Chief Executive Officer's review

> We have made good progress against our strategic objectives.

Martin Sutherland
Chief Executive Officer

An overview

In May 2015, we announced a five year plan to transform De La Rue into a less capital intensive, more technology led security product and services provider, with a more balanced business portfolio that will deliver growth, improve quality of earnings as well as reduce volatility in the business. I identified two areas that required attention. We had to 'Optimise and Flex' the parts of the business facing unpredictable markets or slow growth. At the same time, we needed to 'Invest and Build' in the areas where we saw high growth opportunities.

We are half way through our plan and, despite some headwinds along the way such as the ending of a material contract at the end of 2015, we have made good progress in delivering our strategic objectives. Excluding the exited paper business, Group revenue and adjusted operating profit have been growing on average at 3% and 4% a year, respectively. We have also made good progress in diversifying our revenue streams and improving business mix over the last three years. The 'Invest and Build' product lines now contribute around a third of the Group's revenue and half of its operating profit.

The four strategic priorities shown opposite will guide us towards completing the plan by 2020, in line with our targets. On the following pages, I review each priority in detail and outline some examples that show our progress.

Watch the interview with CEO Martin Sutherland
https://www.delarue.com/investors/new-investors-report

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Deliver operational excellence

This priority is about optimising and flexing those elements of our business that present the greatest downside risk. We sold the underperforming Cash Processing Solutions business in 2016. During the last 12 months our attention turned to our Banknote Paper and Banknote Print businesses – and we have made good progress in both areas.

Finding a long term solution for our paper business was one of our top strategic priorities. The sale of our paper business – Portals De La Rue Limited – and a ten year supply agreement have reduced our exposure to the volatility of the oversupplied paper market, as well as secured paper supply for our print business over the long term. The capital investment related to the paper business can now be redeployed. This, combined with the cash proceeds from the transaction, gives us greater flexibility in allocating capital in order to generate better returns and drive sustainable growth.

There is more to do regarding our print business, where we are exposed to market volatility. Here, again, we can report steady progress. We've reconfigured our manufacturing footprint in the last two years. Although machine upgrades are still ongoing in Kenya and Sri Lanka, our production capacity is now more closely aligned with average annual demand. Working with our external partners gives us the flexibility we need to cope with additional demand, and it's already working well – over the last year we outsourced over 100m notes to our long term partners. In short, we're now able to do more with less. In 2017/18 we produced more banknotes with fewer print lines than we managed in the previous years, and we expect this trend to continue.

Additionally, DLR Analytics™ launched in May 2017 helps central banks to better understand their cash cycle and requirements. The new module released in May 2018 will help them to forecast future demands, thus reducing the peaks and troughs on demand side.

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17 PARTNERSHIPS FOR THE GOALS

8 DECENT WORK AND ECONOMIC GROWTH

Securing a strategic relationship for our paper business

In February, we agreed to sell our paper business Portals De La Rue, comprising both the Overton and Bathford mills, to private equity house Epiris Fund II for around £61m.

The banknote paper market has been oversupplied for a number of years, a factor that we expected to continue. While we pursued cutting production costs and driving efficiencies as short-term fixes, we continued to explore other more strategic options during the year – culminating in the deal with Epiris.

This is a significant milestone in delivering our strategy to transform De La Rue into a less capital intensive, more technology led product and service provider. It limits our exposure to the volatility of the paper market, strengthens our balance sheet and enables further investment in innovative technology solutions for the currency, identity and brand protection markets.

At the same time, we secured the long term paper supply for our print requirements with a ten year supply contract.

All affected staff were transferred in accordance with TUPE regulations and rights.

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Collaborating to stay ahead of the counterfeiters

In order to stay ahead of the counterfeiters, we seek to accelerate technology and product development through partnerships and acquisitions. In October 2017, we teamed up with Opalux to create a strategic partnership that will add new capabilities to our security features portfolio. Together, we're going to explore product development and sales opportunities across the world.

Opalux develops and manufactures tunable photonic crystals, smart materials that change colour in response to external stimuli.

