

Chief Executive Officer's review



Martin Sutherland
Chief Executive Officer

In May 2015, we announced a five year strategic plan to transform De La Rue from a banknote and passport manufacturer into a technology-led security product and service provider. The plan aims to deliver:

- Better business mix
- Higher quality earnings
- Improved profitability
- Improved cash flow
- Better return on capital
- High performing culture

1 Address key issues

In a constantly changing market, we must be more flexible and agile in managing our customer relationships, product pipelines and delivery. We face a number of risks that could have material impacts to the business. These include volatility of earnings which is caused by unpredictable demand in the banknote print and paper markets. Working with third party partners gives us added flexibility, helping reduce risk and manage surge in demand. At the same time, we use the insights and analytics we have gathered over decades to help our customers improve their forecasting.

The banknote paper market has been oversupplied for a number of years and we expect this to continue. In the short term, cutting production costs and driving efficiency will help to maintain profitability. For the longer term, we continue to explore our strategic options.

We completed the sale of the underperforming Cash Processing Solutions business on 22 May 2016.

2 Driving efficiency

Driving down costs enables us to remain price competitive while protecting margins. We are working hard to improve manufacturing efficiency. In 2012, we launched our Operational Excellence programme to modernise banknote production and deliver continuous improvement through best practice. We successfully completed Level 2 of the programme during the year.

To optimise our cost base, we are restructuring our manufacturing footprint to ensure it is aligned with long term average demand, while also benefiting from the greater flexibility delivered by changes in working practices. Launched in December 2015, this programme will complete in 2018/19 and is expected to generate c£13m cash savings per year.

1 to 6 Strategic priorities, see page 20

1 to 17 UN Sustainable Development Goals (SDGs), see page 43



Watch the interview with CEO Martin Sutherland
www.delarue.com/about-us/our-strategy

We are also creating a leaner and more agile organisation. We began changing our systems and processes in 2015/16 and are now upgrading our finance and management information systems to increase efficiency and improve decision-making. We have also significantly improved a number of commercial processes which have shortened our timescales to submit bids and win new business.

3 Diversifying revenues

More than half of the Group's revenue is generated from Banknote Print and Paper. In order to diversify our revenue streams and benefit from a more balanced product mix, we have increased investment in areas with potential for high growth – such as Polymer and Identity Solutions – or high profitability, including Security Features and Product Authentication & Traceability (PA&T). We also aim to increase recurring revenues from software solutions and services. In addition, our focus on long term agreements will help to reduce volatility in banknote earnings caused primarily by unpredictable demand.

To grow our sales pipeline, we are targeting direct sales of product components to state print works (SPWs), system integrators and other commercial printers. Our renewed focus on direct sales will not only increase our addressable market, but also even out the peaks and troughs we experience in orders for finished products.

We aim to maximise internal synergies by leveraging our existing products. In addition, we also aim to build stronger customer relationships via a network of new regional offices and a direct sales force, reducing reliance on third party partners. During the year, we set up sales hubs in Dubai and Miami and relocated sales staff to be closer to our customers in Africa and Asia. These changes will help us better understand customer needs, ensuring we offer the right products and services.

4 Investing in innovation

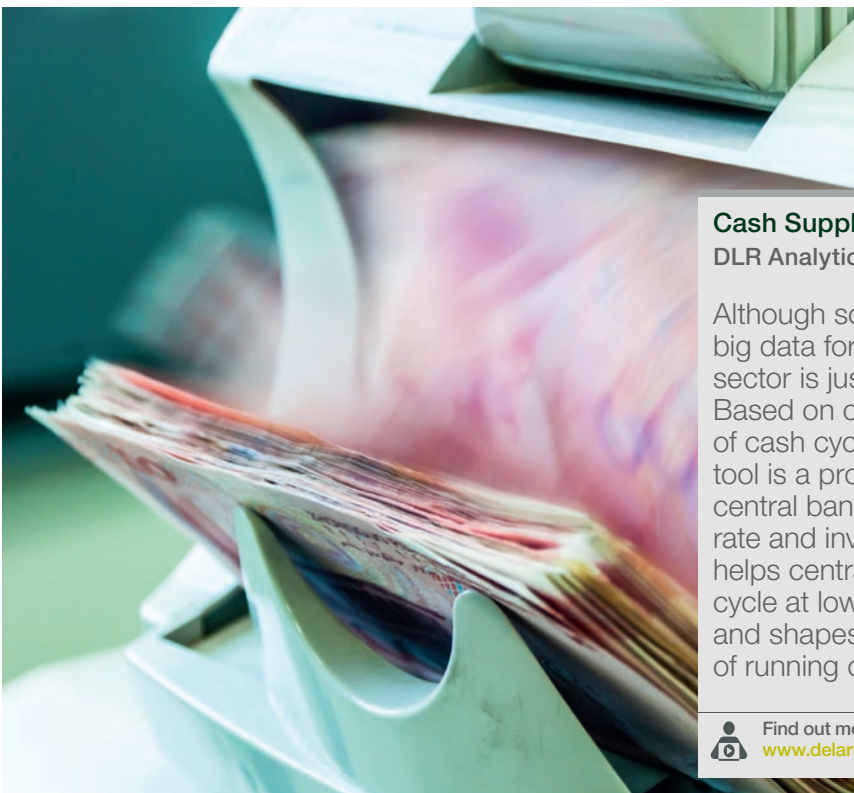
Innovation drives product differentiation and is therefore the engine for our growth. We plan to double our investment in R&D in the years to 2020, prioritising product development in high growth and high margin businesses.

