Operational and financial review

Operational review

Banknote print volume
Billion notes

Year	Value
2018	7.3
2017	7.1
2016	7.1
2015	6.5
2014	6.2

Polymer volume
Tonnes

Year	Value
2018	810
2017	380
2016	100

Currency revenue
£m

Year	Value
2018	371.8
2017	349.5
2016	352.5
2015	317.1
2014	340.8

Currency adjusted operating profit*
£m

Year	Value
2018	45.1
2017	50.3
2016	55.1
2015	50.5
2014	61.0

* This is an non-IFRS measure. See further explanations and reconciliations to the comparable IFRS measures on page 157.

Group revenue increased by 7% to £493.9m, with solid performance across all three segments. Adjusted operating profit was 11% lower at £62.8m. A significant reduction in the profitability of the paper business was the major factor causing the profit decline, with the write off of the UK Passport bid costs as well as planned investments in R&D and sales being offset in part by additional margin from increased sales and certain provision and accrual releases, where we now have additional information as to the likelihood and amount of potential liabilities.

Excluding the exited paper business, Group revenue was up 4% to £426.4m and adjusted operating profit was up 7% to £56.9m.

Currency

The Currency business comprises Banknote Print, Banknote Paper, Polymer and Security Features.

The Currency business delivered 6% growth in revenue to £371.8m (2016/17: £349.5m), benefiting from the high volumes from Banknote Print, Banknote Paper as well as Polymer. Adjusted operating profit was £45.1m (2016/17: £50.3m). A significant reduction in the profitability of the paper business was the major factor causing the profit decline, offset in part by additional margin from increased sales and certain provision and accrual releases, where we have additional information as to the likelihood and amounts of potential liabilities.

Excluding the exited paper business, revenue was up 2% to £312.0m and operating profit was 11% higher to £40.5m.

Banknote Print
Banknote Print volume increased by 3% to 7.3bn notes (2016/17: 7.1bn), and revenue was up 5%, reflecting both the higher volumes and higher average price. The manufacturing footprint programme completed its second year, with refurbishment of banknote print lines in Kenya and Sri Lanka progressing slower than expected. A new varnishing line which makes printed banknotes more durable has been added to the Kenya factory, providing more operational flexibility in line with other sites.

In FY17/18, we outsourced the printing of 115m banknotes and are expecting the outsource volume to increase in the current financial year. Separately, a plan to roll out quality control systems, including note inspection machines, to improve quality and reduce costs is now in place.

Banknote Paper
Banknote Paper revenue grew by 5%, driven by the higher volumes of 12,200 tonnes (2016/17: 11,700 tonnes). However high raw material cost, compounded with production issues, resulted in a decline in profitability. Banknote Paper, as part of Portals De La Rue, was sold on 29 March 2018.

Polymer
Polymer volumes more than doubled to 810 tonnes (2016/17: 380 tonnes) in the year. In January 2018, we helped Botswana transition its 10 Pula note from paper to polymer, which was also designed and printed by De La Rue. Following the award of the milestone contract in October 2017 to supply polymer substrate for the Bank of England's new £20 note, we also secured a contract to provide polymer substrate to a state print works of a West African country.

Security features
Security thread volume was up 23% year on year. There was good uptake on Kinetic StarChrome™ launched in 2014 with multiple wins, including the Macedonia 2000 Denar and the Bangladesh 100 and 500 Taka. We also secured the first order of Starchrome Portrait™, one of the four new features launched in May last year. In addition, we have further strengthened our product portfolio through the launch of two new features in May 2018 – Ignite™ and PureImage™.

A number of joint development projects with customers and partners are underway, including the personalisable security feature for identity products with Opalux, which is expected to launch within the current financial year.

At the year end, the 12 month order book for Currency excluding the paper orders was £272m (2016/17: £265m).

Identity Solutions

Identity Solutions performed as expected, with revenue up 2% to £82.0m (2016/17: £80.6m). Adjusted operating profit was 27% lower than the prior year due to the £3.7m write off of the bid costs associated to the UK Passport retender. Excluding the bid costs, operating profit was up 5%.

Excluding the exited paper business, revenue was up 4% to £76.4m and operating profit was 20% lower to £7.1m, or 21% higher excluding the one off UK Passport bid costs.

We have made good progress in our core markets as countries are switching from Machine Readable Passport to ePassport. During the year, we helped Kenya to launch its first polycarbonate ePassport with production starting in January 2018. It was the first adoption amongst the East Africa Community members. The momentum continued with two new wins in East Africa transitioning to ePassport, as well as a new eID end-to-end solution contract with the Government of Malta.

