

## 2017 full year results

22 February 2018

Serco Group plc

LEI: 549300PT2CIHYN5GWJ21

Year ended 31 December	2017	2016
Revenue – continuing and discontinued operations <sup>(1)</sup>	£2,953.6m	£3,047.8m
Reported Revenue (continuing operations only) <sup>(1)</sup>	£2,953.6m	£3,011.0m
Underlying Trading Profit (UTP) <sup>(2)</sup>	£69.8m	£82.1m
Reported Operating Profit (after exceptional items; continuing operations only) <sup>(2)</sup>	£30.0m	£42.2m
Underlying EPS, basic <sup>(3)</sup>	3.42p	4.13p
Reported EPS, basic (after exceptional items; continuing and discontinued operations)	(0.02p)	(0.11p)
Free Cash Flow <sup>(4)</sup>	(£6.7m)	(£33.0m)
Net Debt	£141.1m	£109.3m

Rupert Soames, Serco Group Chief Executive, said: “With profits at the top end of the expectations we set out some 15 months ago, net debt lower than we expected, fully funded pension schemes, and strong order intake, we delivered a solid performance in 2017 in a difficult market. Most importantly, we expect profits to grow in both 2018 and 2019. We understand that getting to this point has been a long haul for investors, and that there is still a long, and probably bumpy, road ahead before we are producing acceptable returns. But we are now moving forward, not backward.

“The benefits of our international footprint have never been more evident as the UK market for public service outsourcing is afflicted by well-publicised traumas. This environment may produce opportunities for suppliers with strong track records of delivery, and Serco also has the advantage of choice as to where we allocate resources and effort between different markets. Therefore, as well as ensuring that we support our UK customers, and respond appropriately to opportunities as they arise, we will also be investing in our businesses in North America, Europe, the Middle East and Asia Pacific.

“The challenges facing governments around the world remain unchanged. Ageing populations are driving demand for more and better public services; almost all governments spend more than they receive in tax; citizens have ever-higher expectations of the quality of public services. In this environment, governments are likely to want to use all means at their disposal to deliver value for money and high quality public services, which should mean a strong continuing role for the private sector as a provider of innovation, investment and operational management.”

### Highlights

- Reported Revenue<sup>(1)</sup> down 2%, comprising a 6% organic decline from net contract attrition, partially offset by a 4% currency benefit.
- Order intake up 36% at £3.4bn (2016: £2.5bn), includes Grafton prison in Australia which is the Group’s largest ever contract win, and over 30 other contract awards worth more than £10m each across the UK, Europe, America and the Middle East; book-to-bill ratio of over 100% for the first time since 2012; closing order book increased to £10.7bn, up from £9.9bn a year earlier.
- Underlying Trading Profit<sup>(2)</sup> was at the top end of our guidance given at the start of the year; run-rate throughout 2017 has been approximately 10% ahead of that achieved in H2 2016.
- Operating costs reduced in proportion to the scale of revenue reduction; further shared services and overhead savings of around £20m achieved, taking total overhead savings over the last three years to over £100m.
- Reported result includes a £16m net charge of Contract & Balance Sheet Review adjustments, compared to a net release of £14m in 2016; cumulatively over the last three years, we are tracking 3% better than the Contract & Balance Sheet Review charges taken in 2014. Closing balance sheet Onerous Contract Provision (OCP) liability now stands at £168m, down from £220m in 2016 and £447m in 2014.
- Pre-exceptional tax costs were £14m (2016: £16m), and net exceptional costs were significantly lower at £25m (2016: £68m).
- Free Cash Flow<sup>(4)</sup> outflow improved by £26m to (£6.7m), which includes (£8m) of outflow as we reduced our working capital facility utilisation to zero by the end of 2017. Net Debt at £141m (2016: £109m) was some £9m below our guidance range at the start of the year, and Net Debt : EBITDA leverage of 1.4x remains well within our medium term target of 1-2x.
- Pension schemes fully funded and in a surplus on an accounting basis; around half of our pension liabilities are now fully underwritten by bulk annuity purchases, further reducing pension scheme residual risks.

- Pipeline of larger new bid opportunities reduced to £4.4bn, as a number of unusually large opportunities moved through the pipeline during 2017; £3bn of the pipeline are opportunities added over the course of 2017.
- Acquisition of BTP Systems completed for \$20m, bringing deep skills in defence satellite communication and radar engineering technical services, together with a pipeline of \$200m.
- We have signed a revised agreement with the Special Managers and Provisional Liquidators of Carillion plc, and while it is subject to requisite third party consents, we continue to work with all relevant parties to acquire the portfolio of selected UK health facilities management contracts.
- IFRS15 estimated restatement to 2017 not anticipated to be significant; decrease revenue by £3m and Underlying Trading Profit by £0.3m.
- Guidance for 2018 unchanged: we expect revenues to be £2.8-2.9bn, broadly flat in constant currency, and Underlying Trading Profit to grow to around £80m, driven largely by transformation savings. We expect 2019 to see further good growth in Underlying Trading Profit.

## For further information please contact Serco:

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## Presentation:

A presentation for institutional investors and analysts will be held today at JPMorgan, 60 Victoria Embankment, London EC4Y 0JP, starting at 9.00am. The presentation will be webcast live on [www.serco.com](http://www.serco.com) and subsequently available on demand. A dial-in facility is also available on +44 (0)330 336 9411 (USA: +1 646 828 8143) with participant pin code 6702165.

## Notes to summary table of financial results:

- (1) Revenue is as defined under current IFRS (before adoption of IFRS15), which excludes Serco's share of revenue of its joint ventures and associates. Revenue including that from discontinued operations (£nil in 2017 and £36.8m in 2016) is shown for consistency with previous disclosures. Reported Revenue excludes revenue from discontinued operations. Organic revenue growth is the change at constant currency after adjusting to exclude the impact of relevant acquisitions or disposals. Change at constant currency is calculated by translating non-Sterling values for the year ended 31 December 2017 into Sterling at the average exchange rate for the year ended 31 December 2016.
- (2) Trading Profit is defined as IFRS Operating Profit adjusted for (i) amortisation and impairment of intangibles arising on acquisition and (ii) exceptional items; it includes the impact of discontinued operations in 2016. Consistent with IFRS, it includes Serco's share of profit after interest and tax of its joint ventures and associates. Underlying Trading Profit additionally excludes Contract & Balance Sheet Review adjustments (principally Onerous Contract Provision (OCP) releases or charges), as well as the beneficial treatment of depreciation and amortisation of assets held for sale during 2016, and other material one-time items such as the pension scheme settlement in the first half of 2016 related to the profit on early exit from a UK local authority contract that occurred in the second half of 2015. A reconciliation of Underlying Trading Profit to Trading Profit and Reported Operating Profit is as follows:

Year ended 31 December £m	2017	2016
<b>Underlying Trading Profit</b>	<b>69.8</b>	<b>82.1</b>
Include: non-underlying items		
Contract & Balance Sheet Review adjustments	(15.8)	14.2
Assets held for sale depreciation and amortisation	-	0.5
Other one-time items	-	3.5
<b>Trading Profit</b>	<b>54.0</b>	<b>100.3</b>
Amortisation and impairment of intangibles arising on acquisition	(4.4)	(5.1)
Operating Profit Before Exceptional Items (continuing and discontinued operations)	49.6	95.2
Exclude: Operating Loss Before Exceptional Items from discontinued operations <sup>(5)</sup>	-	3.3
Reported Operating Profit Before Exceptional Items (continuing operations only)	49.6	98.5
Operating Exceptional Items (continuing operations only)	(19.6)	(56.3)
<b>Reported Operating Profit (after exceptional items; continuing operations only)</b>	<b>30.0</b>	<b>42.2</b>

- (3) Underlying EPS reflects the Underlying Trading Profit measure after deducting pre-exceptional net finance costs and related tax effects.

- (4) Free Cash Flow is the net cash flow from operating activities before exceptional items as shown on the face of the Group's Condensed Consolidated Cash Flow Statement, adding dividends we receive from joint ventures and associates, and deducting net interest paid and net capital expenditure on tangible and intangible asset purchases.
- (5) The Global Services division, representing private sector BPO operations, was classified as a discontinued operation in 2015 and 2016. Disposal of the offshore business was largely completed in December 2015, with the disposals of two remaining much smaller elements completed in March 2016 and December 2016. The residual UK onshore private sector BPO operations were sold or exited in 2016 with the exception of one business, consisting of a single contract, which completed in July 2017. Total revenues for the remaining operations were £5.4m and the loss before exceptional items was £0.6m for the year ended 31 December 2017, and therefore the results have been included in continuing operations in 2017 on the grounds of materiality.

Reconciliations and further detail of financial performance are included in the Finance Review on pages 18 to 37. This includes full definitions and explanations of the purpose and usefulness of each non-IFRS Alternative Performance Measure (APM) used by the Group. The Condensed Consolidated Financial Statements and accompanying notes are on pages 38 to 79.

## **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", "aspire", "aim", "plan", "target", "goal", "ambition" and similar expressions identify forward looking statements. By their nature, these forward looking statements are subject to a number of known and unknown risks, uncertainties and contingencies, 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 or implied 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. Many of these factors are beyond Serco's control or influence. These forward looking statements speak only as of the date of this announcement and have not been audited or otherwise independently verified. Past performance should not be taken as an indication or guarantee of future results and no representation or warranty, express or implied, is made regarding future performance. 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 after the date of this announcement, or to keep current any other information contained in this announcement. Accordingly, undue reliance should not be placed on the forward looking statements.

## Chief Executive's Review

### Summary of financial performance

#### **Revenue and Trading Profit**

Reported Revenue declined 2% to £2,954m (2016: £3,011m); this measure excludes Serco's share of revenue from joint ventures and associates of £357m (2016: £481m); also excluded in the prior year is revenue of £37m from discontinued operations, which reflected the residual run-off of the private sector BPO division. Net currency movements provided a £122m benefit or a 4% increase. At constant currency and adjusting for minor effects of relevant acquisitions and disposals, the organic revenue decline was £188m or 6%; around a third of the organic element of the decline relates to no longer recognising as revenue the value of goods purchased on behalf of customers following changes to two health procurement services contracts in the UK; the balance of the decline relates to the ending or transfer of contracts such as those for the UK Defence Science and Technology Laboratory (DSTL), Armidale Class Patrol Boats (ACPB) for the Royal Australian Navy, Virginia Department of Transportation (VDOT), US Army transition assistance (SFLTAP) and Western Australia Court Security and Custodial Services (WACSCS). These and the effect of other smaller contract attrition were only partially offset by growth elsewhere including that from the phased start of new services during the year at Barts Health NHS Trust, University Hospital Southampton NHS Foundation Trust and Skills Support for the Workforce (SSW).

Underlying Trading Profit was £69.8m (2016: £82.1m), a decline of £12.3m or, excluding the £6.5m net currency benefit, a decline of £18.8m. The reduction was driven by the first half of 2016 benefitting from £11m of non-recurring trading items, which included: the previous higher shareholding and therefore larger share of the profits of the Atomic Weapons Establishment (AWE); the final settlement arrangements on the transfer of the Northern Rail franchise; the conclusion of the VDOT and SFLTAP operations; and a spike in activity on a defence logistics contract in the Middle East. In addition, as well as the attrition impact from profitable contracts coming to an end, some of the new contracts added revenue growth in 2017 but were at reduced profitability due to their initial transition and transformation stages.

In the second half of 2016 our Underlying Trading Profit was £31.5m, which was a period that did not benefit from the non-recurring trading items that were a feature of the first half of 2016, and was a period that had broadly comparable average currency rates to 2017. Profits in both the first and second half 2017 were £35m, and therefore we have delivered a run-rate approximately 10% ahead of that achieved in the second half of 2016.

Within our performance for the year, we delivered our target of £20m of cost savings from efficiencies in central support functions and overheads. Cumulatively over the last three years, over £100m of cost has been removed through our programmes to deliver savings by reducing the number of management layers, implementing better procurement and driving greater efficiency in the operation of shared services. These savings have been central to our efforts to reduce the scale of Serco's cost base in proportion to the scale of the revenue reduction incurred through the loss of contracts and the disposals undertaken.

Trading Profit was £54.0m (2016: £100.3m), with three categories of adjusting items which are within Trading Profit, but excluded from our measure of Underlying Trading Profit. First, there was a £15.8m net charge (2016: net release of £14.2m) within Trading Profit arising from the review of Onerous Contract Provisions (OCPs) and other Contract & Balance Sheet Review items; the OCP adjustments comprised gross charges totalling £62m (2016: £56m), partially offset by gross releases totalling £43m (2016: £66m). By far the most significant charge (£47m) related to the future revenue and cost assumptions of operating the Caledonian Sleepers contract, though across other OCPs in the UK & Europe division there was a net release of £16m and in AsPac a net release of £11m. Notwithstanding this year's net charge, it is worth noting that cumulatively over the last three years, the net improvement to Trading Profit from OCPs and other Contract & Balance Sheet Review items is £19m; we are therefore tracking 3% better than the original charge taken through Trading Profit in 2014. A detailed review of provisions and Contract & Balance Sheet Review items is included in the Finance Review on pages 18 to 37. The second area that we exclude from Underlying Trading Profit is other material one-time items; in 2016 we therefore excluded from Underlying Trading Profit a £3.5m beneficial pension settlement negotiated as part of the early termination of the Thurrock contract. Third, and again only related to 2016, we excluded the beneficial impact of £0.2m related to depreciation and amortisation treatment of assets classified as held for sale during 2016.

As with prior years, both Trading Profit and Underlying Trading Profit benefited from losses on previously-identified onerous contracts being neutralised by the utilisation of OCPs; the £69m utilised in 2017 was both better than our expectations of around £80m, and lower than the £84m utilised in 2016. The closing balance of OCPs now stands at £168m, compared to £220m a year earlier and the initial charge of £447m taken at the end of 2014. We expect of the remaining £168m provision approximately £70m will be utilised in 2018.



## **Financing and pensions, tax and exceptional costs**

Pre-exceptional net finance costs were £11.6m (2016: £12.6m); while average net debt of £184m was £65m higher than the prior year, the increased cost of financing this was more than offset by other small movements. Cash net interest paid was £17.0m (2016: £19.0m).

Within net finance costs is a net credit of £3.8m (2016: £4.7m) related to the strong funding position of Serco's pension schemes. This net credit is lower than the prior year following the purchase in June 2017 by the Trustees of the Serco Pension and Life Assurance Scheme (SPLAS) of a bulk annuity from an insurer, which, for a significant proportion of scheme members, has the effect of fully removing longevity, investment and accounting risks. Assets of the pension scheme have been transferred to the insurer to purchase the annuity, resulting in a reduction in the IAS19 net balance sheet asset. The gross liability remains recognised on our balance sheet, but there is now an equal and opposite insurance asset reflecting the perfect hedge established by the transaction.

Including the effect of the transaction, the overall pension scheme accounting surplus, before tax, was £26m at 31 December 2017 on a scheme gross asset base of £1,385m. As described below, the transaction resulted in an exceptional non-cash tax charge of £16.1m reflecting a deferred tax adjustment related to the pension asset movements. Further details of Serco's pension funding and the bulk annuity purchase are described more fully in the Finance Review.

## **Tax and exceptional costs**

The underlying effective tax cost was £20.6m (2016: £24.4m), representing an underlying effective rate of 35% (2016: 35%) based upon £58.2m (2016: £69.5m) of Underlying Trading Profit less pre-exceptional net finance costs. The rate is higher than the UK statutory rate of corporation tax as there was no deferred tax credit taken against UK losses incurred in the year, and because it reflects the tax charges at locally prevailing rates in the international divisions which tend to be higher than the UK's rate; these two factors are partially offset by the proportion of Serco's profit before tax generated by consolidating our share of joint venture and associate earnings which have already been taxed. The Underlying effective rate was lower than our initial guidance of approximately 50% due to a beneficial mix of profitability earned for the year, and due to a one-off effect of UK tax legislation enactment being recognised as an exceptional tax cost rather than within the underlying measure.

Tax on non-underlying items was a net credit of £6.6m (2016: credit of £8.5m). The principal driver of this has been a credit to reflect recognising a UK deferred tax asset of £11.1m based upon the improved outlook of future profitability; there is now UK deferred tax asset totalling £17.4m recognised on the balance sheet; there is a further estimated £160m deferred tax asset in the UK that is currently unrecognised and therefore contingent upon further improvement in the outlook. Total pre-exceptional tax costs were therefore £14.0m (2016: £15.9m). Exceptional tax costs were £5.0m (2016: credit of £3.1m). The principal drivers of this were one-time non-cash deferred tax adjustments as follows: a charge of £16.1m related to the pension asset movements on the bulk annuity purchase; a charge of £3.7m related to the change in UK tax legislation regarding the speed of utilising tax losses and hence our deferred tax assets; and a £12.5m credit reflecting the reduction in the US deferred tax liability following the fall in future expected US rates primarily due to the enactment of the Tax Cuts & Jobs Act in December 2017.

Total tax costs were therefore £19.0m (2016: £12.8m). Cash net tax paid was £11.4m (2016: £5.6m). As previously described, although we expect our cash tax to be reasonably predictable in future periods, our effective tax rates are likely to be volatile until we are able to show sufficient profitability in our UK business to be able to recognise on our balance sheet all of the UK tax asset arising from losses in 2014 and 2015 principally as a result of the Contract & Balance Sheet Review. Our guidance of the underlying effective tax rate for 2018 is however for a modest reduction towards 30%, reflecting our forecast mix of profitability and the net effect of US tax reform, and for it to continue to reduce further over the longer term assuming further improvement in profits.

The Group incurred operating exceptional costs of £19.6m (2016: £56.3m), mainly comprising £28.6m of restructuring programme costs related to the Transformation stage of our strategy, including redundancy charges, asset impairments and other incremental costs; these were partially offset by a non-cash credit of £10.3m related to the previous transfer of employees from the Serco defined pension scheme back to the Principal Civil Service Pension Scheme (PCSPS). Together with exceptional tax costs of £5.0m (2016: credit of £3.1m) and exceptional items related to discontinued operations were £nil (2016: £14.6m); total net exceptional costs were therefore £24.6m (2016: £67.8m).

## **Reported result for the year**

The reported result for the year, as presented at the bottom of the Group's Condensed Consolidated Income Statement on page 38, was a profit of £0.1m (2016: loss of £1.1m). This reflects: Trading Profit of £54.0m (2016: £100.3m); amortisation and impairment of intangibles arising on acquisition of £4.4m (2016: £5.1m); pre-exceptional net finance costs of £11.6m (2016: £12.6m); a non-cash fair value gain of £0.7m (2016: £nil) relating to increasing

our ownership in a joint venture; pre-exceptional tax costs of £14.0m (2016: £15.9m); and total net exceptional costs of £24.6m (2016: £67.8m).

## **Earnings Per Share (EPS)**

Underlying EPS, which reflects the Underlying Trading Profit measure after deducting pre-exceptional finance costs and related tax effects, was 3.42p (2016: 4.13p). The reduction reflects the lower Underlying Trading Profit, partially offset by lower net finance costs; the weighted average number of shares in issue was broadly unchanged at 1,089.7m (2016: 1,088.3m). Reported EPS, which includes the impact of the other non-underlying items and lower tax and exceptional costs, was a loss per share of 0.02p (2016: loss per share of 0.11p).

## **Cash Flow and Net Debt**

Free Cash Flow was negative £7m (2016: negative £33m). Cash generated from Underlying Trading Profit was largely offset by the outflows related to loss-making contracts subject to OCPs. These cash outflows lessened versus the prior year, as reflected in the lower rate of OCP utilisation. There was a working capital outflow of £9m (2016: outflow of £24m), which included £8m (2016: £22m) of reduction in the utilisation of the Group's receivables financing facility; at 31 December 2017 there was £nil utilisation of the £30m facility, whereas £8m was utilised a year earlier.

Closing net debt at 31 December 2017 increased to £141m (2016: £109m); the increase includes the Free Cash outflow, together with a £33m cash outflow related to exceptional items. There was a beneficial gross currency translation effect on net debt of £17m, predominantly reflecting the Group's US Private Placement debt, however this was partially offset by a £3m adverse movement on hedging instruments. The closing net debt compares to a daily average of £184m (2016: £119m) and a peak net debt of £243m (2016: £183m).

At the closing balance sheet date, our leverage for debt covenant purposes was 1.4x EBITDA (2016: 0.7x), which compares with the covenant requirement to be less than 3.5x and remains well within our medium term target range of 1-2x.

## **Dividends**

The Board is not recommending the payment of a dividend in respect of the 2017 financial year. The Board's appraisal of the appropriateness of dividend payments takes into account the Group's underlying earnings, cash flows and financial leverage, together with the requirement to maintain an appropriate level of dividend cover and the prevailing market outlook. Although the Board is committed to resuming dividend payments as soon as it believes it prudent to do so, in assessing whether we should resume dividend payments in respect of 2017, we have been mindful of the fact there has been a reduction in earnings, a free cash outflow and an increase in net debt. In these circumstances, the Board believes that it would not be prudent to resume dividend payments at the current juncture. For 2018, our guidance is for an improvement in Underlying Trading Profit, but we anticipate a further modest Free Cash outflow and expect net debt to still increase, largely as a result of cash outflows related to exceptional restructuring costs and taking opportunities for value-enhancing infill acquisitions. The Board will continue to keep the dividend policy under close consideration as we progress with transforming the Group and implementing our strategy.

*The Revenue and Trading Profit performances are described further in the Divisional Reviews. More detailed analysis of earnings, cash flow, financing and related matters are described further in the Finance Review.*

## **Summary of operating performance and strategy implementation**

Delivering a financial performance for 2017 at the top end of our expectations has been accompanied by strong operational delivery and further progress on implementing our strategy and transformation. Within our operating framework, we insist that all our management initiatives fit into one or more of four categories: winning good business, executing brilliantly, making Serco a place people are proud to work, and delivering profitability and sustainability.

Problematic contracts continue to reduce in number and financial impact versus where we started three years ago, and relationships with customers in each of our markets are also fundamentally improved. Where we have exited contracts during the year, we have done so with pride and excellence, mindful of the military adage that you judge a battalion as much by how it leaves its barracks, as by how it arrives. Where we have started new operations, which have involved the transition and recruitment of several thousand employees, again I am pleased with the skill of our operational managers. Where we are making losses on contracts, we are resolute in still delivering what is required of us to appropriately serve our customers and service users; and while doing so, working to improve the financial performance of individual contracts. Three years on, it is reassuring to note how accurate was our initial estimation of the total level of onerous provisions required.

Similarly, delivering cost savings at the same time as investing in and improving the business is challenging, but this has also been paramount to ongoing transformation. We achieved our savings target for 2017, and the cumulative reduction of over £100m from efficiencies in central support functions and overheads is equivalent to approximately 24% over the last three years. Our guidance, as set out in more detail below, includes that we expect Underlying Trading Profit to grow over the next two years, and this will be driven largely by further transformation savings. Over that period, we are in particular looking to transform our IT systems, capabilities and structures. This means not only reducing their cost, but also improving their performance and security. We are implementing further operating model changes to deliver greater efficiency and effectiveness of the organisation; there will also be increased contribution to savings from the transformation of the finance function and centralising expertise for reporting, forecasting, planning and analysis with a third party provider, and seeking additional rationalisation of disparate procurement spend across the Group.

Our ongoing transformation of the business involves further strengthening of our sector propositions, building differentiated capability, and capturing business development opportunities to enhance our pipeline and order book. As previously reported, we are using Centres of Excellence (CoEs) for Group-wide propositions and capabilities in our core markets, which are improving the sharing of skills, best practice and intellectual property across Serco.

Whilst demand across our markets has not been as strong as we anticipated at the time we announced our strategy in 2015, the availability of value-adding acquisitions, be they of companies or of contracts, presents an opportunity to increase our scale and capabilities which was not foreseen in 2015. In our US defence business, the acquisition of BTP Systems for \$20m adds deep skills in satellite communication and radar engineering technical services, which complements our existing service offering, and also brings with it a pipeline of new opportunities of \$200m. In December 2017 we also signed a Business Purchase Agreement to acquire a portfolio of selected UK health facilities management contracts from Carillion plc, and have subsequently signed a revised agreement with the Special Managers and Provisional Liquidators of Carillion; whilst it is subject to requisite third party consents, we continue to work with all relevant parties to give effect to achieving the transfer of the contracts. If it is executed as envisaged, this transaction would significantly increase the scale of our equivalent Health business, and would add around £1bn to our order book.

Serco employs (including our joint venture operations) over 50,000 people, the vast majority delivering services to customers. Motivating and engaging employees is absolutely central to our business, and will be a key determinant of demonstrating we have successfully implemented our strategy. The latest results of our global employee survey, managed independently by Aon Hewitt, and with some 31,000 responses, showed a fourth successive year of improvement in the aggregated measure of 'employee engagement'. During 2017, we also delivered many other elements to build capabilities and support our ambition to be the best-managed business in our sector. Some 200 out of 300 senior managers have completed our highly tailored Oxford Saïd Serco Management course. We have rolled out Continuous Improvement training to all managers and embedded it as part of onboarding new staff, and over 1,400 employees are now trained to more advanced levels. And we have further invested in our Contract Management tools such as apps that monitor contractual obligations and report in real time, our Learning Management System for tracking training and qualifications, and our Serco Management System which covers all aspects of a contract's lifecycle, processes and compliance requirements.

## **Contract awards, order book, rebids and pipeline**

### ***Contract awards***

The Group signed contracts with a total value of £3.4bn during the year (2016: £2.5bn), which was another year of strong performance. This is the largest order intake since 2012, and represents a book-to-bill ratio of approximately 115%. There were over 30 contract awards worth more than £10m each, and the large value of new business won resulted in this being approximately 70% of the total value signed, with the balance represented by the value of secured extensions or rebids of existing work; the latter was also an abnormally small balance by virtue of there being a relatively small amount of contracts coming up for rebid or extension during 2017.

The largest new contract signed in the year was to operate the New Grafton Correctional Centre (NGCC) in New South Wales, which, when completed, will be the largest correctional facility in Australia; the estimated total contract value to Serco over a 20-year term is approximately AUD2.6bn (equivalent to approximately £1.5bn). The second largest new contract was with University Hospital Southampton NHS Foundation Trust to transform catering and cleaning, with an estimated value of £125m over the ten-year term. The third largest was in the Americas division to deliver US Army base modernisation services and in particular IT support, valued at a total of \$140m for the five-year base period and five one-year option periods, with the fourth also in the US to provide three Navy Fleet Readiness Centers with supply chain management services for hazardous materials, valued at a total of \$101m for the base period and four one-year option periods. Smaller new bids won included environmental services for Rushmoor Borough Council, contact services support in Australia for the Department of Human Services, facilities management

to a financial services company in Abu Dhabi, safety service patrol for the Texas Department of Transportation, and numerous US Navy ship and shore defence equipment modernisation task orders.

Of rebids and extensions secured, the largest was for NHS Forth Valley to continue providing facilities management services for a further seven years, followed by the US Patent & Trademark Office (USPTO) for a further ten years. Others of note included contact services for Hertfordshire County Council, specialist scientific and engineering support for the European Space Agency, facilities management at the Cleveland Clinic in Abu Dhabi, fleet services for Louisville Gas & Electric Company, air navigation services in Bahrain and Iraq, environmental services for various London boroughs, traffic camera support in the Australian state of Victoria, and support to passenger information services for the Western Australia Public Transport Authority.

Win rates by volume were over 50% for new bids and over 90% for rebids and extensions. Win rate by value was around 25% for new work, with the benefit from the sheer scale of the Grafton win being offset by the loss of the other big opportunities in Middle East rail and UK immigration escorting; the win rate by value was approximately 90% for securing existing work.

## **Order book**

The Group's order book now stands at an estimated £10.7bn, up by £0.8bn versus a year earlier. There is £2.4bn of revenue secured in the order book for 2018, equivalent to around 85% visibility of our £2.9bn revenue guidance at current exchange rates. The secured order book is £1.6bn for 2019 and £1.2bn for 2020.

## **Rebids**

Through to the end of 2020, across the Group there are around 60 contracts in our order book with annual revenue of over £5m where an extension or rebid will be required, representing current annual revenue of approximately £1.4bn in aggregate or approaching half of the Group's 2018 £2.9bn revenue guidance. This proportion of revenue that requires securing at some point over the next three years is not unusual given our average contract length of around seven years (or approximately ten years on average on a revenue-weighted basis, as larger contracts typically have longer terms). Contracts that could potentially end at some point by the end of 2018 have aggregate annual revenue of around £500m, with the higher amount versus recent years driven in particular by the US Affordable Care Act contract becoming due for full rebid this year, and with the next largest being Northern Isles Ferries. In 2019, it increases to around £700m, with Australian immigration services, the Dubai Metro, one of our US Navy installation contracts and COMPASS all due for rebid or potential extension. In 2020, it is around £200m, with PECS the only particularly large contract anticipated to become due in that year.

## **Pipeline**

Our pipeline is tightly defined as new bid opportunities with estimated Annual Contract Value (ACV) of at least £10m and which we expect to bid and to be adjudicated within a rolling 24-month timeframe. The Total Contract Value (TCV) of individual opportunities is capped at £1bn. The definition does not include rebids and extension opportunities, and on average over the last five years, more than half of our order intake has come from opportunities outside the reported pipeline. It is a relatively small proportion of the total universe of opportunities, many of which either have annual revenues less than £10m, or are likely to be decided beyond the next 24 months, or are rebids and extensions. It should also be remembered that in the Americas division in particular, we have numerous arrangements which are classed as 'IDIQ' – Indefinite Delivery / Indefinite Quantity – which are essentially framework agreements under which the customer issues task orders one at a time; whilst the ultimate value of such an agreement may be very large and run over many years, a value is only recorded in our order book as individual task orders are contracted, and few of them would appear in the pipeline as they tend to be individually less than £10m and contracted on short lead times.

