Stock Exchange Announcement

2018 full year results

21 February 2019
Serco Group plc
LEI: 549300PT2CIHYN5GWJ21

Year ended 31 December	2018	2017[5]	Change at reported currency	Change at constant currency
Revenue[1]	£2,836.8m	£2,950.9m	(4%)	(2%)
Underlying Trading Profit (UTP)[2]	£93.1m	£69.3m	+34%	+40%
Reported Operating Profit (ie after exceptional items)[2]	£80.5m	£21.1m	+282%	+300%
Underlying Earnings Per Share (EPS), diluted[3]	5.21p	3.36p	+55%	+63%
Reported EPS (ie after exceptional items), diluted	5.99p	(0.76p)		
Free Cash Flow[4]	£25.0m	(£6.7m)		
Net Debt	£188.0m	£141.1m		

Rupert Soames, Serco Group Chief Executive, said: "2018 marked an inflection point for Serco. After several years of declining revenues and profits, Underlying Trading Profit at constant currency rose 40%, Reported Operating Profit grew fourfold and Revenue started to grow again in the second half. Underlying Earnings per Share (EPS) grew by 63%, Reported EPS was positive for the first time since 2013, and Free Cash Flow also turned positive for the first time since 2014. Our balance sheet remains strong, with Net Debt : EBITDA for covenant purposes at 1.1x, down from 1.4x in 2017; our pension schemes are well funded; there was no use of working capital finance facilities; we pay our suppliers on average in 30 days and our customers pay us on average in 29 days; and we have recently successfully completed the refinancing of a £250m banking facility committed to December 2023, on terms similar to previous arrangements.

"Strong order intake gave us a book-to-bill ratio of over 100% for the second year in a row, and in addition the acquisition of the Carillion health contracts contributed to our order book growing to £12.0bn at the end of 2018, an increase of around 20% since 2016. Also for the second year in a row, and reflecting the Group's broad international footprint, 80% of our order intake in 2018 came from outside the UK. Our confidence has been further bolstered by the signing in the first six weeks of 2019 of two very large contracts: AASC – asylum accommodation and support services in the UK valued at £1.9bn, and NGHS – defence healthcare provision in Australia valued at £0.6bn.

"We expect to deliver further progress in 2019, with Revenue and Underlying Trading Profit both expected to grow. Beyond 2019, and consistent with our strategy announced in 2015, we believe we will able to continue to improve our margins, with a target of achieving 5% or above in the longer term. In terms of demand, we now believe that the weighted growth rate across all our geographies and sectors has slowed from the 5-7% seen in 2010-2014 to around 2-3% now; whilst demand in some markets – for example US defence – remains robust, conditions in the UK, which represents about 40% of our revenues, are weak and this is acting as a drag to aggregate market growth. Despite this, our recent strong order intake means that we believe we should be able to outperform a weaker market in the next few years, absent unforeseen headwinds or major rebid losses. We expect Serco to achieve revenue growth of 3-4% in 2019, accelerating to around 5% in 2020 as contracts such as Grafton, Icebreaker, AASC and NGHS become fully operational."

Highlights

- Revenue[1] at constant currency declined 5.6% in the first half, but grew 2.5% in the second half, resulting in a decline for the full year of 1.7%, comprising a 3.1% organic decline from net contract attrition, partially offset by a 1.4% net contribution from acquisitions. The adverse impact of currency in the full year was £65m, or 2.2%, resulting in a 3.9% decline in revenue at reported currency.
- Underlying Trading Profit[2] at constant currency increased by 40% as a result of a strong operating performance, further good progress on transformation savings and other cost efficiencies, as well as £10m of non-recurring trading items such as end-of-contract settlements. There was an adverse currency impact of £4.0m or 6%, resulting in a 34% increase at reported currency. Margin increased by a percentage point to 3.3% (2017: 2.3%). The improvement in performance was widely spread, with all regional divisions delivering double-digit percentage growth in UTP and increases in margin.
- Reported Operating Profit increased nearly fourfold, and includes a £23.6m net credit from Contract & Balance Sheet Review items (2017: net charge of £24.2m) offset by a net charge for exceptional items of £31.9m (2017: net charge of £19.6m), neither of which are included in Underlying Trading Profit. Onerous Contract Provisions (OCPs) are ahead of our 2014 plan and the residual liability now stands at £82m, down from £447m in 2014 and £147m at the start of the year.
- Underlying EPS increased by 55%, reflecting the growth in Underlying Trading Profit, together with the benefit of the tax rate reducing from 35% to 26%. Reported EPS, which includes the after-tax impact of non-underlying items as well as net exceptional costs, stood at 5.99p (2017: loss per share of 0.76p).

- After three years of outflows, Free Cash Flow[4] turned positive at £25m.
- Net debt increased by £47m (2017: £32m), as the positive Free Cash Flow was offset by £19m of exceptional items, net acquisition consideration of £31m and a £22m negative net foreign exchange impact largely related to our US$ denominated debt. However, the growth in EBITDA resulted in underlying leverage of 1.23x and of 1.06x for covenant purposes, comfortably around the bottom of our normal target range of 1-2x. During the year we successfully refinanced our banking facility on terms similar to those previously in place, with a £250m Revolving Credit Facility now committed until December 2023.
- Acquisitions: BTP Systems, acquired for £13m in February 2018 with the intention of deepening our satellite and radar capabilities, is now fully integrated within our US defence business. Six Carillion health facilities management contracts in the UK, acquired for £17m, have now been successfully transitioned to our ownership and management.
- Order intake of £2.9bn, book-to-bill ratio over 100%; 80% of order intake was from customers of our Americas, Middle East, AsPac and continental European operations, with the remaining 20% from the UK. 66% of the order intake comprised existing work being rebid or extended, and 34% was new business. The largest award was the rebid of our US health insurance eligibility contract valued at around £700m, with over 40 other awards worth more than £10m.
- Order book increased to £12.0bn, up from £10.7bn a year earlier; the increase includes the strong order intake together with £0.7bn added via the acquisition of the Carillion health facilities management contracts and an adjustment to the definition to align with IFRS15 future contractual revenue.
- Pipeline of larger new bid opportunities increased by £0.9bn to £5.3bn at 31 December 2018; the £2.5bn of contract awards in January and February 2019 for AASC and NGHS have the effect of reducing the pipeline by £1.7bn.
- Revenue guidance for 2019 is increased from a range of £2.8-£2.9bn to a range of £2.9-£3.0bn, reflecting recent contract wins. Following an encouraging start to the year, Underlying Trading Profit is now expected to be approximately £105m under IFRS16; this represents the top end of the £95-100m guidance range given at the Closed Period Update issued on 13 December 2018, together with a £5m increase as a result of the adoption of IFRS16 (with an offsetting £5m increase to Net Finance Costs). Net debt at the end of 2019, excluding lease obligations newly recognised under IFRS16, is expected to be approximately £200m, equivalent to covenant leverage of approximately 1.3x.

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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 10.00am. The presentation will be webcast live on www.serco.com and subsequently available on demand. A dial-in facility is also available on +44 (0) 207 192 8338 (USA: +1 646 741 3167) with participant pin code 6470977.

Notes to summary table of financial results:

(1) Revenue is as defined under IFRS, which excludes Serco's share of revenue of its joint ventures and associates. 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 2018 into Sterling at the average exchange rates for the prior year.

(2) Trading Profit is defined as IFRS Operating Profit excluding amortisation of intangibles arising on acquisition as well as exceptional items. 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) and other material one-time items. A reconciliation of Underlying Trading Profit to Trading Profit and Reported Operating Profit is as follows:

Year ended 31 December £m	**2018**	**2017**
Underlying Trading Profit	**93.1**	**69.3**
Include: non-underlying items		
Contract & Balance Sheet Review adjustments	23.6	(24.2)
Trading Profit	**116.7**	**45.1**
Amortisation of intangibles arising on acquisition	(4.3)	(4.4)
Operating Profit Before Exceptional Items	112.4	40.7
Operating Exceptional Items	(31.9)	(19.6)
Reported Operating Profit (after exceptional items)	**80.5**	**21.1**

(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 results for the year ended 31 December 2017 have been restated for the adoption of IFRS15. The restatement to revenue is £2.7m from £2,953.6m to £2,950.9m, and to Underlying Trading Profit is £0.5m from £69.8m to £69.3m. All references to prior year performance referred to in the Chief Executive's Review and the Divisional Reviews have been restated accordingly. Further details regarding the impact of the adoption of IFRS15 are included in note 1 to the condensed consolidated financial statements on pages 39 to 43.

Reconciliations and further detail of financial performance are included in the Finance Review on pages 16 to 33. 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 34 to 72.

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 3.9% to £2,837m (2017: £2,951m); this measure excludes Serco's share of revenue from joint ventures and associates of £375m (2017: £356m). Net currency movements reduced revenue by £65m or 2.2%, whilst the net revenue contribution from acquisitions added £43m or 1.4%. At constant currency, the organic revenue decline was therefore £92m or 3.1%; this decline was driven mainly by contracts which were exited or lost on recompete in 2017, including Glasgow ACCESS in the UK, the Armidale Class Patrol Boats contract in Australia and the Western Australia Court Security and Custodial Services contract. The effect of these and other losses were offset partly by increased revenues from a number of new contracts in the UK, US and AsPac, and the impact of the BTP and Carillion healthcare acquisitions. Importantly, after a 5.6% organic decline in revenue in the first half of the year, revenues in the second half were broadly flat on an organic basis and grew 2.5% including the benefit of acquisitions.

Underlying Trading Profit increased by £23.8m or 34% to £93.1m (2017: £69.3m); excluding the £4.0m net currency impact, the increase was £27.8m or 40%. The improvement reflected a strong operating performance together with further good progress on transformation savings and other cost efficiencies; these more than offset the impact of contract attrition and the reduction in workload volumes on some contracts, as well as some new contracts which were mobilised and incurred start-up and transition costs. It is particularly pleasing to note that all our regional divisions delivered double-digit growth in UTP and improved their margins as set out on page 10. Transformation has continued to focus on driving efficiencies in central support functions and overheads, with our reported administrative expenses a net £20m lower than the prior year; this takes the total cumulative reduction in the cost of overheads and central support services since 2014 to over £120m. In addition, there were a number of non-recurring trading items such as end-of-contract settlements which contributed approximately £10m to UTP. Reflecting the strong increase in profits, the Underlying Trading Profit margin improved a whole percentage point to 3.3% (2017: 2.3%).

Trading Profit was £116.7m (2017: £45.1m), £23.6m higher than Underlying Trading Profit as a result of a net credit of Contract & Balance Sheet Review and other material one-time items, whereas in 2017 there was a £24.2m net charge. 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 Onerous Contract Provisions (OCPs); the £52m utilised in 2018 was lower than our expectations at the start of the year and the £69m utilised in 2017. The closing balance of OCPs now stands at £82m, compared to £147m at the start of the year and the initial charge of £447m taken at the end of 2014.

Reported Operating Profit and Exceptional Costs
Reported Operating Profit of £80.5m (2017: £21.1m) was £36.2m lower than Trading Profit as a result of £4.3m (2017: £4.4m) of amortisation of intangibles arising on acquisition and operating exceptional costs of £31.9m (2017: £19.6m), mainly comprising restructuring programme costs of £32.3m (2017: £28.6m) related to the Transformation stage of our strategy, including redundancy charges, asset impairments and other incremental costs; they also included a £13.9m exceptional profit from a settlement related to the disposal of Serco GmbH in 2012, and a £9.6m exceptional charge related to equalising Guaranteed Minimum Pension (GMP) payments on pension schemes. Within reported net finance costs there was a £7.5m exceptional profit related to the early repayment of the vendor loan note issued on the disposal of the Intelenet business in 2015. Together with an exceptional tax credit of £2.1m (2017: charge of £5.0m), total net exceptional costs were therefore £22.3m (2017: £24.6m).

Financing and pensions
Pre-exceptional net finance costs were £13.9m (2017: £11.2m), with the increase driven principally by a lower credit related to pension schemes. Average net debt was £51m higher than the prior year, very similar to the £47m increase between the start and the end of the year, though the impact on our interest expense was largely offset by the effect of having repaid some of our US private placement notes during the year. Cash net interest paid was £18.1m (2017: £17.0m).

Serco's pension schemes are in a strong funding position, resulting in a balance sheet accounting surplus, before tax, of £71m (2017: £26m) on scheme gross assets and gross liabilities each of approximately £1.3bn. The net asset position leads to a small net credit within net finance costs of £0.8m (2017: £3.8m), which is lower than the prior year due to 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 around half of all scheme members, has the effect of fully removing longevity, investment and accounting risks; the gross liability remains recognised on our balance sheet, but there is an equal and opposite insurance asset reflecting the perfect hedge established by the annuity.

Tax

The underlying effective tax cost was £20.6m (2017: £20.2m), representing an underlying effective rate of 26% (2017: 35%) based upon £79.2m (2017: £58.1m) of Underlying Trading Profit less 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 rate is lower than the prior year reflecting the improvement in and mix of the Group's profitability, together with the net effect of US tax reform; we expect the rate to continue to reduce over the longer term as a result of further improvements in the profitability of the UK business. The tax on non-underlying items was a net credit of £11.8m (2017: £6.6m), which includes an additional £2.9m of deferred tax asset in relation to UK losses to reflect the improved forecast of UK taxable income. Total pre-exceptional tax costs were £8.8m (2017: £13.6m). Cash net tax paid was £10.6m (2017: £11.4m). Our reported 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.

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 34, was a profit of £67.4m (2017: loss of £8.0m). This reflects: Trading Profit of £116.7m (2017: £45.1m); amortisation of intangibles arising on acquisition of £4.3m (2017: £4.4m); pre-exceptional net finance costs of £13.9m (2017: £11.2m); a non-cash fair value gain in 2017 of £0.7m (2018: nil); pre-exceptional tax costs of £8.8m (2017: £13.6m); and total net exceptional costs of £22.3m (2017: £24.6m).

Earnings Per Share (EPS)

Underlying EPS, which reflects the Underlying Trading Profit measure after deducting pre-exceptional net finance costs and related tax effects, increased by 55% to 5.21p (2017: 3.36p). The improvement reflects the 34% increase in Underlying Trading Profit at reported currency, and the increase in net finance costs which was more than offset by the lower tax rate; the weighted average number of shares in issue, after the dilutive effect of share options, was broadly unchanged at 1,125.4m (2017: 1,120.6m). Reported EPS, which includes the impact of the other non-underlying items and exceptional costs, was a profit per share of 5.99p (2017: loss per share of 0.76p).

Cash Flow and Net Debt

Free Cash Flow was positive £25m (2017: negative £7m), the first year of positive Free Cash Flow since 2014. Cash generated from Underlying Trading Profit was partially offset by the outflows related to loss-making contracts subject to OCPs, principally the Caledonian Sleeper, COMPASS and PECS contracts. These cash outflows were lower than the prior year, as reflected in the lower rate of OCP utilisation of £52m (2017: £69m). There was a working capital outflow of £22m (2017: outflow of £14m); whilst the company has a working capital financing facility, it has not been drawn since the first quarter of 2017. Average working capital days in the year were broadly unchanged: the average credit period taken by Serco's customers is 29 days (2017: 23 days) and the average credit period taken by Serco for our trade purchases is 30 days (2017: 33 days), with 85% of UK supplier invoices paid in under 30 days.

Closing net debt at 31 December 2018 increased to £188m (2017: £141m); the increase of £47m includes the Free Cash inflow of £25m, offset principally by three sources of outflow: a £19m (2017: £33m) cash outflow related to exceptional items; £31m net outflow for acquisitions (which includes £17m for the Carillion health contracts and £13m for the BTP Systems acquisitions); and a net adverse currency translation effect of £22m, predominantly reflecting the Group's US$ Private Placement debt. The closing net debt compares to a daily average of £235m (2017: £184m) and a peak net debt of £307m (2017: £243m), with the peak reflecting the timing of acquisition outflows and the adverse currency impact.

At the closing balance sheet date, our leverage for debt covenant purposes was 1.06x EBITDA (2017: 1.36x), which compares with the covenant requirement to be less than 3.5x; removing the benefit of the £23.6m of non-underlying items within covenant EBITDA, underlying leverage is 1.23x and remains therefore comfortably around the bottom of our normal target range of 1-2x.

During the year we successfully refinanced our Bank facilities on terms similar to those previously in place, with a £250m Revolving Credit Facility now in place until December 2023.

Dividends

The Board is not recommending the payment of a dividend in respect of the 2018 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 judges it prudent to do so, in assessing whether we should resume dividend payments in respect of 2018, we are mindful of the fact that 2019 is the last year of significant outflows of cash related to OCPs and operating exceptional costs, which together will mean that net debt is likely to increase again 2019, albeit modestly. The Board will continue to keep the dividend policy under careful and regular consideration as we progress with completing the transformation stage and driving forward with the growth stage of 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.

Contract awards, order book, rebids and pipeline

Contract awards

The Group's order intake totalled £2.9bn during 2018, representing a book-to-bill ratio of just over 100%; this is the second year in succession that the book-to-bill ratio has been positive. There were over 40 contract awards worth more than £10m each, by far the largest of which was the rebid of our health insurance eligibility support contract in the US for the Center for Medicare & Medicaid Services (CMS) which is estimated to be worth around £700m over the next five years. Rebids and extensions of existing work together represented 66% of the total value signed, with the balancing 34% represented by the value of new business won.

Other notable contract awards included, again in the US: a sole-source contract vehicle to support Naval Electronic Surveillance Systems (NESS); program management to the United States Air Forces Central Command (AFCENT); installation support for Close-In Weapons Systems (CIWS); US Army global acquisition and logistics operations support; and defence training support services. There was also a single-award Indefinite Delivery/Indefinite Quantity (ID/IQ) framework to support the Federal Emergency Management Agency (FEMA), though only a very small initial value is included within the awards value. In the UK, we received a 10-year extension supporting Peterborough County Council with a range of frontline and back office services, an 18-month extension for the NorthLink Ferries service, and a new award for environmental services with Hart and Basingstoke councils. In AsPac, awards were dominated by new contact centre services for Victoria Police, Australia's National Disability Insurance Scheme and the Department of Human Services, together with a new contract to manage road tunnels in Hong Kong. In the Middle East, we received a letter of intent to extend our Dubai Metro operations for a further two years, successfully rebid the MELABS defence base logistics and support services contract and facilities management support in Abu Dhabi, added new fire and rescue services at King Fahd International Airport in Dammam in Saudi Arabia, and extended our air traffic control services contract in Iraq. In aggregate, around 80% of order intake came from customers of our Americas, AsPac, Middle East and continental European operations, with the remaining 20% from the UK.

The largest losses of bids for new work were the Defence Fire & Risk Management Organisation (DFRMO) tender in the UK, and two bids in the US - maintenance and logistics support for Solid State Phased Array Radar Systems (SSPARS) and Navy C5ISR kitting and cabling work (CIKC). In regard to DFRMO, our legal challenge to the award is still in process. Of existing work, the largest loss was our support of air traffic control services in Bahrain, though the annual revenue was less than 0.5% of the Group overall.

Win rates by volume for the year were around 50% for new bids and 90% for rebids and extensions. Win rate by value was around 25% for new work and around 93% for securing existing work.

In the first six weeks of 2019 we signed two major contracts: in the UK we won our largest ever contract, being £1.9bn over 10 years for AASC (providing asylum accommodation and support services) and £0.6bn for NGHS (providing health services to the Australian Defence Force working as a sub-contractor to Bupa).

Order book

The Group's order book is an estimated £12.0bn at the end of 2018, up by £1.3bn versus £10.7bn at the start of the year, and by £2.1bn from the level at the end of 2016. The increase includes the strong order intake and the £0.7bn added to the order book as a result of the transfers of the six UK health facilities management contracts from Carillion. It also includes the change in definition to align with the IFRS15 disclosures of the future revenue expected to be recognised from the remaining performance obligations on existing contractual arrangements. It is worth noting that this excludes unsigned extension periods; however, the £12.0bn would be £13.0bn if option periods in our US business were included; as option periods have always tended to be exercised in our US business, we do include these in our assessment of order intake, as was the case with the value of the CMS contract as noted in the above section on contract awards.

There is £2.4bn of revenue secured in the order book for 2019, equivalent to around 80% visibility of our £2.9-3.0bn revenue guidance.