Our product development programme is based on a number of technology platforms we have developed in material science. This approach allows us to maximise our technology know-how and create various platform-based applications for different products.

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Innovation drives product differentiation and is therefore the engine for our growth.

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Cash Supply Chain DLR Analytics™

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Although some industries have been using big data for many years, the central banking sector is just beginning to realise its power. Based on our know-how and vast database of cash cycle management, our DLR Analytics tool is a proprietary software solution that enables central banks to monitor the movement, utilisation rate and inventory of cash. The data generated helps central banks better manage their cash cycle at lower cost, guides their decision-making and shapes policies, while also reducing the risk of running out of cash.



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Chief Executive Officer's review continued

We aim to accelerate technology development through partnerships and acquisitions – and in December 2016 we acquired the US-based brand protection company, DuPont Authentication, for \$25m. Not only does DuPont Authentication develop and own the highly specialised Lippmann holographic technology¹, but it is one of the very few companies worldwide that can mass-produce 3D Lippmann holograms.

In addition to our ongoing work to enhance our two proprietary software solutions – DLR Identify™ and DLR Certify™ – we have initiated a digital strategy with a number of initiatives, with the objective of modernising the business and improving competitiveness.

The fact that around 40% of denominations in circulation globally and 60% of denominations issued in 2016/17 were designed by De La Rue endorses our design capability as one of our core strengths and differentiators. During the year, we have changed our approach to increase interaction between the design team and customers.

5 Strengthening our financial position

One of our key objectives is to focus on strengthening our financial position by increasing profit and prudent cash management. In April 2017, we extended the maturity date of our existing £250m committed revolving credit facility by two years to December 2021.

We have also created a joint working group with the pension trustees to explore ways to proactively improve the management of our pension obligations.

6 Driving culture change

We continue to foster a dynamic, agile and results-focused culture that will drive business growth in the years to 2020 and beyond.

To encourage a high performing culture, we have implemented performance management and all employees now have a set of individual objectives aligned to Group strategy.

To ensure that we have the right skills and capabilities to take our business forward, we have changed 50% of the senior leadership team over the last two years and continue to upgrade the skill set of our sales force.

We continue to invest in extensive training, development and recognition programmes. In June 2016 we launched the second phase of the Leadership Development Programme. This focuses on developing the agility and capability to lead and inspire colleagues in a matrix organisation, and is helping to build a strong pipeline for succession planning.

Being ethical and always acting with integrity is at the heart of our ability to work with more than 140 countries, and we use regular ethics training and assessment to reinforce this approach across the company.

We are proud to join the 12,000+ participants of the United Nations Global Compact (UNGC), a voluntary initiative based on the principles of human rights, labour rights, the environment and anti-corruption. These principles will guide how we function across our business and how we engage with our local communities. De La Rue has been helping to create inclusive, sustainable societies for 200 years and we will continue to do so. UNGC will provide us a framework to report our progress. Read more about our progress on pages 42 to 49.

Cash Supply Chain

Bank of England £5 note design

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We were exceptionally proud to work in partnership with the Bank of England on the ground-breaking new £5 note. We collaborated with the Bank and its other suppliers to create the highly secure and iconic new design, which we are now printing. We are also working closely with the Bank on the designs for the new £10 and £20 notes and look forward to their issue in the near future.

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¹ Lippmann holographic technology, also called 3D holographic, is a type of hologram that projects volume or a 3D image of the object. Compared with the conventional embossed holograms which produce colourful 2D images, it requires advanced replication technology. Only a handful of companies worldwide are capable of producing 3D holograms.