Following several years of decline, at the start of 2015 the pipeline stood at around £5bn and began to grow again, increasing to £6.5bn at the start of 2016, and stood at £8.4bn at the start of 2017. During the year, around £7bn has come out of the pipeline, predominantly due to: wins, such as Grafton prison (which was capped in the pipeline at £1bn) and Southampton NHS Foundation Trust; losses, such as those in Middle East rail, UK immigration escorting and a US Navy systems support opportunity; as well as due to a small number of other opportunities being removed such as immigration services in the US. A number of new opportunities have now matured to the stage where they meet our pipeline definition, adding in aggregate around £3bn over the course of the year. As a result, the pipeline currently stands at £4.4bn, which consists of around 25 bids that have an ACV averaging approximately £30m and a contract length averaging around six years.

In the services industry in which Serco operates, pipelines are often lumpy, as individual opportunities can be very large, and when they come in and out of the pipeline they can have a material effect on reported values. In 2017, a number of unusually large bids travelled through the pipeline, and, as anticipated, immediately replacing these has been challenging in the prevailing market conditions. A lower pipeline is not a matter of undue concern: growing our



pipeline should not be expected to be a smooth progression given the effects of the timing and scale of individual awards, and we expect profit growth in the next two years to be driven by transformation savings. However, progress beyond the next two years will require seeing improvements in the trading conditions across our markets which will need to be first evidenced by a pipeline that is growing once again.

Key opportunities in the pipeline are described further in the Divisional Reviews.

## **Risks associated with Serco's trading environment**

Last year, we reported on the risks around our trading environment, and focused on the possible impact of Brexit, instability in the Middle East, and lack of clarity in the US following the election of President Trump.

None of these risks has markedly reduced in the last twelve months: in terms of Brexit, our business directly serving European bodies which accounts for around 5% of Serco's revenue is unlikely to be greatly affected, as it is served by EU-resident companies. We believe Brexit may have an impact on labour cost and availability in the UK if EU citizens cannot come to UK to work in essential frontline service roles. The greatest impact for us is that UK Central Government is largely focused upon the overwhelming need to manage Brexit, which has been described by the Head of the Civil Service as the greatest peacetime challenge ever faced by the Civil Service, and it is clear that their priority is going to be focused in this direction for several years to come. However, in the medium term the repatriation of swathes of regulatory functions may lead to important opportunities, and many of our largest customers – most notably the Ministry of Defence, the Ministry of Justice and the Home Office – still have pressing needs to reduce costs and increase efficiency.

In the US, it is clear that the Affordable Care Act or 'Obamacare', and associated contracts such as ours providing eligibility processing services to those seeking health insurance, will continue in some form, although the promised expansion in Defence spending is yet to be seen. Disappointingly, there are few signs of resolution in the dispute between Qatar and other states in the Middle East.

However, since last year's report, in addition to the risks set out above, the UK public sector outsourcing market has in recent months been thrown into turmoil as the result of the collapse of Carillion, and the crystallisation on some contracts of very significant risks which government had transferred to suppliers. This has reignited the debate about the wisdom of government outsourcing to private companies the delivery of public services, and we suspect that this will become a theme in the next General Election. There is a very real risk that this will make the UK Government more than normally cautious in dealing with its suppliers. On the other hand, it may make them more inclined to deal with suppliers who have established a track record for strong delivery, prudent accounting and who have a robust balance sheet. The possible consequences of these events are examined in more detail under 'Industry Backdrop and Concluding Thoughts', below.

## **Guidance and outlook**

Our guidance for 2018 and outlook beyond is unchanged from that initially provided in our update on 13 December 2017.

For 2018, we expect that Underlying Trading Profit will grow to around £80m, on revenues of £2.8-2.9bn (i.e. broadly flat organic revenue growth on a constant currency basis). We therefore expect some improvement in margins, driven largely by transformation savings. Our guidance reflects latest currency rates, which now imply greater pressure from adverse currency impacts estimated at £5-6m for profit and £100-120m for revenue when compared to the average rates for 2017.

As we have noted before in regard to our previous guidance, we reiterate that the range of potential outcomes is significantly wider than that implied by our budget's central case, both to the upside and downside; this reflects Serco's relatively low margins and the sensitivity of our profits to even small changes in revenues and costs, as well as movements in currency. Furthermore, and as described in more detail in the Divisional Reviews, the outcome of new bids in our pipeline and in our progress securing extensions or rebids including that for the Affordable Care Act in the US, could have a material impact on our business both in 2018 and more so the following year.

The 2018 financial year will be the first to be reported under the new IFRS15 accounting standard. As previously disclosed and reflective of the prudent accounting practices adopted in recent years by Serco, we do not anticipate the impact to be significant – as set out in Note 1 to the Group's Condensed Consolidated Financial Statements, the estimated restatement to 2017 is to decrease revenue by £3m and Underlying Trading Profit by £0.3m. IFRS15 will be potentially of more relevance to the Group in relation to the accounting for new contracts rather than those already in place at the time of adopting the new standard. The changes brought about by IFRS15 on previous percentage of completion accounting is expected to have little impact on Serco as this form of accounting has never been of

particular relevance to Serco. However, if Serco enters into future contracts that have significant transition phases, this could result in a greater proportion of revenue and profit being recognised later on in the life of the contract than under previous accounting. The UK Defence Fire & Risk Management Organisation (DFRMO) contract, which we are currently bidding, is one such.

In 2018, we anticipate our net finance costs to increase modestly to around £15m, our underlying effective tax rate to reduce towards 30%, and exceptional restructuring costs of approximately £35m as we implement further transformation activity in 2018. Further background to these areas are included in the Finance Review.

We anticipate a further small Free Cash outflow. After the cash outflow on exceptional costs, and the acquisition consideration for BTP Systems, we anticipate closing accounting net debt to increase to £200-250m, equivalent to leverage for covenant purposes in the range of 1.5-2x EBITDA.

As noted in our previous announcement regarding the potential acquisition of health facilities management contracts formerly operated by Carillion plc, the effect of this transaction is not included in any of our guidance at this stage.

Looking further ahead, we expect 2019 to be a year of further good growth in Underlying Trading Profit, which is again likely to be driven by additional transformation savings. The rate of growth thereafter will be more dependent on our ability to grow revenues. The Strategy Review announced in March 2015 set out a long term ambition that the business could grow in line with a market which was expected to expand at a long term trend rate of 5-7% a year and deliver margins of 5-6%. Our margin ambition was predicated on three conditions: first, reducing costs as a percentage of sales; second, containing losses on onerous contracts and converting a number of them into profitable contracts on rebid; and, thirdly, increasing margins by growing revenues whilst bearing down on overheads. We remain broadly on track on costs and onerous contracts, but some markets, and in particular the UK, are currently growing more slowly than their former trend rate. We can and will partly compensate for a weaker organic revenue outlook through increased actions on the cost base, and our long term ambitions of 5-7% revenue growth and 5-6% margin remain intact, but the timing of achieving this will be dependent upon when demand reverts to historic levels in our target markets.

## Industry backdrop and concluding thoughts

“No plan ever survives first contact with the enemy” was a phrase first coined by the military strategist Helmuth von Moltke in the 19<sup>th</sup> century. So far, Serco’s three-stage plan (Stabilise – Transform – Grow), which we conceived in late 2014, has survived contact with the flow of events surprisingly well. After a period of decline, our profits have started to grow again; we have re-established our reputation for operational delivery; we have kept our promises to our customers; our portfolio of onerous contracts is running off in line with the expectations we set in 2014; we have had a strong year of order intake in 2017; and we are taking steps to improve margins to take us to more normal levels, even if weak demand will probably mean it will take us longer to get there. We are not yet able to resume dividend payments, but our pension schemes are fully funded and our balance sheet is robust.

Into this generally positive scene of Serco’s own progress has intruded a traumatic event in the form of the collapse of one of the UK’s largest suppliers of public services, Carillion. Quite apart from the usual miseries associated with the bankruptcy of a major company, it has put at risk the supply of a number of sensitive public service contracts and caused the UK Government distraction and expense. Not unnaturally, this has reignited the already-glowing embers of the debate about the desirability of allowing private companies to deliver public services. This cuts to the heart of what we do; the UK is Serco’s home market, and accounts for around half of our revenue, and understanding recent developments is high on the agenda of many investors.

It must be stressed that the UK Government successfully buys some £200bn of goods and services from private companies and charities each year. There are over one million people employed by the private sector delivering services to Government, and the vast majority of this work is delivered to a high standard. Huge benefits have been delivered by private companies and charities providing public services which are both efficient and innovative. Nevertheless, the collapse of Carillion stands as a reminder that since 2010 a significant number of businesses supplying Government services in the UK have suffered very large losses, Serco included, and that all is not right in the market for Government services in the UK.

How has this situation arisen? In one sense, this is the market at work, with a tendency for the balance of advantage to move between buyers and sellers in accordance with supply and demand. In the ‘90’s and ‘00’s, Government was keen to enlist the support of private sector companies to improve the efficiency and productivity of public services, and many new opportunities came to market; the Government was feeling its way and trying to develop new contracting structures such as Private Finance Initiatives which had never been tested before, and was sometimes outrun by more sophisticated and canny suppliers, who were double-digit revenue growth a year with strong margins,

cash flows and returns on capital. As is the way of markets, this strong growth attracted new competitors, many from abroad or from other sectors. As is also the way of markets, the flow of milk and honey did not last indefinitely.

Around 2010, the balance of power in the market began to turn. Government introduced austerity and sought to reduce expenditure, the supply of new work slowed, just as new competitors entered the market. At the same time, Government started to hire poachers and made them its gamekeepers, and in recent years has improved its commercial and contracting capabilities beyond all recognition. Feeling compelled to deliver the growth they had promised, suppliers competed fiercely for a reducing pool of new business; prices fell, and a newly-savvy Government discovered it had anxious suppliers prepared to accept risks and contract terms which in normal conditions they would not have agreed to. Sophisticated buying techniques were imported from the private sector; contracts for sensitive public services such as caring for asylum seekers were awarded to the lowest bidder by online auction. As margins fell, suppliers shrank their capital employed and increased their debt; some made assumptions in their accounting which had the effect of pulling forward reported profits; some used opaque financing facilities and extended the payment terms to their suppliers to make their reported cash flow more nearly match the stretched profits. At the same time, falling interest rates and increasing longevity sent pension deficits soaring. So in a matter of a few years, a sector which previously had delivered healthy returns and supported well-capitalised balance sheets became under-capitalised, over-leveraged, and operationally and financially fragile. Given the amount of contractual risk suppliers were carrying, that fragility was going to show itself sooner or later.

Serco was the first major UK public services supplier to reveal the consequences of carrying those risks. In 2014, we had to take £447m of onerous contract provisions to reflect the cost of contractual commitments we had made, and in total some £1.3bn of provisions and write-downs were required. Fortunately, our banks and shareholders backed our decision to stand by our commitments to our customers, and we raised some £700m of equity and a further £250m from disposals to make our balance sheet robust. Since then, few suppliers in the sector have escaped unscathed, but Carillion is the first major bankruptcy.

Does this matter? Over 12,000 companies go into insolvency in a year in the UK, so why should Carillion be of such concern? The reason is that the nature of public services contracts are that they often involve the delivery of services of national importance that need to operate 24 hours a day. Hospitals cannot operate without cleaners and caterers; courts cannot operate without prisoner transport; defence bases cannot operate without air traffic control. The security of supply of these contracts is a matter of national importance and a proper concern of Government.

How did we get into this position? The answer is: nobody is blameless. Company managers and directors should have remembered the adage that "no deal is better than a bad deal"; and that over-optimistic accounting judgements, or flattering reported cash flow, will always be found out in the end; and that pension deficits were not a temporary aberration but a liability that needed to be addressed. And for its part, Government has used its position as a monopoly buyer to push companies, large and small, into accepting contractual terms and risks that they could not conceivably manage or hedge. Sooner or later, some of those risks were bound to crystallise, and when they did, suppliers delivering vital public services would be mortally wounded and even become functionally or formally insolvent, which would not be in the interests of either taxpayers or service users.

Where will the market go next? Clearly, both Government and suppliers should take time to consider carefully the implications of recent events. Suppliers will likely become much more wary; there will be fewer new entrants; existing players may shift the balance of their attention towards other markets, if they can. The UK Government runs the risk of being offered less choice and innovation, less competition and higher risk premiums. And efforts to encourage small and medium sized suppliers into the market are likely to be set back, as they see what has happened to some of the large and strong companies who supply Government.

In the short term, the situation may offer opportunities to companies such as Serco which have already re-financed their balance sheets and focused on developing the strength and depth of their management. But this is no time for *schadenfreude*. Serco's interest lies in seeing the market restored to health as soon as possible, where suppliers have the confidence to invest in bringing innovation and efficiency to help Government rise to the challenges of providing what it so badly needs, which is more public services, of higher quality, at lower cost. And Government needs to feel confident that it has a choice of strong suppliers, who it can trust to deliver and stand by their promises, and who have balance sheets robust enough to sustain them through the lumps and bumps inherent in the delivery of large and complex contracts.

We believe that recent events present an opportunity for both Government and its suppliers to work together to construct a new approach to the provision of public services which will avoid the problems of the past. There is broad consensus that public service provision should be a mixed economy of the state, not-for-profit organisations, and the private sector; and also that the provision of public services should not be completely exposed to the harshest rough-and-tumble, boom-and-bust cycle of a totally free market where the relative powers of either buyer or seller may

become unbalanced. Few people believe that the delivery of public services should always be a monopoly of employees of the state. The question is a practical one of how to make the procurement of public services, whether delivered by the state itself, by not-for-profits, or private companies, work better.

Serco will be contributing energetically to this discussion, and we will be proposing four principles which we suggest should govern relations between Government and its suppliers, be they public bodies, not-for-profit organisations or private sector companies.

- We should **strengthen transparency in public contracting**. This means that for large contracts for public services, which are not commoditised, which do not impinge on National Security, and which do not include significant amounts of intellectual property, the presumption should be in favour of open-book accounting, in which the Cabinet Office and National Audit Office can see the suppliers' accounts of major contracts, whether they be performed by public or private operators. There should also be far greater transparency of operational performance: except in exceptional circumstances, suppliers, be they private or Government-owned, should be required to publish every six months their performance against key operational indicators, so they are held accountable for the delivery of their promises to the taxpayers who are paying for them and the users who they are serving. And we believe that there should be a formal, rigorous and transparent decision-making process by which Government decides what mechanism it should use, be it in-house or by a third party, to deliver a given project or policy. We call this the "Transparency Principle".
- **Both suppliers and the Government should have the right, on payment of an agreed break fee, to exit a contract** at pre-determined intervals. We call this the "Orderly Exit Principle". The purpose of this is to give both Government and supplier the ability to exit contracts which are not working out as intended. For instance, if the supplier is making greater than expected profits, or Government policy changes, or performance is unsatisfactory but still within the bounds of the contract, the Government should be able, on payment of a break fee, to re-compete or take back in-house the contract; and likewise if the supplier was making unexpected losses, or changes in regulation had made it impossible to deliver the contract as intended, the supplier can exit the contract on payment of a fee which would compensate the Government for the cost of re-tendering. This would, for both Government and supplier, significantly reduce the risk of being stuck together in unhappy marriages.
- **Suppliers of sensitive contracts should be obliged to lodge with Government a "living will"**, being a set of arrangements to facilitate the transfer of a contract back to Government or to another supplier if required. This would significantly reduce the operational risk to Government of supplier failure. This is the "Security of Supply Principle".
- **Government and suppliers should agree to abide by a mutually-agreed code of conduct**, which would set out expected standards of behaviour from Government and its contractors. This would involve the Government agreeing not to impose punitive or unfair terms and conditions or transfer unmanageable state risk; and suppliers would agree to maintain certain metrics of financial stability; pay their sub-contractors in a timely fashion; and adequately fund their pensions. We think it would be important to have a process of independent arbitration built into the code of conduct to ensure that there is some avenue of redress and calling to account those who do not abide by the code. We call this the "Fairness Principle".

It is vital to the well-being of any country that public services are delivered to high standards and offer value for money, and for the most part, in the UK, private and third-sector providers have done a good job of doing this. The UK has hundreds of new hospitals and schools, built and maintained to high standards; thousands of contracts have delivered innovation, improved services and lowered costs, along with far higher degrees of visibility of operational performance than is commonly available from public sector delivery. And as the UK advances towards Brexit, it is clear that there will be the need for a whole lot more Government as we "take back control". With this in mind, we believe that there is an urgent need to re-think the relationship between the UK Government and its suppliers. We believe an approach based on the Four Principles above would serve to restore trust and common sense in the market; remove the risk of excessive profits or losses; and encourage a more vibrant and competitive market for Government services, one in which Serco would be an enthusiastic participant.

**Rupert Soames**  
Group Chief Executive  
Serco – and proud of it.



## Divisional Reviews

Serco's operations are reported as four regional divisions: UK & Europe (UK&E); the Americas; the Asia Pacific region (AsPac); and the Middle East. The Global Services division previously consisted of Serco's private sector BPO operations, which for statutory reporting purposes were classified in 2016 as discontinued operations following the previously announced strategic exit from this market and the subsequent disposals. Serco presents alternative measures to include the Revenue and Trading Profit of these discontinued operations in prior periods for consistency with previous disclosures. Reflecting statutory reporting requirements, Serco's share of revenue from its joint ventures and associates is not included in revenue, while Serco's share of joint ventures and associates' profit after interest and tax is included in Underlying Trading Profit. As previously disclosed and for consistency with guidance, Serco's Underlying Trading Profit measure excludes Contract & Balance Sheet Review adjustments (principally OCP releases or charges), and the benefit in 2016 from not depreciating and amortising assets held for sale, and other one-time items such as those in 2016 related to the early exit from the Thurrock contract.

Year ended 31 December 2017 £m	UK&E	Americas	AsPac	Middle East	Corporate costs	Total
<b>Revenue</b>	<b>1,334.7</b>	<b>688.0</b>	<b>579.0</b>	<b>351.9</b>	-	<b>2,953.6</b>
<i>Change</i>	(3%)	0%	(7%)	+8%		(2%)
<i>Change at constant currency</i>	(4%)	(7%)	(14%)	+2%		(6%)
<i>Organic change at constant currency</i>	(4%)	(7%)	(15%)	+2%		(6%)
<b>Underlying Trading Profit/(Loss)</b>	<b>35.1</b>	<b>36.4</b>	<b>23.7</b>	<b>16.2</b>	<b>(41.6)</b>	<b>69.8</b>
<i>Change</i>	(23%)	(15%)	(5%)	(2%)	(4%)	(19%)
<i>Change at constant currency</i>	(25%)	(21%)	(13%)	(10%)	(4%)	(27%)
<i>Margin</i>	2.6%	5.3%	4.1%	4.6%	n/a	2.4%
Contract & Balance Sheet Review adjustments	(30.6)	3.4	11.4	-	-	(15.8)
<b>Trading Profit/(Loss)</b>	<b>4.5</b>	<b>39.8</b>	<b>35.1</b>	<b>16.2</b>	<b>(41.6)</b>	<b>54.0</b>
Amortisation of intangibles arising on acquisition	-	(3.0)	(1.4)	-	-	(4.4)
<b>Operating profit/(loss) before exceptionals</b>	<b>4.5</b>	<b>36.8</b>	<b>33.7</b>	<b>16.2</b>	<b>(41.6)</b>	<b>49.6</b>

Year ended 31 December 2016 £m	UK&E	Americas	AsPac	Middle East	Corporate costs	Sub-total continuing	Global Services	Total
<b>Revenue including discontinued operations</b>	<b>1,375.1</b>	<b>691.4</b>	<b>619.7</b>	<b>324.8</b>	-	<b>3,011.0</b>	<b>36.8</b>	<b>3,047.8</b>
Discontinued operations adjustment*	-	-	-	-	-	-	(36.8)	(36.8)
<b>Revenue</b>	<b>1,375.1</b>	<b>691.4</b>	<b>619.7</b>	<b>324.8</b>	-	<b>3,011.0</b>	-	<b>3,011.0</b>
<b>Underlying Trading Profit/(Loss)</b>	<b>45.7</b>	<b>43.0</b>	<b>24.9</b>	<b>16.6</b>	<b>(43.5)</b>	<b>86.7</b>	<b>(4.6)</b>	<b>82.1</b>
<i>Margin</i>	3.3%	6.2%	4.0%	5.1%	n/a	2.9%	(12.5%)	2.7%
Contract & Balance Sheet Review adjustments	35.3	(36.6)	9.3	2.2	3.2	13.4	0.8	14.2
Assets held for sale depreciation and amortisation	-	-	-	-	-	-	0.5	0.5
Other one-time items	3.5	-	-	-	-	3.5	-	3.5
<b>Trading Profit/(Loss)</b>	<b>84.5</b>	<b>6.4</b>	<b>34.2</b>	<b>18.8</b>	<b>(40.3)</b>	<b>103.6</b>	<b>(3.3)</b>	<b>100.3</b>
Amortisation of intangibles arising on acquisition	(0.3)	(2.8)	(2.0)	-	-	(5.1)	-	(5.1)
Discontinued operations adjustment*	-	-	-	-	-	-	3.3	3.3
<b>Operating profit/(loss) before exceptionals</b>	<b>84.2</b>	<b>3.6</b>	<b>32.2</b>	<b>18.8</b>	<b>(40.3)</b>	<b>98.5</b>	-	<b>98.5</b>

\* Statutory reporting only includes the post-tax result of discontinued operations as a single line in the Condensed Consolidated Income Statement.

The trading performance and outlook for each division are described on the following pages. Reconciliations and further detail of financial performance are included in the Finance Review on pages 18 to 37. This includes full definitions and explanations of the purpose of each non-IFRS Alternative Performance Measure (APM) used by the Group. The Condensed Consolidated Financial Statements and accompanying notes are on pages 38 to 79.

## UK & Europe

Serco's UK & Europe division supports public service delivery and outcomes across all five of the Group's chosen sectors: our Justice & Immigration business provides a wide range of services to support safeguarding society and reducing reoffending, from secure accommodation management through to housing and welfare services for asylum seekers; in Defence, we are trusted to deliver critical support services and operate sensitive facilities; we operate complex public Transport systems and services; our Health business provides primarily non-clinical support services to hospitals; and the Citizen Services business provides environmental and leisure services, as well as a wide range of other front, middle and back-office services to support public sector customers in the UK or European institutions. Serco's operations in the UK represent approximately 40% of total Revenue for the Group, and those across the rest of Europe approximately 5%.

Serco announced in September 2017 that it would merge its UK and European operating divisions to create a single, integrated business, Serco UK & Europe. This combined the two previous divisions – UK Central Government and UK & Europe Local & Regional Government – and will simplify and improve the efficiencies and capabilities of our operations in the region, in particular as we continue to drive transformation benefits across the Group as a whole. Kevin Craven, previously Chief Executive of UK Central Government became the Chief Executive of Serco UK & Europe. Kevin joined Serco in September 2014, prior to which he was CEO of Balfour Beatty Services, leading a business with 16,000 employees and revenues of over £1.6bn, covering sectors such as facilities management, rail, highways and utilities. Before joining Balfour Beatty, he was the Managing Director for Healthcare, Education & Defence at Aramark, and the Managing Director of Transport & Travel for Sodexo.

Revenue for 2017 was £1,334.7m (2016: £1,375.1m), a decline of 3%; reported revenue excludes that from our joint venture and associate holdings which are predominantly the operations of AWE, Merseyrail and previously Northern Rail, with these representing the vast majority of the Group's activity in joint ventures and associates. At constant currency, the decline in revenue was 4%. Drivers of the reduction included: in our Health business, we ceased to recognise as revenue the value of goods purchased on our customers' behalf following changes to two procurement services contracts; in our Defence business, the phased transfer back during 2016 of services that Serco had previously been providing to the Defence Science & Technology Laboratory (DSTL) and for Defence Business Services (DBS); we also saw reduced volumes in our Child Maintenance Group operations, and the ending or reduced scale of various other BPO and IT support services contracts. These revenue reductions were partially offset from growth elsewhere, namely the start of hospital facility management services for Barts Health NHS Trust and University Hospital Southampton NHS Foundation Trust, as well as some growth in our European agency operations and from the new Skills Support for the Workforce (SSW) contracts.

Underlying Trading Profit was £35.1m (2016: £45.7m), representing an implied margin of 2.6% (2016: 3.3%). Trading Profit includes the profit contribution (from which tax and interest have already been deducted) of joint ventures and associates; if the £350m (2016: £474m) proportional share of revenue from joint ventures and associates was also included and if the £7.0m (2016: £7.4m) share of interest and tax cost was excluded, the overall divisional margin would have been 2.5% (2016: 2.9%). The joint venture and associate profit contribution of £26.6m (2016: £31.3m) was £4.7m lower, reflecting the end of the Northern Rail franchise in March 2016 and the lower shareholding of AWE from September 2016. The reduction in Underlying Trading Profit also included the impact of other contract attrition and in-contract reductions, and the lower profitability from new contracts in their initial transition and transformation stages. The non-repeat of certain costs and impairments that occurred in 2016 and the progress made on cost efficiencies in 2017 only partially offset these areas of profit reduction. Within Underlying Trading Profit there was £55m of OCP utilisation (2016: £60m), which served to offset the Division's loss-making operations, principally COMPASS UK asylum seeker support services, the Caledonian Sleeper, Future Provision of Marine Services (FPMS), Lincolnshire Country Council, and the Prisoner Escort & Custody Services (PECS) contracts.

Contract & Balance Sheet Review adjustments resulted in a £30.6m net charge, driven by updating the assumptions regarding operational and maintenance costs of running the Caledonian Sleepers contract, partially offset by a net £16m of releases across other contracts. The Caledonian Sleepers charge of £47m reflects a sharp increase in the estimated costs related to the delayed introduction and operation of the new sleeper service. We will be examining every option for reducing operating costs; the position under the contract is expected to improve over time, as the terms of the Franchise Agreement provide a mechanism that requires Transport Scotland to bear 50% of contract losses from 1 April 2020. In addition, from 1 April 2022, we have the right to seek adjustments to the financial terms of the Franchise Agreement that would result either in a small positive profit margin for Serco from that date, or allow us to exit the contract. A detailed review of provisions and Contract & Balance Sheet Review items is included in the Finance Review on pages 18 to 37. After these adjustments, Trading Profit was £4.5m (2016: £84.5m, reflecting £35.3m net release for Contract & Balance Sheet Review adjustments and a £3.5m one-time profit arising from a pension scheme settlement).

The UK & Europe division represented around £0.7bn of the Group's aggregate total value of signed contracts during 2017. The largest award was a new contract to transform catering and cleaning for University Hospital Southampton NHS Foundation Trust, with an estimated value of £125m over the ten-year term. Other new work included adding patient transport services to our relationship with Barts Health NHS Trust, and environmental services to Rushmoor Borough Council. Of large new bids where we were unsuccessful, these included immigration escorting for the Home Office and the regional MOD contracts for Technical Support Services Provision to the UK's Royal Air Force.

The largest rebid or extension that was due during the year was for our provision of facilities management services at NHS Forth Valley, where we successfully secured these for a further seven years. Others secured included contact services for Hertfordshire County Council, specialist scientific and engineering support for the European Space Agency, our helicopter aircrew training for the MOD and a number of other defence support services contracts, parking services for the West London Alliance, environmental services for Wandsworth Council, and citizen services support to customers including Invest Northern Ireland, the Department of Health and the Skills Funding Agency.

Of existing work where an extension or rebid will be required at some point before the end of 2020, there are 30 contracts with annual revenue of over £5m within the UK & Europe division; in aggregate, these represent approximately a third of the current level of annual revenue for the division. The largest of these are the Northern Isles Ferries operations that are expected to be extended from April 2018 to the end of 2019; the COMPASS contract is also due in 2019, along with a large European agency contract; and in 2020, PECS is now assumed to be rebid if a final extension option is not exercised by the customer, as well as that year our Anglia Support Partnership healthcare shared services operations. The Glasgow ACCESS operations transferred by the end of 2017, therefore representing known attrition of approximately 4% of divisional revenue.

Our pipeline of new bid opportunities has been significantly reduced following the removal of wins such as the Barts and Southampton NHS contracts, as well as from losses such as immigration escorting for the Home Office. The Defence Fire & Risk Management Organisation (DFRMO) tender is still ongoing, as is that for an immigration removal centre. We have partially reloaded the pipeline with some other smaller tenders for various defence support, hospital facilities management and environmental services. For the successor to the COMPASS arrangements, we are also including in our new bid pipeline the incremental opportunity beyond the regions where we currently operate.

## Americas

Our Americas division accounts for approximately 23% of Serco's overall revenue, and provides professional, technology and management services focused on Defence, Transport, and Citizen Services. The US Federal Government, including the military, civilian agencies and the national intelligence community, are our largest customers. We also provide services to the Canadian Government and to some US state and municipal governments.

Revenue for 2017 was £688.0m (2016: £691.4m), a modest reduction in reported currency. In US dollars, the main currency for operations of the division, revenue was equivalent to approximately US\$890m (2016: US\$940m). The strengthening of local currencies against Sterling increased revenue by £42m or 7%; the organic change at constant currency was therefore a decline of 7%. The decline was driven by the end of the contracts during 2016 for the Virginia Department of Transportation (VDOT) and for US Army transition assistance (SFLTAP). These and other smaller reductions were partially offset by growth in our support of advanced anti-terrorism systems for ships and infrastructure at US Navy ports and federal facilities, and some increases elsewhere in the volume of workload or task orders.