Rebids

As we look ahead over the next three years through to the end of 2021, 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 £1.2bn in aggregate or around 40% of the Group's 2019 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); at the start of 2018 the three-year forward rebid value was £1.4bn. Contracts that could potentially end at some point before the conclusion of 2019 have aggregate annual revenue of over £400m, the largest of which are the Australian immigration services and NorthLink Ferries operations. In 2020, the annual value of contracts due for extension or re-compete is currently less than £400m, with our work under a US Navy installation framework (GIC) and the Prisoner Escorting Services (PECS) in the UK being the largest contracts anticipated to become due in that year.

Pipeline

Our measure of Pipeline is probably more narrowly defined than is common in our industry; it was originally designed as an indicator of future growth and focuses on bids for new business only. As a consequence, on average over the last five years less than half of our achieved order intake has come from the Pipeline. It measures only opportunities for new business that have an estimated Annual Contract Value (ACV) of at least £10m, and which we expect to bid and to be awarded within a rolling 24-month timeframe; we cap the Total Contract Value (TCV) of individual opportunities at £1bn, to attenuate the impact of single large opportunities; the definition does not include rebids and extension opportunities; and in the case of framework, or call-off, contracts such as 'ID/IQ' (Indefinite Delivery / Indefinite Quantity contracts which are common in the US) we only take the individual task orders into account. It is thus 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.

On this definition our Pipeline stood at £4.4bn at the beginning of 2018. Around £3.7bn has come out of the Pipeline due to wins and losses, together with the net effect of a small number of removals due to opportunities no longer meeting our definition, and value changes. A number of new opportunities matured to the stage where they meet our Pipeline definition, adding in aggregate £4.6bn over the course of the year. As a result, the Pipeline increased to stand at £5.3bn at 31 December 2018, which consists of around 30 bids that have an ACV averaging approximately £30m and a contract length averaging around six years.

As we have noted before, 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 2019 to date, Serco has already won the two largest opportunities in its Pipeline – AASC in the UK and NGHS in Australia, valued at £2.5bn in aggregate. Removing these opportunities from the £5.3bn Pipeline as at 31 December 2018 would reduce it by £1.7bn to around £3.6bn; the reason why the Pipeline will not drop by the full amount of orders won is that part of AASC was a rebid of an existing region.

Guidance for 2019

At our Closed Period Update on 13 December 2018, we provided 2019 guidance for revenue of £2.8-2.9bn and Underlying Trading Profit (UTP) of £95-100m. Reflecting recent contract wins, namely the AASC asylum support services contracts in the UK and the NGHS defence health contract in Australia, we now believe that 2019 revenues will be higher, and in the £2.9-3.0bn range. Those contract wins are expected to have a negligible effect on profitability in 2019 due to mobilisation and transition costs, but in 2020 and thereafter we expect those contracts to be materially positive to both profitability and cash flow.

As previously stated in our December 2018 update, 2019 will not benefit from the £10m of non-recurring trading items such as end-of-contract settlements that contributed to the very strong profit growth delivered in 2018. However, profit growth and margin progress are still anticipated in 2019, in line with current market consensus. Whilst there are declines in some contracts, most notably MELABS in the Middle East division, these are expected to be offset by strong growth in the profits delivered by our UK Healthcare business as a consequence of the full-year effect of our acquisition of six Carillion health contracts and other contracts coming out of transition, together with the benefit of further cost efficiencies.

Following an encouraging start to the year, and adjusting for the adoption of IFRS16, our guidance for UTP in 2019 is now approximately £105m. This represents the top end of the range provided with our December 2018 update, together with an additional increase £5m to take account of the new IFRS16 accounting standard for leases which is effective for the Group from 1 January 2019. IFRS16 results in the previous operating lease expense which was fully charged to UTP being split into: a depreciation charge of a newly recognised 'right of use' lease asset, with the depreciation being charged to UTP over the life of the lease calculated on a 'straight-line' basis; and secondly an 'interest cost' element of a newly recognised lease liability which will be charged to Net Finance Costs (NFC), but with this being calculated on a 'reducing balance' basis. In 2019, the increases to UTP and NFC are estimated to each be around £5m and therefore broadly net out. For all new leases they will fully net out over the life of each lease, though the interest cost will be higher in the early years of a lease and lower in the later years; this will therefore have a noticeable effect on the accounting for the thousands of property leases on the AASC contract in 2020, which will be its first full year of operation.

Previous guidance for NFC was for these to increase in 2019, principally as a result of an approximate £3m net reduction in investment revenue following the early repayment in October 2018 of the vendor loan note issued on our disposal of Intelenet in 2015. Together with the impact of IFRS16 described above, our NFC guidance is updated to approximately £20m. The interest cost associated with lease liabilities that are newly recognised under IFRS16 may prove to be volatile, particularly given the effect of the length of property leases which may not be known in advance. Importantly, whilst the NFC impact may be volatile from year-to-year both at individual lease and at aggregate level across the whole book of lease commitments, cashflows will follow the terms of the underlying leases, and will generally be smooth over the life of a lease.

The Group's underlying effective tax rate is expected to reduce to below 25% in 2019 as a result of improving profitability in the UK business. Exceptional restructuring costs are expected to be approximately £20m as we implement the final steps of the Group's transformation stage of our strategic plan implementation. The weighted average number of shares for diluted EPS is expected to be approximately 1,145m. Further background to these areas is included in the Finance Review.

With regard to Free Cash Flow, having turned positive in 2018 after three years of outflows, it is expected to be broadly similar in 2019, with the lack of non-recurring credits within 2018's FCF being offset by improved profitability and lower OCP utilisation in 2019. After the cash cost of exceptional items and a smaller acquisition-related payment, the overall movement in Net Debt is expected to be a modest outflow, resulting in closing net debt before the effect of IFRS16 (and therefore comparable to the opening position of £188m) of approximately £200m. IFRS16 has no cash flow impact, with reclassifications between operating and financing cash flows fully netting out over the life of a lease, nor is there any covenant impact, as the Group's financing facilities will continue to be calculated under the prior standard, IAS17. Guiding to net debt excluding lease obligations newly recognised with IFRS16 is therefore considered both more insightful and consistent with the covenant measure for the Group's financing facilities. Underlying leverage is expected to be approximately 1.3x EBITDA at the end of 2019, compared with 1.2x at the end of 2018.

As we remind people every year, there remains a wide range of potential outcomes reflecting the sensitivity of our profits to even small changes in revenues and costs. A key sensitivity is the movement of currency rates during the year, with our guidance based upon recent currency rates prevailing throughout 2019, which, given opposite movements in the US dollar and Australian dollar against sterling, currently implies a broadly neutral impact when compared to the average rates for 2018.

Outlook beyond 2019

When we set out our strategy in early 2015, we noted that for our mix of geographies and market sectors, the market grew by about 5-7% in the four years to 2014, with competitors achieving margins of 5-6%. It was our stated ambition for Serco to match market growth and industry margins in the longer term. Since then, market conditions have become less favourable in the UK, our largest market, and this has acted as a drag on our updated estimate of the weighted average rate of market growth.

Despite this we still believe that the Four Forces (relentlessly increasing demand for public services; expectations of higher service quality; structural fiscal deficits; electoral resistance to tax increases) will continue to encourage governments to seek innovative ways to deliver more services, of higher quality, and at lower cost (what we call ‘More and Better for Less’). So, in the longer term, average annual market growth of 5%+ seems to us achievable. However, at the moment, we believe that the current weighted average rate of growth across all our geographies and sectors is currently running lower than that at 2-3%, in large part because of the difficult conditions in the UK, which represents some 40% of our revenues. It is not possible to forecast with any certainty how demand in the UK market will evolve during and after Brexit; the possible outcomes range from a rapid increase in demand, through to a gradual decline and where they will actually fall is unknowable, but we are inclined to believe that the risk to our business is weighted slightly to the upside. There is more commentary on our views on the UK market on pages 12 to 13.

In this more uncertain outlook for market growth, a number of factors favour Serco and give us confidence that over the next few years, and absent unforeseen headwinds or losses on major rebids, we should be able to grow our revenues faster than the underlying market; we think that 2019 will see revenue growth of 3-4%, and that revenue growth will accelerate to around 5% in 2020 as contracts such as Grafton, Icebreaker, AASC and NGHS become fully operational.

The reasons we believe that we can grow faster than the market are, first, because although the UK Government’s appetite for new projects has been reduced, frontline services of the type we provide tend to be non-discretionary and critical in nature; a government may decide whether it wants to invest in a major new outsourcing project, and can more or less speed up or slow down such projects at will. It cannot, however, suddenly decide it does not want to house 20,000 asylum seekers, or move its ships and submarines, or clean its hospitals. Our core competence in providing vital, frontline, people-enabled services, having been regarded as somewhat “below the salt”, is now, we believe, an important asset. Second, our order intake in the last two years has been strong, and our order book – up around 20% since 2016 and about to be further blessed with £2.5bn of orders received in the first six weeks of 2019 – will underpin growth in our revenues over the next few years as those large new contracts become fully operational.

In terms of our ambition of achieving margins of at least 5% over the longer term, we believe that this is still achievable by a combination of contract and overhead cost efficiency, running off OCP contracts and the conversion of some of them into profitable contracts (of which AASC is a shining example), and revenue growth.

Summary

We have referenced in previous Annual Reports the maxim of the Prussian military strategist Helmuth von Moltke the Elder that “no strategy ever survives first contact with the enemy”. A more contemporary version of this maxim comes from the boxer Mike Tyson who said: “Everyone’s got a plan until they get punched in the mouth”. As strategies age, the more punches events land upon them. Our own strategy, launched in 2015, is surviving well against the battering of events, including an unforeseen blow in the form of Brexit and its impact on the UK market. Notwithstanding this punch, we still think we can deliver on our objective of 5% revenue growth and margins working their way up to 5%, and hopefully beyond.

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. 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).

Year ended 31 December 2018 £m	UK&E	Americas	AsPac	Middle East	Corporate costs	**Total**
Revenue	**1,300.7**	**645.6**	**548.2**	**342.3**	**-**	**2,836.8**
Change	*(2%)*	*(6%)*	*(5%)*	*(3%)*		*(4%)*
Change at constant currency	*(2%)*	*(3%)*	*0%*	*+1%*		*(2%)*
Organic change at constant currency	*(4%)*	*(5%)*	*(1%)*	*+1%*		*(3%)*
Underlying Trading Profit/(Loss)	**39.2**	**45.7**	**26.8**	**21.5**	**(40.1)**	**93.1**
Change	*+12%*	*+26%*	*+20%*	*+24%*	*(4%)*	*+34%*
Change at constant currency	*+12%*	*+30%*	*+27%*	*+30%*	*(4%)*	*+40%*
Margin	**3.0%**	**7.1%**	**4.9%**	**6.3%**	**n/a**	**3.3%**
Change	*+40bps*	*+180bps*	*+100bps*	*+140bps*		*+100bps*
Contract & Balance Sheet Review adjustments	12.4	(2.5)	13.7	-	-	23.6
Trading Profit/(Loss)	**51.6**	**43.2**	**40.5**	**21.5**	**(40.1)**	**116.7**
Amortisation of intangibles arising on acquisition	(0.5)	(3.2)	(0.6)	-	-	(4.3)
Operating profit/(loss) before exceptionals	**51.1**	**40.0**	**39.9**	**21.5**	**(40.1)**	**112.4**

Year ended 31 December 2017 £m	UK&E	Americas	AsPac	Middle East	Corporate costs	**Total**
Revenue	**1,331.5**	**689.3**	**577.5**	**352.6**	**-**	**2,950.9**
Underlying Trading Profit/(Loss)	**34.9**	**36.4**	**22.3**	**17.3**	**(41.6)**	**69.3**
Margin	**2.6%**	**5.3%**	**3.9%**	**4.9%**	**n/a**	**2.3%**
Contract & Balance Sheet Review adjustments	(39.0)	3.4	11.4	-	-	(24.2)
Trading Profit/(Loss)	**(4.1)**	**39.8**	**33.7**	**17.3**	**(41.6)**	**45.1**
Amortisation of intangibles arising on acquisition	-	(3.0)	(1.4)	-	-	(4.4)
Operating profit/(loss) before exceptionals	**(4.1)**	**36.8**	**32.3**	**17.3**	**(41.6)**	**40.7**

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 16 to 33. 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 34 to 72.

UK & Europe

Serco's UK & Europe division supports public service delivery across all five of the Group's chosen sectors: our Justice & Immigration business provides a wide range of services to support the safeguarding of society and the reduction of reoffending, from prison management through to housing and welfare services for asylum seekers; in Defence, we are trusted to deliver critical support services and operate highly sensitive facilities of national strategic importance; 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 and European institutions. Serco's operations in the UK represent approximately 41% of the Group's reported revenue, and those across the rest of Europe approximately 5%.

Revenue for 2018 was £1,300.7m (2017: £1,331.5m), a decline of 2%. Reported Revenue excludes that from our joint venture and associate holdings which largely comprise the operations of AWE and Merseyrail. At constant currency, the decline in Revenue was also 2%, or £33m. The net contribution from acquisitions, driven by the transfer of the Carillion health facilities management contracts, was £23m or 2%, therefore the organic decline was £56m or 4%. The Glasgow ACCESS operations which transferred at the end of 2017 had a £57m impact and therefore accounted for virtually all of the organic decline; some other smaller contracts ending as well as some areas of reduced project work or volumes, such as the London Cycle Hire Scheme and the Child Maintenance Group, extended the level of revenue reduction. These were offset by new contract growth, in particular annualising 2017's start of hospital facility management services for Barts Health NHS Trust and University Hospital Southampton NHS Foundation Trust, as well as from the new Skills Support for the Workforce (SSW) contracts.

Underlying Trading Profit was £39.2m (2017: £34.9m), representing an implied margin of 3.0% (2017: 2.6%). Trading Profit includes the profit contribution (from which interest and tax have already been deducted) of joint ventures and associates; if the £374m (2017: £350m) proportional share of revenue from joint ventures and associates was also included and if the £5.7m (2017: £7.1m) share of interest and tax cost was excluded, the overall divisional margin would have been 2.7% (2017: 2.5%). The joint venture and associate profit contribution was modestly ahead at £28.1m (2017: £26.3m). The further improvement in Underlying Trading Profit included the benefit of transformation and cost efficiency programmes in the division as well as some improvement in the profitability of certain contracts moving out of their transition stages, with these more than offsetting the impact of other contract attrition and the investment required to mobilise and transition the Carillion contracts.

Within Underlying Trading Profit there was a reduced rate of OCP utilisation at £47m (2017: £55m), which served to offset the Division's loss-making operations, principally the Caledonian Sleeper, COMPASS asylum seeker support services, Prisoner Escort & Custody Services (PECS) and Lincolnshire Country Council contracts. Contract & Balance Sheet Review and other material one-time items resulted in a £12.4m net credit (2017: £39.0m net charge) to Trading Profit which increased sharply to £51.6m (2017: loss of £4.1m).

The UK & Europe division represented around £0.7bn or 25% of the Group's order intake. The two largest awards were a £105m ten-year contract extension for frontline and back office services to Peterborough City Council, and a £104m 18-month contract extension to continue managing and operating the NorthLink Ferries service for Transport Scotland. The largest new contract was an eight-year joint award for environmental services for Hart District Council and Basingstoke & Deane Borough Council. Other notable awards in the year included successfully rebidding with BAE Systems our repair and maintenance contract for Command Support Air Transport (CSAT) aircraft operated out of RAF Northolt by 32 (The Royal) Squadron, rebidding and adding new areas of support for the European Commission Directorate General for Informatics; expanding our contact centre services for the DWP, launching a new cycle hire scheme for Transport for Edinburgh, fire and rescue services for the construction phase of Hinkley Point C nuclear power station, and extending our support services for the European Organisation for Nuclear Research (CERN).

The signing of the Asylum Accommodation and Support Services Contracts (AASC) in January 2019 is very significant for the division, and indeed for the Group. AASC supersedes the current COMPASS contracts which have been incurring annual losses (offset in the P&L by the utilisation of the OCP) of around £15-20m for the last four years. Under the new AASC contracts, we did not retain the Scotland & Northern Ireland region, but gained the much larger Midlands region, whilst retaining our "home" region of the North West; as a consequence we will now be the largest provider of asylum seeker accommodation in the UK. Given our past experience, we also bid the regions at prices which we believe should allow us to make a fair return; we expect the new contract to deliver revenues of around £150m in the initial year, as against the current COMPASS run-rate of around £70m.

Of existing work where an extension or rebid will be required at some point before the end of 2021, there are over 20 contracts with annual revenue of over £5m within the UK & Europe division; in aggregate, these represent approximately 20% of the current level of annual revenue for the division. The largest of these are the NorthLink

Ferries contract that was extended to 31 October 2019 and is now being rebid for the next six-year term; in 2020, the current PECS contract ends assuming a final extension option is not exercised by the customer; and in 2021, our strategic partnership contract supporting Hertfordshire County Council.

The rebid profile and the new bid pipeline have both reduced with the successful outcome of our bidding for AASC. Other opportunities in the new bid pipeline include several environmental services and health facilities management tenders, and a smaller number of other opportunities to support various defence, Citizen Services and Justice operations. We expect to add to our pipeline in 2019 those opportunities that will be competed for under the recently launched prison operator services framework.

Conditions in the UK market are highly uncertain as a result of Brexit, which is an overlay of immense complexity and distraction on top of what were already significant challenges to Departments as a result of Government efforts to reduce the structural deficit, whilst increasing spending on the NHS. As we predicted eighteen months ago, the Government and the Civil Service have now come to be focused upon the challenges of negotiating and preparing for Brexit, and this has had the effect of reducing their appetite for new outsourcing and transformation projects. However, Government is still proceeding with procurements of non-discretionary services as existing arrangements come to an end. Examples of this include AASC and the upcoming PECS rebid.

In terms of the likely direct impact of Brexit upon our business – we are facing the same fog of uncertainty as every other business in the UK. It is certain that “taking back control” will require more people working for or on behalf of Government to do the taking back and the controlling; already 20,000 additional civil servants have been recruited into Central Government, and one would expect over time that the numerous additional regulatory functions will require some sort of support. We neither export nor import to any significant degree, therefore we are not exposed directly to the border issues that worry other businesses, although we are mindful that we will need to maintain continuity of supplies to the 5,000 prisoners we are responsible for, and indeed the 7 million patients cared for each year in the 18 NHS hospitals that Serco supports. In terms of the balance of risks, we think they are marginally balanced to the upside. In the short term there is a small possibility that there could be an upturn in demand if Government needs help quickly; on the downside, we think it unlikely that there will be any precipitous drop in demand as a result of Brexit. As far as our business in Europe is concerned, which accounts for about 5% of Group revenue, the vast majority of this is supplied via our wholly-owned EU-resident companies, and therefore should be largely unaffected. Finally, of our UK employees, only 6% are continental EU nationals, so whilst there might be an indirect effect of labour shortages, the direct effect should be limited.

As well as the challenges of Brexit, the Government has been wrestling with the fallout from the collapse of Carillion in early 2018, which has been accompanied by other major contractors becoming distressed and having to raise equity or refinance their debt. There has been a recognition by Government that it can neither abjure all responsibility for, nor ignore, its supply chain becoming so seriously distressed. Nor can it be blind to liquidity issues amongst outsourcers as banks become increasingly reluctant to support the sector.

In this difficult environment, Serco has worked hard to be a helpful and constructive partner of Government. We have publicly stated our admiration for the way they managed the liquidation of Carillion. We have published ideas to improve the working of the market in the form of Four Principles. These principles cover: greater **Transparency** in regard to the make-or-buy decision-making process for Government services, as well as publishing operational and financial key performance indicators so that taxpayers could see the quality of service they were receiving; **Security of Supply**, including the lodging of ‘Living Wills’; **Orderly Exit** provisions, for both the Government and suppliers; and **Fairness**, including codes of conduct for both Government and suppliers.

In the middle of 2018, the Cabinet Office set up a joint Government / Industry group to improve the working of the public services market; Serco has been deeply engaged in this process which resulted in the publication in February 2019 of an ‘Outsourcing Playbook’ along with a comprehensive set of guidance notes. This sets out the ground rules for suppliers and Government departments for the outsourcing of public services. It also reiterates the value that Government sees in having private companies and third sector organisations being able to provide services. The Minsters responsible, David Lidington and Oliver Dowden, have been highly supportive of the role of the private sector, and forthright in stating their belief that the role of Government should be to procure services that deliver high quality, resilience and value for money for the taxpayer and service user, and be agnostic and even-handed as to whether this is achieved through the public or private sectors. This approach is all that a strong and healthy private sector should reasonably hope for; if we cannot deliver better innovation, value and quality than the public sector, then we don’t deserve the taxpayer’s shilling. We think that the publication of the Playbook, which reflects many of the ideas we put forward in our Four Principles, is an important and positive development.

