Serco Group plc interim report 2002

serco

Company highlights for the six months to 30 June 2002

- Record value of bids submitted at £4.7bn
- 62 new contracts awarded
- A further 56 contracts successfully rebid or extended, maintaining our 90% success rate
- Contracts signed totalling £400m
- Appointed preferred bidder for contracts totalling a further £250m, including Skynet 5 for global military satellite communications for UK armed forces
- International growth strategy continues with first contract from European Parliament to provide IT support, and one of the Middle East's first multi-activity outsourcing contracts from Dubai Ports, Customs and Free Zone Corporation
- Forward order book of £6bn

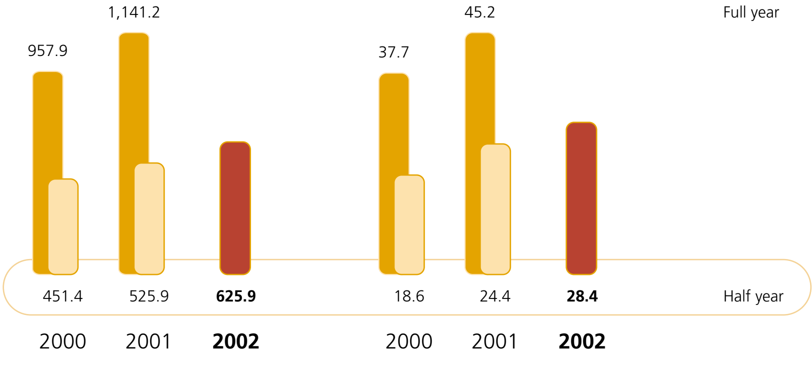
Financial highlights for the six months to 30 June 2002

Serco is on track for a 15th successive year of strong organic growth.

	6 Months to 30.6.02	Restated 6 Months to 30.6.01	
Turnover	**£625.9m**	£525.9m	up 19.0%
Profit before tax – pre goodwill	**£28.4m**	£24.4m	up 16.4%
Earnings per share – pre goodwill	**4.84p**	4.36p	up 11.0%
Dividend per share	**0.64p**	0.57p	up 12.3%
*Underlying pre-tax profit – pre goodwill**	***£27.3m***	*£22.7m*	*up 20.5%*

*Underlying pre-tax profit is calculated after adjusting for the effect of acquisitions and non-recurring items. A reconciliation together with more information on our financial performance and accounting policies is in the Financial Review on page 14.

Turnover+ £'m **Profit before tax* £'m**



+including share of joint ventures

*before amortisation of goodwill

A message from the Board

Serco is on track for a 15th successive year of strong organic growth. Our forward order book remains buoyant and our future earnings are highly visible.

Our resilience and growth are founded on reliable contracts with quality customers, predominantly national and local governments. Our continuing high success rate in winning contract rebids and extensions reflects our ability to deliver real improvements in efficiency and value for money. We have an ever-widening portfolio of contracts and markets, with a strong pipeline of new business opportunities going forward.

The UK government is strongly committed to involving the private sector in delivering public services, and a growing number of overseas governments are following similar paths. Serco has been at the forefront of this trend, working with governments to develop public private partnership (PPP) models such as private finance initiatives (PFIs). Our addressable market in PPPs continues to grow, both in the UK and internationally.

Recognising the increasing complexity of these emerging procurement models, we have increased the level of disclosure in our Annual Report and have now added a Financial Review to this Interim Report: this includes commentary on our cash flow and our accounting policies for bid costs and PFI joint ventures. We have also expanded and updated 'Our approach to PFIs', a document which we originally published in September 2001 to help readers understand and analyse our performance in this area. Copies are available on request, or from our website at www.serco.com.

Financial performance
In the six months to 30 June 2002, turnover was £625.9m (2001: £525.9m) – an increase of 19% on the first half of 2001. Pre-tax profit grew 16.4% to £28.4m (2001: £24.4m) before goodwill amortisation. As explained in the Financial Review, this measure is not directly comparable year-on-year. An alternative comparison shows underlying profit growth of 20.5% before goodwill. Earnings per share (EPS) before goodwill grew 11% to 4.84p. Operating cash flow, before one-off items, was 69% (2001: 56%) and 41% (2001: 33%) of operating profit and EBITDA respectively.

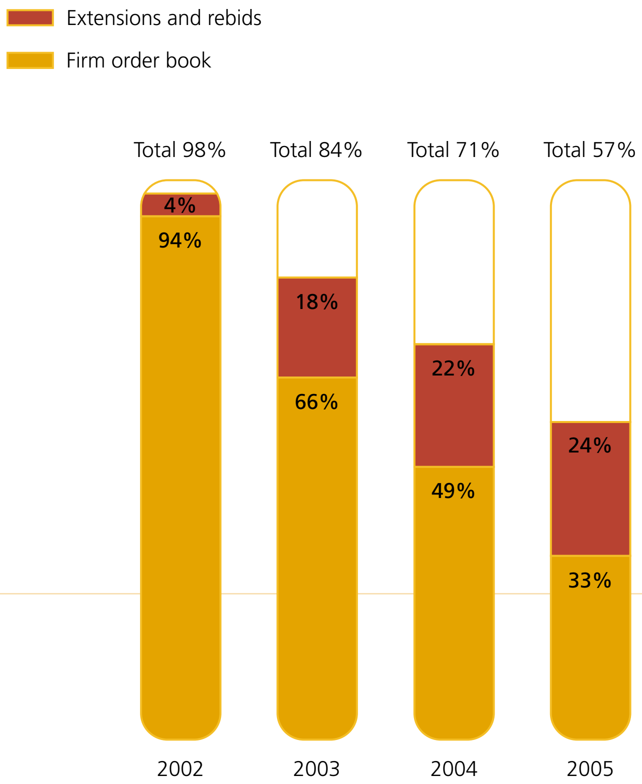
Further details of our financial performance are given in the Financial Review on page 14.

Dividend
In recognition of continued strong performance, we have increased the interim dividend by 12.3% to 0.64p per Ordinary Share (2001: 0.57p). It will be paid on 11 October 2002 to shareholders on the register at close of business on 13 September 2002.

Operational performance
Our goal is to continue strengthening our position as a leading global outsourcing company, focusing primarily on the public sector: we aim to capitalise on the worldwide trend for governments to seek private-sector support in improving the quality and efficiency of public services. Our growth strategy is to focus primarily on organic expansion, while using acquisitions, joint ventures and strategic alliances to build platforms in new or emerging markets with good long-term organic growth potential.

Figure 1 – Forward revenue visibility 2002-2005 as at 30 June 2002

Assuming a continuing 90% renewal rate on rebids, we already have contracts in place to provide 98% of forecast revenue this year, 84% in 2003, 71% in 2004 and 57% in 2005.

