

## De La Rue Analyst Call

8.30am, 1 February 2018

Hosted by: Martin Sutherland  
Jitesh Sodha

Coordinator Good morning, ladies and gentlemen. Welcome to the De La Rue Analyst Call, hosted by Martin Sutherland. My name is David and I'm the event manager today. During the presentation your lines will remain on listen-only. [Operator instructions]. I would like to advise all parties that this conference call is being recorded for replay purposes.

With that, I would like to hand over to Martin. Please go ahead.

Martin Thank you, David. Thanks, everybody, for joining the call this morning. I'm here with Jitesh and Lili. As you will have seen on the RNS, we announced this morning that we're entering into a strategic relationship with Epiris, the UK-based private equity firm. They're taking a 90% stake in our paper business. That's well-trailed that we have been seeking to joint-venture our paper business so I see this as a significant milestone in the execution of our strategy.

If I could just remind you briefly of what our strategy is that we set out in May of 2015. We set ourselves the ambition of transforming De La Rue into a less capital-intensive and more technology-driven solution provider. We consider the business in two halves; areas that are volatile or are facing challenges due to changes in market conditions and those business lines that we believe are exposed to stable and higher potential growth.

In terms of dealing with the long-term risk to the business we've already reduced our currency print capacity and have started using outsource partners to increase flexibility in our currency business and we sold our underperforming our CPS business a couple of years ago.

The announcement this morning addresses another risk, our exposure to the over-supplied paper market. Epiris becomes a majority shareholder of our paper business to be renamed Portals De La Rue. That's including the Overton paper mill and the slightly smaller Bathford paper mill. Epiris will have a 90% shareholding for a cash consideration of £61 million. This equates—for the mathematicians amongst you to a 12.8 times EV on a four-year average adjusted EBIT over the years 2015 to 2018.

We've also entered into a ten-year supply agreement with Portals De La Rue who will guarantee paper supply for most of our anticipated internal demand for printing banknotes and passports. Equally, we'll be the preferred supplier of security features to Portals De La Rue when they're specified by customers.

We've enjoyed high volumes in our paper business in the past two years leading to a strong financial performance. However, this has not changed our view about the market overall. Demand is historically unpredictable and pricing is under pressure due to oversupply.

One of our goals is to improve earnings quality and reduce volatility in our business. And this transaction removes our exposure to selling market into the unpredictable external market while securing supply of our own paper needs. The cash proceeds will allow us to strengthen our balance sheet on top of the £70 million reduction in the pension deficit which we announced at the half-year results in November.

Also at the half year results, we said that we would continue to increase investment in product development, in new technologies and in sales capabilities to drive growth. Our target to double R&D in the next—well from the five years starting May 2015, and we are on track to do that. This transaction allows us to release the capital tied up in the paper business and to invest in the strategic growth areas of identity solutions and product authentication both organically and through M&A should the right opportunities arise, which over time will help us achieve higher returns.

Currency obviously remains central to De La Rue's business. We are the largest commercial supplier of finished banknotes. This transaction we have announced will cement this position for us. The transaction will also provide the paper business and its employees an experienced management team that has a singular focus on growing that business. We obviously look forward to working with Epiris and Portals De La Rue to continue to provide the best currency solutions to our customers.

I'll now hand over to Jitesh who will provide some further details about the financials of the transaction and then be more than happy to take some questions at the end. Jitesh.

Jitesh

Thank you, Martin. As Martin has already mentioned, on completion we expect cash proceeds of £61 million for 90% of the paper business. In addition there will be £4 million of one-off exceptional costs related to the transaction and to the separation of the business.

Previously we have never provided separate numbers for the paper business from the currency segment when we report. The paper business is estimated to generate £120 million of turnover in this fiscal year, '17 and '18, of which approximately £70 million is related to external sales and £50 million is related to internal sales, which are eliminated on group consolidation.

The paper business is expected to generate £10 million of EBIT in FY '17-'18. The segmental split is approximately 70% in currency, 20% in the ID segment and 10% in product authentication and traceability.

Depreciation and capex are both approximately £5 million per annum. There are around about £4 million of trapped costs in the business which we will start to remove in the next fiscal year, FY '18-'19 and we'll see the full benefit of these savings that will flow down in fiscal year '19-'20. On completion we also expect to take a provision of £4 million, a non-cash provision, for liabilities related to the successful separation of the business.

As Martin has already mentioned, the valuation of £68 million equates to 12.8 times adjusted EBIT over the four-year period, 2015 to 2018. We believe we have achieved a good price when comparing this to recent, similar transactions in the industry.

