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Serco's full year 2024 trading update shows resilient outlook for 2025

8 months ago

Serco, the provider of services and support to governments internationally, has provided its scheduled trading update for 2024 and guidance for 2025.

Strong 2024 performance anticipated, cash and net debt guidance upgraded

- Revenue: ~£4.8bn in 2024, in line with guidance; an organic revenue decline of approximately 3%, with an improving trend as we moved through the year (H1: -5%, H2: -1%) led by North America.
- Underlying operating profit: ~£270m, up ~9% in the full year, and an increase of more than 25% in the second half compared to the same period of 2023.
- Margin: 50 basis point increase in full year margin to ~5.6% with ongoing focus on efficiency and productivity.
- Order intake: much improved order intake in second half resulting in an expected book-to-bill for the full year of approximately 100%. Pipeline of new business opportunities set to end the year at highest level in more than a decade.
- Free cash flow: guidance increased by £20m to ~£170m, cash conversion guidance increased to ~90%.
- Strong financial position: adjusted net debt now expected to be around £145m, £20m better than prior guidance, leverage c.0.6x net debt to EBITDA, below our 1-2x target leverage range.
- Share buyback: £140m buyback programme completed, taking the total amount returned to shareholders through buybacks to £340m since 2021.

Resilient outlook for 2025

- Revenue: expected to be in line with 2024 at around £4.8bn, despite c.7% revenue reduction from immigration contracts in UK and Australia. Good organic growth anticipated in US defence.
- Underlying operating profit: around £260m is expected. Contract ramp-ups and further portfolio improvements anticipated to largely offset previously disclosed headwinds from our Australian immigration contract ending, lower activity levels within our UK immigration business and higher UK national insurance contributions. Good margin of around 5.4%, within our medium-term target of 5-6%.
- Well positioned: The fiscal and geopolitical challenges facing governments are creating opportunities to support our customers, as can be seen in our increased pipeline of potential new work. Our strength in key areas of government need, positions us well for 2025 and beyond.

Commenting on this update, Mark Irwin, Serco Group Chief Executive, said:

"We are proud of the progress throughout 2024, reporting a strong financial performance and delivering important services to our customers in a dynamic global environment. We built stronger trading momentum in the second half of the year, particularly in our North America business, and delivered good margin gains through our relentless focus on performance improvement and disciplined execution. Our strong cash generation and balance sheet have enabled us to complete our largest ever share buyback during the year. We have also seen significant improvement in safety outcomes and an increase in colleague engagement this year.

The outlook for 2025 is positive, with continued momentum in North America and new contracts mobilising, mitigating previously announced higher UK employment costs and lower revenues in immigration. Our European business has seen significant growth over the past two years, and we are optimistic about further growth opportunities across the EU.

Overall, we are confident in the Group's outlook, built on the innovation, expertise and efficiency we bring to our partnership with governments. Our financial position is strong, which leaves us well positioned to actively apply our capital allocation priorities of investing to support organic growth, increase ordinary dividends, pursuing value-enhancing acquisition opportunities and to return surplus cash to shareholders."

Expected outcome for 2024

Revenue: We expect revenue of around £4.8bn in 2024, a 2% decline on the £4.9bn reported in 2023 and an organic decline of 3%, which is in line with prior guidance. Acquisitions, principally European Homecare which has performed well, will contribute 3% and currency is expected to be a drag of 2%. We have seen good growth from new and expanded contracts in defence, justice and citizen services sectors. The reduction reflects lower volume-variable work in the immigration sector in both the UK and Australia, our CMS contract being in its new five-year agreement and the annualisation of our previously announced exit from certain low-margin contracts.

After the first half experienced an organic revenue decline of 5%, the second half is expected to improve to a decline of c.1%. The improving trend in the second half is despite a c.5% impact from the expected lower revenue on our UK immigration contract, with strong organic growth in North America after securing new contracts in the defence sector.

Underlying operating profit: Underlying operating profit is expected to grow by c.9% to £270m, despite a slightly higher than expected currency drag of £6m. There were also higher costs associated with mobilising our electronic monitoring contract. We more than offset these with our efforts to improve the productivity and efficiency of the business and the positive contribution from acquisitions. We are pleased with second half progress, in which every region is expected to deliver higher profits compared to the same period in 2023. The outcome of this is we expect our margin to be 50 basis points higher in the year as a whole and to increase by more than 100 basis points in the second half alone. We are confident these improvements pave the way for additional opportunities in the future.