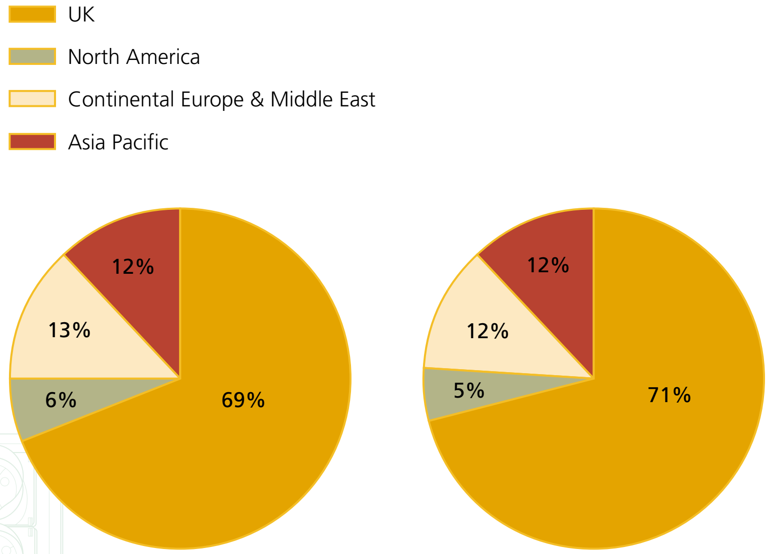


During the first half of the year we submitted bids totalling £4.7bn – a record level. We anticipate news of these during the second half. Excluding any success from these and excluding some £250m of bids where we have already been appointed preferred bidder, the forward order book is £6bn, equivalent to over five times our 2001 turnover with consequent high visibility of future sales as shown in figure 1.

During the half-year we won business totalling £400m. New awards accounted for 26% of this; 36% came from rebids; and 38% from extensions in duration and scope of existing contracts. Running our contracts as businesses helps us to develop new opportunities at contract level, and we have maintained our success rate of over 90% on rebids. We increasingly target long-term contracts – which give higher levels of visibility to our future earnings – and we continue to win over half the contracts we bid for. But our success is not predicated on winning large new contracts: as in the past, almost half of our turnover growth in the first half came from add-ons and extensions to existing contracts.

Figure 2 – Turnover growth to 30 June 2002

Figure 3 – Regional turnover



Half year 2001
Total £525.9m

Half year 2002
Total £625.9m

Major successes included appointment as preferred bidder for the new Skynet 5 satellite system, and on a three-year contract from the BBC to provide travel news on all UK road, rail, air and sea services. We won our first contract from the European Parliament, to provide IT support. And in the Middle East we won one of the region's first multi-activity outsourcing contracts from the Dubai Ports, Customs and Free Zone Corporation.

UK

The UK continues to offer abundant opportunities and remains our most significant market. First-half sales rose 23% compared with the first half of last year and market conditions favour continued healthy growth, demonstrated by our submission of over £4bn of new bids to UK customers. The government is intent on achieving significant improvement in public services with private sector support; and we expect significant new opportunities to flow from its recent Comprehensive Spending Review, which will provide an additional £125bn public spend over the next three years.

The UK has been a leader in PFIs, and Serco has been actively involved in this market as it has developed. Extensive experience in PFIs convinces us of their value in acquiring the sophisticated, long-term, multi-service contracts that we seek, both in the UK and internationally. Long-term success in this market depends on recognising and understanding the associated cash flows and risks: we have developed appropriate techniques for carefully assessing and selecting the contracts we bid, controlling bid costs and managing risk as contracts progress.

International

A distinctive feature of Serco's business is its international portfolio. Our presence in overseas markets extends the range of addressable opportunities and helps to spread risk. By enhancing our reach and scale, it also helps us to bid for larger and more sophisticated multi-service opportunities and capitalise on the UK's recognised leadership in outsourcing models.

We are focused on four overseas regions where increasingly sophisticated outsourcing opportunities are emerging – North America, Continental Europe, the Middle East and Asia Pacific.

The US is the world's largest outsourcing market. Today, the federal government purchases over US$80bn in services, including information technology, base operations and engineering services, growing by an anticipated 12% annually. The market is developing in a way that plays to our strengths, with rising investment in infrastructure and IT accompanied by an enthusiasm for innovative solutions and contract models. Our US and Canadian business is still relatively small. To make an impact in such a large market we will need to increase the scale of our operation and we continue to review the opportunities for acquisition, joint venture or strategic alliance.

In Continental Europe, where our first-half sales rose 10%, we see particular promise in Italy and Germany. Both countries are substantially increasing private sector involvement in public services. Building on our experience in the UK, we intend to continue broadening our range of services from its original focus on IT and facilities management. In Italy we submitted seven bids during the first half, and in Germany we made our largest bid yet, to operate the army's tank training school.

In Asia Pacific we continue to focus on enhancing the operational returns from the business, while preparing to address a range of emerging opportunities in New Zealand and Australia, where we await the outcome of our largest bid so far – to undertake warehousing, distribution and maintenance of defence supplies and equipment.

A message from the Board continued

Managing the business

In pursuing strong long-term growth, we take care to sustain the distinctive, highly devolved Serco culture. Our ability to enter new sectors or geographic markets successfully owes much to the resilience of this culture and to the continuing development of the Serco Management System, our methodical approach to managing both people and processes.

We replicate the group management system in all our businesses and are adapting it for managing individual contracts – which we aim to run as businesses in their own right, with individual strategic development plans. Larger contracts have management boards including non-executive directors, usually drawn from other parts of Serco. In this way, we can plan organic business growth, empowering local management to develop their businesses while maintaining effective controls.

To ensure effective governance across a diverse and devolved business, our Corporate Assurance Group provides continuous, integrated assessment of business risk and ensures that our controls remain relevant and adequate. It reports formally to the Board quarterly.

People

Whatever the strengths of our strategy and systems, we know that our success depends ultimately on the dedication and hard work of our people. We thank them for their continuing support and enthusiasm.

We remain committed to developing skills at all levels and continue to provide a broad range of management training through the Serco Best Practice Centre. During the first half, nearly 1,000 of our people attended internal workshops. We have also built strong links with relevant awarding bodies, including the UK's Institute of Directors (IoD) and the first IoD/Serco Certificates in Company Direction were achieved in April 2002.

Recognising the need to engage with employees and their representatives who may fear the impact of outsourcing on their own prospects, we continue to build constructive relationships with trade unions. In the UK we have been supporting the TUC Partnership Initiative, which aims to foster partnership between employers and trade unions: we have formed several 'working partnership' relationships with unions at contract level and will look at others in the future.

Outlook

Looking ahead, revenue visibility is excellent: assuming a continuing 90% renewal rate on rebids, we already have contracts in place to provide 98% of forecast revenue this year, 84% in 2003 and 71% in 2004.

We continue to increase our contract bid pipeline. After submitting bids worth some £4.7bn in the first half, we are currently addressing a further £12bn of opportunities. As always, we will be bidding for a well-balanced mix of business, including add-ons and extensions to existing contracts, new contracts across a broad spectrum of sectors, and a few carefully selected large contracts with annual values to Serco of between £50m and £100m.