Government has always been keen to emphasise that it wants to attract new suppliers, and that the barriers to entry into its supply chain are low; they are now seeing that, for both suppliers and their lenders, the barriers to exit are low as well. They are also seeing that a distressed supply base can be as much of a problem for customers as it is for suppliers. The effectiveness of the new Playbook in modifying some of the damaging behaviours of the past, by both Government and suppliers, should be decisive in maintaining a competitive, innovative and capable supply chain which Government can have at its behest to deliver high quality, resilient and cost-effective public services. The challenge will be ensuring Government departments comply with the good intentions of Ministers and the policy documents of the Cabinet Office. In order to ensure the Playbook works in practice, we hope that the principle of "comply or explain", which has been so effective in promoting good practice in the world of public company governance, will be used to encourage compliance. We also hope that the Playbook will be incorporated into formal Treasury guidance on procurement, and that Cabinet Office and the National Audit Office will be given the resources they need to be able to act as guardians of its implementation.

Notwithstanding the fact that over 80% of our order intake in the last two years has been from governments outside the UK, the UK does still account for around 40% of our revenues, and it is therefore in Serco's interest, and it is our responsibility, to support the work of the UK Government to ensure a vibrant and successful supply base, and to defend the consensus that the private sector has an important role to play in the delivery of public services. We are encouraged by the new Playbook, and are committed to being a leading player in the UK market for public service delivery. We believe that we are well placed to act in such a role given our credentials: deep capability and experience in many areas of public service delivery; a strong financial position; a track record of dealing fairly with suppliers, employees and customers; a strong public service ethos and commitment to social value; and a reputation for standing by our contractual commitments, but being resolute in not accepting risk that cannot either be mitigated or managed.

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 2018 was £645.6m (2017: £689.3m), a 6% reduction in reported currency. In US dollars, the main currency for operations of the division, revenue for the period was equivalent to approximately US$860m (2017: US$890m). The strengthening of Sterling reduced revenue by £23m or 3%; the acquisition of BTP added 2% to revenue; the organic change at constant currency was therefore a decline of 5%, or £33m. Lower volumes of work and the new contract structure of our CMS health insurance eligibility support contract drove a £54m decline, with further impact of fewer task orders in areas of ship modernisation work particularly in the first half of the year. There was partial offset from growth related to the new contract for supply chain management services for the Defense Logistics Agency (DLA), and for Anti-Terrorism/Force Protection (ATFP), Army base modernisation (IMCOM) and Naval Electronic Surveillance Systems (NESS) services. While there was the 5% organic decline for the year as a whole, there was organic growth of 3% in the second half.

Underlying Trading Profit was £45.7m (2017: £36.4m), representing a margin of 7.1% (2017: 5.3%). The benefit of profitable growth from new contracts, the new structure of the CMS contract and other cost efficiencies more than offset the effect of lower ship modernisation work in the first half of the year and the adverse currency movement of £1.6m. Within Underlying Trading Profit there was negligible OCP utilisation required to offset the loss-making Ontario Driver Examination Services (DES) contract in 2018 (2017: £5m). There was a £2.5m charge for Contract & Balance Sheet Review adjustments (2017: £3.4m credit), after which Trading Profit was therefore £43.2m (2017: £39.8m).

Americas represented around £1.3bn ($1.8bn) or 45% of the Group's order intake. The largest award was the rebid of our health insurance eligibility support contract for the US Department of Health and Human Services, Center for Medicare & Medicaid Services (CMS), with an estimated total value to Serco, subject to workload volumes, of approximately $900m if all options of the five-year contract are exercised. The second largest was a $232m sole-source contract vehicle for Serco to continue supporting Naval Electronic Surveillance Systems (NESS). Along with numerous defence equipment modernisation task orders under our various ID/IQ frameworks, other notable awards included: programme management and technical support services to the United States Air Forces Central Command (AFCENT); installation support for Close-In Weapons Systems (CIWS) on US Navy, Army and Coast Guard vessels; supporting the US Army Sustainment Command (ASC) with global acquisition and logistics operations support; and training support services to the US Army Joint Munitions Command (JMC) and the Defense Ammunition Center (DAC).

A new single-award Indefinite Delivery/Indefinite Quantity (ID/IQ) contract to provide public technical assistance to the Federal Emergency Management Agency (FEMA) was awarded to Serco; while this has a potentially large ceiling value of $600m over the next five years, only a very small initial value for programme management is recognised in our value of signed contracts and order book, as the workload will ultimately be dictated by task orders issued in response to declared major disasters and emergencies.

Of existing work where an extension or rebid will be required at some point before the end of 2021, there are 13 contracts with annual revenue of over £5m within the Americas division; in aggregate, these represent around 35% of the current level of annual revenue for the division, which is a significantly lower proportion versus a year earlier now that the CMS and NESS contracts were secured during 2018. There are few material contracts with potential end dates in 2019. Those coming up for rebid or extension in 2020 include the Global Installation Contract covering areas of our defence ship modernisation work, the Federal Aviation Administration's (FAA) Contract Tower (FCT) Program, and our operational support to Federal Retirement Thrift Investment Board.

Our pipeline of major new bid opportunities due for decision within the next 24 months includes a broad spread of defence support functions, transport operations including air traffic control support, and in areas of Citizen Services case management and processing.

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 2018 was £548.2m (2017: £577.5m), a decline of 5%. In Australian dollars, the main currency for operations of the division, revenue for the period was equivalent to approximately A$980m, flat on the prior year. The strengthening of Sterling reduced revenue by £31m or 5%; 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 1%, or £6m. This net reduction included a £31m impact from the Armidale Class Patrol Boats (ACPB) and Western Australia Court Security & Custodial Services (WACSCS) contracts, both of which ended in the first half of 2017, which was largely offset by growth in our Citizen Services business which provides contact centre and processing support services, and a small increase in workload in Immigration Services. While there was a small organic decline for the year as a whole, there was organic growth of 10% in the second half.

Underlying Trading Profit was £26.8m (2017: £22.3m), representing a margin of 4.9% (2017: 3.9%). There was profitable growth from the new Citizen Services work, a number of non-recurring commercial settlement benefits and good progress on transformation savings and other cost efficiencies; these more than offset other areas of margin pressure and the adverse currency impact of £1.6m. Within Underlying Trading Profit there was £5m of OCP utilisation (2017: £9m), significantly reduced following the end of the ACPB contract.

Contract & Balance Sheet Review adjustments resulted in a £13.7m credit (2017: £11.4m), principally reflecting the release of the remaining OCP balance on the ACPB contract following the expiry of all warranty periods, together with the successful recovery of an insurance claim related to one of the ACPB vessels. After these credits, Trading Profit was therefore £40.5m (2017: £33.7m).

AsPac represented around £0.5bn or 20% of the Group's order intake. The largest new award was to provide for Victoria Police contact centre services for non-urgent incidents. Other similar awards in our Citizen Services business have included contact services for Australia's National Disability Insurance Scheme, and further expanding operations supporting the Department of Human Services. In Hong Kong, we won a new contract to manage, operate and maintain two new tunnels that will form part of a major road link project in the region.

The signing of the National Garrison Health Services (NGHS) contract in February 2019 is an extremely important event for our Australian business. Valued at around £560m over the initial six-year term, under this contract we will work as a sub-contractor to BUPA sourcing and managing more than 1,000 professional staff who will support the delivery of an integrated health care system to over 80,000 Australian Defence Force members and reservists, and we expect this contract to make a noticeable contribution to revenues in 2019 and profits from 2020.

Of existing work where an extension or rebid will be required at some point before the end of 2021, there are 14 contracts with annual revenue of over £5m within the AsPac division; in aggregate, these represent well 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 around 30% of current divisional revenue. Also in 2019 our contract for South Queensland Correctional Centre will require further extending or rebidding, along with Traffic Camera Services in Victoria and some of our Hong Kong transport management services. Others that will require extending or rebidding in 2020 are the Australian Tax Office framework contract, while Fiona Stanley Hospital and Acacia Prison become potentially due in 2021.

As set out above, the largest opportunity in our pipeline of major new bid opportunities at the start of the new year has already been won – NGHS for the Australian Defence Force. Others due for decision within the next 24 months include a relatively broad spread across Defence support and in our Justice & Immigration, Citizen Services, Transport and Health sectors.

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 2018 was £342.3m (2017: £352.6m), a decrease of 3%. The strengthening of Sterling reduced revenue by £13m or 4%; the organic change at constant currency was therefore growth of 1%. The increase included some volume growth of transport operations, with other expanding or new work, such as the fire and rescue services in Saudi Arabia, broadly offsetting other small areas of attrition or reductions in scope or volumes.

Underlying Trading Profit was £21.5m (2017: £17.3m), representing a margin of 6.3% (2017: 4.9%). The improvement in profitability was due in large part to the non-repeat of the heavy costs of bidding the rail tenders experienced in the prior year, together with some progress on other cost efficiencies; the profitability of the MELABS contact was also higher in its final year of the previous terms ahead of rebid; these together more than offset other areas of margin pressure, attrition and a £1.0m adverse currency movement. 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 latest or prior year, therefore no difference between Underlying Trading Profit and Trading Profit.

The Middle East represented around £0.4bn or 15% of the Group's order intake. Included is a letter of intent from the customer for Serco to continue operating the Dubai Metro for a further two years through to September 2021. The MELABS defence base logistics and support services contract was successfully rebid, though as previously described the new contract will significantly reduce the Middle East division's profitability in 2019; other existing work secured included facilities management for Abu Dhabi Global Market Square, and air navigation services and training in Iraq; Serco was unsuccessful in its bid to continue providing air navigation services in Bahrain. The largest new contract was with Dammam Airports Company (DACO) for the provision of fire and rescue services at King Fahd International Airport (KFIA), the first Saudi airport to leverage an international service provider's expertise in firefighting systems; other new contracts included integrated facilities management for Aldar commercial properties in Abu Dhabi.

Of existing work where an extension or rebid will be required at some point before the end of 2021, there are 12 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 are a number of smaller integrated facilities management contracts due for rebid or extension during the course of 2019. From early 2020, our contracts for air navigation services in both Dubai and Iraq become due, together with the Saudi rail and a number of other operations. The relatively high proportion of current annual revenue on a cumulative three-year basis reflects that the Dubai Metro contract is anticipated to become due again in September 2021.

Our pipeline of major new bid opportunities in the region reduced very significantly in 2017 following the outcome of the light rail and tram bids. The current pipeline has some other smaller opportunities in integrated facilities management, and effort is ongoing to rebuild a stronger pipeline across other sectors.

In April 2019, Phil Malem will become the divisional Chief Executive Officer of Serco Middle East. Phil joins from Atkins, one of the world's leading design, engineering and project management consultancies, where he was Managing Director for its transportation and infrastructure business, Middle East & Africa.

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 2018 reduced by 4% to £40.1m (2017: £41.6m).

Finance Review

For the year ended 31 December 2018	Underlying £m	Non underlying items £m	Trading £m	Amortisation and impairment of intangibles arising on acquisition £m	Statutory pre exceptional £m	Exceptional items £m	Statutory £m
Revenue	2,836.8	-	2,836.8	-	2,836.8	-	2,836.8
Cost of sales	(2,570.2)	23.6	(2,546.6)	-	(2,546.6)	-	(2,546.6)
Gross profit	266.6	23.6	290.2	-	290.2	-	290.2
Administrative expenses	(202.3)	-	(202.3)	(4.3)	(206.6)	(31.9)	(238.5)
Share of profits in joint ventures and associates, net of interest and tax	28.8	-	28.8	-	28.8	-	28.8
Profit before interest and tax	93.1	23.6	116.7	(4.3)	112.4	(31.9)	80.5
Margin	*3.3%*		*4.1%*		*4.0%*		*2.8%*
Net finance costs	(13.9)	-	(13.9)	-	(13.9)	7.5	(6.4)
Profit before tax	79.2	23.6	102.8	(4.3)	98.5	(24.4)	74.1
Tax charge	(20.6)	8.7	(11.9)	3.1	(8.8)	2.1	(6.7)
Effective tax rate	*(26.0%)*		*(11.6%)*		*(8.9%)*		*(9.0%)*
Profit / (loss) for the period	58.6	32.3	90.9	(1.2)	89.7	(22.3)	67.4
Minority interest	0.0	-	0.0	-	0.0	-	0.0
Earnings / (loss) per share –basic (pence)	*5.36*		*8.31*		*8.20*		*6.16*
Earnings / (loss) per share –diluted (pence)	*5.21*		*8.08*		*7.97*		*5.99*

For the year ended 31 December 2017 (restated*)	Underlying £m	Non underlying items £m	Trading £m	Amortisation and impairment of intangibles arising on acquisition £m	Statutory pre exceptional £m	Exceptional items £m	Statutory £m
Revenue	2,950.9	-	2,950.9	-	2,950.9	-	2,950.9
Cost of sales	(2,686.4)	(24.2)	(2,710.6)	-	(2,710.6)	-	(2,710.6)
Gross profit	264.5	(24.2)	240.3	-	240.3	-	240.3
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	27.0	-	27.0	-	27.0	-	27.0
Profit before interest and tax	69.3	(24.2)	45.1	(4.4)	40.7	(19.6)	21.1
Margin	*2.3%*		*1.5%*		*1.4%*		*0.7%*
Net finance costs	(11.2)	-	(11.2)	-	(11.2)	-	(11.2)
Other gains	-	0.7	0.7	-	0.7	-	0.7
Profit before tax	58.1	(23.5)	34.6	(4.4)	30.2	(19.6)	10.6
Tax charge	(20.2)	5.0	(15.2)	1.6	(13.6)	(5.0)	(18.6)
Effective tax rate	*(34.8%)*		*(43.9%)*		*(45.0%)*		*(175.5%)*
Profit / (loss) for the period	37.9	(18.5)	19.4	(2.8)	16.6	(24.6)	(8.0)
Minority interest	0.3		0.3		0.3		0.3
Earnings / (loss) per share – basic (pence)	*3.45*		*1.75*		*1.50*		*(0.76)*
*Earnings / (loss) per share – diluted (pence)***	*3.36*		*1.70*		*1.45*		*(0.76)*

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 2 to the Financial Statements.
** Earnings per share is not diluted on a statutory basis

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 Executive 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 Strategic Report, including the other sections of this Finance Review, as well as the Condensed Consolidated Financial Statements and their 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 other than the APM for earnings per share which has changed to be with reference to the diluted weighted average number of shares rather than the basic weighted average number of shares. The basis of the change is due to the fact that:

- The Group has made a statutory profit and therefore unvested options reduce earnings per share, whereas unvested options could not have been included in prior years as their conversion would have reduced loss per share; and
- More options are expected to vest and are therefore relevant in assessing the expected earnings per share.

Earnings per share on both a basic and diluted basis have been presented to illustrate the impact of the change.

The comparative numbers within this Finance Review have been restated to reflect the impact of IFRS15 as disclosed within note 1 on page 39. The restated balances are as previously included within the Group's Financial Statements for the 6 months to 30 June 2018 with an additional adjustment relating to the adoption of IFRS15 as set out in note 1 of the Financial Statements which had no net impact to the income statement or balance sheet.

Alternative revenue measures

Reported revenue at constant currency

Reported revenue, as shown on the Group's Condensed Consolidated Income Statement on page 34, reflects revenue translated at the average exchange rates for the period. 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 2018 into Sterling at the average exchange rate for the year ended 31 December 2017. All revenue in 2018 arose from continuing activities.

For the year ended 31 December	2018 £m
Reported revenue at constant currency	2,902.0
Foreign exchange differences	(65.2)
Reported revenue at reported currency	2,836.8

Organic Revenue at constant currency
Reported revenue may include revenue generated by businesses acquired during a particular year from the date of acquisition 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.

There are three acquisitions excluded for the calculation of Organic Revenue in the year to 31 December 2018:

- The acquisition of 50% of the issued share capital of Serco Sodexo Defence Services Pty Ltd (SSDS) on 24 August 2017, resulting in full control being obtained. SSDS 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.
- The acquisition of 100% of the issued share capital of BTP Systems, LLC (BTP) on 26 January 2018.
- The acquisition of six UK health facilities management contracts which were transferred from Carillion plc between June 2018 and August 2018.

An adjustment is required for the two disposals outlined below:

- The disposal of contracts within the Anglia Support Partnership on 31 October 2018.
- 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 did 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.
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	2018 £m
Organic Revenue at constant currency	2,838.2
Foreign exchange differences	(64.2)
Organic Revenue at reported currency	2,774.0
Impact of any relevant acquisitions or disposals	62.8
Reported revenue at reported currency	2,836.8

For the year ended 31 December	2017 (restated*) £m
Organic Revenue at reported currency	2,929.7
Impact of any relevant acquisitions or disposals**	21.2
Reported revenue at reported currency	2,950.9

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1 to the Financial Statements.
** Impact of relevant acquisitions and disposals has been restated for comparison purposes.

Revenue
Reported revenue, as shown on the Group's Condensed Consolidated Income Statement on page 34, reflects only that from continuing operations. In prior reporting periods an alternative measure to include discontinued operations has been used 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 2018 and in 2017. In 2017 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 which related to the UK private sector BPO business which had previously been disclosed as a discontinued operation.

Revenue plus share of joint ventures and associates

Reported revenue, as shown on the Group's Condensed Consolidated Income Statement on page 34, 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	2018 £m	2017 (restated*) £m
Revenue plus share of joint ventures and associates	3,211.9	3,307.3
Exclude share of revenue from joint ventures and associates	(375.1)	(356.4)
Reported revenue	2,836.8	2,950.9

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1 to the Financial Statements.

Alternative profit measures

For the year ended 31 December	2018 £m	2017 (restated*) £m
Underlying Trading Profit	93.1	69.3
Non-underlying items:		
Include OCP charges and releases	12.8	(27.4)
Include other Contract & Balance Sheet Review adjustments and one-time items	10.8	3.2
Total Non-underlying items	23.6	(24.2)
Trading Profit	116.7	45.1
Include operating exceptional items	(31.9)	(19.6)
Include amortisation and impairment of intangibles arising on acquisition	(4.3)	(4.4)
Operating profit	80.5	21.1

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1 to the Financial Statements.

Underlying Trading Profit (UTP)

The Group uses an alternative measure, Underlying Trading Profit, to make adjustments for unusual items that occur and remove the impact of historical issues. UTP therefore provides a measure of the underlying performance of the business in the current year.

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 £51.8m in 2018 (2017 restated: £64.6m) 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. Items in 2018 which were recorded within this category included a release of a provision made during the 2014 Contract & Balance Sheet Review following a change in the Group's obligations and a settlement received.

Both OCP adjustments and other Contract & Balance Sheet Review and one-time items 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.

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 16 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 34, by making two 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.

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 2018 into Sterling at the average exchange rate for the year ended 31 December 2017.

For the year ended 31 December	2018 £m
Underlying Trading Profit at constant currency	97.1
Foreign exchange differences	(4.0)
Underlying Trading Profit at reported currency	93.1

Alternative Earnings or Loss Per Share (EPS) measures

For the year ended 31 December	2018 pence	2017 (restated*) pence
Underlying EPS, basic	5.36	3.45
Net impact of non-underlying items and amortisation and impairment of intangibles arising on acquisition	2.84	(1.95)
EPS before exceptional items, basic	8.20	1.50
Impact of exceptional items	(2.04)	(2.26)
Reported EPS, basic	6.16	(0.76)

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1 to the Financial Statements.

For the year ended 31 December	2018 Pence	2017 (restated*) pence
Underlying EPS, diluted	5.21	3.36
Net impact of non-underlying items and amortisation and impairment of intangibles arising on acquisition	2.76	(1.91)
EPS before exceptional items, diluted	7.97	1.45
Impact of exceptional items	(1.98)	(2.20)
Remove impact of loss	-	(0.01)
Reported EPS, diluted	5.99	(0.76)

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1 to the Financial Statements.

EPS before exceptional items

EPS, as shown on the Group's Condensed Consolidated Income Statement on page 34, 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

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 is provided in the summary income statements on page 16.

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 38. 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	2018 £m	2017 (restated*) £m
Free Cash Flow	25.0	(6.7)
Exclude dividends from joint ventures and associates	(29.7)	(28.2)
Exclude net interest paid	16.1	17.0
Exclude capitalised finance costs paid	2.0	-
Exclude purchase of intangible and tangible assets net of proceeds from	29.5	30.1
Cash flow from operating activities before exceptional items	42.9	12.2
Exceptional operating cash flows	(40.2)	(32.5)
Cash flow from operating activities	2.7	(20.3)

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1 to the Financial Statements.