Underlying Trading Profit was £36.4m (2016: £43.0m), representing a margin of 5.3% (2016: 6.2%). While there was a £2.4m favourable currency movement, there was the impact of the first half of 2016 benefitting from the longer running of the VDOT and SFLTAP contracts which were only partially offset by cost efficiencies in 2017. Within Underlying Trading Profit there was £5m (2016: £9m) of OCP utilisation, which reflects the offset of losses on the Ontario Driver Examination Services contract.

Contract & Balance Sheet Review adjustments resulted in a £3.4m net release. After these adjustments, Trading Profit was £39.8m (2016: £6.4m, reflecting £36.6m net charge for Contract & Balance Sheet Review adjustments).

Americas represented around £0.8bn of the Group's aggregate total value of signed contracts during the year. The largest new award was for US Army base modernisation services and in particular IT support, valued at a total of \$140m for the five-year base period and five one-year option periods. The second largest was to provide supply chain management services for hazardous materials at three US Navy Fleet Readiness Centers, valued at a total of \$101m for the base period and four one-year options. Smaller new awards included safety service patrol for the Texas Department of Transportation, and numerous US Navy ship and shore defence equipment modernisation task orders. Of rebids and extensions secured, the largest was for the US Patent & Trademark Office (USPTO) for a

further ten years, albeit the new contract is for a reduced volume of work; others secured included fleet services for Louisville Gas & Electric Company, parking meter management in San Francisco and support services for the US Federal Retirement Thrift Investment Board and the US Government Accountability Office. Serco was unsuccessful in a large new bid opportunity to be prime contractor for US Navy systems support, but has potential for a share of work through sub-contract relationships; there were no other major new pipeline decisions or large rebids or extensions due during the year.

Of existing work where an extension or rebid will be required at some point before the end of 2020, there are 12 contracts with annual revenue of over £5m within the Americas division; in aggregate, these represent around 50% of the current level of annual revenue for the division; this high proportion reflects that our contract supporting the US Affordable Care Act (ACA), which currently accounts for around 30% of divisional revenue, requires securing a rebid from 30 June 2018; the Global Installation Contract covering areas of our defence ship modernisation work is due for rebid in 2019, while our support to the Federal Aviation Administration's (FAA) Contract Tower (FCT) Program will become due for rebid once again in 2020.

Our pipeline of major new bid opportunities due for decision within the next 24 months includes further important opportunities to provide various support functions to the US Navy. A defence opportunity to support US Air Force radar systems as well as various other defence support bids were added during the year, as were other tenders for transport operations and fleet support and Citizen Services records management. Opportunities for immigration services were removed from the pipeline due to delays in tender processes.

Future profitability will as usual be shaped by the outcomes of the major new bid opportunities in the region, but in particular by the rebid outcome due by 30 June 2018 and the future scale of operation of the ACA contract and its absorption of overhead costs.

Serco was pleased to announce in June 2017 that David J. Dacquino would become Chief Executive Officer of the Americas division, with Dan Allen having informed the business back in February of his intention to retire. Dave Dacquino joined Serco in 2015 to lead the Americas' Defence business, bringing deep knowledge and experience from across the defence, aeronautics, logistics and technical services industries.

## **AsPac**

Operations in the Asia Pacific division include Justice, Immigration, Defence, Health, Transport and Citizen Services in Australia, New Zealand and Hong Kong. Serco's operations in Australia are by far the largest element of the division; the country represents approximately 19% of total Revenue for the Group.

Revenue for 2017 was £579.0m (2016: £619.7m), a decline of 7%. In Australian dollars, the main currency for operations of the division, revenue for the year was equivalent to approximately A\$980m (2016: A\$1,140m). The movements in local currencies against Sterling increased revenue by £48m or 7%; the acquisition of the other 50% of a small defence services joint venture added 1% to revenue; the organic change at constant currency was therefore a decline of 15%. This reduction was driven by the end of the Armidale Class Patrol Boats (ACPB), Western Australia Court Security & Custodial Services (WACSCS) and Mount Eden contracts, together with some smaller reductions from other contracts ending or reducing in scope; there was some growth in Citizen Services contact and processing support which partially offset this attrition.

Underlying Trading Profit was £23.7m (2016: £24.9m), representing a margin of 4.1% (2016: 4.0%). While there was a favourable currency movement of £2.1m, the net of other movements reflected contract attrition and other margin pressures with only partial offset from progress on cost efficiencies and growth from new work. Within Underlying Trading Profit there was £9m of OCP utilisation (2016: £12m).

Contract & Balance Sheet Review adjustments resulted in a £11.4m net release, the largest element of which was a further OCP release on ACPB reflecting revised assumptions of the residual liability after the contract transferred to a new operator during the year. The ACPB contract was the largest of the OCP contracts, and is the first of the major OCP contracts to come to an end. After these adjustments, Trading Profit was £35.1m (2016: £34.2m, reflecting £9.3m net release for Contract & Balance Sheet Review adjustments).

AsPac represented around £1.8bn of the Group's aggregate total value of signed contracts during the year. By far the largest element of this was approximately £1.5bn for the 20-year contract valued at A\$2.6bn for the operation of New Grafton Correctional Centre (NGCC) which is expected to commence in 2020; NGCC will be the largest correctional centre in Australia, consisting of a total of 1,700 beds in three individual security categories, and draws upon Serco's experience of managing correctional facilities in the UK, New Zealand and elsewhere in Australia, which includes Australia's current largest facility, Acacia Prison. Other smaller new wins included contact services support in Australia for the Department of Human Services. Extensions and rebids awarded in the year included



traffic camera support in the Victoria, and passenger and integrated transport information services for transport authorities in Western Australia and New South Wales. There were no other larger rebids or major new bid pipeline decisions made in the year.

Of existing work where an extension or rebid will be required at some point before the end of 2020, there are 10 contracts with annual revenue of over £5m within the AsPac division; in aggregate, these represent just over half of the current level of annual revenue for the division; this high proportion reflects that the Australia onshore immigration services contract requires rebid or extension at the end of 2019, with this accounting for over 30% of current divisional revenue.

Our pipeline of major new bid opportunities due for decision within the next 24 months includes some further (but far smaller than Grafton) Justice & Immigration opportunities, as well as in Defence support services. We will look to build the pipeline further in these sectors as well as Citizen Services, Transport and Health.

## **Middle East**

Operations in the Middle East division include Transport, Defence, Health and Citizen Services, with the region accounting for approximately 12% of the Group's total revenue.

Revenue for 2017 was £351.9m (2016: £324.8m), an increase of 8%. The strengthening of local currencies against Sterling provided growth of £21m or 6%; the organic change at constant currency was therefore growth of 2%. Growth came from new contracts for facilities management at Dubai Airport and for a financial services company in Abu Dhabi, though these were partially offset by reductions related to the Dubai Air Navigation Services and Staff College training for the Qatar Armed Forces contracts, as well as a small number of other operations reducing in scope or volume including the Middle East Logistics & Base Support (MELABS) contract that supports the Australian Defence Force in the region.

Underlying Trading Profit was £16.2m (2016: £16.6m), representing a margin of 4.6% (2016: 5.1%). While there was a £1.2m favourable currency movement, there was an overall reduction in profitability due in large part to the non-repeat of the higher defence logistics volumes experienced in the first half of 2016, together with the impact of other contract scope reductions and attrition. There are no OCP contracts in the division and therefore no OCP utilisation within Underlying Trading Profit.

There were no Contract & Balance Sheet Review adjustments in the year, therefore Trading Profit was also £16.2m (2016: £18.8m, reflecting £2.2m net release for Contract & Balance Sheet Review adjustments).

The Middle East represented around £0.1bn of the Group's aggregate total value of signed contracts during the year. Amongst smaller contract awards were new wins to provide facilities management in Abu Dhabi and defence training support in Qatar. Serco was unsuccessful however in pursuing the very large tenders for light rail and tram operations in the region. Extensions to existing work included facilities management for Cleveland Clinic Abu Dhabi, and air navigation services and training in Bahrain and Iraq; there were no other large rebid or extension decisions due in the year.

Of existing work where an extension or rebid will be required at some point before the end of 2020, there are 13 contracts with annual revenue of over £5m within the Middle East division; in aggregate, these represent well over half of the current level of annual revenue for the division. There is a high proportion of work to secure in 2019, when the Dubai Metro, MELABS and Cleveland Clinic Abu Dhabi contracts each require extending or rebidding; by 2020, our Dubai Air Navigation Services will also become due for further extension or rebid.

Our pipeline of major new bid opportunities in the region has reduced very significantly following the outcome of the light rail and tram bids. There are some other smaller opportunities in transport and defence support services, and effort is ongoing to rebuild a stronger pipeline.

## **Corporate costs**

Corporate costs relate to typical central function costs of running the Group, including executive, governance and support functions such as HR, finance and IT. Where appropriate, these costs are stated after allocation of recharges to operating divisions. The costs of Group-wide programmes and initiatives are also incurred centrally.

Benefiting from actions to deliver savings and improve efficiencies of our central functions, corporate costs in 2017 reduced to £41.6m (2016: £43.5m).

## Finance Review

<b>For the year ended 31 December 2017</b>	Underlying £m	Non underlying items £m	Trading £m	Amortisation and impairment of intangibles arising on acquisition £m	Less discontinued pre exceptional* £m	Statutory pre exceptional £m	Continuing and discontinued exceptional items £m	Less discontinued exceptional items* £m	Statutory £m
Revenue	2,953.6	-	2,953.6	-	-	2,953.6	-	-	2,953.6
Cost of sales	(2,688.9)	(15.8)	(2,704.7)	-	-	(2,704.7)	-	-	(2,704.7)
Gross profit	264.7	(15.8)	248.9	-	-	248.9	-	-	248.9
Administrative expenses	(222.2)	-	(222.2)	(4.4)	-	(226.6)	(19.6)	-	(246.2)
Share of profits in joint ventures and associates, net of interest and tax	27.3	-	27.3	-	-	27.3	-	-	27.3
Profit before interest and tax	69.8	(15.8)	54.0	(4.4)	-	49.6	(19.6)	-	30.0
<i>Margin</i>	2.4%		1.8%			1.7%			1.0%
Net finance costs	(11.6)	-	(11.6)	-	-	(11.6)	-	-	(11.6)
Other gains	-	0.7	0.7	-	-	0.7	-	-	0.7
Profit before tax	58.2	(15.1)	43.1	(4.4)	-	38.7	(19.6)	-	19.1
Tax charge	(20.6)	5.0	(15.6)	1.6	-	(14.0)	(5.0)	-	(19.0)
<i>Effective tax rate</i>	(35.4%)		(36.2%)			(36.2%)			(99.5%)
Profit / (loss) for the period	37.6	(10.1)	27.5	(2.8)	-	24.7	(24.6)	-	0.1
Minority interest	0.3		0.3			0.3			0.3
<i>Earnings / (loss) per share (pence)</i>	3.42		2.50			2.24			(0.02)

\* No amounts are recorded as discontinued operations for the year ended 31 December 2017.

<b>For the year ended 31 December 2016 (restated*)</b>	Underlying £m	Non underlying items £m	Trading £m	Amortisation and impairment of intangibles arising on acquisition £m	Less discontinued pre exceptional £m	Statutory pre exceptional £m	Continuing and discontinued exceptional items £m	Less discontinued exceptional items £m	Statutory £m
Revenue	3,047.8	-	3,047.8	-	(36.8)	3,011.0	-	-	3,011.0
Cost of sales*	(2,782.9)	18.2	(2,764.7)	-	40.1	(2,724.6)	-	-	(2,724.6)
Gross profit*	264.9	18.2	283.1	-	3.3	286.4	-	-	286.4
Administrative expenses*	(216.2)	-	(216.2)	(5.1)	-	(221.3)	(70.5)	14.2	(277.6)
Share of profits in joint ventures and associates, net of interest and tax	33.4	-	33.4	-	-	33.4	-	-	33.4
Profit before interest and tax	82.1	18.2	100.3	(5.1)	3.3	98.5	(70.5)	14.2	42.2
<i>Margin</i>	2.7%		3.3%			3.3%			1.4%
Net finance costs	(12.6)	-	(12.6)	-	-	(12.6)	(0.4)	0.4	(12.6)
Profit before tax	69.5	18.2	87.7	(5.1)	3.3	85.9	(70.9)	14.6	29.6
Tax charge	(24.4)	6.7	(17.7)	1.8	0.1	(15.8)	3.1	-	(12.7)
<i>Effective tax rate</i>	35.2%		20.2%			18.4%			42.9%
Profit for the period from continuing operations	45.1	24.9	70.0	(3.3)	3.4	70.1	(67.8)	14.6	16.9
Loss for the period from discontinued operations	-	-	-	-	(3.4)	(3.4)	-	(14.6)	(18.0)
Profit / (loss) for the period	45.1	24.9	70.0	(3.3)	-	66.7	(67.8)	-	(1.1)
Minority interest	0.1		0.1			0.1			0.1
<i>Earnings / (loss) per share (pence)</i>	4.13		6.42			6.12			(0.11)

\* Costs included within cost of sales and administrative expenses have been reallocated, resulting in a restatement. See note 1 to the Condensed Consolidated Financial Statements.

## Change regarding the classification of cost items within cost of sales and administrative expenses

The Group has undergone a programme of work on its financial data structures to appropriately allocate and charge costs to the relevant divisions and between cost of sales and administrative expenses. As a result of the activities performed in this area, the Group's classification of cost items in the income statement has changed. The prior year's results have been restated to reflect the cost items identified which should have been reallocated in 2016. This resulted in increasing administrative expenses by £43.0m and decreasing cost of sales by the same amount. The change in policy has no impact on operating profit, any other item below this on the income statement, or any of the Group's key performance measures.

Cost of sales are considered to be the costs of operating contracts. This includes the unavoidable costs of servicing contracts and all costs that a contract would incur purely on its own without a parent company, regardless of how those services are delivered within the wider Group, such as IT or Human Resource management services provided centrally.

## Alternative Performance Measures (APMs) and other related definitions

### Overview

APMs used by the Group are reviewed below to provide a definition and reconciliation from each non-IFRS APM to its IFRS equivalent, and to explain the purpose and usefulness of each APM.

In general, APMs are presented externally to meet investors' requirements for further clarity and transparency of the Group's financial performance. The APMs are also used internally in the management of our business performance, budgeting and forecasting, and for determining Directors' remuneration and that of other management throughout the business.

APMs are non-IFRS measures. Where additional revenue is being included in an APM, this reflects revenues presented elsewhere within the reported financial information, except where amounts are recalculated to reflect constant currency. Where items of profits or costs are being excluded in an APM, these are included elsewhere in our reported financial information as they represent actual profits or costs of the Group, except where amounts are recalculated to reflect constant currency. As a result, APMs allow investors and other readers to review different kinds of revenue, profits and costs and should not be used in isolation. Other commentary within the preliminary announcement, including the other sections of this Finance Review, as well as the Condensed Consolidated Financial Statements and the accompanying notes, should be referred to in order to fully appreciate all the factors that affect our business. We strongly encourage readers not to rely on any single financial measure, but to carefully review our reporting in its entirety.

The methodology applied to calculating the APMs has not changed during the year for any measure.

### Alternative revenue measures

#### *Reported revenue at constant currency*

Reported revenue, as shown on the Group's Condensed Consolidated Income Statement on page 38, reflects revenue translated at the average exchange rates. In order to provide a comparable movement on the previous year's results, reported revenue is recalculated by translating non-Sterling values for the year to 31 December 2017 into Sterling at the average exchange rate for the year ended 31 December 2016. All revenue in 2017 arose from continuing activities.

For the year ended 31 December	2017 £m
<b>Reported revenue at constant currency</b>	2,832.0
Foreign exchange differences	121.6
<b>Reported revenue at reported currency</b>	2,953.6

## Organic Revenue at constant currency

Reported revenue may include revenue generated by businesses acquired during a particular year and/or generated by businesses sold during a particular year up to the date of disposal. In order to provide a comparable movement which ignores the effect of both acquisitions and disposals on the previous year's results, Organic Revenue at constant currency is recalculated by excluding the impact of any relevant acquisitions or disposals.

For the year ended 31 December 2017, an adjustment was required for the disposal of the remaining element of the UK private sector BPO business, consisting of a single contract, sold on 3 July 2017. This business was previously reported within discontinued operations but included as continuing in 2017 as it does not have a material impact on the Group's results. The Group disposed of Service Glasgow LLP on 1 December 2017, which also consisted of a single contract. However, this disposal arose as a result of normal contract attrition rather than as a result of the disposal of a wider business and hence this is not excluded for the Organic Revenue calculation.

The only acquisition excluded for the calculation of Organic Revenue in the year relates to the acquisition of 50% of the issued share capital of Serco Sodexo Defence Services Pty Ltd, resulting in full control being obtained. Serco Sodexo Defence Services Pty Ltd was previously a 50% owned joint venture accounted for on an equity accounting basis and therefore no revenues had previously been recorded in the Group's results.

Organic Revenue growth is calculated by comparing the current year Organic Revenue at constant currency exchange rates with the prior year Organic Revenue at reported currency exchange rates.

For the year ended 31 December	2017 £m
<b>Organic Revenue at constant currency</b>	2,823.1
Foreign exchange differences	121.3
<b>Organic Revenue at reported currency</b>	2,944.4
Impact of any relevant acquisitions or disposals	9.2
<b>Reported revenue at reported currency</b>	2,953.6

For the year ended 31 December	2016 £m
<b>Organic Revenue at reported currency (continuing activities only)</b>	3,011.0
Impact of any relevant acquisitions or disposals	-
<b>Reported revenue at reported currency (continuing activities only)</b>	3,011.0

## Revenue from continuing and discontinued operations

Reported revenue, as shown on the Group's Condensed Consolidated Income Statement on page 38, reflects only that from continuing operations, with the post tax result of discontinued operations consolidated as a single line at the bottom of the Condensed Consolidated Income Statement. The alternative measure includes discontinued operations for the benefit of consistency with previously reported results and to reflect the overall change in scale of the Group's operations. The alternative measure allows the performance of the discontinued operations themselves, and their impact on the Group as a whole, to be evaluated on measures other than just the post tax result. No operations were classified as discontinued in 2017 as there was a single remaining business as at 1 January 2017 which generated insignificant revenue and profit up to the date of disposal of 3 July 2017. Discontinued operations in the prior year reflect the former Global Services division which consisted of the Group's private sector BPO operations.

For the year ended 31 December	2017 £m	2016 £m
<b>Revenue from continuing and discontinued operations</b>	2,953.6	3,047.8
Exclude revenue from discontinued operations	-	(36.8)
<b>Reported revenue (continuing activities only)</b>	2,953.6	3,011.0

## Revenue from continuing operations, including share of joint ventures and associates

Reported revenue, as shown on the Group's Condensed Consolidated Income Statement on page 38, excludes the Group's share of revenue from joint ventures and associates, with Serco's share of profits in joint ventures and associates (net of interest and tax) consolidated within Reported Operating Profit as a single line further down the Condensed Consolidated Income Statement. The alternative measure includes the share of joint ventures and associates for the benefit of reflecting the overall change in scale of the Group's ongoing operations, which is



particularly relevant for evaluating Serco's presence in market sectors such as Defence and Transport. The alternative measure allows the performance of the joint venture and associate operations themselves, and their impact on the Group as a whole, to be evaluated on measures other than just the post tax result.

For the year ended 31 December	2017 £m	2016 £m
<b>Revenue from continuing operations, including share of joint ventures and associates</b>	3,310.3	3,491.8
Exclude share of revenue from joint ventures and associates	(356.7)	(480.8)
<b>Reported revenue (continuing activities only)</b>	2,953.6	3,011.0

## Alternative profit measures

For the year ended 31 December	2017 £m	2016 £m
<b>Underlying Trading Profit</b>	69.8	82.1
Non-underlying items:		
Include OCP charges and releases	(19.0)	9.6
Include other Contract & Balance Sheet Review adjustments	3.2	4.6
Include benefit from non-depreciation and amortisation of assets held for sale	-	0.5
Include other one-time items	-	3.5
	(15.8)	18.2
<b>Trading Profit</b>	54.0	100.3
Include operating exceptional items (continuing operations only)	(19.6)	(56.3)
Include amortisation and impairment of intangibles arising on acquisition from continuing and discontinued operations	(4.4)	(5.1)
Exclude operating loss from discontinued operations	-	3.3
<b>Operating profit (continuing activities only)</b>	30.0	42.2

## Underlying Trading Profit (UTP)

The Group uses an alternative measure, Underlying Trading Profit, to make adjustments for unusual items that occur within Trading Profit and remove the impact of historical issues. UTP therefore provides a measure of the underlying performance of the business in the current year. For 2016 there were four items excluded from UTP, only two of which required adjustment in 2017.

Charges and releases on all Onerous Contract Provisions (OCPs) are excluded in the current and prior years. OCPs reflect the future multiple year cost of delivering onerous contracts and do not reflect only the current cost of operating the contract in the latest individual year. It should be noted that, as for operating profit, UTP benefits from OCP utilisation of £69.3m in 2017 (2016: £84.2m) which neutralises the in-year losses on previously identified onerous contracts, therefore it is only charges or releases of OCPs that are adjusted for.

Revisions to accounting estimates and judgements which arose during the 2014 Contract & Balance Sheet Review are separately reported where the impact of an individual item is material. Only one such item was noted in 2017, relating to a release of a provision made during the Contract & Balance Sheet Review which has been released following a change in the Group's obligations.

Both OCP adjustments and other Contract & Balance Sheet Review adjustments are identified and separated from the APM in order to give clarity of the underlying performance of the Group and to separately disclose the progress made on these items.

The benefit of depreciation and amortisation charges not being taken in the Group accounts in relation to assets held for sale were excluded in the prior year. Such charges were being taken in the subsidiary accounts to reflect the reduction in value of the underlying assets, and we consider it relevant to show the effect this would have on the Group performance measure. No assets are included as held for sale in 2017 and therefore no adjustment is required in 2017.

Finally, any other significant items that have a one-time financial impact are excluded, which for 2016 related to the one-time pension settlement associated with the early exit of a UK local authority contract in 2015. This item was distinct from exceptional items in that it arose from normal contract exit conditions. No such material one-time items occurred in 2017.

Underlying trading margin is calculated as UTP divided by revenue from continuing and discontinued operations.

The non-underlying column in the summary income statement on page 18 includes the tax impact of the above items and tax items that, in themselves, are considered to be non-underlying. Further detail of such items is provided in the tax section below.

## **Trading Profit**

The Group uses Trading Profit as an alternative measure to operating profit, as shown on the Group's Condensed Consolidated Income Statement on page 38, by making three adjustments. Trading Profit is a metric used to determine the performance and remuneration of the Executive Directors.

First, Trading Profit excludes exceptional items, being those considered material and outside of the normal operating practice of the Group to be suitable of separate presentation and detailed explanation.

Second, amortisation and impairment of intangibles arising on acquisitions are excluded, because these charges are based on judgements about the value and economic life of assets that, in the case of items such as customer relationships, would not be capitalised in normal operating practice.

Third, the Trading Profit of discontinued operations is included as this benefits from consistency with previously reported results, reflects the overall change in scale of the Group's operations and takes account of the performance of the discontinued operations themselves. This allows their impact on the Group as a whole to be evaluated on measures other than just the post tax result. There were no discontinued operations in 2017.

## **UTP at constant currency**

UTP disclosed above has been translated at the average foreign exchange rates for the year. In order to provide a comparable movement on the previous year's results, UTP is recalculated by translating non-Sterling values for the year to 31 December 2017 into Sterling at the average exchange rate for the year ended 31 December 2016.

For the year ended 31 December	2017 £m
<b>Underlying Trading Profit at constant currency</b>	63.3
Foreign exchange differences	6.5
<b>Underlying Trading Profit at reported currency</b>	69.8

## **Alternative Earnings or Loss Per Share (EPS) measures**

For the year ended 31 December	2017 pence	2016 pence
<b>Underlying EPS from continuing and discontinued operations, basic</b>	3.42	4.13
Impact of non-underlying items and amortisation and impairment of intangibles arising on acquisition	(1.18)	1.99
<b>EPS from continuing and discontinued operations before exceptional items</b>	2.24	6.12
Impact of exceptional items	(2.26)	(6.23)
<b>Reported EPS from continuing and discontinued operations, basic</b>	(0.02)	(0.11)

## **EPS from continuing and discontinued operations before exceptional items**

EPS from continuing and discontinued operations, as shown on the Group's Condensed Consolidated Income Statement on page 38, includes exceptional items charged or credited to the income statement in the year. EPS before exceptional items aids consistency with historical results and is a metric used in assessing the performance and remuneration of the Executive Directors.

## **Underlying EPS from continuing and discontinued operations**

Reflecting the same adjustments made to operating profit to calculate UTP as described above, and including the related tax effects of each adjustment and any other non underlying tax adjustments as described in the tax charge section below, an alternative measure of EPS is presented. This aids consistency with historical results, and enables performance to be evaluated before the unusual or one-time effects described above. The full reconciliation between statutory EPS and Underlying EPS from continuing and discontinued operations is provided in the summary income statements on page 18.

## **Alternative cash flow and Net Debt measures**

### **Free Cash Flow (FCF)**

We present an alternative measure for cash flow to reflect net cash inflow from operating activities before exceptional items, which is the measure shown on the Condensed Consolidated Cash Flow Statement on page 42. This IFRS measure is adjusted to include dividends we receive from joint ventures and associates and deducting net interest paid and net capital expenditure on tangible and intangible asset purchases. FCF is considered relevant to reflect the cash performance of business operations after meeting usual obligations of financing and tax. It is therefore a measure that is before all other remaining cash flows, being those related to exceptional items, acquisitions and disposals, other equity-related and debt-related funding movements, and foreign exchange impacts on financing and investing activities. FCF is therefore a measure to assess the cash flow generated by the business and aids consistency for comparison to historical results. FCF is a metric used to determine the performance and remuneration of the Executive Directors.

For the year ended 31 December	2017 £m	2016 £m
<b>Free Cash Flow</b>	(6.7)	(33.0)
Exclude dividends from joint ventures and associates	(28.2)	(40.0)
Exclude net interest paid	17.0	18.7
Exclude capitalised finance costs paid	-	0.3
Exclude purchase of intangible and tangible assets net of proceeds from disposal	34.6	31.6
<b>Cash flow from operating activities before exceptional items</b>	16.7	(22.4)
Exceptional operating cash flows	(32.5)	(39.9)
<b>Cash flow from operating activities</b>	(15.8)	(62.3)

### **UTP cash conversion**

FCF as defined above, includes interest and tax cash flows. In order to calculate an appropriate cash conversion metric equivalent to UTP, Trading Cash Flow is derived from FCF by excluding tax and interest items. UTP cash conversion therefore provides a measure of the efficiency of the business in terms of converting profit into cash before taking account of the impact of interest, tax and exceptional items. As Trading Cash Flow was an outflow in 2016, a conversion percentage of UTP is not presented.

For the year ended 31 December	2017 £m	2016 £m
<b>Free Cash Flow</b>	(6.7)	(33.0)
Add back:		
Tax paid	11.4	5.6
Non-cash R&D expenditure	0.2	0.4
Net interest received	17.0	18.7
Capitalised finance costs paid	-	0.3
<b>Trading Cash Flow</b>	21.9	(8.0)
<b>Underlying Trading Profit</b>	69.8	82.1
<b>Underlying Trading Profit cash conversion</b>	31%	N/A

## Net Debt

We present an alternative measure to bring together the various funding sources that are included on the Group's Condensed Consolidated Balance Sheet on page 41 and the accompanying notes. Net Debt is a measure to reflect the net indebtedness of the Group and includes all cash and cash equivalents and any debt or debt like items, including any derivatives entered into in order to manage risk exposures on these items.

For the year ended 31 December	2017 £m	2016 £m
Cash and cash equivalents	112.1	177.8
Loans receivable	25.7	22.9
Loans payable	(271.5)	(299.9)
Obligations under finance leases	(20.2)	(28.2)
Derivatives relating to Net Debt	12.8	18.1
<b>Net Debt</b>	<b>(141.1)</b>	<b>(109.3)</b>

## Pre-tax Return on Invested Capital (ROIC)

ROIC is a measure to assess the efficiency of the resources used by the Group and is a metric used to determine the performance and remuneration of the Executive Directors. ROIC is calculated based on UTP and Trading Profit using the Condensed Consolidated Income Statement for the year and a two point average of the opening and closing balance sheets. The composition of Invested Capital and calculation of ROIC are summarised in the table below.

For the year ended 31 December	2017 £m	2016 £m
<b>Non-current assets</b>		
Goodwill	551.3	577.9
Other intangible assets	66.7	83.6
Property, plant and equipment	65.2	69.3
Interest in joint ventures and associates	14.3	14.4
Trade and other receivables	57.3	44.4
<b>Current assets</b>		
Inventory	17.4	22.4
Trade and other receivables	506.5	543.5
<b>Total invested capital assets</b>	<b>1,278.7</b>	<b>1,355.5</b>
<b>Current liabilities</b>		
Trade and other payables	(462.8)	(524.5)
<b>Non-current liabilities</b>		
Trade and other payables	(28.7)	(16.8)
<b>Total invested capital liabilities</b>	<b>(491.5)</b>	<b>(541.3)</b>
<b>Invested Capital</b>	<b>787.2</b>	<b>814.2</b>
<b>Two point average of opening and closing Invested Capital</b>	<b>800.7</b>	<b>768.7</b>
<b>Trading Profit</b>	<b>54.0</b>	<b>100.3</b>
<b>ROIC%</b>	<b>6.7%</b>	<b>13.0%</b>
<b>Underlying Trading Profit</b>	<b>69.8</b>	<b>82.1</b>
<b>Underlying ROIC%</b>	<b>8.7%</b>	<b>10.7%</b>



## Overview of financial performance

### **Revenue**

Reported Revenue declined by 2% in the year to £2,953.6m (2016: £3,011.0m), a 6% reduction in constant currency.