In the UK, the additional spending announced by the government in its Comprehensive Spending Review will further enhance our growth prospects; while our existing portfolio of international markets will generate a continuing flow of new opportunities. We are confident of achieving strong growth for the remainder of 2002, and for the longer term we anticipate sustained double-digit organic growth.

Figure 4 – Breakdown of contracts signed to 30 June 2002

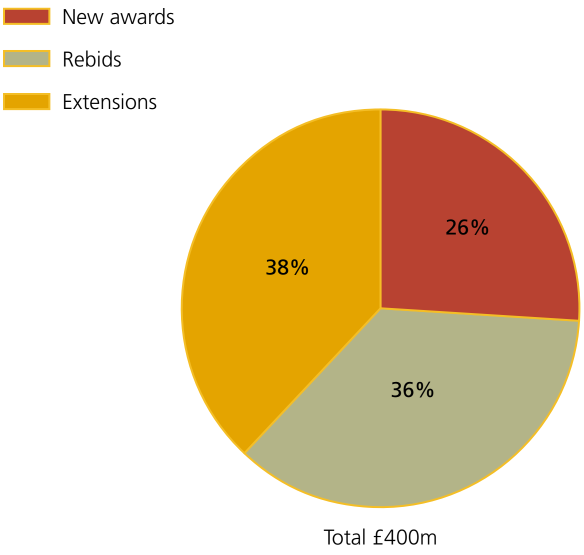
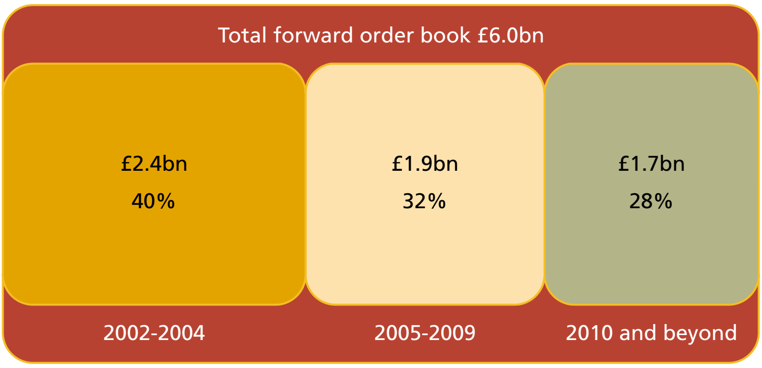


Figure 5 – Forward order book profile as at 30 June 2002



Business review

One of Serco's distinguishing characteristics is our range of geographic markets, business sectors and activities. This diversified portfolio reduces risk and gives us a broader choice of opportunities to pursue as market conditions develop.

Defence

The defence sector, our largest and longest-established market, accounted for 28% of sales.

In all our regions, defence and security activity has increased since September 11 last year. In the UK the Chancellor's 2002 Comprehensive Spending Review will raise defence spending by £3.5bn to £32.8bn in 2005/06 – the largest planned real-terms increase in 20 years. In the US the Bush Administration has secured a US$48bn increase in defence spending and a doubled homeland security budget of US$37.7bn.

Serco is a major provider of services to the UK Ministry of Defence (MoD), which has been in the forefront of developing cost-effective ways to outsource defence support activities; we expect its spending in this area to reach £6.5bn by 2010. We are also a leading provider of services to the Australian and New Zealand forces.

Our strategy is to retain and expand our existing business, leveraging our core capabilities into new, but related, areas and selected major bid opportunities. We currently hold over £1.5bn worth of defence contracts and see no shortage of future opportunities.

In February we were selected as preferred bidder for Skynet 5, a major project to provide new-generation global military satellite communications for the UK armed forces. As a member of the Paradigm Secure Communications consortium, Serco will provide network and facilities management services including spacecraft and network operations, network maintenance, training, supply management and through-life buildings and facilities maintenance. The contract, due to be awarded in October, will be the largest defence private finance initiative (PFI) to date. It is potentially worth £220m to us over 15 years.

We won two important rebids with a total operational value of almost £25m. One is a wide-ranging contract at RAF Halton, which extends through general engineering and management of the armoury to cleaning and media services. The other is to provide a comprehensive range of engineering, supply and support functions for the RAF on Ascension Island.

The UK's most powerful computer was installed at the Atomic Weapons Establishment, as part of our joint venture contract. This has cut program run time from two months to 15 minutes. Negotiations on a 15-year extension to the current 10-year contract are at an advanced stage. We are hopeful of a successful outcome, but a decision could still take some months.

In the US we successfully rebid our vehicle operations and maintenance contract at Wright-Patterson Air Force Base in Ohio. The new contract, to maintain over 400 vehicles and provide transport services, is for four years plus up to an additional three years.

In Germany we are developing a good relationship with the Ministry of Defence, and the Secretary of Defence recently opened the first of two IT training centres that we are equipping and operating for the country's armed forces. This three-year €8.1m contract is one of the German military's outsourcing pilot projects.

In the first half we submitted bids worth a total of some £3.3bn. Major bids currently awaiting decisions include: the contract to manage the MoD's entire property estate in Scotland; the RAF's Airfield Support Services Project; Army Training Estate and Northwood Permanent Joint Headquarters contracts in the UK; a contract to provide training support services at the Armoured Training Centre in Munster, Germany – the Panzertruppenschule; and the Defence Integrated Distribution System in Australia, a contract to undertake warehousing, distribution and maintenance of defence supplies and equipment. In partnership with BAE Systems, Boeing and Spectrum Capital, we are one of the two final bidders for the UK's Future Strategic Tanker Aircraft project. We expect the announcement of preferred bidder in 2003.

Transport

The transport sector has been a strong source of growth for us in recent years. In the first half it accounted for 26% of sales.

The UK government plans to increase transport spending by 12% annually in real terms, to reach £11.6bn in 2005/06.

Our UK civil transport strategy is currently primarily concentrated on road and rail. We hold the UK Rail Operator of the Year Award for the Docklands Light Railway, where we operate infrastructure, rolling stock and rail services. We operate Manchester's Metrolink light rail system, and helped keep the city moving during the Commonwealth Games by running more frequent services over longer hours to meet increased demand. Serco Rail Maintenance was recently named Training Provider of the Year 2002 by Sentinel Alliance Partners – representing Railtrack, Rail Training Audit Services and the Association of Rail Training Providers.

We remain at the cutting edge of providing solutions to complex technical problems for our customers. For example, we are preferred bidder on a contract from Railtrack to lead the technical implementation of a more sophisticated method of high-speed track recording. The ability to measure and monitor track condition within normal train operating patterns will have considerable benefits on heavily-used rail routes.

We have intended for some time to bid for selected UK rail franchises where they meet our assessment criteria. Our position has now been reinforced by an agreement to form a joint venture with the Dutch national rail operator, Nederlandse Spoorwegen. This gives us additional resources to bid further contracts and our initial targets over the coming months include the Wales and Borders and Merseyrail Electrics franchises.

In Copenhagen we are preparing for the October opening of the new Metro, which we will operate under a contract worth DKK541m. The automated, driverless light rail system will initially serve an 11-station, 13.9km route with some 180 staff, rising eventually to 300 as we open extensions.

