

Operational review

Currency

De La Rue Currency provides market leading printed banknotes, banknote paper and an unparalleled portfolio of banknote security features. Working in partnership with its customers to provide effective currency solutions, the business can also advise on critical issues of currency strategy such as design, demand forecasting, denominational structure and protection against counterfeiting.

Performance in 2010/11

The paper production issues described in the Chairman's statement and a separate and unrelated sharp decline in banknote print volumes contributed to a significantly lower revenue and profit than in the prior period.

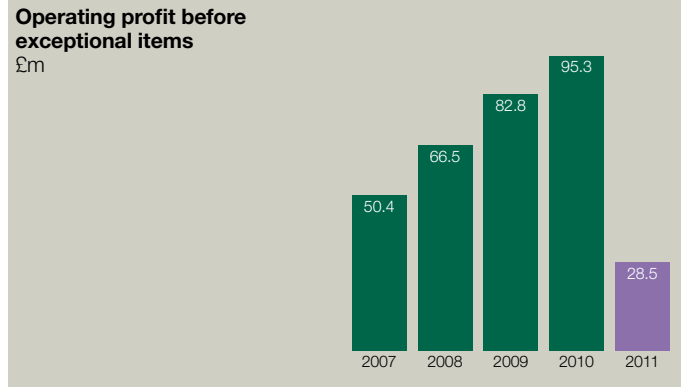
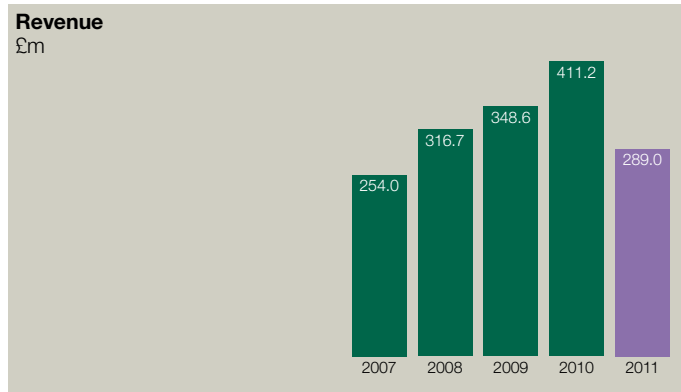
Banknote print volumes at 5.9bn notes (2009/10: 7.8bn) were 24 per cent below the high level of the prior year due to a number of factors including the timing of orders, changes by customers to existing order volumes and tenders that were expected but not issued or not won. This reduction reflects the potential for short term order variability caused by the timing of a small number of key orders.

Paper volumes of 9,900 tonnes (2009/10: 15,500 tonnes) were down 36 per cent primarily as a result of the suspension of certain supplies following the paper production issues.

Revenue fell by 30 per cent to £289.0m (2009/10: £411.2m) reflecting the reduction in trading volumes. Operating profit at £28.5m (2009/10: £95.3m) was down 70 per cent, the result of the lower volumes and adverse product mix compared with the prior year. Consequently operating margins were 9.9 per cent (2009/10: 23.2 per cent) down 13 percentage points after offsetting productivity benefits and a favourable foreign exchange impact (due to the continued weakness of sterling against the euro and the US dollar).

The year end order book, excluding currently suspended orders, was £155m (2009/10: £166m), with a greater weighting towards the first half than in the previous year (see graph on page 7). In addition enquiries are at a higher level than at this time last year and there is a good pipeline of opportunities.

The significant increase in worldwide cotton prices during the final quarter of the financial year had a limited impact. However, if prices remain at the current level, the impact in the 2011/12 financial year will be more significant.



Market

The issuance of new notes into circulation is driven by central bank policy decision making. These policies address counterfeiting, new designs, note cleanliness, fitness standards, cash recycling requirements and developments in cash handling solutions. Each issuing authority also has to consider the local climatic environment in which the notes circulate and the prevailing economic conditions.

Security continues to be one of the prime factors affecting the market as the sophistication of counterfeiting increases. De La Rue's leading portfolio of security features, which includes high value security threads and holograms, positions the business well to meet customer needs in counteracting this threat.

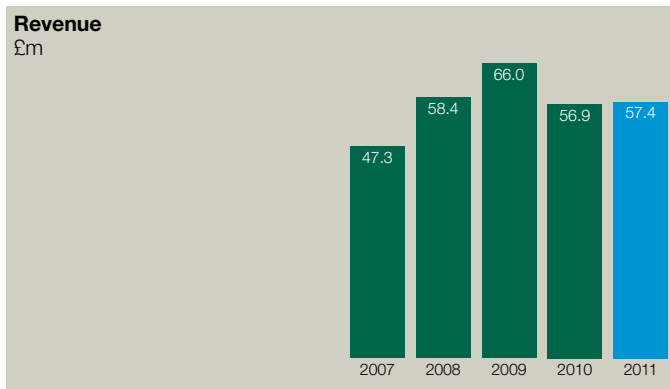
The durability of banknotes directly affects the life of a note in circulation and hence the cost to a central bank. De La Rue has invested in a range of features to improve durability including, for example, Cornerstone™, a reinforced paper feature that has been adopted by 60 issuing authorities worldwide across a total of 188 denominations. To enhance the range of durable options available to customers, Flexycoin™, a polymer substrate for banknotes that provides a durable option at the coin note boundary, was launched during the year.