No revenue arose in 2017 from operations classified as discontinued, with total revenues for the year ended 31 December 2016 from continuing and discontinued operations being £3,047.8m.

Commentary on the revenue performance of the Group is provided in the Chief Executive's Review and the Divisional Reviews sections.

### **Trading Profit**

Trading Profit for the year was £54.0m (2016: £100.3m). Trading Profit for the year ended 31 December 2016 included a loss on discontinued operations of £3.3m.

Commentary on the trading performance of the Group is provided in the Chief Executive's Review and the Divisional Reviews sections.

### **Underlying Trading Profit**

UTP was £69.8m (2016: £82.1m), down 15%. At constant currency, UTP was £18.8m lower than 2016 at £63.3m, with a movement of £4.6m relating to the results of discontinued operations in 2016.

Commentary on the underlying performance of the Group is provided in the Chief Executive's Review and the Divisional Reviews sections.

Excluded from UTP were net charges from OCPs of £19.0m (2016: net releases of £9.6m) following the annual reassessment undertaken as part of the budgeting process. Also excluded from UTP were net releases of £3.2m (2016: net releases of £4.6m) relating to other provisions and accruals for items identified during the 2014 Contract & Balance Sheet Review. UTP also excluded the benefit arising from the non-depreciation and amortisation of assets classified as held for sale in 2016 of £0.5m; there were no such assets in 2017. Other one-time items of £3.5m excluded from UTP in 2016 related to a pension scheme settlement arising from the early exit of a UK Local Authority contract in 2015; there were no such adjustments necessary for one-time items in 2017.

The cumulative to date improvement to Trading Profit as a result of OCP charges and releases and adjustments to items identified during the 2014 Contract & Balance Sheet Review is £19.3m (2016: £35.1m). This represents 3% of the 2014 total charge to Trading Profit arising from the Contract & Balance Sheet Review.

The tax impact of items in UTP and other non underlying tax items is discussed in the tax section of this Finance Review.

### **Discontinued operations**

The Global Services division, representing private sector BPO operations, was classified as a discontinued operation in 2015 and 2016. Disposal of the offshore BPO business was largely completed in December 2015, with the disposals of two much smaller remaining elements completed in March 2016 and December 2016. The residual UK onshore private sector BPO operations were sold or exited in 2016 with the exception of one business, consisting of a single contract, the disposal of which completed in July 2017. Total revenues for the remaining operations were £5.4m and the loss before exceptional items was £0.6m for the year ended 31 December 2017, therefore the results have been included in continuing operations in 2017 on the grounds of materiality.

# Stock Exchange Announcement



The amounts reported as discontinued operations in the prior year were as follows:

For the year ended 31 December	2016 £m
<b>Revenue</b>	36.8
<b>Underlying Trading Loss</b>	(4.6)
Onerous contract and Contract & Balance Sheet Review adjustments	0.8
Benefit from non-depreciation and non-amortisation of assets held for sale	0.5
<b>Trading Loss</b>	(3.3)
Amortisation and impairment of intangibles arising on acquisition	-
<b>Operating loss before exceptional items</b>	(3.3)
Exceptional loss on disposal of subsidiaries and operations	(2.8)
Other exceptional operating items	(11.4)
<b>Exceptional operating items</b>	(14.2)
<b>Operating loss</b>	(17.5)
Exceptional finance costs	(0.4)
<b>Loss before tax</b>	(17.9)
Tax charge	(0.1)
<b>Net loss on discontinued operations (attributable to equity owners of the Company) as presented in the income statement</b>	(18.0)

## Joint ventures and associates – share of results

In 2017, the most significant joint ventures and associates in terms of scale of operations were AWE Management Limited and Merseyrail Services Holding Company Limited, with dividends received of £17.1m (2016: £19.6m) and £7.3m (2016: £7.3m) respectively. Total revenues generated by these businesses were £951.8m (2016: £968.1m) and £155.7m (2016: £150.3m) respectively. From September 2016, there was a change in the AWE Management Limited shareholding structure, with the Group's shareholding reducing from 33.3% to 24.5% by way of a return of shares.

While the revenues and individual line items are not consolidated in the Group Condensed Consolidated Income Statement, summary financial performance measures for the Group's proportion of the aggregate of all joint ventures and associates are set out below for information purposes.

For the year ended 31 December	2017 £m	2016 £m
<b>Revenue</b>	356.7	480.8
Operating profit	34.4	40.7
Net investment finance costs	(0.1)	(0.6)
Income tax expense	(7.0)	(6.7)
<b>Profit after tax</b>	27.3	33.4
<b>Dividends received from joint ventures and associates</b>	28.2	40.0

The decline in revenue and profits on the prior year is partly due to the change in shareholding in AWE Management Limited and partly due to the end of the Northern Rail franchise on 31 March 2016.

## Exceptional items

Exceptional items are items of financial performance that are outside normal operations and are material to the results of the Group either by virtue of size or nature. As such, the items set out below require separate disclosure on the face of the income statement to assist in the understanding of the performance of the Group.

Exceptional items arose on both the continuing and discontinued operations of the Group in 2016. Exceptional items arising on discontinued operations are disclosed on the face of the Condensed Consolidated Income Statement within the profit or loss attributable to discontinued operations. There were no discontinued operations in 2017.

For the year ended 31 December	2017 £m	2016 £m
<b>Exceptional items arising on continuing operations</b>		
Exceptional profit on disposal of subsidiaries and operations	0.3	2.9
<b>Other exceptional operating items on continuing operations</b>		
Impairment of goodwill	-	(17.8)
Restructuring costs	(28.6)	(17.2)
Aborted transaction costs	-	(0.1)
Costs associated with UK Government review	(0.4)	(0.1)
Release of UK frontline clinical health contract provisions	0.4	0.6
Settlement of defined benefit pension obligations	10.3	(10.7)
Impairment of interest in joint venture and related loan balances	4.5	(13.9)
Impairment of AsPac customer lists	(6.1)	-
<b>Other exceptional operating items</b>	(19.9)	(59.2)
<b>Exceptional operating items arising on continuing operations</b>	(19.6)	(56.3)
<b>Exceptional items arising on discontinued operations</b>		
Exceptional loss on disposal of subsidiaries and operations	-	(2.8)
<b>Other exceptional operating items on discontinued operations</b>		
Restructuring costs	-	(1.1)
Movements in indemnities provided on business disposals	-	(13.7)
Movement in the fair value of assets transferred to held for sale	-	3.4
<b>Other exceptional operating items</b>	-	(11.4)
<b>Exceptional operating items arising on discontinued operations</b>	-	(14.2)
<b>Exceptional operating items arising on continuing and discontinued operations</b>	(19.6)	(70.5)
Exceptional finance costs – discontinued	-	(0.4)
Exceptional tax – continuing	(5.0)	3.1
<b>Total operating and financing exceptional items in continuing and discontinued operations</b>	(24.6)	(67.8)

## **Exceptional profit on disposals**

There were no material disposals of continuing operations in 2017.

## **Other exceptional operating items**

The annual impairment testing of CGUs in 2017 has identified no impairment of goodwill.

The Group is incurring costs in relation to restructuring programmes resulting from the Strategy Review announced in 2015. These costs include redundancy payments, provisions, external advisory fees and other incremental costs, including in 2017 £2.8m of intangible asset impairment (2016: £nil). Due to the nature and scale of the impact of the transformation phase of the Strategy Review, the incremental costs associated with this programme are considered to be exceptional. Costs associated with the restructuring programme resulting from the Strategy Review must meet the following criteria: that they are directly linked to the implementation of the Strategy Review; they are incremental costs as a result of the activity; and they are non business as usual costs. In 2017, a charge of £28.6m (2016: £17.2m) arose in relation to the restructuring programme resulting from the Strategy Review. Non-exceptional restructuring charges are incurred by the business as part of normal operational activity, which in the year totalled £11.1m (2016: £6.7m) and were included within operating profit before exceptional items. We expect restructuring costs of approximately £35m to be incurred in 2018 which will be treated as exceptional.

There were exceptional costs totalling £0.4m (2016: £0.1m) associated with the UK Government reviews and the programme of Corporate Renewal. These costs have historically been treated as exceptional and consistent treatment is applied in 2017.

There were releases of provisions of £0.4m (2016: £0.6m) which were previously charged through exceptional items in relation to the exit of the UK frontline clinical health contracts.

An exceptional charge of £10.7m arose in 2016 in respect of the bulk transfer of a number of employees that are being transferred from the Serco Pension and Life Assurance Scheme (SPLAS) to the Principal Civil Service Pension Scheme. This transfer was legally agreed in December 2016 at which point all obligations of SPLAS to pay retirement benefits for these individuals were eliminated and as a result, a settlement charge of £10.7m arose, for which a provision was made. In 2017 a new agreement was reached with the UK Government to transfer out the scheme members on an individual basis and the 2016 legal and commercial arrangements were cancelled by consent of all parties. As a result of the changes, the impact of the transfer was treated as an experience gain adjustment through other comprehensive income and the majority of the provision made in 2016 was reversed, resulting in a £10.3m credit to exceptional items in 2017.

In 2016, a review of a joint venture's cash flow projections led to the impairment of certain equity interests and associated receivables balances, totalling £13.9m. The impairment was outside of the normal course of business and of a significant value, and was therefore considered to be an exceptional item. In the year ended 31 December 2017 payments of £4.5m were received against the impaired loan. The likelihood of further cash receipts against the receivables remains uncertain.

As a result of contracts coming to the end of their natural lives and no significant new contracts being awarded by the customer, the remaining customer relationship intangible assets of the DMS Maritime Pty Limited business acquired in 2012 were impaired, totalling £6.1m.

## Exceptional tax

Exceptional tax for the year was a tax charge of £5.0m (2016: £3.1m credit), comprising a £2.3m credit on exceptional items within operating profit and a £7.3m charge in respect of other exceptional tax items.

Exceptional costs of £19.6m only gave rise to a credit of £2.3m, as the majority of these costs were incurred in the UK where they only impact our unrecognised deferred tax in relation to losses.

The other exceptional tax items relate to two matters, the first is the impact on tax of the pension buy-in disclosed in note 18 to the Condensed Consolidated Financial Statements which led to a £95.0m reduction in the IFRS valuation of the Group's defined benefit pension schemes and consequently a deferred tax charge to the income statement of £16.1m. Movements in the valuation of the Group's defined benefit pension schemes and the associated deferred tax impact are reported in the Condensed Consolidated Statement of Comprehensive Income (SOCl) and do not flow through the income statement, therefore do not impact profit before tax or the tax charge. However, the net amount of deferred tax recognised in the balance sheet relates to both the pension accounting and other timing differences, such as recoverable losses. As the net deferred tax balance sheet position is at the level supported by future profit forecasts, the decrease in the deferred tax liability associated with the pension scheme (with the benefit reported in the SOCl) leads to a corresponding decrease in the deferred tax asset to match the future profit forecasts. Such a reduction in the deferred tax asset therefore leads to a charge to tax in the income statement.

The second element is a credit of £8.8m related to legislative changes in the UK and the US which have impacted the value of deferred tax held on the balance sheet. There is a reduction in the deferred tax liability that is held in connection with our US operations of £12.5m, as future US tax liabilities are expected to crystallise at lower US tax rates. The fall in future expected US rates is primarily due to the enactment of the Tax Cuts & Jobs Act in December 2017 which reduces the corporate income tax rate in the US from 35% to 21% effective from 1 January 2018. In addition, there was a change in UK tax law in 2017. This UK change will reduce the quantum of loss brought forward that can be used to offset taxable profits arising in a year, and will also enable losses carried forward in one company to be used to offset profits in another. The combined impact of these UK law changes results in a tax charge of £3.7m.

## Pre exceptional finance costs and investment revenue

Investment revenue of £7.6m (2016: £9.3m) includes interest accruing on net retirement benefit assets of £3.8m (2016: £4.7m), interest earned on deposits and other receivables of £2.6m (2016: £3.6m) and the movement in discounting of other receivables of £1.2m (2016: £1.0m).

Finance costs of £19.2m (2016: £21.9m) includes interest incurred on the USPP loans and the Revolving Credit Facility of £14.0m (2016: £15.6m), facility fees and other charges of £3.0m (2016: £3.5m), interest payable on finance leases of £1.3m (2016: £1.6m), the movement in discount on provisions of £1.3m (2016: £2.4m) and a credit for foreign exchange on financing activities of £0.4m (2016: £1.2m).



## Other gains

On 24 August 2017 the Group acquired 50% of the issued share capital of Serco Sodexo Defence Services Pty Ltd for £1.6m, obtaining full control. Serco Sodexo Defence Services Pty Ltd was previously a 50% owned joint venture accounted for on an equity accounting basis. As a result of the increase in ownership from 50% to 100%, the Group fair valued the existing 50% shareholding and the resulting uplift in value of £0.7m was recorded in Other gains, outside of operating results.

## Tax

### Tax charge

#### *Underlying tax*

In 2017 we recognised a tax charge of £20.6m on underlying trading profits after finance cost. The effective tax rate in 2017 (35.4%) is at a similar level to 2016 (35.2%).

#### *Pre exceptional tax*

We recognised a tax charge of £14.0m (2016: £15.8m) on pre exceptional profits which includes £20.6m underlying tax, £1.6m tax impact of amortisation on intangibles arising on acquisition and £5.0m credit on non-underlying items. The £5.0m credit consists of the tax impact on non-underlying items together with tax items that are in themselves considered to be non-underlying, specifically:

- As noted above with regards to exceptional tax, movements in the valuation of the Group's defined benefit pension schemes leads to a corresponding adjustment to the deferred tax asset to match the future profit forecasts. Such a change in the deferred tax asset impacts tax in the income statement. Where deferred tax charges or releases are the result of movements in the pension scheme valuations rather than trading activity, these are excluded from the calculation of tax on underlying profit and the underlying effective tax rate, with the prior periods being restated to reflect this. These amounted to £1.9m for 2017 (2016: £nil).
- During the current period we have recognised an additional £11.1m of deferred tax asset in relation to UK losses to reflect the improved forecast profits of our UK operations. This credit nets against the charge (£3.7m) taken to exceptional tax and described below, which relates to the UK law change in 2017 to give a net increase in UK deferred tax assets of £7.4m.
- The tax on non-underlying items during the period totalled a credit of £4.2m reflecting the impact of current or future tax deductions available.

The tax rate on profits before exceptional items on continuing operations, at 36.2% is higher than the UK standard corporation tax rate of 19.25%. This is due to the upward impact of higher rates of tax on profits arising on our international operations, together with the absence of any deferred tax credit for current year losses incurred in the UK. This is only partially offset by the downward impact of our joint ventures whose post-tax results are included in our pre-tax profit and additional deferred tax assets that have been recognised in relation to historic UK losses. Our tax charge in future years will continue to be materially impacted by our accounting for UK deferred taxes. To the extent that future UK tax losses are incurred and are not recognised, our effective tax rate will be higher than prevailing standard corporation tax rates. When our UK business returns to sustainable profitability our existing UK tax losses will be recognised or utilised, and the effective rate will be reduced.

The enactment of the Tax Cuts & Jobs Act in the US has not impacted our pre exceptional tax charge during 2017 with the impact on our valuation of deferred tax shown as an exceptional item and explained further above. In the medium term, the new law is expected to have only a marginal impact on our tax liability in the US. This is because although we will benefit from the fall in tax rate, our US business bears interest cost, associated with historic funding put in place to acquire US businesses, an element of which will not lead to tax deductions in the medium term.

#### *Exceptional tax*

Analysis of exceptional tax is provided in the Exceptional items section above.

#### *Contingent tax assets*

A £17.4m UK tax asset has been recognised at 31 December 2017 (2016: £10.0m) on the basis of utilisation against forecast taxable profits.

At 31 December 2017, the Group has estimated unrecognised UK deferred tax assets of an additional £160m which are contingent on further improvement in the UK profit forecast.

## Taxes paid

Net corporation tax of £15.3m was paid during the year, relating primarily to our operations in AsPac (£5.5m), Europe (£3.2m), Middle East (£1.5m) and Americas (£5.1m). The Group's UK operations have transferred tax losses to its profitable joint ventures and associates giving a cash tax inflow in the UK of £4.4m. In addition there were small cash tax refunds where we have overpaid tax in previous periods. This results in an overall tax paid figure in our cash flow statement of £11.4m.

The amount of tax paid (£11.4m) differs from the tax charge in the period (£19.0m) mainly due to the effect of future expected cash tax outflows for which a charge has been taken in the current period and the impact of the time lag on receipts of cash from joint ventures and associates for losses transferred to them.

Further detail of taxes paid during the year is shown below.

## Total tax contribution

Our tax strategy of paying the appropriate amount of tax as determined by local legislation in the countries in which we operate, means that we pay a variety of taxes across the globe. In order to increase the transparency of our tax profile, we have shown below the cash taxes that we have paid across our regional markets.

In total during 2017, Serco globally contributed £578m of tax to government in the jurisdictions in which we operate.

## Taxes by category

	Taxes borne £m	Taxes collected £m	Total £m
<b>For the year ended 31 December 2017</b>			
Corporation tax	15.3	-	15.3
VAT and similar	9.7	152.2	161.9
People taxes	109.0	284.1	393.1
Other taxes	6.7	0.5	7.2
<b>Total</b>	<b>140.7</b>	<b>436.8</b>	<b>577.5</b>

## Taxes by region

	Taxes borne £m	Taxes collected £m	Total £m
<b>For the year ended 31 December 2017</b>			
UK & Europe	82.8	235.7	318.5
AsPac	25.6	121.5	147.1
Americas	30.2	76.8	107.0
Middle East	2.1	2.8	4.9
<b>Total</b>	<b>140.7</b>	<b>436.8</b>	<b>577.5</b>

Corporation tax, which is the only cost to be separately disclosed in our Condensed Consolidated Financial Statements, is only one element of our tax contribution. For every £1 of corporate tax paid directly by the Group (tax borne), we bear a further £8.20 in other business taxes. The largest proportion of these is in connection with employing our people.

In addition, for every £1 of tax that we bear, we collect £3.10 on behalf of national governments (taxes collected). This amount is directly impacted by the people that we employ and the sales that we make.

## Dividends

The Board is not recommending the payment of a dividend in respect of the 2017 financial year. The Board's appraisal of the appropriateness of dividend payments takes into account the Group's underlying earnings, cash flows and financial leverage, together with the requirement to maintain an appropriate level of dividend cover and the prevailing market outlook. Although the Board is committed to resuming dividend payments as soon as it believes it prudent to do so, in assessing whether we should resume dividend payments in respect of 2017, we have been mindful of the fact there has been a reduction in earnings, a free cash outflow and an increase in Net Debt. In these circumstances, the Board believes that it would not be prudent to resume dividend payments at the current juncture. For 2018, our guidance is for an improvement in Underlying Trading Profit, but we expect Net Debt to still increase, largely as a result of cash outflows related to exceptional restructuring costs and taking

opportunities for value-enhancing infill acquisitions. The Board will continue to keep the dividend policy under close consideration as we progress with transforming the Group and implementing our strategy.

## Share count and EPS

The weighted average number of shares for EPS purposes was 1,089.7m for the year ended 31 December 2017 (2016: 1,088.3m). EPS before exceptional items from both continuing and discontinued operations was 2.24p per share (2016: 6.12p); including the impact of exceptional items, EPS was a loss of 0.02p (2016: 0.11p). Underlying EPS was 3.42p per share (2016: 4.13p).

## Cash flows

The UTP of £69.8m (2016: £82.1m) converts into a trading cash inflow of £21.9m (2016: outflow of £8.0m). The negative conversion in 2016 was primarily due to the adverse working capital movement of £23.7m and the cash outflows arising on the utilisation of contract provisions of £84.2m. In 2017, the working capital outflow is £9.0m and the OCP utilisation is £69.3m.

The table below shows the operating profit and FCF reconciled to movements in Net Debt. FCF for the year was an outflow of £6.7m compared to an outflow of £33.0m in 2016. The improvement in FCF is largely as a result of a reduction in operating profit before exceptional items on continuing and discontinued operations from £95.2m in 2016 to £49.6m in 2017, which is more than offset by an improvement in the net movement in non exceptional provisions from a reduction in 2016 of £118.4m to a reduction in 2017 of £46.4m. The movement in non exceptional provisions is partly due to the reduction in total provision utilisation from £123.4m in 2016 to £82.2m in 2017.

The movement in Net Debt is an increase of £31.8m in 2017, a reconciliation of which is provided at the bottom of the following table. The movement includes a net outflow of £5.6m arising on the acquisition and disposal of subsidiaries, primarily relating to the cash held by Service Glasgow LLP, an entity disposed of in the year. In 2016 a net cash inflow of £19.2m arose primarily as a result of the disposal of the private sector BPO business. The movement in Net Debt for 2017 also includes a net exchange gain of £17.4m, compared to a £41.8m loss in 2016.

<b>For the year ended 31 December</b>	<b>2017 £m</b>	<b>2016 £m</b>
Operating profit on continuing operations	30.0	42.2
Operating loss on discontinued operations	-	(17.5)
Remove exceptional items	19.6	70.5
<b>Operating profit before exceptional items on continuing and discontinued operations</b>	<b>49.6</b>	<b>95.2</b>
Less: profit from joint ventures and associates	(27.3)	(33.4)
Movement in provisions	(46.4)	(118.4)
Depreciation, amortisation and impairment of property, plant and equipment and intangible assets	50.0	52.4
Other non-cash movements	11.4	11.5
<b>Operating cash inflow before movements in working capital, exceptional items and tax</b>	<b>37.3</b>	<b>7.3</b>
Working capital movements	(9.0)	(23.7)
Tax paid	(11.4)	(5.6)
Non-cash R&D expenditure	(0.2)	(0.4)
<b>Cash flow from operating activities before exceptional items</b>	<b>16.7</b>	<b>(22.4)</b>
Dividends from joint ventures and associates	28.2	40.0
Interest received	0.5	1.4
Interest paid	(17.5)	(20.1)
Capitalised finance costs paid	-	(0.3)
Purchase of intangible and tangible assets net of proceeds from disposals	(34.6)	(31.6)
<b>Free Cash Flow</b>	<b>(6.7)</b>	<b>(33.0)</b>
Net cash (outflow) / inflow on acquisition and disposal of subsidiaries	(5.6)	19.2
Other movements on investment balances	0.2	0.7
Capitalisation and amortisation of loan costs	(0.8)	(0.7)
Unwind of discounting and capitalisation of interest on loans receivable	3.4	2.9
New, acquired and disposed finance leases	(4.7)	(0.5)
Exceptional items	(32.5)	(40.2)
Cash movements on hedging instruments	(2.5)	47.0
Foreign exchange gain / (loss) on Net Debt	17.4	(41.8)
<b>Movement in Net Debt including assets and liabilities held for sale</b>	<b>(31.8)</b>	<b>(46.4)</b>
Assets held for sale movement in Net Debt	-	4.7
Net Debt at 1 January	(109.3)	(67.6)
Net Debt at 1 January including assets and liabilities held for sale	(109.3)	(62.9)
<b>Net Debt at 31 December</b>	<b>(141.1)</b>	<b>(109.3)</b>



## Net Debt

As at 31 December	2017 £m	2016 £m
Cash and cash equivalents	112.1	177.8
Loans receivable	25.7	22.9
Loans payable	(271.5)	(299.9)
Obligations under finance leases	(20.2)	(28.2)
Derivatives relating to Net Debt	12.8	18.1
<b>Net Debt</b>	<b>(141.1)</b>	<b>(109.3)</b>

Average Net Debt as calculated on a daily basis for the year ended 31 December 2017, was £184.3m (2016: £119.4m), compared with the opening and closing positions of £109.3m and £141.1m respectively. Peak Net Debt was £242.7m (2016: £182.9m).

## Treasury operations and risk management

The Group's operations expose it to a variety of financial risks that include liquidity, the effects of changes in foreign currency exchange rates, interest rates and credit risk. The Group has a centralised treasury function whose principal role is to ensure that adequate liquidity is available to meet the Group's funding requirements as they arise and that the financial risk arising from the Group's underlying operations is effectively identified and managed.

Treasury operations are conducted in accordance with policies and procedures approved by the Board and are reviewed annually. Financial instruments are only executed for hedging purposes and speculation is not permitted. A monthly report is provided to senior management outlining performance against the Treasury Policy and the treasury function is subject to periodic internal audit review.

## Liquidity and funding

As at 31 December 2017, the Group had committed funding of £741m (2016: £770m), comprising £261m of private placement notes and a £480m revolving credit facility with a syndicate of banks, which was undrawn. In addition, the Group had a receivables financing facility of £30.0m which was unutilised at the year-end (2016: utilisation of £7.7m).

Following the further small disposals relating to the private sector BPO business, the Group was required to offer two thirds of the net disposal proceeds to the debt holders in prepayment. As a result of this process, £3.7m (\$4.9m) of private placement notes were repaid at par on 29 June 2017.

## Interest rate risk

Given the nature of the Group's business, we have a preference for fixed rate debt to reduce the volatility of net finance costs. Our Treasury Policy requires us to maintain a minimum proportion of fixed rate debt as a proportion of overall Net Debt and for this proportion to increase as the ratio of EBITDA to interest expense falls. As at 31 December 2017, more than 100% of the Group's Net Debt was at fixed rates. Interest on the revolving credit facility is at floating rate, however it was undrawn.

## Foreign exchange risk

The Group is subject to currency exposure on the translation to Sterling of its net investments in overseas subsidiaries. The Group manages this risk where appropriate, by borrowing in the same currency as those investments. Group borrowings are predominantly denominated in Sterling and US Dollar. The Group manages its currency flows to minimise foreign exchange risk arising on transactions denominated in foreign currencies and uses forward contracts where appropriate to hedge net currency flows.

## Credit risk

Cash deposits and in-the-money financial instruments give rise to credit risk on the amounts due from counterparties. The Group manages this risk by adhering to counterparty exposure limits based on external credit ratings of the relevant counterparty.

## Debt covenants

The principal financial covenant ratios are consistent across the private placement loan notes, receivables financing facility and revolving credit facility, with a maximum Consolidated Total Net Borrowings (CTNB) to covenant EBITDA of 3.5 times and minimum covenant EBITDA to net finance costs of 3.0 times, tested semi-annually. A reconciliation of the basis of calculation is set out in the table below.

For the year ended 31 December	2017 £m	2016 £m
Operating profit before exceptional items on continuing and discontinued operations	49.6	95.2
Remove: Amortisation and impairment of intangibles arising on acquisition	4.4	5.1
Trading Profit	54.0	100.3
Exclude: Share of joint venture post-tax profits	(27.3)	(33.4)
Include: Dividends from joint ventures	28.2	40.0
Add back: Net non-exceptional charges to OCPs	19.0	-
Add back: Depreciation, amortisation and impairment of property, plant and equipment and non acquisition intangible assets	45.6	47.3
Add back: Foreign exchange credit on investing and financing arrangements	0.4	1.2
Add back: Share based payment expense	11.4	9.7
<b>Covenant EBITDA</b>	<b>131.3</b>	<b>165.1</b>
Net finance costs on continuing and discontinued operations	11.6	12.6
Exclude: Net interest receivable on retirement benefit obligations	3.8	4.7
Exclude: Movement in discount on other debtors	1.2	1.0
Exclude: Foreign exchange on investing and financing arrangements	0.4	1.2
Add back: Movement in discount on provisions	(1.3)	(2.4)
<b>Covenant net finance costs</b>	<b>15.7</b>	<b>17.1</b>
Recourse Net Debt	141.1	109.3
Exclude: Disposal vendor loan note, encumbered cash and other adjustments	30.3	28.5
Covenant adjustment for average FX rates	7.8	(23.0)
<b>CTNB</b>	<b>179.2</b>	<b>114.8</b>
<b>CTNB / covenant EBITDA (not to exceed 3.5x)</b>	<b>1.36x</b>	<b>0.70x</b>
<b>Covenant EBITDA / covenant net finance costs (at least 3.0x)</b>	<b>8.4x</b>	<b>9.7x</b>

## Net assets summary

As at 31 December	2017 £m	2016 £m
<b>Non-current assets</b>		
Goodwill	551.3	577.9
Other intangible assets	66.7	83.6
Property, plant and equipment	65.2	69.3
Other non-current assets	75.3	73.0
Deferred tax assets	55.0	50.8
Retirement benefit assets	41.8	150.4
	855.3	1,005.0
<b>Current assets</b>		
Inventories	17.4	22.4
Trade and other current assets	516.8	548.4
Current tax assets	11.2	11.0
Cash and cash equivalents	112.1	177.8
<b>Total current assets</b>	657.5	759.6
<b>Total assets</b>	1,512.8	1,764.6
<b>Current liabilities</b>		
Trade and other current liabilities	(464.0)	(525.1)
Current tax liabilities	(25.3)	(25.9)
Provisions	(148.5)	(172.3)
Obligations under finance leases	(8.5)	(12.3)
Loans	(31.8)	(9.7)
<b>Total current liabilities</b>	(678.1)	(745.3)
<b>Non-current liabilities</b>		
Other non-current liabilities	(28.7)	(16.8)
Deferred tax liabilities	(20.4)	(30.5)
Provisions	(211.5)	(249.4)
Obligations under finance leases	(11.7)	(15.9)
Loans	(239.7)	(290.2)
Retirement benefit obligations	(15.5)	(17.7)
	(527.5)	(620.5)
<b>Total liabilities</b>	(1,205.6)	(1,365.8)
<b>Net assets</b>	307.2	398.8

At 31 December 2017 the balance sheet had net assets of £307.2m, a movement of £91.6m from the closing net asset position of £398.8m as at 31 December 2016. The decrease in net assets is mainly due to the following movements:

- A decrease in the net retirement benefit assets of Group funded defined benefit pension schemes of £106.4m. In June 2017, the Trustees of the Group's primary defined benefit pension scheme entered into a bulk annuity purchase whereby an insurer will fund future benefit payments to the relevant members. The liability to pay the members remains with the pension scheme which continues to include the relevant pension liabilities, but an insurance asset is held which is an equal and opposite amount to the liability. This removes the risk of longevity and investment movements for this portion of the scheme on a funding basis, and also removes the accounting risk of movements in underlying assumptions on the liabilities. The transaction resulted in a significant reduction in the surplus of the pension scheme under IFRS accounting convention, but resulted in a reduction in the deficit that is actuarially assessed for funding purposes of approximately £12m. As at 31 December 2017 the estimated actuarial deficit of this scheme was £33.7m (2016: £42.6m).
- A decrease in provisions of £61.7m. Further details on provision movements is provided below.