Our PFI to establish the Traffic Control Centre (TCC) for England's strategic motorways and trunk roads is making good progress, and the structural work is substantially complete. We have been operating the Midlands Driver Information System since January, which has released valuable police resource.

In Hong Kong, where our transport sector work is focused on traffic management, we successfully rebid our contract to manage the Aberdeen Tunnel.

We have built a strong position in applying IT to the management of transport systems and information, based on our National Rail Enquiry Services and TCC contracts in the UK. Now the BBC has appointed us as preferred bidder for a three-year contract to provide it with national, regional and local travel information services covering all UK road, rail, air and sea services.

In Australia we further enhanced our tourism business for Great Southern Railway by negotiating access to the Alice Springs-Darwin rail link for our Ghan train service. The link is expected to open in December 2003.

Civil government

This is our most rapidly-evolving market with significant opportunities emerging in sectors such as healthcare and education, where outsourcing is relatively new.

In the first half, civil government contracts (excluding the transport and science sectors, which are reported as separate segments) accounted for 24% of sales.

In the UK, the Comprehensive Spending Review will take annual spending by government departments from £240bn in 2002 to £301bn in 2005/06 – a 25% uplift in three years, with the stated aim of improving public services. The principal beneficiaries will be justice, health and education. Our long track record of proven success in delivering service improvements cost-effectively puts us in a strong position to benefit from this increased spending.

Justice

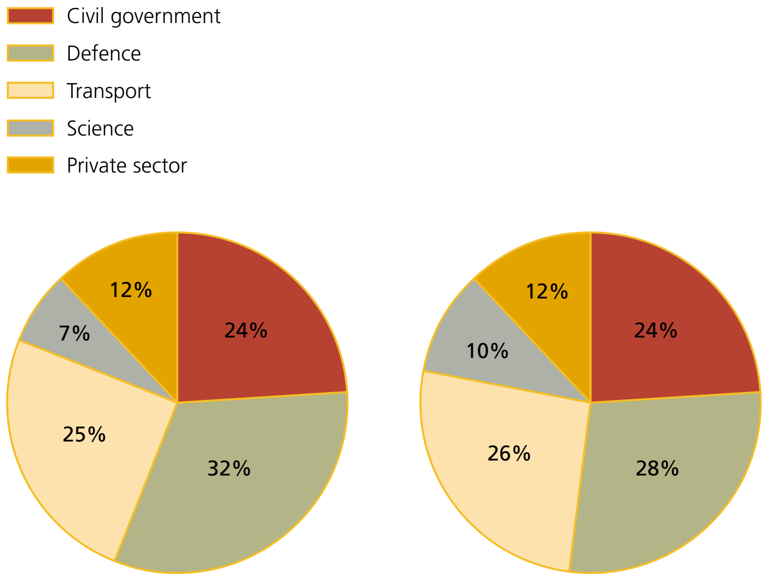
Our activity in this field is currently focused on the UK, where the criminal justice budget for England and Wales is £14.7bn this year, rising to £18.3bn over three years. We estimate our current addressable market at about £1.3bn, covering intelligence, operational support, demand management and technology services. There is a major opportunity to work with police forces in England and Wales to identify non-core activities that can be outsourced, allowing operational staff to concentrate on policing and investigation.

In addition to work for police forces, large-scale individual opportunities will come from a growing number of PFIs to provide custodial facilities for the prison services and other justice agencies. The custodial market continues to expand – current plans include two new prison PFI tenders this year, plus five new secure training centres for juvenile offenders and a considerable increase in new immigration centres over the next five years.

Electronic tagging and monitoring of prisoners is a current and rapidly-growing non-custodial market which could receive a further boost if the UK adopts proposals for weekend and night-time prison sentences that would enable offenders to retain normal employment.

Last year we stepped in at short notice to support a critical national intelligence system serving the UK's 66 police forces and other agencies. We have now been awarded a five-year contract to maintain and support the system. Building on our growing reputation for services to police forces, we won a contract from Merseyside Police to provide and support its new command and control system. We were also awarded contracts to supply and install over 300 road safety camera locations in Lancashire and West Yorkshire.

Figure 6 – Turnover by sector



Half year 2001
Total £525.9m

Half year 2002
Total £625.9m

Our development work continues on the National Crime Squad (NCS) Operations and Intelligence Management System and we have delivered the first modules, including the Evidence Management System. We have added several enhancements to the original contract. These include opening and managing a new 39,000ft^2 seized assets store, introducing a secure knowledge management system and providing the IT and communications infrastructure for the newly-formed Immigration Crime Teams. We will provide support services to these teams in line with the main NCS contract.

In May we declared our intention to acquire the remaining 50% of our Premier Custodial Group joint venture, following the merger of our partner's parent company, The Wackenhut Corporation, with Group 4 Falck A/S. Wackenhut have contested Serco's right to acquire their 50% and court proceedings have commenced to determine this right. The acquisition, if successful, will consolidate our position in a substantial and growing market.

Education

In the UK, this market has expanded and evolved rapidly over the past year. Opportunities for working in partnership with local education authorities (LEAs) continue to emerge. Over the longer term schools will continue to gain increasing autonomy to purchase the services currently provided or procured by LEAs. The education budget for England will rise by 6% a year in real terms to reach £58bn over three years – when spending per pupil will be 50% higher in real terms than in 1997. We have been developing an extended range of services for schools to enhance our market position. Our turnover in education is currently around £50m a year.

In April we retained and expanded a contract worth over £3m a year to inspect more than 200 schools annually for the education inspectorate, Ofsted. Since then, our progress in Walsall where we provide services on behalf of the LEA, has demonstrated how our effective management drives strong organic growth. In April, Ofsted commended our service quality in Walsall and our progress in restructuring and redefining school support services. After reviewing the remaining services provided by the LEA, Ofsted recommended that these, too, should be outsourced. We have been invited to take responsibility for them, and expect to conclude a contract during September, resulting in a threefold increase in the contract.

Outside the UK, our activities in the education sector include managing and maintaining school and university facilities in Australia and Sweden. We recently won a new contract to provide facilities management, teaching assistants and administrative support to a new 1,200-pupil secondary school in Hong Kong. We are currently preparing the school for its opening in September, and will be pursuing further opportunities in web-based learning, school improvements and management services.

Health

The majority of our activity is currently in the UK – where the health sector was the principal beneficiary of the Comprehensive Spending Review budget increases. NHS spending is set to rise by £40bn a year to reach £109.4bn in 2007/08. We expect this to open up new opportunities for public private partnership (PPP) in the NHS. We are in an excellent position to build on our track record in PFIs with the new capital investment programme in primary and secondary care infrastructure. New markets are emerging in information technology and in clinical service provision as well as a variety of support service partnerships in areas like education and training. Outside the UK we provide hospital support services in Hong Kong and Australia.

