

# WHAT have we BEEN doing and WHERE?

## BUSINESS REVIEW

One of our greatest business strengths is our diversity – we apply our management skills across a broad range of activities and geographic markets around the world.

In addition to maintaining our 90% rebid win rate, during the year we continued to extend our capabilities, winning new contracts and forming new partnerships across our principal markets in defence, transport, civil government, science and the private sector. We maintained strong growth in the UK, made good headway in our priority markets in Europe and the Middle East, broadened our base in North America, and consolidated our position in Asia Pacific.



In the following pages we review the year's activities by sector and provide an overview of our operations and markets worldwide.

#### **DEFENCE**

Defence, our longest-established market, accounted for 27% of sales in 2002.

Defence and security activity has increased in all our regions. In the UK the Chancellor's 2002 Comprehensive Spending Review will raise defence spending by £3.5bn to £32.8bn in 2005/06 – the largest planned real-terms increase in 20 years.

Serco is a major provider of services to the UK Ministry of Defence (MOD), which has been in the forefront of developing cost-effective ways to outsource defence support activities. We are encouraged by the Defence Logistics Organisation's declared intention of moving from 'provider to decider' on delivery of services, and expect MOD spending on outsourcing to double, reaching £6.5bn by 2010. We are also a leading provider of services to the Australian and New Zealand forces.

Our strategy is to retain and expand our existing business, leveraging our core capabilities into new but related areas and selected major bid opportunities. We currently hold over £2.5bn worth of defence contracts and see no shortage of future opportunities.

The defence sector accounted for our largest-ever business win at the start of this year. In January 2003 the MOD agreed a 15-year extension to our contract for managing the Atomic Weapons Establishment (AWE) in partnership with Lockheed Martin and BNFL. Since we began the original 10-year contract in 2000 we have delivered all milestones on time, surpassed 13 out of 16 performance targets and won the UK's

top award for industrial safety performance at the site. The extension, until 2025, brings the total contract value for Serco to over £1.7bn and will enable AWE to raise external capital if required for investment to continue developing the site as a world-class scientific facility with safety at the heart of its mission. Meanwhile, investments at AWE during the year included installation of the UK's most powerful computer, which has cut program run time from two months to 15 minutes for some applications.

In February 2002 the Paradigm Secure Communications team was selected as preferred bidder for the largest defence PFI to date – to provide Skynet 5 global military satellite communications services to the UK armed forces. Serco will provide network and facilities management services including spacecraft and network operations, network maintenance, training, supply management and through-life buildings and facilities maintenance under a contract potentially worth £220m to us over 15 years. Our team has already commenced the implementation of our phase-in plan and good progress continues to be made towards contract award.

The Warship Support Agency signed a partnering agreement with our Serco Denholm joint venture – 90% owned by Serco – to manage the Devonport, Portsmouth and Clyde marine services contract. This three-year partnership, worth up to £110m, builds on an earlier contract awarded in 1996. The aim is to reduce overall costs by generating new solutions for long term provision of marine services.

Our strength in IT seat management at scientific and secure sites helped us win a five-year contract with the Defence Scientific and Technical Laboratory. We will

provide communications and information services to this agency, which currently has over 3,000 staff at sites across the UK. The contract has options for three one-year extensions and additional scope, which together could take the value from a baseline £30m to as much as £80m.

We successfully strengthened our position in services to electronic warfare operations, with an MOD contract to provide multi-activity services to the Electronic Warfare Tactics Range at RAF Spadeadam. And in a competitive rebid we won a further five-year contract from NATO to provide engineering services to its Multi-service Electronic Warfare Support Group at Yeovilton. This is the latest extension to a contract we first won in 1984 and competitively rebid in 1998.

At HMND Clyde we began a partnership with Babcock Naval Services who now operate the site. Under a five-year contract worth £26m we will provide a one-stop shop for estate management services.

