FINANCIAL REVIEW

Colin Child
Group Finance Director

The Group is in a strong financial position and, with the momentum generated in 2011/12, is on track to deliver the Improvement Plan and continue the investment programme.

Key financial summary

	2012	2011	Change
Revenue	**£528.3m**	£463.9m	13.9%
Operating profit before exceptional items[(1)]	**£63.1m**	£40.4m	56.2%
Profit before tax and exceptional items[(1)]	**£57.7m**	£33.3m	73.3%
Profit before tax	**£32.9m**	£72.8m	(54.8%)
Basic earnings per share	**31.8p**	67.6p	(52.9%)
Headline earnings per share[(1)]	**43.5p**	24.0p	81.3%
Operating cash flow[(2)]	**£78.4m**	£14.7m	
Cash conversion[(3)]	**97%**	15%	
Net debt	**£24.8m**	£31.2m	
Dividends per share[(4)]	**42.3p**	42.3p	

(1) Before an exceptional operating charge of £24.8m in 2011/12 and net exceptional income of £39.5m in 2010/11 (representing exceptional operating charges of £15.6m and exceptional non operating profit of £55.1m)

(2) Before one off special pension contribution of £35.0m in 2010/11 (2011/12: £nil)

(3) This is a measure of the extent of conversion of operating profit to cash. It is calculated as follows: operating cash flow excluding exceptional items, special pension contributions and movement in advance payments (2011/12: - £13m, 2010/11: + £11m), less capital expenditure, divided by operating profit

(4) Includes proposed final dividend

Introduction
In 2011/12 the Group has reported good growth in revenues and operating profit which has generated a healthy cash inflow from operations. The Group is in a strong financial position and, with the momentum generated in 2011/12, is on track to deliver the Improvement Plan and continue the investment programme.

Financial results
Group revenue increased by £64.4m to £528.3m (2010/11: £463.9m) reflecting strong revenue growth in both the Currency and Solutions business units. Currency, representing £44m of the increase, benefited from increased banknote print and paper volumes in the year which grew by approximately 8 and 11 per cent respectively. This reflects the good opening order book and strong order intake during the year. Within Solutions, CPS revenue increased by £8m following increased sales of large sorters. IDS revenue increased by £12m following the transition to full scale production on the UK Passport contract while Security Products revenue remained at a similar level to the prior year. The adverse impact of foreign exchange on revenue for the year was £1m.

Operating profit before exceptional items rose by 56 per cent to £63.1m (2010/11: £40.4m), reflecting the volume increases noted above, an improved Currency product mix sold and the initial benefits of the Improvement Plan. This was partly offset by increased raw material component costs, most notably on cotton which had an adverse impact of £9m compared with 2010/11, as well as difficult trading conditions in the Security Products operating unit. The adverse impact of foreign exchange on operating profit for the year was £1m. Operating profit margins (before exceptional items) were 11.9 per cent (2010/11: 8.7 per cent).

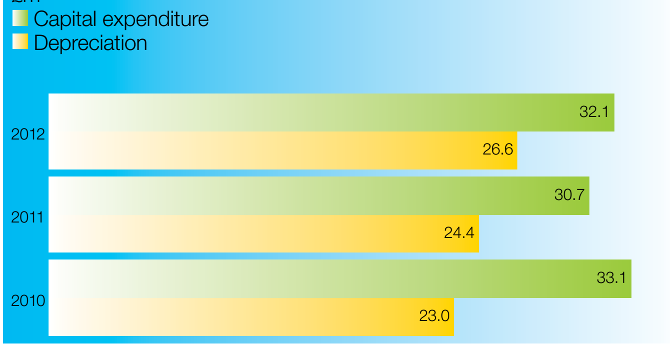
Profit before tax and exceptional items increased by 73 per cent to £57.7m (2010/11: £33.3m) reflecting the trading improvement noted above. This was further enhanced by lower pension interest charges of £1.3m (2010/11: £3.3m) while external interest remained broadly consistent with the prior year at £4.1m (2010/11: £3.8m). Headline earnings per share increased by 81 per cent to 43.5p (2010/11: 24.0p).