Our involvement in two of the first wave of UK hospital PFIs, Norfolk and Norwich University Hospital and Wishaw General Hospital – both now operational – has brought our total health turnover to some £40m a year. A further 13 hospital PFIs are currently planned in England and additional opportunities will come from the NHS Local Improvement Finance Trust (LIFT) programme, which aims to deliver £1bn of extra investment into modernising primary care facilities and services.

In May we broadened our capabilities by acquiring SDC Consulting, a leading provider of strategic consultancy services to NHS customers. We combined this with another recent acquisition – Serco Euromedic, a brokerage business facilitating the private-sector treatment of patients on NHS waiting lists. This enables us to grow into both existing and emerging health markets by developing a new solutions business – Serco Health – combining a strengthened consultancy and advisory practice, delivery of mid-size capital schemes like LIFT and participation in clinical and non-clinical support service PPPs.

Other public services

In the UK we won a 10-year rebid and expansion of our environmental services contract with Canterbury City Council, worth £53m. The new contract represents a deeper level of partnership with the council – and includes operating the call centre which is the customer's first point of contact, taking 100,000 calls a year on a wide range of council services.

Science

Contracts in the science sector accounted for 10% of sales. This is a relatively recent but fast-emerging sector where we have particular competitive strength. Our activities range from managing the UK's National Physical Laboratory (NPL) to working as a leading supplier of scientific and IT services to the European Space Agency. We aim to be recognised by governments around the world as the best private-sector partner for the management of scientific organisations, science programme management and the delivery of consulting and related services.

In the UK we have demonstrated our capability in PPPs, nuclear and safety activities, and managing large science-based organisations. This provides a model which we believe can be applied in other countries as they involve the private sector in the delivery of public science services. UK government investment in science, engineering and technology was £6.8bn in 2000 and we expect it to increase to £7.6bn by the end of 2003/04.

In the run-up to a rebid at NPL, our contract has been extended for a further three months to 30 September 2003. This extends our original contract to a total of eight years.

Serco Assurance (formerly the consulting division of AEA Technology) has substantially augmented our offering in nuclear safety. It has been integrated with our science business, is performing in line with expectations and is already generating new opportunities. Contract extensions included two three-year contracts from the UK MoD to provide research and support services aimed at detecting and managing battlefield radioactivity hazards.

In May Serco Assurance won a new contract to support the BNFL Magnox Reactor Services Organisation with a range of technical services, in a consortium led by Mitsui Babcock. The consortium will provide 85% of the external technical support to the organisation's six operating Magnox nuclear power stations, and this is the first time such a contract has been let in the UK civil nuclear industry. The value to Serco will be approximately £10m over three years, with a possible two-year extension.

Private sector

The private sector accounted for 12% of sales. Because of the scope available to us in the public sector, this market has not been a primary focus so far. But it does provide opportunities which we address selectively. Our existing business consists mainly of multi-service facilities management contracts for blue-chip clients.

In the Middle East, our new Serco Gulf joint venture won a 10-year contract to deliver engineering and other support services to the Dubai Ports, Customs and Free Zone Corporation at Jebel Ali, Port Rashid and other locations in Dubai. This is a ground-breaking contract that should provide a springboard to other government contracts in this expanding marketplace – initially in Dubai and eventually in the rest of the United Arab Emirates and other Gulf countries.

In Germany we manage several service and repair training centres for automotive customers. We recently successfully rebid a five-year contract with Ford to manage its Buchholz training centre.

Our core outsourcing business has developed sophisticated change management skills and processes, and we are always alert to new ways of applying these techniques. We have recently formed a relationship with Warnborough Asset Management, which will use our change management expertise to add value to the businesses it invests in. Warnborough Asset Management has launched a new fund that will invest in UK and Continental European companies valued between £10m and £150m.

Financial review

Financial performance

Sales

Total sales increased by 19% to £625.9m. This includes a contribution of £22.8m from Serco Assurance (formerly the consulting division of AEA Technology), which was acquired in September 2001.

Gross profit

Gross profit of £71.1m represents a return on sales of 13.6%, up from 13.3% for the six months to 30 June 2001.

Pre-tax profit

Pre-tax profit increased 16.4% to £28.4m before goodwill amortisation.

Underlying pre-tax profit

Underlying pre-tax profit before goodwill grew 20.5% to £27.3m. This is stated after adjusting for a £1.1m contribution from Serco Assurance, which is included in the half-year results for the first time. This contribution is before goodwill and after financing and phase-in costs.

Underlying profit for the first six months of 2001 is stated after adjusting for a net contribution of £1.7m from three non-recurring items: £10.2m cost of the unsuccessful National Air Traffic Services (NATS) acquisition, £3.4m investment in the People and Technology programme and £15.3m profit from refinancing the rolling stock of Great Southern Railway (GSR).

	6 Months to 30.6.02 £'m	6 Months to 30.6.01 £'m	Increase
Reported pre-tax profit before goodwill amortisation	**28.4**	24.4	16.4%
Net one-off items	**–**	(1.7)	
Acquisition: Serco Assurance	**(1.1)**	–	
Underlying pre-tax profit before goodwill amortisation	**27.3**	22.7	20.5%

Tax

The tax charge was £8.3m (2001: £7.3m), representing an effective tax rate of 34% (2001: 32.5%).

Earnings per share

Taking into account the above and the new equity issued in March, earnings per share before goodwill amortisation grew by 11% to 4.84p (2001: 4.36p).

Dividends

The proposed interim dividend of 0.64p per share is a 12.3% increase on 2001.

Cash flow
During the six months to 30 June 2002 there was a net cash inflow of £95.9m. This was after making a one-off payment of £15.5m into the Serco Pension and Life Assurance Scheme in February and receiving £118m from the equity issue in March. These items are explained in greater detail below.

Operating cash flow, before one-off items, was £11.7m, which converts 69% (2001: 56%) of our operating profit into cash.

We believe that, as operating profit is calculated after deducting goodwill and depreciation, the appropriate measure for operating cash flow performance is the conversion of Group EBITDA (Earnings Before Interest, Tax, Depreciation, Goodwill Amortisation) before one-off items into cash. For the six months to 30 June 2002 this was 41% (2001: 33%).

Dividends from joint ventures increased from £2.4m in the six months to 30 June 2001 to £6.2m in the six months to 30 June 2002.

Capital expenditure, excluding investment in PFI Special Purpose Companies (SPCs), for the six months to 30 June 2002 was £8.2m; as a proportion of turnover this expenditure has remained at a similar level to previous years.

Share placement
In March £118m, net of fees, was successfully raised through an international bookbuilt placing of 39.5m new shares representing 9.9% of Serco's issued share capital. This enabled the Serco Assurance acquisition finance to be repaid and the balance sheet to be strengthened to finance future growth.

Private Finance Initiatives (PFIs)
The document 'Our Approach to PFIs', which was originally issued in September 2001, has been updated and provides a summary of our accounting for PFIs. It is available on our website www.serco.com or in printed form on request.

PFI profile
For the six months to 30 June 2002 PFIs contributed £51.5m to turnover and £7.1m to profit for the year, of which £46.3m of the turnover and £3.7m of the profit related to the operating contracts, and £5.2m of the turnover and £3.4m of the profit to Serco's share of the SPCs.

