START OF TRANSCRIPT

Paul Keel

Hello, everyone, and thanks for tuning in to Smiths 2022 Capital Markets Event. For those of you who I have not already met, I'm Paul Keel, CEO of Smiths. I joined our company in May of 2021 and have been on board now for about 18 months. As you will see in the coming slides, we accomplished a great deal during this time. For example, we posted our fastest organic growth in the last nine years, we completed our most significant portfolio action in the last 10, and we completed our largest return of capital to shareholders in the last 15. We've also posted six straight quarters of growth, including 13 per cent in Q1, giving us a strong start on accelerating further here in fiscal '23.

In addition to detailing progress today, we'll also look at it in the context of our longer-term strategy. We spoke with many of you following fiscal '22 results. As part of those discussions, we asked what you wanted us to focus on in today's discussion. The agenda you see here is in response to that feedback. We'll focus on four things. First, how we're progressing towards our near, medium, and longer-term objectives. I'll cover that in the next 45 minutes or so, giving you a balanced view of what's working well and what we're still working on.

Second, you asked for a deeper dive into our two highest performance businesses in fiscal '22 Flex-Tek and Interconnect who each posted double digit growth with strong margin expansion and now represent nearly half of Smiths' profit. You'll hear from Pat McCaffrey who leads Flex-Tek and Julian Fagge, President of Smiths Interconnect.

Third, you wanted to hear more about our ESG strategy supplementing what was detailed in our first sustainability report released just last month. John Ostergren, our Chief Sustainability Officer will take us through this.

Fourth, everyone wanted to hear more from Clare Scherrer, our new CFO. Clare has her own list of investor questions that she'll work us through. Last year we took a hybrid approach to CMD. We posted the presentations on our website in advance and then came together in person for Q&A in a technology expo. That approach worked well, so we're replicating it again this year.

As you're watching now, that hopefully means the digital portion is up and running. I do hope you'll join us later today at the Tate Modern. I previewed the technology expo last week and it's pretty amazing. If engagement at last year's event is any indicator, we should be in for another lively Q&A session this year as well. With that as a backdrop, let's jump in. I'll start with a few opening thoughts to set the stage.

First, our value creation thesis is unchanged from what we shared with you last year. Eighteen months in, I'm more convinced than ever that this is an intrinsically strong company, purpose driven, with compelling capabilities and crystal-clear priorities. As evidenced by our encouraging progress over the past year and a half I'm also convinced that we can do even more. Second, our strong momentum, improving execution and great start in Q1 gives us confidence in delivering our fiscal '23 guidance, even with the uncertain macro outlook which, to be clear, is impacting us a well. The past six quarters of accelerating growth though, our strong order book and initiatives underway to increase operating leverage all support our view.

Third, in the medium term our balanced portfolio balance both in terms of end-users and geographic markets as well as between OE and aftermarket, supports delivery of our five financial targets. We are not immune to macro condition, but our high-value business model and diversified portfolio provides growth as well as resilience. Fourth, our fundamental strengths and participation in secular megatrends like energy transition, rising security needs, and the world's insatiable appetite for data, supports attainment of Smiths vast long-term potential. So, a strong foundation, building momentum, and more opportunity ahead.

Let me quickly recap Smiths strategy captured in our value engine which connects the three components of our success, our purpose, our strengths, and our priorities. Our purpose is compelling. To improve our world through smarter engineering is both timely and timeless, yet authentically describes who we are today and who we aspire to be tomorrow. Our strengths are unique and powerful, world-class engineering, leading positions in critical markets, global capabilities, and a robust financial framework. Our purpose and strengths are then directed towards advancing three priorities for value creation, accelerating growth, improving execution, and doing ever more to inspire and empower our wonder people.

It's been a year since our last capital markets event and our global team has accomplished a great deal during that time. With respect to growth, we started fiscal '22 well with first half organic growth of 3.4 per cent and we built on this in the second half at 4.1 per cent, breaking into our 4 to 6 per cent medium-term growth range. Later in the summer we implemented a new operating model for our business in China. Last month we published Smiths first ever sustainability report, which is available on our website and details key elements of our ESG strategy. In support of this we updated our remuneration plans to directly link compensation to ESG delivery. Just yesterday we announced Q1 organic growth of 13 per cent, our best start since 2008.

