ANNUAL RESULTS 2013/2014
FULL TRANSCRIPT

SLIDE – ANNUAL RESULTS 2013/14

SLIDE – CAUTIONARY STATEMENT

SLIDE – PHILIP BOWMAN

Ladies and gentlemen, good morning and welcome to the 2014 annual results presentation for Smiths Group. Before I begin, can I ask you to check that your wireless devices are turned off?

Peter Turner, our Finance Director, is alongside me. The divisional general managers and some senior members of the corporate team are seated in the front row. As usual, all of the team will join Peter and me in answering your questions at the end of the session. Let me also take this opportunity to introduce Richard Ingram who took up his post as President of Smiths Detection in May and Roland Carter, Interim President of Smiths Interconnect since April.

Richard – perhaps you could stand up for a moment and Roland, and finally Silvio Bracone who joined in April as Group Strategy Director.

Thank you.

SLIDE – AGENDA

I will start by giving a brief outline of the results before handing over to Peter to present the financials in greater detail. I will again ask some of the general managers to present their divisional results. Duncan Gillis will update you on progress at John Crane while both Jeff McCaulley and Richard Ingram are now well placed to share with you their first impressions of Medical and Detection respectively – both the challenges and the opportunities. I will then review the operational progress in the remaining divisions and set out our group priorities for the rest of the year.

SLIDE – KEY MESSAGES

There are five key aspects that I would like to highlight from today's results.

First, we are continuing to make good progress in those businesses with predominantly commercial end markets. John Crane, Flex-Tek and Interconnect all saw improved revenues and margins. They are already benefiting from our steady investment in product innovation, sales effectiveness, and high-growth markets. However, the businesses that serve healthcare, homeland security and defence still face challenging conditions.

Second, we also experienced a significant foreign exchange headwind of £43m or around 8% of headline operating profit with 5% from foreign exchange translation and 3% from transaction. Peter will elaborate on this later.

Third, our initiatives to rebalance the Group have undoubtedly left us better positioned to take advantage of markets with higher growth prospects. Our previous dependence on government contracts and developed economies is sharply reduced from five years ago. However, as seen in today's results, the benefits to date have – frustratingly – been obscured by the stubbornly tough trading in some of our markets reliant on government funding and by some of the steps we are taking to fix the Detection business. In the light of increasingly challenging market conditions, the Detection team, supported by Corporate resource, has closely examined both existing programmes and their balance sheet to understand exposures and to ensure that provisions made against them, insofar as these can reliably be estimated, are appropriate and adequate. Richard will outline the steps we have taken and our priorities to improve performance and drive future value at Detection.

Fourth, our focus remains firmly on investment in the drivers of future revenue and value growth such as product innovation. We are committed to maintaining our technology leadership. Company-funded investment in R&D grew 5% at constant currencies and increased across most divisions. Whilst this is delivering an improved pipeline of new products to support revenue and margin growth over the medium to long-term, some Divisions are still too slow in getting these new products to market.

Another key driver is to gain share in emerging markets and we have continued to invest in expanding our presence to improve the Group's growth profile over the medium term. While there was progress in some areas such as Smiths Interconnect and John Crane, revenue was flat at around 16% of Group sales due, in particular, to a disappointing performance in China by Smiths Medical and fewer large contracts for Detection. This again demonstrates that it takes time to establish market acceptance through building a local sales presence and a local brand.

And finally fifth, our *Fuel for Growth* restructuring programme is well underway across all divisions. As I said at the interim results, this is about driving out further efficiencies to generate the funds for investment in growth initiatives. We are targeting £60m in annual savings by the end of FY17 and £10m has been delivered to date. Peter will give some more details later.

SLIDE – RESULTS OVERVIEW

So now to today's results.

Overall, these are disappointing numbers. Reported headline revenue declined 5% and was flat on an underlying basis. Improvements at John Crane, Smiths Interconnect and Flex-Tek were more than offset by declines at Smiths Medical and Smiths Detection as the healthcare and homeland security sectors continued to experience tough trading.

Headline operating profit fell 10% and was down 6% on an underlying basis. Margins improved in John Crane, Smiths Interconnect and Flex-Tek. However, a combination of continued price pressure, adverse transactional forex and the US medical device tax weighed on Medical's margins. Profitability at Smiths Detection was affected by working capital adjustments, adverse price and mix, additional delivery costs on long standing programmes and other one-off charges.

