Financial review

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In this section of the Business review we analyse the performance for the 2010/11 year and financial position of the Group at 26 March 2011.

Key financials

	2011	2010	Change
Revenue	**£463.9m**	£561.1m	(17.3%)
Operating profit before exceptional items[1]	**£40.4m**	£109.2m	(63.0%)
Profit before tax and exceptional items[1]	**£33.3m**	£104.1m	(68.0%)
Profit before tax	**£72.8m**	£96.6m	(24.6%)
Basic earnings per share	**67.6p**	71.0p	(4.8%)
Headline earnings per share[1]	**24.0p**	76.2p	(68.5%)
Operating cash flow[2]	**£14.7m**	£116.1m	
Net debt at end of year	**£31.2m**	£11.0m	
Dividends per share[3]	**42.3p**	42.3p	

(1) before exceptional income of £39.5m (2009/10: exceptional cost £7.5m)

(2) before one off special pension contribution of £35.0m (2009/10: nil)

(3) includes proposed final dividend

Financial results

Revenue fell by 17 per cent to £463.9m (2009/10: £561.1m) predominantly as a result of the lower paper and print volumes sold in the year representing £122m of the movement. IDS revenue increased by £31m following the completion of the implementation phase of the UK Passport contract. Security Products revenue was down £12m mainly due to the flow through impact of lower internal component sales from the Holographics operation into the Currency business. During the year, favourable foreign exchange movements contributed £10m to revenue (2009/10: £27m).

Operating profit before exceptional items decreased by 63 per cent to £40.4m (2009/10: £109.2m) due to the volume shortfalls noted above as well as a less favourable product mix. These reductions were partly mitigated by an improved trading performance of £4m in CPS, following the reorganisation of the business, and a favourable impact of foreign exchange of £6m (2009/10: £7m). Operating profit margins (before exceptional items) were 8.7 per cent (2009/10: 19.5 per cent).

Profit before tax and exceptional items decreased by 68 per cent to £33.3m (2009/10: £104.1m) due to the trading issues noted above and in addition, there was no income in the year from associates (2009/10: £6.3m), following the sale of the Group's investment in Camelot, the UK national lottery operator. This was partly offset by lower external interest of £3.8m (2009/10: £5.1m) and pension interest charges of £3.3m (2009/10: £6.3m). Headline earnings per share decreased by 69 per cent to 24.0p (2009/10: 76.2p) while the basic earnings per share was 67.6p compared with 71.0p in 2009/10, representing a decrease of 5 per cent.

Exceptional items

The results for the year include the following items:

- An exceptional operating gain of £16.0m arising as a result of the previously announced closure, to future accrual, of the Group's defined benefit pension schemes
- Exceptional operating charges of £29.0m relating to the paper production quality issues referred to in the Chairman's statement. These include the write off of inventories and trade receivables together with other costs relating to the investigation and rectification of these matters. Provision has not been made for the potential costs of resolutions or for potential fines from regulatory authorities (as more fully described in note 27: Contingent liabilities). The nature and extent of these resolutions will be the subject of ongoing discussions, the outcome of which cannot be estimated reliably at present
- Corporate costs of £2.6m incurred in relation to the engagement of legal and professional advisers following a takeover approach for the Group
- A non operating gain of £55.1m on the sale of the Group's investment in Camelot. The sale was completed on 8 July 2010

These charges and gains gave rise to a related tax credit of £3.6m (2009/10: £2.4m).

Interest charge

The Group's net interest charge was £3.8m (2009/10: £5.1m), which reflects the lower level of debt, primarily in the first half of the year, following the cash receipt of £77.6m for the Group's investment in Camelot. In addition, the IAS 19 (accounting for defined benefit pension plans) related finance item, arising from the difference between the interest on liabilities and the expected return on assets decreased to £3.3m (2009/10: £6.3m). The decrease is a result of higher than expected returns on the increased market valuation of pension assets at the 2009/10 year end and the additional scheme assets following a special contribution of £35.0m after the Camelot divestment noted above.

Taxation

The net tax charge for the year was £5.4m (2009/10: £26.2m). The effective tax rate, pre exceptional items, was 27 per cent, broadly in line with the previous year's rate.

