

what kind of a year HAVE we HAD? a

CHAIRMAN'S STATEMENT

Seroo has delivered another impressive performance – our 15th successive year of strong and profitable growth. In addition we have already secured 91% of our planned revenue for 2003 and 80% of our planned revenue for 2004.

Our markets remain buoyant. Our forward order book continues to grow and, at £7.1bn, is roughly 5.5 times last year's turnover. We are currently addressing a further £12bn of opportunities across a range and scale of activities that ensures we can continue to bid selectively.

Our portfolio approach to a wide range of public sector markets has provided a strong platform during this period of difficult global economic conditions. We remain confident of achieving double-digit growth both this year and over the longer term.



I am delighted to report another excellent performance – our 15th successive year of strong and profitable growth. Turnover was up 16.2% and pre-tax profits rose 26.3% before goodwill, maintaining our record of consistently high growth. In delivering this growth we have continued to convert a high proportion of profits into cash while funding the working capital required to bid successfully and implement new business activities and contracts. This is a very satisfying result for a year that proved unsettling for the support services sector in the UK.

Our vigorous organic growth reflects Serco's key strengths: our long term contract base, ability to enhance customers' operations continuously, and long experience of delivering outsourced public services across a wide range of markets. We have a well-diversified portfolio, rigorous risk management processes integrated with the way we do business, and a selective approach to bidding.

Contract wins during the year totalled £1.2bn. We won 122 new contracts, achieving our target of winning over half of new bids. In addition, we were awarded 180 rebids or extensions to existing contracts, maintaining our success rate of over 90% in this area.

Financial performance

Turnover grew 16.2% to £1.3bn. Pre-tax profits were up 26.3% to £57m before goodwill amortisation and by 22.2% to £48.9m

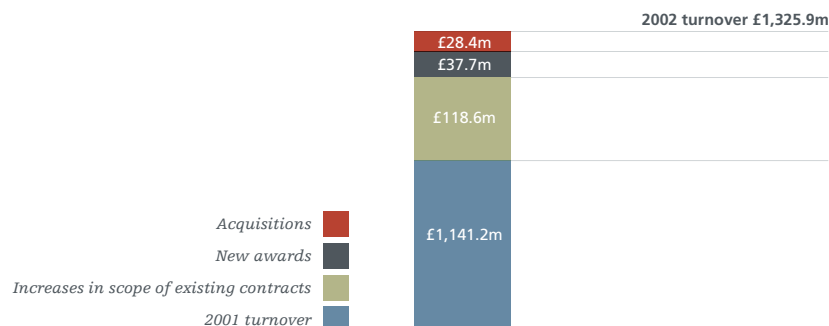
after goodwill amortisation. There were no exceptional items in 2002.

Earnings per share rose 16.1% to 9.58p before goodwill and 10.4% to 7.66p after goodwill.

Cash generation remains robust, with 75.1% of group EBITDA (Earnings Before Interest, Tax, Depreciation and Goodwill Amortisation) converted into cash.

We raised £117.4m through an international placing of new shares in March. This was partly to refinance the September 2001 acquisition of AEA Technology's nuclear consulting business – now successfully integrated into Serco Assurance – and partly to strengthen the balance sheet to facilitate future growth. Since flotation in 1988 Serco has raised new equity totalling £161m – less than our acquisition costs of £180m over the same period. Apart from this, we have funded our growth from under £50m to over £1.3bn annual sales entirely from internally-generated cash flow.

More sophisticated forms of contract inevitably mean more complex financial statements. In response, we have introduced Financial Review sections to our annual and interim results announcements and continue to extend our commentary on relevant aspects of accounting and corporate governance. To help investors better understand our Private Finance Initiative



2002 TURNOVER GROWTH
Including joint ventures

(PFI) projects we have also published *Our Approach to PFIs*. The latest edition, updated in September 2002, is available on our website at www.serco.com or on request.

Dividend

The recommended final dividend of 1.44p per share gives a cumulative dividend for the year of 2.08p – an increase of 11.8% over 2001. It is proposed that the dividend will be paid on 13 May 2003 to shareholders on the register on 28 February 2003 (record date).

Pensions

The recent poor performance of the equity markets has impacted the group's defined benefit pension schemes. A valuation at 31 December 2002 has identified a net deficit of £73.6m in accordance with FRS 17 on our defined benefit schemes. This will result in additional funding and an additional profit and loss charge of £9m per annum. Notwithstanding this increase in contributions, we remain on course to achieve good growth going forward.