- The combined position of trade and other current assets and trade and other current liabilities increased by £29.5m and Net Debt increased by £31.8m. Further details of these movements are provided in the cash flow and Net Debt sections above.
- A decrease in goodwill of £26.6m, caused by movements in foreign exchange rates.

## Provisions

The total of current and non-current provisions has decreased by £61.7m since 31 December 2016. The movement is due to a decrease in onerous contract provisions of £52.0m, an increase in employee-related provisions of £10.6m, a decrease in property provisions of £0.9m and a reduction in other provisions of £19.4m.

The £10.6m increase in employee-related provisions is partly due to the ongoing Strategy Review restructuring programme and partly relating to obligations arising at the end of certain contracts. The decrease in other provisions is primarily due to the release of £10.3m of exceptional provisions relating to pensions, with the remaining movement comprised of contract settlements and releases for potential claims.

Movements in contract provisions since the 31 December 2016 balance sheet date, are as follows:

	Onerous Contract Provisions £m
<b>At 1 January 2017</b>	220.2
Charged to the income statement during the year – trading	62.0
Released to the income statement – trading	(43.0)
Released to the income statement – exceptional	(0.4)
Utilisation during the year	(69.3)
Unwinding of discount	1.3
Foreign exchange	(2.6)
<b>At 31 December 2017</b>	168.2

The balance of OCPs at 31 December 2017 was £168.2m (2016: £220.2m). OCP balances are subject to ongoing review and a full bottom-up assessment of the forecasts that form the basis of the OCPs is conducted as part of the annual budgeting process. The net non-exceptional charge to OCPs was £19.0m in 2017 and utilisation was £69.3m.

In 2017, additional charges have been made in respect of future losses on a number of onerous contracts totalling £62.0m. This increase related to revisions to existing OCPs of £61.5m and a new provision raised on one contract totalling £0.5m. The new contract has been operating for a number of years and is expected to be terminated in 2018.

Included within additional charges made to existing OCPs is £47.0m relating to the Caledonian Sleepers contract. This increase is partly due to revised assumptions for the higher costs of running the contract and the impact from delays in the delivery of new trains, which includes the higher cost of the running old trains for longer, associated penalties and the forecast benefit of revenue growth from the new trains being pushed back. In addition, we have revised our revenue forecast for the contract based on the 2017 performance, where even a modest reduction in annual revenue can have a significant impact on a multi-year OCP. There continue to be a number of assumptions underpinning the provision that have a range of potential outcomes, including the train manufacturer delivering the new trains to the latest timetable and volume and pricing increases driven by the improved passenger service from the new trains. The position under the contract is expected to improve over time, as the terms of the Franchise Agreement provide a mechanism that requires Transport Scotland to bear 50% of contract losses from 1 April 2020. In addition, from 1 April 2022, we have the right to seek adjustments to the financial terms of the Franchise Agreement that would result either in a small positive profit margin for Serco from that date, or allow us to exit the contract.

In addition to the Caledonian Sleepers contract, there have been net OCP releases of £16.4m in UK & Europe and £11.4m in AsPac.

## Acquisitions

On 26 January 2018, the Group acquired 100% of the issued share capital of BTP Systems, LLC, for consideration of US Dollar \$20.5m in cash. Further details on this post year end transaction are provided in note 21 to the Condensed Consolidated Financial Statements.

The Group signed a revised Business Purchase Agreement (BPA) on 13 February 2018 with the Special Managers and Provisional Liquidators acting on behalf of the relevant Carillion plc subsidiaries to acquire a portfolio of selected UK health facilities management contracts. The portfolio has annual revenues of approximately £90m and a weighted average remaining term of 14 years. Upon the receipt by the Special Managers and Provisional Liquidators of the requisite third party consents, each individual contract will be transferred to Serco on a cash-free, debt-free basis, with the consideration to be paid in instalments and to be satisfied using Serco's existing financing facilities. If all the contracts are transferred to Serco under the revised BPA process, the total consideration payable would be £29.7m. The consideration payable is lower than the amount of £47.7m announced on 13 December 2017 in respect of substantially the same contracts that were subject to the initial BPA signed with Carillion plc at that date. The change in consideration reflects the Group's re-evaluation of potential liabilities, indemnities, warranties and the additional working capital investment required as a result of Carillion's liquidation. The financial effects of this transaction have not been recognised at 31 December 2017. As consents are required for each individual contract to be transferred and therefore acquired, at the time the financial statements were authorised for issue, no legal transfer or control of assets had taken place and so no disclosures have been made in respect of the assets and liabilities being acquired. The fair values of the assets and liabilities will be determined at the date when contracts are acquired. It is also not yet possible to provide detailed information about each class of acquired receivables and any contingent liabilities in respect of the acquired contracts.

As noted in the overview of performance above, the Group obtained full control of Serco Sodexo Defence Services Pty Ltd by acquiring the remaining 50% of issued share capital for £1.6m.

## IFRS15

The Group has undertaken a robust assessment to determine the impact of IFRS15 on the opening balance sheet at 1 January 2017 and for the year ended 31 December 2017. The impact on opening retained earnings will be a reduction of £32.8m and the impact on the opening OCP balance will be a reduction of £21.7m. Underlying Trading Profit will decrease by £0.3m and, as a result of a lower OCP release, Trading Profit will decrease by £8.7m for the year ended 31 December 2017. This low adjustment is reflective of the prudent accounting practices adopted by the Group following the Contract & Balance Sheet Review undertaken in 2014 and the repeat nature of the services provided. Further detail on the adjustment is provided in note 1 of the Group's Condensed Consolidated Financial Statements.



## Financial Statements

### Condensed Consolidated Income Statement For the year ended 31 December

	2017 £m	2016 (restated *) £m
<b>Continuing operations</b>		
<b>Revenue</b>	2,953.6	3,011.0
<b>Cost of sales*</b>	(2,704.7)	(2,724.6)
<b>Gross profit*</b>	248.9	286.4
<b>Administrative expenses*</b>		
General and administrative expenses	(222.2)	(216.2)
Exceptional profit on disposal of subsidiaries and operations	0.3	2.9
Other exceptional operating items	(19.9)	(59.2)
Other expenses - amortisation and impairment of intangibles arising on acquisition	(4.4)	(5.1)
Total administrative expenses*	(246.2)	(277.6)
Share of profits in joint ventures and associates, net of interest and tax	27.3	33.4
<b>Operating profit</b>	30.0	42.2
<b>Operating profit before exceptional items</b>	49.6	98.5
Investment revenue	7.6	9.3
Finance costs	(19.2)	(21.9)
Total net finance costs	(11.6)	(12.6)
Other gains	0.7	-
<b>Profit before tax</b>	19.1	29.6
Tax on profit before exceptional items	(14.0)	(15.8)
Exceptional tax	(5.0)	3.1
<b>Tax charge</b>	(19.0)	(12.7)
<b>Profit for the year from continuing operations</b>	0.1	16.9
Loss for the year from discontinued operations	-	(18.0)
<b>Profit / (loss) for the year</b>	0.1	(1.1)
Attributable to:		
Equity owners of the Company	(0.2)	(1.2)
Non controlling interests	0.3	0.1
<b>Earnings per share (EPS)</b>		
Basic EPS from continuing operations	(0.02p)	1.55p
Diluted EPS from continuing operations	(0.02p)	1.50p
Basic EPS from discontinued operations	-	(1.66p)
Diluted EPS from discontinued operations	-	(1.66p)
Basic EPS from continuing and discontinued operations	(0.02p)	(0.11p)
Diluted EPS from continuing and discontinued operations	(0.02p)	(0.11p)

\* Costs included within cost of sales and general and administrative expenses have been reallocated, resulting in a restatement. See note 1.

## Condensed Consolidated Statement of Comprehensive Income For the year ended 31 December

	2017 £m	2016 £m
<b>Profit / (loss) for the year</b>	0.1	(1.1)
<b>Other comprehensive income for the year:</b>		
<b>Items that will not be reclassified subsequently to profit or loss:</b>		
Net actuarial (loss) / gain on defined benefit pension schemes*	(106.5)	9.0
Actuarial (loss) / gain on reimbursable rights*	(0.6)	2.9
Tax relating to items not reclassified*	18.1	(1.7)
Share of other comprehensive income in joint ventures and associates	0.9	14.8
<b>Items that may be reclassified subsequently to profit or loss:</b>		
Net exchange (loss) / gain on translation of foreign operations**	(14.6)	80.3
Fair value (loss) / gain on cash flow hedges during the year**	(0.2)	2.3
Tax relating to items that may be reclassified	-	-
Share of other comprehensive income in joint ventures and associates	-	1.0
<b>Total other comprehensive income for the year</b>	(102.9)	108.6
<b>Total comprehensive income for the year</b>	(102.8)	107.5
Attributable to:		
Equity owners of the Company	(102.9)	107.1
Non controlling interest	0.1	0.4

\* Recorded in retirement benefit obligations reserve in the Condensed Consolidated Statement of Changes in Equity.

\*\* Recorded in hedging and translation reserve in the Condensed Consolidated Statement of Changes in Equity.

## Condensed Consolidated Statement of Changes in Equity

	Share capital £m	Share premium account £m	Capital redemption reserve £m	Retained earnings £m	Retirement benefit obligations reserve £m	Share based payment reserve £m	Own shares reserve £m	Hedging and translation reserve £m	Total shareholders' equity £m	Non controlling interest £m
<b>At 1 January 2016</b>	22.0	327.9	0.1	68.5	(101.3)	80.9	(59.8)	(57.7)	280.6	1.5
Total comprehensive income for the year	-	-	-	14.6	10.2	-	-	82.3	107.1	0.4
Shares transferred to option holders on exercise of share options	-	-	-	-	-	(7.7)	7.7	-	-	-
Expense in relation to share based payments	-	-	-	-	-	9.7	-	-	9.7	-
Change in non controlling interest	-	-	-	-	-	-	-	-	-	(0.5)
<b>At 1 January 2017</b>	22.0	327.9	0.1	83.1	(91.1)	82.9	(52.1)	24.6	397.4	1.4
Total comprehensive income for the year	-	-	-	0.6	(89.0)	-	-	(14.5)	(102.9)	0.1
Shares transferred to option holders on exercise of share options	-	-	-	-	-	(6.0)	6.0	-	-	-
Expense in relation to share based payments	-	-	-	-	-	11.4	-	-	11.4	-
Change in non controlling interest	-	-	-	-	-	-	-	-	-	(0.2)
<b>At 31 December 2017</b>	22.0	327.9	0.1	83.7	(180.1)	88.3	(46.1)	10.1	305.9	1.3

## Condensed Consolidated Balance Sheet

	At 31 December 2017 £m	At 31 December 2016 £m
<b>Non current assets</b>		
Goodwill	551.3	577.9
Other intangible assets	66.7	83.6
Property, plant and equipment	65.2	69.3
Interests in joint ventures and associates	14.3	14.4
Trade and other receivables	57.3	44.4
Derivative financial instruments	3.7	14.2
Deferred tax assets	55.0	50.8
Retirement benefit assets	41.8	150.4
	855.3	1,005.0
<b>Current assets</b>		
Inventories	17.4	22.4
Trade and other receivables	506.5	543.5
Current tax assets	11.2	11.0
Cash and cash equivalents	112.1	177.8
Derivative financial instruments	10.3	4.9
	657.5	759.6
<b>Total assets</b>	1,512.8	1,764.6
<b>Current liabilities</b>		
Trade and other payables	(462.9)	(524.5)
Derivative financial instruments	(1.1)	(0.6)
Current tax liabilities	(25.3)	(25.9)
Provisions	(148.5)	(172.3)
Obligations under finance leases	(8.5)	(12.3)
Loans	(31.8)	(9.7)
	(678.1)	(745.3)
<b>Non current liabilities</b>		
Trade and other payables	(28.7)	(16.8)
Deferred tax liabilities	(20.4)	(30.5)
Provisions	(211.5)	(249.4)
Obligations under finance leases	(11.7)	(15.9)
Loans	(239.7)	(290.2)
Retirement benefit obligations	(15.5)	(17.7)
	(527.5)	(620.5)
<b>Total liabilities</b>	(1,205.6)	(1,365.8)
<b>Net assets</b>	307.2	398.8
<b>Equity</b>		
Share capital	22.0	22.0
Share premium account	327.9	327.9
Capital redemption reserve	0.1	0.1
Retained earnings	83.7	83.1
Retirement benefit obligations reserve	(180.1)	(91.1)
Share based payment reserve	88.3	82.9
Own shares reserve	(46.1)	(52.1)
Hedging and translation reserve	10.1	24.6
<b>Equity attributable to owners of the Company</b>	305.9	397.4
<b>Non controlling interest</b>	1.3	1.4
<b>Total equity</b>	307.2	398.8

## Condensed Consolidated Cash Flow Statement For the year ended 31 December

	2017 £m	2016 £m
<b>Net cash inflow / (outflow) from operating activities before exceptional items</b>	16.7	(22.4)
Exceptional items	(32.5)	(39.9)
<b>Net cash outflow from operating activities</b>	(15.8)	(62.3)
<b>Investing activities</b>		
Interest received	0.5	1.4
Increase / (decrease) in security deposits	0.2	(0.4)
Dividends received from joint ventures and associates	28.2	40.0
Proceeds from disposal of property, plant and equipment	1.5	0.6
Proceeds from disposal of intangible assets	0.1	0.1
Net cash (outflow) / inflow on disposal of subsidiaries and operations	(7.1)	19.4
Acquisition of subsidiaries, net of cash acquired	1.5	(0.2)
Proceeds from loans receivable	0.6	-
Purchase of other intangible assets	(18.4)	(15.1)
Purchase of property, plant and equipment	(17.8)	(17.2)
<b>Net cash (outflow) / inflow from investing activities</b>	(10.7)	28.6
<b>Financing activities</b>		
Interest paid	(17.5)	(20.1)
Exceptional finance costs paid	-	(0.3)
Capitalised finance costs paid	-	(0.3)
Repayment of loans	(3.8)	(135.5)
Decrease in loans to joint ventures and associates	-	1.1
Capital element of finance lease repayments	(12.6)	(17.0)
Cash movements on hedging instruments	(2.5)	47.0
<b>Net cash outflow from financing activities</b>	(36.4)	(125.1)
<b>Net decrease in cash and cash equivalents</b>	(62.9)	(158.8)
<b>Cash and cash equivalents at beginning of year</b>	177.8	323.6
Net exchange (loss) / gain	(2.8)	7.8
Cash reclassified to assets held for sale	-	5.2
<b>Cash and cash equivalents at end of year</b>	112.1	177.8



## Notes to the Condensed Consolidated Financial Statements

### 1. General information, going concern and accounting policies

The basis of preparation in this preliminary announcement is set out below.

The financial information in this announcement does not constitute the Company's statutory accounts as defined in section 434 of the Companies Act 2006 for the years ended 31 December 2017 or 2016, but is derived from these accounts. The auditors' report on the 2016 and 2017 accounts contained no emphasis of matter and did not contain statements under S498 (2) or (3) of the Companies Act 2006 or equivalent preceding legislation.

The preliminary announcement has been prepared in accordance with International Financial Reporting Standards adopted for use in the European Union (IFRS). Whilst the financial information included in this preliminary announcement has been computed in accordance with IFRS, this announcement does not itself contain sufficient information to comply with IFRS. The Company expects to publish full Group and parent company only financial statements that comply with IFRS and FRS101 respectively, in March 2017.

The financial statements have been prepared on the historical cost basis, except for the revaluation of financial instruments. Historical cost is generally based on the fair value of the consideration given in exchange for goods and services. The following principal accounting policies adopted have been applied consistently in the current and preceding financial year except as stated below.

#### Going concern

The Directors have a reasonable expectation that the Company and the Group will be able to operate within the level of available facilities and cash for the foreseeable future and accordingly believe that it is appropriate to prepare the financial statements on a going concern basis.

In assessing the basis of preparation of the financial statements for the year ended 31 December 2017, the Directors have considered the principles of the Financial Reporting Council's 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting, 2014'; namely assessing the applicability of the going concern basis, the review period and disclosures. The Directors have undertaken a rigorous assessment of going concern and liquidity, taking into account financial forecasts, which indicate sufficient capacity in our financing facilities and associated covenants to support the Group. In order to satisfy themselves that they have adequate resources for the future, the Directors have reviewed the Group's existing debt levels, the committed funding and liquidity positions under our debt covenants, and our ability to generate cash from trading activities and working capital requirements. The Group's current principal debt facilities at the year end comprised a £480m revolving credit facility, and £261m of US private placement notes. As at 31 December 2017, the Group had £741m of committed credit facilities and committed headroom of £588m.

In undertaking this review the Directors have considered the business plans which provide financial projections for the foreseeable future. For the purposes of this review, we consider that to be the period ending 30 June 2019.

#### Prior year restatement

The Group has undergone a programme of work on its financial data structures to appropriately allocate and charge costs to the relevant divisions and between cost of sales and administrative expenses. As a result of the activities performed in this area, the Group's classification of cost items in the income statement has changed. The prior periods' results have been restated to reflect the cost items identified which should have been reallocated in 2016.

Cost of sales are considered to be the direct costs of operating ongoing contracts. This includes the unavoidable costs of servicing contracts and all costs that a contract would incur purely on its own without a parent company, regardless of how those services are delivered within the wider Group, such as IT or Human Resource management services provided centrally.

The impact on the relevant line items in the Condensed Consolidated Income Statement for the year ended 31 December 2016 is as follows:

Impact on Condensed Consolidated Income Statement	Year ended 31 December 2016 as previously stated £m	Adjustment £m	Year ended 31 December 2016 as restated £m
Cost of sales	(2,767.6)	43.0	(2,724.6)
Gross profit	243.4	43.0	286.4
General and administrative expenses	(173.2)	(43.0)	(216.2)

## Adoption of new and revised standards

None of the changes to IFRS that became effective in the current reporting period have had a significant impact on the Group's financial statements.

### New standards and interpretations not applied: IFRS15 *Revenue from Contracts with Customers*

IFRS15 *Revenue from Contracts with Customers* (effective 1 January 2018), provides a single, principles-based five step model to be applied to all sales contracts, based on the transfer of control of goods and services to customers. It replaces existing revenue recognition guidance for goods, services and construction contracts currently included in IAS11 *Construction Contracts* and IAS18 *Revenue*.

Under the transition rules IFRS15 will be applied retrospectively to the prior period in accordance with IAS8 *Accounting policies, changes in accounting estimates and errors*, subject to the following expedients:

- contracts completed prior to 1 January 2018 and that begin and end within the same annual reporting period will not be restated;
- for contracts that have variable consideration and which have completed prior to 1 January 2018, the revenues recognised will reflect the actual outcome, rather than being estimated and trued up; and
- the disclosures required for comparative periods in respect of amount of revenue allocated to the remaining performance obligations and an explanation of when that amount is expected to be recognised will not be made.

The cumulative effect of initially applying the standard will be shown as an adjustment to brought forward retained earnings as at 1 January 2017.

Below is set out the expected revenue recognition policy under IFRS15 together with the estimated impact of adopting the standard.

### Revenue recognition: Repeat service based contracts

The majority of the Group's contracts are repeat service based contracts where value is transferred to the customer over time as the core services are delivered and therefore in most cases revenue will be recognised on the output basis, with revenue linked to the deliverables provided to the customer. Where any price step downs are required in a contract accounted for under the output basis and output is not decreasing, revenue will require deferral from initial years to subsequent years in order for revenue to be recognised on a consistent basis.

There are some contracts where a separate performance obligation has been identified for services where the pattern of delivery differs to the core services and are capable of being distinct. In these instances, where the transfer of control is most closely aligned to our efforts in delivering the service, then the input method is used to measure progress, and revenue is recognised in direct proportion to costs incurred. Where deemed appropriate, the Group will utilise the practical expedient within IFRS15, allowing revenue to be recognised at the amount which the Group has the right to invoice, where that amount corresponds directly with the value to the customer of the Group's performance completed to date.

Under IFRS15, unless upfront fees received from customers including transition payments can be clearly attributable to a distinct service the customer is obtaining, then such payments do not constitute a separate performance obligation and instead are deferred and spread over the life of the core services.

Any changes to the enforceable rights and obligations with customers and / or an update to the transaction price will not be recognised as revenue until there is evidence of customer agreement in line with the Group's policies.

Any variable amounts will only be recognised where it is highly probable that a significant reversal will not occur.

Where the Group is required to assess whether it is acting as principal or as an agent in respect of goods or services procured for customers, the Group is acting as principal if it is in control of a good or a service prior to transferring to the customer and an agent where it is arranging for those goods or services to be provided to the customer without obtaining control.

## ***Revenue recognition: Long-term project based contracts***

The Group has a limited number of long-term contracts for the provision of complex, project-based services. When control of such a deliverable is passed onto the customer at the final stage of a contract, the recognition of revenue is delayed until control has been passed. However, where the customer has control over the life of the deliverable or where the Group has a legally enforceable right to remuneration for the work completed to date, or at milestone periods, revenue will be recognised in line with the associated transfer of control or milestone dates.

## ***Revenue recognition: Other***

Sales of goods are recognised when goods are delivered and title has passed.

Interest income is accrued for on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Dividend income from investments is recognised when the right to receive payment has been established.

## ***Contract costs***

Bid costs are capitalised only when they relate directly to a contract and are incremental to securing the contract. Any costs which would have been incurred whether or not the contract is actually won are not considered to be capitalised bid costs.

Contract costs are charged to the income statement as incurred, including the necessary accrual for costs which have not yet been invoiced, unless the expense relates to a specific time frame covering future periods.

Contract costs can only be capitalised when the expenditure meets all of the following three criteria and are not within the scope of another accounting standard, such as inventories, intangible assets, or property, plant and equipment:

- The costs relate directly to a contract. These include: direct labour, being the salaries and wages of employees providing the promised services to the customer; direct materials such as supplies used in providing the promised services to a customer; and other costs that are incurred only because an entity entered into the contract, such as payments to subcontractors.
- The costs generate or enhance the resources used in satisfying performance obligations in the future. For initial contract costs capitalised, such costs only fall into one of the following two categories: the mobilisation of contract staff, being the costs of moving existing contract staff to other Group locations; or directly incremental costs incurred in meeting contractual obligations incurred prior to contract delivery, which are required to ensure a proper handover from the previous contractor. Redundancy costs are never capitalised.
- The costs are expected to be recovered, i.e. the contract is expected to be profitable after amortising the capitalised costs.

## Estimated impact of the adoption of IFRS15

The impact for the Group of adopting IFRS15 is as follows:

	Year ended 31 December 2017 as reported £m	Adjustment £m	Year ended 31 December 2017 as restated £m
Revenue	2,953.6	(3.0)	2,950.6
Underlying Trading Profit	69.8	(0.3)	69.5
Operating profit before exceptional items	49.6	(8.7)	40.9
Profit before tax	19.1	(8.7)	10.4
Tax	(19.0)	0.4	(18.6)
Profit after tax	0.1	(8.3)	(8.2)

	As at 1 January 2017 £m
Retained earnings at 1 January 2017 as reported	83.1
Adjustment to retained earnings before the impact of onerous contract provisions	(54.5)
Impact of onerous contract provisions	21.7
Retained earnings at 1 January 2017 as restated	50.3

The Group will continue to work to design, implement and refine procedures to apply the new requirements of IFRS15 and to finalise accounting policy choices, including in its subsidiaries and joint ventures. As a result of this ongoing work, it is possible that there may be some changes to the impact above prior to the 30 June 2018 results being issued. However, at this time these are not expected to be significant.

The total adjustment to the opening balance of the Group's equity at 1 January 2017 is a decrease of £32.8m. The principal components of the estimated adjustment are as follows:

- A decrease of £14.4m due to revenues being recognised at a constant amount over the life of the contract where the level of services provided is broadly consistent.
- A decrease of £11.4m due to a change in the basis of measuring progress for asset maintenance and replacement services, including dry docking. Where the resources used to fulfil the performance obligations best depicts how control is passed to the customer, the input method of accounting has been applied.
- A decrease of £6.8m due to upfront fees and transition payments being deferred and spread in line with delivery of the core services.

The following table details the specific areas impacted as a result of the adoption of IFRS15 and cross-referenced below the table are Serco's policies in adopting the requirements of the standard:

Impact on retained earnings as at 1 January 2017 and the Condensed Consolidated Income Statement for the year ended 31 December 2017	Retained earnings £m	Revenue £m	Operating profit before exceptional items £m
Under current accounting standards	83.1	2,953.6	49.6
IFRS15 adjustments:			
(i) Upfront fees	(2.6)	0.9	0.8
(ii) Transition, transformation and other mobilisation activities	(4.2)	2.1	(3.0)
(iii) Asset maintenance and replacement, including vessel dry docking	(11.4)	1.3	(0.8)
(iv) Percentage of completion accounting	(0.2)	0.5	0.1
(v) Pass through revenues and procurement arrangements	-	(12.6)	-
(vi) Consideration payable to a customer	-	(0.5)	(0.4)
(vii) Variable pricing	(14.4)	5.3	3.0
(viii) OCP charges and releases	-	-	(8.4)
<b>Adjusted under IFRS15</b>	<b>50.3</b>	<b>2,950.6</b>	<b>40.9</b>

- (i) Upfront fees. For some contracts, the Group receives non-refundable amounts at the start of the contract to cover initial costs. Under IFRS15, unless upfront fees are attributable to a good or a service the customer is in control of, such fees do not constitute a separate performance obligation and instead are allocated to the performance obligations of the contract, therefore being spread over the life of the other services. In some instances such upfront fees were recognised as revenue under IAS18 but are deferred under IFRS15. Upfront payments are analysed to determine whether they constitute a material financing arrangement under IFRS15.
- (ii) Transition, transformation and other mobilisation activities. Transition activities which are administrative in nature are not treated as separate performance obligations. Transition and transformation activities which are more than administrative in nature are assessed to determine whether they form a separate performance obligation. Where it can be demonstrated that the transition activities benefit the customer without future activities being provided then the transition phase is accounted for as a separate performance obligation under the contract and revenue recognised accordingly. Where it is concluded that the transformation, transition or mobilisation activity does not form a separate performance obligation under the contract, any payments received from the customer are allocated to the performance obligations of the contract and recognised over the life of the other services. In some instances revenue recognised under IAS18 is deferred under IFRS15.
- (iii) Asset maintenance and replacement, including vessel dry docking. In many of the contracts the Group enters into, the provision of maintenance and replacement services are capable of being distinct and therefore these have been accounted for as separate performance obligations. The input method of accounting is used to reflect the pattern of delivery to the customer and the enhancement of customer owned assets. In some instances the output method of accounting is used due to the ongoing repetitive nature and frequency of the services. Adopting IFRS15 will result in the deferral of revenue recognised under IAS18 on certain contracts.
- (iv) Percentage of completion accounting. Changes to the Group's current accounting policy arise when the percentage of completion model under IAS11 is replaced by the output method of accounting. The output method is used where the customer simultaneously receives and consumes the benefits in direct proportion to the deliverable performed rather than the level of expense incurred to date.
- (v) Pass through revenues and procurement arrangements. A pass through arrangement is where goods or services are provided by a third party, but sourced by the Group on behalf of the customer. In this instance, the Group does not recognise revenue for the amount received from the customer as compensation of the cost of the good or service but rather only the margin element (if any) is recorded as revenue. Recognition of such revenues under IFRS15 is linked directly to whether the Group has control of the deliverable prior to transfer rather than an assessment of the risks and rewards associated with the services as was the case under IAS18. For certain procurement arrangements the Group does not have control prior to transfer, but does have a level of risk associated with the activity, and therefore these arrangements are not recognised on a net basis instead of the gross basis under IAS18.
- (vi) Consideration payable to a customer. Under IFRS15 all amounts payable to a customer (including all payments to the customer and all reductions to amounts paid by the customer) are recorded as a reduction in revenue. In 2017, an element of reductions have been recorded as costs.
- (vii) Variable pricing. It is not uncommon in outsourcing arrangements for the payment terms to be set to decline over the future periods (i.e. a 5% reduction in fees is built into years five to six, 6% reduction in years seven to eight and so on). However, where revenue recognition under IFRS15 is based on the output method and the service remains consistent over the contract life, the reduction in the amounts paid by the customer should not be reflected in declining revenues, even if this was appropriate under IAS18. As a result, revenue recognised in prior years for certain contracts will be deferred under IFRS15.
- (viii) OCP charges and releases. Where an adjustment is required by IFRS15 and the relevant contract is loss making, the deferral of revenue from prior years can result in a decrease in the level of OCP needed under IFRS15, as future losses will reduce by the level of deferred revenue. During the year one contract recorded a release against the OCP balance held under current accounting standards. As a result of IFRS15, revenues on this contract have been deferred, reducing the opening OCP balance, increasing deferred revenue and therefore the release of the relevant OCP balance is lower under IFRS15.

