

Defence

The defence sector, which accounted for 26% of sales this half year, is our longest-established market.

Our largest win was the extension to our management contract at the Atomic Weapons Establishment (AWE), which will now run until 2025 – adding £1bn to the forward order book. With our partners Lockheed Martin and British Nuclear Fuels (BNFL), we will now be able to raise private finance as required to invest in major capital projects that provide environmental and operational improvements and increase efficiency. New facilities will ensure that AWE continues to develop as a world-class facility.

Another important business win was the successful rebid of our site support services contract at the Canadian Forces Base, Goose Bay – the cornerstone of our Canadian operations. The new contract, worth C\$36m a year, extends our original five-year contract by a further 11 years and broadens our responsibilities by transferring to us the base's vehicle fleet including snow clearing vehicles and other emergency equipment.

Among a series of contracts and rebids from the UK Ministry of Defence (MOD), we were particularly pleased to win the £60m support services multi-activity contract and multi-engine interim aircraft solution contract at RAF Cranwell. This includes introducing a new training aircraft, the King Air B200, to the RAF: we are leasing seven B200s to the station, which provides initial officer training, aircrew training and all the RAF's multi-engine pilot training. We also extended our support services multi-activity contracts at RAF Brampton, Wyton and Henlow, with contracts worth a total of £18m.

We further broadened our relationship with the Defence Procurement Agency at its Abbey Wood site – one of the largest office complexes in Europe. Abbey Wood provides a good example of organic growth based on strong customer relationships: since starting our original contract there, we have won over £2m of additional work spanning the next five years.

In May we formally signed an interim contract with Paradigm Services Limited to provide Skynet 4 satellite communications network and facilities management services for the UK armed forces. The contract began on 30 May after a seven-month phase-in period, and involved the transfer of these services from the RAF. This contract is a precursor to the main Skynet 5 contract, which we expect to sign in September: this will cover provision of these services for both the Skynet 4 and Skynet 5 communications networks.

In April we completed the phase-in of the communications and information services contract for the Defence Science and Technology Laboratory, to provide support to over 3,500 scientists at 17 locations across the UK. This eight-year partnership contract further enhances our portfolio of IT support contracts in the defence and scientific sectors.

We also broadened our Merlin Avionics Test Systems contract for Lockheed Martin, and successfully rebid our contract to manage the Southern Air Weapons Ranges, worth some £8.6m over five years.

In October we begin transportation and supply services contracts covering United States Air Force Europe operations at five RAF sites. This is a significant step, taking us into a new market area in the UK. The five-year £5.5m contract includes ground passenger transportation, cargo transportation services, vehicle management, vehicle maintenance, personal property, supply support and supply training.

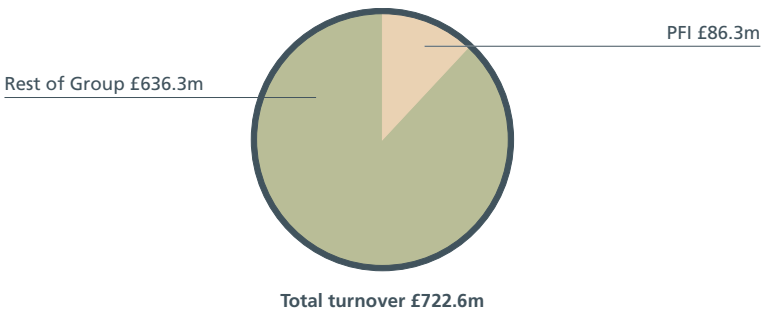
In Germany the Ministry of Defence decided not to outsource training services at the Panzertruppenschule armoured training centre. But we continued to build new defence business with a contract to supply NATO with mobile self-powered IT and communications modules including road trailers.

Transport

The transport sector has been a strong source of growth for us in recent years and now accounts for 27% of our turnover.

Road

In the UK we won a £4.7m contract to support Glasgow’s Quality Bus Corridors scheme. We are installing automatic vehicle location, bus fleet management and real time passenger information systems over an 18-month period, and will maintain them for a further five years.



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We also successfully rebid a five-year contract to maintain the London Core Traffic Data Collection System for the Department for Transport.

The design, build and implementation stages of the Highways Agency National Traffic Control Centre are nearing completion. The team that will operate the centre is undertaking final system testing and pre-trialling to prove system operation. We have also completed the phase-in of a new contract to provide 24-hour fault repair and maintenance services to the communications equipment on the motorways in southeast England. In San Francisco we completed the installation of over 22,500 'smart' parking meters ahead of schedule.

