FINANCIAL REVIEW

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In this section of the Business Review we analyse the strong performance and financial position of the Group at 27 March 2010.

Key financials (Continuing Group – excluding the disposed business of Cash Systems but including CPS)

	2009/2010	2008/2009	Change
Revenue	**£561.1m**	£502.4m	11.7%
Profit before tax	**£96.6m**	£96.1m	0.5%
Profit before tax and exceptional items[1]	**£104.1m**	£105.0m	(0.9%)
Operating profit before exceptional items[1]	**£109.2m**	£96.5m	13.2%
Basic earnings per share	**71.0p**	50.9p	39.5%
Headline earnings per share[1]	**76.2p**	57.0p	33.7%
Operating cash flow	**£116.1m**	£69.4m	67.3%
Net debt at end of year[2]	**£11.0m**	£33.1m	66.8%
Dividends per share[3]	**42.3p**	41.1p	2.9%

[1] before exceptional costs of £7.5m (2008/2009: £8.9m).

[2] cash and cash equivalents of £41.6m (2008/2009: £58.5m) less current and non-current borrowings of £52.6m (2008/2009: £91.6m).

[3] includes proposed final dividend.

Financial results
Revenues grew by 12 per cent to £561.1m (2008/2009: £502.4m) and operating profit before exceptional items rose by 13 per cent to £109.2m (2008/2009: £96.5m). Operating profit margins (before exceptional items) were 19.5 per cent (2008/2009: 19.2 per cent), reflecting productivity improvements, customer mix and foreign exchange. Overall for the Group, movement in the value of sterling against the euro and US dollar contributed £27m to revenue and £7m to operating profit (2008/2009: £26m and £6m respectively).

Profit before tax and exceptional items decreased by 1 per cent to £104.1m (2008/2009: £105.0m) due to the increased interest charges arising from the return of capital in 2008 and lower income from associates. Headline earnings per share increased by 34 per cent to 76.2p (2008/2009: 57.0p) mainly reflecting the benefits of the previous share consolidation. Basic earnings per share from continuing operations were 71.0p compared with 50.9p in 2008/2009, representing an increase of 39 per cent.

Exceptional items
Exceptional charges of £7.5m in the period reflect the resolution of a legacy overseas indirect tax issue and the reorganisation of CPS, the latter expected to have a payback within two years. Reorganisation costs principally covered redundancy charges and rationalisation of products and site capabilities. These charges gave rise to a related tax credit of £1.0m. In addition £1.4m of tax credit arose when the tax treatment of some prior year exceptional items was determined.

During 2008/2009, De La Rue announced its intention to reduce central costs by approximately 50 per cent following the disposal of Cash Systems. This programme was completed ahead of schedule. Central reorganisation costs relating to this programme principally covered redundancy, separation costs and site rationalisation charges.

The Group completed the sale of its Cash Systems activities on 1 September 2008. Profit from discontinued operations (after tax) was £296.5m, which included £12.6m (after tax) from the trading of the discontinued activities for the five months to 1 September 2008.

Interest charge
The Group's net interest charge was £5.1m (2008/2009: income £1.4m), which reflects the debt taken on in connection with the return of capital in 2008. In addition the IAS 19 related finance item, arising from the difference between the interest on liabilities and the expected return on assets rose to £6.3m (2008/2009: £1.8m) as a result of lower expected returns on the reduced market valuation of pension assets at the 2008/2009 year end.

Taxation
The tax charge for the year was £26.2m (2008/2009: £28.5m). The effective tax rate pre exceptional items, was 27.5 per cent, broadly in line with the previous year's rate. The effective tax rate excluding associate income (shown post-tax) would have been 29 per cent. A credit of £2.4m arises on the exceptional charges noted above.

Cash flow and borrowings
Operating cash flow was £116.1m (2008/2009: £69.4m) with a strong cash conversion of 99 per cent (2008/2009: 98 per cent). Management of working capital remains a strength of the Group as demonstrated by the improvement in stock days to 40 (2008/2009: 58) and debtor days to 34 (2008/2009: 39). Advance payments of £44.0m (2008/2009: £39.6m) benefited from some large receipts immediately prior to the year end.

Capital expenditure of £33.1m (2008/2009: £29.3m) was higher than depreciation, reflecting the investment programme directed at enhancing the future capability of the business, including the preparation for delivery of the UK passport contract.

The Group ended the year with net debt of £11.0m (2008/2009: £33.1m).

During the year, the Group negotiated a new borrowing facility running to September 2013. Key financial covenants on this facility are unchanged and require that the interest cover be greater than four times, and the net debt to EBITDA ratio be less than three times.

Pension deficit and funding
The Group's last formal (triennial) funding valuation of its UK defined benefit pension scheme took place on 5 April 2009 and identified the scheme had a deficit of £204m (5 April 2006: £56m deficit). The deficit increased despite special contributions of £51m over the three years prior to April 2009, primarily as a result of a fall in asset values following the financial crisis and continued improvements in life expectancy.

