

Closed Period trading update

12 December 2019

Serco Group plc

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Update for 2019: Serco expects to deliver around 14% revenue growth and 30% Underlying Trading Profit growth; record order intake; NSBU acquisition performing well. Outlook for 2020: further strong growth expected in revenues and profits.

Serco Group plc ('Serco' or 'the Group'), the international service company, today provides its scheduled Closed Period update on trading for the 2019 financial year, together with its initial outlook for 2020. Serco will be in a Closed Period between 1 January 2020 and publication of the results for the 2019 financial year on Wednesday 26 February 2020. Serco will be holding meetings with analysts today, during which no additional material information will be disclosed.

Highlights

- Strong revenue growth, particularly in the second half. FY19 revenue expected to grow by about 14% to £3.2bn, comprising 7% organic growth, 5% contribution from acquisitions and 2% currency benefit. Second half revenue growth expected to be approaching 20%, of which approximately 10% will be organic growth, and 8% as a result of the five months of contribution of the Naval Systems Business Unit (NSBU) acquisition.
- Underlying Trading Profit expected to grow by about 30% (25% at constant currency) to around £120m, with Underlying Trading Profit margin increasing to around 3.7%.
- Record order intake at over £5bn, and a book-to-bill ratio of over 150%. 2019 will be the third year in a row in which order intake exceeds revenues.
- Acquisition of NSBU, a leading provider of ship and submarine design and engineering services to the US Navy, completed in August. Integration progressing well and the business is trading to plan.
- Adjusted Net Debt at 31 December 2019 expected to be in line with previous guidance of around £250m and underlying leverage of approximately 1.5x.
- Continued strong growth expected in 2020 with revenue of £3.4-3.5bn; total growth of 7-8%, which assumes organic growth of around 4%, an acquisition contribution of 5-6% from the annualisation of NSBU, and a currency headwind of around 2%. Underlying Trading Profit expected to grow by about 20% to around £145m, which includes the previously announced impact of PECS transition costs of £4m and an estimated £3-4m adverse currency impact.

Commenting on today's update, Rupert Soames, Serco Group Chief Executive, said: "The results that we expect to report for 2019 will represent the second successive year of strong growth in revenue and profits, while our positive outlook for 2020 means that we expect to double our Underlying Trading Profit from the £69m achieved in 2017 to the £145m we plan to deliver in 2020.

"Once again, we see the advantage of having a broad international footprint, with excellent growth in both our North America and Asia Pacific divisions, and the ability to successfully execute acquisitions such as NSBU in the US. The UK also delivered a good performance, returning to organic growth in the second half, which is the first time since 2013. Perhaps the most notable aspect of 2019, however, is the record order intake of over £5bn, representing over 150% of annual revenues, which demonstrates the confidence our customers have in us to deliver critical, sensitive and complex public services. Between the start of 2017 and the end of 2019, our order book will have increased by more than 40% from £10bn to over £14bn."

Expected outturn for 2019

For the 2019 financial year, we expect to report revenue of £3.2bn (2018: £2.8bn) and Underlying Trading Profit (UTP) of around £120m (2018: £93m). This includes currency movements that have been modestly favourable in aggregate versus the average rates for 2018, resulting in an uplift in revenue of £40-50m and in UTP of around £3m. Reported growth in revenue is therefore expected to be around 14% (12% at constant currency), whilst UTP growth is expected to be around 30% (25% at constant currency).

Total revenue growth includes an approximate 5% contribution from acquisitions. This comprises 4% from the initial five months' contribution of the NSBU acquisition which completed on 1 August 2019, and 1% from the annualisation of the Carillion health facilities management contracts that transferred to Serco between June and August 2018.