Earnings per share declined 12% but operating cash conversion remained strong at 97%, with free cash flow of £143m. Return on capital employed fell 90 basis points to 15.7%

The recommended total dividend for the year is up 2% to 40.25 pence. We have a progressive dividend policy for future pay-outs while maintaining a dividend cover of around 2.5 times over the medium-term. In order to underpin progressive returns to shareholders, the Board has agreed to exercise flexibility in applying the 2.5 times cover to take account of short-term impacts such as foreign exchange. We expect to rebuild cover over the medium term.

SLIDE – PROMOTING RESPONSIBILITY: DELIVERING CONTINUED IMPROVEMENTS ON KEY METRICS

We continued to make good progress in improving our health, safety and environmental record. We saw another fall in our recordable incident rate while the lost time rate, already near its record low, was unchanged. These statistics underline our commitment to an enhanced safety culture and greater employee engagement.

Having beaten the multi-year targets for our environmental metrics at the end of FY13, we have set new five-year goals of reducing energy, greenhouse gases and non-recycled waste by 15% and water by 10%.

Last year marked the start of the new period and we made good progress in reducing greenhouse gases and non-recyclable waste. However, the exceptionally cold winter in North America and increased demand for products that involve water intensive production slightly increased energy and water usage. We expect improvements in these metrics to resume as we make further investment in enhanced manufacturing processes and energy-efficient plant.

So with that introduction, I will now hand over to Peter.

SLIDE – PETER TURNER

Thank you Philip and good morning everyone.

SLIDE – UNDERLYING HEADLINE SALES AND PROFIT PERFORMANCE

Philip has given you an overview of the results. I will start by reviewing the underlying performance at a divisional level.

John Crane delivered further revenue growth driven by demand from both OEM and aftermarket, particularly in the energy services sector. The growth was held back by declines in its upstream energy services business, which Duncan will cover later. Profit grew strongly reflecting better volumes and the benefit from several efficiency initiatives.

After a disappointing first half performance at Smiths Medical, caused largely by the impact of US distributor demand patterns, we saw a return to growth in the second half. Revenue was up 3% in H2 against a weak comparator period - with a strong performance in our infusion pumps business. Margins declined with adverse pricing, foreign exchange transaction impacts, and costs of the US medical device tax.

At Smiths Detection, we entered the year with a slightly weaker order book which in turn led to lower sales – against a strong comparator period. Margins fell with the lower volumes, adverse price/mix and a number of one-off charges. I will take you through these movements on the next slide.

Smiths Interconnect saw a strong turnaround in the second half – with growth in revenues from Microwave's commercial markets more than offsetting a modest decline in Connectors. There are signs that the defence markets are starting to stabilise. Margins grew in all three business units through a combination of productivity savings, restructuring, and increased volumes.

And finally Flex-Tek – which delivered another good performance. Growth was driven by US residential construction, specialty heating elements, and medical hoses. Strong operational gearing and better pricing enhanced margins.

As before, we have provided margin causals for each of the divisions in the appendix. However, as there have been a number of moving parts in Detection's profitability, I will spend a few moments looking at this division in more detail.

SLIDE – SMITHS DETECTION: MARGINS AFFECTED BY TOUGH TRADING AND ONE-OFF COSTS

You will recall that FY13's headline operating profit of £58m was affected by £19m, with a charge for programme delivery costs. You can see these on last year's causal.

In the year under review, lower volumes and adverse price/mix each caused an £8m profit decline. R&D costs also increased by £8m as the project mix shifted from capitalised to expensed projects – particularly as the XCT product has now been launched. Total company-funded investment – both expensed and capitalised – increased 3% at constant currencies. Foreign exchange created a £5m adverse swing. There was a benefit of £7m from savings in SG&A and other areas contributing to operational efficiencies.

You will be aware that we announced in May that this year's profit would be affected by some working capital adjustments and additional programme delivery costs. In conjunction with Richard and his new management team, we have continued our thorough investigation in this area, which has resulted in an increase to some of these costs since May. In addition, we have made a charge of £7m in connection with ongoing price reviews associated with certain historical supply arrangements. In total, this resulted in one-off costs in the year of £30m.

We are very disappointed by these additional costs which are the result of a very thorough review aimed at drawing a line under these issues. Given the nature of the business, it is impossible to give any guarantees that we won't have difficult contracts in the future, but we believe that we have got to the bottom of these issues and we have a base from which we can now move forward.