Product Authentication

DuPont Authentication

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In line with our 2020 Strategic Plan, our acquisition of DuPont Authentication for \$25m in January 2017 has given us access to new capabilities. DuPont Authentication produces photopolymer holographic films and 3D holograms based on the highly specialised Lippmann technology. Headquartered in Utah, USA and with operations in Delaware, the business has a well-established global customer base in brand protection and identity authentication. Its flagship product, Izon®, is used on a number of globally recognised brands, such as Lenovo and Brother, as well as on one of the world's most secure passports.



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Operational review

Our 2020 Strategic Plan has a dual focus. Based on the market dynamics of each business line, we have identified two different strategic priorities:

Invest and Build ↑

Invest in the business lines that are exposed to higher growth markets and enhance our capabilities in order to deliver sustainable growth, specifically Polymer, Security Features, Identity Solutions (IDS), and Product Authentication & Traceability (PA&T).

Optimise and Flex ∞

Drive efficiency and flexibility in the business lines that are facing markets with unpredictability or slower growth, specifically Banknote Print and Banknote Paper.

Reclassification of results between Product Authentication & Traceability and Identity Solutions

Historically the results of one of the Group's manufacturing sites have been included in the PA&T segment as this segment represented the majority of its business. However, due to growth in IDS business within this site, we have started reviewing information including the results of this site split between IDS and PA&T. In order to align the Group's external reporting segments to the information reviewed internally, the results of this site have been split in the current year between the IDS and PA&T segment. The 2015/16 figures have also been adjusted for comparability. See note 1 in the accounts for further details.

Currency

Currency comprises Banknote Print, Banknote Paper, Polymer, and Security Features. Each business line faces different market dynamics and growth prospects.

Banknote Print ∞

While overall volumes of cash are growing globally at c4% a year, issuances and orders of cash remain lumpy. This creates unpredictability in our production schedule and, in turn, profitability. We aim to reduce this unpredictability by optimising production capacity and by using outsourcing to create extra flexibility to deal with surge in demand.

Our manufacturing footprint restructuring programme, designed to optimise our capacity, has now completed its first phase. Two print lines have been decommissioned in Malta and machine upgrades in other sites are going to plan. In November 2016, we refined the plan to improve our blend of outsourcing and in-house production, and this led to a decision to retain the remaining banknote print line in Malta. The plan to deliver c£13m annual cost savings from FY18/19 remains unchanged, although some of these savings are expected to be reinvested in the business.

Chief Executive Officer's review continued

In August, we agreed to enter into a joint venture that would see the Government of Kenya acquire a 40% interest in our wholly-owned Kenyan subsidiary for £5.0m. This will further strengthen our ties with the country and secure our position as a supply hub of currency and security solutions in East Africa. We expect this to complete in the current financial year.

We seek to build outsourcing partnerships in banknote print to provide added flexibility, reduce risk and manage surge demand. At the same time, we aim to increase earnings visibility through LTAs with customers. We also look to smooth demand by helping our customers improve their cash requirement forecasting. In May 2017, we launched DLR Analytics™ – a software solution that helps central banks manage their cash cycle by drawing on insights and intelligence from the collected data and our database. It is currently piloted with 26 customers.

Banknote Paper

Although demand for banknote paper has increased in recent months, we believe that the long term market dynamics remain unchanged.

We are focusing on driving direct sales to SPWs in order to increase machine utilisation.

During the year, we launched a cost reduction programme which aims to reduce the spoilage rate and improve throughput. While total volume grew by 18%, unit production cost also increased due to the increased cost of imported raw materials such as cotton.

In the meantime, we continue to engage in complex and constructive dialogue with a number of paper-makers in order to identify a long term solution for the business.

Polymer

This business has gained significant traction since the launch of our polymer substrate, Safeguard®, in 2012. Today, as the only integrated polymer provider, we are well positioned to achieve further growth.

We aim to grow our market share by targeting existing polymer customers as well as paper and coin customers looking to switch to polymer. In 2016/17, we increased our production volumes from 100 tonnes to 380 tonnes.

The number of Safeguard® customers reached 15, representing c40% of total polymer banknote issuers. We also won our first coin-to-note customer.

We continue to invest in developing security features suitable for both polymer and paper substrates to increase differentiation. For customers who issue both polymer and paper notes in different denominations, substrate agnostic features provide a degree of consistency which helps to build public confidence.

We are also working closely with suppliers to reduce production costs, an initiative that will combine with our increased scale to further improve profitability.

Security Features

As security features tend to last the lifetime of the banknote design, they provide a reliable revenue stream. The most versatile product in our portfolio, security features can be applied across all other product lines.