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The organic growth for the year is expected to be approximately 7%, comprising the 4% reported for the first half, and around 10% in the second half. The very strong growth rate in the second half has been driven by a number of contracts, including: the start of the two particularly large contract awards (the AASC asylum accommodation and support contract in the UK, and the AHSC defence garrison healthcare services contract in Australia); another strong performance in winning extensions and rebids of existing contracts; and better-than-expected short-term volume related work and procurement notably from our customers on US defence frameworks, the US Federal Emergency Management Agency (FEMA) contract, as well as certain Citizen Services operations in Australia. This has resulted in particularly strong organic growth in each of our Americas and AsPac divisions, and, after several years of organic decline in the UK & Europe division, we saw encouraging organic growth in the second half.

Growth in UTP in 2019 has been led by the Americas division; the first half of the year was driven in particular by the CMS contract (re-awarded to Serco in June 2018), which now has a different contract structure and phasing of profitability across the year, and which benefited from an unusually high volume of fixed price variable work in the first half. This partially normalised in the second half, reducing the level of contract contribution. Offsetting this, NSBU started to contribute to revenues and profits from August. The UK profitability improvement has been driven in particular by the improved performance of the healthcare business, enhanced by the Carillion acquisition. Large new contract wins such as AASC in the UK and AHSC in Australia have moved to their full operational stages quicker than anticipated, with profitability in the second half more than offsetting the transition costs mainly incurred in the first half.

Net Finance Costs guidance is unchanged at around £20m. The underlying effective tax rate is expected to be around 25%. The weighted average number of shares for diluted EPS purposes is approximately 1,200m. Underlying EPS is therefore expected to be around 6.2p, an increase on 2018 of about 20%.

Free Cash Flow for the year of £30-40m, Adjusted Net Debt at 31 December 2019 of around £250m and underlying leverage of about 1.5x are all expected to be in line with previous guidance. We would note, however, that working capital timing effects and currency movements between now and the end of the financial year make these metrics in particular subject to variation.

Our order intake has been extremely strong and is expected to exceed £5bn for the year, a record for Serco and the third year in a row in which order intake has exceeded revenue. Order intake was £3.3bn in the first half of the year, which included £1.9bn for AASC and £0.6bn for AHSC. In the second half, the largest awards have been £0.8bn for the Prisoner Escort and Custody Services (PECS) contract covering London and the whole of the southern region, and £0.4bn for the extension of the Australian immigration services contract. Our Americas Division also had strong order intake, well ahead of revenues, and much of it from increased volumes of task orders under framework contracts; we are also pleased with the orders that NSBU has taken in the four months since completion of the acquisition. We have not included in our order intake the contract to continue operating the Northern Isles Ferry Services, which was announced by the customer in September and that has a likely total contract value of £450m, as we have not yet signed the contract due to a procurement challenge by the unsuccessful bidder.

Our order book is expected to have grown to over £14bn, up from £12.0bn at the start of the year.

Outlook for 2020

Having recently completed our budget process, our initial outlook for 2020 anticipates continued progress and further strong growth in line with market expectations, taking into account the previously announced PECS transition costs and recent currency movements.

Revenue in 2020 is expected to be £3.4-3.5bn, which would represent total growth of 7-8%. This assumes organic growth of around 4%. Within this, the performance of the Americas division is more susceptible to the volumes of task order work, such as in our Ship & Shore modernisation operations and the FEMA contract, which have been particularly strong in 2019, and this will create a tough comparative for 2020. The acquisition of NSBU is expected to add to revenue growth by about 5-6%, representing the seven months through to the anniversary of completion of the transaction in August. If recent currency rates were to prevail throughout 2020, there would be a currency headwind of £50-60m or around 2% of revenues.

Underlying Trading Profit is expected to be around £145m, which would represent growth of about 20%, and includes an assumed currency headwind of £3-4m. 2020 will benefit from the full-year contribution of the AASC and AHSC contracts, as well as the annualisation of the NSBU acquisition. The transition of the recently awarded PECS contract is expected to cost around £4m in 2020, as set out in our announcement of 30 October, and, as previously indicated, we expect a significant reduction in contribution from the CMS contract. We plan to continue investing in measures to enhance efficiency, capability and the service standards of our operations. During the second half of 2019, the

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Group successfully completed a significant upgrade of its SAP system, bringing the core system version from the 2009 release to the latest version. By the start of 2020, we expect to have over 13,000 users on our Time2Work rostering and time management systems.

