Dialight plc
("Dialight" or "the Group")

Unaudited preliminary results for the year ended 31 December 2018

Dialight plc (LSE: DIA.L), the global leader in sustainable LED lighting for industrial applications, announces its full year results for the year ended 31 December 2018.

	2018 Unaudited £m	2017 Audited £m
Revenue	**169.6**	181.0
Underlying[1] profit from operating activities	**8.0**	9.7
Underlying basic EPS	**17.3p**	17.9p
Non-underlying costs	**(0.4)**	(6.4)
Statutory profit from operating activities	**7.6**	3.3
Statutory EPS - basic	**16.4p**	4.8p
Net (debt)/cash	**(2.9)**	12.8

RESULTS HEADLINES	• Underlying Group profit in line with revised expectations • Europe revenues up 4%, APAC up 16%, US down 5% (with improved Q4) • Profit achieved despite cost impacts of operational issues • Increase in inventory as expected, to be reversed during 2019 • All product assembly now back in-house, full exit from former manufacturing partner by end of H1 2019
STRATEGIC HEADLINES	• New facilities in Mexico and Malaysia • New market approach centred on regional technical and product innovation • Three new product launches in 2019 to significantly expand served market

Marty Rapp, Group Chief Executive, said:

"2018 was a challenging year for Dialight but one in which we made considerable progress to address the operational issues we faced at the start of the year, reducing late orders significantly during the year. This improvement is primarily due to moving manufacturing under our hybrid model back in-house and terminating the relationship with our manufacturing partner. Further improvement in our operations remains a priority for us.

With a strong focus on product development and expansion of the available market, we have laid the foundations to drive growth and restore market share. We are planning to launch three major products in 2019 that will significantly expand the Group's served market. We have two new facilities, in Mexico and Malaysia, to provide us with sufficient capacity to meet our growth aspirations.

Our market proposition remains compelling, with the sustainability benefits of reduced energy usage, lower carbon emissions, reduced maintenance and improved safety offering real value to our customers. We remain excited by the Group's prospects over the medium to long term and are confident of delivering future growth. The Board's expectations of further progress in 2019 remain unchanged, again with a second half weighting."

Results presentation:

A presentation to analysts and investors will be held today at 09.00 GMT at Investec, 30 Gresham Street, London EC2V 7QP, United Kingdom. The presentation and an audiocast will be made available on the company's website, www.dialight.com.

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About Dialight:

Dialight (LSE: DIA.L) is a global leader in sustainable LED lighting for industrial applications**.** Dialight's LED products are providing the next generation of lighting solutions that deliver reduced energy consumption and create a safer working environment. Our products are specifically designed to provide superior operational performance, reliability and durability, reducing energy consumption and ongoing maintenance and achieving a rapid return on investment.

The company is headquartered in the UK with operations in the USA, UK, Denmark, Germany, Malaysia, Singapore, Australia, Mexico, Dubai and Brazil. www.dialight.com.

Notes:

1. Defined as excluding non-underlying items of £0.4m (2017: £6.4m)
2. Constant currency impact is calculated by re-translating the prior year numbers at the exchange rate prevailing in the current year.
3. Cautionary Statement: This announcement contains certain statements, statistics and projections that are or may be forward-looking. The accuracy and completeness of all such statements, including, without limitation, statements regarding the future financial position, strategy, projected costs, plans and objectives for the management of future operations of Dialight Plc and its subsidiaries is not warranted or guaranteed. These statements typically contain words such as 'intends', 'expects', 'anticipated', 'estimates' and words of similar import. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. Although Dialight Plc believes that the expectations will prove to be correct. There are a number of factors, many of which are beyond the control of Dialight Plc, which could cause actual results and developments to differ materially from those expressed or implied by such forward-looking statements. This announcement contains inside information on Dialight Plc.

OVERVIEW

2018 was a challenging year for Dialight, but one in which made we made significant progress to address the operational issues we faced at the start of the year. The most critical issue facing us was the continued inability of our manufacturing partner to achieve adequate production output, resulting in late product deliveries and lost orders. The primary focus during the year was improving our service levels, and I am happy to say that at year-end all product assembly was back in-house and performing as expected. While there is still work to be done to completely disengage from our manufacturing partner and achieve targeted service levels, our fate is back in our own hands. Our markets remain strong and growing, the Dialight brand is well respected in the market, and we have developed a clear and comprehensive growth plan that is centred on bringing technical and product innovation to our customers in a regionally-focused way.

Early in the year, we took several targeted actions to improve our operational performance and, although these actions produced significant improvements, they were not adequate to restore our performance to acceptable levels. The main action taken was transitioning production of High Bay, our largest product line, back to our own facility, which resulted in a significant reduction in late orders on this line and service levels returning to normal levels.

In August 2018, having seen a further deterioration in the performance of our manufacturing partner and the success achieved in our own facilities, we terminated our contract on 27 September 2018. Given the extent of the transfer of our operations to our manufacturing partner (including facilities and equipment), it was impossible to take resolute actions as quickly as we would have liked and this process is ongoing.

We have made significant progress in upgrading, expanding and geographically diversifying our current operational footprint. The Lighting business has moved to a hybrid operations model with our own distribution centres. We have secured two new facilities in Tijuana, Mexico and Penang, Malaysia to provide sufficient capacity to meet our future growth aspirations. The Group's operational performance improved markedly in the final months of 2018, giving us growing confidence in our strategy.

While we have placed top priority on the operational challenges, we have also maintained a strong focus on product development and have started establishing regional development centres which will expand our capacity to develop new products appropriate for local markets. We have made significant progress in better understanding our core markets and looking at ways to expand our available market. We are planning to launch three major products in 2019 that will significantly expand the Group's served market. We have also made changes in the management team and structure in order to ensure that we have the necessary skills and experience to maximise the opportunities for the Group.

Business performance

The Group achieved revenues of £170m and underlying profit from operating activities of £8m for the year ended 31 December 2018. Our results were adversely affected by reduced production output from our former manufacturing partner, significant use of air freight to mitigate against late orders and dual running costs as we kept our own facility partially staffed prior to the transfer back to in house assembly. It is a testament to the strength of the Dialight products and the sales team that we achieved revenues marginally down on 2017 and overall statutory profit before tax has improved by 147%.

Dialight has built up strong sales capabilities across our three global regions. Lighting revenue excluding obstruction was 1% down compared to 2017 at constant currency. We saw the strongest growth in our APAC region which achieved 16% growth at constant currency. The European Lighting business was 4% up on the previous year at constant currency. Both regions operate with a narrow product range that is serviced largely from inventory, therefore were not as affected by the operational issues.

The US Lighting business has been the most impacted by the significant delivery issues and extended lead times, resulting in a decline in revenue of 5% at constant currency. The team had deferred bidding on certain large capital projects which have short lead times due to the extended delivery from our former manufacturing partner. The US also has 40% of its revenue from customers' maintenance budgets which are supplied from inventory at our distribution channels. The extended lead times have reduced inventory within the channel and hence impacted revenue. However, this team is extremely strong and with the operational issues easing were able to achieve good recovery in the fourth quarter of the year.

Our Obstruction business consists of lighting and safety systems for the wind market in EMEA and cell phone towers in the US. There has been a decline of 32% at constant currency across these businesses as some larger customers have deferred their capital projects. We aborted the transfer of obstruction products to our manufacturing partner just before the planned transfer date, and our on-time deliveries suffered as a result of a depleted supply chain. There has also been insufficient investment made in updating these product lines in prior years. We will be focused on rejuvenating this business during 2019.