I'll hand back to Martin.

Martin Are there any questions? I'm sure there will be. Well, I hope there are at least. Any questions?

Coordinator I just asked whether you like me or not to open up the question and answer session. The lines are open. There is one already incoming from Chris Dyett of Investec. I'm opening the line now. Please go ahead.

Chris Good morning, team De La Rue. Two questions from me. First question not actually on the transaction itself but just given there's no comment on covering trading in the statement given when we last heard from you several months ago, just to confirm that trading is with the rest of the group as expected.

Second question around likely completion and timing of this. Should we assume that it comes out of the group from the start of the new financial year or is there anything you need to go through to get approvals for this to be disposed of or—

Martin Thanks, Chris. Just on the trading, things are in line with previously set expectations. I think that's the formal line.

What about you, Jitesh, do you want to add anything to that?

Jitesh Yes. We haven't said anything because, to be honest, Chris, we don't really have anything to say or add. I think, as you're clearly aware, if we had something to add we would be obliged to say it. We wanted today to be about a significant new milestone on our strategy. That's on the current trading.

In terms of completion, we've said that completion will be in the first half. We are trying to target to complete by the end of this fiscal year, but as you can understand this a complicated transaction. The paper business is very integrated into De La Rue, so the separation of the

business is quite a task. In terms of assumptions, yes, if you want to assume that the paper business is out for the next fiscal year I'd be comfortable with that.

You also asked about any conditions. Obviously there's an employee consultation process that we have to go through, but I don't think there are any regulatory or kind of competition-related barriers for us to go through.

Chris Sure. Maybe just a couple of quick follow-ups. In our calculations the balance sheet looks like it's going to be kind of 0.4, 0.5 times leverage. How should we think about the balance sheet in terms of, are there M&A targets or the potential for some kind of cash return?

Martin I think we can be pretty clear on that one. We have no intention of returning cash. We, as I said in the statement and for some time now, we see that this is a business that will benefit from a strategic investment. We will continue to invest in R&D, in go-to-market and sales capability and yes, if there are interesting acquisitions that we can do to help accelerate growth in our chosen growth areas then we will do exactly that.

Chris Thank you.

Coordinator You have another question coming in from the line of Dominic Convey of Peel Hunt. Your line is open. Please go ahead.

Dominic Hi. Good morning. I guess just a couple questions around the terms of the deal. You talk about obviously a pre-agreed price mechanism for the next ten years. I wonder if you're prepared to give us a little bit more colour on that, and crucially, how you can protect the quality of the product effectively now that you're outsourcing the supply to a third party.

Martin Sure. We've for some time been talking about constructive yet complex conversations with third parties around for the future of the business. A few things to note. One is that we're retaining a 10% stake in the business and we think it's important, which it also gives us a board seat on the Portals De La Rue. We've obviously maintained a very close working relationship with this business which now becomes one of our key suppliers and a key element of our supply chain.

The complexity of the negotiations that we've been having are the ongoing relationship agreement as we call it, so effectively this ten-year supply agreement. In that ten-year supply agreement we are guaranteeing specific volumes to specific pricing. Basically what that means is that we are covering the majority of our paper requirements through the relationship with Portals De La Rue.

We do have the flexibility to buy some of our paper in the open market. As far as we're concerned we think that's the best of all worlds because we've got surety of supply but also some of the benefits of buying in

the local market. Clearly for Portals De La Rue and for Epiris, the new owners, we've become their most significant customer and therefore we effectively will have an ongoing, close working relationship.

Obviously we've worked closely with the management of Portals De La Rue, so the existing management of our paper business are transferring over as part of this deal. We know them well; we've worked well with them for years and they will continue on in that role. Yes, I think we feel comfortable that we're entering into a strategic relationship which works for all parties.

Dominic                      Okay, thanks.

Coordinator                Your next question is coming in from the line of Alex Savvides from J O Hambro. I am going to open up the line now. Please go ahead.

Alex                          Hi, guys. Well done on this by the way.

Martin                      Thank you.

Jitesh                        Thank you.

Alex                          Just a couple of questions on Portals and their sort of strategy. What's your expectation of how the company is going to be financed, debt to equity? What's the balance sheet going to look like? Then, what's their strategy for expansion, cash generation, dividend payments going to be?

Then, just questions for knock-on effects to you guys. What's your—because obviously we lose £10 million of EBIT which has implications for the pension and cash generation through the company. Obviously it has implications for your dividend paying capacity. Just any comments on the knock-on effects to the pension and dividend payments as well.