Net Finance Costs, as previously indicated, are expected to increase by approximately £5m to around £25m, which reflects the full-year impact of new property leases related to the AASC contract. The underlying effective tax rate is expected to continue at around 25%, which reflects the higher proportion of our pre-tax profits now coming from our international operations, particularly the US. The weighted average number of shares for diluted EPS purposes, fully annualising for the Equity Placing conducted in May 2019, is expected to be approximately 1,260m.

A further improvement in Free Cash Flow is anticipated in 2020, and Adjusted Net Debt is expected to reduce to approximately £200m, resulting in leverage towards the bottom of our normal target range of 1-2x. This excludes any assumption for the resumption of dividend payments to Serco's shareholders, which the Board will consider ahead of the reporting of the results for the 2019 financial year.

Our outlook for 2020 is based upon recent currency rates. The rates used in this statement, along with their estimated impact on revenue and UTP are shown in the table below:

	2018 actual	2019 estimate	2020 outlook
Average FX rates:			
US Dollar	1.34	1.28	1.30
Australian Dollar	1.78	1.83	1.90
Euro	1.13	1.14	1.17
Year-on-year impact:			
Revenue	(£65m)	£40-50m	(£50-60m)
UTP	(£4.0m)	~£3m	(£3-4m)

To note regarding the basis of our outlook guidance

In our Closed Period trading updates, Serco gives unusually detailed forward guidance across a large number of key metrics, which has the advantage that investors and other stakeholders have a clear idea of what we think will happen at a given point of time. The disadvantage of this approach is that it is almost inevitable that events will prove us wrong on one or more metrics. We believe however that transparency and clarity is helpful, albeit that, as we always point out, our profits can be affected by small percentage changes in revenues and costs, as well as currency rates.

Ends

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About Serco

Serco is 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 and four geographies: Defence, Justice & Immigration, Transport, Health and Citizen Services, delivered in UK & Europe, North America, Asia Pacific and the Middle East.

More information can be found at www.serco.com

Forward looking statements

This announcement contains statements which are, or may be deemed to be, "forward-looking statements" which are prospective in nature. All statements other than statements of historical fact are forward-looking statements. Generally, words such as "expect", "anticipate", "may", "could", "should", "will", "aspire", "aim", "plan", "target", "goal", "ambition", "intend" and similar expressions identify forward looking-statements. By their nature, these forward-looking statements are subject to a number of known and unknown risks, uncertainties and contingencies, and actual results and events could differ materially from those currently being anticipated as reflected in such statements. Factors which may cause future outcomes to differ from those foreseen or implied in forward-looking statements include, but are not limited to: general economic conditions and business conditions in Serco's markets; contracts awarded to Serco; customers' acceptance of Serco's products and services; operational problems; the actions of

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competitors, trading partners, creditors, rating agencies and others; the success or otherwise of partnering; changes in laws and governmental regulations; regulatory or legal actions, including the types of enforcement action pursued and the nature of remedies sought or imposed; the receipt of relevant third party and/or regulatory approvals; exchange rate fluctuations; the development and use of new technology; changes in public expectations and other changes to business conditions; wars and acts of terrorism; and cyber-attacks. Many of these factors are beyond Serco's control or influence. These forward-looking statements speak only as of the date of this announcement and have not been audited or otherwise independently verified. Past performance should not be taken as an indication or guarantee of future results and no representation or warranty, express or implied, is made regarding future performance. Except as required by any applicable law or regulation, Serco expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward looking statements contained in this announcement to reflect any change in Serco's expectations or any change in events, conditions or circumstances on which any such statement is based after the date of this announcement, or to keep current any other information contained in this announcement. Accordingly, undue reliance should not be placed on the forward-looking statements.