The recent challenges in our Lighting business have overshadowed our other business – Signals & Components. This business continues to perform well, with 3% revenue growth (6% at constant currency) and 15% EBIT growth (23% at constant currency) in 2018. This is a more mature market than our industrial lighting business, but the strong leadership team in Signals & Components has proven that there are growth opportunities even in mature markets and that diligent efforts in manufacturing and sourcing can lead to solid margins. We will continue to explore ways to incrementally grow this business.

Operations

In September 2018 we terminated our agreement with our manufacturing partner to retake control of our manufacturing operations. By year-end, we had moved all final assembly back in-house. We are in the process of moving our equipment for machining and coating housings that currently resides in the facility of our former manufacturing partner back to our own facilities. By the end of the first half of 2019 we will have completely exited our outsourcing agreement. The separation process from our manufacturing partner has been relatively smooth to date. We continue to negotiate our final exit, including remaining working capital balances.

There are three main actions being undertaken to further improve our operations base. First, we are continuing our move to a regional operations model. In Mexico, we have secured a new facility in Tijuana which is easily accessible from our current facility in Ensenada and close to the US commercial port of entry in Tijuana. This new building will house the CNC machines and paint line, owned by Dialight, which will be moved from our former manufacturing partner in the first half of 2019. In Malaysia, we are in the process of relocating the operations in our current facility in Penang to a new and larger nearby facility by the end of Q2 2019. This new facility will house our Signals and Components operations, lighting assembly, and subassembly manufacturing operations. We have not finalised a location for our EMEA operations facility but expect to secure a facility in Eastern Europe in the second half of 2019 that will be operational in 2020.

Second, we are establishing distribution centres within our assembly plants so that we can provide rapid collection, packaging and shipping of a diverse set of lights for a single order, allowing us to "ship in full" in the shortest possible time. This will ensure we have market leading customer response time.

Third, we are maturing the hybrid model, whereby we use a local supply base to produce the majority of our sub-assemblies but establish and retain internal capacity and capability ensuring we have the best possible mix of speed of response, fixed capital investment, and working capital usage.

As we returned production back to our own facility our on-time delivery improved compared to the normal level of service we would have experienced in the past. Our aim is to set a new standard rather than just return to the levels prior to outsourcing our manufacturing. Our target is to have greater than 95% on-time delivery in full, everywhere we compete. Our on-time-delivery as we exited 2018 was 70%. This was impacted by the late orders that were transferred from our former manufacturing partner. The significant change in our ability to service our customers has been in faster turnaround of orders. In Q4 we were able to deliver orders with a 3-4 week lead time as opposed to our former manufacturing partner's average lead time of 12-18 weeks.

Strategy

An enormous amount of energy and resources have been consumed in the ultimately unsuccessful efforts to improve the performance of our manufacturing partner. Most functions in the company were affected. Not only were the financial results impacted, but the growth of Dialight was stunted. Following the extended period of poor operational performance, we need to prioritise repairing the impact on our relationships with both our customers and channel partners.

We believe that simply getting things back to where they were is not good enough. Our reputation has been diminished in the market, we have allowed competitors to sell into applications that have traditionally been Dialight product users and the market has simply moved ahead by two years in terms of LED acceptance and product sophistication.

We need to not only continue to provide the best products in our current niche, but to also offer a wider product range so that we become more relevant to our customers and channel partners. Dialight pioneered the use of LED technology in the heavy industrial space, and was very successful in convincing "early adopters" to make the leap to LED to reap the advantages of energy efficiency, significantly reduced maintenance cost, and less frequent replacement and cost in doing so. This led to a high market share first in the US then Australia, but market share growth elsewhere has been difficult to achieve given the operational challenges and the fact that the products had been designed primarily to serve US market preferences.

The current product portfolio is serving an approximately £500m served market size, but we must enter a larger market space to provide adequate room to grow. The Dialight product range is well respected in the market, and there are many applications where customers would prefer the Dialight efficiency, product longevity, and toughness but just can't afford to pay the price for our current products. We have been selectively using price reduction and feature removal to extend our served market, but there are limits to this strategy as broadly discounting prices of a premium product risks devaluing the product position.

We completed a comprehensive market analysis during 2018 in which we studied the broader industrial lighting market. In facilities where Dialight's current products are being used there are a wide range of other lights with varying degrees of environmental protection and "toughness" requirements. We believe that there is a significantly larger opportunity for Dialight in applications where the customer would prefer to use a light of Dialight's quality but can't afford to pay for a traditional higher specification Dialight product, designed for use in more challenging applications. If we specifically design products to suit these "tough but not quite as tough as our current products" applications, there is a significantly expanded market of about four times the size of our current market, at c.£2bn per annum. We can offer these products to our current customers in the same facilities where we are already selling our existing lights, through the same sales channels. Importantly, from our analysis we believe we will be able to drive similar gross margins from these new, lower functionality products.

As part of our market analysis, we also found that the products used for similar applications differed to a more significant extent across the geographic regions. We have concluded that we can grow market share of our existing products and expand our product range, by offering products that are specifically designed to meet regional and local preferences for shape, performance, installation method and price. We believe that the opportunity to expand our served market is significant in all regions if we pursue this strategy.

In order to provide regionalised products and access an expanded market, we need to develop a significantly larger number of products quicker than we have done in the past. We are doing this by improving our internal new product development processes to be faster and more efficient, by establishing product development centres in the UK and Malaysia, and by using outside design firms to help with some aspects of the product development process.

Achieving these growth and transformational plans requires different skills and experiences and we have recruited to make significant changes to the skill sets within the Group. In operations, we have a number of new managers who come with broad experience in larger global companies in areas including manufacturing, supply chain management, trade compliance and logistics. Our operations team is fully in place and is working to help us deliver the outstanding customer service experience and cost structure that we need for the future. We have recruited new senior leaders in Engineering and Product Management. They have experience in managing larger and more complex global networks of product lines and design centers feeding multiple manufacturing plants. We have restructured to provide the focus in our Technology organisation to maintain and grow our leading technology position and deliver the strategy described here.

None of these actions will have an immediate effect on our financial performance, but we are now on the path that will lead to a larger, faster, and more regionally responsive and balanced company. The first three of our large new product lines designed to allow us to serve a wider market will be launched in the year, and we also have updates and upgrades of our existing products planned, so 2019 promises to be an exciting year.

Dialight has been through a very challenging period – with an extended inability to deliver products on time when the market is growing and customers want our products. We have strained relationships – with our customers, our channel partners, our employees, and our shareholders. I am confident that the plan that we are now executing will result in a full recovery and will regain confidence in Dialight.

Business fundamentals

Despite the short-term challenges, we must not forget that Dialight remains well positioned in a growing market in which we are the market leader in terms of our technology.

Customers convert to LED lighting and buy Dialight's products because doing so remains the most efficient way to drive down energy usage and total cost of ownership of their lighting. We are delivering the next generation of lighting solutions that not only reduce energy consumption further but create a safer working environment. Our products are specifically designed to provide superior operational performance, reliability and durability, reducing energy consumption and ongoing maintenance and delivering attractive return on investment to our customers. Our market proposition is compelling, with the sustainability benefits of reduced energy usage, lower carbon emissions, reduced maintenance and improved safety offering real value to our customers.