In terms of execution, we've also covered a lot of ground in the last 12 months. We closed the sale of Smiths Medical in January, roughly six months earlier than many expected. Shortly thereafter we relaunched our Smiths Excellence System. As I'll cover shortly, SES is fast becoming the way we work at Smiths, providing a regular operating cadence, delivering improved results, and accelerating talent development. We meaningfully ramped up new product development, launching 21 new products last year. As we did with ESG to further align incentives, we formally linked bonus pay to new product growth. In support of this we increased R&D investment by 14 per cent last year.

When it comes to people, I'll highlight just a few of the many steps forward we've taken together. In January we named our first chief sustainability officer and established a committee on our board of directors to accelerate progress in science, sustainability, and SES. We announced a number of executive leadership changes throughout the year, well-balanced in terms of diversity as well as between internal promotions and external recruitment. In August we put in place our Smiths Leadership Behaviours. A unified description of and shared commitment to what leadership means in our great company. So, a busy 12 months of accelerating growth, improving execution, and investing in our people.

All this activity is clearly yielding results. Both organic and reported growth have consistently accelerated over the past two years, which positions us nicely for continued progress here in fiscal '23. Let's turn to that now. Despite the many challenges in our world today, there are a number of factors that give us confidence for continued momentum. These include continued strong demand in most of our end markets, our high value business model, enabling us to capture price in excess of input cost inflation. Our Detection business is now back in growth and SES and restructuring activities are de-risking macro uncertainty and delivering stronger operating leverage.

Let's briefly take a look at each of these, beginning with what we're seeing in our core end markets. Smiths competes in four main markets, industrial, safety and security, energy, and aerospace. These are all large global sectors populated by sophisticated customers who choose Smiths because of our differentiated technology and service capabilities. In total, these markets are all growing. Incrementally beneficial for Smiths, are doing so at different rates depending upon where they're at in their relative cycles.

Later in this presentation I'll say more about how this plays out both in terms of growth and resilience.

Breaking this down by business, John Crane generates about 60 per cent of its sales from energy markets where order growth is strong, supported by broad-based demand. The remaining 40 per cent of Crane's sales are in industrial, water, pharma, chemicals, et cetera, and these markets are also showing good growth. With both end markets expanding we expect accelerating growth for John Crane in fiscal '23. Smiths Detection competes in both aviation security, accounting for roughly 70 per cent of sales, and other security systems, urban security, ports and borders, chemicals and the like, which collectively represent around 30 per cent. Non-aviation markets returned to growth last year.

Aviation is still variable, depending upon where you're at in the world, but in total it continues to recover as expected. Smiths Detection is a large player in all of these markets, so it too is growing again. Detection was our fastest-growing business in Q1, and it will grow across fiscal '23. I'll say more about the outlook here and the resulting benefit to Smiths' Group in just a moment. Flex-Tek, our fastest growing business last year competes in both industrial and aerospace markets. Double-digit aircraft production is forecasted for the next several years, providing a sustained tailwind for our business. With mortgage rates rising though, the residential construction market is drawing attention.

About 60 per cent of Flex-Tek sales, or about 16 per cent of total Smiths, are exposed to this sector. While we don't see evidence of it yet in our own business, US construction is expected to soften and this in turn would moderate, but not reverse our own growth. The net result is that we expect Flex-Tek to post solid growth once again in fiscal '23, although probably not at the record levels of last year. Pat covers these trends more deeply in his presentation. Interconnect which also posted double-digit growth last year competes in the industrial, security, and aerospace markets. All three are growing well, propelled by demand drivers like electrification and the world's ever-increasing bandwidth needs.

We occasionally get asked about Smiths exposure to semi-conductors. Roughly a quarter of Interconnect sales, but under three per cent of total Smiths comes from this end market. Similar to my comments on residential construction, macro forecasts do call for a slowing in semicon, which would have some impact on our business. The net result here is continued growth for Smiths Interconnect, but likely below the very high levels of last year. Julian walks us through all of this in his comments.

