

# Stock Exchange Announcement

## Trading Update for 2015 Outcome and 2016 Outlook

7 December 2015

Serco Group plc ('Serco' or 'the Group'), the international service company, today provides a trading update covering the expected trading outcome for its 2015 financial year and the outlook for 2016.

### Summary

- Trading in 2015 likely to be ahead of previous guidance; Underlying Trading Profit (as defined below) expected to be around £95m.
- Reported Trading Profit in 2015 likely to be significantly higher than Underlying Trading Profit; improved operational performance or renegotiation on some loss-making contracts will result in a substantial net release of OCPs and other Contract and Balance Sheet Review items.
- Free cash outflow for 2015 will be better than previously anticipated; closing net debt, assuming completion of the offshore BPO disposal in the coming weeks, now expected to be around £100m.
- Revenue and Trading Profit will decline further in 2016, reflecting the BPO disposal and net contract attrition; Underlying Trading Profit anticipated to be around £50m; however, the positive developments on onerous contracts contribute to an anticipated improvement in free cash outflow compared to 2015.
- Targeted cost savings exceeded in 2015; over £50m of further central support and other overhead savings targeted for 2016.

Rupert Soames, Group Chief Executive Officer, said: *"We expect to deliver a better performance than we originally expected in 2015, which reflects the fact that we are beginning to make progress and are delivering on our promises."*

*"Serco has achieved a great deal in 2015: we have reinforced the balance sheet, significantly reduced net debt, agreed the disposal of our offshore BPO business, started to implement our new strategy, reduced costs, vastly improved the reporting processes, recruited new management, and improved the position on several of our largest loss-making contracts."*

*"In November 2014, when we announced the initial findings of our Contract and Balance Sheet Review with its consequent write down of assets, we said that we expected 2016 to be a further challenging year. We still expect this to be the case, caused in part by continued attrition of the contract base, and in part by the BPO disposal. 2016 and 2017 involves much work to rebuild our new business pipeline and become more cost efficient, but our view of the longer term recovery potential is unchanged, and we are increasingly confident that we have the right team, actions and underlying business strength to succeed."*

### 2015 Trading Outcome

At the time of the Group's half-year results reported on 11 August 2015, we maintained our guidance given at the time of our Rights Issue which included Revenue of around £3.5bn and Underlying Trading Profit of around £90m. Underlying Trading Profit excludes OCP releases or charges, other Contract and Balance Sheet Review adjustments, the beneficial treatment of depreciation and amortisation of assets held for sale, and any other one-time items such as the previously described profit on early termination of a UK local authority contract. It also assumes that the offshore private sector BPO operations would be consolidated in Revenue and Trading Profit through to 31 December 2015; completion of the agreed sale of this business, which is subject to regulatory approvals, is still anticipated to occur by the end of the year or very early in 2016.

On the same basis, Revenue is likely to be around the previous guidance of £3.5bn. It was stated at the time of the half-year results that 'risks were weighted to the upside' in respect of Underlying Trading Profit guidance of around £90m; our latest view, based upon trading to the end of November and the forecast for the month of December, is now an outcome of around £95m. This improvement is in part due to us exceeding our targets to extract £20m of overheads and other cost savings in 2015 from specific initiatives, which has helped to offset other pressures such as lower levels of ad hoc work for customers.

As noted in the recent announcement regarding the Armidale Class Patrol Boat (ACPB) contract, we expect a decrease in the overall level of the Group's OCPs. The net provision release will result in a Reported Trading Profit significantly higher than the Underlying Trading Profit for the 2015 financial year. A detailed assessment of Serco's contracts subject to OCPs, as well as all other Balance Sheet Review items, will be carried out as part of

the year-end audit process. The full year results will include reconciliations of the various profit measures and also report on the profit forecast provided at the time of the Rights Issue.

Free cash flow has been hard to forecast as we have sought to normalise cash management at statutory period ends. We now expect the level of free cash outflow to be better than we previously anticipated, which includes the benefit of lower utilisation of OCPs. Our latest view of overall cash generation is therefore ahead of previous guidance, and now indicates that closing net debt would be around £300m before net proceeds from the BPO disposal; if the transaction completes prior to 31 December 2015, closing net debt would be around £100m.

### 2016 Outlook

The Group has yet to finalise its budgets for 2016. However, we now have enough information to form an initial view of the likely trading performance for 2016. Assuming the BPO disposal has completed by the end of 2015, we now expect Revenue of approximately £2.8bn and Underlying Trading Profit of approximately £50m in 2016. This view of Underlying Trading Profit is before any future adjustments to OCPs should these arise during the year.

As described in the announcement of 16 September 2015, the exit of private sector BPO operations will reduce Revenue by approximately £300m. The offshore BPO operations being disposed are expected to contribute Underlying Trading Profit of over £20m in 2015; assuming completion by the end of 2015, there will be no profit contribution in 2016. The UK private sector onshore BPO operations are expected to make an Underlying Trading Loss of around £10m in 2015. The budgeted Underlying Trading Loss from the residual UK operations up to the point of their assumed exit during 2016, together with the effect of 'stranded' costs, is unlikely to reduce this level of loss materially in 2016 compared to 2015. The overall impact from exiting our private sector BPO operations is therefore budgeted to reduce the Group's Underlying Trading Profit by approximately £20m.

Revenue attrition is now estimated to be up to £500m. This is a higher level of attrition than the £350m that was known at the time of reporting the half-year results, with the increase arising mainly in the Americas division. Including the joint venture profit reduction from the end of the Northern Rail franchise, the impact of the profit contribution associated with attrition is approximately £40m.

The budgets include around £100m of incremental Revenue from already secured or potential new business. Limited progress on new growth in 2016 reflects the weakness in the bid pipeline during the last two years.

The total net Revenue reduction is therefore potentially up to £700m, or approximately 20%, of which just under half reflects the exit of private sector BPO operations. In the light of the associated reduction in profit contribution, we are continuing to target cost reductions in both central support functions and other overheads. Having over-achieved against our target of £20m in savings in 2015, within our budgets we are now setting ourselves an increased target of achieving over £50m in further savings in 2016.

Free cash outflow is anticipated to improve compared to 2015 due to the stabilisation of working capital flows and lower cash outflows related to contracts with an OCP; we anticipate total net cash outflow of around £100m in 2016, which would result in closing net debt of around £200-250m, equivalent to financial leverage of approximately 2-2.5x EBITDA (as defined for covenant purposes).

### Ends

#### For further information please contact Serco:

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#### Conference call details for institutional investors and analysts:

A call for institutional investors and analysts will be held today at 8.30am UKT. This can be fully accessed on +44 (0) 20 3003 2666 (UK toll-free 0800 109 0700; USA +1 212 999 6659; USA toll-free 866 966 5335). The call will also be audiocast live on a listen-only basis on [www.serco.com](http://www.serco.com) with a replay available subsequently on demand. A replay will be available for seven days on +44 (0) 20 8196 1998 (UK toll-free 0800 633 8453; USA toll-free 866 583 1035) using replay PIN code 4731745#.

#### 2015 full year results announcement date:

Serco will release its 2015 results on Thursday 25 February 2016.

### **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](http://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", "should", "will" and similar expressions identify forward looking statements. By their nature, these forward looking statements are subject to a number of risks and uncertainties 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 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 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. These forward looking statements speak only as of the date of this announcement. 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.