Driving awareness of the economic benefits as well as the sustainability and safety benefits of our lighting at the corporate level can change the perception of our lighting away from just maintenance cost savings.

In addition, Dialight products are being built with upgradeable and integrated controls. Our customers can optimise their lighting solution through direct lighting controls. The value for customers is that they will be able to take advantage of their built-in network of intelligent lighting to provide access to a wide array of sensors and applications in safety and productivity.

The industrial LED opportunity remains largely untapped, as the conservative customer base has sought low-risk, proven solutions. Dialight's 10 years plus of experience has earned a predominant position and we have an installed product base of over one million products. With the aim of improving our quality of earnings we have demonstrated our ability to sell across many industrial sectors and reduce our reliance on oil and gas markets. This initiative has continued despite the operational challenges that we have faced.

Full year guidance for 2019

We expect some gross margin recovery as we return to more normal levels of service. We expect our capital expenditure to be in the region of £8-10m for 2019 together with £8-9m of capitalised development costs.

Outlook

2018 was a challenging year for Dialight but one in which we made considerable progress to address the operational issues we faced at the start of the year, reducing late orders significantly during the year. This improvement is primarily due to moving manufacturing under our hybrid model back in-house and terminating the relationship with our manufacturing partner. Further improvement in our operations remains a priority for us.

With a strong focus on product development and expansion of the available market, we have laid the foundations to drive growth and restore market share. We are planning to launch three major products in 2019 that will significantly expand the Group's served market. We have two new facilities, in Mexico and Malaysia, to provide us with sufficient capacity to meet our growth aspirations.

Our market proposition remains compelling, with the sustainability benefits of reduced energy usage, lower carbon emissions, reduced maintenance and improved safety offering real value to our customers. We remain excited by the Group's prospects over the medium to long term and are confident of delivering future growth. The Board's expectations of further progress in 2019 remain unchanged, again with a second half weighting.

FINANCIAL REVIEW

The Group has had a challenging year as a result of operational issues that came to the forefront in 2017. The Group decided to outsource production of all lighting products in 2016, however our manufacturing partner was unable to ramp up production from the inception of the contract. We dedicated significant internal resources to support the transition including having a team permanently based at our contract manufacturer. In the first half of 2018 we removed our largest product line, High Bay, moving final assembly back to our plant in Ensenada. These actions resulted in some short-term improvements but were not adequate to restore our performance to acceptable levels.

In August 2018, we saw a further deterioration in the performance of our manufacturing partner and this led us to terminate the contract on 27 September 2018. The timing of the termination was challenging during our busiest period of the year, as traditionally the lighting industry is heavily Q4 weighted. However, we believe that having control of our operations and expanding our current operational footprint will help us recover faster.

All final assembly of our lighting products was in house at the end of the year. Our former manufacturing partner is still producing some sub-assemblies but with our new alternate suppliers ramped up, this will also be removed by the end of H1 2019. We have a number of CNC machines and a paint line based at our former manufacturing partner which are also in the process of being removed and re-housed in our new facility in Tijuana, Mexico.

The operational issues affected the Group results in two ways. Firstly, the extended lead times impacted our Group revenue and secondly there were a number of additional costs that impacted our profitability.

Group revenue was 6% behind 2017 at £169.6m and on a constant currency basis was 3% lower than 2017. The revenue was impacted due to the operational issues within the Lighting segment.

We had a number of additional costs which adversely affected our performance, reducing gross margin by 130 bps compared to 2017. The reduced production output from our former manufacturing partner resulted in significant use of air freight to mitigate against late orders and dual running costs as we kept our own facility staffed prior to the transfer back to in house assembly. These costs have not been reported separately as non-underlying items. Overall revenues were only marginally down on 2017 and underlying EBIT was 18% lower than 2017 due to the margin reduction.

During this period, we have had strong cost control discipline and have seen our operating costs (excluding non-underlying) reduce from £57.0m in 2017 to £52.3m in 2018.

The reduction in the Group's underlying EBIT of £1.7m includes the impact of £0.7m of foreign exchange. The key drivers for the reduction in the EBIT on a constant currency basis were as follows:

- (£2.0m) gross margin impact of the revenue reduction;
- (£2.1m) reduction in gross margin due to dual running costs incurred for maintaining the Ensenada plant, additional freight charges, partly offset by improved inventory management; and
- £3.1m operational savings.

The costs associated with the transfer back to our own facilities which consisted of dual running costs and the internal resources dedicated to the transfer have not been treated as a non-underlying item in 2018. In 2017 there was £6.4m of non-underlying costs of which £4.6m related to the transfer to our former manufacturing partner. Therefore, the results for 2018 at a statutory profit before tax level have increased by 147%, £7.4m for 2018 compared to £3.0m in 2017.

Currency impact

Dialight reports its results in Sterling. Our major trading currency is the US Dollar, which in 2018 comprised 80% of the Group's revenue. The Group has both translational and transactional currency exposure. Translational exposures arise on the consolidation of overseas results into Sterling and this is the major currency exposure. Transactional exposure is where the currency of sales or purchases differ from the local functional currency. We use natural hedging on revenue and purchases to mitigate the majority of the currency risk.

The average rate for the US Dollar against Sterling weakened by 3% compared to the prior year, with the rate moving from 1.29 in 2017 to 1.33 in 2018. Based on the current mix of currencies, a 1% movement of the US Dollar relative to Sterling changes revenue by £1.4m and EBIT by £0.1m.

Lighting segment

Lighting	2018 Unaudited £m	2017 Audited £m	Variance
Revenue	**125.0**	137.5	(9%)
Gross profit	**47.1**	54.3	(13%)
Gross profit %	**38%**	40%	(190 bps)
Overheads	**(38.6)**	(43.1)	11%
Underlying EBIT	**8.5**	11.2	(24%)

The Lighting segment represented 74% of the Group's revenue and 65% of the Group's underlying segmental operating profit. Revenues were 9% lower (6% lower at constant currency) compared with the prior year. The production delays adversely impacted the US region which was 5% below 2017 offset by growth in EMEA and APAC. The Obstruction business although not significantly impacted by the operational issues, had revenues 32% (at constant currency) below 2017. There has been a decline in this business as some larger customers have deferred their capital projects. There has also been insufficient investment made in updating these product lines in prior years which has resulted in loss of market share. These issues are being addressed in 2019 with the product portfolio getting a full refresh.

Our order intake, i.e. the value of orders received in the year, was also adversely impacted with a year on year decline of 10% at constant currency. APAC Lighting business delivered order growth of 21% (at constant currency). The US lighting orders were significantly impacted due to the operational issues resulting in a decline of 14% (at constant currency). The EMEA Lighting business is project driven with little revenue attained from stocking distributors. We had some large capital projects in the first half however, due to supply constraints we were unable to bid for many projects in the second half resulting in a 15% decline (at constant currency) compared to 2017. The order intake for the Obstruction business was 31% down (at constant currency) compared to the previous year.

Gross margin contracted by 190 bps to 37.6%. The effects of our operational issues were evident in 2017 which had £2.4m of additional freight costs. The incremental costs over 2016 are:

- (110 bps) reduction due to raw materials markup charged by our former manufacturing partner with no offsetting savings achieved in the period;
- (20 bps) reduction due to continued use of air freight to mitigate the extended lead times;
- (150 bps) reduction due to retaining our skilled production labour force during the transition from our former manufacturing partner: offset by

- 90 bps increase due to elimination of dual plant running costs as we transferred to our facility in Ensenada

As the volume of in-house production increases and service levels return to a more normal level, the negative impact of these additional costs will be mitigated.