On the right side of this chart, you see Smiths revenue and order growth. Two things to underline here, first, double-digit order growth last year contributes to revenue acceleration this year. Second, while order growth may soften, we expect it to still remain above even our accelerated sales levels. Meaning additional growth is available, provided we execute. Our high-value business model and resulting ability to capture price is the third reason for our confidence in further progress this year. The left side of this chart shows R&D as a per cent of sale for Smiths as well as our peers. The median industrial company invest around two and a half per cent, while top quartile players invest as much as twice this amount.

As innovation is central to our business model, we're amongst that top group, consistently investing over four per cent. Of course, R&D spend is not our goal, R&D return is. We see this reflected in our high gross margins and return on capital. We're also seeing it now in our pricing, and this is illustrated on the right-side of the chart. For those of you who've been with us over time, you'll know that price has not historically been a focus for Smiths. In fact, from 2017 to 2021 price increases made little contribution to our growth or margins. Not only was this suboptimal from a financial perspective, but it was frankly inconsistent with our business model.

So, beginning last year we made price a priority and put in place the right operational element to drive execution, visible targets, a regular cadence, and clear accountability. Getting those pieces in place served us well as inflation heated up. As a result, incremental revenue from pricing now is running ahead of incremental cost from input inflation, not just raw materials, but labour and freight as well. This time last year we indicated that Smiths Detection would return to growth in fiscal '23. As you saw from yesterday's trading update, that is now playing out as expected. We report Detection's performance in two ways, original equipment versus after-market and aviation versus other security systems.

We've won a number of large tenders recently, and as a consequence all four of these segments posted positive order growth in fiscal '22. Three of the four also posted positive revenue growth last year, but aviation OE was still in decline for reasons described earlier. The aviation OE market is now beginning to recover as well, and our revenues are catching up to orders. This has a large positive impact on the division's growth, which in turn generates a tailwind for Smiths Group. You see this on the right side of the chart.

Smiths Detection had high single digit contraction each of the past two years. Detection is about a quarter of Smiths, so we incurred a 200ish basis point headwind at the group level. [Unclear] every point of positive growth for the division contributes about 25 basis points for the company. With Detection's strong start in Q1 you now understand another reason for our confidence in further acceleration this year.

In addition to the growth drivers we just walked through, we're also taking actions to deliver earnings leverage and de-risk macro uncertainty. Across my career, the single best mechanism I've seen for buildings the capabilities and culture central to consistent execution are continuous improvement methodologies like the Smiths Excellence System.

We first introduced SES in 2018, learning the language and tools, but we didn't resource it properly, nor did we embed it into the operating fabric of our company. Today at Smiths SES is central to how we solve our problems and deliver results. We now have a high-performing full-time team in place including six Master Black Belts who lead the program and 24 Black Belts who lead the projects. To amplify impact, we brought our SES Academy inhouse. Across fiscal '22 we made a meaningful investment in time and resources and we're now beginning to see a return of this investment. This year SES will deliver roughly £20 million of annualised operating profit and release around £20 million of cash. Some of this will offset macro headwinds and some will strengthen operating leverage.

Separately from SES we're also taking a number of other actions. For example, in Flex-Tek we're expanding our presence in specific geographic markets. In Interconnect we're optimising our global footprint to better respond to customer demand.

We also took a non-headline charge in Q1 to streamline our end-to-end value chains in John Crane and to reduce overhead costs in Smiths Detection. We expect to generate around £25 million to £30 million in profit from these actions, of which roughly half will be captured this year. So, to recap our view on fiscal '23, continued strong demand in most of our end markets, evidenced by order growth above accelerating sales levels. Our high-value business model enabling price in excess of input cost inflation. Smiths Detection back in growth. SES and other initiatives delivering value and de-risking uncertainty and a strong start in Q1.

All that said, we're also managing a variety of headwind. We face ongoing supply shortages across our business, and in particular in John Crane and Detection. Wage and input prices remain high, and indeed are still climbing in some cases. Macroeconomic and geopolitical uncertainly continues to play an active role. Having weighed the various puts and takes we're maintaining the fiscal '23 guidance we provided just a few months back. Four to four and a half per cent organic revenue growth with moderate improvement in operating margins. That gives you our best current view of fiscal ’23.