Just as important are the steps we are taking to address our shortcomings in programme delivery and to resolve these long-running contracts. Richard Ingram will provide more detail about the issues and describe the actions we are taking to get back on the path to improved margins and returns.

SLIDE – HEADLINE PROFIT PROGRESSION 2013 to 2014

Let's now look at the profit progression for the Group as a whole… this next slide summarises the key movements.

Last year's PBT of £498m benefited from £13m of costs not repeated this year but as I have just explained we incurred a further £30m of one-off costs resulting in a net movement of £17m.

Volumes increased in all divisions except Detection.

Negative pricing in Medical, Detection and Interconnect more than offset gains in John Crane and Flex-Tek.

Cost inflation was a £17m headwind which we were able to offset by £28m of efficiencies.

We invested £11m more through a combination of increased R&D and on other growth initiatives. These were funded by cost savings from our *Fuel for Growth* programme.

As expected, we incurred £3m of extra cost from the inclusion of five months of the US medical device tax.

As Philip mentioned earlier, foreign exchange had a significant adverse effect on our profit this year, with a £27m impact from translation and £16m from transaction.

The translation hit was driven mainly by the weakness of the US dollar against Sterling. Two thirds of the transaction impact was in Medical – the largest impact there was caused by the weakness of the Japanese Yen.

Currency rates have continued to be volatile. Looking ahead, using the year end rates at 31 July, we would expect a further translational hit in the coming year which would fall primarily in the first half. We would also expect a modest adverse transaction impact. However, since the year end, rates have now moved to lessen the impact.

To help provide some guidance in this area, we have included the usual translation FX ready reckoner on the slide.

SLIDE – GROUP CASH CONVERSION

Turning now to operating cash conversion. At 97% – this is in line with our usual full year performance.

It was achieved through a continued focus on working capital management. The depreciation charge fell as assets, such as the ERP infrastructure, became fully depreciated.

Overall, this is a consistently strong cash performance and cash generation remains a key priority for the Group.

SLIDE – RECONCILATION: HEADLINE OPERATING PROFIT TO STATUTORY PROFIT

I'll now give some detail on the items that reconcile headline operating profit to the statutory numbers.

Starting with the exceptionals at the operating profit level which amounted to a net charge of £81m in the period.

The £29m restructuring charge predominantly relates to the *Fuel for Growth* restructuring programme. I will give some more detail on this shortly.

There was also a £49m charge associated with the John Crane Inc. asbestos litigation – as I mentioned in our interims this is higher than our normal run-rate. This reflects above trend cash expenditure this financial year caused by two large verdicts. Our claims experience over many years has shown that, while it can be lumpy in any one year, the expenditure tends to average out over the long term to a fairly consistent trend. We expect it to revert to trend next year of typically around £20-25m a year.

We also rolled forward the provision for Titeflex litigation for product claims. Like the John Crane provision, this is a rolling 10-year discounted provision which is reviewed every six months.

There was a further £7m gain from other small items.

The amortisation of acquired intangible assets was £39m.

SLIDE – FUEL FOR GROWTH – DRIVING EFFICIENCIES TO SUPPORT GROWTH INVESTMENT

Philip mentioned that our *Fuel for Growth* programme is well underway and this slide presents the costs and savings by division.

The two columns on the left set out the costs and savings incurred to date by division and on the right are the forecasts for the whole programme. The overall expectations of savings and costs are unchanged but we have refined our plans by division since the half year results.

To date, we have incurred costs of £27m which have been treated as exceptional. This has delivered initial savings of £10m in the period – reflecting that we are at the start of the programme.

SLIDE – PENSIONS: DEFICIT IMPROVED BY £12M TO £242M

Turning now to pensions - you will see the net deficit has fallen £12m since July last year to £242m. Partially offsetting this, we now have built up £111m in the escrow which is invested in gilts. Of course, you'll know that the net deficit is higher on both an actuarial and buy-out basis.

The deficit reduction reflects the benefit of asset returns and contributions offset by lower discount rates in both the UK and US.

We are expecting cash contributions for the year to total around £80m – in line with last year as detailed on the slide. In addition, we continue to invest £24m into the escrow.

Working in conjunction with the trustees of the schemes, we have continued to take steps to the reduce volatility of the schemes. During the year a further buy-in in the UK of £165m of annuities was completed to match pensioner liabilities and we have also increased our investments in other assets that better match the liabilities. After the year end, we also reduced liabilities by $165m as we offered deferred members of the US plan the option to cash-out their benefits. We continue to pursue further opportunities to reduce the volatility and funding obligations associated with these closed defined benefit schemes.

