Financial review

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Introduction

Challenging market conditions across the business have impacted the Group's results for 2014/15 and therefore are, as previously announced, lower than the corresponding period.

Pricing pressures have continued within Currency resulting in lower margins, while in Identity Systems and Security Products, the level of new business has been lower than anticipated. Some mitigation of these conditions has been achieved through further operational efficiencies which have realised additional benefits of £7m in the period. The actions taken in CPS during the year have returned this business to underlying profitability.

At 28 March 2015, the Group's 12 month closing order book, calculated on a revised basis to include estimated call off orders for material contracts, was £243m (2013/14 restated: £307m). This revised calculation gives a better indication of the underlying order book as we enter the new financial year. Pricing in recent tenders continues to reflect the ongoing challenging market conditions.

Financial results

Group revenue was down by 8 per cent to £472.1m (2013/14: £513.3m) and underlying operating profit down by 22 per cent to £69.5m (2013/14: £89.3m). Underlying profit before tax fell by 25 per cent to £57.7m (2013/14: £77.3m) and consequently, underlying earnings per share decreased by 25 per cent to 45.3p (2013/14: 60.7p).

Net exceptional charges, before tax, in the period totalled £18.8m (2013/14: £17.5m) predominantly relating to the invocation of guarantees along with further costs in respect of site relocation, restructuring and asset impairments (more fully described below).

Profit before tax was £38.9m (2013/14: £59.8m).

Underlying operating cash flow, comprising underlying operating profit adjusted for depreciation and the movement in working capital, was £85.6m (2013/14: £99.1m). This represents a cash conversion ratio of 123 per cent (2013/14: 111 per cent). Net debt at 28 March 2015 was however, up £21.1m at £111.0m (2013/14: £89.9m).

Dividend

The Board is recommending a final dividend of 16.7p per share (2013/14: 28.2p per share). Together with the interim dividend paid in January 2015, this will give a total dividend for the year of 25.0p per share (2013/14: 42.3p per share). Subject to approval by shareholders, the final dividend will be paid on 3 August 2015 to shareholders on the register on 3 July 2015. The proposed total dividend for the year is covered 1.8 times.

The Board is mindful of the importance of dividends to shareholders and will seek to maintain dividends at the 2014/15 level.

Finance charge

The Group's net interest charge was £4.8m (2013/14: £4.7m) reflecting an increase in the average level of net debt during the period. The IAS 19 related finance cost, which represents the difference between the interest on pension liabilities and assets, was £7.0m (2013/14: £7.3m).

Key financial summary

	2015	2014	Change
Revenue	**£472.1m**	£513.3m	(8%)
Underlying operating profit[1]	**£69.5m**	£89.3m	(22%)
Reported operating profit	**£50.7m**	£71.8m	(29%)
Underlying profit before tax[1]	**£57.7m**	£77.3m	(25%)
Reported profit before tax	**£38.9m**	£59.8m	(35%)
Underlying earnings per share[2]	**45.3p**	60.7p	(25%)
Basic earnings per share	**34.0p**	47.3p	(28%)
Underlying operating cash flow[3]	**£85.6m**	£99.1m	
Cash conversion[4]	**123%**	111%	
Net debt	**£111.0m**	£89.9m	
Dividends per share[5]	**25.0p**	42.3p	

1 Before net exceptional charges of £18.8m (2013/14: £17.5m)

2 Before net exceptional charges per note 1 and exceptional tax credits of £7.3m (2013/14: £4.2m)

3 Underlying operating profit £69.5m (2013/14: £89.3m) adjusted for depreciation £24.8m (2013/14: £28.3m) and the movement in working capital -£8.7m (2013/14: -£18.5m)

4 Underlying operating cash flow divided by underlying operating profit

5 Includes proposed final dividend

Financial review continued

Exceptional items

During the period exceptional items, summarised below, totalling £18.8m net, have been charged (2013/14: £17.5m net).

Site relocation and restructuring costs in 2014/15 were £4.7m net (2013/14: £3.5m net). Relocation costs were incurred in connection with the transfer of operations from our Dulles facility into other existing sites. In addition, restructuring costs have been incurred on the reorganisation of CPS and certain operations within Currency.