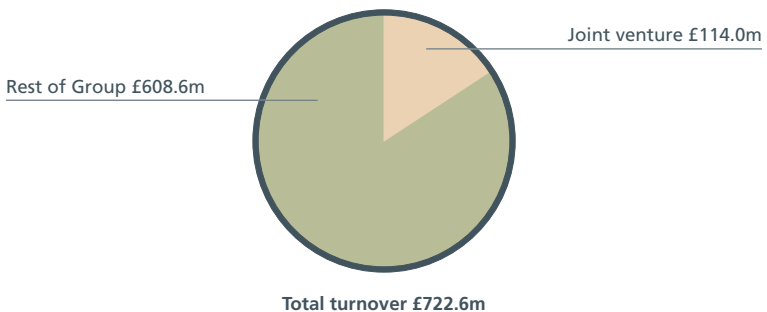
Rail

Our biggest-ever contract, the £1.8bn, 25-year agreement to operate the Merseyrail Electrics network, began in July. We and our partners, NedRailways, have undertaken to deliver innovative and tangible improvements to the existing service. Merseyrail Electrics is a self-contained railway network in and around Liverpool with 66 stations, 1,000 staff and two dedicated maintenance depots.

In Manchester we acquired 100% of Altram, which operates the Metrolink tramway system, and began a new revenue-sharing arrangement with the local transport authority.

Angel Trains, one of the three UK train leasing companies, awarded us an open-ended contract to dismantle obsolete rolling stock at Shoeburyness. We are one of only two companies in the UK able to provide these services and currently hold two of the three national contracts.

In Denmark the second phase of the Copenhagen Metro added two more stations to the system. For a nominal sum we bought-out our partners in the joint venture which will run and maintain the system for the next five years.



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Aviation

We continue to increase our presence in aviation. In the US the Federal Aviation Administration added the 59th tower to our air traffic control contract. The new tower, at Vandenburg Air Force Base, is the first active duty military facility to outsource its air traffic control services.

At the end of the last financial year we teamed-up with a South African partner, Equity Alliance, to acquire 51% of Apron Services from the South African government. Apron Services is a ground handling business operating at the country's six major airports and employing 1,900 staff. The acquisition, part of the government's public private partnership programme, extends our civil aviation activities and provides an opportunity for measured development in South Africa. Our performance improvement programme has already helped our major customer, South African Airways, to achieve record on-time departure rates, and has attracted new customers.

At Dubai International Airport we broadened our aeronautical services contract, adding a further six air traffic controllers and two engineers. The new contract is worth £10.2m over two years.

In the UK the Civil Aviation Authority Safety Regulation Group approved our aviation safety management system (ASMS) – which is only the second ASMS to gain this approval. And we began a new £4.8m four-year contract to manage Newquay Airport in Cornwall.

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. It now accounts for 28% of sales.

The formation of Serco Government Consulting (SGC) has augmented our capability in this rapidly evolving sector. Its relationships and insights will also help our operating divisions to bid for a wider variety of contracts, including IT-enabled business change work. Since its formation earlier this year, SGC has won and successfully delivered strategic work for a number of central government departments, local authorities and the police. Its capability is expected to double over the next 12 months.

Justice

Since Premier opened Doncaster Prison in June 1994 it has grown to employ 3,500 people. In July we took full control of the business: under the terms of the original joint venture agreement we paid our partner £48.6m for its 50% share, which represented 90% of the independently assessed fair value.

The business continues to grow strongly. In March it won a new eight-year contract to design, build and operate a second immigration centre. The 326-bed Colnbrook centre in Middlesex will begin operations in mid-2004 – bringing our share of total capacity in this market to almost

a quarter. Premier has also been awarded a one-year extension to its electronic monitoring contracts in the Midlands & Wales and London & Eastern regions.

One of the benefits of taking full control of Premier is that we now have full responsibility for management performance. Last year the Premier-operated Ashfield Prison and Young Offenders Institution was criticised for some aspects of its management regime and processes. We took prompt action, and the restoration of acceptable standards has been acknowledged in subsequent reports from the Prisons and Probation Ombudsman and a Standards and Security Audit.

Our Enforcement Services team, which provides road safety equipment, won new contracts worth a total of £3.7m with Essex, Lancashire, Cheshire and London Camera Safety Partnerships. The contracts form part of the Government's national initiative on road casualty reduction.

The National Crime Squad formally accepted the ChildBase biometric identification system into service; this marks the successful completion of a complex partnership development programme. Serco is uniquely placed to exploit this technology, which has a very broad range of potential uses.

Education

The contract we hold with Bradford Council for the provision of educational services is now entering its third year. We are implementing its requirements and standards in Bradford schools have risen overall in each of the last two years. Our contract to manage the Walsall Local Education Authority is also making good progress and successfully raising performance standards.

We successfully rebid our one-year school inspections contract with the regulator, Ofsted, increasing the contract size from £3m to £5m. We also successfully re-tendered to provide the National College for School Leadership's head teacher induction programme for England. This three-year contract maintains our prominence in leadership training to schools and Local Education Authorities as well as increasing our access to schools.

CCM Software Services, which provides management information systems and other solutions to schools, colleges and universities internationally, has increased sales ahead of forecast since acquisition in December 2002.

Other public services

Our contract to provide driver examination services in Ontario is currently in its transition phase. We will be providing all driver examination services for Ontario's 12m residents at 92 centres throughout the province and the contract is expected to generate revenue of C\$600m. We are paying an upfront fee of C\$114m for the concession: up to C\$15m will be funded from existing cash resources and the rest from non-recourse debt under a ringfenced facility.