We won three important MOD rebids with a total operational value of over £30m. At RAF Halton we have a wide-ranging contract that extends through general engineering and management of the armoury to cleaning and media services. On Ascension Island we provide a comprehensive range of engineering, supply and support functions for the RAF. At Wattisham Station, where we provide air traffic services, maintenance and helicopter simulator services to the Army Air Corps, the new contract gives us a broader role including airfield management.

At RAF Northolt, where we provide technical services, we expanded our contract to include the Visiting Aircraft Servicing Section – which routinely handles royalty,

international VVIPs and senior military and political visitors. The award decision is a strong endorsement of our performance at Northolt.

In joint venture with SKE Support Services we successfully rebid our contract to maintain over 400 vehicles and provide transport services at Wright-Patterson Air Force Base in Ohio.

In Germany we are continuing to maintain our good relationship with the Bundeswehr – Germany's ministry of defence. Early in 2002 the secretary of defence opened the first of two IT training centres that we equipped and are now operating under a three-year €8.1m contract. The centres have already trained some 3,000 soldiers and civilians, achieving above-average results in externally-assessed examinations. This pilot project has helped to convince officials of the benefits of involving the private sector in non-core Bundeswehr activity, and a third centre has recently been opened in Bonn.

Meanwhile, we have won two new German defence IT contracts – to help introduce a pilot resource management system for the Material Support Command and develop integrated quality assurance for the Army Logistics Information System. And we are bidding to provide training support services at the Armoured Training Centre in Munster – the Panzertruppenschule.

Among a number of contract extensions in Australia we added a further year, worth over AUS\$10.5m, to the manpower and personnel service contract under which we provide engineers, technicians, aviation logistics specialists and managers to the Royal Australian Air Force at bases across the country.

## TRANSPORT

The transport sector has been a strong source of growth for us in recent years, primarily in the UK and Australia. In 2002 it accounted for 27% of sales.

Governments around the world are continuing to invest in technology and services for 'joined-up' transport systems that balance different modes of travel and make better use of public transport. The UK government plans to increase transport spending by 12% annually in real terms, to reach £11.6bn in 2005/06, and we have continued to win new and extended contracts supporting its integrated transport policy.

Information is the key to transport integration, and during the year we secured a contract with the BBC to provide its national and regional travel information services covering all road, rail, air and sea networks. Our broadcast service centre began operations in January 2003 and we are now working to develop new travel information services using the internet, interactive TV, mobile phones and digital radio.

On the roads we secured the contract to equip the UK's first toll motorway, the 27-mile M6 Toll Road, with a £4m communications and traffic management system. It is due to open in late 2003. The phase-in of a new contract to maintain equipment on the motorways in the south east of England was completed on time to start services in February 2003. Early in 2003 Glasgow City Council awarded us an initial 1½-year contract to supply and install a fully integrated system for management and operation of buses running on Quality Bus Corridors in the city. The system will include technology for vehicle location, fleet management and real-time passenger information. Once it is installed we will be contracted to maintain it for at least five years.

We won several rebids to maintain urban traffic management and control systems and national motorway communications systems in England, Scotland and Northern Ireland. We are now the market leader in maintaining technology on the English motorways, with contracts covering over half the system. We also re-secured the contract to sell, through our Swansea-based telesales operation, Select Registrations on behalf of the Driver and Vehicle Licensing Agency.

Our PFI to establish the Highways Agency's Traffic Control Centre continues to make good progress. Construction of the control centre itself was completed on time and on budget, and the fit-out, roll-out of roadside equipment and systems testing are all well underway. As part of this contract, we have been operating the Midlands Driver Information System since January 2002, which has released a valuable police resource.

We operate London's Docklands Light Railway (DLR) and the Metrolink light rail system in Manchester, where we helped keep the city moving during the 2002 Commonwealth Games by running more frequent services over longer hours to meet increased demand. At the 2002 National Rail Awards, Serco Docklands won the Best Rail Operator award for an unprecedented second year running. As operator of the DLR, which carried 44m passengers last year, we have earned a reputation for innovation in passenger service and information. "Few railway businesses have such an impact on community life," said the judges.

