Further to the announcement of 28 April 2014 regarding an update on performance, Serco Group plc (Serco) is issuing the following Interim Management Statement (IMS) covering its performance from 1 January 2014 to date. This provides further detail on our revised outlook for the 2014 financial year together with a trading and operational update; initial comments are also included on a proposed placing of new ordinary shares and on the strategic review process.

Rupert Soames, who takes up the role of Group Chief Executive Officer on 1 May, said: “Year-to-date performance has been weaker than the business expected, and this shortfall has had two impacts. First, it has made the original targets for the second half of 2014 even more challenging, and secondly it has required the Board to take a more cautious view of projections. The judgement of the likely out-turn for the year has therefore been materially reduced, with a consequent impact on our leverage ratios, which, without remedial action, would be uncomfortably close to their limits at the half-year. Accordingly, we will be seeking to strengthen the balance sheet via an equity placing of up to 49,932,918 shares, representing up to 9.99% of existing share capital, and will shortly be making a further announcement in this regard.

“The proposed equity placing has a single purpose: to give us the opportunity to conduct a thorough review of the strategy of the business whilst remaining within the terms of our debt facilities. This strategy review, which has already begun, will take about nine months to complete, and we expect to present the conclusions of it to analysts and investors at the time of reporting our 2014 full year results. I fully expect that this strategy review will enable us to establish a clear path to rebuild for the future.”

Revised outlook for the 2014 financial year

For the year as a whole, our internal forecasts are that revenue will be slightly (about 1%) lower than we previously thought, although we still anticipate that Adjusted revenue will be in the range of £4.7 – 4.9bn at constant currency. The Group has approximately half of its revenue in non-sterling currencies. Should the latest currency rates continue throughout the remainder of the year, it is estimated that the Group’s revenue on a reported basis would be approximately £0.2bn lower.

At the time of reporting our 2013 results, we stated that we expected Adjusted Operating Profit in 2014 would be in the range of £220 – 250m at constant currency. Sharp declines in trading margin in the first quarter, and a weakened outlook for the first half, have led us to reassess the overall margin we are likely to achieve for the year. Factors which are reducing, or may further reduce, the profitability of the business include: new terms on our interim franchise agreement for Northern Rail; transition costs that may be incurred to close our Australian garrison support operations; greater-than-anticipated investment to achieve further improvement in the operational performance of challenging contracts such as PECS and COMPASS; delays in implementing reductions in headcount and related costs, in part caused by the requirements of our Corporate Renewal Programme; and a lower recovery on bid investment costs given fewer new contract
wins than previously anticipated. Revenues are also expected to be about £50m (1%) lower than previously anticipated. Together, these factors have reduced the aggregate of the Divisions’ profit expectations by around £30m. In addition, and recognising the recent under-performance against targets and slower pace of recovery from the events of 2013, the Board has taken a more conservative view of Divisional forecasts. Based on an assessment of the risks in these forecasts, the Board now believes that Adjusted Operating Profit at constant currency in 2014 will be not less than £170m. At latest rates of exchange, currency movements would serve to reduce reported profits by around £15m.

Completion of the proposed placing would reduce Adjusted Net Finance Costs (previously anticipated to be approximately £40m) but increase the weighted average number of shares (previously anticipated to be broadly unchanged from last year’s 489 million shares for basic EPS purposes). The Group’s Adjusted Effective Tax Rate is now anticipated to be around 25%, which would result in Adjusted EPS of not less than 19p at constant currency; at latest rates of exchange, this would be approximately 1p lower.

The phasing of financial performance remains weighted to the second half of the year. Our updated Adjusted Operating Profit forecasts indicate an approximate one-third/two-third split across the two financial half-year periods. The better performance planned for the second half includes the delivery of cost reduction initiatives across the Group, improvement in the financial performance of certain operationally challenged contracts, and an improved performance on new business wins.