We anticipate that the first product developed by our new partnership will be launched later in 2018.

In April 2018, we entered into a strategic partnership with another Canadian technology firm Optel Group, a market leader in track and trace technology which is used for supply chain management as well as brand protection in a number of industries, including pharmaceutical and health care. We will closely collaborate in product development and sales. This partnership will enhance our product offering and extend our market reach in our Product Authentication business.

Find out more about our partnerships
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We are working hard to improve efficiency in our factories as well as at the corporate level so that we can remain price competitive while protecting margins.

During the year, we have reassessed our supply chain management and launched a procurement transformation programme. The goal is to build a strong supply chain through forming strategic partnerships with our key suppliers. In addition, we've introduced an advanced manufacturing engineering function to reduce cost of quality and the time it takes to bring new products to market over time.

We are making progress in driving efficiency and reducing costs across our factories, but recognise that there is more to do in meeting our goal of being a world class manufacturer. We plan to roll out monitoring and note inspection systems into all sites in the next 18 months in order to improve quality and reduce wastage. In the meantime, we are exploring opportunities of automating certain processes to improve operational efficiency.

We are investing in new IT infrastructure to improve the way we work. This has begun in the Finance function, where we are half way through a transformation programme which will see SAP implementation across the Group. The programme will continue in the coming year, which will drive efficiency and improve decision making once complete.

Chief Executive Officer's review continued

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Invest for growth

Our second strategic priority is to invest in order to drive our future growth, and here we see opportunities in four key areas: in security features and polymer for the Currency market; and also across our Identity Solutions (IDS) and Product Authentication & Traceability (PA&T) businesses.

Innovation is a key differentiator for us – we aim to counter the counterfeiters at every turn, and that means having access to the best technology. We continue to invest product management, R&D and sales, with R&D investment up 13% in FY17/18. We are on track to double our R&D investment which is up 74% since 2015. The investments and improved focus in R&D have increased the number of patents filed and granted last year to 33 and 46, respectively. In addition to the six new products launched last year, the Group introduced two more in May 2018 – Ignite™ and PureImage™. We launched more products in the last two years than the previous five years combined.

In May 2017, our significant and ongoing investment in digital expertise led to the launch of DLR Analytics™, which in January 2018 won the 5th Central Banking Awards for Consultancy and Advisory Services. DLR Analytics™ provides analysis on banknote lifespan and distribution trends, which helps central banks to better understand what is happening within their cash cycles. Such data allows institutions to make better-informed decisions on their banknote issuance policy, such as switching from paper to polymer or withdrawing high-denomination banknotes. For us, the advantages go beyond providing better customer service. DLR Analytics™ takes a little more volatility out of the market – because an improved understanding of upcoming needs means that we can plan our resources more effectively. This will support our drive to generate recurring revenue by building longer term partnerships. To date, 70 issuing authorities – almost half of the world's total – have signed up to DLR Analytics™, one third of which are new to De La Rue.

Tracking the supply chain, from manufacturer to consumer

We are proud to be providing the first tax stamp solution to meet the demanding criteria of the WHOs Framework Convention on Tobacco Control (FCTC). Set to be implemented by the UAE in early 2019, this highly secure label and track and trace system comply with the FCTC's strict protocol to eliminate all forms of illicit trade in tobacco products. The FCTC aims to achieve this via several ways, in particular the establishment of an international tracking and tracing system. Our technology supports this capability in full, enabling the tobacco to be tracked from manufacturer right through to consumer, thereby giving governments the tools to ensure that the relevant tax revenue is collected. In short, we are well-positioned to capture the growth opportunities in this market.

Find out more about our products
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The trend towards polymer banknotes is a good example of innovation driving growth as we continue to take share in this fast growing market. Our volumes of polymer more than doubled to 810 tonnes in the year, with future growth underpinned by new contracts including with the Bank of England for the new £20 note which is due to be issued in 2020. Including the notes on order, our polymer substrate Safeguard® has now been adopted by 24 out of 38 polymer note issuing authorities.