Underlying operating costs reduced by £4.7m compared to last year. This was due to sales related costs flexing with the lower revenues and strict cost control procedures.

The result of lower revenues and contraction in gross margin, partially offset by lower costs, was that the overall underlying operating profit in the Lighting segment reduced by 24% to £8.5m (21% at constant currency).

Signals and components

Signals and Components	2018 Unaudited £m	2017 Audited £m	Variance
Revenue	**44.6**	43.5	3%
Gross profit	**13.2**	12.4	6%
Gross profit %	**30%**	29%	100 bps
Overheads	**(8.7)**	(8.5)	(2%)
Underlying EBIT	**4.5**	3.9	15%

Signals and Components is a high-volume business operating within highly competitive markets. This business continues to perform, with 3% revenue growth (6% at constant currency) and 15% EBIT growth (23% at constant currency) in 2018. There remains significant competition from low cost producers but margins have been maintained through diligent efforts in manufacturing and sourcing which mitigated any price erosion. Overall there was an increase in underlying operating profit of £0.6m.

Central overheads

Central overheads comprise of costs not directly attributable to a segment and therefore not allocated to these segments. In 2018 they amounted to £5.0m marginally lower than £5.4m in 2017.

Non-underlying costs

The Group incurs costs and earns income that is non-recurring in nature or that is otherwise considered to not be reflective of the underlying performance of the business. In the assessment of performance of the Group in prior periods, management examined underlying performance, which removed the impact of non-underlying costs and income. The table below presents the components of non-underlying profit or loss recorded within cost of sales and administrative expenses:

Non-underlying costs	2018 Unaudited £m	2017 Audited £m
Pension liability for GMP equalisation	(0.4)	-
Employee severance and restructuring costs	-	0.3
Intangible asset impairment	-	(1.2)
Tangible asset impairment and disposals	-	(0.9)
Production transfer costs	-	(4.6)
Non-underlying costs recorded in administrative expenses and cost of sales	(0.4)	(6.4)

The charge related to Guaranteed Minimum Pension (GMP) equalization have been included as a one-off charge in the year.

In the prior year, non-underlying costs related to the transfer of lighting assembly to our former manufacturing partner. The costs were for set up costs, project management and dedicated engineering time. There are no further transfer costs being incurred, all accrued redundancy costs have been utilised in the period against terminations related to the project.

Pension costs

The company has two defined benefit pension schemes which are closed to new entrants. The valuation of the schemes has reduced by £0.6m in the year and the surplus in the balance sheet at 31 December 2018 is £0.4m. The surplus has reduced due to changes in the discount rate and the impact of adding an additional liability of £0.4m for Guaranteed Minimum Pension, which is 1.8% of scheme liabilities. This has been included within the Consolidated Statement of Comprehensive Income. This has had no impact on the scheme funding in the current year as the next triennial funding valuation is in 2020.

Tax

The effective tax rate for the year is 28.4% compared with 43.3% in the prior year. Non-underlying items in the current year have very little impact on the tax rate, whereas, in the prior year, the tax rate on the underlying business was 37.2%. The reduction in tax rates in the US has helped to reduce the overall tax rate in the current year. However, the overall tax rate is higher than the US rate of 21% as the mix of profits in the year is weighted more towards higher tax rate jurisdictions compared to the US.

Inventory

	2018 Unaudited £'m	2017 Audited £'m
Raw materials and work in progress	**28.6**	17.8
Finished goods	**17.4**	6.8
	46.0	24.6

Total inventory increased by £21.4m as a result of the termination of our outsourced manufacturing agreement. We build up raw materials and finished goods in advance of the transfer back to our own facilities. During the year, inventory write backs totaled £2.3m (2017: write down £1.4m). The write backs are included in the income statement and relate to aged inventory fully reserved in the prior year which has now been sold.

Cash flow

The Group's net cash position decreased by £15.7m in the year from net cash of £12.8m at 31 December 2017 to net debt of £2.9m at 31 December 2018.

The roll forward of net cash was as follows:

Cash flow	£m
Net cash at 31 December 2017	12.8
EBITDA	12.6
Net working capital excluding inventory	0.6
Increase in inventory	(19.6)
Capital expenditure	(6.4)
Taxes	(2.1)
Provisions and other movements	(0.8)
Net debt at 31 December 2018	**(2.9)**

The main driver in the reduction in cash is an increase in inventories. As previously announced, we expected the cash position to reduce as we built up raw material inventory prior to the transfer. The termination of our manufacturing partner contract resulted in all final assembly being transferred prior to the year end. We also purchased a significant amount of our manufacturing partner's excess inventory which will be utilised during 2019. There was an improvement in debtors due to strong cash collection across the Group. The cash generated from earnings in the year was utilised to fund capital expenditure relating to some production and testing equipment required for our own plant in Mexico.

Banking

The Group has its banking relationships with HSBC Bank plc and Wells Fargo. The Group has a revolving credit facility with HSBC of £25m, with a further £25m "accordion" feature, and a five-year term. The Group had net debt of £2.9m at the balance sheet date and remains fully compliant with its covenant requirements. There is sufficient headroom within the facility which ensures significant financial flexibility.

Capital management and dividend

The Board's policy is to maintain a strong capital base in order to maintain customer, investor and creditor confidence and to sustain future development of the business. The Board considers consolidated total equity as capital. At 31 December 2018 this equated to £85.1m (2017: £76.1m).

The Board is not proposing any final dividend payment for 2018 (2017: nil). The Group has a clear capital allocation discipline and is committed to returning excess funds to shareholders via future dividend or share repurchase.

Marty Rapp, Group Chief Executive
Fariyal Khanbabi, Group Finance Director
24 February 2019

CONDENSED CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2018

		Twelve months ended 31 December 2018 (Unaudited)			Twelve months ended 31 December 2017 (Audited)		
		Underlying	Non-underlying	Total	Underlying	Non-underlying	Total
	Note	£'m	£'m	£'m	£'m	£'m	£'m
Revenue	2	**169.6**	**-**	**169.6**	181.0	-	181.0
Cost of sales		**(109.3)**	**-**	**(109.3)**	(114.3)	-	(114.3)
Gross profit		**60.3**	**-**	**60.3**	66.7	-	66.7
Distribution costs		**(30.4)**	**-**	**(30.4)**	(34.0)	-	(34.0)
Administrative expenses		**(21.9)**	**(0.4)**	**(22.3)**	(23.0)	(6.4)	(29.4)
Profit from operating activities	2	**8.0**	**(0.4)**	**7.6**	9.7	(6.4)	3.3
Financial income	4	**-**	**-**	**-**	-	-	-
Financial expense	4	**(0.2)**	**-**	**(0.2)**	(0.3)	-	(0.3)
Net financing expense	4	**(0.2)**	**-**	**(0.2)**	(0.3)	-	(0.3)
Profit before tax		**7.8**	**(0.4)**	**7.4**	9.4	(6.4)	3.0
Income tax expense	5	**(2.2)**	**0.1**	**(2.1)**	(3.5)	2.2	(1.3)
Profit for the period		**5.6**	**(0.3)**	**5.3**	5.9	(4.2)	1.7
Profit for the period attributable to:							
Equity owners of the Company				**5.2**			1.3
Non-controlling Interests				**0.1**			0.4
Profit for the period				**5.3**			1.7
Earnings per share							
Basic	6			**16.4p**			4.8p
Diluted	6			**16.1p**			4.8p

The accompanying Notes are extracted from the financial statements.

