

Chairman's statement

Serco has had an excellent six months. While maintaining double-digit growth in sales and profits, we have won major new contracts that will contribute to the business for years to come. Trading, margins and cash generation remain strong.

Our forward order book grew from £7.1bn in December 2002 to £9.9bn as we broke a succession of sales records: our largest new contract, largest rebid and largest contract extension. A high rate of organic growth is our principal objective, and over 70% of the first half's incremental sales came from extensions to the scope and scale of existing contracts. Our success rate in rebids and contract extensions remained above 90%, and we continued to win over half of our new bids.

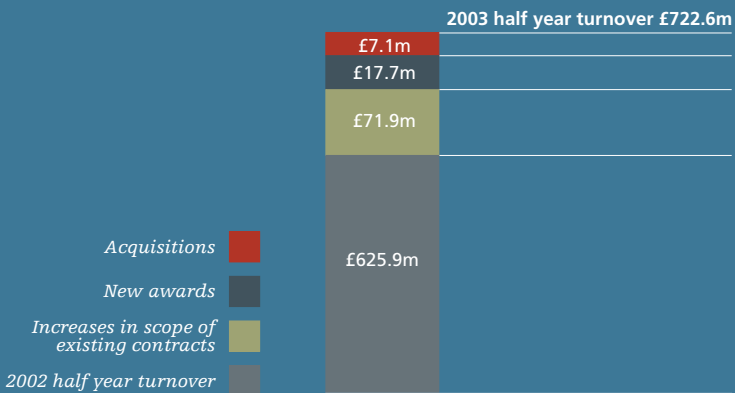
The keys to our record of dependable organic growth are the diversity of our markets, extending across many sectors and geographies, and the quality of the relationships we build with customers. There is no shortage of new opportunities: we currently have bids with a value of £6bn under evaluation and are addressing a further £8bn of opportunities.

Financial performance

Results

In the six months to 30 June 2003, turnover was £722.6m – 15.4% higher than the first half of 2002. Pre-tax profit (before goodwill) grew 10.2% to £31.3m. Earnings per share (before goodwill) grew 6.4% to 5.15p.

These results include an additional £4.5m of pension costs in the first half as a result of the increased pension funding requirement identified with our 2002 preliminary results. Excluding these costs, pre-tax profits (before goodwill) grew by 26%.



TURNOVER GROWTH TO 30 JUNE 2003

We continue to focus on cash generation. During the first half cash performance was strong, with positive free cash inflow of £14.2m compared with an outflow of £11.5m in the six months to 30 June 2002. This is a significant achievement in a business with consistently high growth, which brings incremental demand for working capital.

As part of the focus on cash generation, we arranged the sale and leaseback of the remaining rolling stock belonging to our Great Southern Railway business in Australia. This generated £5.8m of cash and £4m of profit and followed a similar arrangement completed in June 2001.

Further details of our financial performance are given in the financial review on page 11.

Dividend

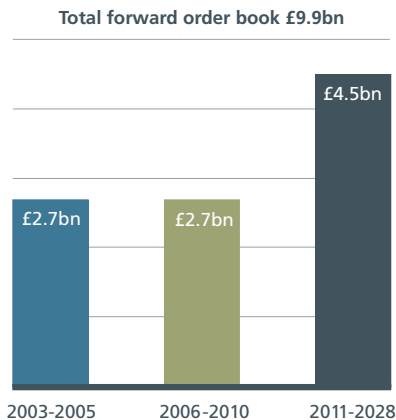
We have increased the interim dividend by 12.5% to 0.72p per ordinary share. It will be paid on 10 October 2003 to shareholders on the register at close of business on 12 September 2003.

Balance sheet

Because of the rapid growth of the business and the scale of opportunities ahead of us, maintaining a strong balance sheet is a priority. In August we took advantage of historically low interest rates by issuing £117m of 8-12 year loan notes. This provides assured funding for the future and allows a mixed profile of debt facilities and maturity. It has also enabled us to repay the short term bank facilities we used to acquire the remaining 50% of Premier Custodial Group.

Operational performance

Notwithstanding excellent organic growth, the period was particularly notable for four business wins: our largest-ever new contract, rebid and extension plus a strategically important win in North America.



LONG TERM FORWARD ORDER BOOK

In May we signed our largest-ever contract, worth £3.6bn, to run the Merseyrail Electrics contract for 25 years from July in partnership with the Dutch rail operator NedRailways. Serco's share of the contract is worth £1.8bn.