Good progress is being made in implementing the Corporate Renewal Programme, with the estimated one-off costs associated with this remaining at approximately £15m. The previously announced restructuring charge estimated at £10-15m to implement further reductions in headcount and related costs is now anticipated to be £15-20m as we accelerate various initiatives.

Excluding the impact of the proposed placing, our internal forecasts for cash generation and net debt have changed broadly in line with the reduction in earnings as described above. Group recourse net debt at the end of 2013 was £725m, and we had previously expected it to be broadly similar to this at the end of 2014. Before the net proceeds of the proposed placing we now anticipate net debt at the end of 2014 would be closer to £800m, however, reflecting phasing, the half-year position would likely be over £800m.

**Proposed placing**

Our current assessment of financial performance, in combination with conversations with shareholders, reinforce the Board’s view of the appropriateness of an equity placing of up to 49,932,918 shares, representing up to 9.99% of existing issued share capital, details of which we anticipate will be announced shortly.

**Strategic review process**

Following his appointment as Group Chief Executive effective 1 May 2014, Rupert Soames’ priority over the initial months is to gain a thorough understanding of all facets of Serco’s businesses by meeting customers and spending time with staff, giving him the background to lead a strategic review of the business, the initial phases of which are already underway. The review will examine all aspects of the business, including assessments of our markets, competitive offering and relative positioning as well as organisation and
structure. The future shape of the Group’s balance sheet, and appropriate levels of leverage, will also be key outputs of the review, as will future dividend policy. This work should be completed over the next nine months, with the findings and our implementation plans expected to be presented alongside the results for the 2014 financial year. In the meantime, Serco will continue to manage its portfolio of businesses, and further disposals of operations considered non-core to our future development may be pursued.

Trading and operational update
In the first quarter, the Group’s revenues were around £1.2bn, representing a 0.3% organic decline. “Organic” excludes the impact of acquisitions and disposals, as well as currency movements. Margins in the period were significantly lower than the prior year, with numerous factors contributing to the reduction. The most significant factors were: changes in contract volumes (e.g. Australia immigration); contract losses (e.g. Electronic Monitoring); contract re-pricing (e.g. AWE and certain private-sector BPO work); and additional costs on contracts to improve operational performance (e.g. COMPASS and PECS). In addition, the Corporate Renewal Programme, along with the need to split our UK&E business, has led to increased costs, a loss of efficiency, and delays in restructuring programmes. Whilst we have benefitted from contracts signed in the second half of 2013 (e.g. support to the US Affordable Care Act), these contracts have tended to be at lower margins, and the overall level of work won has been lower than we need it to be to offset the various other pressures.

Serco’s order book was £17.1bn at 31 December 2013. Since the beginning of the financial year, our contract awards totalled £1.2bn, which is higher than the equivalent stage last year, although this figure does include the Northern Rail contract (see below). Notable contract developments so far in the year are highlighted below.

In UK & Europe frontline services, contract awards have included two important developments that continue existing operations. For the UK Department for Transport, a 22-month interim franchise for Northern Rail has been agreed; the total estimated revenue value to Serco is £520m but the franchise is anticipated to be run at a lower profit margin in the future. Serco’s management of the National Physical Laboratory on behalf of the UK’s Department for Business, Innovation & Skills has also been extended for up to 12 months from 1 April 2014; this contract generated revenues to Serco of approximately £80m in 2013.

In terms of new contract wins, UK & Europe has added Havering as a fifth London borough where we provide environmental services with a total contract value of around £40m, and our services for the UK Ministry of Defence have expanded following the merger of the Service Personnel and Veterans Agency (SPVA) into the Defence Business Services (DBS) organisation, with Serco having supported the operations of DBS since 2012.