SPC funding and accounting
SPC funding is provided by long-term loans which are non-recourse to Serco.

- Our share of non-recourse debt of joint venture SPCs at 30 June 2002 is £211.1m. This is included within investments in joint ventures shown on the Summary Balance Sheet.
- Traffic Information Services (TiS) Limited is the first SPC where Serco has chosen to own 100% of the equity. This SPC has the contract to deliver the Traffic Control Centre contract. A non-recourse loan of £19.7m to fund the asset, currently in the course of construction, is included in long-term creditors in the Summary Balance Sheet. £5.6m was drawn down in the six months to 30 June 2002 and is shown separately in the Summary Cash Flow Statement.
- In June 2002 the senior lenders and the terms of the senior debt on the Joint Services Command and Staff College PFI were changed. This transaction had no effect on profit but allowed £6.7m of cash to be passed from the SPC to Serco by way of dividend and loan.

Review of joint venture accounting and controls

In March 2002, in recognition of the perceived uncertainties arising from certain joint venture accounting practices in the US, the Board undertook a specific review, including asking Deloitte & Touche to undertake an independent review of our accounting procedures and internal controls over our joint ventures. This review confirms the Board's view that all our joint ventures exist for genuine commercial reasons, are correctly accounted for and that our controls and disclosures are appropriate.

Bid costs

Urgent Issues Task Force (UITF) Abstract 34 'Pre-contract costs' was issued in May 2002 for accounting periods ending on or after 22 June 2002. UITF Abstract 34 requires all bid costs to be expensed up to the point where award of a contract is 'virtually certain'. Bid costs incurred after this point may be capitalised. At 31 December 2001 we had £1.2m of bid costs capitalised in relation to contracts for which we had not formally reached preferred bidder status. Applying the Abstract has resulted in a prior period adjustment to treat these capitalised costs as expensed in 2001. There was no material impact on the first half of 2001 or earlier accounting periods. Having made this adjustment our accounting policies now fully comply with UITF Abstract 34.

Deferred taxation

Financial Reporting Standard (FRS) 19 'Deferred Taxation' was issued in December 2000 for accounting periods ended on or after 23 January 2002. FRS 19 requires full provision to be made for deferred tax assets and liabilities arising from timing differences between the recognition of gains and losses in the financial statements and their recognition in a tax computation.

The tax charge for the six months ended 30 June 2002 is based on the tax charge expected for the year to 31 December 2002, which has been calculated in accordance with FRS 19.

As at 31 December 2001 the Group did not have a material level of unprovided deferred tax liabilities or unrecognised deferred tax assets. The application of FRS 19 will not have a material effect on the tax charge for the period.

Pensions

Two of Serco's pension schemes are defined benefit schemes. FRS 17 'Retirement Benefits' was issued in November 2000 to replace SSAP 24 for accounting periods ending on or after 22 June 2003. In July 2002 the Accounting Standards Board announced it was delaying the introduction of FRS 17 until 2005, following an announcement by the International Accounting Standards Board to also issue a new standard.

For 2002 we will continue to apply the transitional rules and disclosures. FRS 17 requires the market value of assets and liabilities to be calculated for defined benefit schemes and to be included on the balance sheet. At 31 December 2001 there was a small net deficit of £3.6m in relation to the defined benefit schemes. While we are not required to undertake a full actuarial valuation of the schemes at 30 June 2002, we estimate that the deficit has increased to £15m. The asset base of the schemes is approximately £300m and long-term contribution rates will address this shortfall if the deficit continues.

The pension charge under FRS 17 for the six months to 30 June 2002 would not have been materially different from the SSAP 24 pension charge.

It is our intention to merge Serco's two defined benefit pension schemes by early 2003 to help improve cost and investment efficiencies. To assist this process £15.5m was injected into the Serco Pension and Life Assurance Scheme in February 2002 to achieve a similar funding level for both schemes.

Presentation of results

As explained above, we have adopted FRS 19 and UITF Abstract 34 in this Interim Report. The adoption of UITF Abstract 34 has resulted in the restatement of the financial statements for the year to 31 December 2001.

In addition, results for the six months to 30 June 2001 have been restated to allow effective comparison with the results for the six months to 30 June 2002. These restatements have no impact on the Group's profit or cash:

- In accordance with industry practice £5.9m of joint venture turnover shown in the 2001 Interim Report, representing the finance income element of the capital repayment from PFIs, has been restated and shown as joint venture interest receivable.
- To achieve consistency with the presentation adopted at 31 December 2001, and in accordance with FRS 5, the PFI asset under construction on the Traffic Control Centre contract has been reclassified from fixed assets to current assets in the Summary Balance Sheet. The corresponding cash outflow is now shown separately in the Summary Cash Flow Statement as a deduction from cash flow from operating activities rather than within capital expenditure.

As in the past we have included a proforma profit and loss account to assist in analysing the Group's results.

Auditors

We have asked Deloitte & Touche to perform a review of the financial statements and notes included in this Interim Report. This is the first time we have asked for such a review and there is no statutory requirement to do so. The review is conducted in accordance with the guidance contained in Bulletin 1999/4 issued by the Auditing Practices Board. The opinion given is not an audit opinion, but assesses whether the accounting policies and presentation have been consistently applied.

Independent review report to Serco Group plc

Introduction

We have been instructed by the company to review the financial information for the six months ended 30 June 2002 which comprises the Summary Profit and Loss Account, Summary Balance Sheet, Summary Cash Flow Statement and related notes 1 and 2. We have read the other information contained in the Interim Report and considered whether it contains any apparent misstatements or material inconsistencies with the financial information.

Directors' responsibilities

The Interim Report, including the financial information contained therein, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the Interim Report in accordance with the Listing Rules of the Financial Services Authority which require that the accounting policies and presentation applied to the interim figures should be consistent with those applied in preparing the preceding annual accounts except where any changes, and the reasons for them, are disclosed.

Review work performed

We conducted our review in accordance with the guidance contained in Bulletin 1999/4 issued by the Auditing Practices Board for use in the UK. A review consists principally of making enquiries of group management and applying analytical procedures to the financial information and underlying financial data and, based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit performed in accordance with UK auditing standards and therefore provides a lower level of assurance than an audit. Accordingly, we do not express an audit opinion on the financial information.

Review conclusion

On the basis of our review we are not aware of any material modifications that should be made to the financial information as presented for the six months ended 30 June 2002.

Deloitte & Touche

Deloitte & Touche
Chartered Accountants
London

5 September 2002

Notes

A review does not provide assurance on the maintenance and integrity of the website, including controls used to achieve this, and in particular on whether any changes may have occurred to the financial information since first published. These matters are the responsibility of the directors but no control procedures can provide absolute assurance in this area.

Legislation in the UK governing the preparation and dissemination of financial information differs from legislation in other jurisdictions.