In addition to the areas where a financial impact has been identified as a result of adoption of IFRS15 as identified above, there are certain accounting policies which are new or change existing policies applied by the Group and may have an impact on the future financial performance of the Group. The policies in these areas to be adopted by the Group are set out below:



- (ix) Contract variations. Contract modifications such as change orders, variations, change notices and amendments could be approved in writing, by oral agreement or implied by customary business practices. Under IFRS15 contract modification are changes in the scope or price (or both) of a contract that is approved by the parties to the contract. If the parties to the contract have not approved a contract modification, revenue should be recognised in accordance with the existing contractual terms and associated cash payments are deferred until the contract modification is approved. The judgements historically applied have been consistent with this policy.
- (x) Variable revenues requiring estimation. IFRS15 provides clear guidance on variable income unlike IAS18 and two areas may be impacted as a result. First, if the consideration paid by a customer includes a variable amount requiring judgement, it is only recognised where it is highly probable that a significant reversal will not occur. Second, service penalties or any claims made by us against the customer which must be recognised in revenue unless it is highly probable that they will not result in future settlement. However, judgements taken historically are consistent with the requirements of IFRS15 and there is no impact of these changes on the Group.
- (xi) Capitalised redundancy costs. Under certain contracts there is an obligation to make redundancies and the Group is compensated for these costs. Historically, the Group may have recognised revenues as and when the customer makes payments or the Group may have capitalised the expense to match with payments being made in the future. Under IFRS15, all redundancy costs must be expensed in the period they are incurred and revenue is not recognised on these redundancy transactions, with any cash payments deferred over the contract in line with the other services being delivered. No adjustment was required in respect of this difference.
- (xii) Licence income. Where the Group receives income for software licences and maintenance services provided through ongoing support and operational functionality, this licence revenue is recognised over the period when the maintenance obligation exists. There are currently no significant licencing arrangements entered into by the Group with its customers which are impacted by IFRS15.
- (xiii) Extension periods granted or other options. Providing the option for a customer to obtain extension periods or other services may lead to a separate performance obligation where a material right exists. If a separate performance obligation exists then there would be an allocation of the transaction price from the original contract in addition to any revenues earned through the option period. A separate performance obligation exists for options under a contract if both of the following conditions are met. First, if the customer is unable to obtain the right to acquire the additional goods or services on the same or similar terms without entering into the original contract (for example they cannot get the option without first entering into the main contract, which would be the case for any extension period). Second, the option does not simply give the customer the right to acquire additional goods or services at a price that reflects the stand alone selling price for those goods or services (for example if the pricing of the option is consistent with what the pricing would have been in any case there is no separate PO, as the customer gains no incremental benefit from the existence of the option). No differences were noted under IFRS15 in this area.
- (xiv) Work in progress. Revenue is only recognised when control is passed to a customer and therefore where revenue is recognised over time no work in progress is created unlike under current accounting standards. None of the contracts with revenues recognised over time have work in progress balances.
- (xv) Significant financing component. Where the timing of payments agreed with the customer provides either party with a significant benefit of financing (either explicitly or implicitly), the associated asset/liability is adjusted for the time value of money and an interest charge or income is recognised and a corresponding offset in revenue. The Group's policy under IFRS15 is to consider "significant" to be greater than 5% of the total transaction price of the contractual arrangement and no such arrangements are in place.
- (xvi) Non cash consideration. If a customer contributes goods or services (for example, materials, equipment or labour) to facilitate the fulfilment of the contract, the Group assesses whether control is obtained for those contributed goods or services. If the Group obtains control of the contributed goods or services, then the estimated fair value of these would be recognised as revenue. No such transactions have been noted.

## Other new standards and interpretations not applied

At the date of authorisation of these financial statements, the following changes to IFRS have not been applied but could potentially have a significant impact:

- (i) IFRS9 *Financial Instruments* has been endorsed by the EU and will be effective from 1 January 2018.

This standard replaces IAS39 and introduces new requirements for classifying and measuring financial instruments and puts in place a new hedge accounting model that is designed to be more closely aligned with how entities undertake risk management activities when hedging financial and non-financial risk exposures.

The impact of IFRS9 on the regular trading activities of the Group is expected to be immaterial. The key areas of focus for the Group under IFRS9 are:

- External loan receivables, including those from equity accounted entities.
- Debt refinancing not accounted for as a significant modification under IAS39.
- Expected credit losses being recognised on trade debtors and contract assets recognised under IFRS15.
- Intercompany loan recoverability.

IFRS9 replaces the 'incurred loss' model in IAS39 with an 'expected credit loss' model. The new model applies to financial assets that are not measured at FVTPL (fair value through profit and loss), including loans, lease and trade receivables, debt securities, contract assets under IFRS15 and specified financial guarantees and loan commitments issued. It does not apply to equity investments.

Under the expected credit loss model, the Group is required to calculate the allowance for credit losses by considering on a discounted basis the cash shortfalls it would incur in various default scenarios for prescribed future periods and multiplying the shortfalls by the probability of each scenario occurring. The allowance is the sum of these probability weighted outcomes. Because every loan and receivable carries with it some risk of default, it is expected that every such asset has a loss attached to it from the moment of its origination.

The financial assets held on the balance sheet have been reviewed in order to determine whether any loss is required to be recorded based on these expected credit losses. However, given the fact that the Group's customers are governments it is unlikely that there will be a default as a result of credit risk and any provision for bad debts is more likely to be related to a contractual dispute. In most cases, each amount receivable has specific risk attached to recoverability which is most likely based on the services provided under the terms of the contract and, given the majority of receivables are backed by organisations with a sovereign credit rating, a general view on recoverability based on the counterparty credit risk could be misleading.

- (ii) IFRS16 *Leases* is pending EU endorsement, which is expected prior to the effective date of 1 January 2019.

The standard replaces IAS17 *Leases* and has been introduced in order to improve the comparability of financial statements through developing an approach that is more consistent with the conceptual framework definitions of assets and liabilities.

The key change will be in respect of leases currently classified as operating leases. Under the new standard leases will be recognised on the balance sheet as liabilities with corresponding assets being created, grossing up the balance sheet but with no net effect on net assets at the start of the lease. The income statement impact will be a new interest charge arising from the rate implicit in the liability and as currently the full impact is a charge to operating profit, the change will result in an improvement to operating results.

We have not quantified the likely impact of the new standard, the transition approach to be taken or concluded whether it will be adopted early, which is allowed from the date IFRS15 is adopted. The quantitative impact of the adoption of IFRS16 will be disclosed prior to the adoption of this new standard.

## 2. Critical accounting judgements and key sources of estimation uncertainty

In the process of applying the Group's accounting policies, which are described in note 1 above, management has made the following judgements that have the most significant effect on the amounts recognised in the financial statements. As described below, many of these areas of judgement also involve a high level of estimation uncertainty.

### Prior year restatement: Change in accounting policy

The accounting policy regarding the classification of cost items within cost of sales and administrative expenses was changed in the year. Judgement was applied in reaching the conclusion that it provides more relevant financial results to exclude these amounts from the underlying transactions of trading operations. Further details are provided in note 1.

### Use of Alternative Performance Measures: Operating profit before exceptional items

IAS1 requires material items to be disclosed separately in a way that enables users to assess the quality of a company's profitability. In practice, these are commonly referred to as 'exceptional' items, but this is not a concept defined by IFRS and therefore there is a level of judgement involved in arriving at an Alternative Performance Measure which excludes such exceptional items. We consider items which are material and outside of the normal operating practice of the company to be suitable for separate presentation. Further details can be seen in note 8.

The segmental analysis of continuing operations in note 4 includes the additional performance measure of Trading Profit on continuing operations which is reconciled to reported operating profit in that note. The Group uses Trading Profit as an alternative measure to reported operating profit by making several adjustments. Firstly, Trading Profit excludes exceptional items, being those we consider material and outside of the normal operating practice of the company to be suitable of separate presentation and detailed explanation. Secondly, amortisation and impairment of intangibles arising on acquisitions are excluded, because these charges are based on judgments about the value and economic life of assets that, in the case of items such as customer relationships, would not be capitalised in normal operating practice. The CODM reviews the segmental analysis for continuing operations together with discontinued operations.

### Provisions for onerous contracts

Determining the carrying value of onerous contract provisions requires assumptions and complex judgements to be made about the future performance of the Group's contracts. The level of uncertainty in the estimates made, either in determining whether a provision is required, or in the calculation of a provision booked, is linked to the complexity of the underlying contract and the form of service delivery. Due to the level of uncertainty and combination of variables associated with those estimates there is a significant risk that there could be material adjustment to the carrying amounts of onerous contract provisions within the next financial year.

Major sources of uncertainty which could result in a material adjustment within the next financial year are:

- The ability of the company to maintain or improve operational performance to ensure costs or performance related penalties are in line with expected levels.
- Volume driven revenue and costs being within the expected ranges.
- The outcome of matters dependent on the behaviour of the customer, such as a decision to extend a contract where it has the unilateral right to do so.
- The outcome of open claims made by or against a customer regarding contractual performance.
- The ability of suppliers to deliver their contractual obligations on time and on budget.

In the current year material revisions have been made to historic provisions, which have led to a charge to contract provisions of £62.0m, including £0.5m in relation to new provisions, and releases of £43.4m. Further details are provided in the Finance Review. All of these revisions have resulted from triggering events in the current year, either through changes in contractual positions or changes in circumstances which could not have been reasonably foreseen at the previous balance sheet date. To mitigate the level of uncertainty in making these estimates Management regularly compares actual performance of the contracts against previous forecasts and considers whether there have been any changes to significant judgements. A detailed bottom up review of the provisions is performed as part of the Group's formal annual budgeting process.

The future range of possible outcomes in respect of those assumptions and significant judgements made to determine the carrying value of onerous contracts could result in either a material increase or decrease in the value of onerous contract provisions in the next financial year. The extent to which actual results differ from estimates

made at the reporting date depends on the combined outcome and timing of a large number of variables associated with performance across multiple contracts.

The individual provisions are discounted where the impact is assessed to be significant. Discount rates used are calculated based on the estimated risk free rate of interest for the region in which the provision is located and matched against the ageing profile of the provision. Rates applied are in the range of 0.72% and 1.95%.

## **Investigation by the Serious Fraud Office**

In November 2013, the UK's Serious Fraud Office announced that it had opened an investigation, which remains ongoing, into the Group's Electronic Monitoring Contract.

We are cooperating fully with the Serious Fraud Office's investigation but it is not possible to predict the outcome. However, disclosed in the Principal Risks and Uncertainties in this Report is a description of the range of possible outcomes in the event that the Serious Fraud Office decides to prosecute the individuals and / or the Serco entities involved.

## **Impairment of assets**

Identifying whether there are indicators of impairment for assets involves a high level of judgement and a good understanding of the drivers of value behind the asset. At each reporting period an assessment is performed in order to determine whether there are any such indicators, which involves considering the performance of our business and any significant changes to the markets in which we operate.

We seek to mitigate the risk associated with this judgement by putting in place processes and guidance for the finance community and internal review procedures.

Determining whether assets with impairment indicators require an actual impairment involves an estimation of the expected value in use of the asset (or CGU to which the asset relates). The value in use calculation involves an estimation of future cash flows and also the selection of appropriate discount rates, both of which involve considerable judgement. The future cash flows are derived from approved forecasts, with the key assumptions being revenue growth, margins and cash conversion rates. Discount rates are calculated with reference to the specific risks associated with the assets and are based on advice provided by external experts. Our calculation of discount rates are performed based on a risk free rate of interest appropriate to the geographic location of the cash flows related to the asset being tested, which is subsequently adjusted to factor in local market risks and risks specific to Serco and the asset itself. Discount rates used for internal purposes are post tax rates, however for the purpose of impairment testing in accordance with IAS36 *Impairment of assets* we calculate a pre tax rate based on post tax targets.

A key area of focus in recent years has been in the impairment testing of goodwill as a result of the pressure on the results of the Group. However, no impairment of goodwill was noted in the year ended 31 December 2017.

## **Deferred tax**

Deferred tax assets are recognised for unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Significant management judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and the level of future taxable profits. Recognition has been based on forecast future taxable profits.

Further details on taxes are disclosed in note 12.

## **Current tax**

Liabilities for tax contingencies require management judgement and estimates in respect of tax audits and also tax exposures in each of the jurisdictions in which we operate. Management is also required to make an estimate of the current tax liability together with an assessment of the temporary differences that arise as a consequence of different accounting and tax treatments. Key judgement areas include the correct allocation of profits and losses between the countries in which we operate and the pricing of intercompany services. Where management conclude that a tax position is uncertain, a current tax liability is held for anticipated taxes that are considered probable based on the current information available.

These liabilities can be built up over a long period of time but the ultimate resolution of tax exposures usually occurs at a point in time, and given the inherent uncertainties in assessing the outcomes of these exposures, these estimates are prone to change in future periods. It is not currently possible to estimate the timing of potential cash

outflow, but on resolution, to the extent this differs from the liability held, this will be reflected through the tax charge / (credit) for that period. Each potential liability and contingency is revisited on an annual basis and adjusted to reflect any changes in positions taken by the company, local tax audits, the expiry of the statute of limitations following the passage of time and any change in the broader tax environment.

On the basis of the currently available information, the Group does not anticipate a material change to the estimated liability in the short term.

## Retirement benefit obligations

Identifying whether the Group has a retirement benefit obligation as a result of contractual arrangements entered into requires a level of judgement, largely driven by the legal position held between the Group, the customer and the relevant pension scheme. The Group's retirement benefit obligations are covered in note 18.

The calculation of retirement benefit obligations is dependent on material key assumptions including discount rates, mortality rates, inflation rates and future contribution rates.

In accounting for the defined benefit schemes, the Group has applied the following principles:

- The asset recognised for the Serco Pension and Life Assurance Scheme is based on the assumption that the full surplus will ultimately be available to the Group as a future refund of surplus.
- No foreign exchange item is shown in the disclosures as the non UK liabilities are not material.
- No pension assets are invested in the Group's own financial instruments or property.
- Pension annuity assets are remeasured to fair value at each reporting date based on the share of the defined benefit obligation covered by the insurance contract.

## 3. Discontinued operations

The Global Services division, representing private sector BPO operations, was classified as a discontinued operation in 2015 and 2016. The most significant part of this business was disposed in 2015, and the disposal of one of the two remaining elements of the offshore business was completed in March 2016 and the final element completed in December 2016. The residual UK onshore private sector BPO operations were sold or exited in 2016 with the exception of one business consisting of a single contract, where disposal was completed in July 2017. Total revenues for the remaining operations were £5.4m and the loss before exceptional items was £0.6m up to the point of disposal, therefore the results have been included in continuing operations in 2017 on the grounds of materiality. The final contract was sold with no profit or loss on disposal, with a net cash outflow of £0.5m.

The results of the discontinued operations were as follows:

For the year ended 31 December	2016 £m
Revenue	36.8
Expenses	(40.1)
<b>Operating loss before exceptional items</b>	<b>(3.3)</b>
Exceptional loss on disposal of subsidiaries and operations	(2.8)
Other exceptional operating items	(11.4)
<b>Operating loss</b>	<b>(17.5)</b>
Exceptional finance costs	(0.4)
<b>Loss before tax</b>	<b>(17.9)</b>
Tax charge on loss before exceptional items	(0.1)
<b>Net loss attributable to discontinued operations presented in the income statement</b>	<b>(18.0)</b>
Attributable to:	
Equity owners of the Company	(18.1)
Non controlling interests	0.1



# Stock Exchange Announcement



Included above are items classified as exceptional as they are considered to be material and outside of the normal course of business. These are summarised as follows:

For the year ended 31 December	2016 £m
<b>Exceptional items arising on discontinued operations</b>	
Exceptional loss on disposal	(2.8)
<b>Other exceptional operating items</b>	
Restructuring costs	(1.1)
Impairment of goodwill	-
Movements in indemnities provided on business disposals	(13.7)
Movement in the fair value of assets transferred to held for sale	3.4
<b>Other exceptional operating items</b>	(11.4)
<b>Exceptional operating items arising on discontinued operations</b>	(14.2)

In 2016 a charge of £1.1m arose in discontinued operations in relation to the restructuring programme resulting from the Strategy Review. This included redundancy payments, provisions and other charges relating to the exit of the UK private sector BPO business, external advisory fees and other incremental costs.

A charge of £13.7m arose in 2016 in relation to the movement in the value of indemnities provided on business disposals made in previous years. These relate to changes in exchange rates where indemnities were provided in foreign currencies and increases to provisions for interest and penalties on any indemnities. There were no changes in the value of these indemnities in 2017.

A charge of £0.4m was incurred in 2016 as a result of early payments to the US Private Placement (USPP) Noteholders following the disposal of the offshore private sector BPO business. These charges were treated as exceptional finance costs as they were directly linked to the restructuring resulting from the Strategy Review.

The net cash flows resulting from the discontinued operations were as follows:

For the year ended 31 December	2016 £m
<b>Net cash inflow from operating activities before exceptional items</b>	5.5
<b>Exceptional items</b>	-
Net cash inflow from operating activities	5.5
Net cash inflow from investing activities	12.5
Net cash outflow from financing activities	(11.4)
<b>Net increase in cash and cash equivalents attributable to discontinued operations</b>	6.6

## 4. Segmental information

The Group's operating segments reflecting the information reported to the Board in 2017 under IFRS8 *Operating Segments* are as set out below.

Reportable segments	Operating segments
UK & Europe	Services for sectors including Citizen Services, Defence, Health, Justice & Immigration and Transport delivered to UK Government, UK devolved authorities and other public sector customers in the UK and Europe;
Americas	Services for sectors including Defence, Transport and Citizen Services delivered to US federal and civilian agencies, selected state and municipal governments and the Canadian Government;
AsPac	Services for sectors including Defence, Justice & Immigration, Transport, Health and Citizen Services in the Asia Pacific region including Australia, New Zealand and Hong Kong;
Middle East	Services for sectors including Defence, Transport and Health in the Middle East region; and
Corporate	Central and head office costs.

Each operating segment is focused on a narrow group of customers in a specific geographic region and is run by a local management team which report directly to the CODM on a regular basis. As a result of this focus, the sectors in each region have similar economic characteristics and are aggregated at the operating segment level in these condensed financial statements.

During the year two existing divisions, UK Central Government and UK & Europe Local & Regional Government, were merged to form the new UK & Europe division (UK&E) with the management team structure and responsibilities altered to match the segment. This note has been adjusted to reflect the impact of this, which has been to add together the results of the two former divisions in the comparative period.

## Geographic information

Year ended 31 December	Revenue 2017 £m	Non current assets* 2017 £m	Revenue 2016 £m	Non current assets* 2016 £m
United Kingdom	1,185.2	340.3	1,244.9	444.7
United States	623.6	273.3	632.9	309.1
Australia	559.3	143.2	593.1	146.0
Middle East	351.9	18.0	324.8	19.7
Other countries	235.3	21.7	215.3	20.4
<b>Total</b>	<b>2,953.6</b>	<b>796.5</b>	<b>3,011.0</b>	<b>939.9</b>

\* Non current assets exclude financial instruments, deferred tax assets and loans to joint ventures and associates

Revenues from external customers are attributed to individual countries on the basis of the location of the customer.

## Information about major customers

The Group has four major governmental customers which each represent more than 10% of Group revenues. The customers' revenues were £1,102.9m for the UK Government within the UK & Europe segment, £569.7m for the US Government within the Americas segment, £522.1m for the Australian Government within the AsPac segment and £238.4m for the Government of the United Arab Emirates within the Middle East segment.

In 2016 the Group had three major governmental customers which each represented more than 10% of Group revenues. The customers' revenues were £1,233.7m for the UK Government within the UK & Europe segment, £623.1m for the US Government within the Americas segment and £581.4m for the Australian Government within the AsPac segment.

# Stock Exchange Announcement



The following is an analysis of the Group's revenue, results, assets and liabilities by reportable segment:

Year ended 31 December 2017	UK&E £m	Americas £m	AsPac £m	Middle East £m	Corporate £m	Total £m
<b>Revenue</b>	1,334.7	688.0	579.0	351.9	-	2,953.6
<b>Result</b>						
Trading profit / (loss) from continuing operations*	4.5	39.8	35.1	16.2	(41.6)	54.0
Amortisation and impairment of intangibles arising on acquisition	-	(3.0)	(1.4)	-	-	(4.4)
<b>Operating profit / (loss) before exceptional items</b>	4.5	36.8	33.7	16.2	(41.6)	49.6
Exceptional profit / (loss) on disposal of subsidiaries and operations	0.3	-	-	-	-	0.3
Other exceptional operating items**	11.9	(0.3)	(7.4)	0.1	(24.2)	(19.9)
<b>Operating profit / (loss)</b>	16.7	36.5	26.3	16.3	(65.8)	30.0
Investment revenue						7.6
Finance costs						(19.2)
Other gains						0.7
<b>Profit before tax</b>						19.1
Tax charge						(14.0)
Tax on exceptional items						(5.0)
<b>Profit for the year from continuing operations</b>						0.1

\* Trading profit / (loss) is defined as operating profit / (loss) before exceptional items and amortisation and impairment of intangible assets arising on acquisition.

\*\* Exceptional items incurred by the Corporate segment are not allocated to other segments. Such items may represent costs that will benefit the wider business.

<b>Supplementary information</b>						
Share of profits in joint ventures and associates, net of interest and tax	26.6	-	0.8	-	(0.1)	27.3
Depreciation of plant, property and equipment	(14.0)	(3.2)	(4.9)	(0.8)	(1.4)	(24.3)
Impairment of plant, property and equipment	0.1	-	-	-	-	0.1
Total depreciation and impairment of plant, property and equipment	(13.9)	(3.2)	(4.9)	(0.8)	(1.4)	(24.2)
Amortisation of intangible assets arising on acquisition	-	(3.0)	(1.4)	-	-	(4.4)
Exceptional impairment and write down of intangible assets arising on acquisition	-	-	(6.1)	-	-	(6.1)
Amortisation of other intangible assets	(1.1)	(1.5)	(4.8)	(0.2)	(13.8)	(21.4)
Exceptional impairment of other intangible assets	-	-	-	-	(2.8)	(2.8)
Total amortisation and impairment of intangible assets	(1.1)	(4.5)	(12.3)	(0.2)	(16.6)	(34.7)
<b>Segment assets</b>						
Interests in joint ventures and associates	13.5	-	0.4	0.4	-	14.3
Other segment assets***	445.9	391.3	223.4	112.0	133.2	1,305.8
Total segment assets	459.4	391.3	223.8	112.4	133.2	1,320.1
Unallocated assets						192.7
Consolidated total assets						1,512.8
<b>Segment liabilities</b>						
Segment liabilities***	(368.5)	(128.6)	(148.5)	(80.7)	(142.0)	(868.3)
Unallocated liabilities						(337.3)
Consolidated total liabilities						(1,205.6)

\*\*\* The Corporate segment assets and liabilities include balance sheet items which provide benefit to the wider Group, including defined benefit pension schemes and corporate intangible assets.

Year ended 31 December 2016 (restated****)	UK&E £m	Americas £m	AsPac £m	Middle East £m	Corporate £m	Total £m
<b>Revenue</b>	1,375.1	691.4	619.7	324.8	-	3,011.0
<b>Result</b>	-					
Trading profit / (loss) from continuing operations*	84.5	6.4	34.2	18.8	(40.3)	103.6
Amortisation and impairment of intangibles arising on acquisition	(0.3)	(2.8)	(2.0)	-	-	(5.1)
<b>Operating profit / (loss) before exceptional items</b>	84.2	3.6	32.2	18.8	(40.3)	98.5
Exceptional profit / (loss) on disposal of subsidiaries and operations	4.4	-	0.4	-	(1.9)	2.9
Other exceptional operating items**	(25.9)	-	(0.9)	-	(32.4)	(59.2)
<b>Operating profit / (loss)</b>	62.7	3.6	31.7	18.8	(74.6)	42.2
Investment revenue						9.3
Finance costs						(21.9)
<b>Profit before tax</b>						29.6
Tax charge						(15.8)
Tax on exceptional items						3.1
<b>Profit for the year from continuing operations</b>						16.9

\* Trading profit / (loss) is defined as operating (loss) / profit before exceptional items and amortisation and impairment of intangible assets arising on acquisition.

\*\* Exceptional items incurred by the Corporate segment are not allocated to other segments. Such items may represent costs that will benefit the wider business.

\*\*\* During the year two existing divisions, UK Central Government and UK & Europe Local & Regional Government, were merged to form the new UK & Europe division. This note has been adjusted to reflect the impact of this, which has been to add together the results of the two former divisions.

## Supplementary information

Share of profits in joint ventures and associates, net of interest and tax	31.3	-	2.0	-	0.1	33.4
Depreciation of plant, property and equipment	(15.0)	(3.1)	(4.5)	(0.9)	(1.3)	(24.8)
Impairment of plant, property and equipment	(0.3)	-	(0.4)	-	-	(0.7)
Total depreciation and impairment of plant, property and equipment	(15.3)	(3.1)	(4.9)	(0.9)	(1.3)	(25.5)
Amortisation of intangible assets arising on acquisition	(0.3)	(2.8)	(1.3)	-	-	(4.4)
Impairment and write down of intangible assets arising on acquisition	-	-	(0.7)	-	-	(0.7)
Amortisation of other intangible assets	(0.6)	(1.5)	(3.3)	(0.7)	(15.7)	(21.8)
Total amortisation and impairment of intangible assets	(0.9)	(4.3)	(5.3)	(0.7)	(15.7)	(26.9)
<b>Segment assets</b>						
Interests in joint ventures and associates	12.3	-	1.7	0.4	-	14.4
Other segment assets****	467.0	428.8	252.1	108.7	228.6	1,485.2
Total segment assets	479.3	428.8	253.8	109.1	228.6	1,499.6
Unallocated assets, including assets held for sale						265.0
Consolidated total assets						1,764.6
<b>Segment liabilities</b>						
Segment liabilities****	(442.9)	(140.7)	(182.8)	(79.3)	(139.7)	(985.4)
Unallocated liabilities, including liabilities held for sale						(380.4)
Consolidated total liabilities						(1,365.8)

\*\*\*\*The Corporate segment assets and liabilities include balance sheet items which provide benefit to the wider Group, including defined benefit pension schemes and corporate intangible assets.

## 5. Joint ventures and associates

AWE Management Limited (AWEML), Merseyrail Services Holding Company Limited (MSHCL) and Northern Rail Holdings Limited (NRHL) were the only equity accounted entities which were material to the Group during the year or prior year. Dividends of £17.1m (2016: £19.6m), £7.3m (2016: £7.3m) and £1.8m (2016: £10.0m) respectively were received from these companies in the year. The Northern Rail franchise ended on 31 March 2016.

Summarised financial information of AWEML, MSHCL, NRHL and an aggregation of the other equity accounted entities in which the Group has an interest is as follows:

### 31 December 2017

Summarised financial information	AWEML (100% of results) £m	MSHCL (100% of results) £m	NRHL (100% of results) £m	Group portion of material joint ventures and associates* £m	Group portion of other joint venture arrangements and associates* £m	Total £m
<b>Revenue</b>	951.8	155.7	0.3	311.2	45.5	356.7
<b>Operating profit</b>	90.8	17.8	3.8	33.0	1.4	34.4
Net investment revenue / (finance costs)	0.2	(0.2)	-	(0.1)	-	(0.1)
Income tax charge	(18.8)	(3.9)	(0.5)	(6.9)	(0.1)	(7.0)
<b>Profit from continuing operations</b>	72.2	13.7	3.3	26.0	1.3	27.3
Other comprehensive income	-	2.0	-	1.0	(0.1)	0.9
<b>Total comprehensive income</b>	72.2	15.7	3.3	27.0	1.2	28.2
Non current assets	665.6	8.7	-	167.5	2.2	169.7
Current assets	197.3	43.5	5.2	72.7	14.5	87.2
Current liabilities	(179.0)	(37.0)	(2.0)	(63.4)	(13.0)	(76.4)
Non current liabilities	(664.3)	(1.6)	-	(163.5)	(2.7)	(166.2)
<b>Net assets</b>	19.6	13.6	3.2	13.3	1.0	14.3
Proportion of group ownership	24.5%	50.0%	50.0%	-	-	-
<b>Carrying amount of investment</b>	4.8	6.8	1.6	13.3	1.0	14.3

\* Total results of the entity multiplied by the respective proportion of Group ownership.