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.

For the year ended 31 December	2018 £m	2017 (restated*) £m
Free Cash Flow	25.0	(6.7)
Add back:		
Tax paid	10.6	11.4
Non-cash R&D expenditure	0.1	0.2
Net interest paid	16.1	17.0
Capitalised finance costs paid	2.0	-
Trading Cash Flow	53.8	21.9
Underlying Trading Profit	93.1	69.3
Underlying Trading Profit cash conversion	58%	32%

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1 to the Financial Statements.

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 37 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	2018 £m	2017 £m
Cash and cash equivalents	62.5	112.1
Loans receivable	-	25.7
Loans payable	(239.5)	(271.5)
Obligations under finance leases	(14.8)	(20.2)
Derivatives relating to Net Debt	3.8	12.8
Net Debt	(188.0)	(141.1)

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 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	2018 £m	2017 (restated*) £m
Non-current assets		
Goodwill	579.6	551.3
Other intangible assets	67.3	66.7
Property, plant and equipment	64.8	61.3
Interest in joint ventures and associates	20.6	19.7
Trade and other receivables	30.3	57.3
Current assets		
Inventory	22.9	17.4
Contract assets, trade and other receivables	543.8	512.0
Total invested capital assets	1,329.3	1,285.7
Current liabilities		
Contract liabilities, trade and other payables	(494.0)	(472.9)
Non-current liabilities		
Contract liabilities, trade and other payables	(109.9)	(112.0)
Total invested capital liabilities	(603.9)	(584.9)
Invested Capital	725.4	700.8
Two point average of opening and closing Invested Capital	713.1	721.9
Trading Profit	116.7	45.1
ROIC%	16.4%	6.2%
Underlying Trading Profit	93.1	69.3
Underlying ROIC%	13.1%	9.6%

* Results and balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1 to the Financial Statements.

Overview of financial performance

Revenue

Reported Revenue declined by 3.9% in the year to £2,836.8m (2017 restated: £2,950.9m), a 1.7% reduction in constant currency.

No revenue arose in 2018 (2017: nil) from operations classified as discontinued.

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 £116.7m (2017 restated: £45.1m). 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 £93.1m (2017 restated: £69.3m), up 34%. At constant currency, UTP was £97.1m, up 40%.

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 releases from OCPs of £12.8m (2017 restated: net charges of £27.4m) following the detailed reassessment undertaken as part of the budgeting process. Also excluded from UTP were net releases and additional profits of £10.8m (2017 restated: net releases of £3.2m) relating to other provisions and accruals for items identified during the 2014 Contract & Balance Sheet Review and other one-time items.

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 £44.5m (2017: £19.3m). This represents 6% 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

There were no operations classified as discontinued in 2018 or 2017.

Joint ventures and associates – share of results

In 2018, 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 £20.0m (2017: £17.1m) and £8.7m (2017: £7.3m) respectively. Total revenues generated by these businesses were £1,024.7m (2017 restated: £951.8m) and £160.8m (2017 restated: £155.1m) respectively.

While the revenues and individual line items are not consolidated in the Group's 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	2018 £m	2017 (restated*) £m
Revenue	375.1	356.4
Operating profit	34.6	34.1
Net investment finance costs	0.3	(0.1)
Income tax expense	(6.1)	(7.0)
Profit after tax before exceptional charge	**28.8**	**27.0**
Exceptional pension charge (see exceptional items below)	(0.3)	-
Profit after tax	28.5	27.0
Dividends received from joint ventures and associates	29.7	28.2

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1 to the Financial Statements.

The increase in revenue and profits on the prior year is due to the improved operating performance of the Group's material joint ventures.

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.

For the year ended 31 December	2018 £m	2017 £m
Exceptional items arising		
Exceptional (loss)/profit on disposal of subsidiaries and operations	(0.5)	0.3
Other exceptional operating items		
Restructuring costs	(32.3)	(28.6)
Increase in onerous lease provision	(1.8)	-
Costs associated with UK Government review	0.4	(0.4)
Release of UK frontline clinical health contract provisions	-	0.4
Settlement of defined benefit pension obligations	-	10.3
Reversal of impairment of interest in joint venture and related loan	0.8	4.5
Reversal of impairment on loan balances	13.9	-
Impairment of AsPac customer lists	-	(6.1)
Cost of Guaranteed Minimum Pension equalisation	(9.6)	-
Increase in other provisions	(2.8)	-
Other exceptional operating items	(31.4)	(19.9)
Exceptional operating items	(31.9)	(19.6)
Exceptional finance income	7.5	-
Exceptional tax	2.1	(5.0)
Total operating and financing exceptional items net of tax	(22.3)	(24.6)

Exceptional profit on disposals

There were no material disposals of continuing operations in 2018 (2017: none).

Other exceptional operating items
The annual impairment testing of CGUs in 2018 has identified no impairment of goodwill.

The Group is incurring costs in relation to restructuring programmes resulting from the Strategy Review. These costs include redundancy payments, provisions (including onerous leases), external advisory fees and other incremental costs. 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 2018, a charge of £32.3m (2017: £28.6m) 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 £6.3m (2017: £11.1m) and were included within operating profit before exceptional items. We expect exceptional restructuring costs of approximately £20.0m will be incurred in 2019, which we expect to be the final year.

There was an exceptional credit totalling £0.4m (2017: charge of £0.4m) 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 2018. The credit reflects the recovery of costs from the Group's insurance providers.

An exceptional charge of £9.6m (2017: nil) has been recorded in the Group's income statement for the year ended 31 December 2018. This is to recognise the Group's obligations associated with equalising the Guaranteed Minimum Pension (GMP) payments between male and female employees for the Group's defined benefit pension schemes following a High Court ruling made in October 2018. The Serco Pension and Life Assurance Scheme (SPLAS) recorded the largest charge being £9.0m. Included in the £9.6m charge is £0.3m related to the Group's share of the GMP cost in one of the Group's joint ventures. This has been recorded as exceptional to ensure consistent treatment of all items in 2018 related to the cost of equalising the GMP payments within the Group's pension schemes. The impact of GMP equalisation is not currently estimated to have a material impact in future years.

An additional charge of £2.8m has been recorded in respect of an existing legal case in the Group's North American Division. The treatment of this additional amount as exceptional is consistent with the recognition of the original charge associated with the same legal matter.

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 2018 payments of £0.8m (2017: £4.5m) were received against the impaired loan.

An exceptional profit of £13.9m (2017: nil) has been recognised for the settlement of consideration associated with the sale of Serco GmbH in 2012 through the offsetting of outstanding loan balances, the receivable of which had been impaired. An exceptional loss on disposal of £27.7m was recorded in 2012 in respect of the sale.

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 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. A cost of this nature did not reoccur in 2018.

In 2017 there were releases of provisions £0.4m which were previously charged through exceptional items in relation to the exit of the UK frontline clinical health contracts. 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 in 2017, totalling £6.1m.

Exceptional finance costs
Part of the consideration for the sale of the Group's private sector BPO business in 2015 was a loan note with a face value of £30m accruing compound interest of 7%. The receivable associated with this loan note was recorded at a fair value of £19.5m. The discount on the loan note has been unwinding through the Group's net finance cost on an annual basis. During October 2018, the Intelenet business was sold and therefore repayment of the loan note was triggered resulting in a gain of £7.5m. As this gain is outside the normal financing arrangements of the Group and significant in size it has been recorded as exceptional investment income.

Exceptional tax

Exceptional tax for the year was a tax credit of £2.1m (2017: £5.0m charge) which arises on exceptional items within operating profit.

No net tax credit arises on the exceptional charge associated with GMP equalisation (further detail on this charge is included in the "Other exceptional operating items" section above). The credit that arises on the deferred tax movement associated with this charge is netted with an equal and opposite charge that arises on the associated reduction in the deferred tax asset in order to retain the net deferred tax position as supported by future forecast profits.

Remaining exceptional costs excluding the pension charge (£14.8m) only gave rise to a credit of £2.1m, as the majority of these costs were incurred in the UK where they only impact our unrecognised deferred tax in relation to losses.

Pre exceptional finance costs and investment revenue

Investment revenue of £4.3m (2017 restated: £8.0m) includes interest accruing on net retirement benefit assets of £0.8m (2017: £3.8m), interest earned on deposits and other receivables of £2.3m (2017: £2.6m), interest arising on customer contracts £nil (2017: £0.4m) and the movement in discounting of other receivables of £1.2m (2017: £1.2m).

Finance costs of £18.2m (2017: £19.2m) includes interest incurred on the USPP loans and the Revolving Credit Facility of £13.8m (2017: £14.0m), facility fees and other charges of £3.1m (2017: £3.0m), interest payable on finance leases of £0.6m (2017: £1.3m), the movement in discount on provisions of £0.5m (2017: £1.3m) and a loss for foreign exchange on financing activities of £0.2m (2017: £0.4m credit).

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.

There were no other gains recorded in the year to 31 December 2018.

Tax

Tax charge

Underlying tax
In 2018 we recognised a tax charge of £20.6m on underlying trading profits after finance costs. The effective tax rate (26.0%) is lower than in 2017 (34.8%). This is mainly due to a fall in the rate of tax incurred by our overseas operations, primarily driven by the fall in US tax rate, together with lower underlying UK tax losses on which no accounting tax credit is available which is only partially offset by a lower adjustment in respect of prior years.

Pre exceptional tax
We recognised a tax charge of £8.8m (2017: £13.6m) on pre-exceptional profits which includes underlying tax (£20.6m), tax impact of amortisation on intangibles arising on acquisition of £3.1m credit and £8.7m credit on non-underlying items. Of the £3.1m credit, £2.3m arises on balancing the UK deferred tax asset to the level supported by forecasts due to the recognition of a deferred tax liability on customer lists arising on the acquisition of the Carillion plc healthcare facility management contracts. This deferred tax liability was recognised against goodwill arising on the acquisition. The £8.7m credit consists of the tax impact on contract and balance sheet review adjustments and other material one-time items (non-underlying items) together with tax items that are in themselves considered to be non-underlying:

- The tax on non-underlying items during the period totalled a debit of £3.2m reflecting the impact of current or future tax charges.
- During the current period we have recognised an additional £2.9m of deferred tax asset in relation to UK losses to reflect the improved forecast taxable income of our UK operations.
- Generally 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 (SOCI) 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 maximum level supported by future profit forecasts, the increase in the deferred tax liability associated with the pension scheme (with the benefit reported in the SOCI) leads to a corresponding increase in the deferred tax asset to match the future profit forecasts. Such an increase in the deferred tax asset therefore leads to a credit 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 £9.0m credit for 2018 (2017:£1.9m charge).

The tax rate on profits before exceptional items on continuing operations, at 8.9% is lower than the UK standard corporation tax rate of 19%. This is due to the credits in relation to pensions and the acquisition and additional recognition of deferred tax assets noted above, together with the impact of our joint ventures whose post-tax results are included in our pre-tax profit which is only partially offset by the 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 (which includes the result of UK divisions and the majority of corporate costs). 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 driven 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.

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

Contingent tax assets

At 31 December 2018, the Group has gross estimated unrecognised deferred tax assets of £1.1bn (£211m net), which are potentially available to offset against future taxable income. These principally relate to tax trading losses of £852m. Of these tax losses, £717m have arisen in the UK business (net £122m).

A £20.3m UK tax asset has been recognised at 31 December 2018 (2017: £17.4m) on the basis of forecast utilisation against future taxable income.

Taxes paid

Net corporate income tax of £10.6m was paid during the year, relating primarily to our operations in AsPac (£8.7m), Europe (£4.1m) and Middle East (£1.1m). 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 £3.3m. A cash tax refund in Canada on the carry back of prior year losses has broadly equalled cash tax paid in the US such that the net cash tax outflow for North America was nil.

The amount of tax paid (£10.6m) differs from the tax charge in the period (£20.6m) mainly due to the effect of future expected cash tax outflows for which a charge has been taken in the current period. In addition, taxes paid/received from Tax Authorities can arise in later periods to the associated tax charge/credit and also there is a time lag on receipts of cash from joint ventures and associates for losses transferred to them.

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

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 Group. 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 2018, Serco globally contributed £568m of tax to government in the jurisdictions in which we operate.

Taxes by category

For the year ended 31 December 2018	Taxes borne £m	Taxes collected £m	Total £m
Corporation tax	15.9	-	15.9
VAT and similar	8.2	157.1	165.3
People taxes	104.4	274.3	378.7
Other taxes	7.2	0.8	8.0
Total	135.7	432.2	567.9

Taxes by region

For the year ended 31 December 2018	Taxes borne £m	Taxes collected £m	Total £m
UK & Europe	82.8	240.3	323.1
AsPac	26.2	113.7	139.9
Americas	24.2	73.8	98.0
Middle East	2.5	4.4	6.9
Total	135.7	432.2	567.9

Corporation tax, which is the only cost to be separately disclosed in our 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 £7.53 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 £3.18 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 2018 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 judges it prudent to do so, in assessing whether we should resume dividend payments in respect of 2018, we have been mindful of the fact that 2019 is the last year of significant outflows of cash related to OCPs and exceptional costs, which together will mean that net debt is likely to increase again in 2019, albeit modestly. The Board will continue to keep the dividend policy under careful and regular consideration as we progress with completing the transformation stage and driving forward with the growth stage of our strategy.

Share count and EPS

The weighted average number of shares for EPS purposes was 1,094.4m for the year ended 31 December 2018 (2017: 1,089.7m) and diluted weighted average number of shares was 1,125.4m (2017 restated: 1,120.6m).

Basic EPS before exceptional items was 8.20p per share (2017 restated: 1.50p); including the impact of exceptional items, Basic EPS was 6.16p (2017 restated: loss of 0.76p). Basic Underlying EPS was 5.36p per share (2017 restated: 3.45p).

Diluted EPS before exceptional items was 7.97p per share (2017 restated: 1.45p); including the impact of exceptional items, Diluted EPS was 5.99p (2017 restated: loss of 0.76p). Diluted Underlying EPS was 5.21p per share (2017 restated: 3.36p).

Cash flows

The UTP of £93.1m (2017 restated: £69.3m) converts into a trading cash inflow of £53.8m (2017: £21.9m). The improvement in 2018 cash conversion was primarily driven by margin growth, largely arising from cost efficiencies and additionally the settlement of a long outstanding legal matter. In 2018, the working capital outflow was £21.6m (2017 restated: £14.3m) and the OCP utilisation is £51.8m (2017 restated: £64.6m).

The table below shows the operating profit and FCF reconciled to movements in Net Debt. FCF for the year was an inflow of £25.0m compared to an outflow of £6.7m in 2017. The improvement in FCF is largely as a result of improved operating profit before exceptional items to £112.4m in 2018 from a restated balance of £40.7m in 2017, partially offset by net provision releases in FY18 of £7.9m, compared to net charges of £37.2m in 2017 (restated). In addition, the utilisation of the OCP's in 2018 of £51.8m was lower than the previous year (2017 restated: £64.6m) through better contract performance and some onerous contracts ending.

The movement in Net Debt is an increase of £46.9m in 2018, a reconciliation of which is provided at the bottom of the following table. The movement includes a net outflow of £29.3m, excluding transactions costs of £0.6m, arising on the acquisition of BTP Systems, LLC and the acquisition of Six Carillion plc healthcare facilities management contracts, as well as both cash and non-cash exceptional items of £20.8m (FY17 restated: £32.5m) and adverse foreign currency exchange movements of £22.2m (2017: £17.4m gain).

For the year ended 31 December	2018 £m	2017 (restated*) £m
Operating profit on continuing operations	80.5	21.1
Remove exceptional items	31.9	19.6
Operating profit before exceptional items	112.4	40.7
Less: profit from joint ventures and associates	(28.8)	(27.0)
Movement in provisions	(68.1)	(33.6)
Depreciation, amortisation and impairment of property, plant and equipment and intangible assets	43.2	46.6
Other non-cash movements	16.5	11.4
Operating cash inflow before movements in working capital, exceptional items and tax	75.2	38.1
Working capital movements	(21.6)	(14.3)
Tax paid	(10.6)	(11.4)
Non-cash R&D expenditure	(0.1)	(0.2)
Cash flow from operating activities before exceptional items	42.9	12.2
Dividends from joint ventures and associates	29.7	28.2
Interest received	0.6	0.5
Interest paid	(16.7)	(17.5)
Capitalised finance costs paid	(2.0)	-
Purchase of intangible and tangible assets net of proceeds from	(29.5)	(30.1)
Free Cash Flow	25.0	(6.7)
Net cash outflow on acquisition and disposal of subsidiaries	(31.3)	(5.6)
Other movements on investment balances	(0.3)	0.2
Capitalisation and amortisation of loan costs	1.3	(0.8)
Unwind of discounting and capitalisation of interest on loans receivable	3.0	3.4
New, acquired and disposed finance leases	(3.4)	(4.7)
Exceptional items	(19.2)	(32.5)
Cash movements on hedging instruments	0.2	(2.5)
Foreign exchange (loss) / gain on Net Debt	(22.2)	17.4
Movement in Net Debt	(46.9)	(31.8)
Net Debt at 1 January	(141.1)	(109.3)
Net Debt at 31 December	(188.0)	(141.1)

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1 to the Financial Statements.

Net Debt

As at 31 December	2018 £m	2017 £m
Cash and cash equivalents	62.5	112.1
Loans receivable	-	25.7
Loans payable	(239.5)	(271.5)
Obligations under finance leases	(14.8)	(20.2)
Derivatives relating to Net Debt	3.8	12.8
Net Debt	(188.0)	(141.1)

Average Net Debt as calculated on a daily basis for the year ended 31 December 2018 was £234.9m (2017: £184.3m), compared with the opening and closing positions of £141.1m and £188.0m respectively. Peak Net Debt was £306.9m (2017: £242.7m).

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 2018, the Group had committed funding of £492m (2017: £741m), comprising £242m of private placement notes and a £250m revolving credit facility (RCF), which was undrawn. In addition, the Group had a receivables financing facility of £30.0m which was unutilised at the year-end (2017: unutilised of £30.0m).

On 3 December 2018 the Group completed the refinancing of its RCF with a syndicate of banks. Serco's RCF provides funds for general corporate and working capital purposes, and the ability to issue bonds to support the Group's business needs. The previous facility of £368m was due to mature in April 2020. The new facility provides £250m of committed funding for five years; the lower amount reflecting the much reduced need for debt in the business. The terms and conditions of the new facility are substantially unchanged from the prior facility.

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 2018, 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.

Following the refinancing in December 2018, the debt covenants have been amended to include the impact of IFRS15. The covenants continue to exclude the future impact of IFRS16 on the Group's results.

For the year ended 31 December	2018 £m	2017 (restated*) £m
Operating profit before exceptional items	112.4	40.7
Remove: Amortisation and impairment of intangibles arising on	4.3	4.4
Trading Profit	116.7	45.1
Exclude: Share of joint venture post-tax profits	(28.8)	(27.0)
Include: Dividends from joint ventures	29.7	28.2
Add back: Net non-exceptional charges to OCPs	-	27.4
Add back: Depreciation, amortisation and impairment of property, plant and equipment and non acquisition intangible assets	38.9	42.2
Add back: Foreign exchange (credit)/charge on investing and financing	(0.2)	0.4
Add back: Share based payment expense	14.7	11.4
Other covenant adjustments to EBITDA	-	3.6
Covenant EBITDA	171.0	131.3
Net finance costs	13.9	11.2
Exclude: Net interest receivable on retirement benefit obligations	0.8	3.8
Exclude: Movement in discount on other debtors	1.2	1.2
Exclude: Foreign exchange (loss)/gain on investing and financing	(0.2)	0.4
Add back: Movement in discount on provisions	(0.5)	(1.3)
Other covenant adjustments to net finance costs	-	0.4
Covenant net finance costs	15.2	15.7
Recourse Net Debt	188.0	141.1
Exclude: Disposal vendor loan note, encumbered cash and other	2.3	30.3
Covenant adjustment for average FX rates	(8.8)	7.8
CTNB	181.5	179.2
CTNB / covenant EBITDA (not to exceed 3.5x)	1.06x	1.36x
Covenant EBITDA / covenant net finance costs (at least 3.0x)	11.2x	8.4x

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1 to the Financial Statements.