Proforma Summary Consolidated Profit and Loss Account

For the six months ended 30 June 2002

	6 Months to 30.6.02 £'000	Restated 6 Months to 30.6.01 £'000	Restated Year to 31.12.01 £'000
Turnover: Group and share of joint ventures – continuing operations	**625,936**	525,895	1,141,203
Less: Share of joint ventures	**(103,895)**	(91,668)	(227,510)
Group turnover	**522,041**	434,227	913,693
Cost of sales	**(450,903)**	(376,476)	(789,686)
Gross profit	**71,138**	57,751	124,007
Administrative expenses	**(46,539)**	(40,203)	(88,742)
Exceptional item: Cost of unsuccessful NATS acquisition	**–**	(10,187)	(10,187)
Exceptional item: GSR refinancing	**–**	15,356	15,356
Share of profits arising from joint ventures – including group joint venture costs and joint venture interest	**6,212**	4,242	9,820
Profit before group interest and goodwill	**30,811**	26,959	50,254
Net group interest	**(2,416)**	(2,563)	(5,092)
Profit on ordinary activities before taxation – pre amortisation of goodwill	**28,395**	24,396	45,162
Amortisation of goodwill	**(3,870)**	(1,970)	(5,123)
Profit on ordinary activities before taxation	**24,525**	22,426	40,039
Taxation on profit on ordinary activities	**(8,339)**	(7,288)	(13,012)
Profit on ordinary activities after taxation	**16,186**	15,138	27,027
Dividends	**(3,257)**	(2,270)	(7,265)
Retained profit	**12,929**	12,868	19,762

Basis of preparation

As in our 2001 Annual Review and Accounts we have included a Proforma Summary Consolidated Profit and Loss Account as an alternative presentation to aid in the understanding of the Group results. The Proforma is derived directly from the Summary Consolidated Profit and Loss Account.

Summary Consolidated Profit and Loss Account

For the six months ended 30 June 2002

	6 Months to 30.6.02 £'000	Restated 6 Months to 30.6.01 £'000	Restated Year to 31.12.01 £'000
Turnover: Group and share of joint ventures – continuing operations	**625,936**	525,895	1,141,203
Less: Share of joint ventures	**(103,895)**	(91,668)	(227,510)
Group turnover	**522,041**	434,227	913,693
Cost of sales	**(450,903)**	(376,476)	(789,686)
Gross profit	**71,138**	57,751	124,007
Administrative expenses	**(50,409)**	(42,173)	(93,865)
Amortisation of goodwill	**(3,870)**	(1,970)	(5,123)
Other administrative expenses	**(46,539)**	(40,203)	(88,742)
Exceptional item: Cost of unsuccessful NATS acquisition	**–**	(10,187)	(10,187)
Other operating costs relating to joint ventures	**(3,887)**	(3,352)	(8,888)
Operating profit - continuing operations	**16,842**	2,039	11,067
Exceptional item: GSR refinancing	**–**	15,356	15,356
Share of operating profit in joint ventures	**9,589**	7,508	17,374
Net interest			
Group	**(2,416)**	(2,563)	(5,092)
Share of joint ventures	**510**	86	1,334
Profit on ordinary activities before taxation	**24,525**	22,426	40,039
Taxation on profit on ordinary activities	**(8,339)**	(7,288)	(13,012)
Profit on ordinary activities after taxation	**16,186**	15,138	27,027
Dividends	**(3,257)**	(2,270)	(7,265)
Retained profit	**12,929**	12,868	19,762
Earnings per share (EPS) of 2p each:			
Basic EPS, after amortisation of goodwill	**3.91p**	3.86p	6.94p
Basic EPS, before amortisation of goodwill	**4.84p**	4.36p	8.25p
Diluted EPS, after amortisation of goodwill	**3.90p**	3.84p	6.91p
Diluted EPS, before amortisation of goodwill	**4.84p**	4.33p	8.22p
Dividend per share	**0.64p**	0.57p	1.86p

Notes to the Summary Consolidated Profit and Loss Account are on page 23.

Summary Consolidated Balance Sheet

As at 30 June 2002

	As at 30.6.02 £'000	Restated As at 30.6.01 £'000	Restated As at 31.12.01 £'000
Fixed Assets			
Intangible assets	**141,570**	70,346	141,170
Tangible assets	**51,379**	46,411	48,724
Investments in joint ventures	**30,650**	31,707	30,510
Investment in own shares	**18,487**	9,350	18,983
Total fixed assets	**242,086**	157,814	239,387
Current assets/(liabilities)			
Stocks	**29,771**	28,231	35,838
Debtors	**295,054**	217,790	275,810
Cash (net of overdraft)	**60,039**	43,467	(35,835)
Trade and other creditors	**(145,868)**	(147,310)	(163,294)
Accruals and deferred income	**(119,004)**	(91,832)	(128,629)
Net current assets/(liabilities)	**119,992**	50,346	(16,110)
Long-term creditors+	**(72,847)**	(59,643)	(68,570)
Provisions for liabilities and charges	**(27,276)**	(25,916)	(25,636)
Equity shareholders' funds	**261,955**	122,601	129,071

+Includes £19.7m of PFI related non-recourse bank loans at 30 June 2002 (at 30 June 2001: £6.6m and at 31 December 2001: £14.1m).

Summary Consolidated Cash Flow Statement

For the six months ended 30 June 2002

	6 Months to 30.6.02 £'000	Restated 6 Months to 30.6.01 £'000	Restated Year to 31.12.01 £'000
Operating profit pre NATS cost	**16,842**	12,226	21,254
Exceptional item: Cost of unsuccessful NATS acquisition	**–**	(10,187)	(10,187)
Operating profit	**16,842**	2,039	11,067
Depreciation and amortisation of goodwill	**11,494**	8,131	18,283
Movement in working capital	**(16,652)**	(13,542)	(13,866)
One-off pension fund contribution	**(15,500)**	–	–
Net cash (outflow)/inflow from operating activities before PFI asset expenditure	**(3,816)**	(3,372)	15,484
Expenditure on PFI asset in the course of construction*	**(5,063)**	(6,501)	(13,733)
Net cash (outflow)/inflow from operating activities after PFI asset expenditure	**(8,879)**	(9,873)	1,751
Dividends received from joint ventures	**6,172**	2,376	9,645
Returns on investments and servicing of finance	**(2,952)**	(2,711)	(5,604)
Taxation	**(2,468)**	(1,824)	(6,417)
Capital expenditure and financial investment	**(8,907)**	9,300	(14,623)
Capital expenditure and financial investment	**(8,907)**	(8,559)	(30,966)
Exceptional item: GSR refinancing	**–**	17,859	16,343
Acquisitions and disposals	**(3,187)**	(3,493)	(73,586)
Equity dividends paid	**(5,536)**	(4,425)	(6,664)
Net cash outflow before financing	**(25,757)**	(10,650)	(95,498)
Financing	**121,631**	8,620	14,166
Financing	**116,031**	2,020	66
Non-recourse debt financing PFI asset*	**5,600**	6,600	14,100
Increase/(decrease) in cash	**95,874**	(2,030)	(81,332)
Opening balance	**(35,835)**	45,497	45,497
Closing balance	**60,039**	43,467	(35,835)

* PFI asset under construction financed by non-recourse loan.