We remain at the cutting edge of providing solutions to complex technical problems for our customers. We have been working with Network Rail (effectively the successor to Railtrack) under an £11m contract to develop a new-generation track measuring vehicle to inspect the UK's main lines on a two-weekly cycle. The ability to measure and

monitor track condition at high speed within normal train operating patterns will have considerable benefits on heavily-used rail routes. The New Measurement Train enters service this spring and two additional monitoring vehicles will be added later.

Network Rail has also given us two short term contract extensions. A £7.5m 15-month extension continues our infrastructure-monitoring contract until April 2003, and a £4m four-month extension to our multi-purpose vehicles contract will cover this year's weedspraying season – during which we will treat about 18,000 miles of track.

Our Cardiff Call Centre, which provides rail passenger information, became the first business in Wales to achieve NVQ Centre of Excellence status for in-house training. And in January 2003, at the Welsh Contact Centre Awards, Serco won both the Best Training Initiative and the e-commerce Most Innovative Use of Technology awards.

Our rail testing business continues to broaden its capabilities to become a one-stop shop for testing and engineering acceptance of rail vehicles. During the year it received accreditation from Railway Safety as a Vehicle Acceptance Body.

In joint venture partnership with SNC Lavalin, we are one of two consortia currently bidding for the Phase 3 network expansion of the Manchester Metrolink – a 25-year concession. The concession will design, build, operate and maintain at least three new extensions to the network while also operating and maintaining the existing system. And in support of our plans to bid for selected UK rail franchises, we have formed a joint venture with NedRailways, the international arm of the Dutch national rail operator, Nederlandse Spoorwegen.

This is currently bidding for the Wales and Borders and Merseyrail Electrics franchises.

The first phase of the Copenhagen Metro was completed on time and formally opened by the Queen of Denmark in October. We are leading the joint venture that operates the system, under a contract worth over DKK500m. The automated, driverless light rail system initially serves an 11-station, 13.9km route with some 180 staff, rising eventually to 300 as we open extensions. Passenger numbers are expected to rise from 60,000 to 120,000 a day by May 2003.

In Hong Kong, where our transport work is focused on traffic management, we successfully rebid our contract to manage, operate and maintain the Aberdeen Tunnel.

In Australia we further enhanced our tourism business for Great Southern Railway by establishing the groundwork to extend The Ghan train service to Darwin from late 2003. In Perth, where we successfully rebid our public transport information call centre contract, we were also selected as preferred bidder to provide facilities management of bus-related infrastructure.

In the US we have extended our relationship with the Federal Aviation Administration (FAA) to include weather observation as well as air traffic control (ATC) services. The FAA has awarded us a five-year contract to operate weather observation stations at seven medium to large airports, with five more to follow in January 2004.

In the Middle East we successfully rebid our contract with the United Arab Emirates – held since 1986 – to provide ATC and engineering services at the Emirates Area Control Centre in Abu Dhabi.

Further growth in our airport business will come from an investment in South Africa signed in November. Our 50:50 joint venture with Equity Alliance has acquired a 51% interest in Apron Services Pty, a government-owned airline ground handling company supporting three international and three domestic airports in South Africa. It has contracts with 53 airlines. This investment of £4m will provide an opportunity to develop our services in civil aviation and a platform for exploring other market opportunities in South Africa.

#### **CIVIL GOVERNMENT**

This is our most rapidly-evolving market, with opportunities emerging in sectors such as justice, education and healthcare where outsourcing is relatively new. In 2002, civil government contracts (excluding the transport and science sectors, which are reported as separate segments) accounted for 27% of sales.

#### **Justice**

Our activity in this field is currently focused on the UK, where the criminal justice budget for England and Wales is £14.7bn this year, rising to £18.3bn over three years. We estimate our current addressable market at about £1.3bn, covering intelligence, operational support, demand management and technology services. There is major potential for working with police forces in England and Wales to identify non-core activities that can be outsourced, allowing operational staff to concentrate on policing and investigation.