Net assets summary

As at 31 December	2018 £m	2017 (restated*) £m
Non-current assets		
Goodwill	579.6	551.3
Other intangible assets	67.3	66.7
Property, plant and equipment	64.8	61.3
Other non-current assets	51.0	80.7
Deferred tax assets	60.9	59.7
Retirement benefit assets	85.8	41.8
	909.4	861.5
Current assets		
Inventories	22.9	17.4
Contract assets, trade receivables and other current assets	551.5	522.3
Current tax assets	7.3	11.2
Cash and cash equivalents	62.5	112.1
Total current assets	644.2	663.0
Total assets	1,553.6	1,524.5
Current liabilities		
Contract liabilities, trade payables and other current liabilities	(497.7)	(474.0)
Current tax liabilities	(29.2)	(25.3)
Provisions	(120.1)	(146.3)
Obligations under finance leases	(5.7)	(8.5)
Loans	(21.9)	(31.8)
Total current liabilities	(674.6)	(685.9)
Non-current liabilities		
Contract liabilities, trade payables and other non-current liabilities	(109.9)	(112.0)
Deferred tax liabilities	(21.4)	(20.4)
Provisions	(119.3)	(174.0)
Obligations under finance leases	(9.1)	(11.7)
Loans	(217.6)	(239.7)
Retirement benefit obligations	(14.9)	(15.5)
	(492.2)	(573.3)
Total liabilities	(1,166.8)	(1,259.2)
Net assets	386.8	265.3

* Balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1 to the Financial Statements.

At 31 December 2018 the balance sheet had net assets of £386.8m, a movement of £121.5m from the restated closing net asset position of £265.3m as at 31 December 2017. The increase in net assets is mainly due to the following movements:

- An increase in the net retirement benefit assets of £44.6m as a result of changes in the financial assumptions underpinning the defined benefit obligation associated with SPLAS, predominantly an increase in the discount rate which is based on UK corporate bond yields, specifically those with a credit rating of AA. The increase in corporate bond yields reflects the broad rise in global corporate bond yields, with macro factors such as the Federal Reserve tightening monetary conditions by raising interest rates, the ongoing trade tensions and heightened political risk – particularly in the UK with Brexit – all contributing to the rise in corporate bond yields. The triennial valuation of SPLAS is in the process of being completed with funding arrangements being agreed with the scheme's trustees. As at 31 December 2018 the estimated actuarial deficit of the SPLAS scheme is £27.8m (2017: £33.7m).
- A decrease in provisions of £80.9m. Further details on provision movements is provided below.
- Net Debt increased by £46.9m. Further details of these movements are provided in the cash flow and Net Debt sections above.
- An increase in goodwill of £28.3m, caused by the acquisitions of BTP Systems, LLC and the UK health facilities management contracts of Carillion plc, as well as the movements in foreign exchange rates.

Provisions

The total of current and non-current provisions has decreased by £80.9m since 31 December 2017, on a restated basis. The movement is predominantly due to:

- A decrease in onerous contract provisions of £64.5m
- An £8.1m release of other provisions following changes in the Group's obligations, £7.5m of which was excluded from UTP as the provision was made during the Contract & Balance Sheet Review
- A final settlement during the period of £8.3m for the Docklands Light Railway defined benefit pension scheme.

Movements in onerous contract provisions since the 31 December 2017 balance sheet date on a restated basis, are as follows:

	Onerous Contract Provisions £m
At 1 January 2018 (restated*)	146.6
Charged to the income statement during the year –	3.4
Released to the income statement – trading	(16.2)
Utilisation during the year	(51.8)
Unwinding of discount	0.5
Foreign exchange	(0.4)
At 31 December 2018	82.1

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017 and a brought forward reclassification of £1.5m. See notes 1 and 16 to the Financial Statements.

The balance of OCPs at 31 December 2018 was £82.1m (2017 restated: £146.6m). 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 release to OCPs was £12.8m in 2018 (2017 restated: £27.4m charge) and utilisation was £51.8m (2017 restated: £64.6m).

In 2018, the net release in OCPs is reflective of the Group's ability to forecast the final years of contracts which are nearing completion, the expiry of contractual obligations and relief of obligations through commercial settlement or sale of contracts such as the Anglia Support Partnership. Additional charges of £3.4m (2017 restated: £61.9m) have been made in respect of future losses on existing onerous contract provisions to reflect the updated forecasts as settlements are agreed and contracts near completion.

Acquisitions

On 26 January 2018, the Group acquired 100% of the issued share capital of BTP Systems, LLC (BTP). The acquired business contributed £12m of revenue and £1.9m of operating profit before exceptional items to the Group's results during year to 31 December 2018. The net cash outflow as a result of the acquisition was £13.2m, being £1.2m cash acquired less £14.4m consideration paid.

BTP provides satellite communications (SATCOM), radar modernisation, 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 specialises 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, Military Strategic & Tactical Relay command post antennas and radar antennas.

As explained in note 5 of the Group's Condensed Consolidated Financial Statements, the Group acquired Carillion plc's facilities management contracts at six major NHS hospital sites over the period from June 2018 to August 2018: Great Western Hospital in Swindon; Darent Valley Hospital in Dartford; James Cook University Hospital in Middlesbrough; Harplands Hospital in Stoke-on-Trent; The Langlands Unit of Queen Elizabeth University Hospital in Glasgow; and Addenbrooke's Treatment Centre in Cambridge.

The total annual revenue of all six contracts is expected to be around £70m and the estimated operating profit before exceptional items, including an appropriate allocation of charges for shared support services and other incremental overheads, will be approximately £4m, the aggregate consideration payable is approximately £18m. The acquired contracts contributed £30.3m of revenue and an operating loss before exceptional items of £2.1m to the Group's results during year to 31 December 2018 due to the transition costs incurred.

IFRS15

The Group has restated all comparative amounts within the Condensed Consolidated Financial Statements to align with IFRS15. The impact on opening retained earnings as at 1 January 2017 was a reduction of £49.3m and the impact on the opening OCP balance as at 1 January 2018 was a reduction of £20.5m. Underlying Trading Profit decreased by £0.5m and Trading Profit decreased by £8.9m 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.

IFRS16

A new leasing standard, IFRS16 'Leases', is effective for the Group from 1 January 2019.

A number of options are allowed under IFRS16 in relation to the adoption of the new standard. The Group will adopt the modified retrospective approach for calculating all right of use assets as at 1 January 2019. This approach is more closely aligned to the full retrospective transition, without the need to recalculate all lease liabilities assuming IFRS16 had always been adopted by the Group.

The Group has also adopted the exemptions allowable under IFRS16:
- all leases with an end date before 31 December 2019 are not subjected to transition to IFRS16
- all short dated leases with a term of less than twelve months or a cost from new of less than £5,000 are not capitalised on the balance sheet and the associated lease expense is recognised through operating costs

A project relating to the implementation of IFRS16 included a review of the transition options to be adopted and a robust data capture exercise. The Group has assessed its lease portfolio under the principles included within IFRS16 where the consideration of whether a lease exists has changed from risks and rewards to one of control. As a result of this assessment there have been no changes to the lease assessments made under IAS17.

The expected impact of IFRS16 on the opening balance sheet of the Group as at 1 January 2019 is a £24.6m reduction in opening retained earnings and a £118.0m increase in Net Debt. As the modified retrospective approach is being adopted, the comparative information for 2018 will not be restated.

Financial Statements

Condensed Consolidated Income Statement
For the year ended 31 December

Continuing operations	2018 £m	2017 (restated *) £m
Revenue	2,836.8	2,950.9
Cost of sales	(2,546.6)	(2,710.6)
Gross profit	290.2	240.3
Administrative expenses		
Other general and administrative expenses	(202.3)	(222.2)
Exceptional profit on disposal of subsidiaries and operations	(0.5)	0.3
Other exceptional operating items	(31.4)	(19.9)
Other expenses - amortisation and impairment of intangibles arising on acquisition	(4.3)	(4.4)
Total administrative expenses	(238.5)	(246.2)
Share of profits in joint ventures and associates, net of interest and tax	28.8	27.0
Operating profit	80.5	21.1
Operating profit before exceptional items	112.4	40.7
Investment revenue	4.3	8.0
Finance costs	(18.2)	(19.2)
Exceptional finance income	7.5	-
Total net finance costs	(6.4)	(11.2)
Other gains	-	0.7
Profit before tax	74.1	10.6
Profit before tax and exceptional finance income	66.6	10.6
Tax on profit before exceptional items	(8.8)	(13.6)
Exceptional tax	2.1	(5.0)
Tax charge	(6.7)	(18.6)
Profit/(loss) for the year	67.4	(8.0)
Attributable to:		
Equity owners of the Company	67.4	(8.3)
Non controlling interests	-	0.3
Earnings per share (EPS)		
Basic EPS	6.16p	(0.76p)
Diluted EPS	5.99p	(0.76p)

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1.

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

	2018 £m	**2017 (restated***) £m**
Profit/(loss) for the year	67.4	**(8.0)**
Other comprehensive income for the year:		
Items that will not be reclassified subsequently to profit or loss:		
Net actuarial (loss)/gain on defined benefit pension schemes*	52.1	(106.5)
Actuarial (loss)/gain on reimbursable rights*	(0.2)	(0.6)
Tax relating to items not reclassified*	(9.2)	18.1
Share of other comprehensive income in joint ventures and associates	2.0	0.9
Items that may be reclassified subsequently to profit or loss:		
Net exchange (loss)/gain on translation of foreign operations**	(5.3)	(14.6)
Fair value (loss)/gain on cash flow hedges during the year**	0.6	(0.2)
Total other comprehensive income for the year	40.0	(102.9)
Total comprehensive income for the year	107.4	(110.9)
Attributable to:		
Equity owners of the Company	107.3	(111.0)
Non controlling interest	0.1	0.1

* 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.

*** Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1.

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
At 1 January 2017 (restated*)	**22.0**	**327.9**	**0.1**	**49.3**	**(91.1)**	**82.9**	**(52.1)**	**24.6**	**363.6**	**1.4**
Total comprehensive income for the year (restated*)	-	-	-	(7.5)	(89.0)	-	-	(14.5)	(111.0)	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)
At 1 January 2018 (restated*)	22.0	327.9	0.1	41.8	(180.1)	88.3	(46.1)	10.1	264.0	1.3
Total comprehensive expense for the year	-	-	-	69.3	42.7	-	-	(4.7)	107.3	0.1
Shares transferred to option holders on exercise of share options	-	-	-	-	-	(28.0)	27.4	-	(0.6)	-
Expense in relation to share based payments	-	-	-	-	-	14.7	-	-	14.7	-
Change in non controlling interest	-	-	-	-	-	-	-	-	-	-
At 31 December 2018	22.0	327.9	0.1	**111.1**	(137.4)	**75.0**	(18.7)	**5.4**	**385.4**	**1.4**

* Balances and results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1.

Condensed Consolidated Balance Sheet

	At 31 December 2018 £m	At 31 December 2017 (restated*) £m	At 1 January 2017 (restated*) £m
Non current assets			
Goodwill	579.6	551.3	577.9
Other intangible assets	67.3	66.7	83.6
Property, plant and equipment	64.8	61.3	67.2
Interests in joint ventures and associates	20.6	19.7	20.1
Trade and other receivables	30.3	57.3	44.4
Derivative financial instruments	0.1	3.7	14.2
Deferred tax assets	60.9	59.7	55.3
Retirement benefit assets	85.8	41.8	150.4
	909.4	861.5	1,013.1
Current assets			
Inventories	22.9	17.4	22.4
Contract assets	244.3	239.6	254.6
Trade and other receivables	299.5	272.4	290.8
Current tax assets	7.3	11.2	11.0
Cash and cash equivalents	62.5	112.1	177.8
Derivative financial instruments	7.7	10.3	4.9
	644.2	663.0	761.5
Total assets	1,553.6	1,524.5	1,774.6
Current liabilities			
Contract liabilities	(74.3)	(64.3)	(71.5)
Trade and other payables	(419.7)	(408.6)	(469.8)
Derivative financial instruments	(3.7)	(1.1)	(0.6)
Current tax liabilities	(29.2)	(25.3)	(25.9)
Provisions	(120.1)	(146.3)	(160.3)
Obligations under finance leases	(5.7)	(8.5)	(12.3)
Loans	(21.9)	(31.8)	(9.7)
	(674.6)	(685.9)	(750.1)
Non current liabilities			
Contract liabilities	(86.6)	(83.3)	(85.5)
Trade and other payables	(23.3)	(28.7)	(16.8)
Deferred tax liabilities	(21.4)	(20.4)	(30.5)
Provisions	(119.3)	(174.0)	(202.9)
Obligations under finance leases	(9.1)	(11.7)	(15.9)
Loans	(217.6)	(239.7)	(290.2)
Retirement benefit obligations	(14.9)	(15.5)	(17.7)
	(492.2)	(573.3)	(659.5)
Total liabilities	(1,166.8)	(1,259.2)	(1,409.6)
Net assets	386.8	265.3	365.0
Equity			
Share capital	22.0	22.0	22.0
Share premium account	327.9	327.9	327.9
Capital redemption reserve	0.1	0.1	0.1
Retained earnings	111.1	41.8	49.3
Retirement benefit obligations reserve	(137.4)	(180.1)	(91.1)
Share based payment reserve	75.0	88.3	82.9
Own shares reserve	(18.7)	(46.1)	(52.1)
Hedging and translation reserve	5.4	10.1	24.6
Equity attributable to owners of the Company	385.4	264.0	363.6
Non controlling interest	1.4	1.3	1.4
Total equity	386.8	265.3	365.0

* Balances as at 31 December 2017 and 1 January 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1.

Condensed Consolidated Cash Flow Statement
For the year ended 31 December

	2018 £m	2017 (restated*) £m
Net cash inflow from operating activities before exceptional items	42.9	12.2
Exceptional items	(40.2)	(32.5)
Net cash inflow/(outflow) from operating activities	2.7	(20.3)
Investing activities		
Interest received	0.6	0.5
(Decrease)/increase in security deposits	(0.3)	0.2
Dividends received from joint ventures and associates	29.7	28.2
Proceeds from disposal of property, plant and equipment	5.3	1.5
Proceeds from disposal of intangible assets	0.5	0.1
Net cash inflow/(outflow) on disposal of subsidiaries and operations	1.5	(7.1)
Acquisition of subsidiaries, net of cash acquired	(32.8)	1.5
Proceeds from loans receivable	29.9	0.6
Exceptional finance income received	7.5	-
Purchase of other intangible assets	(8.9)	(18.4)
Purchase of property, plant and equipment	(26.4)	(13.3)
Net cash inflow/(outflow) from investing activities	6.6	(6.2)
Financing activities		
Interest paid	(16.7)	(17.5)
Capitalised finance costs paid	(2.0)	-
Repayment of loans	(31.3)	(3.8)
Capital element of finance lease repayments	(8.7)	(12.6)
Cash movements on hedging instruments	0.2	(2.5)
Net cash outflow from financing activities	(58.5)	(36.4)
Net decrease in cash and cash equivalents	(49.2)	(62.9)
Cash and cash equivalents at beginning of year	112.1	177.8
Net exchange (loss)	(0.4)	(2.8)
Cash and cash equivalents at end of year	62.5	112.1

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1.

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 2018 or 2017, but is derived from these accounts. The auditors' report on the 2017 and 2018 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 2019.

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 2018, 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 £250m revolving credit facility, and £242m of US private placement notes. As at 31 December 2018, the Group had £492m of committed credit facilities and committed headroom of £308m.

On 3 December 2018 the Group completed the refinancing of its RCF with a syndicate of banks. Serco's RCF provides funds for general corporate and working capital purposes, and the ability to issue bonds to support the Group's business needs. The previous facility of £368m was due to mature in April 2020. The new facility provides £250m of committed funding with a maturity date of December 2023; the lower amount reflecting the much reduced need for debt in the business. The terms and conditions of the new facility are substantially unchanged from the prior facility.

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 2020. The Directors have also reviewed the principal risks considered in the Strategic Report within the Group's Annual Report and Accounts and taken account of the results of sensitivity testing.

Prior year restatement for the impact of 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 has been 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 2017 or that begin and end within the same annual reporting period have not been restated;
- for contracts that have variable consideration and which completed prior to 1 January 2018, the revenues recognised reflected 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 in the financial statements for the year ended 31 December 2018.

There was no material impact of applying the practical expedients noted above.

The cumulative effect of initial application of the standard has been applied as an adjustment to brought forward retained earnings as at 1 January 2017.

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. The restated balances are as previously included within the Group's Financial Statements for the 6 months to 30 June 2018 with one additional balance sheet reclassification relating to the adoption of IFRS15, which had no net impact on the income statement or balance sheet. The impact of the additional adjustment on the balance sheet for the year ended 31 December 2017 was to reduce provisions by £9.7m and to increase deferred income by the same amount with £1.0m being current and the remaining £8.7m being non-current. A reclassification was also made to the balance sheet for the year ended 31 December 2016. This adjustment reduced provisions by £15.7m, increased non-current deferred income by £11.7m and reduced unbilled receivables by £4.0m.

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
As previously stated	83.1	2,953.6	49.6
IFRS15 adjustments:			
(i) Declining unit prices	(14.7)	5.4	5.0
(ii) Upfront fees	(2.7)	0.9	0.8
(iii) Transition, transformation and other mobilisation activities	(4.3)	2.2	(1.7)
(iv) Asset maintenance and replacement, including vessel dry docking	(11.8)	1.3	(4.3)
(v) Pass through revenues and procurement arrangements	-	(12.5)	-
(vi) Consideration payable to a customer	-	(0.5)	(0.4)
(vii) Percentage of completion accounting	(0.3)	0.5	0.1
(viii) OCP charges and releases	-	-	(8.4)
As restated	49.3	2,950.9	40.7

The Group's accounting policy for the items above are covered in the Group's revenue recognition policy below this restatement section. The reason the adjustments noted above arise is:

(i) Declining unit prices. Where unit prices have been set to decline over the future periods, revenue recognised in prior years for these contracts has been deferred under IFRS15 in order to recognise revenue consistently in line with output received by the customer.

(ii) Upfront fees. In some instances upfront fees were recognised as revenue under IAS18 but are deferred under IFRS15 where no separate performance obligation exists relating to these fees.

(iii) Transition, transformation and other mobilisation activities. In some instances revenue recognised under IAS18 has been deferred under IFRS15 where no separate performance obligation exists.

(iv) Asset maintenance and replacement, including vessel dry docking. Adopting IFRS15 has resulted in the deferral of revenue recognised under IAS18 on certain contracts as a result of changing to the appropriate revenue recognition method.

(v) Pass through revenues and procurement arrangements. For certain procurement arrangements the Group does not have control prior to transfer, but does have a level of risk associated with the activity, therefore these arrangements are recognised on a net basis under IFRS15 instead of the gross basis under IAS18 due to the group acting as agent rather than principal in these transactions.

(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) 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.

(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 second half of 2017, 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.