	AWEML (100% of results) £m	MSHCL (100% of results) £m	NRHL (100% of results) £m	Group portion of material joint ventures and associates* £m	Group portion of other joint venture arrangements and associates* £m	Total £m
Cash and cash equivalents	77.2	33.6	6.0	38.7	2.5	41.2
Current financial liabilities excluding trade and other payables and provisions	(8.3)	(1.9)	0.1	(2.9)	(0.6)	(3.5)
Non current financial liabilities excluding trade and other payables and provisions	-	-	-	-	(2.7)	(2.7)
Depreciation and amortisation	-	(2.2)	-	(1.1)	(1.4)	(2.5)
Interest income	0.2	0.1	-	0.1	-	0.1
Interest expense	-	(0.3)	-	(0.2)	-	(0.2)

\* Total results of the entity multiplied by the respective proportion of Group ownership.

The financial statements of MSHCL are for a period which is different from that of the Group, being for the 52 week period ended 6 January 2018 (2016: 52 week period ended 7 January 2017). The 52 week period reflects the joint venture's internal reporting structure and is sufficiently close so as to not require adjustment to match that of the Group. The NRHL franchise ended on 31 March 2016, with the results reflected in year ended 31 December 2017 reflecting the ongoing post contract negotiations.



# Stock Exchange Announcement



Certain employees of the groups headed by AWEML and MSHCL are members of sponsored defined benefit pension schemes. Given the significance of the schemes to understanding the position of the entities the following key disclosures are made:

Main assumptions: 2017	AWEML	MSHCL
Rate of salary increases (%)	2.2%	3.1%
Inflation assumption (CPI %)	2.2%	2.2%
Discount rate (%)	2.6%	2.5%
Post-retirement mortality:		
Current male industrial pensioners at 65 (years)	22.9	N/A
Future male industrial pensioners at 65 (years)	25.2	N/A
<b>Retirement benefit funding position (100% of results)</b>	<b>£m</b>	<b>£m</b>
Present value of scheme liabilities	(2,233.3)	(304.4)
Fair value of scheme assets	1,569.1	193.9
<b>Net amount recognised</b>	<b>(664.2)</b>	<b>(110.5)</b>
Members' share of deficit	-	44.2
Franchise adjustment*	-	66.3
Related asset, right to reimbursement	664.2	-
<b>Net retirement benefit obligation</b>	<b>-</b>	<b>-</b>

\* The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period.

AWEML is not liable for any deficiency in the defined benefit pension scheme under current contractual arrangements. The deficit reflected in the financial statements of MSHCL covers only that portion of the deficit that is expected to be funded over the term of the franchise arrangement the entity operates under. In addition, the defined benefit position reflects an adjustment in respect of funding required to be provided by employees.

## 31 December 2016

Summarised financial information	AWEML (100% of results) £m	MSHCL (100% of results) £m	NRHL (100% of results) £m	Group portion of material joint ventures and associates* £m	Group portion of other joint venture arrangements and associates* £m	Total £m
<b>Revenue</b>	968.1	150.3	132.7	437.5	43.3	480.8
<b>Operating profit</b>	72.9	18.9	13.2	37.4	3.3	40.7
Net investment revenue / (finance costs)	0.2	(1.3)	0.1	(0.5)	(0.1)	(0.6)
Income tax (charge) / credit	(11.3)	(3.7)	(3.4)	(6.8)	0.1	(6.7)
<b>Profit from continuing operations</b>	61.8	13.9	9.9	30.1	3.3	33.4
Other comprehensive income	-	34.0	0.8	17.4	(1.6)	15.8
<b>Total comprehensive income</b>	61.8	47.9	10.7	47.5	1.7	49.2
Non current assets	1,097.0	12.5	-	275.1	3.2	278.3
Current assets	149.3	32.8	14.2	60.1	16.0	76.1
Current liabilities	(133.9)	(31.9)	(10.7)	(54.2)	(14.0)	(68.2)
Non current liabilities	(1,095.2)	(0.9)	-	(268.7)	(3.1)	(271.8)
<b>Net assets</b>	17.2	12.5	3.5	12.3	2.1	14.4
Proportion of group ownership	33% / 24.5%	50%	50%	-	-	-
<b>Carrying amount of investment</b>	4.2	6.3	1.8	12.3	2.1	14.4

\* Total results of the entity multiplied by the respective proportion of Group ownership.

	AWEML (100% of results) £m	MSHCL (100% of results) £m	NRHL (100% of results) £m	Group portion of material joint ventures and associates* £m	Group portion of other joint venture arrangements and associates* £m	Total £m
Cash and cash equivalents	72.4	21.1	14.5	35.4	4.7	40.1
Current financial liabilities excluding trade and other payables and provisions	(7.0)	(2.3)	(0.5)	(3.1)	(0.9)	(4.0)
Non current financial liabilities excluding trade and other payables and provisions	-	(0.6)	-	(0.3)	(3.0)	(3.3)
Depreciation and amortisation	-	(2.3)	(1.7)	(2.1)	(1.0)	(3.1)
Interest income	0.2	-	0.1	0.2	-	0.2
Interest expense	-	(1.3)	-	(0.6)	(0.1)	(0.7)

\* Total results of the entity multiplied by the respective proportion of Group ownership.

Key disclosures with respect of the defined benefit pension schemes of material joint ventures and associates:

Main assumptions: 2016	AWEML	MSHCL
Rate of salary increases (%)	2.3%	2.3%
Inflation assumption (CPI %)	2.3%	2.3%
Discount rate (%)	2.7%	2.7%
Post-retirement mortality:		
Current male industrial pensioners at 65 (years)	22.8	N/A
Future male industrial pensioners at 65 (years)	24.9	N/A

Retirement benefit funding position (100% of results)	AWEML £m	MSHCL £m
Present value of scheme liabilities	(2,556.0)	(275.7)
Fair value of scheme assets	1,460.9	171.1
<b>Net amount recognised</b>	<b>(1,095.1)</b>	<b>(104.6)</b>
Members' share of deficit	-	62.8
Franchise adjustment*	-	41.8
Related asset, right to reimbursement	1,095.1	-
<b>Net retirement benefit obligation</b>	<b>-</b>	<b>-</b>

\* The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period.

AWEML is not liable for any deficiency in the defined benefit pension scheme under current contractual arrangements. The deficit reflected in the financial statements of MSHCL covers only that portion of the deficit that is expected to be funded over the term of the franchise arrangement the entity operates under. In addition, the defined benefit position reflects an adjustment in respect of funding required to be provided by employees.

## 6. Acquisitions

On 26 January 2018, the Group acquired 100% of the issued share capital of BTP Systems, LLC, for consideration of US Dollar \$20.5m in cash. Further details on this post year end transaction are provided in note 21.

The Group signed a revised Business Purchase Agreement (BPA) on 13 February 2018 with the Special Managers and Provisional Liquidators acting on behalf of the relevant Carillion plc subsidiaries to acquire a portfolio of selected UK health facilities management contracts. The portfolio has annual revenues of approximately £90m and a weighted average remaining term of 14 years. Upon the receipt by the Special Managers and Provisional Liquidators of the requisite third party consents, each individual contract will be transferred to Serco on a cash-free, debt-free basis, with the consideration to be paid in instalments and to be satisfied using Serco's existing financing facilities. If all the contracts are transferred to Serco under the revised BPA process, the total consideration payable would be £29.7m. The consideration payable is lower than the amount of £47.7m announced on 13 December 2017 in respect of substantially the same contracts that were subject to the initial BPA signed with Carillion plc at that date. The change in consideration reflects the Group's re-evaluation of potential liabilities, indemnities, warranties and the additional working capital investment required as a result of Carillion's liquidation. The financial effects of this transaction have

not been recognised at 31 December 2017. As consents are required for each individual contract to be transferred and therefore acquired, at the time the financial statements were authorised for issue no legal transfer or control of assets had taken place and so no disclosures have been made in respect of the assets and liabilities being acquired. The fair values of the assets and liabilities will be determined at the date when contracts are acquired. It is also not yet possible to provide detailed information about each class of acquired receivables and any contingent liabilities in respect of the acquired contracts.

On 24 August 2017 the Group acquired 50% of the issued share capital of Serco Sodexo Defence Services Pty Ltd (SSDS) for £1.6m, obtaining full control. SSDS was previously a 50% owned joint venture accounted for on an equity accounting basis. The business has a contract with the Australian Defence Forces Joint Logistics Command relating to the operation of the Defence Forces national clothing stores and strengthens the financial performance of the AsPac division. As a result of the increase in ownership from 50% to 100% the Group fair valued the existing 50% shareholding held at £0.2m, with the resulting uplift in value of £0.7m being recorded in Other gains, outside of operating results. The amounts recognised in respect of the identifiable assets acquired and the liabilities assumed are as set out in the table below:

	Provisional fair value £m
Intangible assets, excluding goodwill	0.9
Trade and other receivables	1.6
Deferred tax assets	1.0
Cash and cash equivalents	3.1
Trade and other payables	(3.3)
Provisions	(1.7)
<b>Acquisition date fair value of consideration transferred</b>	<b>1.6</b>
<b>Satisfied by:</b>	
Cash	0.4
Deferred consideration	1.2
<b>Total consideration</b>	<b>1.6</b>

The net cash inflow as a result of the acquisition was £2.7m, being £3.1m cash acquired less £0.4m consideration paid.

No acquisition related costs were incurred.

The additional stake in SSDS contributed £3.8m and £0.7m to operating profit before exceptional items in the period from acquisition to 31 December 2017. Had the acquisition taken place on 1 January 2017 Group revenue and operating profit before exceptional items for the year would have increased by £4.2m and £0.6m respectively, taking total Group revenue to £2,957.8m and total Group operating profit before exceptional items to £50.2m.

Cash payments were made in the year relating to historic acquisitions. The total impact of acquisitions in the year to the Group's cash flow position was as follows:

	£m
Cash and cash equivalents in SSDS	3.1
Cash payments in respect of SSDS consideration	(0.4)
Deferred consideration paid in respect of Anglia Support Partnership	(1.2)
<b>Net cash inflow arising on acquisitions in the year</b>	<b>1.5</b>

## 7. Disposals

A summary of the disposals taking place in the year ended 31 December 2017 were as follows:

	Profit / (loss) on disposal £m	Cash flow £m
Disposal of Service Glasgow LLP	-	(6.7)
Disposal of final remaining UK onshore private sector BPO contract	-	(0.5)
Impact of historic transactions	0.3	0.1
	0.3	(7.1)

There were no disposals of continuing operations in 2016, the profit on disposal of £2.9m related to transactions completing in prior years.

In December 2017 the Group's interest in Service Glasgow LLP was disposed of, resulting in a net cash outflow of £6.7m with no profit or loss on disposal. Further details are provided below.

	Service Glasgow LLP £m
Inventories	0.9
Trade and other receivables	4.7
Cash and cash equivalents	6.7
Trade and other payables	(9.9)
Provisions	(0.5)
<b>Net assets disposed</b>	<b>1.9</b>

No profit or loss was made on the disposal:

	Service Glasgow LLP £m
Consideration	1.6
Less:	
Net assets disposed	(1.9)
Non controlling interests disposed of	0.3
<b>Income statement impact of disposal</b>	<b>-</b>

The net cash inflow arising on disposal of discontinued operations and the impact on Net Debt is as follows:

	Service Glasgow LLP £m
Consideration	1.6
Less:	
Deferred consideration	(1.6)
Cash and cash equivalents disposed	(6.7)
<b>Net cash flow on disposal and movement in Net Debt</b>	<b>(6.7)</b>

## 8. Exceptional items

Exceptional items are items of financial performance that are outside normal operations and are material to the results of the Group either by virtue of size or nature. As such, the items set out below require separate disclosure on the face of the income statement to assist in the understanding of the underlying performance of the Group.

Exceptional items arising on discontinued operations are disclosed on the face of the income statement within the loss attributable to discontinued operations, of which there are none in 2017 (2016: charge of £3.4m), whereas those arising on continuing operations are disclosed on the face of the income statement within exceptional operating items. Further information regarding the exceptional items arising on discontinued operations in 2016 can be seen in note 3.

### Exceptional gain on disposal of subsidiaries and operations

The exceptional net gain on disposals is included in note 7.

### Other exceptional operating items arising on continuing operations

For the year ended 31 December	2017 £m	2016 £m
Impairment of goodwill	-	(17.8)
Restructuring costs	(28.6)	(17.2)
Aborted transaction costs	-	(0.1)
Costs associated with UK Government review	(0.4)	(0.1)
Release of UK frontline clinical health contract provisions	0.4	0.6
Settlement of defined benefit pension obligations	10.3	(10.7)
Impairment of interest in joint venture and related loan balances	4.5	(13.9)
Impairment of AsPac customer lists	(6.1)	-
<b>Other exceptional operating items</b>	<b>(19.9)</b>	<b>(59.2)</b>

Goodwill is tested for impairment annually or more frequently if there are indications that there is a risk that it could be impaired. The recoverable amount of each cash generating unit (CGU) is based on value in use calculations derived from forecast cash flows based on past experience, adjusted to reflect market trends, economic conditions, the Group's strategy and key risks. These forecasts include an estimated level of new business wins and contract attrition and an assumption that the final year forecast continues into perpetuity at a CGU specific terminal growth rate. The terminal growth rates are provided by external sources and are based on the long-term inflation rates of the geographic market in which the CGUs operate and therefore do not exceed the average long-term growth rates forecast for the individual markets.

In 2016, goodwill of £17.8m arose following the acquisition of Orchard & Shipman (Glasgow) Limited, the Group's subcontractor on the COMPASS contract, providing accommodation to asylum seekers in Scotland and Northern Ireland on behalf of the Home Office. This goodwill was then immediately impaired as the CGU is forecast to be loss making and therefore the asset cannot be supported. The annual impairment testing of CGUs in 2017 has identified no other impairment of goodwill.

The Group is incurring costs in relation to restructuring programmes resulting from the Strategy Review announced in 2015. These costs include redundancy payments, provisions, external advisory fees and other incremental costs, including in 2017 £2.8m of intangible asset impairment (2016: £nil). Due to the nature and scale of the impact of the transformation phase of the Strategy Review the incremental costs associated with this programme are considered to be exceptional. Costs associated with the restructuring programme resulting from the Strategy Review must meet the following criteria: that they are directly linked to the implementation of the Strategy Review; they are incremental costs as a result of the activity; and they are non business as usual costs. In 2017, a charge of £28.6m (2016: £17.2m) arose in relation to the restructuring programme resulting from the Strategy Review. Non-exceptional restructuring charges are incurred by the business as part of normal operational activity, which in the year totalled £11.1m (2016: £6.7m). We expect restructuring costs of approximately £35m to be incurred in 2018 which will be treated as exceptional.

The disposal of the Environmental and Leisure businesses was aborted in 2015 and during 2016 costs related to the aborted transaction were finalised, resulting in a charge of £nil (2016: £0.1m).



In 2017, there were exceptional costs totalling £0.4m (2016: £0.1m) associated with the UK Government reviews and the programme of Corporate Renewal. These costs were treated as exceptional when the matter first arose and consistent treatment is applied in 2017.

In 2017 there were releases of provisions of £0.4m (2016: £0.6m) which were previously charged through exceptional items in relation to the exit of the UK Frontline Clinical Health contracts.

An exceptional charge of £10.7m arose in 2016 in respect of the bulk transfer of a number of employees that are being transferred from the Serco Pension and Life Assurance Scheme (SPLAS) to the Principal Civil Service Pension Scheme. This transfer was legally agreed in December 2016 at which point all obligations of SPLAS to pay retirement benefits for these individuals were eliminated and as a result a settlement charge of £10.7m arose. In 2017 a new agreement was reached with the UK Government to transfer out the scheme members on an individual basis and the 2016 legal and commercial arrangements were cancelled by consent of all parties. As a result of the changes, the impact of the transfer was treated as an experience gain adjustment through other comprehensive income and the majority of the provision made in 2016 was reversed, resulting in a £10.3m credit to exceptional items.

In 2016 a review of a joint venture's cash flow projections led to the impairment of certain equity interests and associated receivables balances, totalling £13.9m. The impairment was outside of the normal course of business and of a significant value, and was therefore considered to be an exceptional item. In the year ended 31 December 2017 payments of £4.5m were received against the impaired loan. The likelihood of further receivables remains uncertain.

As a result of contracts coming to the end of their natural lives and no significant new contracts being awarded by the customer, the remaining customer relationship intangible assets of the DMS Maritime Pty Limited business acquired in 2012 were impaired, totalling £6.1m.

## **Tax impact of above items**

Exceptional tax for the year was a tax charge of £5.0m (2016: £3.1m credit) comprising a £2.3m credit on exceptional items within operating profit and a £7.3m charge in respect of other exceptional tax items.

Exceptional costs of £19.6m only gave rise to a credit of £2.3m, as the majority of these costs were incurred in the UK where they only impact our unrecognised deferred tax in relation to losses.

The other exceptional tax items relate to two matters, the first is the impact on tax of the pension buy-in in the year which led to a £95.0m reduction in the IFRS valuation of the Group's defined benefit pension schemes and consequently a deferred tax charge to the income statement of £16.1m. Movements in the valuation of the Group's defined benefit pension schemes and the associated deferred tax impact are reported in the Statement of Comprehensive Income (SOCl) and do not flow through the income statement, therefore do not impact profit before tax or the tax charge. However, the net amount of deferred tax recognised in the balance sheet relates to both the pension accounting and other timing differences, such as recoverable losses. As the net deferred tax balance sheet position is at the level supported by future profit forecasts, the decrease in the deferred tax liability associated with the pension scheme (with the benefit reported in the SOCl) leads to a corresponding decrease in the deferred tax asset to match the future profit forecasts. Such a reduction in the deferred tax asset therefore leads to a charge to tax in the income statement. Where deferred tax charges or releases are the result of movements in the pension scheme valuations rather than trading activity, these are excluded from the calculation of tax on underlying profit and the underlying effective tax rate, with the prior periods being restated to reflect this. These amounted to £1.9m for 2017 (2016: £nil).

The second element is a credit of £8.8m related to legislative changes in the UK and the US which have impacted the value of deferred tax held on the balance sheet. There is a reduction in the deferred tax liability that is held in connection with our US operations of £12.5m, as future US tax liabilities are expected to crystallise at lower US tax rates. The fall in future expected US rates is primarily due to the enactment of the Tax Cuts & Jobs Act in December 2017 which reduces the corporate income tax rate in the US from 35% to 21% effective from 1 January 2018. In addition, there was a change in UK tax law in 2017. This UK change will reduce the quantum of loss brought forward that can be used to offset taxable profits arising in a year, and will also enable losses carried forward in one company to be used to offset profits in another. The combined impact of these UK law changes results in a tax charge of £3.7m.

## 9. Investment revenue

Year ended 31 December	2017 £m	2016 £m
Interest receivable on other loans and deposits	2.6	3.6
Net interest receivable on retirement benefit obligations (note 18)	3.8	4.7
Movement in discount on other debtors	1.2	1.0
	7.6	9.3

## 10. Finance costs

Year ended 31 December	2017 £m	2016 £m
Interest payable on obligations under finance leases	1.3	1.6
Interest payable on other loans	14.0	15.6
Facility fees and other charges	3.0	3.5
Movement in discount on provisions	1.3	2.4
	19.6	23.1
Foreign exchange on financing activities	(0.4)	(1.2)
	19.2	21.9

## 11. Tax

### 11 (a) Income tax recognised in the income statement

Year ended 31 December	Before exceptional items 2017 £m	Exceptional items 2017 £m	Total 2017 £m	Before exceptional items 2016 £m	Exceptional items 2016 £m	Total 2016 £m
<b>Current income tax</b>						
Current income tax charge / (credit)	14.6	(2.3)	12.3	12.1	(1.3)	10.8
Adjustments in respect of prior years	(0.8)	-	(0.8)	3.6	-	3.6
<b>Deferred tax</b>						
Current year charge / (credit)	2.1	7.3	9.4	1.2	(1.8)	(0.6)
Adjustments in respect of prior years	(1.9)	-	(1.9)	(1.1)	-	(1.1)
	14.0	5.0	19.0	15.8	(3.1)	12.7

The tax expense for the year can be reconciled to the profit in the Condensed Consolidated Income Statement as follows:

Year ended 31 December	Before exceptional items 2017 £m	Exceptional items 2017 £m	Total 2017 £m	Before exceptional items 2016 £m	Exceptional items 2016 £m	Total 2016 £m
<b>Profit before tax</b>	38.7	(19.6)	19.1	85.9	(56.3)	29.6
Tax calculated at a rate of 19.25% (2016: 20.00%)	7.5	(3.8)	3.7	17.1	(11.2)	5.9
Expenses not deductible for tax purposes*	5.9	0.3	6.2	5.7	9.2	14.9
UK unprovided deferred tax**	(4.6)	2.9	(1.7)	(3.9)	-	(3.9)
Other unprovided deferred tax	2.3	0.1	2.4	0.3	1.0	1.3
Effect of the use of unrecognised tax losses	(1.2)	(0.5)	(1.7)	(3.1)	-	(3.1)
Impact of changes in statutory tax rates on current income tax	1.3	(2.2)	(0.9)	-	-	-
Change in deferred tax as a result of legislative changes	-	(8.8)	(8.8)	-	-	-
Overseas rate differences	9.6	(0.8)	8.8	4.6	-	4.6
Other non taxable income	(0.9)	(0.5)	(1.4)	(0.7)	(0.4)	(1.1)
Adjustments in respect of prior years	(2.9)	-	(2.9)	2.5	-	2.5
Adjustments in respect of deferred tax on pensions	2.2	18.3	20.5	-	(1.7)	(1.7)
Adjustments in respect of equity accounted investments	(5.2)	-	(5.2)	(6.7)	-	(6.7)
<b>Tax charge</b>	<b>14.0</b>	<b>5.0</b>	<b>19.0</b>	<b>15.8</b>	<b>(3.1)</b>	<b>12.7</b>

\* Relates to costs that are not allowable for tax deduction under local tax law. Non deductible expenses in relation to exceptional items relate mainly to capital expenses, such as the impairments that are not deductible for tax.

\*\* Arises due to timing differences between when an amount is recognised in the income statement and when the amount is subject to UK tax. In the current year, the Group has received tax deductions for amounts which have been charged to the income statement in previous periods in connection with items such as fixed assets.

The income tax charge for the year is based on the blended UK statutory rate of corporation tax for the period of 19.25% (2016: 20.00%). Taxation for other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

## 11 (b) Income tax recognised in the SOCI

Year ended 31 December	2017 £m	2016 £m
<b>Current tax</b>		
Taken to retirement benefit obligations reserve	-	-
<b>Deferred tax</b>		
Taken to retirement benefit obligations reserve	18.1	(1.7)
	<b>18.1</b>	<b>(1.7)</b>

## 12. Deferred tax

Deferred income taxes are calculated in full on temporary differences under the liability method using local substantively enacted tax rates.

The movement in net deferred tax assets during the year was as follows:

	2017 £m	2016 £m
At 1 January - asset	(20.3)	(19.9)
Income statement charge/(credit)	7.6	(2.0)
Items recognised in equity and in other comprehensive income	(18.1)	1.7
Arising on acquisition	(1.0)	-
Exchange differences	(2.8)	(0.1)
<b>At 31 December - asset</b>	<b>(34.6)</b>	<b>(20.3)</b>

The movement in deferred tax assets and liabilities during the year was as follows:

	Temporary differences on assets / intangibles £m	Share based payment and employee benefits £m	Retirement benefit schemes £m	OCPs £m	Tax losses £m	Other temporary differences £m	Total £m
At 1 January 2017	36.5	(12.0)	17.6	(17.8)	(10.3)	(34.3)	(20.3)
(Credited) / charged to income statement (note 11a)	(6.7)	0.3	2.8	9.2	(8.4)	10.4	7.6
Items recognised in equity and in other comprehensive income (note 11b)	-	-	(18.1)	-	-	-	(18.1)
Arising on acquisition	(0.1)	(0.9)	-	-	-	-	(1.0)
Exchange differences	(3.9)	0.4	0.2	0.7	-	(0.2)	(2.8)
<b>At 31 December 2017</b>	<b>25.8</b>	<b>(12.2)</b>	<b>2.5</b>	<b>(7.9)</b>	<b>(18.7)</b>	<b>(24.1)</b>	<b>(34.6)</b>

Of the amount credited to the income statement, £0.1m (2016: £0.3m) has been taken to costs of sales in respect of the R&D Expenditure credit. Other temporary differences include a deferred tax asset of £nil in respect of derivative financial instruments (2016: £0.1m).

The movement in deferred tax assets and liabilities during the previous year was as follows:

	Temporary differences on assets / intangibles £m	Share based payment and employee benefits £m	Retirement benefit schemes £m	OCPs £m	Tax losses £m	Other temporary differences £m	Total £m
At 1 January 2016	26.8	(9.7)	17.8	(28.3)	(10.8)	(15.7)	(19.9)
(Credited) / charged to income statement (note 11a)	0.9	(0.5)	(1.5)	14.7	0.6	(16.2)	(2.0)
Items recognised in equity and in other comprehensive income (note 11b)	-	-	1.7	-	-	-	1.7
Exchange differences	8.8	(1.8)	(0.4)	(4.2)	(0.1)	(2.4)	(0.1)
<b>At 31 December 2016</b>	<b>36.5</b>	<b>(12.0)</b>	<b>17.6</b>	<b>(17.8)</b>	<b>(10.3)</b>	<b>(34.3)</b>	<b>(20.3)</b>

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority. The following is the analysis of the deferred tax balances (after offset) for financial reporting purposes:

	2017 £m	2016 £m
Deferred tax liabilities	20.4	30.5
Deferred tax assets	(55.0)	(50.8)
	(34.6)	(20.3)

As at the balance sheet date, the UK has a potential deferred tax asset of £177m (2016: £147m) available for offset against future profits. A deferred tax asset has currently been recognised of £17.4m. Recognition has been based on forecast future taxable profits. No deferred tax asset has been recognised in respect of the remaining asset (net £160m) based on current forecasts; additional asset recognition is contingent on further improvement in the UK profit forecast. In the summer of 2016, UK Government announced a reduction in the UK corporation tax rate from 20% to 19% effective from April 2017. Further measures enacted during 2016 cut the rate further from April 2020 to 17%. These measures have reduced the UK 2017 current tax credit and will reduce the Group's future current tax charge accordingly. The deferred tax balance at 31 December 2017 has been calculated reflecting these rates. In addition, the fall in the future expected US tax rates due to the enactment of the Tax Cuts & Jobs Act in December 2017 has generated a £12.5m deferred tax credit in 2017 due to the calculation of the US deferred tax liability at 31 December 2017 using these reduced rates.

Losses of £0.1m (2016: £0.1m) expire within 5 years, losses of £0.1m (2016 £0.2m) expire within 6-10 years, losses of £4.1m (2016 £8.6m) expire within 20 years and losses of £998.4m (2016 £884.6m) may be carried forward indefinitely.

### 13. Earnings per share

Basic and diluted earnings per ordinary share (EPS) have been calculated in accordance with IAS33 *Earnings per Share*.

The calculation of the basic and diluted EPS is based on the following data:

Number of shares	2017 millions	2016 millions
Weighted average number of ordinary shares for the purpose of basic EPS	1,089.7	1,088.3
Effect of dilutive potential ordinary shares: Share options	44.9	37.3
Weighted average number of ordinary shares for the purpose of diluted EPS	1,134.6	1,125.6

At 31 December 2017 options over 236,616 (2016: 246,818) shares were excluded from the weighted average number of shares used for calculating diluted earnings per share because their exercise price was above the average share price for the year and they were, therefore, anti-dilutive.

Due to the loss making position of the combined continuing and discontinued operations in 2016 and for continuing in 2017, the dilutive impact has not been separately disclosed for those measures of profitability.



## Earnings per share for continuing and discontinued operations

	Earnings 2017 £m	Per share amount 2017 pence	Earnings 2016 £m	Per share amount 2016 pence
<b>Basic EPS</b>				
Earnings for the purpose of basic EPS	(0.2)	(0.02)	(1.2)	(0.11)
<b>Basic EPS excluding exceptional items</b>				
Earnings for the purpose of basic EPS	(0.2)	(0.02)	(1.2)	(0.11)
Add back exceptional items	19.6	1.80	70.9	6.51
Add back tax on exceptional items	5.0	0.46	(3.1)	(0.28)
Earnings excluding exceptional operating items for the purpose of basic EPS	24.4	2.24	66.6	6.12

## Earnings per share for continuing operations

	Earnings 2017 £m	Per share amount 2017 pence	Earnings 2016 £m	Per share amount 2016 pence
<b>Basic EPS</b>				
Earnings for the purpose of basic EPS	(0.2)	(0.02)	16.9	1.55
Effect of dilutive potential ordinary shares	-	-	-	(0.05)
Diluted EPS	(0.2)	(0.02)	16.9	1.50
<b>Basic EPS excluding exceptional items</b>				
Earnings for the purpose of basic EPS	(0.2)	(0.02)	16.9	1.55
Add back exceptional items	19.6	1.80	56.3	5.17
Add back tax on exceptional items	5.0	0.46	(3.1)	(0.28)
Earnings excluding exceptional operating items for the purpose of basic EPS	24.4	2.24	70.1	6.44

## Earnings per share discontinued

	Earnings 2017 £m	Per share amount 2017 pence	Earnings 2016 £m	Per share amount 2016 pence
<b>Basic EPS</b>				
Earnings for the purpose of basic EPS	-	-	(18.1)	(1.66)
<b>Basic EPS excluding exceptional items</b>				
Earnings for the purpose of basic EPS	-	-	(18.1)	(1.66)
Add back exceptional items	-	-	14.6	1.34
Earnings excluding exceptional operating items for the purpose of basic EPS	-	-	(3.5)	(0.32)

## 14. Goodwill

	Cost £m	Accumulated impairment losses £m	Carrying amount £m
At 1 January 2016	799.1	(289.2)	509.9
Exchange differences	109.6	(41.6)	68.0
Acquisitions	17.8	-	17.8
Impairment (exceptional)	-	(17.8)	(17.8)
<b>At 1 January 2017</b>	<b>926.5</b>	<b>(348.6)</b>	<b>577.9</b>
Exchange differences	(48.5)	21.9	(26.6)
<b>At 31 December 2017</b>	<b>878.0</b>	<b>(326.7)</b>	<b>551.3</b>

Movements in the balance since the prior year end can be seen as follows:

	Goodwill balance 1 January 2017 £m	Additions 2017 £m	Exchange differences 2017 £m	Impairment 2017 £m	Goodwill balance 31 December 2017 £m	Headroom on impairment analysis 2017 £m	Headroom on impairment analysis 2016 £m
UK & Europe							
Justice & Immigration	49.6	-	-	-	49.6	127.4	126.3
Health	60.6	-	-	-	60.6	19.4	3.2
Direct Services & Europe	66.5	-	0.8	-	67.3	71.5	99.0
Americas	277.9	-	(24.9)	-	253.0	151.8	66.5
AsPac	112.4	-	(1.6)	-	110.8	231.6	203.2
Middle East	10.9	-	(0.9)	-	10.0	145.6	114.7
	<b>577.9</b>	<b>-</b>	<b>(26.6)</b>	<b>-</b>	<b>551.3</b>	<b>747.3</b>	<b>612.9</b>

Included above is the detail of the headroom on the CGUs existing at the year end which reflects where future discounted cash flows are greater than the underlying assets and includes all relevant cash flows, including where provisions have been made for future costs and losses.