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2018

	2018 Unaudited £'m	2017 Audited £'m
Other comprehensive income		
Items that may be reclassified subsequently to profit and loss		
Exchange differences on translation of foreign operations	**4.2**	(5.6)
Income tax on exchange difference on translation of foreign operations	**(0.3)**	0.6
	3.9	(5.0)
Items that will not be reclassified subsequently to profit and loss		
Remeasurement of defined benefit pension liability	**(0.6)**	1.9
Income tax on remeasurement of defined benefit pension liability	**0.1**	(0.4)
	(0.5)	1.5
Other comprehensive income for the year, net of tax	**3.4**	(3.5)
Profit for the year	**5.3**	1.7
Total comprehensive income/(expense) for the period	**8.7**	(1.8)
Attributable to:		
- Owners of the parent	**8.6**	(2.2)
- Non-controlling interest	**0.1**	0.4
Total comprehensive income for the period	**8.7**	(1.8)

The accompanying Notes are extracted from the financial statements.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2018 (Unaudited)

	Share capital £'m	Merger reserve £'m	Translation reserve £'m	Capital redemption reserve £'m	Retained earnings £'m	Total £'m	Non-controlling interests £'m	Total Equity £'m
Balance at 1 January 2018	0.6	1.4	10.4	2.2	61.2	**75.8**	0.3	**76.1**
Profit for the year	-	-	-	-	5.2	**5.2**	0.1	**5.3**
Other comprehensive income:								
Foreign currency translation differences, net of taxes	-	-	3.9	-	-	**3.9**	-	**3.9**
Remeasurement of defined benefit liability, net of taxes	-	-	-	-	(0.5)	**(0.5)**	-	**(0.5)**
Total other comprehensive income	-	-	3.9	-	(0.5)	**3.4**	-	**3.4**
Total comprehensive income for the period	-	-	3.9	-	4.7	**8.6**	0.1	**8.7**
Transactions with owners, recorded directly in equity:								
Share–based payments, net of tax	-	-	-	-	0.3	**0.3**	-	**0.3**
Total contributions by and distributions to owners	-	-	-	-	0.3	**0.3**	-	**0.3**
Balance at 31 December 2018	0.6	1.4	14.3	2.2	66.2	**84.7**	0.4	**85.1**

	Share capital £'m	Merger reserve £'m	Translation reserve £'m	Capital redemption reserve £'m	Retained earnings £'m	Total £'m	Non-controlling interests £'m	Total Equity £'m
Balance at 1 January 2017	0.6	1.4	15.4	2.2	57.6	**77.2**	(0.1)	**77.1**
Profit for the year	-	-	-	-	1.3	**1.3**	0.4	**1.7**
Other comprehensive income:								
Foreign currency translation differences, net of taxes	-	-	(5.0)	-	-	**(5.0)**	-	**(5.0)**
Remeasurement of defined benefit liability, net of taxes	-	-	-	-	1.5	**1.5**	-	**1.5**
Total comprehensive (expense)/income for the period	-	-	(5.0)	-	2.8	**(2.2)**	0.4	**(1.8)**
Transactions with owners, recorded directly in equity:								
Share–based payments, net of tax	-	-	-	-	0.8	**0.8**	-	**0.8**
Total contributions by and distributions to owners	-	-	-	-	0.8	**0.8**	-	**0.8**
Balance at 31 December 2017	0.6	1.4	10.4	2.2	61.2	**75.8**	0.3	**76.1**

CONDENSED CONSOLIDATED STATEMENT OF TOTAL FINANCIAL POSITION

As at 31 December 2018

	2018 Unaudited £'m	2017 Audited £'m
Assets		
Property, plant and equipment	**14.7**	13.9
Intangible assets	**16.5**	13.9
Deferred tax asset	**5.3**	5.3
Employee Benefits	**0.4**	1.0
Other Receivables	**0.2**	0.2
Total non-current assets	**37.1**	34.3
Inventories	**46.0**	24.6
Trade and other receivables	**36.8**	33.6
Income tax recoverable	**1.2**	0.7
Cash and cash equivalents	**2.2**	12.8
Total current assets	**86.2**	71.7
Total assets	**123.3**	106.0
Liabilities		
Trade and other payables	**(30.0)**	(26.9)
Provisions	**(1.0)**	(1.4)
Tax liabilities	**(1.6)**	(0.7)
Borrowings	**(5.1)**	-
Total current liabilities	**(37.7)**	(29.0)
Employee benefits	**-**	-
Provisions	**(0.5)**	(0.9)
Total non-current liabilities	**(0.5)**	(0.9)
Total liabilities	**(38.2)**	(29.9)
Net assets	**85.1**	76.1
Equity		
Issued share capital	**0.6**	0.6
Merger reserve	**1.4**	1.4
Other reserves	**16.5**	12.6
Retained earnings	**66.2**	61.2
	84.7	75.8
Non-controlling interests	**0.4**	0.3
Total equity	**85.1**	76.1

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2018

	2018 Unaudited £'m	2017 Audited £'m
Operating activities		
Profit for the period	**5.3**	1.7
Adjustments for:		
Financial expense	**0.2**	0.3
Income tax expense	**2.1**	1.3
Share–based payments	**0.3**	0.8
Depreciation of property, plant and equipment	**3.1**	2.4
Amortisation of intangible assets	**1.5**	1.5
Pension charge for GMP equalisation	**0.4**	-
Impairment losses on intangible assets and goodwill	**-**	1.2
Impairment losses on tangible assets	**-**	0.9
Operating cash flow before movements in working capital	**12.9**	10.1
(Increase)/decrease in inventories	**(19.6)**	5.1
(Increase)decrease in trade and other receivables	**(1.2)**	3.4
Increase/(decrease) in trade and other payables	**1.8**	(2.6)
Decrease in provisions	**(0.8)**	(2.4)
Pension contributions in excess of the income statement charge	**(0.5)**	(0.5)
Cash generated (used in)/ from operations	**(7.4)**	13.1
Income taxes paid	**(1.7)**	(4.3)
Interest paid	**(0.2)**	(0.3)
Net cash (used in). from operating activities	**(9.3)**	8.5
Capital expenditure	**(3.1)**	(2.6)
Sale of fixed assets	**-**	2.0
Capitalised expenditure on development	**(3.3)**	(2.3)
Net cash used in investing activities	**(6.4)**	(2.9)
Financing activities		
Proceeds from issue of shares	**-**	0.1
Drawdown of bank facility	**5.1**	-
Net cash from financing activities	**5.1**	0.1
Net (decrease)/increase in cash and cash equivalents	**(10.6)**	5.7
Cash and cash equivalents at 1 January	**12.8**	8.0
Effect of exchange rates on cash held	**-**	(0.9)
Cash and cash equivalents at end of period	**2.2**	12.8

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2018 (Unaudited)

1. Basis of preparation and principal accounting policies

Statement of compliance

The financial statements have been prepared on the historical cost basis except for certain financial instruments which are carried at fair value.

