

Stock Exchange Announcement

Challenging market conditions; further progress on strategic positioning

14 November 2013

Serco Group plc (Serco), the international service company, today issues its Interim Management Statement on the Group's performance from 30 June 2013 to date. This also covers the anticipated 2013 outturn relative to expectations, an early 2014 outlook, a summary of contract awards in the period, and an update on the UK Government contract audits and reviews together with the associated one-off costs to date.

Ed Casey, Acting Group CEO, said: "Whilst we are clearly facing challenges and have experienced tougher conditions in recent months, we have still achieved £3bn of contract awards in the year to date and made further progress in our strategy of creating a broader and more balanced portfolio. The Group's opportunities in the large and growing markets in which we are represented around the world continue to provide good long-term growth potential. The UK Government audits and reviews are ongoing and we remain firmly committed to rebuilding the confidence of our UK Government customer."

2013 outturn

Organic revenue growth for the Group is anticipated to be mid-single digit for the year as a whole. As expected, the growth rate has reduced in the second half due primarily to the annualisation effect of previous major contract awards.

In recent months, our relationship with UK Government has been impacted by the issues arising on certain contracts with the Ministry of Justice. This has contributed to our UK & Europe and Global Services divisions experiencing some delays in previously anticipated contract awards, together with a lower level of discretionary spending and ad hoc project work with UK Central Government customers. Similar to the first half, Global Services has also seen an increased level of investment in market development activity, including bidding on some private sector opportunities that have been subject to delay. Additionally, the Americas division experienced some impact during October's US Federal Government shutdown, as well as the general ongoing effect of sequestration.

Expectations had been that the Group's Adjusted operating margin for the year may be slightly down on the 6.4% achieved in 2012. Given the factors described above, there has been some additional pressure on margins. In what remains a relatively wide range of expected outcomes for Group Adjusted operating profit at constant currency, the mid-point would result in a broadly similar outturn to 2012's £307m from ongoing activities. Current market consensus for Adjusted operating profit is approximately £325m. Taking into account recent currency movements, it is estimated that the net adverse impact of such movements would further reduce profits by approximately 1-2%.

2014 outlook

Our early view of prospects for 2014 is developing. At this stage versus the equivalent in previous years, and in part as a consequence of the ongoing issues with our UK Government customer, there has been a lower level of new contract awards to drive organic revenue growth. There is also a greater known impact from attrition, including the ending of our contracts for the Electronic Monitoring service, the management and operation of the UK's National Physical Laboratory and certain US support operations to the US Federal Retirement Thrift Investment Board, the Department of State's National Visa Center and Kentucky Consular Center, and the Department of Veterans Affairs. Revenue is also likely to be impacted by the recent immigration policy changes on the volume-related work we perform to support the Australian Department of Immigration and Border Protection (DIBP), formerly the Australian Department of Immigration and Citizenship (DIAC). Based on the current lower numbers of people in our care, DIBP contract revenues, which have averaged approximately £400m for the last 12 months, may decline significantly in 2014. As a number of these contracts are in higher margin areas due to the complexity of the services, this will also impact the Group's Adjusted operating margin outlook.

Within our UK frontline and BPO operations, in the coming year we are looking to deliver further effectiveness and efficiency, for example through pursuing economies of scale via increased use of our shared service model. Changes that have already begun will see the reduction of around 400 roles from a total UK headcount of approximately 47,000. This will incur exceptional costs of approximately £14m in 2013. The savings generated, before any subsequent reinvestment, indicate a cash payback by the second year. We will continue to look to drive further efficiencies in 2014.

The net impact of the above factors would lead to profits for 2014 being moderately lower than those for 2013. As usual, more detailed guidance on 2014 will be provided at the time of reporting the results for the 2013 financial year.

Contract awards and operational update

At 30 June 2013, Serco had an £18.5bn order book and our pipeline of identified opportunities around the world had a total estimated value of £30bn. Since then, we have been awarded a further £0.9bn of contracts, bringing the total for the year to date to £3bn, comprising signed contracts valued at £2.9bn and preferred bidder appointments valued at £0.1bn. Winning or expanding smaller contracts also plays an important role in our growth and a selection of these is included in today's Contract News Update on www.serco.com. Notable contract developments in the second half of the year to date are highlighted below.

In UK & Europe frontline services, we have secured important extensions for services that include our non-clinical support for Plymouth Hospital Trust, pre-deployment training for the Ministry of Defence and environmental services for Welwyn Hatfield and Breckland Borough Councils. We continue to work on other important extensions and rebids such as Northern Rail and the DLR, as well as areas of new contracting opportunities.

