Positive assessment of corporate renewal plan and update on 2014 outlook

30 January 2014

Serco Group plc (Serco), the international service company, welcomes today’s notification by the Cabinet Office that a positive assessment has been made of Serco’s corporate renewal plan. This assessment marks a significant milestone in a process that has been a major focus of management and has had a near-term negative impact on Serco’s pipeline and profitability. Whilst the impact will continue to be significant in 2014 as Serco implements the programme of corporate renewal and rebuilds its pipeline, today’s announcement enables the business to begin to emerge in a stronger position to compete in its large and growing markets.

Ed Casey, Acting CEO, said: “The significant steps we are taking demonstrate our commitment to rebuilding the confidence of our UK Government customer and ensuring that the issues that emerged last year will not reoccur. We are pleased that our progress has been recognised by the positive assessment of our corporate renewal plan, and we believe that Serco can now be considered on an equal basis to other suppliers for current bids, rebids and extensions, such as the Northern Rail franchise extension and the Defence Infrastructure Organisation (DIO) opportunity.

“We have been through a very difficult period since July of last year, which has had a major impact on Serco: reducing near-term growth, diverting management focus, and adding costs to strengthen the business. We are now able to assess more clearly the adverse impact that continues into 2014. Nonetheless, following today’s announcement by UK Government and the continued implementation of our corporate renewal plans, Serco will be in a stronger position to compete effectively and return to making sustainable progress across our diverse markets. These markets remain attractive in size and future growth potential, both in the UK and around the world. Serco has the capabilities, relationships, and global reputation for delivering excellent customer service to take full advantage of these opportunities.”

Positive assessment of corporate renewal plan

Serco has developed and is now in the process of implementing a comprehensive programme of corporate renewal to deliver organisational change and operational resilience across the Group. Key components include:

- Commitment by leadership throughout the business to ‘do what is right’ by always dealing with customers fairly and placing this above any other conflicting drivers for success
- Revising Serco’s Code of Conduct, Values Statement and Governing Principles, backed up by training, induction and performance management
- Strengthening contract level governance, including improved contract bid processes to ensure appropriate levels of operational resource and the delivery of sustainable performance
• Enhancing transparency and access, with robust reporting of operational and financial contract KPIs, and greater engagement of customers at contract and departmental level
• Creating a separate division for our UK Central Government work to achieve both focus and openness for Government as a collective customer
• Developing our management system to include more prescriptive guidance on required operational processes and procedures, supported by strengthened risk management and internal audit processes and capabilities
• Appointing three additional plc Board non-executive directors, one of whom will chair a new Corporate Responsibility Committee to formalise the process of guidance and decision making on ethical issues
• Establishing formal Ethics Committees and Ethics Officers in each division, accompanied by the redesign of our whistle-blowing process to the highest international standards
• Measuring the progress of attitudinal change throughout the organisation with ongoing independent culture and ethics reviews

The plan to implement this programme has received a positive assessment by the Government Oversight Group, with the input of the independent advisers appointed by Government who will continue to monitor Serco’s implementation against the agreed milestones in the plan. Serco continues to cooperate fully with the ongoing investigations by the Serious Fraud Office.

Update on 2014 outlook

Further to our initial comments about 2014 at the time of our November IMS, Serco’s internal business planning process for the current year is now in the final stages of completion. This has taken full account of the issues with our UK Government customer in 2013 and how this will impact 2014.

A mid-single digit percentage organic decline on 2013 revenue is now anticipated. This reflects the lower level of incremental work won across the Group to date, the attrition from contracts lost such as Electronic Monitoring, and our latest assessment of the impact of volume reductions in our Australian immigration detention services contract to which we referred in November. It also includes assumptions as to the extent to which we will be successful in securing further rebids and extensions as well as new bid opportunities during the year.

2014 will include the additional ongoing costs related to the corporate renewal programme. These are estimated at approximately £10m a year and will be within the Group’s Adjusted operating profit. There will be one-off costs incurred in 2014 of approximately £15m, reflecting principally the external advisers and other directly-related costs of programme implementation, including initial training and systems set-up.

The Adjusted operating margin is anticipated to decline by approximately 50 to 100 basis points on 2013. This takes account of the greater than previously envisaged margin reduction resulting from the revenue impacts described above, and the incremental costs of the agreed corporate renewal programme.
As already announced, Serco’s ongoing portfolio management resulted in further non-core disposals in 2013. These businesses contributed £43m of revenue and £7m of profit up to the point of disposal last year and will not contribute to revenue and profits in 2014.

As initially indicated in the November IMS, currency movements in 2013 were adverse; these continued to weaken over the remainder of the year. The impact of this has reduced revenues in 2013 by approximately £50m and profits by £8m. Our 2014 business planning process assumes constant currency by translating local currencies at 2013 average rates.

Market consensus for 2014 Adjusted operating profit is currently £277m. Given the factors identified above, we currently anticipate a result that could be 10-20% lower than this for ongoing activities, on a constant currency basis.

To deliver additional effectiveness and efficiency in the structure of the Group, a further restructuring charge estimated at £10-15m will be incurred in 2014 to implement reductions in headcount and related costs.

Serco will release its 2013 full year results on Tuesday 4 March 2014 and provide further guidance on the 2014 outlook at that time.

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 11:30 GMT. The call will be hosted by Ed Casey, Acting CEO, and Andrew Jenner, Group CFO. Analysts and institutional investors should dial UK toll number +44 (0)20 3139 4830 followed by participant pin code 85086938# 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