Martin                      Okay, just on the first one on the financing of Portals. I think—without trying to duck the question, I will, because I think that's really a question for Epiris as opposed to for us. It's not really for us to comment on what their plans are moving forward. Sorry for that one.

Alexi                        You'd expect them to sort of obviously try and grow beyond you guys.

Martin                      The financing of the deal, I think that's kind of for them to talk about. I would imagine that their strategy is that they see an opportunity, yes, to grow. I mean they're a UK-based private equity house. They've got about I think £0.5 billion under management which they're trying to grow to about £1 billion.

They are actually a previous investor in Innovia, which as you know was sold to CCL last year. They're sort of familiar with the banknote and the currency market. I think they see this as a strategic investment, yes, ultimately to drive growth. They're that type of investor as

opposed to some of the other private equity houses that we're all aware of. It is good for the business and the employees as well.

Alex Sure, sure, sure. Your 10% stake you just intend to hold, do you?

Martin Yes. Absolutely. Yes.

Alex Okay. Alright.

Jitesh In terms of the question on cash, I guess, what we've guided is that the business will have a £10 million of EBIT this year and you could read that across the next year in terms of reduction. We'll take out trapped costs of £4 million, so then the read-across on a longer-term basis is £6 million. It's a business that has depreciation and capex of £5 so actually we think that the cash impact will be relatively small. On the overall delivery of goods, we've got the cash proceeds to shore up the balance sheet, the £61 million of cash proceeds. I think that from a cash basis and in terms of dividend cover we're absolutely fine and we'll take the balance sheet—sorry?

Alex No implication on the pension?

Jitesh No. No implication on the pension that I'm aware of. We're going to the next tri-annual at the end of March.

Alex Okay. Obviously there's a big slug of cash coming into the business. There's still a pension deficit. I just wondered if part of this negotiation you had to talk to the trustees about what you were doing and what it meant for them and the pensioners.

Jitesh Clearly we did speak with the trustees and they're very supportive of our strategy to try and grow the business and invest in the business. We've also made other changes in the pension deficit. The move from RPI to CPR will reduce the pension deficit by £70 million. Again, I think the entirety of the situation with the pension will be taken into account in the next tri-annual.

Alex Okay.

Martin I guess you'll work out but as we've said here that the sale value is 12.8 times adjusted EBIT if you look at an average over the last four years. This year's EBIT is obviously at a historical high compared with the average over the last four years.

Alex Yes. No, we saw that. The headline looks quite low but we understand that it's very cyclical. You mentioned actually that it looks good relative to some other transactions that have gone on. Could you sort of mention—

Martin Bain Capital bought into Fedrigoni, which is an Italian paper maker. The Swiss National Bank bought Landqart Paper out of Fortress just before Christmas. Actually we heard earlier this week that Arjowiggins

have sold their French paper mill again into a private equity group called Blue Motion, so there have been three deals in the sector in the last six months.

Martin Just to give you some numbers around those. The Blue Motion deal we don't actually have any numbers on but the Swiss National Bank bought Landqart—there were actually two transactions there. There was a land transaction and a transaction for the paper business which was—the combined multiple was 5.6 times—the business multiple of EV to EBITDA was 2.6 times. Bain buying Fedrigoni was at 5 times EV to EBITDA. We think we've got—

Alex Yes, yes. Okay. Just talking about some recent transactions. There's been a transaction at Crane as well. I just wondered if you could make any comments on that and what sort of A, there's a read-through valuation obviously but then also implications for their ongoing strategy, particularly in Malta where they've been building assets as well.

Martin Yes. Again, probably a question for the new owners of Crane who are also called Crane, which obviously will help with the rebranding costs. Yes, really it's for them to comment, isn't it? The valuation I think is kind of interesting. It's an \$800 million valuation for a currency business which is smaller than our currency business.

Alex Yes, okay. Okay, very good. Well look, well done, guys. I'm sure this has taken a lot of time and effort. It's a good job, so congratulations. I will see you again soon.

Martin Thank you and thanks for your questions. Any more questions?

Coordinator There are no other questions in the queue.

Martin Great. Okay, well thanks, everybody, for dialling in. Obviously we're all available if there are any other questions that come up. We'll see you all soon. Thanks very much.

Coordinator Thank you, Martin. Ladies and gentlemen that concludes your conference call for today. You may now disconnect. Thank you for joining. Have a very good rest of your day.

*[END OF CALL]*