Our bids to support the Defence Infrastructure Organisation (DIO) and as part of a consortium bidding to manage decommissioning activities at 12 nuclear sites were not successful in the period. Contract attrition remains as previously described, which includes the ending of our management of the Electronic Monitoring service. Of our existing operations that have performance issues, our contracts for Prisoner Escorting & Custodial Services (PECS) and the COMPASS programme providing services for asylum applicants are
among several contracts requiring the investment of significant additional resources to improve service and performance.

In the Americas division, the major new contract awards for US Affordable Care Act eligibility support services and for Virginia Department of Transport traffic management services that began in the second half of last year are helping to offset other contract attrition as previously described. The estimated value of contract awards and task orders in the period totalled over $200m, which includes progress on securing certain rebid work for a US intelligence agency providing program management and acquisition support. Other developments on IDIQ contract vehicles enable Serco to compete for task orders to deliver electronic surveillance systems support to the US Navy and C4ISR tasks providing worldwide communications and infrastructure support to the US Army. Overall, however, the short-term outlook for the Federal Government services market remains challenging.

In the AMEAA region, immigration services in Australia – the Group’s largest contract in 2013 – is seeing significantly reduced revenues for reasons as previously described. The number of people in our care for 2014 to date has averaged approximately 5,000, though the current level of 4,200 is now already some 40% lower than the average for 2013. Our contracts for defence garrison support services in Australia, operated by our joint venture partnership, are due to expire in June 2014. If we do not retain this business, we would expect to incur transition costs in the current year.

Work successfully rebid or extended in the period includes air navigation services in Bahrain valued at approximately £30m, and public facilities management contracts for both the City of Melbourne and Abu Dhabi Municipality, together valued at approximately £35m. New work won includes further healthcare support services also in Abu Dhabi, valued at approximately £27m.

Global Services, Serco’s BPO business, has seen some important contract awards from UK local authorities with a new win valued at over £70m with Lincolnshire County Council for the provision of a range of business process and contact centre services; meanwhile for Peterborough City Council and the London Borough of Enfield, our ICT services have been extended, valued at £22m and £20m respectively. For the private sector, customer contact services contracts valued in total at approximately £50m have been awarded across Australia, Qatar and the United States. Also valued at approximately £50m is an extension in Australia to Serco’s Traffic Camera Services processing contract. Further work is underway to rebuild Global Services’ pipeline, increasingly support bid activity in the other divisions and deliver increased operating efficiencies in order to improve the division’s outlook for growth and profitability.

Ends

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Analyst and institutional investor conference call

There will be a conference call for analysts and institutional investors to discuss this statement at 08:30 BST on Thursday 1 May 2014. The call will be hosted by Group Chief Executive Officer Rupert Soames, Group Chief Operating Officer Ed Casey and Group Chief Financial Officer Andrew Jenner. Analysts and institutional investors should dial UK toll number +44 (0) 20 3139 4830 followed by participant pin code 86481894# to register for the call. The call can also be listened to live via the Serco website www.serco.com and a replay facility will be made available after the call with details posted on the website.

About Serco

Serco is an international service company, which combines commercial know-how with a deep public service ethos.

Around the world, we improve essential services by managing people, processes, technology and assets more effectively. We advise policy makers, design innovative solutions, integrate systems and - most of all - deliver to the public.

Serco supports governments, agencies and companies who seek a trusted partner with a solid track record of providing assured service excellence. Our people offer operational, management and consulting expertise in the aviation, BPO, defence, education, environmental services, facilities management, health, home affairs, information and communications technology, knowledge services, local government, science and nuclear, transport, welfare to work and the commercial sectors.

More information can be found at www.serco.com

Forward looking statements

This announcement contains forward looking statements. The terms "expect", "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; 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.

**Important notice**

The new ordinary shares to be issued in connection with the placing have not been and will not be registered under the United States Securities Act of 1933, as amended ("Securities Act") or the securities laws of any other jurisdiction of the United States, and may not be offered, sold or transferred, directly or indirectly, in the United States absent registration under the Securities Act or an available exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and the securities laws of any other jurisdiction of the United States.