Closed Period trading update

27 June 2019
Serco Group plc
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Serco Group plc ('Serco' or 'the Group'), the international service company, today provides its scheduled Closed Period update on trading for the first half of 2019, together with a review of guidance for the 2019 financial year as a whole. Serco will be in a Closed Period between 1 July 2019 and publication of the results for the first half of the 2019 financial year on Wednesday 31 July 2019. Serco will be holding meetings with analysts today, during which no additional material information will be disclosed.

Highlights of expected H1 performance

- >20% growth in Underlying Trading Profit; revenue growth around 6%, with 4% organic growth driven by the Americas and Asia Pacific divisions.
- >£3bn order intake, including the award of our largest-ever contract (AASC); 2019 will be the third year in a row in which order intake exceeds revenues.
- FY19 revenue expected to be around the top end of the previously stated £2.9-3.0bn range; Underlying Trading Profit guidance is maintained at around £105m.
- Announcement of the acquisition of NSBU, a leading provider of ship and submarine design and engineering services to the US Navy, announced in May, funded by a successful Equity Placing and new bank financing. Acquisition expected to complete in H2.
- Adjusted Net Debt at 30 June, excluding Placing proceeds, expected to be in the range of £210-230m. At the year end, following the expected completion of the NSBU acquisition and including Placing proceeds, Adjusted Net Debt expected to be around £250m and underlying leverage around 1.5x.

Commenting on today's update, Rupert Soames, Serco Group Chief Executive, said: "Following a strong 2018, which marked an inflection point for Serco after several years of decline, we expect to report another good performance in the first half of 2019. The revenue growth seen in the second half of 2018 has continued, and profits and margins are both well up on the first half of last year. Order intake in the first half of this year has been very strong at over £3bn, already exceeding our revenue forecast for the whole of 2019. The strategic advantage of having a strong international footprint shows clearly in these results, with strong revenue growth in North America and AsPac; I am also delighted to see improvement in the trading performance of our UK division, which is showing the benefit of the Carillion health facilities management acquisition completed in 2018.

"The NSBU acquisition announced last month adds materially to the scale and capability of our US defence business, and we look forward to closing the transaction in the second half and to the earnings accretion it will deliver in 2020."

Update on trading

For the first half of 2019, we expect to report revenue approaching £1.5bn and Underlying Trading Profit (UTP) of around £50m. This includes currency movements that have been modestly favourable in aggregate, increasing revenue by approximately £20m and UTP by £1-2m. Also included is the effect of the adoption of the new accounting standard for leases, IFRS16, which, in line with previous guidance, has increased UTP by approximately £2m; prior periods are not restated for the effect of IFRS16. For the first half of 2018, reported revenue was £1,366m and UTP was £37.6m. Revenue growth at constant currency is therefore expected to be approximately 6%, whilst UTP growth at constant currency and excluding the effect of IFRS16 is expected to increase by over 20%.

Revenue growth includes an approximate 2% contribution from acquisitions, driven by the Carillion health facilities management contracts that transferred to Serco between June and August last year. The approximate 4% organic growth was driven by strong performances in the Americas division (predominantly in our defence business) and Asia Pacific (largely from growth in Citizen Services operations). Growth in UTP has been led by the Americas division and in particular by the CMS contract (re-awarded to Serco in June 2018), which now has a different contract structure, phasing of profitability across the year and experienced an unusually high volume of variable work in this latest period; UK profitability also benefited from the Carillion acquisition.

Our order intake has been extremely strong, driven by the signing of contracts for asylum accommodation and support services in the UK valued at £1.9bn and for defence healthcare provision in Australia valued at £0.6bn. Together with other new wins, rebids and extensions that have been secured, we expect over £3bn of order intake in the first half, more than we expect to take as revenues for 2019 as a whole. 2019 will be the third year in a row in which order intake exceeds revenue.

Review of guidance for the 2019 financial year

Except where stated, the guidance below excludes any potential contribution from the acquisition of NSBU, which is expected to complete in the second half of 2019; the part-year financial contribution following the date of completion will only be reflected into revised guidance when the date of completion, and therefore the point from which consolidation within Serco's results begins, is known.

At the time of the announcement of our 2018 full-year results in February, our guidance for 2019 revenues was a range of £2.9-3.0bn (2018: £2,837m). We now anticipate revenue for the year to be around the top end of this range, partly reflecting a small favourable currency movement based on current rates.

We continue to expect UTP in 2019 of approximately £105m (2018: £93.1m), which includes an estimated £5m increase from IFRS16 (largely offset by an increase in Net Finance Costs); aside from a small currency movement, our expectations are unchanged from those set out in February. The second half of 2018 benefited from non-recurring trading items such as end-of-contract settlements, and against this comparator UTP growth in the second half of 2019 will be muted.

As we have previously observed, our profits can be affected by even small percentage changes in revenues and costs, as well as currency rates. Trading in the second half will also be particularly sensitive to continued successful progress mobilising and transitioning large new contracts, of which there are several in train, including asylum accommodation and support services in the UK, and in Australia the defence garrison healthcare, Clarence Correctional Centre (formerly known as Grafton) and icebreaker vessel contracts.

We continue to expect Net Finance Costs to be around £20m (2018: £13.9m), which includes the estimated £5m increase from IFRS16 which broadly nets out the increase in UTP, and a Group underlying effective tax rate reducing to below 25% (2018: 26%). We continue to expect 2019 Free Cash Flow (FCF) to be broadly similar to the prior year (2018: £25.0m); the phasing of FCF, with an outflow in the first half and an inflow in the second half, is also expected to be similar to the prior year.

In February we guided to Adjusted Net Debt for the end of 2019 of approximately £200m; this measure excludes all lease liabilities including those newly recognised under IFRS16 and is therefore broadly consistent with the covenant measure for the Group's financing facilities. As stated in the announcement regarding the NSBU acquisition, this Adjusted Net Debt guidance was increased to around £250m, with leverage for covenant purpose on an underlying pro-forma basis expected to increase by around 0.2x to approximately 1.5x following completion of the acquisition. The £140m gross Proceeds of the Equity Placing related to the NSBU acquisition will be consolidated within Serco's Net Debt calculations at the 30 June 2019 balance sheet date, with no corresponding outflow for the NSBU acquisition as the transaction will not close until the second half. Excluding the benefit of the Placing proceeds, Adjusted Net Debt at the half year is expected to be approximately £210-230m, with underlying leverage on this basis of approximately 1.3-1.4x.

The weighted average number of shares for diluted EPS purposes was previously expected to be approximately 1,145m. As a result of the Equity Placing related to the NSBU acquisition, an additional 111m shares were admitted to trading on the London Stock Exchange on 28 May 2019. As indicated in the acquisition announcement, this increases the weighted average number of shares for diluted EPS purposes to approximately 1,200m for 2019, fully annualising to approximately 1,260m for 2020.

Ends

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