The custodial market continues to expand – opportunities include prison PFI tenders, secure training centres for juvenile offenders and development of new immigration accommodation centres over the next five years. Electronic tagging and monitoring of offenders is a current and rapidly-growing non-custodial market which could receive a further

boost if the UK adopts proposals for weekend and night-time prison sentences enabling offenders to retain normal employment.

In 2001 we stepped in at short notice to support a critical national intelligence system serving the UK's 66 police forces and other agencies. Our response proved effective, and in 2002 we were awarded a five-year contract to maintain and support the system.

Building on our growing reputation for services to police forces, we won a contract from Merseyside Police to provide and support its new command and control system. The pilot system went live very successfully in November and full operations will begin in March 2003. Other forces for whom we operate command and control systems include the Hampshire and Isle of Wight Constabulary – which has now appointed us to support the system with a full business continuity and disaster recovery solution.

We are the UK market leader in providing road safety cameras. During the year we won contracts to supply and install over 300 additional camera locations in Lancashire and West Yorkshire.

Our development work continues on the National Crime Squad (NCS) Operations and Intelligence Management System and we have delivered the first modules, including the Evidence Management System. We have added several enhancements to the original contract. These include opening and managing a new 39,000ft<sup>2</sup> seized assets store, introducing a secure knowledge management system and providing the IT and communications infrastructure for the newly-formed Immigration Crime Teams. We will provide support services to these teams in line with the main NCS contract.

Premier Custodial Group (PCG) continues to perform well. The business now comprises five prisons, one secure training centre, one immigration detention centre and court escort and electronic tagging activities. There have been some performance issues at HMP Ashfield Young Offenders Institution, which we are working through and are well on the way to being resolved.

As previously reported we are pursuing through the courts a contractual right to acquire full control of PCG following our partner's merger with Group 4 Falck: the court's decision is expected in the middle of this year.

#### **Education**

In the UK, this market has expanded and evolved rapidly over the past year. Opportunities for working in partnership with local education authorities (LEAs) continue to emerge. Over the longer term we believe schools will gain increasing autonomy to purchase the services currently provided or bought by LEAs. The education budget for England will rise by 6% a year in real terms to reach £58bn over three years – when spending per pupil will be 50% higher in real terms than in 1997. We have been developing an extended range of services for schools to enhance our market position. Our turnover in education is currently over £75m a year and in the UK we are one of the sector's leading service providers.

Our education business is not only with LEAs. In April, for example, we retained and expanded a contract worth over £3m a year to inspect more than 200 schools annually for the UK education inspectorate, Ofsted.

Our progress in Walsall, where we have provided services to 129 schools on behalf of the LEA since 2001, has demonstrated how our effective management drives strong organic growth.

In April 2002, Ofsted commended our service quality in Walsall and our progress in restructuring and redefining school support services. After reviewing the remaining services provided by the LEA, Ofsted recommended that these, too, should be outsourced. The result was a threefold expansion of our contract from September: over the remaining 5½ years it will be worth some £100m to us. A further 300 Walsall Council staff transferred to Serco in January this year.

Ofsted has also recognised the significant progress made by our educational partnership with Bradford Council. The performance targets set by the contract are demanding and there is much work still to do before we can meet them all. But already government figures show above-average improvement in Bradford schools since we arrived and in the primary school league tables Bradford is the third most improved LEA in the country.

Outside the UK, our activities in the education sector include managing and maintaining school and university facilities in Australia and Sweden. Last year we won a new contract to provide facilities management, teaching assistants and administrative support to a new 1,200-pupil secondary school in Hong Kong which opened in September.

Our strategic focus on organic growth means that when we make acquisitions we tend to buy complementary capabilities rather than capacity. The acquisition in 2000 of Quality Assurance Associates in the UK – the basis for our fast-growing education business – was a case in point. In December 2002 we acquired CCM Software Services for an initial consideration of £8.6m. CCM produces, maintains, updates and operates scheduling, resource allocation and finance systems that complement our existing school management and improvement products to make a unique integrated toolkit. Its customers

include a rapidly growing number of schools, universities and colleges and nearly all the secondary schools in Ireland.

