndicate renewed for five years on terms substantially unchanged.

Commenting on today's update, Rupert Soames, Serco Group Chief Executive, said: "As we predicted when we set out our five-year strategy in 2015, profits have grown strongly in 2018 with margins increasing as a result of improved operational performance and cost reduction. With revenues no longer reducing, cash generation turning positive and the benefit of a strong balance sheet, we are pleased with progress, and we expect further improvement in 2019. We expect to deliver another year of strong order intake in 2018, driven in particular by our international businesses, and our operations and transformation plans continue to deliver an organisation which is leaner, fitter and much stronger."

Outcome for 2018

As highlighted in our unscheduled trading update issued on 28 September 2018, trading in the second half of the year has been better than we anticipated at the start of the year. In part, this has reflected a strong operating performance, together with good progress on transformation savings and other cost efficiencies. In addition, there have been a number of non-recurring trading items such as end-of-contract settlements and other commercial negotiations. We continue to expect Underlying Trading Profit within the range of £90-95m; this represents a significant improvement over the £80m we expected at the start of the year, and would represent growth of some 30-40% on the result for 2017 of £69.3m. As anticipated, we expect to report revenue for the year of around £2.8bn, representing a reduction of approximately 4% on 2017; after a 6% decline in the first half, we expect revenue in the second half of the year to be broadly flat on an organic basis, and growing if the contribution from acquisitions is included.

Underlying net finance costs guidance is unchanged at £13-14m. The underlying effective tax rate is now expected to come down towards 25%, which reflects the improvement in and mix of the Group's profitability. The weighted average number of shares for basic EPS purposes is broadly unchanged at 1.1bn. Underlying basic EPS is expected to be in a range of 5.0 to 5.5p.

Net debt at the end of the year is likely to be around £200m, lower than previous guidance, and we expect to achieve positive Free Cash Flow in 2018 after three years of outflows. Underlying leverage is anticipated to be 1.2-1.3x, and lower on a covenant basis.

Through to the end of October 2018, the Group's order intake totalled £2.5bn, compared to revenues of about £2.3bn. Whilst it is difficult to predict the precise timing of customers' decisions, we are hopeful that we will achieve a book-to-bill ratio for the year of around 100% or greater, as we did in 2017. Given the difficulties in our markets in the UK, we think this would be a robust performance, underlining the importance of our strong position internationally. Together with the acquisition of the Carillion health facilities management contracts, we also expect to see significant growth in our order book.

Outlook for 2019

As stated in the September update, 2019 will not benefit from the non-recurring trading items that have formed part of the very strong profit growth delivered in 2018. However, having recently completed our detailed budget process, we anticipate continued progress in 2019. We expect revenue of £2.8-2.9bn, which includes the potential for modest growth in organic terms, together with the annualised contribution of recent acquisitions, principally the UK health facilities management contracts from Carillion. We expect Underlying Trading Profit in the range of £95-100m, in line with current market consensus; within this we expect declines in the profitability of some contracts in the Middle East, most notably on the MELABS contract, but we also expect these declines to be more than offset by progress elsewhere across the Group, notably by strong growth in the profits delivered by our UK Healthcare business as a consequence of our acquisition of the Carillion contracts, and by further transformation savings and efficiencies.

As previously indicated, underlying net finance costs are expected to increase principally as a result of an approximate £3m net reduction in investment revenue following the early repayment in October 2018 of the vendor loan note issued on our disposal of Intelenet in 2015. The underlying effective tax rate is expected to reduce to below 25% in 2019 as a result of improving profitability in the UK business.

A further improvement in Free Cash Flow is anticipated in 2019. The overall Movement in Net Debt is expected to be a modest outflow.

As we have clearly expressed in the past, in every year there remains a wide range of potential outcomes reflecting the sensitivity of our profits to even small changes in revenues and costs. There is also sensitivity to currency rates during the year, with our guidance based upon recent currency rates prevailing throughout 2019, which, given recent weakening of sterling, implies a modest favourable impact when compared to the average rates for 2018.

All guidance stated above for 2019 is on a pre-IFRS16 basis. This new accounting standard for leases is effective for the Group from 1 January 2019; the quantitative impact of adoption is in the final stages of assessment and our estimates will be disclosed at the time of reporting the financial results for 2018. The standard will result in an operating lease expense now being reclassified to finance costs and depreciation, which will reflect the corresponding lease liabilities and right of use assets that will now be recognised on the balance sheet. The increases to Underlying Trading Profit and net finance costs will broadly net out (and will fully net out over the life of each lease); we expect the impact on Profit Before Tax, on the basis of our current book of business, to be immaterial. There is no cash flow impact, with reclassifications between operating and financing cash flows fully netting out. There is no covenant impact, with the Group's financing facilities continuing to be calculated under the prior standard, IAS17.

Refinancing of Revolving Credit Facility (RCF) completed

Serco's RCF provides funds for general corporate and working capital purposes, and the ability to issue bonds to support the Group's business needs. The previous facility of £368m was due to mature in April 2020. The refinancing of the facility has recently been successfully completed with a syndicate of banks and provides £250m of committed funding for five years; the lower amount reflects the much reduced need for debt in the business. The terms and conditions of the new facility are substantially unchanged from the prior facility. The RCF was undrawn at 31 December 2017 and is anticipated to be undrawn at 31 December 2018. The Group has not utilised any factoring or other working capital facilities during 2018. The Group's other committed funding consists of approximately £245m of US private placement notes with maturities out to 2024. The Group's committed credit facility headroom is considered more than sufficient to meet the expected requirements of the business.

Ends

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About Serco

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More information can be found at www.serco.com

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