For the balance of my presentation then, I’ll open the aperture and talk about delivery of our medium-term commitments and then an even further future-facing look at Smiths promising long-term potential. Let’s start with the characteristics of Smiths that give us both resilience and growth. First on that list is our balanced portfolio, diversified in terms of end market and also geography. Over time we built a large installed base of OE equipment which supports a growing proportion of higher margin recurring after-market sales.

Second, with more than 10 divestitures over the past several years we now have a focused portfolio of similar industrial technology businesses with common operating models and shared fundamentals. All our engineering businesses with differentiated technology drives competitive advantage. All leverage SES as a common approach to continuous improvement. All share the same fundamentals, a common purpose, compelling strengths, and clear priorities. These support the financial stability that is a hallmark of Smiths. A rock-solid balance sheet and consistently high margins, ROCE, and cash generation. All coming together to fund the accelerating innovation-led growth that we’ve been building over the past several quarters.

Let me now say a bit more about the medium-term outlook for our markets. Across Smiths roughly 40 per cent of our sales come from a broad diversity of industrial markets. We’re currently seeing good demand across the group. We include semicon and construction in this category. As mentioned earlier, our businesses are still strong in both segments although we are cognisant of the softening macro outlook, and these have been factored into our fiscal ’23 guidance. Safety and security accounts for about a third of our sales. The aviation security market, while challenged of late, has clear long-term growth characteristics as passenger volume has only declined in three of the past 40 years. The two years straddling 9/11 and, of course, COVID-19.

As you can see from the chart on the right, passenger volume has roughly trebled over this time. Energy accounts for about a fifth of our sales. Like safety and security, the long-term growth characteristics of this market are also attractive. Here global energy demand has contracted in only two of the past 40 years, during the global financial crisis of ’08/’09, and again during COVID lockdowns. Aerospace accounts for the remainder of our revenues. As I mentioned, the medium and long-term outlook for this market is similarly favourable, although only a bit over five per cent of our sales are generated here.

In the same way that our portfolio is diversified by industry, we built good balance geographically as well. This benefits us in a number of ways. For example, we have worldwide reach which is needed to serve large global customers. We have long followed a local for local strategy when it comes to our supply chains. We seek to source where we manufacture and manufacture where we sell. This better insulates us from the transportation, currency, and tariff risks inherent in export-oriented models. We built strong positions across both the US and Europe benefitting from the commercial and operational balance that this brings.

In the same way, over half our sales are dollar denominated while we consolidate in sterling, providing additional hedge and because of their faster growth, we have a particular focus on developing markets. Our China business, for instance, has delivered double-digit compounded growth for many years. To better access this in the context of macro and COVID complexities, we launched a new model for our China business earlier this year, providing greater empowerment to our local team to respond more quickly to shifting customer needs.

Slide 18 gives you more detail on our aftermarket sales which are growing, recurring, and margin accretive. Smiths Detection is shown on the left. The growth of original equipment in this market is propelled by secular factors like rising security needs, regulatory upgrades, and technology advances. Service, of course, is directly linked to installed base, so it’s also a function of these drivers. Service growth is also correlated with operating hours, so it's not surprising that the long-term trend here looks a lot like the chart I just showed for aviation volumes. Steady year-over-year growth with only two exceptions, 911 and COVID. Now, in addition to growing more quickly in OE, service revenues have also notably higher margins, about two and a half time as high in this case.

So, our aftermarket business provides a built-in growth and margin expander. If we went back far enough, we’d see a similar trend for John Crane, but Crane has been serving customers around the world for more than a century, so we’d need to go back quite a way. Our large installed base today supports stable aftermarket contribution of around 65 to 70 per cent. Again, there’s only been a few departures from this trend. Like Smiths Detection, John Crane’s aftermarket margins are highly accretive, almost 2X OE, providing the same structural growth and margin benefit. As Pat and Julian cover their businesses separately, I won’t address them here other than to say that the trends are similar.

Across all our businesses' aftermarket revenue contributes consistently faster growth and higher margins. We measure our progress in the medium-term across five financial commitments, those you see here. With four of five either at or above target or showing year-over-year improvement, we're making good progress. Organic growth was 3.8 per cent last year, up meaningfully from fiscal '21. EPS growth has been above range each of the last two years. ROCE is up 140 bps over the past two years, while margins are up three and a half points.