Bolton Borough Council has made us preferred bidder to operate its sports and leisure facilities. The £73.5m turnover, 15-year partnership would involve transferring over 300 staff to Serco. We are also preferred bidder for a similar 15-year, £24m contract to operate Eastbourne's sports and leisure sites.

In April we began an innovative partnership to provide Woking Borough Council's ground maintenance and street cleaning services using area-based multifunctional service teams. The contract features a gain share mechanism to stimulate investment in service enhancements and future projects, and should be worth £25-30m over 10-20 years.

In Australia we won an asset maintenance contract from Melbourne water utility City West Water. Worth over A\$8m a year, the contract is for a minimum of three years.

Science

In the science sector, which accounts for 8% of sales, we were an early entrant and have established a strong competitive position.

At Britain's National Physical Laboratory (NPL) we have been building world-class new science facilities under a PFI with Laing Investments Limited, our construction partner. The construction phase is close to completion and we have acquired Laing's 50% share in the joint venture for £0.8m. We are currently rebidding the scientific service provision contract under which we manage NPL itself.

Over the past six months NPL has won a number of UK government contracts including major projects to investigate the characterisation of tissue scaffolds, where NPL will be playing a leading role, and to develop a standard for measuring extremely small forces.

CERN, the European Organisation for Nuclear Research, awarded us a contract to provide electrical, mechanical and electronic support services for its particle accelerator and experimental areas in Switzerland. We are collaborating with two French companies and the value to Serco will be some £7m over five years.

At the European Space Research and Technology Centre (ESTEC) in the Netherlands – where we have been providing support services for over 30 years – we successfully rebid a contract worth over €1m a year to provide site services for up to five years. ESTEC's Earth Observation Projects Department also appointed us in a consortium to provide project engineering, documentation and administrative support services.

At the European Space Operations Centre in Darmstadt, Germany, we successfully rebid the contract we have held for 23 years to maintain and run the operational computing and communications infrastructure; the new contract adds five more years plus a five-year renewal option.

Serco Assurance relocated its two Oxfordshire sites into one new building at Harwell. It won a contract to provide regulatory advice, assessment and inspection support to the MOD's new Nuclear Weapon Regulator; and the MOD also selected it as one of the contractors to develop an integrated sensor management system.

Private sector

Because of the scope available to us in the public sector, this has not been a primary focus for us so far. But it does provide opportunities which we address selectively, and currently accounts for 11% of sales.

In the UK GlaxoSmithKline added a three-year extension to the facilities management contract that we have held at its Ware site since 1995.

In Germany Audi awarded us a five-year contract to train service engineers for its A8 and A3 models. And we won our first facilities management contract in Italy, covering the external areas of Rome's EUR district. This wide-ranging contract includes parks and gardens maintenance and a call centre operation; it has an initial annual value of €1.7m.

In North America the Canada Mortgage and Housing Corporation awarded us a five-year extension to the contract under which we provide document services, project management, customer services, call centre operations and general contract support. East Kentucky Power awarded us a US\$1.5m fleet maintenance contract covering 250 light and heavy duty vehicles and equipment.

Telecom New Zealand broadened a long-established relationship by appointing us as property manager for its corporate, mobile and network estates throughout New Zealand under a new three-year NZ\$6.9m contract. This is an exciting development, giving us responsibility for managing the company's property assets in line with its strategic business objectives. Successful rebids included a NZ\$5.2m facilities maintenance contract with New Zealand Steel, a NZ\$4m traffic management contract with Transit NZ and a NZ\$1.3m rebid of the contract we have held since 1997 to operate the famous Wellington Cable Car.

Training and development

Serco is committed to investment in training and developing its people throughout their careers.

One of the keys to our sustained growth is the way we identify and develop our managers. In the first half we finalised our comprehensive approach to development at director level and began creating personal plans for all directors worldwide. We are currently establishing a programme to identify managers with high potential and accelerate their development.

In May, 39 people completed the development programme we run in conjunction with the Institute of Directors (IoD), achieving an above-

average pass rate in Certificate and Diploma level exams. The link with the IoD enables directors and managers with director potential to obtain accredited qualifications and further develop their capability.

Safety

As a public service business we take health and safety issues very seriously – in relation both to our own employees and to the wider public. This applies especially where we are operating in sensitive environments such as nuclear and defence installations.

So we and our partners at AWE were particularly pleased to win two prestigious categories in the Royal Society for the Prevention of Accidents (RoSPA) and Occupational Health and Safety Awards. AWE won the Defence Industry Sector Award – for the third year running – and the Astor Trophy for the UK's best managed occupational health programme.

Serco Assurance, which operates in the nuclear industry and other sectors where safety and quality are crucial, won RoSPA's Gold Award for Occupational Safety for the second year running. During the first half it also extended its ISO14001:1996 certification, gained the latest ISO9001:2000 certification and was shortlisted for the 2003 Warrington Business Awards for Environmental Training.

Other RoSPA Gold Award winners included Air Surveillance and Control Systems at four sites, Serco Aerospace, Serco Denholm, and Works Service Management at 28 sites. Our team at Fylingdales was highly commended in the defence category.

Lowdham Grange prison, operated by Premier, won the British Safety Council's National Safety Award for 2002.