SLIDE – STRONG BALANCE SHEET SUPPORTS GROWTH INVESTMENT AND RETURNS

Now moving to net debt - free cash flow of £143m and a £70m benefit from foreign exchange translation was offset by £275m in final and special dividends. This resulted in an increase in net debt of £60m to £804m.

Just to remind you, we completed the refinancing of our existing bank facility in February with a new $800m committed revolving credit facility that matures in 2019 – with two one-year extension options. As at the end of the year, $620m of this facility was undrawn.

The Group continues to benefit from good cash flows and the strength of our balance sheet which is funded mainly through the public debt markets with a broad range of maturities. We remain very well placed to fund targeted acquisitions and organic investment opportunities.

SLIDE – GUIDANCE – FINANCIAL ITEMS

So finally looking ahead to 2015. Here is a summary of some of the key financial items.

We expect the headline tax rate to be in the range of 26-27% for the coming year and cash conversion will be between 85 and 95% - slightly below our usual run-rate reflecting our plans to invest more in capex to restructure and grow the business.

I have already covered the pension contributions.

At current exchange rates, we foresee net debt of around £800 to 850m at the year-end, subject to M&A activity and future FX movements.

I will now hand you back to Philip.

SLIDE – PHILIP BOWMAN

Thank you, Peter.

SLIDE – REPOSITIONING TO ACCELERATE REVENUE GROWTH AND DRIVE VALUE

A key theme today is how we are continuing to reposition the Group to accelerate revenue growth whilst enhancing margins and returns over the medium-term. As I commented earlier, some of the good progress seen in these results is masked by ongoing trading challenges – particularly in Detection and Medical.

The rest of the presentation will focus on the steps we are taking in each of the divisions to rebalance the Group by leveraging some common themes: investment in product innovation, expansion in emerging markets, capitalising on our core market positions and driving further operational efficiencies.

In Medical, we have faced difficult trading in developed markets and there is no doubt performance was disrupted by the uncertainties that flowed from the approach we received last year. Our key priority is delivering sustainable profitable growth. Jeff has a track record in his last few roles of strengthening underperforming businesses, particularly through refreshing product portfolios and driving growth in emerging markets, while enhancing margins. Not surprisingly, the priorities for Medical lie in these areas and Jeff will provide more colour shortly.

In Detection, our main imperative is to stabilise the business in a challenging and rapidly changing market. As Peter said, we have taken a lot of pain this year in terms of additional costs and working capital adjustments in order to establish a base from which we can grow and improve returns. Richard, who joined us from the aerospace industry, has experience in delivering complex programmes and he will set out his views of the business and his key priorities for the next 18 months.

John Crane has been a consistently strong performer. Duncan has set out a clear plan to drive value and he will provide an update on progress. Management has successfully undertaken a major restructuring while continuing to grow the business. We are also seeing greater traction in the strategy to cross-sell some of the newer product lines such as specialist filtration systems. The key priority for 2015 is to deliver improved revenue growth and to capitalise on a strong order book.

Smiths Interconnect saw a turnaround in the second half. Management has made excellent progress in expanding the commercial microwave business this year which has offset the pressures from weak defence spending. The business also has a strong track record in product innovation. Interconnect has delivered strong growth in emerging markets, indeed the best performance across all divisions this year. The objective now is to build on this solid base.

Flex-Tek is well-placed to grow in its largest markets -- US residential construction and aerospace. Its strategy of expanding into higher value added product lines in heating elements and flexible hoses has also borne fruit. These highly engineered products carry higher margins and are helping to move Flex-Tek away from some of its more commoditised product lines. The priority is to continue expanding in core markets while capitalising on opportunities to develop these specialty offerings.

With that brief overview of the operations and, given the challenges in Medical and Detection this year, I have asked Jeff, followed by Richard, to open the divisional presentations. Duncan will then give an update on the good progress at John Crane before I come back to cover Interconnect and Flex-Tek.

SLIDE – JEFF MCCAULLEY

Thank you Philip and good morning.

SLIDE – SMITHS MEDICAL: TOUGH TRADING ENVIRONMENT; RECOVERY IN SECOND HALF

I will begin with a review of the results for Medical, and then offer my perspective on the business and its potential, my priorities, and the outlook for the coming year.