In April 2006, the Group agreed with the Trustee to make additional special contributions of £12m per annum until 2012 or until the deficit was cleared, if sooner. Following the completion of the latest triennial valuation and in addition to the one-off contribution resulting from the Camelot sale (£35m), agreement has been reached with the Trustee to increase the annual funding plan to £15m per annum (commencing in 2010/2011 and running for approximately 11 years) with a 4 per cent annual increment.

During 2009/2010, special funding payments of £17m were made to the Group pension fund, comprising the scheduled contribution of £12m and an early payment of part of the 2010/2011 contribution for reasons of tax efficiency.

Pension scheme changes
The final salary section was closed to new entrants from July 2004, with new employees joining the De La Rue Retirement Plan which is a combination of a 1/100ths accrual final salary section and a defined contribution arrangement. From June 2007 the normal retirement age was increased from 62 to 65, with retirements before the normal retirement age resulting in a 5 per cent per annum actuarial reduction in pension accrued after June 2007.

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

	2010 Group Assets £m	**2010 Cash/(debt) £m**	**2010 Net Assets† £m**	2009 Net Assets† £m
£ sterling	**(41.9)**	**(3.0)**	**(44.9)**	(47.2)
US dollar	**34.1**	**(17.1)**	**17.0**	14.9
euro	**23.9**	**1.2**	**25.1**	41.1
All other	**1.2**	**7.9**	**9.1**	8.9
	17.3	**(11.0)**	**6.3**	17.7

†Excluding minority interest.

Principal exchange rates used in translating the Group's results

	2009/2010 Average	**2010 Year end**	2008/2009 Average	2009 Year end
£				
US dollar	**1.58**	**1.49**	1.73	1.43
euro	**1.13**	**1.11**	1.21	1.08

After a consultation process with members the following agreed changes to the pension scheme will be implemented:

- A new defined contribution scheme, open to all UK employees, to be created from the summer of 2010
- The Final Salary and Retirement Plan defined benefit schemes to be closed to future accrual for all employees with effect from 1 April 2013

Closing the defined benefit scheme will result in a one off exceptional benefit in the income statement for 2010/2011 of c£16m and a reduction in the deficit of c£20m.

IAS 19 accounting

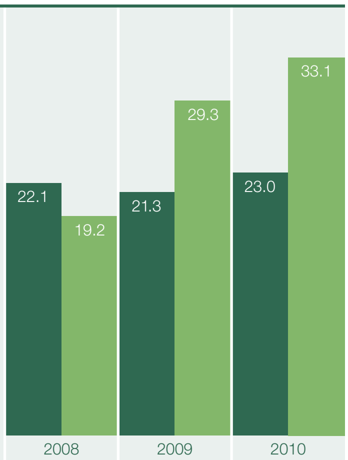
It is the responsibility of the Trustee to set the method and assumptions for calculating the scheme liabilities under scheme Funding Valuation. The assumptions used to calculate the IAS 19 valuation used in the consolidated accounts are set by the Group in compliance with the guidance given in IAS 19 and advice from its actuary. The discount rate used for calculating IAS 19 liabilities is the yield prevailing on AA rated corporate bonds. Those used for ongoing funding valuation are based on actuarial advice taking into account the actual investment profile of assets between bonds and equities over the longer term. This is the principal difference between the two sets of assumptions.

The valuation of the UK pension scheme under IAS 19 principles indicates a scheme deficit pre-tax at 27 March 2010 of £124.8m (March 2009: £67.5m). This significant increase in deficit during the period has mainly arisen due to the reduction, from 6.8 per cent to 5.8 per cent, in the bond discount rate used to value the scheme liabilities. This is partly offset by the increased asset values from the market low point in March 2009 and the Group's ongoing regular contributions. The charge to operating profits in respect of the UK pension scheme for 2009/2010 was £4.5m (2008/2009: £5.8m). In addition, under IAS 19 there was a finance charge of £6.3m arising from the difference between the expected return on assets and the interest on liabilities (2008/2009: £1.8m).

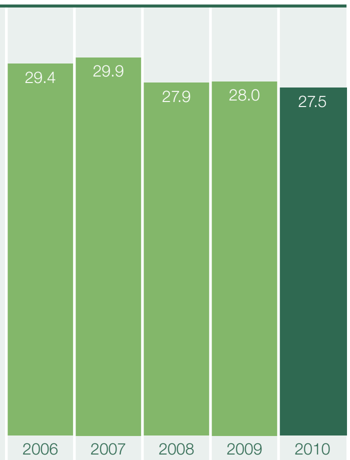
Capital expenditure relative to depreciation
£m

Depreciation

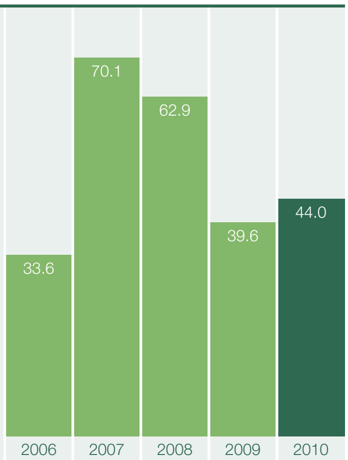
Capital expenditure



Underlying effective tax rate before exceptional items
%



Group working capital – advance payments
£m



Group working capital – trade working capital
£m

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