As previously announced, the Group has had unresolved issues since 2010 with a major customer regarding banknote paper production contracts. In April 2015, the Group was advised that guarantees, which have been in place since the contracts were entered into, with a value of £13.3m, had been invoked by the customer concerned. As this cost related to a matter pre-existing at the balance sheet date it has been accounted for as an adjusting post balance sheet event. The Board considers this to be a material step towards resolution of this issue and discussions continue with this important customer. The warranty provision relating to this matter, previously charged as an exceptional item, has been reviewed resulting in a £3.0m release.

Following an impairment review of capitalised development costs, £3.8m of intangible assets within Security Products were identified as having a carrying value in excess of the recoverable amount. The amounts written off represent the first generation of software that is no longer being marketed as it has been superseded by an enhanced software product.

The net cash cost of exceptional items in the year (excluding the £13.3m above, which was paid in April 2015) was £6.6m of which £1.6m related to prior periods.

In the prior year, the following additional exceptional items were incurred; £1.1m of charges in connection with the preparation of bids for the supply of products or services under multi year arrangements, £2.2m of charges with regard to the resolution of an overseas historic indirect tax liability, £1.0m of legal and professional fees in relation to an aborted acquisition and £14.2m in relation to tangible and intangible asset impairments. These costs were partly offset by a gain on sale of fixed assets in the year of £4.5m.

Net tax credits relating to exceptional items arising in the period were £2.6m (2013/14: £0.9m).

In respect of the 2015/16 financial year, an exceptional gain of c£9m will be recognised on the disposal of surplus land (see note 27).

Cash flow and borrowings

Underlying operating cash flow, comprising underlying operating profit adjusted for depreciation and the movement in working capital, was £85.6m (2013/14: £99.1m). This represents a cash conversion ratio (underlying operating cash flow divided by underlying operating profit) of 123 per cent (2013/14: 111 per cent).

Net debt increased by £21.1m to £111.0m (2013/14: £89.9m) mainly reflecting the reduced operating cash flow, continued capital expenditure, special pension contributions in line with the agreed deficit funding arrangement and dividend payments.

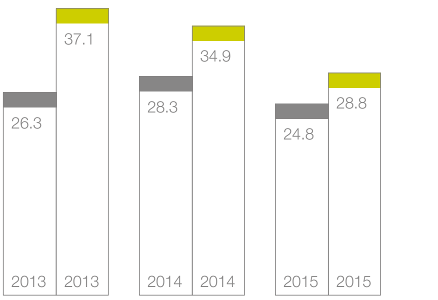
To provide finance for future growth and investment the Group has increased its revolving credit facility by £50m to £250m and extended the term by three years to December 2019, the financial covenants remain unchanged. The covenants require that the ratio of EBIT to net interest payable be greater than four times and the net debt to EBITDA ratio be less than three times. At the period end the specific bank covenant tests were as follows: EBIT/net interest payable of 13.5 times, net debt/EBITDA of 1.23 times.

Capital structure

At 28 March 2015 the Group had net liabilities of £146.9m (29 March 2014: £70.4m), reflecting the recognition of the long term retirement benefit obligations of £236.7m.

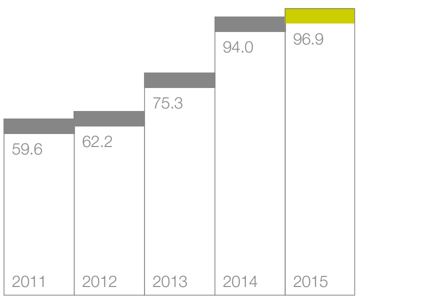
The Company had shareholders' funds of £199.6m (2013/14: £235.5m) and had 101.1m fully paid ordinary shares in issue (2013/14: 100.7m) at the period end.