This year we have launched Serco Learning, which brings the CCM products together with our existing portfolio of virtual learning environment, leadership training and consultancy products. Together, these put us in a unique position to work with schools on all areas of development.

#### **Health**

The majority of our activity is currently in the UK, where we are involved in two of the first wave of hospital PFIs – Norfolk and Norwich University Hospital and Wishaw General Hospital, both now operational. New UK markets are emerging in information technology and clinical service provision as well as a variety of support service partnerships. Outside the UK we provide hospital support services in Hong Kong and Australia.

In June we broadened our capabilities by acquiring SDC Consulting, a leading provider of strategic consultancy services to NHS customers. This enables us to grow into both existing and emerging health markets by developing a new solutions business that combines a strengthened consultancy and advisory practice with participation in clinical and non-clinical support service partnerships. The government has recognised our capabilities by making Serco one of only eight private companies approved to support underperforming NHS trusts identified in the NHS franchise programme – a role similar to the one we are playing with local education authorities.

Our track record at three hospitals in Hong Kong won us contracts to provide cleaning and non-clinical services at two more: the Tseung Kwan O Hospital and the busy 1,265-bed United Christian Hospital. During the year our efforts were

recognised by the Hong Kong government, which rewarded us with a prestigious Caring Company award.

#### **Other public services**

In addition to the principal areas described above we also provide a wide range of other services – both behind the scenes and in direct contact with the public.

In the UK we won a 10-year rebid and expansion of our environmental services contract with Canterbury City Council, worth £53m. The new contract represents a deeper level of partnership with the council – and includes operating the call centre which is the customer's first point of contact, taking 50,000 calls a year on a wide range of council services.

Our local council services business made further headway in January 2003, when we won Woking Borough Council's ground maintenance and street cleaning services. Subject to contract, we will work from a dedicated depot in the Woking area, with contract management and support from our existing operation in Winchester. This partnership contract is expected to be worth at least £25m over 10 years, with additional revenue depending on the service and extension options that the borough exercises.

In Belgium three contracts further strengthened our relationships with major European institutions. The European Commission (EC), already an established IT customer, awarded us a new contract to provide IT support. The European Parliament chose us to provide IT services to its members and their offices in both Brussels and Strasbourg. We also successfully rebid our 'complete life cycle' computer services contract with the EC's Directorate General for Regional Policy.

In New Zealand, Wellington City Council awarded us a contract to provide planned and responsive maintenance services for

over 30 buildings ranging from high profile council offices, museums and libraries to retail and office buildings. Our developing relationship with Manukau City Council has earned us an additional contract each year since 1999. In 2002 we won two further contracts to maintain its playgrounds, structures and asset management of buildings, bringing total annual revenue from the city to over NZ\$7.6m. Impressed by our track record, Rodney District Council awarded us a NZ\$17.2m five-year contract to manage parks, reserves and coastal areas.

In Australia we successfully rebid our property management contract, worth AUS\$22.2m over five years, covering all the justice buildings in Perth and all education buildings in south Perth.

Hong Kong is planning a sophisticated meter system covering all its on-street parking. This will use reloadable smartcard technology compatible with the island's Octopus transport and cash transaction card. Our joint venture with Wilson Parking will design, install and maintain the system using dual language technology that we have developed, under a seven-year contract worth almost HK\$87.9m. In Singapore we have carved out a niche with the government as a provider of accommodation management services. Last year we gained a further contract, as managing agent for 411 housing units.

In the US we extended our contract in San Francisco to install and manage over 25,000 parking meters, to run for a further five years. All our US government contracts begin and end with an environmental baseline study, which we can provide in-house through Serco Environmental Services. We also market these services externally, and recently won a contract – indemnified by the Canadian government – to conduct a major baseline study on the largest non-commercial bulk fuel storage tank farm in North America.