The project with Note Printing Australia to design and develop Australia's next generation passport due to be launched in 2020 is progressing well.

While losing the new UK Passport tender will not affect the financial performance of this segment in the next 18 months as we will continue to fulfil our existing ten year contract with Her Majesty's Passport Office and assist with transitioning to the new supplier, we are reassessing our capabilities and cost base in order to remain competitive in this market.

Product Authentication & Traceability

Product Authentication & Traceability (PA&T) continued to perform well. Revenue increased by 27% to £40.1m (2016/17: £31.6m), driven by De La Rue Authentication Solutions (DAS, previously DuPont Authentication). Adjusted operating profit in the period was up 4% to £9.4m (2016/17: £9.0m). Increased investment in sales and R&D, particularly software solutions, resulted in a lower margin.

Excluding the exited paper business, revenue was up 31% to £38.0m and operating profit was 16% higher at £9.3m.

We made good progress in the government revenue services (GRS) area, winning a contract with an initial five year term under a build, operate, transfer model to implement a full FCTC compliant track and trace tax stamp solution for the Federal Tax Authority in the UAE. The scheme is expected to roll out in early 2019, initially applying to the tobacco industry. Successful implementation will give us an excellent reference in the Gulf Cooperation Council region.

On brand protection, DAS exceeded management's expectations in the first year post-acquisition, with both revenue and operating profit ahead of plan. Operating costs of £3m were in line with plan and the business benefited from the investment and sales synergy of being part of the Group.

To enhance our product and service offering, we have partnered with Canadian firm Optel Group, one of the leaders in track and trace technology being used in pharmaceutical and health care industries, the most mature and regulated brand protection market. The two groups will closely collaborate on product development and sales to accelerate growth.

Identity Solutions revenue[1]
£m

Year	£m
2018	82.0
2017	80.6
2016	76.5
2015	75.9
2014	87.1

Identity Solutions adjusted operating profit*[1]
£m

Year	£m
2018	8.3
2017	11.4
2016	8.3
2015	12.2
2014	21.9

Product Authentication & Traceability revenue[1]
£m

Year	£m
2018	40.1
2017	31.6
2016	28.8
2015	32.7
2014	36.7

Product Authentication & Traceability adjusted operating profit*[1]
£m

Year	£m
2018	9.4
2017	9.0
2016	7.0
2015	6.4
2014	10.6

* This is a non-IFRS measure. See further explanations and reconciliations to the comparable IFRS measures on page 157.

[1] The Group reclassified the results of one of its manufacturing sites in FY2016/17 in order to align the external and internal reporting. The historic revenue and operating profit numbers (except 2014 adjusted operating profit) in IDS and PA&T have been adjusted to reflect this change.

Financial review

Underlying effective tax rate (before exceptional items)
%

Year	%
2018	15.5
2017	15.8
2016	14.7
2015	17.6
2014	19.5

Bank covenants
Times

Year	Times
2018	14.0
2017	16.1
2018	0.66
2017	1.27

● Adjusted EBIT/net interest covenant >= 4.0
● Adjusted net debt/EBITDA covenants <= 3.0

Financial performance

Overview

The Group has made good progress in improving working capital management during the year with successful initiatives in inventory management and strong cash collections. We have also significantly strengthened our balance sheet following the receipt of £60.3m for the disposal of the Portals De La Rue paper business which has resulted in significantly lower net debt of £49.9m compared to £120.9m last year. Finally, following the indexation change from RPI to CPI on the Group's UK defined benefit pension scheme, the liability has substantially reduced to £87.6m from £237.0m last year. The Group generated revenues of £493.9m which was a 7% increase on last year. Adjusted operating profit was £62.8m which was down on the £70.7m in the prior year. A number of factors have impacted operating profit during the year and further details on these are set out below. All figures and commentary in this section are for continuing operations only unless otherwise stated.

Revenue and profit

Group revenue was £493.9m representing a 7% increase over the prior year (2016/17: £461.7m). Good growth was generated by the Currency division with revenue up £22m in particular relating to banknote sales due to both higher volumes and average price. The PA&T and IDS divisions both saw revenue growth following the acquisition of DuPont Authentication Inc in January 2017 of £8.5m and £1.4m respectively.