The Directors have reviewed short-term and medium-term strategic forecasts including consideration of the principal risks faced by the Group, as detailed on page 28. Following this review, the Directors have a reasonable expectation that the Company has sufficient resources to continue to operate and meet their liabilities as they fall due for a period no shorter than 12 months from the date of this report. Thus, they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

The financial information set out above, which is unaudited for the year ended 31 December 2018, does not constitute the company's statutory accounts for the years ended 31 December 2018 or 2017. The financial information for 2017 is derived from the statutory accounts for 2017 which have been delivered to the registrar of companies. The auditor has reported on the 2017 accounts; their report (i) was unqualified, (ii) did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under section 498 (2) or (3) of the Companies Act 2006.

The financial information set out above for the year ended 31 December 2018 is unaudited. However, consistent with the report of the auditor on the 2017 accounts, it is expected that the report on the 2018 accounts will: (i) be unqualified (ii) not include a reference to any matters to which the auditor will draw attention by way of emphasis without qualifying their report and (iii) not contain a statement under section 498 (2) or (3) of the Companies Act 2006.

The audited financial statements for the year ended 31 December 2018 will be posted to shareholders in due course and the statutory accounts for 2018 will be finalised on the basis of the financial information presented by the directors in this preliminary announcement and will be delivered to the registrar of companies after its annual general meeting.

The financial information contained in this preliminary announcement was approved by the directors on 24 February 2019 and has been agreed with the company's auditors for release.

The financial information set out above does not constitute the company's statutory accounts for the years ended 31 December 2018 or 2017 but is derived from those accounts. Statutory accounts for 2017 have been delivered to the registrar of companies, and those for 2018 will be delivered in due course. The auditor has reported on those accounts; their reports were (i) unqualified, (ii) did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under section 498 (2) or (3) of the Companies Act 2006.

Use of estimates, judgements and assumptions

In the process of applying the Group’s accounting policies, management has made a number of judgements. The process of preparing the Group’s financial statements inevitably requires the Group to make estimates and assumptions concerning the future and the resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and judgements that have the most significant effect on the amounts included in these consolidated financial statements are as follows:

1. Basis of preparation and principal accounting policies (continued)

Significant judgements

Inventory

The valuation of inventory requires the use of judgement both in the identification of directly attributable costs, to be absorbed into inventory valuation, and the level of normal production over which these costs are absorbed. The estimation of normal production considers current year actual and prior periods actual production when concluding on the appropriate level over which to absorb production costs. Similarly, judgement is used in determining which costs are considered to be directly attributable to the production of inventory based on inventory turns. Management use their detailed experience in this process in forming their view on the adjustment required to record inventory at cost. The value of directly attributable costs over which judgement was exercised was £6.4m, which represents 13% of inventory.

Development and patent costs

The Group capitalises development costs and patent costs provided they meet all criteria set out in the respective accounting policy. Costs are only capitalised where management are satisfied as to the ultimate commercial viability of the projects concerned based on available information. The capitalised costs are amortised over the useful economic life, which is determined based on the reasonable commercial prospects for the resultant product. The Group has £6.5m of development costs that relate to the current product portfolio and new product expected to launch in 2019. Management have reviewed all of these for impairment by using our market intelligence and are satisfied that there is no evidence of impairment.

Deferred Tax

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which temporary differences can be utilised. The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the assets to be recovered. There are £4.9m of deferred tax assets relating to losses in Dialight Europe Ltd and Dialight GmBh. We expect to recover this over 5 years as we use these entities to expand our European market. Recovery is based on the 3-year board approved strategy extrapolated for years 4 and 5 based on no growth.

Significant estimates

Manufacturing partner

The decision to terminate the agreement with our manufacturing partner during the year requires the Group to consider all estimates regarding potential liabilities at the balance sheet date. Management have assessed the risks and have concluded that only a low level risk of liability exists, and no provision has been made for this.

Inventory provision

The Group operates in an environment of technological change, presenting the risk of obsolete inventory. Inventory is reviewed by operational and financial management on a regular basis, product by product, and the level of provision required is assessed against historical and forecast use for that product. The impact of the significant increase in inventory value year on year was assessed for any potential obsolescence. The inventory ageing profile shows that a significant amount of this inventory was built up in the second half of the year and consequently no additional provision for inventory was required. The inventory provision at the balance sheet date was £4.7m, which represents 10% of inventory (2017: £7.3m, 30% of inventory).

1. Basis of preparation and principal accounting policies (continued)

Warranty

The Group offers performance warranties on many of its products which apply over a period of 5 to 10 years. Products with a 10-year warranty were introduced from 2014 onwards. A provision is made for the expected costs of future warranty claims relating to past product sales. This provision is estimated based on historical trends for returns, product specific warranty term, internal knowledge of product performance characteristics and the expected costs of remedying warranty-returned products. Actual returns may be materially higher or lower than these estimates, which may have a material impact on the adequacy of the provision for warranty claims. The warranty provision at the balance sheet date was £1.5m. A 10% increase in the warranty provision would result in an increase of £ 0.2.m.

Changes in accounting policies

The Group has consistently applied the accounting policies set out in this note to all periods presented in these consolidated financial statements. The Group has adopted a number of standards and amendments to standards, including any consequential amendments to other standards, with a date of initial application of 1 January 2018. There was no material impact on the financial performance of the Group.

Adoption of new and revised standards

A number of new standards, amendments to standards and interpretations, including IFRS 9 Financial instruments, IFRS 15 Revenue from Contracts with Customers (effective for annual periods beginning after 1 January 2018) have been adopted in these financial statements.

IFRS 16 Leases (effective for annual periods beginning after 1 January 2019) has not been applied in preparing these consolidated financial statements. IFRS 16 – Leases: the standard is effective for accounting periods beginning on or after 1 January 2019 and will be adopted by the Group on 1 January 2019. The Directors are assessing the likely impact on the reported results and financial position of the Group. The existing obligations under operating lease agreements at 31 December 2018 are £7.7m, which primarily relate to buildings. We are using the modified retrospective approach for transition on 1 January 2019 and we are taking advantage of the exemption on transition relating to low value assets. We have not yet concluded on the value of the expected adjustment to the balance sheet for leases capitalised and the corresponding lease liability. Similarly, the expected impact on the income statement for the year ending 31 December 2019 has not been concluded.

IFRS 15 Revenue from Contracts with Customers (effective for the year beginning 1 January 2018), and subsequent amendments 'Clarifications to IFRS 15' set out the requirements for recognising revenue and costs from contracts with customers. IFRS 15 provides a single source of accounting requirements for all contracts with customers, thereby replacing all current accounting pronouncements on revenue.

Under IFRS 15, revenue is recognised in a manner that depicts the completion of performance obligations to customers in an amount that reflects the consideration to which the provider of the goods or services expects to be entitled. The Group has identified the applicable performance obligations and the primary obligation is the supply of lighting fixtures with some lesser obligations related to revenue rebates. Revenue continues to be recognised based on Incoterms, normally on dispatch. Warranty is not a separate obligation and therefore does not impact the timing of revenue recognition. All credits to customers under rebate programs continue to be accounted for as reductions to revenue. Consequently, the recognition requirements of IFRS 15 did not have any impact on the timing and amount of revenue recorded in the Financial Statements.

IFRS 9 – 'Financial instruments' replaces IAS 39 (Financial instruments– Recognition and measurement) and addresses the classification and measurement of financial instruments, introduces new principles for hedge accounting and a new forward-looking impairment model for financial assets. The primary impact of IFRS 9 on the Group relates to provisioning for potential future credit losses on financial assets.