In February the Canadian Department of National Defence appointed us to provide site support services at its Goose Bay Canadian Forces Base for a second term in our largest-ever rebid: an 11-year contract worth some C\$400m.

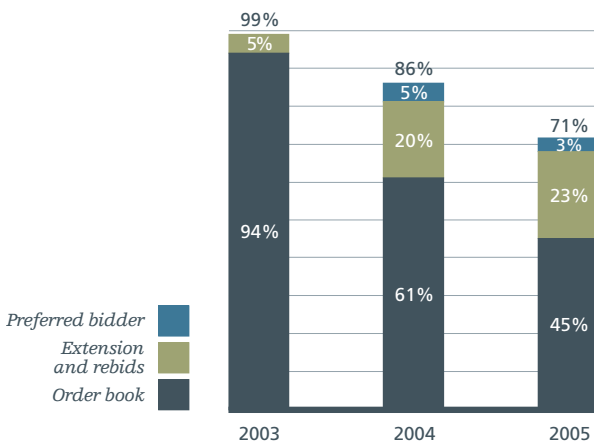
In January the UK government announced a 15-year extension to the 10-year contract under which we and our partners are managing the Atomic Weapons Establishment – adding £1bn to our order book and extending the contract to 2025.

In addition to these wins, we broke new ground in North America with a 10-year public private partnership under which we will provide driver examination services throughout the state of Ontario in Canada. This is the first contract of its kind in the North American market and is a model which could be replicated in future.

UK

The UK continues to be an exceptionally fruitful market for us. Two further important UK wins were a £60m multi-activity contract to provide flight training and support services at RAF Cranwell, and a Private Finance Initiative (PFI) contract to procure a 326-bed immigration detention centre in Colnbrook, Middlesex and operate it for eight years.

The contract at RAF Cranwell further strengthens our position in the buoyant defence market, where we currently have several very large bids under consideration including the £13bn Future Strategic Tanker Aircraft contract and the RAF's Airfield Support Services Project, which covers over 100 UK military bases and airfields.



NEAR TERM FORWARD ORDER BOOK

Percentage of planned revenue for the year

Our rail business continues to bid for carefully selected contracts. We were disappointed not to win the Wales & Borders franchise after reaching the final shortlist, but our Merseyrail success has encouraged us in our bids for the Northern Rail franchise and the third phase of the Manchester Metrolink.

In the road transport sector we continue to secure new business and are on schedule to open the Highways Agency's Traffic Control Centre in early 2004.

We are also making good progress in civil government. Our leisure, healthcare, education and local authority direct service businesses are all addressing opportunities with innovative solutions and a high rate of success.

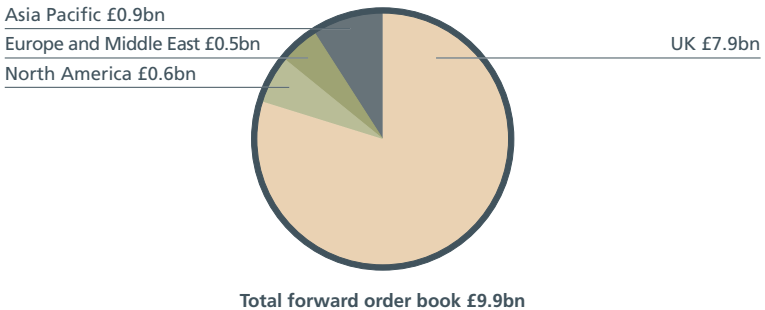
We remain enthusiastic but selective participants in PFI contracts, which account for some 12% of our turnover. Our interest in PFIs is focused on the long term operating contracts that follow the construction or asset procurement phase. Over the past few years we have built a PFI forward order book worth some £3.4bn, and we are already generating net positive cash flows after our £13.2m equity and subordinated debt investment in these contracts.

International

We continue to attach great importance to our international growth strategy, and several of our primary target markets are beginning to show real promise.

In Canada we have achieved a degree of critical mass by securing the Goose Bay rebid and winning the Ontario driver examination services franchise.

In Australia our Great Southern Railway business will gain a further boost in February 2004, when the Alice Springs-Darwin link opens.



Ticket sales for the extended journey to Darwin topped A\$5m in the first five weeks after bookings opened – six months before the first train is due to run.

In Europe we continue to gain ground in Italy and Germany. In Germany we are making steady progress in the defence and government sectors; in Italy we have won our first facilities management contract as we build on our early successes in government IT outsourcing to gain entry into new and evolving market sectors.