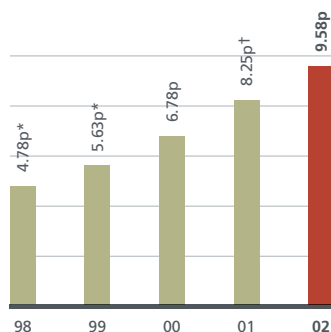
Operational performance

Our business is made up of five distinct areas: defence (which accounted for 27% of 2002 sales), transport (27%), civil government (27%), science (9%) and private sector clients (10%). Within these sectors, revenues from PFI contracts accounted for 12% of total sales.

The year was characterised by strong organic growth built on solid foundations: a track record of effectiveness that attracts and convinces new customers, strategic alliances with partners who enhance our capability and credibility, and an approach to working with customers that encourages partnerships, extensions and broadening of relationships. As in the past, a significant part of our turnover growth has come from add-ons and extensions to existing contracts.

Major contract awards in 2002 included an innovative partnership with the UK's Ministry of Defence (MOD) Warship Support Agency to manage the Devonport, Portsmouth and Clyde marine services contract. This three-year partnership, worth up to £110m, builds on an earlier contract we have had since 1996. We also won a partnership contract to provide communications and information technology services to the Defence Scientific and Technical Laboratory, worth some £10m annually for up to eight years.

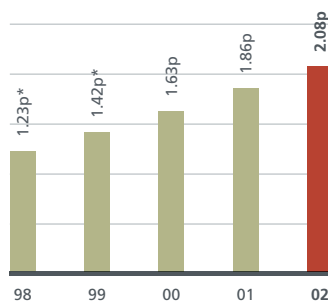
As a member of the Paradigm Secure Communications team, which was selected in February 2002 as preferred bidder to provide and operate Skynet 5 global military satellite communications services, Serco will be providing network and facilities management. This is the largest UK MOD PFI to date, potentially worth some £220m to Serco over 15 years, and good progress continues to be made towards contract signature.



BASIC EARNINGS PER SHARE
Before amortisation of goodwill

* Restated to reflect the capitalisation issue on 5 April 2000.

† Restated after the adoption of UITF Abstract 34 in 2002.



DIVIDEND PER SHARE

As in any year there were a few disappointments – principally our unsuccessful bid to manage the Army Training Estate and Essex County Council's decision not to pursue the outsourcing of educational services. But disappointment over the Essex decision was tempered by continuing growth for our education business in Walsall: the local council transferred a further 300 staff to us, tripling the value of our contract to £100m over the remaining 5½ years. This followed a very favourable review of our performance by Ofsted, the education regulator, which led to a decision to transfer the majority of Walsall's Local Education Authority activities to Serco.

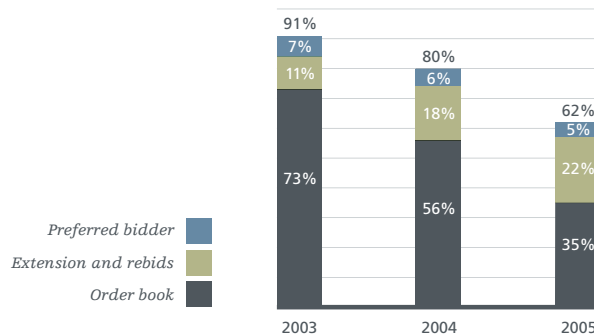
This was one of many cases where strong performance was rewarded with substantial contract extensions. Others included the National Crime Squad, which more than doubled the size of our partnership contract to support its IT operations and to design and develop its Intelligence Management System. In the US, the Federal Aviation Administration significantly broadened our role: we are already one of its largest private providers of air traffic control services, and it has now awarded us a contract to provide weather observation services.

The largest addition of all – indeed, the largest contract ever awarded to the group – was announced in January this year:

a 15-year extension to the contract under which we manage the UK's Atomic Weapons Establishment (AWE) in partnership with Lockheed Martin and British Nuclear Fuels (BNFL). The contract will now run until 2025, adding over £1bn to our forward order book.

Our stature as a light rail operator continues to grow. For an unprecedented second year running we won the UK Rail Operator of the Year award, recognising our operational excellence and innovative customer service on London's Docklands Light Railway (DLR). We intend to build on our achievements with the DLR, Manchester Metrolink and Copenhagen Metro by selectively addressing additional rail operating opportunities. We have formed a joint venture with NedRailways, the international arm of Dutch national rail operator Nederlandse Spoorwegen, to pursue some of these.

In the UK our strategy is to build on our contract base and to expand into new areas. While continuing to grow in our traditional markets, we seek out contracts that require greater managerial or technological sophistication, with structures that focus on outputs rather than specified inputs. We continue to bid for selected PFIs and expect our PFI projects to deliver sustained long term benefits both to the public and to our investors. They and their associated service contracts



NEAR TERM CONFIRMED ORDER BOOK AS AT FEBRUARY 2003

Percentage of planned revenue for the year.

will provide an income stream to supplement our revenues from traditional contracts. Under the auspices of the CBI public services strategy board, we have joined other public service providers in a programme to promote better understanding of the benefits of public private partnerships. This aims to stress their importance and effectiveness in obtaining value for money and diversity in public service delivery.

