Financial review

Jitesh Sodha
Chief Financial Officer

The Group has delivered a good performance this year, with full year adjusted operating profit* of £70.7m (2015/16: £70.4m). We also completed our first acquisition in 14 years with the purchase of DuPont Authentication Inc (subsequently renamed as De La Rue Authentication Solutions) on 6 January 2017. We are pleased with the performance of this business post acquisition.

* This is a non-IFRS measure. See further explanations and reconciliations to the comparable IFRS measure on pages 153 to 154.

This section is for continuing operations only unless otherwise stated.

Financial performance

Revenue and profit

Group revenue was £461.7m, representing a 2% increase over the prior year (2015/16: £454.5m), resulting in good growth in the Identity Solutions and Product Authentication and Traceability product lines. Adjusted operating profit* at £70.7m was marginally higher than the prior year as higher adjusted operating profit generated by the Identity Solutions and Product Authentication and Traceability product lines was offset by lower adjusted operating profit from the Currency business, partly due to the conclusion of a material contract in December 2015.

Adjusted EBITDA* was £97.4m (2015/16: £96.4m).

Operating profit on an IFRS basis was higher than last year at £70.2m, compared to £66.8m in 2015/16 due to lower exceptional charges (see commentary below for further details on exceptional items).

Adjusted profit before tax* was consistent with the prior year at £58.7m (2015/16: £58.5m), resulting from adjusted operating profits which were flat on the prior year and marginally lower net finance charges at £4.6m (2015/16: £4.8m), and a higher IAS 19 related finance cost of £7.4m (2016/15: £7.1m). Profit before tax on an IFRS basis was £58.2m (2015/16: £54.9m) and was higher than last year due to a lower net charge for exceptional items at £0.4m compared to £3.6m in 2015/16.

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Profit from continuing operations on an IFRS basis was £49.5m compared to £48.6m in the prior year as the impact of lower net charges for exceptional items was partly offset by a higher tax charge.

Finance charge

The Group's net interest charge was £4.6m, a slight decrease on the prior year (2015/16: £4.8m). The IAS 19 related finance cost, which represents the difference between the interest on pension liabilities and assets, was £7.4m (2015/16: £7.1m).

Exceptional items

During the period, exceptional net charges on continuing operations amounted to £0.4m, compared to £3.6m in 2015/16.

Exceptional net charges comprise: site relocation and restructuring costs of £0.2m (2015/16: £9.2m); gains on sale of land of £0.2m (2015/16: £9.5m); a credit relating to the release of warranty provisions of £0.5m (2015/16: credit of £1.3m); asset impairment charges of £nil (2015/16: £5.2m) and acquisition related costs of £0.9m (2015/16: £nil).

Site relocation and restructuring costs were lower in 2016/17.

The significant gain on sale of land in 2015/16 related to the sale of surplus land in Overton which generated a profit of £9.5m. A few small land assets were sold in the current year.

Costs of £0.9m have been incurred following the acquisition of De La Rue Authentication Solutions Inc. This included £0.5m of professional advisor fees in addition to the non-cash unwind of the fair value adjustment recorded against inventory of £0.4m.

See note 4 in the accounts for further details.

Taxation

The net tax charge for the year was £8.7m (2015/16: £6.3m). The effective tax rate before exceptional items was 15.8% (2015/16: 14.7%). The tax rate was lower in 2015/16 due to a non-recurring tax benefit arising on the release of a provision.

Net tax credits relating to exceptional items, on continuing operations, arising in the period were £0.6m (2015/16 £2.3m).

Earnings per share

Adjusted basic earnings per share* was 47.1p compared to 48.1p in 2015/16. The decrease was caused by a higher tax charge in the current year.

Reported basic earnings per share on an IFRS basis was 47.2p, higher than the prior year (2015/16: 46.8p) due to lower net exceptional charges.

Loss from discontinued operations

The loss from discontinued operations in the year was £8.0m, including two months of Cash Processing Solutions' trading loss prior to disposal of £2.2m and exceptional charges net of tax of £5.8m.

Dividend

The Board is recommending a final dividend of 16.7p per share (2015/16: 16.7p per share). Together with the interim dividend paid in January 2017 of 8.3p per share, this will give a total dividend for the year of 25.0p per share (2015/16: 25.0p per share). Subject to approval by shareholders, the final dividend will be paid on 3 August 2017 to shareholders on the register on 30 June 2017.

Financial position

Cash flow and borrowings

Cash generated from operating activities was £64.3m (9% higher than the prior year (2015/16: £58.9m)), including a £5m inflow relating to discontinued operations. There was an adverse working capital movement in the current year due to the timing of cash receipts from debtors because of a high level of sales in the last month of the year and lower advanced payments compared to the prior year. Cash generated from operating activities included £3.3m (2015/16: £12.5m) of payments relating to exceptional items.

Cash conversion ratio was 114% (2015/16: 160%). Cash conversion is the ratio of adjusted operating profit plus depreciation, amortisation and the movement in working capital over adjusted operating profits.

The cash conversion ratio was adverse to the prior year due to the movement in working capital.

