Chairman's statement

A YEAR OF TRANSITION

The Group has achieved a reasonable underlying performance and has continued its strategic progress in a year of transition.

Our continued investment in R&D and sales in the past few years has started to bear fruit. Despite having fewer business lines**, the Group's turnover and intake of orders have been the strongest we have seen in five years. We are also making progress in diversifying our revenue, from providing banknotes into more digital and service-oriented businesses. Here we have won several new contracts in Product Authentication & Traceability (PA&T), a business we expect to double revenues in the next three years.

The conclusion of the UK passport contract later this year, and our expectation that the strong demand for banknotes of the past few years will weaken somewhat, leading to pressure on prices, will create a challenging couple of years ahead. We shall, therefore, take immediate action to ensure our business is fit for purpose for the future.

We are announcing a proposal to realign the Group's operating model into two divisions focused on Currency and Authentication. The growth businesses, represented mainly by PA&T and Security Features, will command the greater share of R&D expenditure, while the Banknote Print and Polymer businesses, aligned mainly to the slower growing banknote market, will focus primarily on the cost effective delivery of high quality products.

The realignment of the operating model will provide each of our divisions with the opportunity to focus better on their respective markets, and will create future strategic options.

Our three year cost reduction programme, aimed at delivering cost savings of in excess of £20m by FY22, will partially mitigate the pricing pressure in Banknote Print, and support the growth agenda for the growth businesses. This growth will be achieved organically, supplemented as appropriate by partnerships and acquisitions. Martin comments more fully on this in the Review of Strategy and Operations on pages 24 to 31.

The higher than expected level of net debt was disappointing. Detailed commentary on cash flow and borrowings is included in the Financial Review on pages 32 to 34. We have taken further measures to improve cash management and there remains much to do.

The Board

Martin Sutherland will be stepping down as Chief Executive Officer and as a Director of the Company. The Board has commenced a process to identify Martin's successor and Martin has agreed to continue to serve as CEO until his successor is in place in order to assist an orderly succession.

For the past five years, Martin has brought tremendous energy and strategic insight to moving the Company from a traditional manufacturing business to a service-oriented business building on leading edge technological solutions, as well as refocusing the business on its core strengths and bringing greater balance to the portfolio. The Company is now well-positioned to move to the next phase of this journey. I would like to take this opportunity to thank Martin on behalf of the Board and colleagues for all that he has achieved. I would also like to thank him for his commitment to ensuring a smooth handover of his responsibilities.

Helen Willis joined De La Rue as Chief Financial Officer on 19 July 2018, and was appointed to the Board after the annual general meeting on 26 July 2018. Her extensive experience in finance and manufacturing, gained with a number of large international businesses, is a valuable addition to the Board.

The Group's turnover and intake of orders have been the strongest we have seen in five years.

The Board recognises the importance of having an inclusive and diverse culture, and we aim to reflect this within its composition. Today, two of seven Directors, or nearly 30% of the Board, are female. The range of experience, knowledge and expertise within the Board provides support to management, and challenges decisions in an effective manner.

Culture and people

The Board considers leadership, culture and good governance as essential factors in the Group's ongoing transformation. Since 2015, the Group has been aiming to forge a dynamic, responsive and high performing culture, and the Board supports this fully.

Our commitment to high ethical standards is incorporated in our Code of Business Principles, which our colleagues, business partners, and other third party suppliers must adhere to.

Our people are our greatest assets, and are vital to the success of the business, and to fulfilling our purpose. We have appointed a Non-executive Director responsible for workforce engagement. FY19 was a particularly challenging year for our colleagues and the UK passport loss has had an impact on people's morale and pride. However, they have stayed strong, and despite many uncertainties, achieved a solid set of results. On behalf of the Board, I would like to express our thanks for their hard work and dedication.

Financial performance

Group revenue increased by 12% to £516.6m (FY18: £461.4m) excluding paper† and by 14% on a reported basis to £564.8m (FY18: £493.9m).

Adjusted operating profit* excluding paper† increased by 6% to £60.1m (FY18: £56.9m). The growth in adjusted operating profit on an excluding paper† basis was a reflection of a greater volume of jobs but with more complexity and lower margin in the currency division; higher profits in Identity Solutions largely reflecting the fact that the prior year included the write off of the costs of £3.7m in respect of the UK passport bid, and FY19 included a non-recurring credit due to the release of a bad debt provision where the cash was received; and lower profits in PA&T due to product investment for future growth and operating expenses relating to the new contracts. Overall, adjusted operating profit* excluding paper† included £6.9m benefit from IFRS 15, and a net credit of £4.0m due to the release of an accrual relating to a dispute which arose out of the well publicised events of 2010 concerning one of De La Rue's key customers, and the recognition of a net significant bad debt expense (excluding amounts relating to Venezuela). FY18 adjusted operating profit* also benefited from a similar value of non-recurring credits from certain provision and accrual releases.