We also see opportunities to accelerate technology development through partnerships and acquisitions. In October 2017, we entered into a strategic partnership with Opalux, a Canadian authentication firm, to explore its tunable photonic crystals technology for the identity market. And in April 2018, we partnered with another Canadian technology firm Optel Group, a market leader in track and trace technology, further enhancing our product offering.

The acquisition of DuPont Authentication in 2017 brought world-leading Lippmann hologram technology into De La Rue. Currently being applied in the identity and product authentication sectors, we are now working hard to modify this technology for the currency market.

We are putting more efforts in sales and marketing in the growth areas, particularly in IDS and PA&T. Since 2016 sales investments in these two segments are up 79% and 47%, respectively. Given the typical 18-24 months sales cycle of public services contracts, early signs of returns on these investment have just started to emerge. Order intakes in IDS excluding the UK Passport contract increased by 117% and in PA&T by 97% in FY17/18, including some long term contracts. Implementation of some of these contracts is expected to start in the second half of FY18/19, which will generate stable revenue and profit from FY19/20 onwards.

3 Strengthen our financial position

We are committed to strengthening our financial position through improving profit and managing cash prudently.

The additional effort put into managing cash better has borne fruit. During the year, inventory and trade debtors, excluding the exited paper business, reduced by £13m and £10m, respectively. The £60.3m cash proceeds from the sale of Portals De La Rue completed on 29 March 2018 has further reduced our net debt at the year end to £49.9m (25 March 2017: £120.9m), the lowest in five years. Cash conversion rate in the year was 163% (2016/17: 114%). The year on year increase was driven by lower inventory due to structural changes and a focus on inventory management, and lower account receivable on strong cash collections in the last two months of the year. See more details on page 34.

In November 2017, we announced that the Group's pension trustee had decided to change indexation linked to future pension increases from RPI to CPI for our UK defined benefit pension scheme. This change has reduced the pension liabilities and the corresponding deficit by £80.5m. The pre-tax pension deficit at the year end was £87.6m, substantially lower than the £237.0m a year ago.

The stronger balance sheet gives us greater flexibility in allocating resources and enables us to continue investing for growth. We are sharpening our focus on the deployment of capital. Our disciplined approach to capital investments means our capex programme is more targeted.

The purchase of DuPont Authentication has already proved to be a successful transaction for us. It's given us market-leading and differentiating technology, and a great team of skilled people who are making a real difference across the organisation.

The Group's return on capital employed in the year was 36% (2016/17: 39%), demonstrating our ability to generate good returns on our investments. See more details on page 34.

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8 DECENT WORK AND ECONOMIC GROWTH

16 PEACE, JUSTICE AND STRONG INSTITUTIONS

Reducing our liabilities

Addressing the Company's pension deficit has played a key role in strengthening our financial position. Our Pension Trustee has agreed that from April 2018, the indexation for future increases in the Group's UK defined benefit pension scheme should be changed from RPI to CPI. This has the effect of reducing the scheme's liabilities and corresponding deficit by £80.5m, which is reflected in the full year financial accounts. See more details on pages 143 to 146.

At the time of its last triennial valuation in April 2015, the scheme's underlying actuarial funding deficit had increased to £252m, £92m higher than in 2012, despite contributions of around £70m being made by the company in that period. Clearly this was unsustainable – the change in indexation has reduced risks for the members and put the scheme on a stronger footing, while helping to secure pensions for current and deferred pensioners. At the same time, it will enable us to continue to invest in jobs and R&D and attract sufficient investment for the long-term growth of the business.

Find out more about our employees
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4 Drive culture change

Our culture underpins every aspect of our business. It's the strategic priority that enables all the other priorities to be delivered effectively.

When I joined in 2014, I quickly learnt that De La Rue was a great organisation with a long history of quality service that had led to enduring customer relationships, some of which went back – and still do – well over a century. But I also realised that things had to change. There was a clear disconnect between the strategy we needed to pursue and how people here were actually working. De La Rue simply couldn't do what it needed to do without a dramatic shift in culture – so we set a goal of creating a high performance, accountable and results-based culture.