Exceptional items
Exceptional costs of £24.8m have been incurred in 2011/12 mainly in connection with the closure of three sites and the relocation of manufacturing activity, including £11.3m in staff compensation, £1.1m of fixed asset impairment charges, £8.8m for site exit costs and £2.9m in other associated reorganisation costs. The exceptional charge also includes additional costs of £0.7m associated with the paper quality issue that arose in 2010/11.

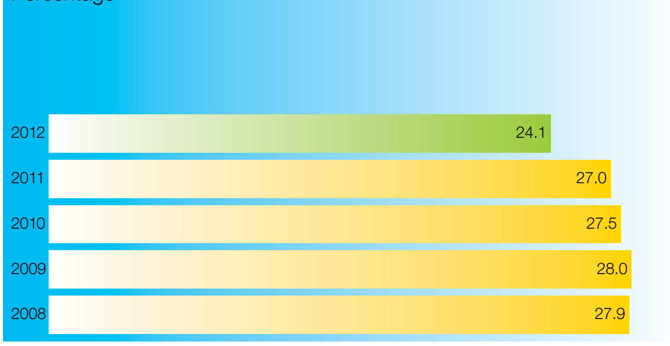
Exceptional costs relating to the Improvement Plan were originally estimated at c£25m. With the experience and knowledge gained from implementing the first phases of the Plan we now expect the total exceptional costs of the Plan to be up to £10m higher over the next two years.

The £15.6m exceptional operating charges reported in 2010/11 comprised £29.0m of costs relating to the paper production quality issues and £2.6m of corporate costs incurred in relation to a takeover approach for the Group. These were offset by a £16.0m exceptional curtailment gain on the closure of the defined benefit pension scheme. In addition, in 2010/11 the Group also reported a non operating exceptional profit of £55.1m on the sale of the Group's investment in Camelot.

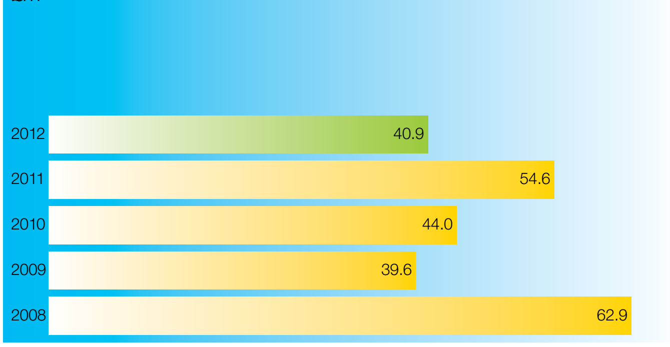
Capital expenditure relative to depreciation
£m



Underlying effective tax rate before exceptional items
Percentage

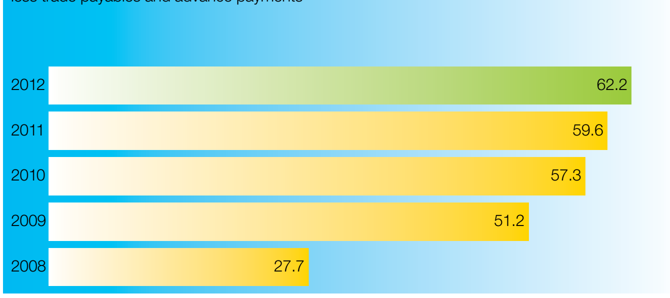


Group working capital – advance payments
£m



Group working capital – trade working capital
£m

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



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Dividend
The Board is recommending a final dividend of 28.2p per share which together with the interim dividend paid in January 2012, will give a total dividend for the year of 42.3p per share (2010/11: 42.3p per share).

The Board's normal dividend policy is to maintain a cover of approximately 1.75 times on underlying earnings. The proposed total dividend for the year is below this level but reflects the Board's confidence in delivering the Improvement Plan.

Taxation
The net tax charge for the year was £0.7m (2010/11: £5.4m). The effective tax rate pre exceptional items, was 24.1 per cent (2010/11: 27.0 per cent), predominantly reflecting the drop in the UK statutory tax rates.