Impact on condensed consolidated income statement	Year ended 31 December 2017 as previously stated £m	Adjustment £m	Year ended 31 December 2017 as restated £m
Revenue	2,953.6	(2.7)	2,950.9
Cost of sales	(2,704.7)	(5.9)	(2,710.6)
Gross profit	248.9	(8.6)	240.3
Administrative expenses			
General and administrative expenses	(222.2)	-	(222.2)
Exceptional profit on disposal of subsidiaries and operations	0.3	-	0.3
Other exceptional operating items	(19.9)	-	(19.9)
Other expenses - amortisation and impairment of intangibles arising on acquisition	(4.4)	-	(4.4)
Total administrative expenses	(246.2)	-	(246.2)
Share of profits in joint ventures and associates, net of interest and tax	27.3	(0.3)	27.0
Operating profit	30.0	(8.9)	21.1
Operating profit before exceptional items	49.6	(8.9)	40.7
Investment revenue	7.6	0.4	8.0
Finance costs	(19.2)	-	(19.2)
Net finance costs	(11.6)	0.4	(11.2)
Other gains	0.7	-	0.7
Profit before tax	19.1	(8.5)	10.6
Tax on profit before exceptional items	(14.0)	0.4	(13.6)
Exceptional tax	(5.0)	-	(5.0)
Tax charge	(19.0)	0.4	(18.6)
Profit/(loss) for the year	0.1	(8.1)	(8.0)
Earnings per share (EPS)			
Basic EPS	(0.02p)	(0.74p)	(0.76p)
Diluted EPS	(0.02p)	(0.74p)	(0.76p)

Impact on condensed consolidated statement of other comprehensive income	Year ended 31 December 2017 as previously stated £m	Adjustment £m	Year ended 31 December 2017 as restated £m
Profit for the year	0.1	(8.1)	(8.0)
Other comprehensive income for the year:			
Items that will not be reclassified subsequently to profit or loss:			
Net actuarial loss on defined benefit pension schemes	(106.5)	-	(106.5)
Actuarial loss on reimbursable rights	(0.6)	-	(0.6)
Tax relating to items not reclassified	18.1	-	18.1
Share of other comprehensive income in joint ventures and associates	0.9	-	0.9
Items that may be reclassified subsequently to profit or loss:			
Net exchange loss on translation of foreign operations	(14.6)	-	(14.6)
Fair value loss on cash flow hedges	(0.2)	-	(0.2)
Total other comprehensive income for the year	(102.9)	-	(102.9)
Total comprehensive income for the year	(102.8)	(8.1)	(110.9)

Impact on condensed consolidated balance sheet	As at 31 December 2017 as previously stated £m	Adjustment £m	As at 31 December 2017 as restated £m
Non current assets			
Goodwill	551.3	-	551.3
Other intangible assets	66.7	-	66.7
Property, plant and equipment	65.2	(3.9)	61.3
Interests in joint ventures and associates	14.3	5.4	19.7
Trade and other receivables	57.3	-	57.3
Derivative financial instruments	3.7	-	3.7
Deferred tax assets	55.0	4.7	59.7
Retirement benefit assets	41.8	-	41.8
	855.3	6.2	861.5
Current assets			
Inventories	17.4	-	17.4
Trade and other receivables	506.5	5.5	512.0
Current tax assets	11.2	-	11.2
Cash and cash equivalents	112.1	-	112.1
Derivative financial instruments	10.3	-	10.3
	657.5	5.5	663.0
Total assets	1,512.8	11.7	1,524.5
Current liabilities			
Trade and other payables	(462.9)	(10.0)	(472.9)
Derivative financial instruments	(1.1)	-	(1.1)
Current tax liabilities	(25.3)	-	(25.3)
Provisions	(148.5)	2.2	(146.3)
Obligations under finance leases	(8.5)	-	(8.5)
Loans	(31.8)	-	(31.8)
	(678.1)	(7.8)	(685.9)
Non current liabilities			
Trade and other payables	(28.7)	(83.3)	(112.0)
Deferred tax liabilities	(20.4)	-	(20.4)
Provisions	(211.5)	37.5	(174.0)
Obligations under finance leases	(11.7)	-	(11.7)
Loans	(239.7)	-	(239.7)
Retirement benefit obligations	(15.5)	-	(15.5)
	(527.5)	(45.8)	(573.3)
Total liabilities	(1,205.6)	(53.6)	(1,259.2)
Net assets	307.2	(41.9)	265.3
Equity			
Share capital	22.0	-	22.0
Share premium account	327.9	-	327.9
Capital redemption reserve	0.1	-	0.1
Retained earnings	83.7	(41.9)	41.8
Retirement benefit obligations reserve	(180.1)	-	(180.1)
Share based payment reserve	88.3	-	88.3
Own shares reserve	(46.1)	-	(46.1)
Hedging and translation reserve	10.1	-	10.1
Equity attributable to owners of the Company	305.9	(41.9)	264.0
Non controlling interest	1.3	-	1.3
Total equity	307.2	(41.9)	265.3

Impact on components of the cash flow statement	Year ended 31 December 2017 as previously stated £m	Adjustment £m	Year ended 31 December 2017 as restated £m
Operating profit for the year	30.0	(8.9)	21.1
Adjustments for:			
Share of profits in joint ventures and associates	(27.3)	0.3	(27.0)
Share based payment expense	11.4	-	11.4
Exceptional impairment of intangible assets	8.9	-	8.9
Impairment and write down of intangible assets	(0.1)	-	(0.1)
Depreciation of property, plant and equipment	24.3	(3.4)	20.9
Amortisation of intangible assets	25.8	-	25.8
Exceptional profit on disposal of subsidiaries and operations	(0.3)	-	(0.3)
Loss on disposal of property, plant and equipment	0.3	-	0.3
Loss on disposal of intangible assets	0.3	-	0.3
Non cash R&D expenditure offset against intangible assets	(0.7)	-	(0.7)
Decrease in provisions	(56.0)	12.8	(43.2)
Other non cash movements	0.1	-	0.1
Total non cash items	(13.3)	9.7	(3.6)
Operating cash inflow before movements in working capital	16.7	0.8	17.5
Decrease in inventories	3.7	-	3.7
Decrease in receivables	12.6	0.4	13.0
Decrease in payables	(37.2)	(5.7)	(42.9)
Movements in working capital	(20.9)	(5.3)	(26.2)
Cash generated by operations	(4.2)	(4.5)	(8.7)
Tax paid	(11.4)	-	(11.4)
Non cash R&D expenditure	(0.2)	-	(0.2)
Net cash outflow from operating activities	(15.8)	(4.5)	(20.3)

Adoption of new and revised standards

IFRS9 *Financial Instruments* (effective 1 January 2018) 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 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. 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, the counterparty credit risk is not considered to be material.

New standards and interpretations not applied: IFRS16 *Leases*

IFRS16 Leases (effective 1 January 2019), specifies how to recognise, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset is of a low value. Lessors continue to classify leases as operating or finance, with the IFRS 16 approach to lessor accounting remaining substantially unchanged from its predecessor, IAS 17.

Under the applicable transition rules a lessee shall either apply IFRS 16 with full retrospective effect or alternatively not restate comparative information but recognise the cumulative effect of initially applying IFRS 16 as an adjustment to opening equity at the date of initial application, subject to the Group's application of the following expedients:

- No reassessment is required as to whether a contract is, or contains, a lease at the date of initial application.
- No reassessment is required for:
  - leases with a lease term end date within one year of the date of initial application; or
  - leases for low value assets, which the Group considers to be those with an initial cost value less than £5,000 except for circumstances where those assets form part of a bundle of leased assets accounted for as a single lease contract.
- The Group has adopted the modified retrospective transition approach and as such the valuation of the right of use asset at 1 January 2019 is calculated as if the lease had always existed and hence the net book value of the asset on 1 January 2019 is based on the assumption of straight line amortisation.
- The lease liability at 1 January 2019 is calculated as the present value of future payments in relation to the lease, discounted at the applicable incremental borrowing rate.

Below is set out the expected lease accounting policy under IFRS16 together with the estimated impact of adopting the standard.

Leases

A right of use asset is recognised as an asset of the group at the present value of minimum lease payments determined at the inception of the lease, which is equal to the lease liability on inception. The corresponding liability to the lessor is included in the balance sheet as a lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly to the income statement, unless they are directly attributable to a qualifying asset, in which case they are capitalised in accordance with the Group's general policy on borrowing costs (see below).

Leases for assets with an initial cost of less than £5,000 except for circumstances where those assets form part of a bundle of leased assets accounted for as a single lease contract, or with a lease term of less than 12 months, or both, are charged to the income statement on a straight-line basis over the term of the relevant lease.

Estimated impact of the adoption of IFRS16

The estimated impact for the Group of adopting IFRS16 is as follows:

		As at 1 January 2019 £m
Retained earnings at 31 December 2018		110.6
Lease liability recognised	(118.0)	
Right of use asset recognised, net of impairments	88.0	
Deferred tax asset recognised	5.4	
Adjustment to retained earnings due to the implementation of IFRS16		(24.6)
Retained earnings at 1 January 2019		86.0

The Group will continue to work to design, implement and refine procedures to apply the new requirements of IFRS16 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 changes to the impact shown above prior to the 30 June 2019 results being issued. However, at this time these are not expected to be significant.

In calculating the lease liability to be recognised on transition, the Group used a weighted average incremental borrowing rate on 1 January 2019 of 3.50%. Applying this weighted average incremental borrowing rate to the operating lease commitments as at 31 December 2018 gives a liability of £187.2m. This differs from the lease liability recognised as a result of transitioning to IFRS16 for the following reasons:

	As at 1 January 2019 £m
Operating lease commitments discounted at the weighted average incremental borrowing rate	187.2
Less: leases ending within 12 months of the transition date to IFRS16 covered by the practical expedient	(44.8)
Less: leases included in the operating lease commitment not meeting the recognition criteria of IFRS16	(24.4)
Lease liability on transition to IFRS16	118.0

The implementation of IFRS16 Leases has required the Group to make a number of judgements and estimates. The key judgements applied relate to the likelihood of lease extension options being exercised, the certainty of the exercise of termination options and the identification of leases embedded within other contracts. The key estimates used in assessing the impact of adopting the new standard are the incremental borrowing rates applied in calculating the present value of future lease payments to identify the lease liability at 1 January 2019.

In addition to the areas where a financial impact has been identified as a result of adoption of IFRS16 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:

(i) Lease amendments. Where changes in a lease occur, this will trigger a reassessment of the lease liability. Changes in the lease liability will be recognised via an adjustment to the right of use asset. However, if the carrying amount of the right-of-use asset is reduced to zero and there is a further reduction in the measurement of the lease liability, any remaining amount of the remeasurement will be recognised in profit or loss.

(ii) Lease incentives. Where a lease incentive is received prior to the commencement of a lease, the amount is offset against the right of use asset at inception. Where a lease includes a period or periods of reduced or free rentals, these are included in the calculation of the present value of the lease liability on inception.

(iii) Variable lease payments. Where a contract to lease an asset has a pricing mechanism that allows for changes after the commencement date, other than those that change simply due to the passage of time, it is considered to have variable lease payments. These payments will depend on an index or rate and are included in the calculated lease liability at the lease commencement date according to the rate or index as at that date.

(iv) Sub-leases. Where a group entity leases an asset and this asset is subsequently leased to another entity, this is considered to be a sub-lease if the original head lease remains in place. In this instance the entity which has entered into the head lease is acting as both a lessee and a lessor simultaneously. As a result, the head lease is accounted for in accordance with the group's lease accounting policy. When acting as a lessor, there is a requirement to determine whether the sub-lease is an operating lease or a finance lease, with the accounting following this determination.

(v) Separate lease and non-lease components. Lease contracts can often contain elements related to the use of an asset and elements that are unrelated, for example where a property lease also includes a charge for insurance or maintenance. The lease component and the associated non-lease component are accounted for as a single lease component.

New standards and interpretations not applied: IFRIC23 *Uncertainty over Income Tax Treatments*

As an interpretation, IFRIC23 Uncertainty over Income Tax Treatments clarifies the application of the recognition and measurement criteria of IAS12 when there is uncertainty over income tax treatments yet to be accepted by tax authorities. The interpretation has an effective date of 1 January 2019 and is not expected to have a significant impact on the Group's financial statements.

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.

Key sources of estimation uncertainty

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, an amount of £3.4m was charged to historic provisions, and releases of £16.2m have been made. No charges have been made to new onerous contract provisions during the current year. Further details are provided in the Finance Review within the Strategic Report. 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 1.24%.

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 2018.

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 and other pension scheme arrangements 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 equal to the full surplus that will ultimately be available to the Group as a future refund.
- 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.

Critical accounting judgements

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 3 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.

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 and timing. 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.

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.

3. Segmental information

The Group's operating segments reflecting the information reported to the Board in 2018 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 financial statements.

The accounting policies of the reportable segments are the same as the Group's accounting policies described in note 1.

Information about major customers

The Group has four major governmental customers which each represent more than 8% of Group revenues. The customers' revenues were £1,113.1m (2017: £1,104.3m) for the UK Government within the UK & Europe segment, £522.8m (2017: £571.1m) for the US Government within the Americas segment, £498.7m (2017: £523.5m) for the Australian Government within the AsPac segment and £232.9m (2017: £239.8m) for the Government of the United Arab Emirates within the Middle East segment. The amounts shown for 2017 have been restated to show the impact of applying IFRS15 Revenue from Contracts with customers.

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

Year ended 31 December 2018	UK&E £m	Americas £m	AsPac £m	Middle East £m	Corporate £m	Total £m
Revenue	1,300.7	645.6	548.2	342.3	-	2,836.8
Result						
Trading profit/(loss) from continuing operations*	51.6	43.2	40.5	21.5	(40.1)	116.7
Amortisation and impairment of intangibles arising on acquisition	(0.5)	(3.2)	(0.6)	-	-	(4.3)
Operating profit/(loss) before exceptional items	51.1	40.0	39.9	21.5	(40.1)	112.4
Exceptional profit/(loss) on disposal of subsidiaries and operations	(0.5)	-	-	-	-	(0.5)
Other exceptional operating items**	(11.0)	(2.8)	(4.5)	-	(13.1)	(31.4)
Operating profit/(loss)	39.6	37.2	35.4	21.5	(53.2)	80.5
Investment revenue						4.3
Finance costs						(18.2)
Exceptional finance income						7.5
Profit before tax						74.1
Tax charge						(8.8)
Tax on exceptional items						2.1
Profit for the year from continuing operations						67.4

* 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.

Year ended 31 December 2018	UK&E £m	Americas £m	AsPac £m	Middle East £m	Corporate £m	Total £m
Supplementary information						
Share of profits in joint ventures and associates, net of interest and tax	28.6	-	0.2	-	-	28.8
Depreciation of plant, property and equipment	(11.4)	(3.3)	(2.5)	(0.7)	(1.6)	(19.5)
Impairment of plant, property and equipment	(0.7)	-	-	-	-	(0.7)
Total depreciation and impairment of plant, property and equipment	(12.1)	(3.3)	(2.5)	(0.7)	(1.6)	(20.2)
Amortisation of intangible assets arising on acquisition	(0.5)	(3.2)	(0.6)	-	-	(4.3)
Amortisation of other intangible assets	(0.4)	(1.5)	(4.9)	(0.3)	(11.5)	(18.6)
Impairment of other intangible assets	(0.1)	-	-	-	-	(0.1)
Total amortisation and impairment of intangible assets	(1.0)	(4.7)	(5.5)	(0.3)	(11.5)	(23.0)
Segment assets						
Interests in joint ventures and associates	19.6	-	0.6	0.4	-	20.6
Other segment assets***	487.6	426.4	222.1	123.4	135.0	1,394.5
Total segment assets	507.2	426.4	222.7	123.8	135.0	1,415.1
Unallocated assets						138.5
Consolidated total assets						1,553.6
Segment liabilities						
Segment liabilities***	(339.4)	(130.3)	(152.1)	(93.6)	(142.8)	(858.2)
Unallocated liabilities						(308.6)
Consolidated total liabilities						(1,166.8)

*** 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.

Year ended 31 December 2017 (restated***)	UK&E £m	Americas £m	AsPac £m	Middle East £m	Corporate £m	Total £m
Revenue	1,331.5	689.3	577.5	352.6	-	2,950.9
Result						
Trading profit/(loss) from continuing operations*	(4.1)	39.8	33.7	17.3	(41.6)	45.1
Amortisation and impairment of intangibles arising on acquisition	-	(3.0)	(1.4)	-	-	(4.4)
Operating profit/(loss) before exceptional items	(4.1)	36.8	32.3	17.3	(41.6)	40.7
Exceptional profit 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)
Operating profit/(loss)	8.1	36.5	24.9	17.4	(65.8)	21.1
Investment revenue						8.0
Finance costs						(19.2)
Other gains						0.7
Profit before tax						10.6
Tax charge						(13.6)
Tax on exceptional items						(5.0)
Loss for the year from continuing operations						(8.0)

* 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.

*** Results and balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1.

Year ended 31 December 2017 (restated***)	UK&E £m	Americas £m	AsPac £m	Middle East £m	Corporate £m	Total £m
Supplementary information						
Share of profits in joint ventures and associates, net of interest and tax	26.3	-	0.8	-	(0.1)	27.0
Depreciation of plant, property and equipment	(12.3)	(3.2)	(3.2)	(0.8)	(1.4)	(20.9)
Reversal of impairment of plant, property and equipment	0.1	-	-	-	-	0.1
Total depreciation and impairment of plant, property and equipment	(12.2)	(3.2)	(3.2)	(0.8)	(1.4)	(20.8)
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)
Segment assets (restated*)**						
Interests in joint ventures and associates	18.9	-	0.4	0.4	-	19.7
Other segment assets****	452.4	387.6	225.2	113.7	133.2	1,312.1
Total segment assets	471.3	387.6	225.6	114.1	133.2	1,331.8
Unallocated assets						192.7
Consolidated total assets						1,524.5
Segment liabilities (restated*)**						
Segment liabilities****	(407.5)	(124.9)	(161.3)	(86.2)	(142.0)	(921.9)
Unallocated liabilities, including liabilities held for sale						(337.3)
Consolidated total liabilities						(1,259.2)

*** Results and balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1.

****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.

4. Joint ventures and associates

AWE Management Limited (AWEML) and Merseyrail Services Holding Company Limited (MSHCL) were the only equity accounted entities which were material to the Group during the year or prior year. Dividends of £20.0m (2017: £17.1m) and £8.7m (2017: £7.3m) respectively were received from these companies in the year.

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

31 December 2018

Summarised financial information	AWEML (100% of results) £m	MSHCL (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
Revenue	1,024.7	160.8	331.5	43.6	375.1
Operating profit before exceptional items	100.4	17.1	33.2	1.4	34.6
Exceptional items	-	(0.6)	(0.3)	-	(0.3)
Operating profit	100.4	16.5	32.9	1.4	34.3
Net investment revenue/(finance costs)	0.6	0.2	0.2	0.1	0.3
Income tax charge	(18.6)	(3.3)	(6.2)	0.1	(6.1)
Profit from continuing operations	82.4	13.4	26.9	1.6	28.5
Profit from continuing operations before exceptional items	82.4	14.0	27.2	1.6	28.8
Other comprehensive income	-	4.1	2.0	-	2.0
Total comprehensive income	82.4	17.5	28.9	1.6	30.5
Non current assets	518.5	8.0	131.0	2.6	133.6
Current assets	210.1	45.7	74.3	15.4	89.7
Current liabilities	(190.6)	(28.0)	(60.7)	(12.5)	(73.2)
Non current liabilities	(517.6)	(0.8)	(127.2)	(2.3)	(129.5)
Net assets	20.4	24.9	17.4	3.2	20.6
Proportion of group ownership	24.5%	50.0%	-	-	-
Carrying amount of investment	5.0	12.4	17.4	3.2	20.6

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

	AWEML (100% of results) £m	MSHCL (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	98.1	34.3	41.2	5.1	46.3
Current financial liabilities excluding trade and other payables and provisions	(9.7)	(2.0)	(3.4)	(0.2)	(3.6)
Non current financial liabilities excluding trade and other payables and provisions	-	-	-	(2.3)	(2.3)
Depreciation and amortisation	-	(2.0)	(1.0)	(1.0)	(2.0)
Interest income	0.6	0.2	0.2	0.1	0.3
Interest expense	-	-	-	-	-

* 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 5 January 2019 (2017: 52 week period ended 6 January 2018). 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 cost associated with the Group's share of MSHCL's obligation in respect of the equalisation of guaranteed minimum pension (GMP) payments has been recorded as exceptional to ensure consistent treatment across all defined benefit pension schemes the Group is liable for. More information is provided in note 8.

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: 2018	AWEML	MSHCL
Rate of salary increases (%)	2.2%	3.1%
Inflation assumption (CPI %)	2.2%	2.2%
Discount rate (%)	3.0%	2.9%
Post-retirement mortality:		
Current male industrial pensioners at 65 (years)	23.0	N/A
Future male industrial pensioners at 65 (years)	25.6	N/A

Retirement benefit funding position (100% of results)	£m	£m
Present value of scheme liabilities	(2,030.4)	(290.3)
Fair value of scheme assets	1,512.8	193.3
Net amount recognised	(517.6)	(97.0)
Members' share of deficit	-	58.2
Franchise adjustment*	-	38.8
Related asset, right to reimbursement	517.6	-
Net retirement benefit obligation	-	-

* 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 2017 (restated)**

Summarised financial information	AWEML (100% of results) £m	MSHCL (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
Revenue	951.8	155.1	310.7	45.7	356.4
Operating profit	90.8	17.2	30.8	3.3	34.1
Net investment revenue/(finance costs)	0.2	(0.2)	(0.1)	-	(0.1)
Income tax (charge)/credit	(18.8)	(3.9)	(6.6)	(0.4)	(7.0)
Profit from continuing operations	72.2	13.1	24.1	2.9	27.0
Other comprehensive income	-	2.0	1.0	(0.1)	0.9
Total comprehensive income	72.2	15.1	25.1	2.8	27.9
Non current assets	665.6	8.7	167.5	2.2	169.7
Current assets	197.3	43.5	70.1	17.1	87.2
Current liabilities	(179.0)	(26.1)	(57.0)	(14.0)	(71.0)
Non current liabilities	(664.3)	(1.6)	(163.5)	(2.7)	(166.2)
Net assets	19.6	24.5	17.1	2.6	19.7
Proportion of group ownership	24.5%	50.0%	-	-	-
Carrying amount of investment	4.8	12.3	17.1	2.6	19.7

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

** Results and balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1.

	AWEML (100% of results) £m	MSHCL (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	35.7	5.5	41.2
Current financial liabilities excluding trade and other payables and provisions	(8.3)	(1.9)	(3.0)	(0.5)	(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.