Today, De La Rue is a business transformed. Every individual but one of my Executive Leadership Team is new in the last two or three years. Among the senior leadership team, we have seen turnover of around 50% over the same period and a fall in numbers too, which has helped us on the cost side. The sales force is also unrecognisable from its composition in 2015, with around 40% being relatively new faces.

But a change in culture needs more than just new faces, some nice values, mugs and mousemats. It needs solid foundations. We now have a marked emphasis on performance. Our people have objectives aligned to the strategy, and we have refreshed the entire incentive framework.

We are also investing in training and development. These place a key role in identifying and supporting internal talent pools so we can reach the point where 80% of management positions are filled by internal candidates. At the same time, our salesforce is being upskilled to help them focus on the ID and product authentication sectors where the sales process is more consultative.

Valuing and respecting our people

We know that diverse organisations perform better and are more engaging places to work.

During the year, we launched our first inclusion and diversity strategy, which aims to ensure that all our people feel they have a perspective that is valued and a voice that is listened to and respected. Our first action was to increase awareness of unconscious bias – what it is, why we have it, and where we see it in De La Rue. Among other initiatives, we've also identified and implemented changes in our recruitment methods to remove barriers to inclusion. For example, we've started to reviewed job descriptions and adverts to remove any language or tone that may create a barrier.

We have a number of specific programmes around gender diversity, including a target that women should account for 25% of our senior leadership team by 2020. For the last financial year, that figure was 18%. We've also established a Women's Network to explore potential benefits of greater inclusion. Specific initiatives include: supporting managers to enable them to champion flexible working; reviewing our existing flexible working policies; and establishing a culture of flexible working through our employee value proposition to attract talent to De La Rue.

We recognise that we're just starting out on this journey – as we learn we'll develop our strategy further.

Find out more about our employees
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It almost goes without saying that ethics are absolutely central to what we do and how we do it. We apply the highest standards and expect our supply chain to follow our lead, at all times and without exception. De La Rue has always worked like this – but we are strengthening our emphasis on ethics to ensure we maintain the full respect of the banks and leading organisations we work with.

We are also supporting a drive towards a more diverse workforce – more aligned with the cultural and ethnic diversity of our customers. We launched an inclusion and diversity strategy in October 2017, encouraging inclusivity through changes in recruitment practices and training programmes. In addition, we've moved away from an agent-led sales function towards a more direct approach, with locally based sales teams who understand the local markets and cultures, working out of regional hubs. We have already opened hubs in Dubai and Miami and are close to doing the same in Kuala Lumpur.

It's been a long and at times challenging journey, for the Company and for our people. But there is evidence that it has been worthwhile – the latest employee engagement survey indicated a shift in culture. People have bought into what we are doing. They appreciate reward and thank you programmes. They acknowledge the work we are doing to reduce the gender pay gap, which at 10% is good but needs to be zero. And they see all the other good work taking place around diversity, health and wellbeing.

Looking ahead

While losing the new UK Passport tender was disappointing, it does not change our goals. We will continue to seek out every opportunity to improve operational efficiency during the year ahead, while investing in the innovation that will keep our business one step ahead of the counterfeiters as well as the competition. This twin-track approach will be supported and enabled by our ongoing focus on strengthening our financial position and driving a positive, results-led culture.

The strong 12 month order book gives good revenue coverage for the year ahead. Operating profit is expected to be in line with FY17/18 as we continue to invest in R&D and sales to drive long term sustainable growth.

The sale of the paper business and the associated long term paper supply agreement have reduced our exposure to the volatility of the oversupplied paper market, while securing the surety of supply for our print business. Through this, and good cash generation from the business, we have significantly strengthened our balance sheet with net debt now at its lowest in five years. The stronger balance sheet provides the Group with greater flexibility to allocate capital to deliver long term shareholder value.

Martin Sutherland
Chief Executive Officer