In the Americas division, given government budget and funding issues, conditions in the US federal contracting market have been further challenged by the implementation of sequestration and the partial Federal Government shutdown in October. This revenue reduction was offset by the start of important new contracts that are successfully broadening the Americas portfolio, notably our application processing support for US healthcare eligibility and our operations for Virginia's Department of Transportation. Recent awards

include additional work under the healthcare processing contract, a Transition Assistance Program for Veterans, and the rebid of our support services for the US intelligence community.

In the AMEAA region, while the number of people in our care for the Australian DIBP has begun to reduce significantly from the peak levels experienced in the summer, the average number in our care in the second half of 2013 is likely to be similar to the comparable period in 2012. We continue to maintain a very strong customer relationship in the operation of this sensitive contract, and will look to develop the opportunity to continue to provide services on behalf of DIBP beyond the original initial contract period which runs to mid-2014. Elsewhere, our operational management of the Fiona Stanley Hospital in Australia begins next month, and awards in the second half include the contract extension for the Dubai Metro, facilities management services in the United Arab Emirates and an extension of our air traffic control services in Iraq.

Global Services, Serco's BPO business, has continued to see progress with additional procurement services for the Anglia Support Partnership and a number of smaller awards including an expansion of telecare services for Hertfordshire County Council and other contact centre services for public and private sector clients.

Update on UK Government contract audits and reviews, and associated one-off costs

As announced in July, Serco has been cooperating fully with the detailed independent forensic audit into the billing practices in respect of our Electronic Monitoring (EM) contract. Additionally, we have undergone separate audits of our other Ministry of Justice (MoJ) contracts and have supported the Cabinet Office's wider review across other major UK Central Government contracts. Serco will also cooperate fully with the Serious Fraud Office's investigation into EM contracts.

As announced by the Government on 28 August, Serco agreed to undertake a process of corporate renewal, with the changes put in place by Serco to be assessed by a committee of Government non-executive directors after a three-month period. Serco established a Committee of the Board with the independent input of Lord Gold to oversee the in-depth programme of cultural and systems review, supported by independent experts, to recommend changes where appropriate and to implement them accordingly. Serco's announcement on 25 October updated on key elements of the programme. At that time, the Government stated they would take full account of all the changes we had announced, and whilst early days, saw our update as a positive move and a step forward. The ongoing financial impact of the corporate renewal programme, including the separation of the UK & Europe division into two and our other actions to strengthen governance and transparency, continues to be evaluated.

The audits, reviews and corporate renewal processes are incurring one-off costs that will be treated as exceptional items in 2013. Since July, there have been external adviser and other directly-related incremental costs that are estimated to amount to approximately £12m. In addition, there are one-off costs and accounting charges of up to £15m identified to date that have arisen within the contracts subject to the audits and reviews. The most significant of these relate to the two main contracts where issues have been raised: Prisoner Escort and Custody Services (PECS), which includes the impact of the previously announced agreement to repay historic profits earned and the related costs of service improvement; and EM, which includes the impact of the required accelerated transition to a new service provider.

As previously stated, we have confirmed that we will also repay any amount agreed to be due on the EM contract. The MoJ have previously expressed that their audit team had calculated that their interpretation of the difference on billing totalled low tens of millions of pounds since the contract commenced in 2005. Any such potential repayment and any other directly-related incremental costs, would be charged as further exceptional items.

Transactions and financial position

Our proactive portfolio management involves an ongoing assessment of our existing operations against their fit to our strategy, taking also into account their expected future levels of performance and returns. On 4 October, Serco announced the sale of our UK occupational health business for £3.5m. The operations had become non-core to the future development of Serco's Health portfolio. In 2012, the business had approximately £15m of revenues and £1m of Adjusted operating profit. The exceptional accounting loss on disposal is expected to be approximately £4m. We also continue to look at potential acquisitions that bring new skills, capabilities, or market access to enhance the portfolio, as well as further disposals of non-core operations.

No other material events, transactions or impacts on the Group's strong financial position have taken place since the 30 June 2013 balance sheet date.

Ends

For further information please contact Serco:

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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 GMT. The call will be hosted by Andrew Jenner, Group CFO. Analysts and institutional investors should dial UK toll number +44 (0)20 3139 4830 followed by participant pin code 29850345# 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