Despite the increase in the number of electronic transactions, the underlying requirement for cash continues to grow steadily, reflecting its universal acceptance and continued attraction as a store of value.

Although the patterns vary considerably from country to country, the growth trend for the world market for banknotes is expected to be between 3 and 4 per cent annually. Consequently it is expected that the market available to commercial providers of banknotes and their components will grow at a similar trend rate.

The currency market does exhibit short term variations in order patterns according to the individual decisions taken by the central banks of countries which themselves differ greatly in the volume of their requirements at any point in their issuance cycle. This has the potential to create material volume variation year on year for commercial providers.

The global capacity for banknote paper will increase over the next few years in both commercial and state sectors and this is expected to produce short term over capacity. De La Rue's presence as an integrated provider with a focus on the supply of printed banknotes should help mitigate this exposure.



Cash Processing Solutions

De La Rue Cash Processing Solutions (CPS) is integral to the Currency offering with shared central bank customers.

The business provides bulk cash handling organisations with a range of sophisticated high speed cash sorting and authentication systems as well as software solutions, consultancy, service and support to enhance the productivity, performance and security of cash processing operations.

Performance in 2010/11

CPS has made steady progress during the year, returning to profit, despite continued challenging trading conditions and some delays in customer decision making. This progress is expected to continue in the new financial year.

Although revenue remained broadly unchanged, the business reported an operating profit of £0.5m (2009/10: loss £3.5m). This reflected the positive impact of both the restructuring in 2009/10 which delivered a significant reduction in the cost base and the rationalisation of the product range.

Sales of the large DLR 7000 banknote sorters progressed well across all market sectors and geographies leading to an improved product order book at the end of the financial year. Service revenues were maintained and remain an important source of income from the installed base.



Market

The underlying demand for cash continues to grow and it is this that underpins the growth opportunity in CPS's market. The drive for efficiency and cost reduction continues to generate demand for automated cash processing equipment, particularly in commercial markets.

As customers become more cost focused and data driven, so the increased requirement for enhanced process control and operating visibility drives the demand for cash management software solutions. The trend for central banks to outsource the recycling of banknotes to the commercial sector also increases demand for advanced solutions.

CPS's large installed machine base is supported by a global service network which generates stable, long term revenue by providing regular service and maintenance to customers.

Operational review

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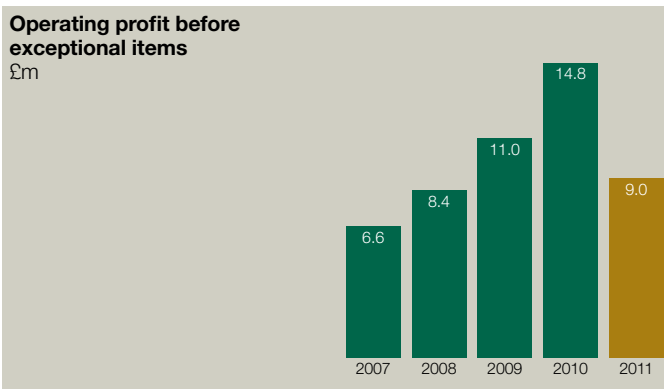
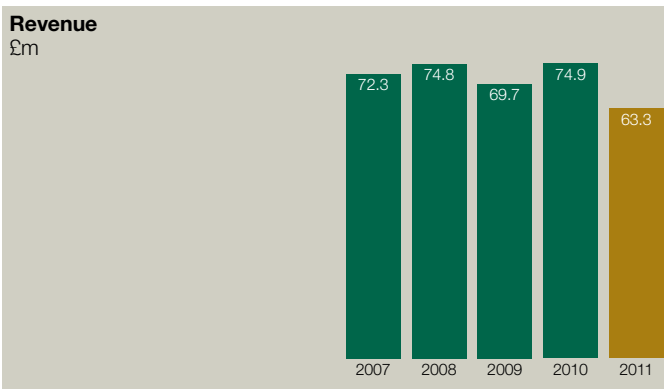
Security Products

De La Rue Security Products consists of specialist businesses whose solutions are critical to authenticating products and documents as well as protecting revenues for governments, global corporations and financial institutions around the world. It produces authentication labels, brand licensing products, government documents, cheques and postage stamps as well as vital components for Currency and IDS.