Adjusted operating profit was £62.8m, down from the £70.7m last year. The reduction was due to the write-off relating to capitalised bid costs for the UK Passport retender of £3.7m, the impact of the poor performance of the paper business in addition to the impact of higher operating costs due to planned increases in sales and marketing and research and development activity as we invest in the business for the future. During the year adjusted operating profit also benefited from certain provision and accrual releases where we now have additional information as to the likelihood and amount of the potential liabilities.

Adjusted EBITDA was £87.3m down from £97.4m in 2016/17.

Operating profit on an IFRS basis was higher at £123.0m compared to £70.2m in 2016/17 as the impact of lower adjusted operating profit was offset by the £80.5m gain on the re-measurement of the pension liability following the change in indexation from RPI to CPI. This gain was partly offset by the impairment of the disposal group relating to the sale of the paper business (Portals De La Rue) of £9.3m in addition to costs associated with the transaction and higher site relocation and restructuring costs in the current year.

See commentary below for further details on exceptional items.

Adjusted profit before tax was lower than the prior year at £53.4m (2016/17: £58.7m) as the impact of lower adjusted operating profit was partially offset by lower net finance expense of £9.4m compared to the prior year (2016/17: £12.0m) primarily due to a lower IAS 19 interest charge. Profit before tax on an IFRS basis was £113.4m (2016/17: £58.2m).

Profit from continuing operations on an IFRS basis was £96.8m compared to £49.5m in the prior year the increase being accounted for by the credit of £60.9m on exceptional items.

Finance charge

The Group's net interest charge was £3.8m a reduction on the prior year. The reduction was due to a release of accruals for potential interest charges relating to tax liabilities. The IAS 19 related finance cost, which represents the difference between the interest on pension liabilities and assets was £5.6m (2016/17: £7.4m). The charge is lower in the current year reflecting the fall in the pension liability which was effective from November 2017 when the Trustees of the main scheme agreed to the change in indexation method from RPI to CPI.

Exceptional items relates to the disposal of Portals De La Rue
In March 2018 the Group disposed of the Portals De La Rue paper business for cash consideration of £60.3m. In addition the group received further consideration in the form of loan notes valued at £3.8m and holdings of shares in parent company of Portals De La Rue valued at £2.8m. In accordance with IFRS 5 prior to the sale an impairment of the disposal group of £9.3m was recorded representing the difference between the carrying value of the assets and liabilities of the disposal group and the fair value less costs to sell.

Costs associated with the transaction of £4.2m were also recorded primarily relating to advisor and professional fees. In addition a loss of £0.9m was incurred relating to the early close out of some derivatives prior to the sale.

The Group has entered into a relationship agreement with Portals De La Rue which provides guaranteed supply to meet our paper needs going forwards.

Other exceptional items
Excluding items related to the paper disposal the group incurred other exceptional items, which on a net basis totalled a gain of £75.3m (2016/17: net charges of £0.4m).

Exceptional items comprise: A gain of £80.5m on the revaluation of the defined benefit pension scheme liability following the change of indexation from RPI to CPI. Costs of £1.0m were also recorded relating to professional advisor and other costs directly associated with this change.

Site relocation and restructuring costs of £4.0m (2016/17: £0.2m) which relate the manufacturing footprint review announced in December 2015 of £1.8m and costs relating to the upgrading of our finance systems and processes of £2.2m.

Costs of £0.2m have been incurred during the year in relation to the acquisition of DuPont Authentication Inc in January 2017.

See note 4 "exceptional items" for further details.

Taxation
The net tax charge in respect of continuing operations for the year was £16.8m (2016/17: £8.7m). The effective tax rate before exceptional items and tax on the movement of acquired intangibles was 15.5% (2016/17: 15.8%).

A net tax charge relating to exceptional items, on continuing operations, arising in the period were £9.7m (2016/17 credit of £0.6m).

Earnings per share
Adjusted basic earnings per share was 42.9p compared to 47.1p in 2016/17 lower due to lower adjusted operating profit in the current year.

Reported basic earnings per share were 93.7p compared to 47.2p in 2016/17 due to the impact of the gain of £80.5m on the re-measurement of the defined benefit pension scheme following the change in indexation.

Loss from discontinued operations
The loss from discontinued operations in the year was £1.8m and included charges of £3.6m relating to costs incurred on a loss making contract which the Group had to retain post the disposal of the Cash Processing Solutions (CPS) business and other costs associated with the closure of the business. These charges were offset by the receipt of £1.4m in further consideration for sale of CPS for which a receivable was not recorded due to the likelihood of this amount being paid.

A net tax credit on discontinued operations of £1.2m.