A credit of £6.2m (2010/11: £1.1m) arises on the exceptional charges noted above. In addition there was also an exceptional tax credit of £7.0m in respect of the determination of the tax treatment of prior year exceptional items (2010/11: £2.5m prior year credit).

Cash flow and borrowings
Cash inflow from operations was £78.4m reflecting the strong trading as well as an improved working capital position (2010/11: outflow of £20.3m after a one off special pension contribution of £35.0m). Cash conversion was strong at 97 per cent (2010/11: 15 per cent). The value of inventory was broadly unchanged, but the Group benefited from positive movements on trade debtors and other payables. Advance payments were £40.9m (2010/11: £54.6m) with the prior year balance benefiting from some large receipts immediately prior to the 2010/11 year end.

Capital expenditure of £32.1m (2010/11: £30.7m) was higher than depreciation, but lower than previously forecast mainly reflecting the phasing of cash spend on planned Improvement Plan projects.

The Group ended the year with net debt of £24.8m (2010/11: £31.2m), lower than previously forecast, largely reflecting the positive trading noted above combined with a tax refund received in the year and the cash phasing on committed capital expenditure projects.

The Group utilises a £175.0m revolving credit facility which expires in September 2013. Key financial covenants on this facility require that the interest cover be greater than four times and the net debt to EBITDA ratio be less than three times.

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

	2012 Group assets/ (liabilities) £m	2012 Group cash/ (debt) £m	2012 Net assets/ (liabilities)† £m	2011 Net assets/ (liabilities) £m
Sterling	**(102.8)**	**(9.6)**	**(112.4)**	(55.8)
US dollar	**22.5**	**(18.9)**	**3.6**	4.6
Euro	**52.1**	**0.7**	**52.8**	55.1
All other	**3.5**	**3.0**	**6.5**	9.4
	(24.7)	**(24.8)**	**(49.5)**	13.3

†Excluding non controlling interest.

Capital structure
At 31 March 2012 the Group had net liabilities of £45.6m (2010/11: net assets £16.8m), predominantly reflecting the increase in retirement benefit obligations and dividends paid.

The Company had shareholders' funds of £204.8m (2010/11: £173.3m) and had 99.5m fully paid ordinary shares in issue (2010/11: 99.2m) at the year end.

Interest charge
The Group's net interest charge was £4.1m, marginally up on the prior year (2010/11: £3.8m). The IAS 19 related finance cost, which represents the difference between the interest on pension liabilities and the expected return on assets, has reduced to £1.3m (2010/11: £3.3m) as a result of an additional £35.0m special contribution made in 2010/11.

Principal exchange rates used in translating the Group's results

	2011/12 Average	2012 Year end	2010/11 Average	2011 Year end
US dollar	**1.60**	**1.60**	1.55	1.61
Euro	**1.16**	**1.20**	1.17	1.14

Pension deficit and funding
The Group's latest formal (triennial) funding valuation of the 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). A new valuation as at 5 April 2012 has commenced. During 2011/12, special funding payments of £23.1m were made to the Group's pension fund.

IAS 19 – Employee Benefits
The assumptions used to calculate the IAS 19 valuation 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.

The valuation of the UK pension scheme under IAS 19 principles indicates a scheme deficit pre tax at 31 March 2012 of £143.3m (2010/11: £100.5m) an increase of £42.8m despite the ongoing special contributions of £23.1m paid during the period. This change primarily reflects the increase in the projected value of scheme liabilities following the reduction in the discount rate from 5.6 per cent to 4.8 per cent. The charge to operating profits in respect of the UK pension scheme for 2011/12 was £7.8m (2010/11: £7.6m). In addition, under IAS 19 there was a finance charge of £1.3m arising from the difference between the expected return on assets and the interest on liabilities (2010/11: £3.3m).

The IAS 19 calculation is sensitive to small changes in the base assumptions used in the valuation. An indication of the sensitivity is as follows:

	Change in assumption	Change in liability
Discount rate	+0.1%	-£15m
	-0.1%	+£15m
Inflation rate	+0.1%	+£11m
	-0.1%	-£11m