Underlying revenues declined due to difficult trading conditions in developed markets, especially in the first half. Performance in the second half materially improved, albeit on weaker year-on-year comparisons. Our markets continue to be challenging because of sluggish procedure volumes, shorter lengths of stay, ongoing price pressures, and capital budget constraints. Margins were adversely affected by transactional FX (particularly the weak Yen), price erosion in developed markets, and the US Medical Device Excise Tax.

Medication Delivery revenues showed healthy growth, driven by strong ambulatory infusion sales. Syringe infusion sales recovered well in the second half after a weak first half.

Vital Care revenuesdeclined reflecting continued weak utilisation, price pressures, and distributor destocking (mainly in the first half). We saw improvement in the second half in all of our Vital Care product lines.

Safety revenues also fell amid increasing price pressures and competition in Sharps Safety, PIVC, and Vascular Access. However, we saw a marked improvement in the rate of decline in the second half as marketing, sales, and pricing programmes gained traction.

SLIDE – SMITHS MEDICAL: GROWTH POTENTIAL, DESPITE RECENT UNDER PERFORMANCE

While Medical has underperformed in the recent past, there is now a strong foundation on which to build a more competitive, higher growth, higher margin business:

First and foremost, we have a broad portfolio and platforms that provide exposure to many growth opportunities in our core and adjacent markets.

Moreover, this is a business with globally recognised, strong, and trusted brands that engender great loyalty.

We are also well positioned in lower risk interventional procedures in areas that are vital to patient care and in daily use around the world.

And, lastly, we are well positioned in multiple care settings, including alternate site and home care, which will continue to grow with the shift to lower cost care environments.

Similarly, there is a good foundation in recent investment:

Innovation continues to be paramount. We are increasing our R&D investment and although this has not yet translated into increased new product vitality, the pipeline is building.

Investments in China are taking much longer to pay off, but we are delivering strong growth in other emerging markets.

Service levels could be further improved and margins have eroded. However, our *Fuel for Growth* initiatives are focused on optimising the supply chain and enhancing service levels.

SLIDE – SMITHS MEDICAL: INITIATIVES TO DRIVE MEDIUM-TERM GROWTH

Looking ahead, I am focused on improving our sustainable competitiveness, accelerating growth, and expanding margins. Specifically, we are concentrating on a number of key drivers:

R&D investment is at a new high at about 5% of sales and will be slightly higher next year. We believe 5-6% is the right level for our business, but we must improve R&D productivity. In turn, we recently hired a new, highly experienced Chief Technology Officer, consolidated all engineering under him, and are committed to enhancing our engineering talent in key areas. We are also committed to improving process disciplines, including better voice of customer, stage gate, and multi-generational product development – which we know to be important and effective in improving speed to market and new product vitality.

Investment in products for the emerging markets is a particular priority, and we now have a new product development team in Shanghai focusing on the China infusion market.

We continue to see the positive impact of new product launches, such as the CADD Solis PIB pump that gained FDA clearance and was launched in the US in February. We also continue to benefit from prior year launches that are gaining traction, such as the new Bivona tracheostomy product. These successes further validate the investment case, as well as the positive impact of improving speed to market.

Developed markets, despite slower growth rates, continue to offer real absolute growth potential. While we have great brands globally, our penetration by franchise varies widely from market to market. Simply put, we have not been focused and effective in selling the entire portfolio in all geographies. This is a now strong focus going forward, and we are changing both sales alignment and incentives to drive it.

We will continue to invest in the emerging markets, which today represent only about 10% of our revenues. We have seen good growth in some areas, including Brazil (up 12%) and India (up 74%), as we've strengthened local sales teams and distributor networks. Our performance in China was disappointing (down 7%), pending the introduction of new products, especially in our infusion franchise. These products will launch in FY15. We are also taking steps to broaden our portfolio in China, re-align our sales channels and focus, and enlist new distributor partners.

We also see growth opportunities in the shift to alternate site and home care settings, and have re-organised our marketing organisation to ensure appropriate focus and resources on this segment.

Lastly, there are real opportunities to improve service levels and total cost productivity. We are in the first year of a multi-year project to consolidate and optimise our manufacturing network and footprint, streamline our supply chains, and improve vertical integration. All of which will improve service levels and margins. We are also undertaking a more general organisational restructuring intended to ensure a more focused, more streamlined organisation with lower SG&A.