Performance in 2010/11

Security Products had a difficult year reporting reduced revenue of £63.3m (2009/10: £74.9m) and operating profit of £9.0m (2009/10: £14.8m). Performance was adversely impacted by the reduction in banknote print and paper volumes in the Currency business which it supplies, compounded by an adverse product mix within the Holographics business. Together these issues resulted, despite the execution of a cost reduction plan to mitigate the impact, in a 6 percentage point reduction in the operating profit margin.

Sales cycles in the market can be lengthy but during the year the Division achieved some important contract wins, including the first advanced tax stamp solution which includes newly developed track and trace software. In addition, enhanced operational standards were successfully implemented for Microsoft, one of the business' major customers.



Market

Both external market segments in this business – government revenue protection and brand authentication – are driven fundamentally by the threat of illicit trade and counterfeiting. Security Products is well placed to meet customer needs in counteracting these threats.

Governments are increasingly seeking to maximise tax revenues by protecting yields from revenue raising schemes on high tax products such as alcohol and tobacco. There is a move to greater international standardisation such as the recently introduced Framework Convention on Tobacco Control, necessitating additional revenue protection measures.

On a global basis there is a growing trend for businesses to protect their revenues and brand equity on high value genuine consumer goods through the use of sophisticated authentication solutions. A similar trend is developing within the pharmaceutical industry in some parts of the world.

Augmenting physical protection with digital authentication is an emerging trend presenting opportunities for which De La Rue has developed solutions.

In addition to external sales, products and technology developed in this business are also sold into the Currency and IDS divisions, reflecting the market drivers in those businesses.

Identity Systems

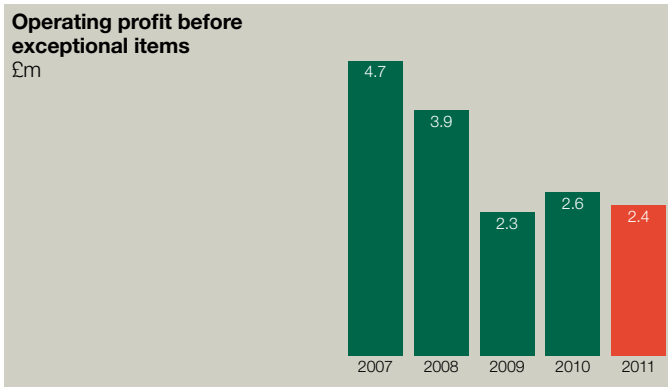
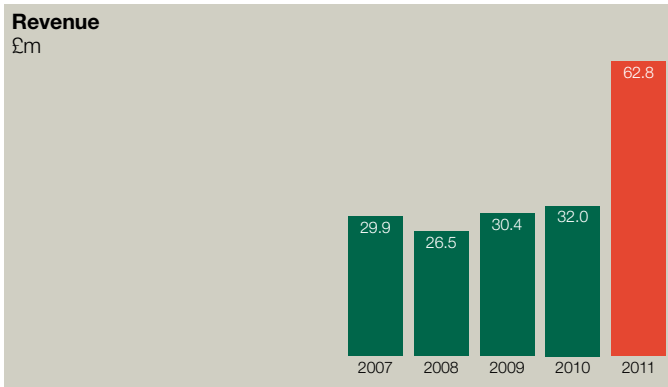
De La Rue Identity Systems (IDS) is a world expert in the delivery and management of secure government identity programmes, systems and solutions. A reliable and trusted partner of governments worldwide, IDS has implemented over 100 projects in 65 countries focusing on the provision of passport, ePassport, national ID and eID, driving licence and voter registration schemes.

Performance in 2010/11

IDS reported increased revenue of £62.8m (2009/10: £32.0m). This increase is largely a result of the completion of the implementation phase of the UK Passport contract. Operating profit of £2.4m (2009/10: £2.6m) is after a £0.6m write down on an asset made obsolete following investment for the UK Passport. Excluding this write down, underlying profit would have been up 15 per cent.

During the year IDS successfully commenced production and issuance of the new UK Passport. This is one of the largest and most prestigious identity systems in the world with volumes of up to six million books on an annualised basis, worth c£400m over 10 years.

The international part of the business performed satisfactorily, winning new contracts and implementing projects across the full product range, including an increasing number of electronic identity solutions.



Market

The transition to electronic identity solutions is the most significant trend in the market place and strategic roadmaps towards these solutions are being developed with key customers.

The government identity market is fragmenting as customers become more focused on complete and integrated solutions rather than just document issuance. As a result, a greater range of technologies is being demanded by customers. The sector is as a consequence attracting a wider range of providers to meet these needs. De La Rue is well placed to take a leading role in this area as both a technology and solution provider as well as a specialist systems integrator.

The underlying growth prospects for this market reflect the increasing demand for both travel documents and personal identification solutions. The technological infrastructure of each country implementing such systems determines the degree of sophistication of the solution developed.

IDS is a contract based business focusing on government customers. The nature of this business is such that revenues can be variable in nature and subject to cancellation or delay. Maintaining as broad a portfolio of business as possible and a strong pipeline of opportunities mitigates this risk.