1. Basis of preparation and principal accounting policies (continued)

The adoption of IFRS 9 hedge accounting principles did not result in a restatement of the group's results and the impact on the year ended 31 December 2018 is not material. The adoption of IFRS 9 did not result in any changes in the measurement or classification of financial instruments as at 1 January 2018. All classes of financial assets and financial liabilities at 1 January 2018 had the same carrying values under IFRS 9 as they had under IAS 39.

There is no material impact on the Financial Statements of adopting IFRS 9.

2. Operating segments

The Group comprises two reportable operating segments. These segments have been identified based on the internal information that is supplied regularly to the Group's chief operating decision maker for the purposes of assessing performance and allocating resources. The chief operating decision maker is considered to be the Group's Chief Executive Officer.

The two reportable operating segments are:

- Lighting, which develops, manufactures and supplies highly efficient LED lighting solutions for hazardous and industrial applications in which lighting performance is critical and includes anti-collision obstruction lighting; and
- Signals and Components, which develops, manufactures and supplies status indication components for electronics OEMs, together with niche industrial and automotive electronic components and highly efficient LED signaling solutions for the traffic and signals markets.

There is no inter-segment revenue and no individual customers that represent more than 10% of revenue.

All revenue relates to the sale of goods. Segment gross profit is revenue less the costs of materials, labour, production and freight that are directly attributable to a segment. Overheads comprise operations management, selling costs plus corporate costs, which include share-based payments.

Reporting segments

2018 (Unaudited)	Lighting £'m	Signals and Components £'m	Total £'m
Revenue	125.0	44.6	169.6
Gross Profit	47.1	13.2	60.3
Overhead costs	(38.6)	(8.7)	(47.3)
Segment operating profit	8.5	4.5	13.0
Unallocated expenses			(5.0)
Underlying operating profit			8.0
Non-underlying expenses			(0.4)
Operating profit			7.6
Net financing expense			(0.2)
Profit before tax			7.4
Income tax expense			(2.1)
Profit after tax			5.3
Other segmental data			
Depreciation	2.3	0.8	3.1
Amortisation	1.1	0.4	1.5

2. Operating segments (continued)

2017 (Audited)	Lighting £'m	Signals and Components £'m	Total £'m
Revenue	137.5	43.5	181.0
Gross Profit	54.3	12.4	66.7
Overhead costs	(43.1)	(8.5)	(51.6)
Segment operating profit	11.2	3.9	15.1
Unallocated expenses			(5.4)
Underlying operating profit			9.7
Non-underlying expenses			(6.4)
Operating profit			3.3
Net financing expense			(0.3)
Profit before tax			3.0
Income tax expense			(1.3)
Profit after tax			1.7

Other segmental data

Depreciation	1.8	0.6	2.4
Amortisation	1.1	0.4	1.5
Impairment losses on tangible asset write-down	0.9	-	0.9
Impairment losses on intangible asset write-down	1.1	0.1	1.2

Geographical segments

The Lighting, Signals and Components segments are managed on a worldwide basis, but operate in three principal geographic areas, North America, EMEA and Rest of World. The following table provides an analysis of the Group's sales by geographical market, irrespective of the origin of the goods. All revenue relates to the sale of goods.

Sales revenue by geographical market

	2018 Unaudited £'m	2017 Audited £'m
North America	**124.1**	136.0
EMEA	**20.3**	21.2
Rest of World	**25.2**	23.8
Consolidated revenue	**169.6**	181.0

3. Non-underlying expense

The Group incurs costs and earns income that is non-underlying in nature or that is otherwise considered to not be reflective of the underlying performance of the business. In the assessment of performance of the Group in prior periods, management examined underlying performance, which removed the impact of non-underlying costs and income.

The table below presents the components of non-underlying profit or loss recorded within administrative expenses:

	2018 Unaudited £'m	2017 Audited £'m
Intangible asset impairment	-	(1.2)
Increase pension liability for GMP equalisation	(0.4)	
Tangible asset impairment and disposals	-	(0.9)
Production transfer and start up	-	(4.6)
Employee severance costs	-	0.3
Non-underlying costs recorded in administrative expenses	(0.4)	(6.4)

In the current year, there is a one-off charge of £0.4m for the impact of Guaranteed Minimum Pension (GMP) equalisation. This is an increase in the pension liability related to the equalisation of pension entitlements between the sexes which dates back to the 1990's and which is treated as a past service cost and therefore a charge to the Income Statement. It is a one-off event and has no cash impact at the moment as we are within an agreed triennial funding window until 2020.

In the prior year, non-underlying costs related to the transfer of lighting assembly to our manufacturing partner. The costs were for set up costs, project management and dedicated engineering time. There are no further transfer costs being incurred, all accrued redundancy costs have been utilised in the period against terminations related to the project.

4. Net financing expense

	2018 Unaudited £'m	2017 Audited £'m
Net interest on net defined benefit liability	-	(0.2)
Interest expense on financial liabilities	(0.2)	(0.1)
Net financing expense	(0.2)	(0.3)

5. Income tax expense

	2018 Unaudited £'m	2017 Audited £'m
Current tax expense		
Current year	2.1	2.5
Adjustment for prior years	0.2	(0.2)
	2.3	2.3
Deferred tax expense		
Origination and reversal of temporary differences	(0.4)	(0.5)
Adjustment for prior years	0.1	(0.8)
Reduction in tax rate	0.1	0.4
Recognition of previously unrecognised losses	-	(0.1)
Income tax expense	2.1	1.3

5. Income tax expense (continued)

Reconciliation of effective tax rate

	2018 Unaudited %	2018 Unaudited £'m	2017 Audited %	2017 Audited £'m
Profit for the year		5.3		1.7
Total income tax income		2.1		1.3
Profit excluding income tax		7.4		3.0
Income tax using the UK corporation tax rate	19.0	1.4	19.3	0.6
Effect of tax rates in foreign jurisdictions	5.8	0.4	16.9	0.5
Increase in tax rate	0.9	0.1	13.6	0.4
Non-deductible expenses	-	-	33.9	1.0
Recognition of tax effect of previously unrecognised losses	-	-	(3.4)	(0.1)
Adjustment for prior years	3.9	0.3	(33.6)	(1.0)
Non-taxable income	-	-	-	-
Research and development credits	(2.0)	(0.2)	(6.8)	(0.2)
Other	0.8	0.1	3.4	0.1
	28.4	2.1	43.3	1.3

The effective tax rate for the year is 28.4% compared with 43.3% in the prior year. Non-underlying items in the current year have very little impact on the tax rate, whereas, in the prior year, the tax rate on the underlying business was 37.2%. The reduction in tax rates in the US has helped to reduce the overall tax rate in the current year. However, the overall tax rate is higher than the US rate of 21% as the mix of profits in the year is weighted more towards higher tax rate jurisdictions compared to the US.

Tax recognised directly in equity

	2018 Unaudited £'m	2017 Audited £'m
Employee benefits	(0.3)	0.4
Other	0.1	(0.6)

Current tax

Current tax is calculated with reference to the profit of the Company and its subsidiaries in their respective countries of operation. Set out below are details in respect of the significant jurisdictions where the Group operates and the factors that influenced the current and deferred taxation in those jurisdictions.

UK

The UK companies are subject to a corporate tax rate of 19.0% (2017: 19.25%). The UK tax authorities have reduced the UK rate of corporation tax will reduce by 2% to 17% from 1 April 2020. No further UK corporation tax rate reductions have been announced. As such, the UK timing differences have been recognised at the rate at which the timing differences are expected to unwind.