SLIDE – RESTORING COMPETITIVENESS, GROWTH AND MARGINS

Looking ahead to the coming year.

We expect the developed markets to remain challenging; but we believe we can drive better performance on improved sales and marketing execution, and on the strength of recent and pending product launches.

More specifically, we expect to stabilise the business and start to achieve growth by improving balanced selling in the developed markets. We believe we can do the same in China. We also believe key launches for interoperability in the US, as well as a new line of Graseby infusion pumps and key launches in our Airway franchise in China, will bolster our competitiveness and results.

Longer term, we expect to build a more robust pipeline of new products to ensure better vitality across our portfolio, both in core and adjacent segments.

Lastly, our *Fuel for Growth* initiatives should begin to drive service level improvements and total cost productivity to help offset price pressure, fund growth initiatives, and improve margins.

In summary, while Medical has underperformed in recent years, there is a strong foundation on which to build a more competitive, higher growth, higher margin business on a sustainable basis. This will take some time, especially in certain areas. Still, our second half results were encouraging and an early sign of progress.

I will now hand the presentation over to Richard.

SLIDE – RICHARD INGRAM

Thank you Jeff and good morning.

SLIDE – SMITHS DETECTION: TOUGH TRADING ENVIRONMENT; MARGINS UNDER PRESSURE

I will review Detection's results first and then set out how I view the business and my key priorities to improve performance and returns. I will conclude with the outlook for the coming year.

Revenue declined 5% against a very strong comparator period. In a tough and competitive trading environment, sales fell in the transportation, military, and ports and borders markets.

Peter has already taken you through the main movements behind the decline in margins As he said, a comprehensive review of programmes was well underway before I joined, and I believe we have got to the bottom of the historic issues – and while there will always be some degree of risk – we now have a base from which to take the business forward. I will come back to this shortly.

So I will now turn to our key end markets…
Underlying revenue from transportation fell 5% amid aggressive competitive activity in all regions.

A 16% drop in ports and borders sales reflected lower contract activity.

Military sales fell 10%, again illustrating the trend of a variable annual cycle of activity in this largely contract-driven sector. Overall however, the trend is downward as pressure on budgets leads to fewer replacement programmes.

Critical Infrastructure - public and commercial buildings and key installations - is diverse and unregulated, which encourages increased competition. However, revenues rose 11% despite the challenge of low-cost participants.

Another bright spot was the 10% growth in aftermarket sales, which now represents 30% of revenues.

SLIDE – SMITHS DETECTION: FACING UP TO THE CHALLENGES

Having joined on 1 May, I have now been in the role around 140 days. Standing back from the immediate challenges, I believe this is fundamentally a good business. The ever present need for improved security drives long-term growth. We have good technology; a sound portfolio of products; and an excellent installed product base with aftermarket growth opportunities.

However, I am well aware of the challenges. I will now explain in more detail about the issues we are facing and then outline the actions we are taking to tackle these to get back on the path to growth and improved results.

First, the challenges:

We have faced a tough trading environment for the last few years because of constrained customer budgets and increasing price pressure.

Our programme delivery has been especially poor – we have been slow to adapt to the changing requirements of larger, increasingly complex contracts. There is no doubt that the business model has shifted significantly in the past five years from a simple equipment supplier model to a more complex role of a government contracting business. This often requires other services such as infrastructure enabling and networking to be provided. Contract sizes have become larger so order flow is lumpier and capacity management is harder. However, it is also important to put the programme issues into context. At any time we have around 100 programmes underway and, of these, we have had significant challenges with just a handful of them.

Many of the issues can be traced back to people and working practices – especially around poor cost control and project leadership – where we have failed to adapt to the changing environment and customer demands.

Our high cost base continues to affect our competitiveness in an increasingly price-sensitive environment. Put simply, we have too many sites carrying too much inventory in high-cost locations. We have also made a significant investment in R&D but it has not always been appropriately targeted.

Finally, we struggle to deliver consistently high levels of customer satisfaction. We need to be more closely aligned with our customers' needs, particularly in areas such as new product development.

SLIDE – A PRIORITISED ACTION PLAN TO DELIVER IMPROVED PERFORMANCE

Improving our performance in the coming year is all about execution; restoring our competitiveness as well as improving controls and reducing programme risk.

So what are we doing about it?