Finally, cash conversion averaged 108 per cent from 2017 to '21 but dipped to 80 per cent last year as we made a number of investments in our supply chain to service demand. We have more work to do here to bring this back into balance. There's more opportunity for us in each of these five areas, but we're encouraged by the progress we're making. Having now covered both the near and medium terms, I'll close with a few thoughts on reaching our full long-term potential, achievement of which is underpinned by our fundamental strengths.

We have built many capabilities across our 171-year history, but four stand out in terms of distinctive and lasting competitive advantage. In terms of engineering, we have credibly pioneered progress across multiple industries, technologies, and geographies. We consistently invest proportionately more in innovation than our competition, and this had led to our strongest new product pipeline in years. Our engineering strength also shines through in our service capabilities where our 2000 plus specialists and 300 plus sites are unmatched by competition.

With respect to market position, we're in over 50 per cent of the homes in the US and over 90 per cent of the world's largest airports. The vast majority of all satellites launched in North America, Europe, or Japan contains Smiths technology and we've earned leading positions with all major energy producers around the world. Clare walks through our powerful financial framework in her presentation, but a preview, ours is characterised by the recurring aftermarket revenues that we just covered. These helps support high margins in ROCE, which in combination with low asset intensity results in consistently strong cashflows. Add to this our accelerating growth, and you understand why we're so optimistic about our long-term potential.

An important part of this potential is buoyed by powerful megatrends which we are uniquely positioned to access. As a result of our broad portfolio, we participate in several, including energy transition, the world's ever-rising security needs, and our insatiable appetite for data. Perhaps the most compelling of all of these is sustainability which underpins all aspects of our business. I've already touched a bit on global security. Julian covers data bandwidth and connectivity in his comments, and who better to handle sustainability than John Ostergren, our CSO who capably does so in his presentation. I do hope you're able to review those presentation.

In the interest of time then, I'll just say a few words about energy transition which describes the historic transformation of global supply from fossil based to zero carbon sources. Big numbers, energy transition will require over $100 trillion of investment over the next 30 years. Energy transition is fundamentally an engineering opportunity. So, while John Crane and Flex-Tek participate most directly, all four of our businesses are currently engaged. Perhaps the most exciting part of this future is that it is already here. Energy transition is one of the central themes being advanced at COP 27, the UN Conference on Climate Change that is underway as we speak in Sharm el-Sheikh, Egypt.

That's a whistle-stop tour of our near-term momentum, medium-term commitment, and long-term potential. I'll wrap up with a few closing thoughts. First, this time last year we laid out a strategy to bring Smiths performance better in line with our vast potential. Twelve months on we feel we're building a credible track record executing that strategy and delivering on our commitment. With respect to growth, fiscal '22 came in around four per cent, our best in nearly a decade, and we're off to a good start here in fiscal '23. We're working hard to take full advantage of the growth we see across most of our diverse end markets.

We're moving aggressively to develop and commercialise a strong pipeline, including high-impact green technologies and we're moving quickly to build out priority adjacencies. Supplementing these organic levers is our solid track record of disciplined accretive M&A. We're also making good progress on execution. Our Smiths Excellence System is central to this as we accelerate pace and establish a more consistent operating rhythm. As John describes in his comment, we're also building on our strong ESG track record, publicly stating our commitment and transparently sharing our progress. All of which contribute to steadily expanding margins, returns, and cashflow.

The foundation of all we do is our people. The progress I shared today wouldn't be possible without their dedication and brilliance. Together we're building on our world-class safety record, accelerating talent development through our Smiths Leadership Behaviours, creating a more diverse and inclusive culture, and living our values each and every day.

I'll close with the same way I opened, with the Smiths value engine. Here you have the full picture. We're grounded in our purpose, powered by our strengths, and focused on our priorities. We're committed to delivering top quartile performance.

Thank you for taking the time to tune in today. Please join us later for our technology expo and management Q&A, either in person for those of you who will be in the London area or via webcast. Until then, all the best.

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