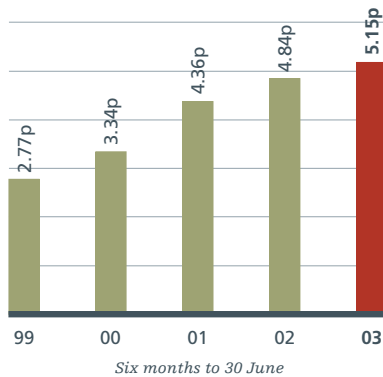
In the Middle East we are continuing to grow our core air traffic services business while developing newer markets in facilities management, technology and training services. We are on a shortlist of two bidders for the first Omani PFI, to build and operate a joint services technical training college.

Strategic developments

Acquisitions

During the first half we bought-out our partners in three businesses, two of which are PFI projects. At the National Physical Laboratory we took full control of Laser, formerly a joint venture with Laing Investments Limited. In Manchester we acquired the Altram consortium which had built Phase 2 of the Metrolink system and operates and maintains Phases 1 and 2. In Denmark we made a similar move by buying out the joint venture we formed with Arriva to commission and run the Copenhagen Metro, which opened last October.

In July we also acquired our partner's share of Premier Custodial Group, our custodial support services business. This £48.6m deal followed our partner's acquisition by a competitor and gives us the opportunity to develop the business in the UK and overseas. The custodial market is expanding rapidly and opportunities arising over the next few years in the UK alone will include new prisons, secure training facilities for



BASIC EARNINGS PER SHARE
Before amortisation of goodwill

juvenile offenders, and immigration accommodation centres. Premier has a number of PFI contracts, and its assets and non-recourse debt will be consolidated in the second half.

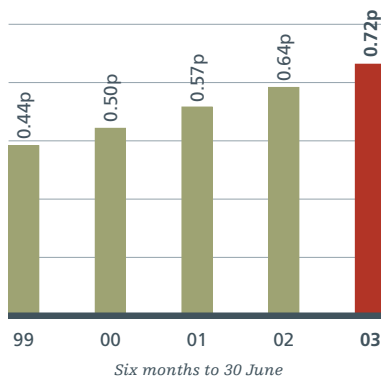
All our PFI acquisitions bring non-recourse debt onto the Group balance sheet. During the first half, the amount of non-recourse debt on the balance sheet increased from £29.7m to £117.8m. The Premier acquisition will add around £180m. All these debts are long term bank loans secured on the assets held in the companies which operate the PFI concessions and not on the assets of Serco Group. Although we consolidate these non-recourse loans on the balance sheet, they are ringfenced and do not affect our debt facility covenants or our ability to fund the Group going forward.

Restructuring

In our 2002 preliminary results announcement and at our AGM in May, we referred to the review that we are undertaking to focus the business on areas with greatest potential and to reduce underperforming activities.

As our businesses grow, we need to back them with efficient and consistent support processes. So we have restructured our UK support operations, bringing them together on a single business campus in Hampshire to create Serco Business Services. We have also rationalised our Australian support offices to a single centre in Sydney. The redundancy and relocation costs result in an exceptional charge of £4.5m in the accounts for the first half, but will generate ongoing savings of some £1.5m a year.

A further result of the strategic review was an agreement with Network Rail in the UK to withdraw from our track maintenance contract for the East Midlands zone in January 2004.



DIVIDEND PER SHARE

New capability

We have continually encouraged customers to let larger and more sophisticated contracts, and have developed the resources to handle them. Helping customers to develop and manage this type of contract has now become a growth opportunity in its own right. Having already built the financial capability to structure finance for complex, large-scale contracts and to manage our own investment portfolio, we have now supplemented and extended that capability to create a new business, Serco Government Consulting. The team currently includes some 20 management consultants who provide strategic consulting advice and help customers shape, define and implement business solutions. It will also provide strategic advice and management support to our operating businesses.

People

In June we appointed David Richardson to the board as a non-executive director. David is finance director of Whitbread, the FTSE 100 leisure group. His previous roles there have included eight years as strategy director. He will take over as chairman of the audit committee when Rhidian Jones retires in April 2004.

A further change to the board is planned in March next year, when Iestyn Williams retires as a director. Iestyn has been with the company for 25 years and a board member since 1986. He will continue his association with the company as non-executive chairman of our education business, Serco Learning.

One of our major objectives, as a business employed predominantly by the public sector, is to demonstrate that a private sector business can have a public service ethos. There can be few more convincing examples of this than the conduct of our 500 support staff working in Hong Kong hospitals during the SARS outbreak. Almost 1,750 people caught the disease in Hong Kong – and more than a fifth of them were hospital

workers. Many of our people admitted they were scared. But that didn't stop them from delivering much-needed services on the front line throughout the crisis. We respect all of them for their courage and thank them for their dedication.