At the macro level, we are focusing our immediate efforts on:

- Reducing our cost base in order to improve competitiveness;
- Leveraging our installed base to grow our aftermarket in order to smooth revenue streams;
- Developing new income streams from growth markets such as Asia and the Middle East; and
- Focusing the divisonal culture towards execution and accountability.

We are introducing standard processes for all programmes. The major ones are reviewed by me and a group of senior managers, on a monthly basis. In addition, we are investing in training our programme managers so that they are all appropriately qualified.

To address our cost base, we announced last month that we will close three facilities in North America and consolidate their activities amongst existing plants.

The facilities in Toronto, Danbury, and Ijamsville, will all close in FY15. Production of hand-held chemical identification sensors, trace Detection consumables and software development will transfer to Smiths Detection's Edgewood facility in Maryland.

Development and production of trace products will be concentrated at Watford in the UK, while production of small X-ray systems at the Malaysia facility will be increased to exploit the manufacturing efficiencies already achieved by this new plant.

Our value engineering programme will help in our drive for cost efficiencies and will also enhance the value proposition of our key products. We also plan to streamline our product portfolio and focus our R&D more tightly on a smaller number of more attractive product opportunities. A slightly lower overall R&D spend will be offset by higher amortisation on capitalised projects.

Finally, a new customer insight programme and a focus on sales effectiveness should help us improve our customer satisfaction scores. And investment in an SAP upgrade will improve the quality of our management information.

SLIDE – SMITHS DETECTION: OUTLOOK

Looking ahead to the coming year. The trading environment is still challenging with government capital spending constrained. In addition, pricing will remain competitive in some markets. The order book is at a level close to same time last year and, therefore is expected to deliver broadly similar revenues in the coming year, although there will be a bias towards the second half. Margins should improve against a weak comparator. Pricing pressures are expected to be mitigated by gains from productivity initiatives and other cost savings over the next 12-18 months.

I look forward to updating you on progress at future meetings.

I will now hand over to Duncan for John Crane.

SLIDE – DUNCAN GILLIS

Thank you Richard and good morning. I'll start with an overview of our results.

SLIDE - JOHN CRANE: DELIVERING REVENUE GROWTH, ENHANCED MARGINS AND RETURNS

Our revenue growth was driven by healthy demand from both mid- and downstream oil and gas customers. Operating margins remained high reflecting both improved revenues and operational efficiencies. And the order book ended the year at a record level. Overall, a strong performance.

Second half operating margins were inflated by about 80 basis points due to some one-time events, so the normalized full year operating margin was about 24.3%.

Full year underlying aftermarket revenues, excluding our upstream oil services business, rose more than 4%, in line with our operating ranges. On the same basis, the second half growth rate was 6%, double that of the first half on the back of strong activity from energy services customers across our main markets in the Middle East and the Americas. Key renewals and new aftermarket service contracts were signed with global customers such as Shell, Chevron and additional wins in China and Mexico contributed to the record order book.

Underlying revenues from our upstream oil services business declined, reflecting the increasingly competitive environment in the US and the unusually severe winter across North America. However, after a sharp decline in the second quarter, the business began stabilising on a sequential monthly basis in the second half.

First-fit original equipment sales rose 4% as our customers continue to invest, particularly in high-growth markets. There were major contract wins for projects in the United Arab Emirates, Saudi Arabia, and Iraq. Additionally, China experienced double-digit first-fit revenue growth. Overall, we continue to see customer confidence in the oil and gas pump segment, whereas the power generation turbo-machinery segment remains challenging.

And, we’re seeing a good balance with both OEM and aftermarket revenues in the mid- and downstream segments growing at 4%. This positions us well for mid-term growth through repair, refurbishments and replacements.

SLIDE – JOHN CRANE: DELIVERING A VALUE GROWTH PLATFORM

Many of you will recall the Capital Markets day in Dubai last December and my outline of our planned global reorganisation for growth, which I’m pleased to report that we successfully implemented while continuing to grow the business.

Our new structure of three global business units – first fit customer sales & projects, end-user sales & service, and operations – is driving enhanced customer focus, better global coordination and increased sharing of best practices.

Combining our factories and supply chain operations into a Global Operations business unit is also driving better quality, lowering costs, and improved focus on delivery to promise.

We have continued to increase our investment in growth initiatives, including the first reinvestments from our *Fuel for Growth* programme. These are focused on transforming our sales organisation through an improved customer relationship management sales tool – CRM – and sales training. We have made much better progress in our cross-selling initiatives – with some real traction with our filtration business during the year. We have also invested in expanding our service centre network and increased manufacturing capacity to support the record order book.