Capital expenditure relative to depreciation
£m
Capital expenditure
Depreciation

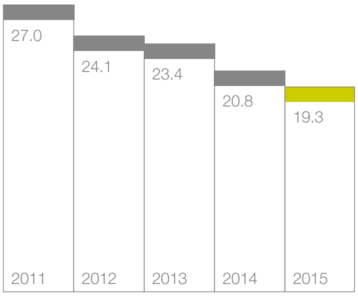


Group trade working capital
£m

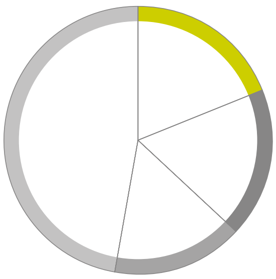
Trade working capital comprises inventory plus trade receivables less trade payables and advance payments



Underlying effective tax rate before exceptional items
Percentage



Geographic revenue by destination
- UK 19%
- Rest of Europe 18%
- Americas 16%
- Rest of world 47%



Taxation

The net tax charge for the year was £3.8m (2013/14: £11.9m). The effective tax rate, before exceptional items, was 19.3 per cent (2013/14: 20.8 per cent), predominantly reflecting the reduction in the UK statutory tax rates.

Net tax credits relating to exceptional items arising in the period were £2.6m (2013/14: £0.9m). In addition there was an exceptional credit of £4.7m (2013/14: £3.3m) in respect of the determination of the tax treatment of prior year exceptional items, of which £4.5m credit related to tax matters retained by the Group following the disposal of a discontinued operation a number of years ago.

Principal exchange rates used in translating the Group's results

	2014/15 Average	2015 Year end
US dollar	**1.61**	**1.49**
Euro	**1.28**	**1.37**

	2013/14 Average	2014 Year end
US dollar	1.59	1.66
Euro	1.19	1.21

The weakness in the euro has continued into the new financial year and is giving euro zone suppliers some commercial advantage.

Pension deficit and funding

During 2014/15, special funding payments of £18.6m (including scheme administration fees) were made to the Group's UK defined benefit pension scheme (closed to new members in 2010 and future accrual from April 2013). The Group's latest formal (triennial) funding valuation of the UK defined benefit pension scheme took place on 5 April 2012 and identified that the scheme had a deficit of £180m. A new valuation as at 5 April 2015 has commenced. The Group has agreed, with the scheme Trustees and the Pensions Regulator, deficit funding payments to the scheme of £18.2m in 2015/16, rising by 4 per cent per annum. The special funding arrangements, agreed in 2012, remain unchanged and are aimed to eliminate the deficit by 2022.

Recognition of the current deficit in accordance with IFRS results in the negative net assets shown on the Group balance sheet.

The valuation of the pension scheme under IAS 19 principles indicates a pre-tax scheme deficit at 28 March 2015 of £236.7m (29 March 2014: £168.0m). The increase of £68.7m is largely a reflection of the significant decrease in the discount rate used to project the value of the scheme liabilities (3.2 per cent in 2014/15 compared with 4.5 per cent in the prior year). The increase has been partly mitigated by a reduction in the RPI inflation rate, returns on scheme assets and Group funding contributions.

In common with other final salary schemes, the scheme valuation is very sensitive to any movement in the discount rate, with a 0.25 per cent increase in discount rate resulting in a £56m decrease in liabilities or vice versa, and hence the deficit would reduce should interest and discount rates increase in the future.

The charge to operating profit in respect of the UK defined benefit pension scheme for 2014/15 was £1.1m (2013/14: £1.2m). In addition, under IAS 19 there was a finance charge of £7.0m arising from the difference between the interest cost on liabilities and the interest income on scheme assets (2013/14: £7.3m).

Analysis of the Group's assets/(liabilities) and related cash/(debt) by currency

	2015 Group assets/ (liabilities) £m	2015 Group cash/ (debt) £m	Net assets/ (liabilities)* £m	2014 Net assets/ (liabilities)* £m
Sterling	**(85.9)**	**(93.4)**	**(179.3)**	(133.3)
US dollar	**11.3**	**(26.8)**	**(15.5)**	3.5
Euro	**37.0**	**(0.4)**	**36.6**	40.3
All other	**(4.0)**	**9.6**	**5.6**	14.0
	(41.6)	**(111.0)**	**(152.6)**	(75.5)

*Excluding non-controlling interest

Innovate. Deliver. Grow.
Developing our people

At De La Rue, we recognise that building great leaders and managers who set the direction and tone, create a climate for great performance and inspire their people is critical to delivering long term success and sustainable change. That is why our recent focus has been to work with each of our senior leaders on an individual basis to create specific development plans tailored to their needs. Longer term, as part of a global development platform, we will deliver all leadership and management training across the business with best in class and versatile learning solutions.