Net debt increased by £14.8m to £120.9m (2016/17: £106.1m) primarily due to the $25m acquisition of De La Rue Authentication Solutions Inc.

The Group utilises a £250.0m revolving credit facility and has operated well within the key financial covenants. On 27 April 2017, the Group extended the maturity date of this facility by two years to December 2021. It is subject to the same financial covenants which 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 covenant tests were as follows: EBIT/net interest payable of 16.1 times, net debt/EBITDA of 1.27 times.

Financial review continued

Working capital

Net trade receivables were £89.5m, up from £77.6m in the prior year, due to strong sales in the last quarter of 2017/16.

Inventories were broadly similar to last year, but lower than the level seen at the half year of 2016/17, reflecting strong sales and shipments in the last month of the year.

Advanced payments were £28.5m, down from £45.5m, due to the mix of contracts in the order book.

Trade creditors were £46.5m up from £40.1m in 2015/16.

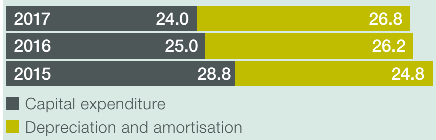
Pension deficit and funding

The Group's formal triennial funding valuation of the UK defined benefit pension scheme (the Scheme) was finalised in June 2016. The Group agreed a revised funding plan with the trustees to eliminate the deficit over a period of 12 years from 31 March 2016. The plan will see the existing funding payment schedule extended from 2022 to 2028. In addition, we have created a joint working group with the pension trustees to proactively manage our pension obligations.

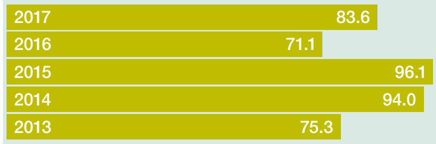
The Group will continue to pay annual fees of £1.6m for managing the Scheme in addition to the cash contributions. In the year ended 25 March 2017, the Group made funding payments and management fees totalling £14.6m. The next triennial funding valuation is due in April 2018.

The valuation of the Scheme under IAS 19 indicates a post-tax deficit at 25 March 2017 of £196.7m (26 March 2016: £178.4m). On a pre-tax basis the net pension deficit was £237.0m (26 March 2016: £217.6m). The increase results from higher liabilities due to the impact of a lower discount rate used to value the Scheme liabilities (2.75% in 2016/17 compared with 3.50% in 2015/16) due to significant falls in corporate bond yields in addition to an increase in the expectation for the longer term inflation rate. The increase in liabilities has been partially offset by an increase in assets which have performed strongly in the year.

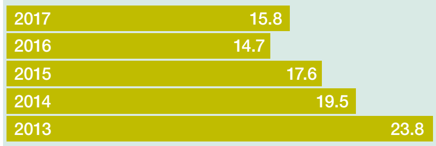
Capital expenditure relative to depreciation
£m



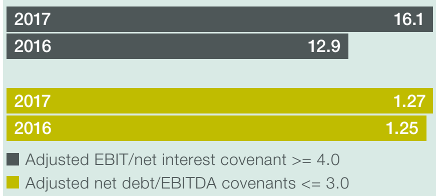
Group trade working capital*
£m



Underlying effective tax rate (before exceptional items)
£m



Bank covenants
Times



* Trade working capital comprises inventories plus trade receivables less trade payables and advance payments. 2013-15 comparatives have not be restated for discontinued operations.

In common with other final salary schemes, the Scheme valuation is very sensitive to any movement in the discount rate, with a 0.25% increase in discount rate resulting in a £55m 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 Scheme in 2016/17 was £1.5m (2015/16: £1.2m). In addition, under IAS 19 there was a finance charge of £7.4m arising from the difference between the interest cost on liabilities and the interest income on scheme assets (2015/16: £7.1m).

Capital structure

At 25 March 2017 the Group had net liabilities of £146.6m (26 March 2016: £145.6m) mainly due to the recognition of the long term retirement benefit obligations of £239.4 (26 March 2016: £219.9m) in accordance with IAS 19 (total pension liabilities of £239.4m also include non UK defined benefit pension schemes).

The Company had shareholders' funds of £230.5m (26 March 2016: £174.4m) and had 101.8m fully paid ordinary shares in issue (26 March 2017: 101.4m) at the year end.

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

	2017 Group assets/ (liabilities) £m	2017 Group cash/ (debt) £m	2017 Net assets/ (liabilities)* £m	2016 Net assets/ (liabilities)* £m
Sterling	(52.3)	(127.5)	(179.8)	(190.6)
US dollar	(7.2)	1.9	(5.3)	(11.5)
Euro	32.1	0.1	32.2	42.4
All other	(6.2)	4.6	(1.6)	7.5
	(33.6)	(120.9)	(154.5)	(152.2)

* Excluding non-controlling interest.

Principal exchange rates used in translating the Group's results

	2016/17 Average	2017 Year End
US dollar	1.32	1.25
Euro	1.20	1.16

	2015/16 Average	2016 Year End
US dollar	1.50	1.41
Euro	1.36	1.27