The key assumptions applied in the impairment review are set out below:

	Discount rate 2017 %	Discount rate 2016* %	Terminal growth rates 2017 %	Terminal growth rates 2016 %
UK & Europe				
Justice & Immigration	10.4	11.2	2.0	2.0
Health	10.4	11.2	2.0	2.0
Direct Services & Europe	11.7	12.5	2.0	2.0
Americas	10.5	12.3	2.4	2.4
AsPac	9.7	11.2	2.4	2.4
Middle East	10.8	10.7	2.5	2.2

\* Restated based on rates applied in impairment testing calculations in the prior year.

### Discount rate

Pre-tax discount rates, derived from the Group's post-tax weighted average cost of capital have been used in discounting the projected cash flows. These rates are reviewed annually with external advisers and are adjusted for risks specific to the market in which the CGU operates.

## Short term growth rates

The annual impairment test is performed immediately prior to the year end, based initially on five year cash flow forecasts approved by senior management. Short term revenue growth rates used in each CGU five year plan are based on internal data regarding our current contracted position, the pipeline of opportunities and forecast growth for the relevant market.

Short term profitability and cash conversion is based on our historic experiences and a level of judgement is applied to expected changes in both. Where businesses have been poor performers in recent history, turnaround has only been assumed where a detailed and achievable plan is in place and all forecasts include cash flows relating to contracts where onerous contract provisions have been made.

## Terminal growth rates

The calculations include a terminal value based on the projections for the fifth year of the short term plan, with a growth rate assumption applied which extrapolates the business into perpetuity. The terminal growth rates are based on long term inflation rates of the geographic market in which the CGUs operate and therefore do not exceed the average long term growth rates forecast for the individual markets. These are provided by external sources.

## Sensitivity analysis

Sensitivity analysis has been performed for each key assumption, a 1% movement in discount rates and a 1% movement in terminal growth rates are considered to be reasonably possible. The only CGU impacted by a reasonably possible change in a key assumption is Health where a 1% increase in discount rates and a 1% decrease in terminal growth rates would result in an impairment of £4.2m. The breakeven point of Health goodwill impairment is a 0.8% increase in discount rate combined with a 0.8% decrease in terminal growth rate. A reduction of £2.0m in the terminal year cash flows for the Health CGU would lead to the recoverable amount no longer exceeding the carrying value. Any additional reduction in terminal year cash flows would result in an impairment of the goodwill of this CGU.

## 15. Analysis of Net Debt

	At 1 January 2017 £m	Cash flow £m	Reclassified as held for sale £m	Acquisitions* £m	Disposals £m	Exchange differences £m	Non cash movements £m	At 31 December 2017 £m
Loans payable	(299.9)	3.8	-	-	-	25.4	(0.8)	(271.5)
Obligations under finance leases	(28.2)	12.6	-	-	-	0.1	(4.7)	(20.2)
<b>Liabilities arising from financing activities</b>	<b>(328.1)</b>	<b>16.4</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>25.5</b>	<b>(5.5)</b>	<b>(291.7)</b>
Cash and cash equivalents	177.8	(57.3)	-	1.5	(7.1)	(2.8)	-	112.1
Loan receivables	22.9	(0.6)	-	-	-	-	3.4	25.7
Derivatives relating to Net Debt	18.1	-	-	-	-	(5.3)	-	12.8
<b>Net Debt</b>	<b>(109.3)</b>	<b>(41.5)</b>	<b>-</b>	<b>1.5</b>	<b>(7.1)</b>	<b>17.4</b>	<b>(2.1)</b>	<b>(141.1)</b>

	At 1 January 2016 £m	Cash flow £m	Reclassified as held for sale £m	Acquisitions* £m	Disposals £m	Exchange differences £m	Non cash movements £m	At 31 December 2016 £m
Loans payable	(381.9)	135.8	-	-	-	(52.8)	(1.0)	(299.9)
Obligations under finance leases	(43.8)	16.7	(0.2)	-	-	(0.4)	(0.5)	(28.2)
<b>Liabilities arising from financing activities</b>	<b>(425.7)</b>	<b>152.5</b>	<b>(0.2)</b>	<b>-</b>	<b>-</b>	<b>(53.2)</b>	<b>(1.5)</b>	<b>(328.1)</b>
Cash and cash equivalents	323.6	(153.7)	-	0.1	-	7.8	-	177.8
Loan receivables	19.9	-	-	-	-	0.1	2.9	22.9
Derivatives relating to Net Debt	14.6	-	-	-	-	3.5	-	18.1
<b>Net Debt</b>	<b>(67.6)</b>	<b>(1.2)</b>	<b>(0.2)</b>	<b>0.1</b>	<b>-</b>	<b>(41.8)</b>	<b>1.4</b>	<b>(109.3)</b>

\* Acquisitions represent the net cash / (debt) acquired on acquisition.

## 16. Provisions

	Employee related £m	Property £m	Contract £m	Other £m	Total £m
<b>At 1 January 2017</b>	45.1	15.2	220.2	141.2	421.7
Arising on acquisition	1.7	-	-	-	1.7
Eliminated on disposal of subsidiary	-	-	-	(0.5)	(0.5)
Charged to income statement – exceptional	4.5	2.7	-	0.1	7.3
Charged to income statement – other	17.5	2.4	62.0	8.6	90.5
Released to income statement – exceptional	(0.9)	(1.3)	(0.4)	(10.5)	(13.1)
Released to income statement – other	(4.9)	(1.4)	(43.0)	(9.0)	(58.3)
Utilised during the year	(4.9)	(3.1)	(69.3)	(5.0)	(82.3)
Unwinding of discount	-	-	1.3	-	1.3
Exchange differences	(2.4)	(0.2)	(2.6)	(3.1)	(8.3)
<b>At 31 December 2017</b>	55.7	14.3	168.2	121.8	360.0
<b>Analysed as:</b>					
Current	17.1	4.4	68.0	59.0	148.5
Non current	38.6	9.9	100.2	62.8	211.5
	55.7	14.3	168.2	121.8	360.0

Contract provisions relate to onerous contracts which will be utilised over the life of each individual contract, up to a maximum of 7 years from the balance sheet date. The present value of the estimated future cash outflow required to settle the contract obligations as they fall due over the respective contracts has been used in determining the provision. The individual provisions are discounted where the impact is assessed to be significant. Discount rates used are calculated based on the estimated risk free rate of interest for the region in which the provision is located and matched against the ageing profile of the provision. In 2017, additional charges have been made in respect of future losses on a number of onerous contracts totalling £62.0m. This increase related to revisions to existing OCPs of £61.5m and a new provision raised on one contract totalling £0.5m.

## 17. Contingent liabilities

The Company has guaranteed overdrafts, finance leases, and bonding facilities of its joint ventures and associates up to a maximum value of £4.3m (2016: £20.4m). The actual commitment outstanding at 31 December 2017 was £4.3m (2016: £17.9m).

The Company and its subsidiaries have provided certain guarantees and indemnities in respect of performance and other bonds, issued by its banks on its behalf in the ordinary course of business. The total commitment outstanding as at 31 December 2017 was £227.1m (2016: £252.1m).

As we have disclosed before, we are under investigation by the Serious Fraud Office. In November 2013, the UK's Serious Fraud Office announced that it had opened an investigation, which remains ongoing, into the Group's Electronic Monitoring Contract.

We are cooperating fully with the Serious Fraud Office's investigation but it is not possible to predict the outcome. However, a description of the range of possible outcomes in the event that the Serious Fraud Office decides to prosecute the individuals and /or the Serco entities involved will be disclosed in the Principal Risks and Uncertainties section of the Group's Annual Report and Accounts.

The Group is aware of other claims and potential claims which involve or may involve legal proceedings against the Group. The Directors are of the opinion, having regard to legal advice received and the Group's insurance arrangements, that it is unlikely that these matters will, in aggregate, have a material effect on the Group's financial position.

## 18. Defined benefit schemes

### Characteristics

The Group contributes to defined benefit schemes for qualifying employees of its subsidiaries in the UK and Europe. The normal contributions expected to be paid during the financial year ending 31 December 2018 are £7.1m (2017: £9.7m).

Among our non contract specific schemes, the largest is the Serco Pension and Life Assurance Scheme (SPLAS). The most recent full actuarial valuation of this scheme was undertaken as at 5 April 2015 and resulted in an actuarially assessed deficit of £4.0m for funding purposes. Pension obligations are valued separately for accounting and funding purposes and there is often a material difference between these valuations. As at 31 December 2017 the estimated actuarial deficit of SPLAS was £33.7m (2016: £42.6m) based on the actuarial assessment on the funding basis whereas the accounting valuation resulted in an asset of £41.8m. The primary reason a difference arises is that pension scheme accounting requires the valuation to be performed on the basis of a best estimate whereas the funding valuation used by the trustees makes more prudent assumptions. A revised schedule of contributions for SPLAS was agreed during the year, with 29% of pensionable salaries due to be paid from 1 November 2017 to 31 October 2018 and 28% from 1 November 2018 to 18 December 2022. An additional shortfall contribution of £1.0m is due by 30 April 2018 and four further payments of £0.5m payable at the end of each April through to 2022.

### Events in the year

In June 2017 the Trustees of SPLAS entered into a bulk annuity purchase whereby an insurer will fund future benefit payments to the relevant members, commonly referred to as a "buy-in". The liability to pay the members remains with SPLAS and therefore the pension scheme will continue to include the relevant pension liabilities. However, but an insurance asset is held at fair value, which, in line with IAS19 for qualifying insurance policies, is deemed to be equal to the present value of the related obligations. This removes the risk of longevity and investment movements for this portion of the scheme on a funding basis, and also removes the accounting risk of movements in underlying assumptions on the liabilities. Of the total remeasurements recognised in the statement of other comprehensive income in the year ended 31 December 2017 of £106.5m, £95.0m related to the revaluation of the assets and liabilities as a result of this transaction. Whilst the impact substantially reduced the asset on an IAS19 valuation basis, on an actuarial basis the transaction decreased the deficit of the scheme by approximately £12m. As a result of the transaction, the scheme also exited a longevity swap arrangement early, at a cost borne by the scheme of £7.5m.

In 2016, certain active former members of SPLAS on a specific contract were transferred back to a Government backed pension scheme they had previously been members of. This resulted in contribution savings due to lower rates required under the Government Serco scheme and a curtailment gain of £1.9m was recognised in 2016. In 2017 certain of these deferred members transferred their accrued benefits from SPLAS to the Government scheme. The arrangements for this process had been made by a planned transfer on a bulk basis, which resulted in settlement accounting being applied in 2016 and an exceptional charge booked at the time. However, it was subsequently agreed that the Government would allow the transfer of members on an individual basis and as the members are taking an existing option to take an individual transfer out of the scheme, settlement accounting was no longer applicable following the change of arrangements in 2017. The impact of the individuals transferring out is now treated as a change in actuarial assumptions and impacts on reserves, not through the income statement. The remaining provision of £10.3m was therefore reversed through exceptional items in 2017. The impact of the transfer resulted in a charge to other comprehensive income of £5.1m, included within the effect of experience assumptions.

In November 2017 certain members of SPLAS agreed to transfer their active membership to defined contribution schemes and a curtailment gain of £2.0m is recognised in the year in the Group's income statement.



## Values recognised in total comprehensive income in the year

The amounts recognised in the financial statements for the year are analysed as follows:

	Contract specific 2017 £m	Non contract specific 2017 £m	Total 2017 £m
<b>Recognised in the income statement</b>			
Current service cost - employer	1.0	7.6	8.6
Past service cost	-	0.3	0.3
Curtailment gain recognised	-	(2.0)	(2.0)
Administrative expenses and taxes	-	5.3	5.3
<b>Recognised in arriving at operating profit</b>	1.0	11.2	12.2
Interest income on scheme assets - employer	(0.4)	(41.4)	(41.8)
Interest on franchise adjustment	(0.1)	-	(0.1)
Interest cost on scheme liabilities - employer	0.5	37.6	38.1
<b>Finance income</b>	-	(3.8)	(3.8)

	Contract specific 2017 £m	Non contract specific 2017 £m	Total 2017 £m
<b>Included within the SOCI</b>			
Actual return on scheme assets	11.0	(50.7)	(39.7)
Less: interest income on scheme assets	(0.4)	(41.4)	(41.8)
	10.6	(92.1)	(81.5)
Effect of changes in demographic assumptions	-	1.0	1.0
Effect of changes in financial assumptions	(10.3)	(21.3)	(31.6)
Effect of experience adjustments	0.8	4.8	5.6
<b>Remeasurements</b>	1.1	(107.6)	(106.5)
Change in franchise adjustment	(0.2)	-	(0.2)
Change in members' share	(0.4)	-	(0.4)
<b>Actuarial losses on reimbursable rights</b>	(0.6)	-	(0.6)
<b>Total pension gain recognised in the SOCI</b>	0.5	(107.6)	(107.1)

	Contract specific 2016 £m	Non contract specific 2016 £m	Total 2016 £m
<b>Recognised in the income statement</b>			
Current service cost - employer	0.4	7.4	7.8
Past service cost	-	0.4	0.4
Curtailment loss recognised	-	(1.9)	(1.9)
Administrative expenses and taxes	-	5.4	5.4
<b>Recognised in arriving at operating profit</b>	0.4	11.3	11.7
Interest income on scheme assets - employer	(0.1)	(49.0)	(49.1)
Interest on franchise adjustment	(0.1)	-	(0.1)
Interest cost on scheme liabilities - employer	0.2	44.3	44.5
<b>Finance income</b>	-	(4.7)	(4.7)

	Contract specific 2016 £m	Non contract specific 2016 £m	Total 2016 £m
<b>Included within the SOCI</b>			
Actual return on scheme assets	0.9	285.2	286.1
Less: interest income on scheme assets	(0.2)	(49.0)	(49.2)
	0.7	236.2	236.9
Effect of changes in demographic assumptions	-	26.2	26.2
Effect of changes in financial assumptions	(3.5)	(279.3)	(282.8)
Effect of experience adjustments	-	28.7	28.7
<b>Remeasurements</b>	(2.8)	11.8	9.0
Change in franchise adjustment	1.7	-	1.7
Change in members' share	1.2	-	1.2
<b>Actuarial losses on reimbursable rights</b>	2.9	-	2.9
<b>Total pension gain recognised in the SOCI</b>	0.1	11.8	11.9

## Balance sheet values

The assets and liabilities of the schemes at 31 December are:

	Contract specific 2017 £m	Non contract specific 2017 £m	Total 2017 £m
<b>Scheme assets at fair value</b>			
Equities	9.9	46.3	56.2
Bonds except LDIs	2.9	20.8	23.7
LDIs	-	709.8	709.8
Gilts	0.2	-	0.2
Property	1.6	-	1.6
Cash and other	2.8	3.2	6.0
Annuity policies	-	587.5	587.5
Fair value of scheme assets	17.4	1,367.6	1,385.0
Present value of scheme liabilities	(23.4)	(1,341.3)	(1,364.7)
Net amount recognised	(6.0)	26.3	20.3
Franchise adjustment*	3.6	-	3.6
Members' share of deficit	2.4	-	2.4
<b>Net retirement benefit asset</b>	-	26.3	26.3
Net pension liability	-	(15.5)	(15.5)
Net pension asset	-	41.8	41.8
Net retirement benefit asset	-	26.3	26.3
Deferred tax liabilities	-	(2.5)	(2.5)
<b>Net retirement benefit asset (after tax)</b>	-	23.8	23.8

\* The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period.

	Contract specific 2016 £m	Non contract specific 2016 £m	Total 2016 £m
<b>Scheme assets at fair value</b>			
Equities	3.3	43.3	46.6
Bonds except LDIs	0.7	20.2	20.9
LDIs	-	1,390.6	1,390.6
Gilts	-	72.4	72.4
Property	0.6	-	0.6
Cash and other	1.2	4.2	5.4
Annuity policies	-	20.0	20.0
Fair value of scheme assets	5.8	1,550.7	1,556.5
Present value of scheme liabilities	(12.0)	(1,418.0)	(1,430.0)
Net amount recognised	(6.2)	132.7	126.5
Franchise adjustment*	3.7	-	3.7
Members' share of deficit	2.5	-	2.5
<b>Net retirement benefit asset</b>	-	132.7	132.7
Net pension liability	-	(17.7)	(17.7)
Net pension asset	-	150.4	150.4
Net retirement benefit asset	-	132.7	132.7
Deferred tax liabilities	-	(17.6)	(17.6)
<b>Net retirement benefit asset (after tax)</b>	-	115.1	115.1

\* The franchise adjustment represents the amount of scheme deficit that is expected to be funded outside the contract period.

## Actuarial assumptions: SPLAS

The assumptions set out below are for SPLAS, which reflects 92% of total liabilities and 94% of total assets of the defined benefit pension scheme in which the Group participates. The significant actuarial assumptions with regards to the determination of the defined benefit obligation are set out below.

The average duration of the benefit obligation at the end of the reporting period is 17.9 years (2016: 17.7 years).

Main assumptions	2017 %	2016 %
Rate of salary increases	2.70	2.80
Rate of increase in pensions in payment	2.30 (CPI) and 3.00 (RPI)	2.30 (CPI) and 3.30 (RPI)
Rate of increase in deferred pensions	2.30 (CPI) and 3.00 (RPI)	2.30 (CPI) and 3.30 (RPI)
Inflation assumption	2.20 (CPI) and 3.20 (RPI)	2.30 (CPI) and 3.30 (RPI)
Discount rate	2.50	2.70
<b>Post retirement mortality</b>	<b>2017 years</b>	<b>2016 years</b>
Current pensioners at 65 - male	22.5	22.5
Current pensioners at 65 - female	25.1	25.0
Future pensioners at 65 - male	24.3	24.2
Future pensioners at 65 - female	26.9	26.9

Sensitivity analysis is provided below, based on reasonably possible changes of the assumptions occurring at the end of the reporting period, assuming all other assumptions are held constant. The sensitivities have been derived in the same manner as the defined benefit obligation as at 31 December 2017 where the defined benefit obligation is estimated using the Projected Unit Credit method. Under this method each participant's benefits are attributed to years of service, taking into consideration future salary increases and the scheme's benefit allocation formula. Thus, the estimated total pension to which each participant is expected to become entitled at retirement is broken down into units, each associated with a year of past or future credited service. The defined benefit obligation as at 31 December 2017 is calculated on the actuarial assumptions agreed as at that date. The sensitivities are calculated by changing each assumption in turn following the methodology above with all other things held constant. The

change in the defined benefit obligation from updating the single assumption represents the impact of that assumption on the calculation of the defined benefit obligation.

	2017 £m	2016 £m
Discount rate - 0.5% increase	(107.9)	(116.5)
Discount rate - 0.5% decrease	122.0	132.5
Inflation - 0.5% increase	83.4	106.1
Inflation - 0.5% decrease	(78.0)	(87.6)
Rate of salary increase - 0.5% increase	3.6	7.8
Rate of salary increase - 0.5% decrease	(3.5)	(7.4)
Mortality - one year age rating	41.6	44.2

## 19. Related party transactions

Transactions between the Company and its wholly owned subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. Transactions between the Group and its joint venture undertakings and associates are disclosed below.

### Transactions

During the year, Group companies entered into the following transactions with joint ventures and associates:

	Transactions 2017 £m	Current outstanding at 31 December 2017 £m	Non current outstanding at 31 December 2017 £m
<b>Sale of goods and services</b>			
Joint ventures	0.5	0.1	-
Associates	7.1	0.5	-
<b>Other</b>			
Dividends received - joint ventures	11.1	-	-
Dividends received - associates	17.1	-	-
Receivable from consortium for tax - joint ventures	2.4	5.3	-
<b>Total</b>	<b>38.2</b>	<b>5.9</b>	<b>-</b>

Joint venture receivable and loan amounts outstanding have arisen from transactions undertaken during the general course of trading, are unsecured, and will be settled in cash. Interest arising on loans is based on LIBOR, or its equivalent, with an appropriate margin. No guarantee has been given or received. The only loan amounts owed by joint ventures or associates related to a single entity which have been provided for in full.

	Transactions 2016 £m	Current outstanding at 31 December 2016 £m	Non current outstanding at 31 December 2016 £m
<b>Sale of goods and services</b>			
Joint ventures	0.5	0.1	-
Associates	6.2	0.5	-
<b>Other</b>			
Dividends received - joint ventures	20.4	-	-
Dividends received - associates	19.6	-	-
Receivable from consortium for tax - joint ventures	3.2	7.7	-
<b>Total</b>	<b>49.9</b>	<b>8.3</b>	<b>-</b>

## Remuneration of key management personnel

The Directors of Serco Group plc had no material transactions with the Group during the year other than service contracts and Directors' liability insurance.

The remuneration of the key management personnel of the Group is set out below in aggregate for each of the categories specified in IAS24 *Related Party Disclosures*:

	2017 £m	2016 £m
Short-term employee benefits	12.5	11.9
Share based payment expense	6.2	4.7
	18.7	16.6

The key management personnel comprise the Executive Directors, Non-Executive Directors and members of the Executive Committee (2017: 23 individuals, 2016: 20 individuals).

## Aggregate directors' remuneration

The total amounts for directors' remuneration in accordance with Schedule 5 to the Accounting Regulations were as follows:

	2017 £m	2016 £m
Salaries, fees, bonuses and benefits in kind	5.5	5.6
Amounts receivable under long-term incentive schemes	6.3	5.6
Gains on exercise of share options	0.1	-
	11.9	11.2

None of the directors are members of the company's defined benefit pension scheme.

One director is a member of the money purchase scheme.

## 20. Notes to the Condensed Consolidated Cash Flow Statement

Year ended 31 December	2017 Before exceptional items £m	2017 Exceptional items £m	2017 Total £m	2016 Before exceptional items £m	2016 Exceptional items £m	2016 Total £m
Operating profit for the year - continuing operations	49.6	(19.6)	30.0	98.5	(56.3)	42.2
Operating loss for the year - discontinued operations	-	-	-	(3.3)	(14.2)	(17.5)
<b>Operating profit for the year</b>	<b>49.6</b>	<b>(19.6)</b>	<b>30.0</b>	<b>95.2</b>	<b>(70.5)</b>	<b>24.7</b>
Adjustments for:						
Share of profits in joint ventures and associates	(27.3)	-	(27.3)	(33.4)	-	(33.4)
Share based payment expense	11.4	-	11.4	9.7	-	9.7
Exceptional impairment of goodwill	-	-	-	-	17.8	17.8
Exceptional impairment of property, plant and equipment	-	-	-	-	(0.8)	(0.8)
Exceptional impairment of intangible assets	-	8.9	8.9	-	0.3	0.3
Impairment and write down of intangible assets	(0.1)	-	(0.1)	0.7	-	0.7
Impairment of property, plant and equipment	-	-	-	0.7	-	0.7
Depreciation of property, plant and equipment	24.3	-	24.3	24.8	-	24.8
Amortisation of intangible assets	25.8	-	25.8	26.2	-	26.2
Exceptional profit on disposal of subsidiaries and operations	-	(0.3)	(0.3)	-	(0.1)	(0.1)
Loss on disposal of property, plant and equipment	0.3	-	0.3	0.4	-	0.4
Loss on disposal of intangible assets	0.3	-	0.3	0.8	-	0.8
Non cash R&D expenditure offset against intangible assets	(0.7)	-	(0.7)	0.2	-	0.2
Decrease in provisions	(46.4)	(9.6)	(56.0)	(118.4)	(1.1)	(119.5)
Other non cash movements	0.1	-	0.1	0.4	-	0.4
<b>Total non cash items</b>	<b>(12.3)</b>	<b>(1.0)</b>	<b>(13.3)</b>	<b>(87.9)</b>	<b>16.1</b>	<b>(71.8)</b>
<b>Operating cash inflow / (outflow) before movements in working capital</b>	<b>37.3</b>	<b>(20.6)</b>	<b>16.7</b>	<b>7.3</b>	<b>(54.4)</b>	<b>(47.1)</b>
Decrease in inventories	3.7	-	3.7	1.3	-	1.3
Decrease in receivables	8.1	4.5	12.6	59.0	13.9	72.9
Decrease in payables	(20.8)	(16.4)	(37.2)	(84.0)	0.6	(83.4)
<b>Movements in working capital</b>	<b>(9.0)</b>	<b>(11.9)</b>	<b>(20.9)</b>	<b>(23.7)</b>	<b>14.5</b>	<b>(9.2)</b>
<b>Cash generated by operations</b>	<b>28.3</b>	<b>(32.5)</b>	<b>(4.2)</b>	<b>(16.4)</b>	<b>(39.9)</b>	<b>(56.3)</b>
Tax paid	(11.4)	-	(11.4)	(5.6)	-	(5.6)
Non cash R&D expenditure	(0.2)	-	(0.2)	(0.4)	-	(0.4)
<b>Net cash (outflow) / inflow from operating activities</b>	<b>16.7</b>	<b>(32.5)</b>	<b>(15.8)</b>	<b>(22.4)</b>	<b>(39.9)</b>	<b>(62.3)</b>

Additions to property, plant and equipment during the year amounting to £4.7m (2016: £0.5m) were financed by new finance leases.

## 21. Post balance sheet events

On 26 January 2018, the Group acquired 100% of the issued share capital of BTP Systems, LLC (BTP), for consideration of US Dollar \$20.5m / £14.5m in cash. BTP provides satellite communications (SATCOM), radar modernization, operations and maintenance and sustainment services that enable customers to extend the lives of existing systems and achieve phased upgrades with new technology to enhance operational capability. BTP specializes in areas including obsolescence engineering, systems engineering services, test equipment and design, and field engineering services, and maintains a near-field and compact antenna test range at their Ludlow, MA headquarters. BTP's expertise spans shipboard and submarine SATCOM antenna systems, MILSTAR command post antennas and radar antennas. No acquisition related costs were incurred. The acquisition is expected to increase the Group's market share. The financial results and impact of this transaction have not been recognised in



# Stock Exchange Announcement



these Condensed Consolidated Financial Statements, the operating results, assets and liabilities will be recognised with effect from 26 January 2018.

	Provisional fair value US Dollar \$m	Provisional fair value £m
Goodwill	13.6	9.6
Acquisition related intangible assets	4.4	3.1
Property, plant and equipment	0.4	0.3
Inventories	0.5	0.4
Trade and other receivables	2.3	1.6
Cash and cash equivalents	1.7	1.2
Trade and other payables	(2.4)	(1.7)
<b>Acquisition date fair value of consideration transferred</b>	<b>20.5</b>	<b>14.5</b>

The Group signed a revised Business Purchase Agreement (BPA) on 13 February 2018 with the Special Managers and Provisional Liquidators acting on behalf of the relevant Carillion plc subsidiaries to acquire a portfolio of selected UK health facilities management contracts. The portfolio has annual revenues of approximately £90m and a weighted average remaining term of 14 years. Upon the receipt by the Special Managers and Provisional Liquidators of the requisite third party consents, each individual contract will be transferred to Serco on a cash-free, debt-free basis, with the consideration to be paid in instalments and to be satisfied using Serco's existing financing facilities. If all the contracts are transferred to Serco under the revised BPA process, the total consideration payable would be £29.7m. The consideration payable is lower than the amount of £47.7m announced on 13 December 2017 in respect of substantially the same contracts that were subject to the initial BPA signed with Carillion plc at that date. The change in consideration reflects the Group's re-evaluation of potential liabilities, indemnities, warranties and the additional working capital investment required as a result of Carillion's liquidation. The financial effects of this transaction have not been recognised at 31 December 2017. As consents are required for each individual contract to be transferred and therefore acquired, at the time the financial statements were authorised for issue, no legal transfer or control of assets had taken place and so no disclosures have been made in respect of the assets and liabilities being acquired. The fair values of the assets and liabilities will be determined at the date when contracts are acquired. It is also not yet possible to provide detailed information about each class of acquired receivables and any contingent liabilities in respect of the acquired contracts.