We aim to grow revenue by cross-selling banknote features to IDS and PA&T customers. At the same time, our 50%+

Cash Supply Chain

Seychelles new currency

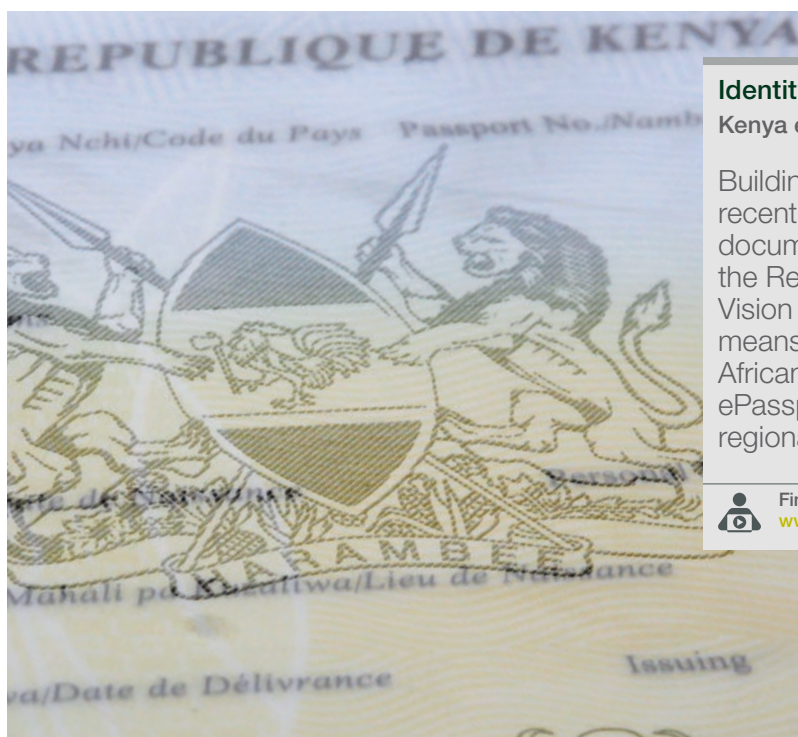
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We worked closely with the Central Bank of Seychelles to produce fully integrated designs for a new four-note series that explores the unique bio-diversity of the Seychelles. The new notes incorporate a suite of world class security features, including Depth™ image holograms, Kinetic StarChrome® and Optiks® security threads.



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Identity Solutions

Kenya ePassport

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Building on a long term partnership, we have recently delivered a new ePassport solution and document with polycarbonate bio-data page for the Republic of Kenya. Part of the Government's Vision 2030 programme, this complete solution means that Kenya is the first member of the East African Community to launch a fully compliant ePassport that meets both international and regional specifications.



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market share in commercial banknote design provides an ideal platform to increase direct sales of security features to SPWs.

A rolling programme of investments in R&D maintains our competitiveness and creates high barriers to market entry. In September 2016, we launched holographic foil on polymer with the issue of the Gibraltar £100 note – and holographic technology is also being applied to laminate features for the ID market. We launched six new products in May 2017, including four security features that were developed using our existing technologies.

We aim to accelerate technology development through partnerships and bolt-on acquisitions, such as the purchase of the Lippmann technology. While its main applications are authentication labels and anti-tampering packaging, this 3D hologram technology can also be applied to identity documents and, with modification, to banknotes.

Overall, the Currency business benefited from an improved mix in Banknote Print and higher volumes in Banknote Paper, which partially offset the impact of the security features contract that concluded in the prior year. Revenue fell by 1% year on year to £350.6m (2015/16: £353.3m). The lower revenue and change in sales mix resulted in a 9% decline in adjusted operating profit.

We achieved good volumes in Banknote Print of 7.1bn notes (2015/16: 7.1bn) in the year despite the decommissioning of two print lines as part of the footprint restructuring programme. This demonstrated not only our sales capability, but also the flexibility of our manufacturing capacity following the restructuring.

Banknote Paper volumes increased by 18% to 11,800 tonnes (2015/16: 10,000 tonnes), primarily driven by stronger external sales. Prices of raw materials such as cotton and ink have increased substantially in recent months and are expected to remain high throughout the coming year.

Polymer almost quadrupled in volume to 380 tonnes in the year, demonstrating continuing good momentum. Margins are expected to improve over time as we continue to reduce production costs and build scale.