Cash flow and borrowings

Cash outflow from operations was £20.3m (2009/10: inflow of £116.1m) after a one off special pension contribution of £35.0m (2009/10: nil). Increased inventory reflected the ramp up of the UK Passport contract as well as higher closing banknote stock volumes while increased debtors reflected the timing of sales around the 2010/11 year end. Advance payments of £54.6m (2009/10: £44.0m) benefited from some large receipts immediately prior to the year end.

Capital expenditure of £30.7m (2009/10: £33.1m) was higher than depreciation, reflecting the phasing of investment expenditure between years predominantly within the IDS and Currency operations.

The Group ended the year with net debt of £31.2m (2009/10: £11.0m) largely reflecting the reduced trading noted above. The gross cash receipt of £77.6m for the Group's investment in Camelot was offset by special pension contributions totalling £42.5m, and dividend payments of £42.1m.

The Group utilises a £175m revolving credit facility which expires in 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.

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

	2011 Group Assets £m	**2011 Cash/(debt) £m**	**2011 Net Assets† £m**	2010 Net Assets £m
Sterling	**(43.0)**	**(12.8)**	**(55.8)**	(44.9)
US dollar	**25.7**	**(21.1)**	**4.6**	17.0
Euro	**55.9**	**(0.8)**	**55.1**	25.1
All other	**5.9**	**3.5**	**9.4**	9.1
	44.5	**(31.2)**	**13.3**	6.3

†Excluding non controlling interest.

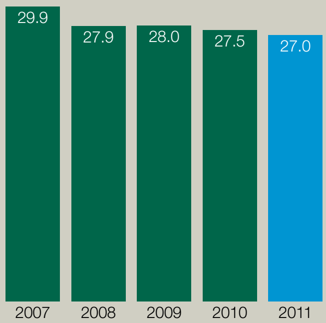
Principal exchange rates used in translating the Group's results

	2010/11 Average	**2011 Year end**	2009/10 Average	2010 Year end
Sterling				
US dollar	**1.55**	**1.61**	1.58	1.49
Euro	**1.17**	**1.14**	1.13	1.11

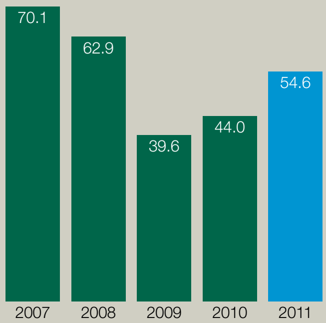
Financial review continued

Capital expenditure relative to depreciation
£m

Underlying effective tax rate before exceptional items
Percentage

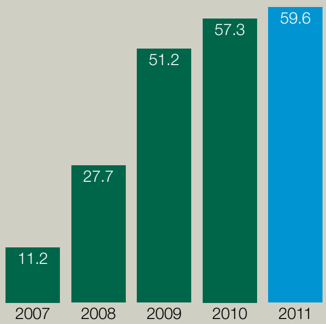


Group working capital – advance payments
£m



Group working capital – trade working capital
£m

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



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).

During 2010/11, special funding payments of £42.5m were made to the Group's pension fund, comprising the scheduled contribution of £7.5m and a one off special contribution of £35m following the sale of the Group's investment in Camelot. Part of the scheduled contribution for 2010/11 was paid in the prior year.

IAS 19 – Employee Benefits

It is the responsibility of the Trustee to set the method and the assumptions for calculating the pension scheme liabilities under the scheme funding valuation. 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. Those used for ongoing (triennial) funding valuations 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 26 March 2011 of £100.5m (March 2010: £124.8m). This significant decrease in deficit during the year was due to the Group's special (£35m) and ongoing special contributions (£7.5m) along with the growth in the underlying stock market. This has been partly offset by the reduction, from 5.8 per cent to 5.6 per cent, in the bond discount rate used to value the scheme liabilities. The charge to operating profits in respect of the UK pension scheme for 2010/11 was £7.6m (2009/10: £4.5m). In addition, under IAS 19 there was a finance charge of £3.3m arising from the difference between the expected return on assets and the interest on liabilities (2009/10: £6.3m).

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% -0.1%	-£12m +£12m
Inflation rate	+0.1% -0.1%	+£9m -£9m