## SCIENCE

Management of government scientific undertakings is a relatively recent but fast-emerging sector, in which Serco was an early entrant and has established a strong competitive position. Our science contracts now account for 9% of sales. We aim to be recognised by governments around the world as one of the best private sector partners for the management of scientific organisations, programmes and consulting services.

UK government investment in science, engineering and technology (SET) supports innovation and competitiveness in the economy, as well as defence, health, safety and environmental management. Government SET expenditure is increasing and we expect it to exceed £8bn in 2003/04.

In the UK we have demonstrated our capabilities in managing highly complex science-based organisations such as the National Physical Laboratory (NPL) under partnership contracts with government – delivering services that range from prize-winning international research to support for small business. We have also built a strong position in nuclear safety and aim to support government in its management of nuclear liabilities: government spending in this area under a long term programme is estimated to be over £30bn. We believe our UK experience provides a model that can be applied in other countries as they involve the private sector in delivering public science services.

In the run-up to a rebid at NPL, our contract has been further extended – taking our original five-year contract into its eighth year. Together with Laing, our construction partner, we are currently developing world-class new science facilities at NPL. After some early setbacks, construction is now well advanced and we are working closely with the

Department of Trade and Industry and Laing to resolve all outstanding issues. Meanwhile, we have launched major new national facilities, including a centre to secure accuracy in radiation therapy for cancer sufferers and a laboratory developing innovative measurement techniques for bioscience.

Serco Assurance (formerly the nuclear consulting division of AEA Technology) has substantially augmented our offering in nuclear safety. Now integrated with our science business, it is performing in line with expectations and generating new opportunities.

In May Serco Assurance won a new contract to support the BNFL Magnox Reactor Services Organisation with a range of technical services, in a consortium led by Mitsui Babcock. The consortium will provide 85% of the external technical support to the organisation's six operating Magnox nuclear power stations; this is the first time such a contract has been let in the UK civil nuclear industry. The value to Serco will be about £10m over three years, with a possible two-year extension.

More recent projects have included testing superalloys for ALSTOM Power in Sweden, environmental studies for a low-level radioactive effluent pipeline, simulation studies of corrosion in Magnox boilers, specialist computer modelling work for the Swedish radioactive waste disposal agency and a variety of environmental protection projects. Contract extensions included two three-year contracts from the UK MOD to provide research and support services aimed at detecting and managing battlefield radioactivity hazards. We also extended a contract with Network Rail under which we are developing asset management information technology, which we have already applied to London Underground and Yorkshire Electricity.

#### **PRIVATE SECTOR**

The private sector accounted for 10% of sales in 2002. Because of the scope available to us in the public sector, this market has not been a primary focus so far, but it does provide opportunities which we address selectively.

Our existing business consists mainly of multi-service facilities management contracts for blue-chip clients. Microsoft, for example, recently added five years to our facilities management contract covering its seven properties in Ireland. It also awarded a one-year contract for support services, with a view to integrating it with the remaining four years of the facilities management contract.

We increased the scope of our work with Ilford – one of the world's leading photographic imaging businesses – by taking over the field force of specialist technicians that supports its equipment across Europe and the US. This gave us the opportunity to develop a new Asset and Equipment Services (AES) business. In August 2002 we finalised agreement with Imation, one of the leaders in removable data storage, to transfer its field services and field technician staff to our AES business in Germany and the Netherlands. Together, these contracts have given us a stable platform for addressing the field service market and possibly creating further opportunities elsewhere in the world.

In the Middle East, our new Serco Gulf joint venture won a 10-year contract to deliver engineering and other support services to the Dubai Ports, Customs and Free Zone Corporation at Jebel Ali, Port Rashid and other locations in Dubai. This is a ground-breaking contract that should provide a springboard to other government contracts in this expanding marketplace – initially in Dubai and eventually in the rest of the United Arab Emirates and other Gulf countries.

We continued to grow our relationship with BHP Steel in Australia, building on our original protective and emergency services contract at its Port Kembla steelworks. Last year we added fire and transport services, and are now responsible for fire equipment inspection and maintenance and personnel transport movement at all BHP Steel operations in the Illawarra region of New South Wales.