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

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**

Retirement benefit funding position (100% of results)	AWEML £m	MSHCL £m
Present value of scheme liabilities	**(2,233.3)**	**(304.4)**
Fair value of scheme assets	**1,569.1**	**193.9**
Net amount recognised	**(664.2)**	**(110.5)**
Members' share of deficit	**-**	**44.2**
Franchise adjustment*	**-**	**66.3**
Related asset, right to reimbursement	**664.2**	**-**
Net retirement benefit obligation	**-**	**-**

* 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.

5. Acquisitions

On 26 January 2018, the Group acquired 100% of the issued share capital of BTP Systems, LLC (BTP). The acquired business contributed £12m of revenue and £1.9m of operating profit before exceptional items to the Group's results during year to 31 December 2018. Having incorporated the assets, liabilities and operations of BTP into the Group, BTP Systems, LLC was liquidated on 26 January 2018.

BTP provides satellite communications (SATCOM), radar modernisation, 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 specialises 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, Military Strategic & Tactical Relay command post antennas and radar antennas.

The Group acquired Carillion plc's facilities management contracts at six major NHS hospital sites over the period from June 2018 to August 2018: Great Western Hospital in Swindon; Darent Valley Hospital in Dartford; James Cook University Hospital in Middlesbrough; Harplands Hospital in Stoke-on-Trent; The Langlands Unit of Queen Elizabeth University Hospital in Glasgow; and Addenbrooke's Treatment Centre in Cambridge.

The total annual revenue of all six contracts is expected to be around £70m and the estimated operating profit before exceptional items, including an appropriate allocation of charges for shared support services and other incremental overheads, will be approximately £4m, the aggregate consideration payable was £18.1m. The acquired contracts contributed £30.3m of revenue and an operating loss before exceptional items of £2.1m of to the Group's results during year to 31 December 2018 due to the transition costs incurred.

	Fair value	Provisional fair value	
	BTP £m	Carillion Health contracts £m	Total £m
Goodwill	10.0	6.8	16.8
Acquisition related intangible assets	3.1	13.6	16.7
Property, plant and equipment	0.2	-	0.2
Inventories	0.3	-	0.3
Trade and other receivables	1.5	-	1.5
Cash and cash equivalents	1.2	-	1.2
Trade and other payables	(1.2)	-	(1.2)
Provisions	(0.7)	-	(0.7)
Deferred tax liability	-	(2.3)	(2.3)
Acquisition date fair value of consideration transferred	14.4	18.1	32.5
Satisfied by:			
Cash	14.4	16.1	30.5
Contingent consideration	-	2.0	2.0
Total consideration	14.4	18.1	32.5

The net cash outflow as a result of acquisitions completed during the year was £32.8m made up of £30.5m consideration paid on acquisitions made during the year, costs related to current year acquisitions of £0.6m, consideration related to historic acquisitions of £2.9m and £1.2m of cash acquired.

Goodwill on the Carillion Health contracts represents the premium associated with taking over contracts considered to have synergies with existing Health related contracts already being operated by the Group, and bring an established workforce able to deliver the services required under the contracts. The contracts acquired are considered to be accretive to the Group's financial performance. The contingent consideration payable on the Carillion Health contracts is contingent on the Group receiving certain indemnities in relation to the contracts acquired.

Goodwill on the acquisition of BTP represents the premium associated with enabling the Group to enter into new markets with a developed customer base and a series of established product and service offerings. These services complement Serco's capabilities in Command, Control, Communications, Computers, Combat Systems, Intelligence, Surveillance and Reconnaissance (C5ISR) services. Combining the skills of Serco and BTP Systems will enable the delivery of expanded C5ISR services supporting naval modernisation and sustainment for ship, shore and hardware integration projects.

Based on estimates made of the full year impact of acquisitions arising during the year, had the acquisitions taken place on 1 January 2018 Group revenue and operating profit before exceptional items for the period would have increased by £41.3m and approximately £6.2m respectively, taking total Group revenue to £2,878.1m and total Group operating profit before exceptional items to £118.6m.
The total impact of acquisitions to the Group's cash flow position in the period was as follows:

	£m
Net cash outflow on acquisition of BTP	(13.2)
Consideration paid in respect of Carillion contract acquisition completed including acquisition related costs	(16.7)
Deferred consideration paid in respect of historic acquisition:	
Anglia Support Partnership	(1.2)
Grafton Correctional Centre	(1.1)
Serco Sodexo Defence Services	(0.6)
Net cash outflow arising in the year on acquisitions	(32.8)

6. Disposals

A summary of the disposals taking place in the year ended 31 December 2018 were as follows:

Year ended 31 December 2018	Profit/(loss) on disposal £m	Cash flow £m
Disposal of the Anglia Support Partnership contract	(0.5)	(0.3)
Settlement of consideration for Service Glasgow LLP	-	1.8
	(0.5)	1.5

In October 2018 the Group's interest in the Anglia Support Partnership contract was disposed of, resulting in a net cash outflow of £0.3m with a loss on disposal of £0.5m. Further details are provided below.

	Anglia Support Partnership contract £m
Trade and other receivables	0.5
Trade and other payables	(0.6)
Net assets disposed	(0.1)

	Anglia Support Partnership contract £m
Consideration	-
Less:	
Net assets disposed	(0.1)
Disposal costs	(0.4)
Income statement impact of disposal	(0.5)

The net cash outflow arising on the disposal of the Anglia Support Partnership contract and the impact on Net Debt is as follows:

	Anglia Support Partnership contract £m
Consideration	-
Less: Disposal costs	(0.3)
Net cash flow on disposal and movement in Net Debt	(0.3)

7. Revenue from contracts with customers

Revenue

As a result of the adoption of IFRS15 all disclosures contained in this note are new or restated from that previously disclosed in the Group's financial statements.

Information regarding the group's major customers, and a segmental analysis of revenue is provided in note 3. An analysis of the Group's revenue from its key market sectors, together with the timing of revenue recognition across the group's revenue from contracts with customers is as follows:

Year ended 31 December 2018	UK&E £m	Americas £m	AsPac £m	Middle East £m	Total £m
Key sectors					
Defence	260.2	338.3	56.2	40.8	695.5
Justice & Immigration	269.8	-	271.4	-	541.2
Transport	151.4	90.2	18.3	204.6	464.5
Health	231.8	-	89.1	28.5	349.4
Citizen Services	387.5	217.1	113.2	68.4	786.2
	1,300.7	645.6	548.2	342.3	2,836.8
Timing of revenue recognition					
Revenue recognised from performance obligations satisfied in previous periods	1.6	-	3.2	-	4.8
Revenue recognised at a point in time	38.9	-	1.8	-	40.7
Products and services transferred over time	1,260.2	645.6	543.2	342.3	2,791.3
	1,300.7	645.6	548.2	342.3	2,836.8

Year ended 31 December 2017	UK&E £m	Americas £m	AsPac £m	Middle East £m	Total £m
Key sectors					
Defence	291.9	325.7	76.9	41.2	735.7
Justice & Immigration	258.0	-	303.0	-	561.0
Transport	153.0	86.5	32.5	204.9	476.9
Health	180.7	-	91.1	33.7	305.5
Citizen Services	447.9	277.1	74.0	72.8	871.8
	1,331.5	689.3	577.5	352.6	2,950.9
Timing of revenue recognition					
Revenue recognised from performance obligations satisfied in previous periods	0.2	-	-	-	0.2
Revenue recognised at a point in time	45.0	-	4.8	-	49.8
Products and services transferred over time	1,286.3	689.3	572.7	352.6	2,900.9
	1,331.5	689.3	577.5	352.6	2,950.9

Transaction price allocated to remaining performance obligations

The following table shows the transaction price allocated to remaining performance obligations. This represents revenue expected to be recognised in subsequent periods arising on existing contractual arrangements. The Group has not taken the practical expedient in IFRS15.121 not to disclose information about performance obligations that have original expected durations of one year or less and therefore no consideration from contracts with customers is excluded from the amounts included below. Forecast variable revenue is included only to the extent that it is highly probable that a significant reversal will not occur.

	UK&E £m	Americas £m	AsPac £m	Middle East £m	Total £m
Within 1 year (2019)	1,138.3	424.8	497.0	241.1	2,301.2
Between 2 – 5 years (2020 – 2023)	2,962.6	162.9	724.8	144.1	3,994.4
5 years and beyond (2025+)	3,849.2	0.6	1,727.2	170.2	5,747.2
	7,950.1	588.3	2,949.0	555.4	12,042.8

Contract balance sheet items

The contract balances arising from contracts with customers are as follows:

Contract assets	2018 £m	2017 £m
Capitalised bid costs	4.9	6.2
Capitalised mobilisation and phase in costs	17.2	18.9
Accrued income and other unbilled receivables	222.2	214.5
	244.3	239.6

These amounts exclude trade and other receivables.

Contract liabilities	2018 £m	2017 £m
Deferred income	(160.9)	(147.6)

These amounts exclude trade and other payables.

During the current year and the prior year, there have been no significant changes in contract assets or contract liabilities other than those arising in the normal course of business.

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.

Other exceptional operating items arising on continuing operations

For the year ended 31 December	2018 £m	2017 £m
Exceptional items arising		
Exceptional (loss)/profit on disposal of subsidiaries and operations	(0.5)	0.3
Other exceptional operating items		
Restructuring costs	(32.3)	(28.6)
Increase in onerous lease provision	(1.8)	-
Costs associated with UK Government review	0.4	(0.4)
Release of UK frontline clinical health contract provisions	-	0.4
Settlement of defined benefit pension obligations	-	10.3
Reversal of impairment of interest in joint venture and related loan balances	0.8	4.5
Reversal of impairment on loan balances	13.9	-
Impairment of AsPac customer lists	-	(6.1)
Cost of Guaranteed Minimum Pension equalisation	(9.6)	-
Increase in other provisions	(2.8)	-
Other exceptional operating items	(31.4)	(19.9)
Exceptional operating items	(31.9)	(19.6)
Exceptional finance income	7.5	-
Exceptional tax	2.1	(5.0)
Total operating and financing exceptional items net of tax	(22.3)	(24.6)

Exceptional profit on disposals

There were no material disposals of continuing operations in 2018 (2017: none).

Other exceptional operating items

The annual impairment testing of CGUs in 2018 has identified no impairment of goodwill.

The Group is incurring costs in relation to restructuring programmes resulting from the Strategy Review. These costs include redundancy payments, provisions (including onerous leases), external advisory fees and other incremental costs. 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 2018, a charge of £32.3m (2017: £28.6m) 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 £6.3m (2017: £11.1m) and were included within operating profit before exceptional items. We expect exceptional restructuring costs of approximately £20.0m will be incurred in 2019, which we expect to be the final year.

There was an exceptional credit totalling £0.4m (2017: charge of £0.4m) 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 2018. The credit reflects the recovery of costs from the Group's insurance providers.

An exceptional charge of £9.6m (2017: nil) has been recorded in the Group's income statement for the year ended 31 December 2018. This is to recognise the Group's obligations associated with equalising the Guaranteed Minimum Pension (GMP) payments between male and female employees for the Group's defined benefit pension schemes following a High Court ruling made in October 2018. The Serco Pension and Life Assurance Scheme (SPLAS) recorded the largest charge being £9.0m. Included in the £9.6m charge is £0.3m related to the Group's share of the GMP cost in one of the Group's joint ventures. This has been recorded as exceptional to ensure consistent treatment of all items in 2018 related to the cost of equalising the GMP payments within the Group's pension schemes. The impact of GMP equalisation is not currently estimated to have a material impact in future years.

An additional charge of £2.8m has been recorded in respect of a legal dispute in the Group's North American Division. The treatment of this additional amount as exceptional is consistent with the recognition of the original charge associated with the same legal matter.

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 2018 payments of £0.8m (2017: £4.5m) were received against the impaired loan.

An exceptional profit of £13.9m (2017: nil) has been recognised for the settlement of consideration associated with the sale of Serco GmbH in 2012 through the offsetting of outstanding loan balances, the receivable of which had been impaired. An exceptional loss on disposal of £27.7m was recorded in 2012 in respect of the sale.

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 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. A cost of this nature did not reoccur in 2018.

In 2017 there were releases of provisions of £0.4m which were previously charged through exceptional items in relation to the exit of the UK frontline clinical health contracts. 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 in 2017, totalling £6.1m.

Exceptional finance income

Part of the consideration for the sale of the Group's private sector BPO business in 2015 was a loan note with a face value of £30m accruing compound interest of 7%. The receivable associated with this loan note was recorded at a fair value of £19.5m. The discount on the loan note has been unwinding through the Group's net finance cost on an annual basis. During October 2018, the Intelenet business was sold and therefore repayment of the loan note was triggered resulting in a gain of £7.5m. As this gain is outside the normal financing arrangements of the Group and significant in size it has been recorded as exceptional investment income.

Exceptional tax

Exceptional tax for the year was a tax credit of £2.1m (2017: £5.0m charge) which arises on exceptional items within operating profit.

No net tax credit arises on the exceptional charge associated with GMP equalisation (further detail on this charge is included in the "Other exceptional operating items" section above). The credit of £1.6m that arises on the deferred tax movement associated with this charge is netted with an equal and opposite charge that arises on the associated reduction in the deferred tax asset in order to retain the net deferred tax position as supported by future forecast profits.

Remaining exceptional costs excluding the pension charge (£14.8m) only gave rise to a credit of £2.1m, as the majority of these costs were incurred in the UK where they only impact our unrecognised deferred tax in relation to losses.

9. Investment revenue

Year ended 31 December	2018 £m	2017 (restated*) £m
Interest receivable on other loans and deposits	2.3	2.6
Net interest receivable on retirement benefit obligations (note 18)	0.8	3.8
Interest arising on customer contracts	-	0.4
Movement in discount on other debtors	1.2	1.2
	4.3	8.0

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1.

10. Finance costs

Year ended 31 December	2018 £m	2017 £m
Interest payable on obligations under finance leases	0.6	1.3
Interest payable on other loans	13.8	14.0
Facility fees and other charges	3.1	3.0
Movement in discount on provisions	0.5	1.3
	18.0	19.6
Foreign exchange on financing activities	0.2	(0.4)
	18.2	19.2

11. Tax

Income tax recognised in the income statement

Year ended 31 December	Before exceptional items 2018 £m	Exceptional items 2018 £m	Total 2018 £m	Before exceptional items 2017 (restated*) £m	Exceptional items 2017 £m	Total 2017 (restated*) £m
Current income tax						
Current income tax charge/(credit)	23.6	(1.4)	22.2	14.6	(2.4)	12.2
Adjustments in respect of prior years	(0.9)	-	(0.9)	(0.8)	-	(0.8)
Deferred tax						
Current year (credit)/charge	(13.8)	(0.7)	(14.5)	1.7	7.4	9.1
Adjustments in respect of prior years	(0.1)	-	(0.1)	(1.9)	-	(1.9)
	8.8	(2.1)	6.7	13.6	5.0	18.6

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1.

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 2018 £m	Exceptional items 2018 £m	Total 2018 £m	Before exceptional items (restated***) 2017 £m	Exceptional items 2017 £m	Total (restated***) 2017 £m
Profit before tax	98.5	(24.4)	74.1	30.2	(19.6)	10.6
Tax calculated at a rate of 19.00% (2017: 19.25%)	18.7	(4.6)	14.1	5.8	(3.8)	2.0
Expenses not deductible for tax purposes*	5.3	-	5.3	5.9	0.3	6.2
UK unprovided deferred tax**	(7.5)	3.5	(4.0)	(3.0)	2.9	(0.1)
Other unprovided deferred tax	2.5	-	2.5	2.3	0.1	2.4
Effect of the use of unrecognised tax losses	(0.3)	-	(0.3)	(1.2)	(0.5)	(1.7)
Impact of changes in statutory tax rates on current income tax	1.7	-	1.7	1.4	(2.2)	(0.8)
Change in deferred tax as a result of legislative changes	-	-	-	-	(8.8)	(8.8)
Overseas rate differences	7.3	(0.7)	6.6	9.2	(0.8)	8.4
Other non taxable income	(2.5)	(0.4)	(2.9)	(0.9)	(0.5)	(1.4)
Adjustments in respect of prior years	(1.0)	-	(1.0)	(2.9)	-	(2.9)
Adjustments in respect of deferred tax on pensions	(10.1)	-	(10.1)	2.2	18.3	20.5
Adjustments in respect of equity accounted investments	(5.3)	0.1	(5.2)	(5.2)	-	(5.2)
Tax charge	8.8	(2.1)	6.7	13.6	5.0	18.6

* Relates to costs that are not allowable for tax deduction under local tax law

** 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. Additional tax is recognised in relation to brought forward losses as shown in the deferred tax note below. UK unprovided deferred tax in relation to exceptional items relates to amounts which have been charged to the income statement in the current period for which no tax deduction has yet been taken, for items such as restructuring costs.

*** Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1.

The income tax charge for the year is based on the blended UK statutory rate of corporation tax for the period of 19.00% (2017: 19.25%). Taxation for other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

Income tax recognised in the SOCI

Year ended 31 December	2018 £m	2017 £m
Current tax		
Taken to retirement benefit obligations reserve	-	-
Deferred tax		
Relating to cash flow hedges	-	-
Taken to retirement benefit obligations reserve	(9.2)	**18.1**
	(9.2)	**18.1**

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:

	2018 £m	2017 (restated*) £m
At 1 January - asset	(39.3)	(24.8)
Income statement (credit)/charge	(14.7)	7.2
Items recognised in equity and in other comprehensive income	9.2	(18.1)
Arising on acquisition	2.3	(1.0)
Exchange differences	3.0	(2.6)
At 31 December - asset	(39.5)	(39.3)

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1.

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 2018 (restated*)	25.8	(12.2)	2.5	(7.9)	(18.7)	(28.8)	(39.3)
(Credited)/charged to income statement (note 11)	(4.7)	(1.8)	(1.7)	0.8	(1.9)	(5.4)	(14.7)
Items recognised in equity and in other comprehensive income (note 11)	-	-	9.2	-	-	-	9.2
Arising on acquisition	2.3	-	-	-	-	-	2.3
Exchange differences	1.2	0.3	(0.1)	(0.3)	-	1.9	3.0
At 31 December 2018	24.6	(13.7)	9.9	(7.4)	(20.6)	(32.3)	(39.5)

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1.

Of the amount credited to the income statement, £0.1m (2017: charge of £0.1m) has been taken to cost 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 (2017: £nil).

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 2017 (restated*)	36.5	(12.0)	17.6	(17.8)	(10.3)	(38.8)	(24.8)
(Credited)/charged to income statement (note 11)	(6.7)	0.3	2.8	9.2	(8.4)	10.0	7.2
Items recognised in equity and in other comprehensive income (note 11)	-	-	(18.1)	-	-	-	(18.1)
Arising on acquisition	(0.1)	(0.9)	-	-	-	-	(1.0)
Exchange differences	(3.9)	0.4	0.2	0.7	-	-	(2.6)
At 31 December 2017	25.8	(12.2)	2.5	(7.9)	(18.7)	(28.8)	(39.3)

* Results and balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1.

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:

	2018 £m	**2017 (restated*) £m**
Deferred tax liabilities	21.4	**20.4**
Deferred tax assets	(60.9)	**(59.7)**
	(39.5)	**(39.3)**

* Balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1.

As at the balance sheet date, the UK has a potential deferred tax asset of £168.8m (2017: £177.0m) available for offset against future profits. A deferred tax asset has currently been recognised of £20.3m (2017: £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 £148.5m) based on current forecasts; additional asset recognition is contingent on further improvement in the UK profit forecast. Measures enacted during 2016 cut the future tax rate from April 2020 from 19% to 17%. These measures will reduce the Group's future current tax charge accordingly. The deferred tax balance at 31 December 2018 has been calculated reflecting the reduced rate.