Our commitment to international diversification – with 30% of our current business turnover overseas – is one of the factors that differentiates us in our sector. But the sheer scale of opportunities open to us in the UK means that we have to be selective. In Europe we see particular opportunities in Italy and Germany, and are making encouraging progress in both. In the Middle East our activities and profile continue to develop well. In Asia Pacific we are focusing principally on Australia and New Zealand, where state governments continue to develop policies on public private partnerships. In North America we see public private partnerships emerging in both the US and Canada: these countries potentially represent a major long term market for our skills and experience.

To concentrate management and financial resources on the most promising opportunities and markets at home and abroad, we continue to review our business portfolio.

This enables us to sharpen our focus on contracts offering superior growth, margins and cash generation, and may lead to minor divestments of certain activities.

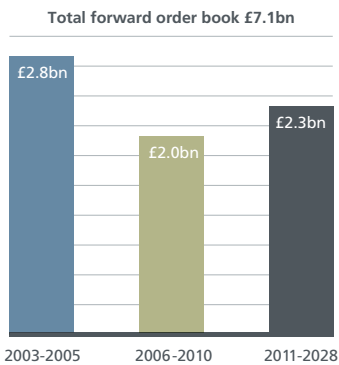
Risk management

One of the keys to Serco’s consistently robust performance is its management system and control framework. Our operations are diversified across some 600 contracts and a range of business sectors. Few contracts represent more than 2% of our turnover and the largest represents only 7%.

The high degree of autonomy that we give to our contract managers is balanced by rigorous monitoring and unobtrusive but effective controls. In 2001 we set up our Corporate Assurance Group (CAG) to integrate our approach to assessing business risks and improving controls, and to ensure that we safeguard the interests of shareholders, customers, staff and the wider community. Reporting directly to the Board, CAG is proving a valuable asset in risk management.

Corporate social responsibility

Although Serco is a private sector business, we earn our living predominantly by delivering public services. We need to demonstrate a public service ethos, as a pre-requisite of our partnership with public sector customers.



LONG TERM ORDER BOOK AS AT FEBRUARY 2003

We take our corporate social responsibility (CSR) seriously. Under our corporate governance framework every contract manager is directly accountable for CSR performance. We have established a global network of CSR champions to raise general awareness and support initiatives that range from developing an alternative water supply for Goose Bay residents in Canada to collecting tonnes of stationery for schools and orphanages in Kabul. We continue to refine our approach and are currently developing a new structure for charitable giving. This is designed to support initiatives by our contracts and individual employees, direct resources towards the communities where we work and recognise the personal commitment of Serco people.

People

Serco's continuing success comes from the outstanding dedication of our people and their personal identification with what they do. In a MORI survey of a cross section of staff, 95% regarded their work as 'more than just a job'. Other positive indications – given our drive for continuous improvement and evolution to meet customer needs – were that around three quarters said they understood workplace objectives and the need for change, and two thirds actively supported the change process. We are grateful for all our people's energy, enthusiasm and imagination – which add value both to our business and to our customers' operations.

We continue to build constructive relationships with trade unions. In the UK we support the Partnership Institute launched by the Trades Union Congress (TUC) to foster co-operative relationships between employers and unions.

We have formed a number of 'working partnerships' with unions at contract level and are investigating further opportunities.

To support and sustain our growth, we attach great importance to training and developing our managers. During the year the Serco Best Practice Centre provided courses and workshops around the world, and our global intranet played an important role by giving people access to training and development online. In a ground-breaking partnership with the UK's Institute of Directors (IoD) we have developed a joint IoD/Serco Certificate in Company Direction assessed and recognised by the IoD. The first 19 Serco managers were awarded the qualification during the year.

Outlook

The committed future income streams from our contracts give us the assurance of highly visible revenues and profits. At the time of writing we have already secured 91% of our planned revenue for 2003 and 80% of our planned revenue for 2004.

Our forward order book continues to grow. On 31 December it stood at £6.1bn, and it now stands at £7.1bn – roughly 5.5 times last year's turnover. We are currently addressing over £12bn of opportunities and our markets are buoyant. Both at home and abroad, opportunities are emerging at a rate which continues to allow us to bid selectively.

Our portfolio approach to a wide range of public sector markets has provided a strong growth platform during this period of difficult global economic conditions. We remain confident of achieving double-digit growth both this year and over the longer term.