Financial position: Free cash flow continues to be strong and is expected to be around £170m for the year, £20m better than prior guidance with a cash conversion of c.90%. As a result, adjusted net debt is now anticipated to be £145m at the end of the year following the £140m share buyback, which has been completed. Net debt to EBITDA leverage is forecast to be c.0.6x, below our medium-term target of 1-2x.

Guidance for 2024 and 2025	2023	2024	2025	
	Actual	Prior guidance	New guidance	Initial guidance
Revenue	£4.9bn	~£4.8bn	~£4.8bn	~£4.8bn
Organic sales growth	4%	~(3)%	~(3)%	~0%
Underlying operating profit	£249m	~£270m	~£270m	~£260m
Net finance costs	£25m	~£35m	~£35m	~£42m
Underlying effective tax rate	23%	~25%	~25%	~25%
Free cash flow	£209m	~£150m	~£170m	~£135m
Adjusted net debt	£109m	~£165m	~£145m	~£60m

NB: Guidance uses an average GBP:USD exchange rate of 1.28, GBP:EUR of 1.18 and GBP:AUD of 1.93 in 2024 and for 2025 an average GBP:USD exchange rate of 1.27, GBP:EUR of 1.20 and GBP:AUD of 1.95, based on currency rates as 30 November 2024. We expect a weighted average number of shares for basic EPS of 1,060m in 2024, 1,015m in 2025 and for diluted EPS 1,080m in 2024, 1,035m in 2025.

Company-compiled consensus for underlying operating profit is £270m in 2024 and £252m in 2025 for analysts who have updated forecasts since our announcement on 8 November. Consensus including analysts who have not updated since the announcement is £270m for 2024 and £263m for 2025.

Resilient outlook for 2025

As we enter 2025, our focus remains steadfast on reinforcing our market positioning by concentrating on growth, operational excellence and cost competitiveness. The outlook for 2025 anticipates revenue will be similar to 2024 despite a potential 7% revenue reduction relating to the UK and Australian immigration contracts, while underlying operating profit will reduce only slightly despite cost pressures. The conversion of profit to cash will continue to be strong and our pipeline of new business opportunities is healthy as we exit 2024.

Revenue: We anticipate revenue of around £4.8bn, with flat organic revenue growth and a c.1% contribution from businesses acquired in 2024. Having had a success rate of more than 90% on rebids in 2023 and the first half of 2024, it was disappointing to be unsuccessful in rebidding the contract for immigration services in Australia. In the UK, we expect to continue supporting the UK Government's efforts to reduce the number of asylum seekers being accommodated in hotels. These two impacts are expected to reduce revenue by approximately 7% in 2025, however the business is making good progress elsewhere in the portfolio to offset this impact. Growth is anticipated to be strongest in the North American market where we expect mid-single digit organic growth after securing new work in the defence sector in 2024. In addition, contracts mobilised during 2024 in the UK justice and citizen services sectors will contribute further in 2025.

Underlying operating profit: Underlying operating profit is expected to be around £260m, compared to the £270m anticipated in 2024. This is a relatively small reduction given the previously disclosed headwinds from our Australian immigration contract ending, lower activity levels within our UK immigration business and higher UK national insurance contributions. Significant progress is expected from the ramp up and reduced costs on newly mobilised contracts, and continued opportunities to improve productivity and efficiency across the portfolio. This supports the expected margin of 5.4%, which remains comfortably within our medium-term target range of 5-6%.

Net finance costs and tax: Net finance costs are expected to increase to around £42m. This is more than 2024 due to the increased volume of lease interest, particularly in relation to immigration services in the UK. The underlying effective tax rate is expected to be around 25%, although this is sensitive to the geographic mix of our profit and any changes to current corporate tax rates.

Financial position: Free cash flow is again expected to be strong at around £135m in the year, in line with our medium-term target of converting at least 80% of profit into cash. This includes the one-off end of contract cash costs of £20m in relation to our immigration contract in Australia, which have already been expensed in previous years. We expect adjusted net debt to end the year at approximately £60m.