Losses of £0.2m (2017: £0.1m) expire within 5 years, losses of £0.1m (2017 £0.1m) expire within 6-10 years, losses of £0.7m (2017 £4.1m) expire within 20 years and losses of £1,015.2m (2017 £998.4m) 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	2018 millions	2017 (restated*) millions
Weighted average number of ordinary shares for the purpose of basic EPS	1,094.4	**1,089.7**
Effect of dilutive potential ordinary shares: Share options	31.0	30.9
Weighted average number of ordinary shares for the purpose of diluted EPS	1,125.4	**1,120.6**

* The number of dilutive ordinary shares has been restated to ensure that the calculation is consistent with the method used for the current financial year. This does not impact the diluted earnings per share for 2017 as the company was in a loss making position.

At 31 December 2018 options over 145,238 (2017: 236,616) shares were excluded from the weighted average number of shares used for calculating diluted earnings per share in accordance with IFRS2 Share Based Payment because their exercise price was above the average share price for the year and they were, therefore, anti-dilutive.

Basic EPS	Earnings 2018 £m	Per share amount 2018 pence	Earnings 2017 (restated*) £m	Per share amount 2017 (restated*) Pence
Earnings for the purpose of basic EPS	67.4	6.16	**(8.3)**	**(0.76)**
Effect of dilutive potential ordinary shares	-	(0.17)	-	-
Diluted EPS	67.4	5.99	(8.3)	(0.76)
Basic EPS excluding exceptional items				
Earnings for the purpose of basic EPS	67.4	6.16	(8.3)	(0.76)
Add back exceptional items	24.4	2.23	19.6	1.80
Add back tax on exceptional items	(2.1)	(0.19)	5.0	0.46
Earnings excluding exceptional operating items for the purpose of basic EPS	89.7	8.20	16.3	1.50

* Results and balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1.

14. Goodwill

	Cost £m	Accumulated impairment losses £m	Carrying amount £m
At 1 January 2017	926.5	(348.6)	577.9
Exchange differences	(48.5)	21.9	(26.6)
At 1 January 2018	878.0	(326.7)	551.3
Exchange differences	24.4	(12.9)	11.5
Acquisitions	16.8	-	16.8
At 31 December 2018	919.2	(339.6)	579.6

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

	Goodwill balance 1 January 2018 £m	Additions 2018 £m	Exchange differences 2018 £m	Impairment 2018 £m	Goodwill balance 31 December 2018 £m	Headroom on impairment analysis 2018 £m	Headroom on impairment analysis 2017 £m
UK & Europe	177.5	6.8	-	-	184.3	593.6	427.7
Americas	253.0	10.0	15.9	-	278.9	159.4	151.8
AsPac	110.8	-	(4.9)	-	105.9	307.8	231.6
Middle East	10.0	-	0.5	-	10.5	57.9	145.6
	551.3	16.8	11.5	-	579.6	1,118.7	956.7

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.

Late in 2017, the Group amalgamated its Central Government and Local and Regional Government divisions into a combined UK & Europe division. Within the UK & Europe division, there are a number of business units, each individually representing a cash generating unit, three of which have an amount of goodwill allocated to them. Following the combination of divisions in 2017, the management structure across the UK & Europe division has been aligned to the management structure across other divisions with divisional resources and certain operational decisions being considered on a division-wide basis. The UK & Europe division now represents the lowest level at which goodwill is monitored for internal management purposes and as a result goodwill will be tested for impairment across the group of CGUs that make up the division.

Had the movements and headroom for the year ended 31 December 2018 been prepared on a basis consistent with the year ended 31 December 2017, the result would have been:

	Goodwill balance 1 January 2018 £m	Additions 2018 £m	Exchange differences 2018 £m	Impairment 2018 £m	Goodwill balance 31 December 2018 £m	Headroom on impairment analysis 2018 £m	Headroom on impairment analysis (restated*) 2017 £m
UK & Europe							
Justice & Immigration	49.6	-	-	-	49.6	188.4	127.4
Health	60.6	6.8	-	-	67.4	64.9	19.4
Direct Services & Europe	67.3	-	-	-	67.3	41.6	71.5
Americas	253.0	10.0	15.9	-	278.9	159.4	151.8
AsPac	110.8	-	(4.9)	-	105.9	307.8	231.6
Middle East	10.0	-	0.5	-	10.5	57.9	145.6
	551.3	16.8	11.5	-	579.6	820.0	747.3

* Within the group's restructuring activities late in 2017, the historic Citizen Services business unit was amalgamated with Direct Services, meaning that no separate financial information is available for 2018. As a result, the headroom on the impairment analysis for 2017 has been restated, increasing by £1.2m, to reflect the value in use calculation of the Citizen Services business unit as at 31 December 2017.

Headroom under the revised approach used in 2018 is greater than that which would have existed under the 2017 approach due to the fact that there are additional business units to which no goodwill was previously allocated which form part of the UK & Europe group of CGUs.

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

	Discount rate 2018 %	Discount rate 2017 %	Terminal growth rates 2018 %	Terminal growth rates 2017 %
UK & Europe	10.0	10.8	2.0	2.0
Americas	10.6	10.5	2.4	**2.4**
AsPac	10.0	9.7	2.4	**2.4**
Middle East	11.8	10.8	2.5	**2.5**

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. No impairment results from these changes being made to the key assumptions either individually or in combination. When reviewing the cash generating units in a manner consistent with 2017, it was noted that a reduction of £6.9m in the terminal year cash flows for the Health CGU would lead to the recoverable amount no longer exceeding the carrying value. Having reviewed the forecast cash flows associated with the group of CGUs making up UK & Europe the required reduction in terminal year cash flows, which would result in an impairment of goodwill, was considered an unlikely scenario.

15. Analysis of Net Debt

The analysis below provides a reconciliation between the opening and closing positions in the balance sheet for liabilities arising from financing activities together with movements in cash loan receivables and derivatives relating to the items included in Net Debt. There were no changes in fair value noted in either the current or prior year.

	At 1 January 2018 £m	Cash flow £m	Acquisitions* £m	Disposals £m	Exchange differences £m	Non cash movements £m	At 31 December 2018 £m
Loans payable	(271.5)	33.3	-	-	(12.9)	11.6	(239.5)
Obligations under finance leases	(20.2)	8.7	-	-	0.1	(3.4)	(14.8)
Liabilities arising from financing activities	(291.7)	42.0	-	-	(12.8)	8.2	(254.3)
Cash and cash equivalents	112.1	(50.4)	1.2	-	(0.4)	-	62.5
Loan receivables	25.7	(37.4)	-	-	-	11.7	-
Derivatives relating to Net Debt	12.8	-	-	-	(9.0)	-	3.8
Net Debt	(141.1)	(45.8)	1.2	-	(22.2)	19.9	(188.0)

	At 1 January 2017 £m	Cash flow £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)
Liabilities arising from financing activities	(328.1)	16.4	-	-	25.5	(5.5)	(291.7)
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
Net Debt	(109.3)	(41.5)	1.5	(7.1)	17.4	(2.1)	(141.1)

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

16. Provisions

	Employee related £m	Property £m	Contract £m	Other £m	Total £m
At 1 January 2018 (restated*)	55.7	13.6	148.1	102.9	320.3
Brought forward reclassification	-	-	(1.5)	-	(1.5)
Arising on acquisition	-	-	-	0.7	0.7
Eliminated on disposal of subsidiary	-	-	-	-	-
Charged to income statement – exceptional	2.8	1.8	-	2.8	7.4
Charged to income statement – other	14.3	2.1	3.4	3.3	23.1
Released to income statement – exceptional	(4.7)	-	-	(0.9)	(5.6)
Released to income statement – other	(0.7)	(2.1)	(16.2)	(12.0)	(31.0)
Utilised during the year	(7.9)	(2.9)	(51.8)	(13.2)	(75.8)
Reclassification	-	-	-	0.5	0.5
Unwinding of discount	-	-	0.5	-	0.5
Exchange differences	-	(0.1)	(0.4)	1.3	0.8
At 31 December 2018	59.5	12.4	82.1	85.4	239.4
Analysed as:					
Current	19.9	4.3	54.6	41.3	120.1
Non current	39.6	8.1	27.5	44.1	119.3
	59.5	12.4	82.1	85.4	239.4

* Balances for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1.

Contract provisions relate to onerous contracts which will be utilised over the life of each individual contract. 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 2018, additional charges have been made in respect of future losses on a number of onerous contracts totalling £3.4m. This increase related to revisions to existing OCPs of £82.1m at 31 December 2018. No new OCPs were created during the year.

A full analysis is performed at least annually of the future profitability of all contracts with marginal performances and of the balance sheet items directly linked to these contracts.

Due to the significant size of the balance and the inherent level of uncertainty over the amount and timing of the related cash flows upon which onerous contract provisions are based, if the expected operational performance varies from the best estimates made at the year end, a material change in estimate may be required. The key drivers behind operational performance is the level of activity required to be serviced, which is often directed by the actions of the UK Government, and the efficiency of Group employees and resources.

Employee related provisions are for long-term service awards and terminal gratuity liabilities which have been accrued and are based on contractual entitlement, together with an estimate of the probabilities that employees will stay until retirement and receive all relevant amounts. There are also amounts included in relation to restructuring. The provisions will be utilised over various periods driven by local legal or regulatory requirements, the timing of which is not certain.

Property provisions relate to leased properties which are either underutilised or vacant and where the unavoidable costs associated with the lease exceed the economic benefits expected to be generated in the future. The provision has been calculated based on the discounted cash outflow required to settle the lease obligations as they fall due, with the longest running lease ending in April 2039.

Other provisions are held for indemnities given on disposed businesses, legal and other costs that the Group expects to incur over an extended period, in respect of past events. These costs are based on past experience of similar items and other known factors and represent management's best estimate of the likely outcome and will be utilised with reference to the specific facts and circumstances. The timing of utilisation is dependent on future events which could occur within the next twelve months or over a longer period with the majority expected to be settled by 31 December 2021.

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 (2017: £4.3m). The actual commitment outstanding at 31 December 2018 was £4.3m (2017: £4.3m).

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 2018 was £225.3m (2017: £227.1m).

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 and timing. However, disclosed in the Principal Risks and Uncertainties in the Group's Annual Report and Accounts 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.

The Group is also aware of other claims and potential claims which involve or may involve legal proceedings against the Group although the timing of settlement of these claims remains uncertain. 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 2019 are £4.9m (2018: £7.1m).

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 2018 the estimated actuarial deficit of SPLAS was £27.8m (2017: £33.7m) based on the actuarial assessment on the funding basis whereas the accounting valuation resulted in an asset of £85.8m. 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 2017, with employer contributions of 29.3% of pensionable salaries to be made up to 31 October 2018, dropping to 28.3% from 1 November 2018 to 31 December 2022. Additional shortfall contributions made up of four payments of £0.5m payable at the end of each April through to 2022 were also agreed. In addition to this agreement a decision was reached between the Group and the SPLAS trustees to make a one-off shortfall contribution of £4.0m during the year, with this payment being made in December 2018. It is anticipated that a revised Schedule of Contributions will be signed before 5 July 2019 following the finalisation of the 2018 SPLAS actuarial valuation.

Events in the year

During the year, the group made two one-off contributions into the SPLAS scheme. In April 2018 a payment of £1.2m was made and this was followed by a payment for £4.0m in December 2018.

Also during the year, following a ruling in the High Court, the Group has recognised a past service cost for the impact of Guaranteed Minimum Pension equalisation. The total amount recognised by the group is £9.6m and this has been treated as an exceptional item in the 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:

Recognised in the income statement	Contract specific 2018 £m	Non contract specific 2018 £m	Total 2018 £m
Current service cost - employer	1.1	4.6	5.7
Past service cost	-	9.3	9.3
Curtailment gain recognised	-	-	-
Administrative expenses and taxes	-	3.9	3.9
Recognised in arriving at operating profit after exceptionals	1.1	17.8	18.9
Interest income on scheme assets - employer	(0.4)	(33.3)	(33.7)
Interest on franchise adjustment	(0.1)	-	(0.1)
Interest cost on scheme liabilities - employer	0.4	32.6	33.0
Finance income	(0.1)	(0.7)	(0.8)

Included within the SOCI	Contract specific 2018 **£m**	Non contract specific 2018 **£m**	Total 2018 **£m**
Actual return on scheme assets	(0.5)	40.7	40.2
Less: interest income on scheme assets	(0.4)	(33.4)	(33.8)
	(0.9)	7.3	6.4
Effect of changes in demographic assumptions	-	-	-
Effect of changes in financial assumptions	1.7	74.0	75.7
Effect of experience adjustments	-	(30.0)	(30.0)
Remeasurements	0.8	51.3	52.1
Change in franchise adjustment	-	-	-
Change in members' share	(0.3)	0.1	(0.2)
Actuarial profit/(loss) on reimbursable rights	(0.3)	0.1	(0.2)
Total pension gain recognised in the SOCI	0.5	51.4	51.9

Recognised in the income statement	Contract specific 2017 £m	Non contract specific 2017 £m	Total 2017 £m
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
Recognised in arriving at operating profit	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
Finance income	-	(3.8)	(3.8)

Included within the SOCI	Contract specific 2017 £m	Non contract specific 2017 £m	Total 2017 £m
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
Remeasurements	1.1	(107.6)	(106.5)
Change in franchise adjustment	(0.2)	-	(0.2)
Change in members' share	(0.4)	-	(0.4)
Actuarial losses on reimbursable rights	(0.6)	-	(0.6)
Total pension gain recognised in the SOCI	0.5	(107.6)	(107.1)

Balance sheet values

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

Scheme assets at fair value	Contract specific 2018 £m	Non contract specific 2018 £m	Total 2018 £m
Equities	9.7	39.9	49.6
Bonds except LDIs	3.8	93.4	97.2
LDIs	-	580.7	580.7
Property	1.2	-	1.2
Cash and other	2.9	8.7	11.6
Private debt mandates	-	11.4	11.4
Annuity policies	-	600.2	600.2
Fair value of scheme assets	17.6	1,334.3	1,351.9
Present value of scheme liabilities	(23.8)	(1,263.2)	(1,287.0)
Net amount recognised	(6.2)	71.1	64.9
Franchise adjustment*	3.7	-	3.7
Members' share of deficit	2.3	-	2.3
Net retirement benefit asset	(0.2)	71.1	70.9
Net pension liability	(0.2)	(14.7)	(14.9)
Net pension asset	-	85.8	85.8
Net retirement benefit asset	(0.2)	71.1	70.9
Deferred tax liabilities	-	(9.9)	(9.9)
Net retirement benefit asset (after tax)	(0.2)	61.2	61.0

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

Scheme assets at fair value	Contract specific 2017 £m	Non contract specific 2017 £m	Total 2017 £m
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
Net retirement benefit asset	-	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)
Net retirement benefit asset (after tax)	-	23.8	23.8

* 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 16.1 years (2017: 17.9 years).

Main assumptions	2018 %	**2017 %**
Rate of salary increases	2.80	**2.70**
Rate of increase in pensions in payment	2.20 (CPI) and 3.00 (RPI)	**2.30 (CPI) and 3.00 (RPI)**
Rate of increase in deferred pensions	2.30 (CPI) and 3.30 (RPI)	**2.30 (CPI) and 3.00 (RPI)**
Inflation assumption	2.30 (CPI) and 3.30 (RPI)	**2.20 (CPI) and 3.20 (RPI)**
Discount rate	2.90	**2.50**

Post retirement mortality	2018 years	**2017 years**
Current pensioners at 65 - male	22.6	**22.5**
Current pensioners at 65 - female	25.1	**25.1**
Future pensioners at 65 - male	24.4	**24.3**
Future pensioners at 65 - female	27.0	**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 2018 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 2018 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.

(Increase)/decrease in defined benefit obligation	2018 £m	2017 £m
Discount rate - 0.5% increase	(102.8)	(107.9)
Discount rate - 0.5% decrease	112.2	122.0
Inflation - 0.5% increase	66.9	83.4
Inflation - 0.5% decrease	(64.7)	(78.0)
Rate of salary increase - 0.5% increase	2.4	3.6
Rate of salary increase - 0.5% decrease	(2.3)	(3.5)
Mortality - one year age rating	39.9	41.6

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 2018 £m	Current outstanding at 31 December 2018 £m	Non current outstanding at 31 December 2018 £m
Sale of goods and services			
Joint ventures	0.4	0.1	-
Associates	7.3	0.6	-
Other			
Dividends received - joint ventures	9.7	-	-
Dividends received - associates	20.0	-	-
Receivable from consortium for tax - joint ventures	4.8	5.3	-
Total	42.2	6.0	-

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

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*:

	2018 £m	2017 £m
Short-term employee benefits	9.5	**12.5**
Share based payment expense	5.3	**6.2**
	14.8	**18.7**

The key management personnel comprise the Executive Directors, Non-Executive Directors and members of the Executive Committee (2018: 17 individuals, 2017: 23 individuals).

Aggregate directors' remuneration

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

	2018 £m	2017 £m
Salaries, fees, bonuses and benefits in kind	4.0	**5.5**
Amounts receivable under long-term incentive schemes	3.1	**6.3**
Gains on exercise of share options	1.8	**0.1**
	8.9	**11.9**

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	2018 Before exceptional items £m	2018 Exceptional items £m	2018 Total £m	2017 (restated*) Before exceptional items £m	2017 Exceptional items £m	2017 (restated*) Total £m
Operating profit for the year	112.4	(31.9)	80.5	40.7	(19.6)	21.1
Adjustments for:						
Share of profits in joint ventures and associates	(28.8)	-	(28.8)	(27.0)	-	(27.0)
Share based payment expense	14.7	-	14.7	11.4	-	11.4
Exceptional impairment of intangible assets	-	-	-	-	8.9	8.9
Impairment of property, plant and equipment	0.7	-	0.7	(0.1)	-	(0.1)
Impairment of intangible assets	0.1	-	0.1	-	-	-
Depreciation of property, plant and equipment	19.5	-	19.5	20.9	-	20.9
Amortisation of intangible assets	22.9	-	22.9	25.8	-	25.8
Exceptional loss/(profit) on disposal of subsidiaries and operations	-	0.5	0.5	-	(0.3)	(0.3)
Reversal of impairment on loan balances	-	(13.9)	(13.9)	-	-	-
Loss on disposal of property, plant and equipment	0.5	-	0.5	0.3	-	0.3
Loss on disposal of intangible assets	1.5	-	1.5	0.3	-	0.3
Exceptional interest in joint ventures and associates	-	0.3	0.3	-	-	-
Non cash R&D expenditure offset against intangible assets	-	-	-	(0.7)	-	(0.7)
Decrease in provisions	(68.1)	(13.8)	(81.9)	(33.6)	(9.6)	(43.2)
Other non cash movements	(0.2)	-	(0.2)	0.1	-	0.1
Total non cash items	(37.2)	(26.9)	(64.1)	(2.6)	(1.0)	(4.2)
Operating cash inflow/(outflow) before movements in working capital	75.2	(58.8)	16.4	38.1	(20.6)	17.5
(Increase)/decrease in inventories	(5.0)	-	(5.0)	3.7	-	3.7
(Increase)/decrease in receivables	(22.9)	0.4	(22.5)	8.5	4.5	13.0
Decrease/(increase) in payables	6.3	18.2	24.5	(26.5)	(16.4)	(42.9)
Movements in working capital	(21.6)	18.6	(3.0)	(14.3)	(11.9)	(26.2)
Cash generated by operations	53.6	(40.2)	13.4	23.8	(32.5)	(8.7)
Tax paid	(10.6)	-	(10.6)	(11.4)	-	(11.4)
Non cash R&D expenditure	(0.1)	-	(0.1)	(0.2)	-	(0.2)
Net cash inflow/(outflow) from operating activities	42.9	(40.2)	2.7	12.2	(32.5)	(20.3)

* Results for the year ended 31 December 2017 have been restated to reflect the adoption of IFRS15 with effect from 1 January 2017. See note 1.

Additions to property, plant and equipment during the year amounting to £3.6m (2017: £4.7m) were financed by new finance leases.

21. Post balance sheet events

On 7 January 2019, the Group signed a contract with the UK Home Office Visas and Immigration department to run two regions of the new Asylum Accommodation and Support Services Contract (AASC). The Group continues to work through the anticipated financial impact that AASC will have on its results and financial position for 2019 and future years, particularly in relation to the lease of accommodation used to service the contract.