IFRS operating profit was substantially lower at £31.5m (FY18: £123.0m), primarily because of the impact of the gain relating to the change in indexation methodology on the UK pension scheme in the prior year, as well as the recording of an £18m credit loss associated with the accounts receivable balance of a customer in Venezuela in FY19.

Adjusted basic earnings per share* excluding paper† increased by 12% to 42.9p (FY18: 38.2p).

IFRS basic earnings per share were down 80% at 18.8p (FY18: 93.7p) due to the impact of the gain on the change in pension indexation in FY18 and additional exceptional charges in FY19.

Cash generated from operating activities was an outflow of £4.6m (FY18: inflow of £73.5m). Net debt increased to £107.5m (31 March 2018: £49.9m).

More detail of the Group's financial performance including cash flow and net debt is covered in the Financial Review section on pages 32 to 34.

Capital allocation

The Board has adopted a capital allocation framework designed to increase shareholder value in the execution of the Group's strategy. The Group's capital allocation priorities are:

- organic growth investments – capital projects, investment in R&D and sales
- dividend payment – aim to at least maintain dividend per share in the short to medium term
- mergers and acquisitions – explore value-enhancing opportunities

The Board is committed to maintaining an efficient balance sheet, appropriate to the Group's medium term investment requirement. We intend to keep the Group's capital structure under regular review.

Dividend

To maintain the Group's financial flexibility to sustain growth, the Board proposes to keep the dividend unchanged, and is recommending a final dividend of 16.7p per share. This, together with the 8.3p paid in January 2019, will make a full year dividend of 25.0p per share. Subject to shareholders' approval, we will pay the final dividend on 2 August 2019, to shareholders on the register on 5 July 2019.

Outlook

We will face some big challenges in the next couple of years with the conclusion of the UK passport contract and the anticipated margin pressure in banknote printing. We must raise our game and stay competitive. In the near term, the proposed realignment of our operating model will allow better strategic focus on the two very different markets and bring cost benefits.

In the medium to long term, the Board remains confident about the future of the business as the cost-out programme, expected to complete in FY22, will partially mitigate the margin impact on banknote print and support the growth agenda. You can find a viability assessment of the business on page 41.

* This is a non-IFRS measure. Amortisation of acquired intangible assets is a non-cash item while exceptional items are non-recurring in nature. By excluding these items from the adjusted operating profit and EPS metrics, the Directors are of the opinion that these measures give a better understanding of the underlying performance of the business. See page 153 for further explanations and reconciliation to the comparable IFRS measures.

† Reported figures included in this report include the paper business results in FY18 as originally reported and in FY19 they include £48.2m of revenue on non-novated contracts with nil profit margin. Figures reported on the 'excluding paper' basis have been adjusted to exclude revenue from non-novated contracts in FY19. In FY18 'excluding paper' figures exclude the results of the paper business. In addition, Security Features sales of £35.0m, which would have previously been treated as internal, have been added back to present the comparative numbers in FY18 on a basis consistent with the IFRS accounting treatment applied in FY19. This change has been made to provide a more meaningful presentation of the financial performance of the business during the period.

** The Group disposed of Cash Processing Solutions business in 2016 and the paper business in 2018.

Financial highlights

£516.6m
Revenue excluding paper†
2018: £461.4m

£79.3m
Adjusted EBITDA*†1
2018: £78.4m

£60.1m
Adjusted operating profit*†2
2018: £56.9m

42.9p
Adjusted basic earnings per share*†3
2018: 38.2p

25.0p
Dividend per share
2018: 25.0p

£51.4m
IFRS EBITDA
2018: £148.2m

£31.5m
IFRS operating profit
2018: £123.0m

18.8p
IFRS basic earnings per share from continuing operations[4]
2018: 93.7p

1 Adjusted EBITDA represents earnings from continuing operations before the deduction of interest, tax, depreciation, amortisation and exceptional items and on an excluding paper basis.

2 Adjusted operating profit represents operating profit from continuing operations adjusted to exclude exceptional items and amortisation of acquired intangible assets and on an excluding paper basis.

3 Adjusted earnings per share are the earnings attributable to equity shareholders, excluding exceptional items, amortisation of acquired intangible assets and discontinued operations divided by the weighted average number of ordinary shares outstanding during the year and on an excluding paper basis.

4 Continuing operations only, excluding the Cash Processing Solutions business which was sold on 22 May 2016.