Security features were adversely impacted by the material contract which concluded in the prior year. Both revenue and operating profit were lower than the prior year. However, underlying performance, i.e. excluding the impact of the concluded contract, was encouraging. We launched four new features in May 2017 – Truelmage™, TextMark™, enhanced Gemini™, Kinetic StarChrome® Portrait – further strengthening our product portfolio.

At the year end the 12 month order book for Currency including estimated call-off orders for contracts was £311m (2015/16: £278m).

Identity Systems

We are the world's largest commercial passport producer, with 32% market share by volume. At the same time, we are looking to grow digital and service revenues via two separate initiatives: firstly, by selling more to existing customers, using our end-to-end identity management solution, DLR Identify™, to help them migrate from MRP to ePassport; and secondly, by offering full eBorder solutions including biometrics verification and border control via partnerships. In addition, we plan to re-enter the national ID market by leveraging our relationships with existing customers.

In 2016/17, we won a new multi-year contract, renewed three service contracts and gained three new customers for passport books. We also continued to drive direct sales of individual passport components, such as passport paper and laminate, to SPWs and other commercial operators.

In June 2016, we launched DLR Identify™ CRVS² – an extension of DLR Identify™, which enables governments to record life events of their citizens such as births, deaths and marriages. These data establish the rights of individuals to services such as education and health care while also enabling governments to plan ahead with greater confidence.

Chief Executive Officer's review continued



Identity Solutions

Rwanda eID

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A key strength of our eGovernment Solutions team lies in helping governments create a better future for their citizens, with improved service delivery. We are working with the Government of Rwanda to create and implement a multi-functional smart card – this will not only enable Rwandans to prove their identity, but also help them gain access to government services.



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Identity Solutions

UK HM Passport Office

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Based on proven De La Rue technology and know-how, the UK passport is a universally trusted document. We provide HM Passport Office with a total service solution, delivering a cutting edge book that fosters pride among its holders. Complex and secure infrastructure maintains the integrity of the service as well as the resilience of the document.

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Product Authentication

Microsoft Certificate of Authenticity

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In the face of ever more sophisticated counterfeiting operations, the task of proving the legitimacy of products is a key challenge for modern businesses. For the last 20 years, our secure label designs have helped Microsoft ensure that customers benefit from genuine products. Combining attractive visuals with state-of-the-art security features, these labels enable Microsoft and our teams to track a product around the world, thereby helping to maintain product integrity.



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As part of the manufacturing footprint restructuring programme, we have created a centre of excellence for identity and security print in Malta, which includes the installation of a new polycarbonate line. This new capability has further strengthened our product offering for both passport and national ID.

Identity Solutions performed well in the year. Revenue grew by 5% to £80.6m (2015/16: £76.5m), with an improved margin of 14.1% (2015/16: 10.8%) from better mix of orders. This reflected an increased proportion of revenues from software and services, as well as increased focus on component sales. Adjusted operating profit in the period increased by 37% to £11.4m (2015/16: £8.3m).

We continue to invest in skills and capabilities. During the year, we more than doubled our R&D investment and added seven new sales people. This increase in investment was paid for by overhead reduction and efficiency in the Currency business.

Product Authentication & Traceability

Product Authentication & Traceability (PA&T) operates in two main markets: tax revenue protection for governments; and brand protection for private enterprises. We aim to grow recurring revenues in both markets by increasing solution sales.

As one of the largest tax stamp providers, we continue to strengthen our position by leveraging existing relationships and expanding our offering with service and digital solutions. Cameroon became the first customer for our track and trace system DLR Certify™ during the year, and we are now pursuing a number of other opportunities.

We have renewed our focus on the fast growing but fragmented enterprise brand protection market. Our objective is to expand by targeting international brands with complex supply chains and distribution networks which require close monitoring. We also aim to accelerate growth through partnerships and acquisitions. For example, DuPont Authentication's flagship product Izon® is recognised as the premier anti-counterfeiting technology for brand protection and is used on a number of well-known brands such as Lenovo and Brother.

Furthermore, we are driving direct sales of components, such as security labels and security features IP licensing, to system integrators and packaging companies.

PA&T delivered an excellent performance in the year. Revenue increased by 20% to £34.6m (2015/16: £28.8m), driven by growth in tax revenue protection. The segment benefited from lower production cost, which was partly offset by increased investment in R&D and sales. Adjusted operating profit in the period was up 29% to £9.0m (2015/16: £7.0m).

We completed the acquisition of DuPont Authentication on 6 January 2017. Integration of the business was completed in April 2017. Excluding the acquisition, revenue in the segment grew by 13% and adjusted operating profit was up 24%.

Martin Sutherland
 Chief Executive Officer

² Civil Registration, Vital Statistics.