Dividend

The Board is recommending a final dividend of 16.7p per share (2016/17: 16.7p per share). Together with the interim dividend paid in January 2018 of 8.3p per share, this will give a total dividend for the year of 25.0p per share (2016/17: 25.0p per share). Subject to approval by shareholders, the final dividend will be paid on 3 August 2018 to shareholders on the register on 6 July 2018.

Capital expenditure relative to depreciation
£m

Year	Capital expenditure	Depreciation and amortisation
2018	19.9	25.2
2017	24.0	26.8
2016	25.0	26.2

Group trade working capital*
£m

Year	£m
2018	68.5
2017	83.6
2016	71.1
2015	96.1
2014	94.0

* Trade working capital comprises inventories plus trade receivables less trade payables and advance payments. Amounts stated for 2018 are before the impact of the portals disposal. 2013-15 comparatives have not be restated for discontinued operations.

Financial position

Cash generation and cash conversion

The group delivered strong cash flows in the year with cash generated from operating activities of £73.5m higher than the £64.3m recorded in 2016/17. The increase was due to a significant reduction in inventory holdings compared to the prior year (a £13m benefit excluding the impact of the disposal of Portals De La Rue) due to successful initiatives to manage inventory holdings and strong cash collections from debtors (a £10m benefit in the year). Cash generated from operating activities is also stated after special pension funding payments of £13.5m.

Cash conversion ratio for the year was 163%. The improvement resulting from the improvement in working capital levels during the year which more than offset the lower adjusted operating profit reported in the year. Cash conversion is the ratio of adjusted operating profit adjusted for depreciation, amortisation and the movement in working capital over adjusted operating profits.

Investing and financing cashflows and net debt

In addition to the £60.3m proceeds received from the sale of Portals De La Rue, £3.0m was also received in relation to the sale of the CPS business. These amounts related to £0.8m of deferred consideration which was payable on the first anniversary of the transaction in May 2017 and £0.8m working capital adjustment. These were in addition to the £1.4m received in the current year as referred to in the discontinued section above.

These proceeds in addition to the strong operating cashflows generated in the year have resulted in us being able to repay £67.0m of debt and invest £24.7m in capex. The Group ended the year with substantially lower net debt of £49.9m down by £71.0m from £120.9m at 25 March 2017.

The Group utilises a £275m revolving credit facility which expires in December 2021. The Group has operated well within the key financial covenants on this facility. These are 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 bank covenant tests were as follows: EBIT/net interest payable of 14.0 times and Net debt/EBITDA of 0.66 times.

Pension deficit and funding

In November 2017 it was announced that the Group's pension trustee had decided to change the indexation of future increases from RPI to CPI for its UK defined benefit pension scheme effective from April 2018. At the time of the Group's last triennial in April 2015, the Scheme's underlying actuarial funding deficit increased to £252m, £92m higher than in 2012 despite c£70m contributions made to the scheme by the Group in that period. The funding plan agreed in June 2016 to eliminate the deficit over a 12 year period will remain in place until the conclusion of the next triennial review commencing in April 2018. The agreed funding plan was for payments of £13.5m in 2018, increasing to £20.5m in 2019 and then rising by 4% per annum to 2022. It will be frozen at £23.0m per year between 2023 and 2028.

On a pre-tax basis the net pension deficit was £87.6m (25 March 2017: £237.0m) The decrease results primarily from the change in indexation method which has accounted for £80.5m of the reduction in the pre-tax pension deficit. However in addition the scheme benefited from positive investment returns on assets and favourable changes in assumptions for the long term rate of inflation and life expectancy which resulting in an actuarial gain of £58.8m presented within reserves.

The charge to operating profit in respect of the UK defined benefit pension scheme in 2017/18 was £2.3m (2016/17: £1.5m). This amount was higher due to costs associated with the indexation change. The element of the £2.3m which directly relates to the indexation change (£1.0m) has been recorded in exceptional items consistent with where the gain on re-measurement has been recorded. In addition, under IAS 19 there was a finance charge of £5.6m arising from the difference between the interest cost on liabilities and the interest income on scheme assets (2016/17: £7.4m). This charge was lower following the reduction in the pension deficit following the CPI change becoming effective in November 2017.

Capital structure

At 31 March 2018 the Group had net liabilities of £20.7m (25 March 2017 (restated): £142.8m). The significant reduction reflects the fall in the pension deficit recognised during the year.

The Company had shareholders' funds of £210.5m (25 March 2017: £230.5m) and had 102.4m fully paid ordinary shares in issue (26 March 2017: 101.4m) at the year end.