As always, we also thank all our people for their part in Serco's continuing growth and success.

Corporate social responsibility

Social responsibility has been an integral part of our culture for over 40 years. We have a structured approach which delegates accountability for corporate social responsibility performance to every contract manager. This ensures that initiatives are managed at a local level, where they have most impact. The first Business in the Community Corporate Responsibility Index, announced in March, indicates that this approach is delivering encouraging results: Serco was ranked in the second quintile, and our overall score of 79% only just fell short of the top quintile.

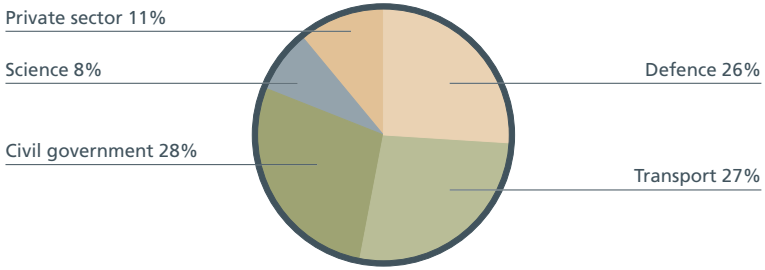
Outlook

Our total order book has increased from £7.1bn to £9.9bn – equivalent to about seven times last year's turnover. We are currently addressing a further £14bn of opportunities. Assuming a continuing 90% renewal rate on rebids, we already have contracts in place to provide 99% of planned revenue this year, 86% in 2004 and 71% in 2005.

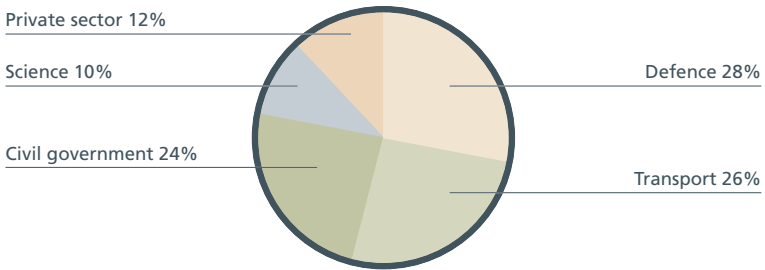
The unremitting pressure on governments to deliver value for taxpayers' money plays to our strengths. We are confident that our standing among customers and potential customers remains high, and our credibility is underpinned by a track record of delivery. We look forward to sustained, profitable growth – in the second half and for the foreseeable future.

3 September 2003

SECTOR SEGMENTAL ANALYSIS – TOTAL GROUP

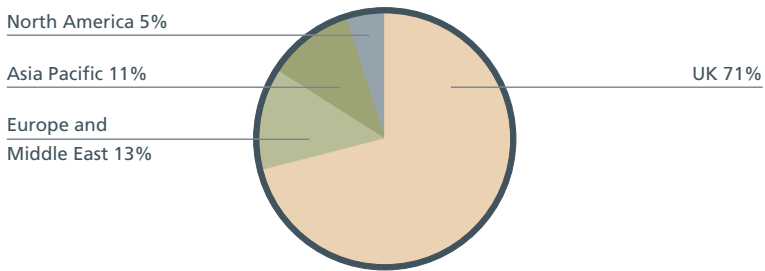


2003 half year turnover £722.6m
Including share of joint ventures

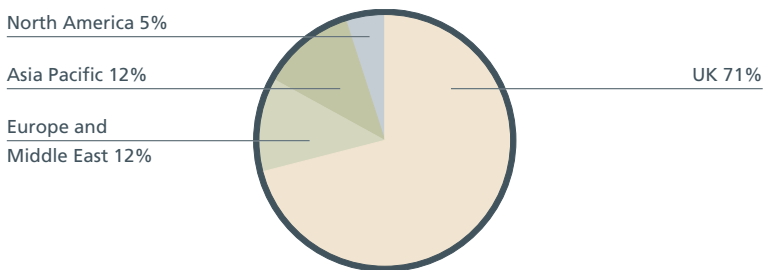


2002 half year turnover £625.9m
Including share of joint ventures

GEOGRAPHIC SEGMENTAL ANALYSIS – TOTAL GROUP



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Including share of joint ventures



2002 half year turnover £625.9m
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