Interim Report

As required by Section 240 of the Companies Act 1985, notification is hereby given that the accounting information contained in the Interim Report for 2002 does not comprise a full set of accounts and that no full accounts have been delivered to the Registrar of Companies. The interim results for both 2001 and 2002 are unaudited whilst the results for the 2001 full year were audited, and an unqualified audit report was made. The 2001 full year accounts have been delivered to the Registrar of Companies.

Distribution of Report

Copies of this Report are being sent to all shareholders of Serco Group plc. Copies can be obtained from our website www.serco.com or on request from the Registered Office:

Serco Group plc
Dolphin House
Windmill Road
Sunbury-on-Thames
Middlesex TW16 7HT
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Notes

For the six months ended 30 June 2002

1. Earnings per share

The calculation of basic earnings per Ordinary Share after goodwill is based on profits of £16,186,000 for the six months ended 30 June 2002 (2001: £15,138,000) and the weighted average number of 414,132,355 (2001: 392,139,870) Ordinary Shares of 2p each in issue during the period.

The calculation of basic earnings per Ordinary Share before goodwill is based on profits of £20,056,000 for the six months ended 30 June 2002 (2001: £17,108,000) and the weighted average number of 414,132,355 (2001: 392,139,870) Ordinary Shares of 2p each in issue during the period.

The calculation of diluted earnings per Ordinary Share after goodwill is based on profits of £16,186,000 for the six months ended 30 June 2002 (2001: £15,138,000) and the weighted average number of 414,798,700 (2001: 394,727,800) Ordinary Shares of 2p each in issue during the period.

The calculation of diluted earnings per Ordinary Share before goodwill is based on profits of £20,056,000 for the six months ended 30 June 2002 (2001: £17,108,000) and the weighted average number of 414,798,700 (2001: 394,727,800) Ordinary Shares of 2p each in issue during the period.

2. Analysis of profit before tax – pre goodwill

	6 Months to 30.6.02 £'000	6 Months to 30.6.01 £'000
Profit on ordinary activities before taxation reported	**24,525**	22,426
Amortisation of goodwill	**3,870**	1,970
Profit on ordinary activities before taxation – pre amortisation of goodwill	**28,395**	24,396
Exceptional item: Cost of unsuccessful NATS acquisition	**–**	10,187
Investment: People and Technology project	**–**	3,440
Exceptional item: GSR refinancing	**–**	(15,356)
Less: Serco Assurance contribution after phase-in costs and associated financing costs	**(1,091)**	–
Underlying profit on ordinary activities before taxation – pre amortisation of goodwill	**27,304**	22,667

Shareholder information

Shareholder enquiries
Shareholders who have questions relating to the Group's business or wish to receive further copies of this Interim Report should contact Serco's investor relations team on +44 (0)1932 755900 or email investorcentre@serco.com.

If you have any queries about your shareholding please contact the company's Registrars at the following address:

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T (UK only): 0870 600 3964
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www.shareview.co.uk

Further information
You can find further information about Serco on our website at www.serco.com. This includes a news section for the latest company press releases and a dedicated investor centre where you can view and download our Interim Report and Annual Review and Accounts. The investor centre also offers useful information specifically for Serco shareholders including how to change your contact details, check your share account online, receive electronic communications or reinvest your dividend.

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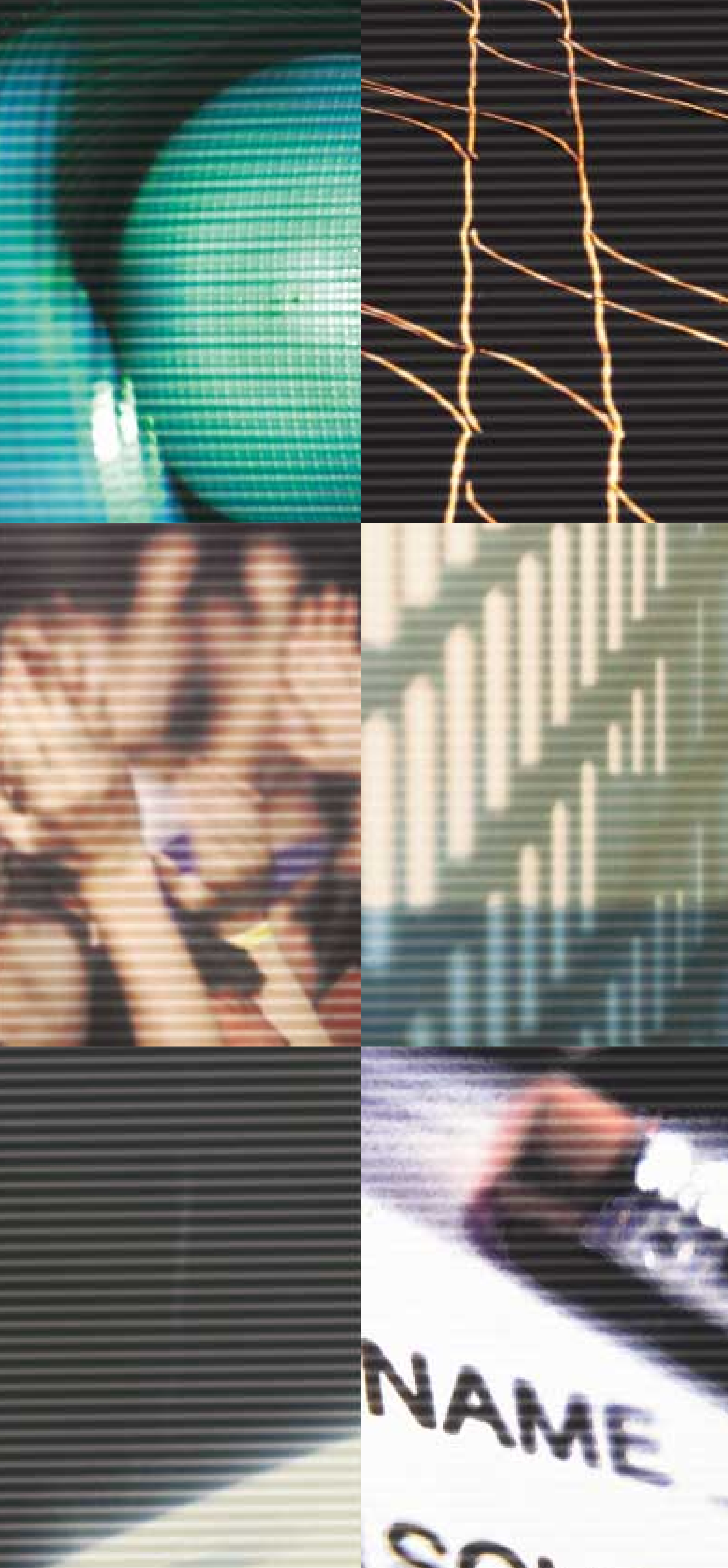
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