US

The majority of the Group's profits arise in the US where the corporation tax rate reduced from 35% in the prior year to 21% in the current year and this is the main driver for reduction in effective tax rate.

6. Earnings per share

Basic earnings per share

The calculation of basic earnings per share ("EPS") at 31 December 2018 was based on a profit for the year of £5.3m (2017: £1.7m) and the weighted average number of ordinary shares outstanding during the year of 32,527,708 (2017: 32,510,106).

Diluted earnings per share

The calculation of diluted EPS at 31 December 2018 was based on a profit for the year of £5.3m (2017: £1.7m) and the weighted average number of ordinary shares outstanding during the year of 33,019,517 (2017: 33,014,680) was calculated as follows:

Weighted average number of ordinary shares

	2018 Unaudited Number '000	2017 Audited Number '000
Weighted average number of shares	**32,541**	32,510
Dilutive effect of share options	**479**	505
Diluted weighted average number of shares	**33,020**	33,015

Underlying earnings per share are highlighted below as the Directors consider that this measurement of earnings gives valuable information on the performance of the Group.

	2018 Unaudited Per share	2017 Audited Per share
Basic earnings	**16.4p**	4.8p
Underlying basic earnings*	**17.3p**	17.9p
Diluted earnings	**16.1p**	4.8p
Underlying diluted earnings*	**17.0p**	17.6p

* Underlying earnings excludes non-underlying items as explained in note 3 and allocates tax at the appropriate rate (see note 5)

7. Provisions

	Warranty £'m	Restructuring £'m	Total £'m
Balance at 1 January 2018 (audited)	**1.5**	**0.8**	**2.3**
Effects of foreign exchange movements	**0.2**	**-**	**0.2**
Provisions made during the year	**0.9**	**-**	**0.9**
Provisions used during the year	**(1.1)**	**(0.8)**	**(1.9)**
Provisions not required	**-**	**-**	**-**
Balance at 31 December 2018 (unaudited)	**1.5**	**-**	**1.5**

The warranty provision relates to sales made over the past five years. The provision has been estimated based on historical warranty data with similar products. The Group expects to settle the majority of the liability over the next two to three years. Movements related to discounting the warranty provision was less than £0.1m in the prior year and therefore not disclosed. The restructuring provision related to redundancy costs linked to our outsourcing program that was utilised in the year (see note 3).

	2018 Unaudited £'m	2017 Audited £'m
Due within one year	**1.0**	1.4
Due within one and five years	**0.5**	0.9
	1.5	2.3

8. Dividends

There were no dividends declared or paid in the 12 months ended 31 December 2018.

9. Cash and cash equivalents

	2018 Unaudited £'m	2017 Audited £'m
Cash and cash equivalents in the statement of total financial position	**2.2**	12.8
Cash and cash equivalents in the statement of cash flows	**2.2**	12.8

10. Debt facilities

On 12 December 2016, the Company signed a 5-year unsecured £25m multi-currency Revolving Credit Facility with HSBC Bank plc. Under the terms of the facility, the Group also has a £25m "accordion" facility, by which further facilities may be made available by HSBC under the current terms to support significant investment opportunities that may arise. At 31 December 2018, there was £5.1m drawn against the facility.

11. Principal exchange rates

	2018 Unaudited Average rate	2018 Unaudited At balance sheet date	2017 Audited Average rate	2017 Audited At balance sheet date
US dollar	**1.33**	**1.27**	1.29	1.35
Euro	**1.13**	**1.11**	1.14	1.13
Canadian dollar	**1.73**	**1.74**	1.67	1.69
Mexican Peso	**25.63**	**25.02**	24.33	26.55

12. Related party transactions

The Group's related parties are its subsidiary undertakings and key management personnel.

Subsidiaries
Transactions between the Company and its subsidiaries have been eliminated on consolidation.

Key management personnel
There are no loans between the Group and key management personnel

13. Reconciliation to non-GAAP performance measures

	2018 Unaudited £'m	2017 Audited £'m
Profit from operating activities	**7.6**	3.3
Non-underlying items	**0.4**	6.4
Underlying operating profit/underlying EBIT	**8.0**	19.7
Profit from operating activities	**7.6**	3.3
Non-underlying items	**0.4**	6.4
Depreciation of property, plant and equipment	**3.1**	2.4
Amortisation of intangible assets	**1.5**	1.5
Adjusted underlying EBITDA	**12.6**	13.6
Profit from operating activities	**7.6**	3.3
Non-underlying items	**0.4**	6.4
Depreciation of property, plant and equipment	**3.1**	2.4
Amortisation of intangible assets	**1.5**	1.5
Net movement on working capital (inventories, trade and other receivables, trade and other payables) as per consolidated statement of cash flow	**(19.0)**	5.9
Movements in working capital related to non-underlying	**-**	-
Adjusted operating cash flow	**(6.4)**	19.5

Constant currency

The Group's revenues are mainly earned in the US and it presents certain key metrics on a constant currency basis to remove any impact of currency fluctuations. The constant currency impact is calculated by re-translating the prior year numbers at the exchange rate prevailing in the current year.

Net debt

Net debt is defined as total Group borrowings less cash. Net debt of £2.9m at the year-end consisted of borrowings of £5.1m less cash of £2.2m.

14. Principal risks and uncertainties

The Board is responsible for identifying the nature and extent of the risks the Group has to manage in order to successfully pursue its growth strategy and generate shareholder value over the long term.

The Board uses a risk framework which is designed to support the process for identifying, evaluating and managing both financial and non-financial risk. The Group has identified the following key risks. This is not an exhaustive list but rather a list of the most material risks facing the Group. The impact of these risks, individually or collectively, could potentially affect the ability of the Group to operate profitably and generate positive cash flows in the medium to long term. As a result, these risks are actively monitored and managed, as detailed below.

- **Production capacity** – Dialight needs to ensure that it has sufficient production capacity to fulfill customer orders in a timely manner and to be scalable to support growth. Insufficient capacity results in an inability to fulfill orders
- **Supply chain management** – The procurement planning process is dependent on the accuracy of sales forecast to ensure adequacy of component supply. The inability to source key raw materials and components required for the manufacture of our products could impact our ability to manufacture products and satisfy customer orders. Inaccuracy in forecasting could also lead to higher inventory obsolescence
- **IT systems** – The Group uses IT systems to operate and control its businesses: any disruption would lead to an adverse impact on the business
- **Political conditions** – The Group's main manufacturing plant is in Mexico and its main market is in North America. Proposed import tariffs could impact the Group. "Brexit" has introduced uncertainty to the level of tariffs in goods imported from Europe. The Group also operates in areas with political uncertainty which could impact taxes payable
- **Succession planning and staff caliber** – The Groups performance is dependent on attracting and retaining high quality of staff
- **Intellectual property** – Theft or violation of intellectual property or third parties taking legal action for infringements will have an adverse impact on the Group
- **Market trend and competition** – The Group must be able to identify customer demands and ensure its product portfolio match their requirements
- **Product development strategy** – The Group needs to ensure it can deliver new products to the market in a timely manner
- **Product recall** – The Group gives a ten-year warranty on its Lighting products
- **Foreign exchange** – This is the most significant treasury risk and in times of currency volatility it can have a material impact on the performance of the Group.

The identification of risks and opportunities, the development of action plans to manage the risks and maximise the opportunities, and the continual monitoring of progress against agreed key performance indicators (KPIs) are integral parts of the business process and core activities throughout the Group.

These will continue to be evaluated, monitored and managed through 2019.