Emerging markets continued to provide a strong platform for growth, rising 6% and now representing around 22% of John Crane sales. Strong demand in China was behind the opening of a new service centre in Dalian and a second in Chengdu, taking the number of service centres in the region to eight. The expansion of our existing Tianjin facility with its new global R&D hub, improved training centre and increased manufacturing capacity – helps to take our customer service capabilities in the region to a new level.

We also strengthened capabilities in Australia and ASEAN countries, highlighted by a new service centre in Gladstone, Australia, and a new sales and service office in Kuala Lumpur, Malaysia.

SLIDE – JOHN CRANE: OUTLOOK

Our record high order book should support sales growth from the mid- and downstream segment in the first half of fiscal year 2015. However, we expect revenue growth below our operating range in the first half because of the challenging upstream market conditions and some short-term manufacturing capacity constraints. We anticipate these conditions will improve slightly as the year progresses and new manufacturing capacity comes on line. We expect operating margins to be at the top end of the guidance provided, with further expansion limited by additional investment in growth initiatives.

I will now hand you back to Philip.

SLIDE – SMITHS INTERCONNECT: RETURN TO GROWTH; MARGINS BENEFIT FROM PRODUCTIVITY INITIATIVES

Thank you Duncan, and turning next to Smiths Interconnect.

Underlying sales rose 1% on the back of strong second half growth in Microwave which offset a slight decline in Connectors. Margins in all three business units benefited from productivity improvements, restructuring, increased volumes, and procurement savings.

In Connectors, underlying sales fell 2%. Defence orders were weak, particularly in Europe with the continued decline in Eurofighter production. However, aerospace, medical and semiconductor test markets provided good pockets of growth. Several new products, such as an ultra-fine pitch socket for testing specialist semiconductor chips, performed well.

Underlying revenue from the Microwave business rose 5%, with healthy growth in commercial markets more than offsetting contraction in defence. Both wireless telecoms and Test & Measurement performed well. There was robust global demand for the next generation version of our PIM tester. Sales of our high performance cable assemblies for production testing of wireless devices experienced a surge in orders. The defence segment suffered from lower budgets and the US withdrawal from Afghanistan.

Underlying sales in the Power business were flat with modest growth in the second half offsetting the slight first-half decline. Data centre demand remains positive with strong international growth and a robust performance in the US. However this growth rate is slowing. Our power protection products face challenges as demand from the wireless telecoms market reduces. In response, we are restructuring this part of the business and there are some signs of improvement from defence-related customers.

SLIDE – SMITHS INTERCONNECT: PRODUCT INNOVATION AND EMERGING MARKET GROWTH

Company-funded investment in R&D rose 5% to £24m to support the transition from a weak defence sector to higher growth commercial markets. The customer-funded portion rose by almost one third to £3m as spending on next-generation defence projects begins to flow through; the opportunity will be to turn this activity into delivery orders in the medium term.

The vitality index – the proportion of revenue from products developed in the last three years – continues at well over 30%. Our increased exposure to faster-growing, emerging markets, particularly China and India, delivered a 15% rise in sales and now represent 18% of Interconnect's total revenues.

SLIDE – INTERCONNECT: OUTLOOK

A sustained improvement in commercial markets such as telecoms, semiconductor test and data centres is likely to be offset by continuing budget constraints on defence markets, although these do at last seem to have stabilised. Emerging markets should continue to support some modest growth. However, normal seasonality in some markets and the timing of benefits from investments will again bias performance towards the second half. Margins progression will be constrained by our increased investment in growth initiatives.

Finally to Flex-Tek.

SLIDE – FLEX-TEK: GROWTH FROM US CONSTRUCTION & SPECIALTY HEATING; STRONG MARGIN BOOST

Flex-Tek's revenues grew again, helped by the continued improvement in the US residential construction market and growth in sales of specialty heating elements and medical hoses. Margins rose 180 basis points, helped by operating leverage from higher volumes and improved mix.

Fluid Management revenues declined slightly reflecting ramp downs in existing aero-engine platforms before orders from new programmes begin to build. Underlying demand is strong with a sizeable order backlog from major airframe and engine manufacturers.

Construction sales rose 8% on the back of improved demand for HVAC ducting and flexible gas piping products combined with market share gain. Cross-selling of the product range has been particularly successful.

Revenues from Heat Solutions rose 7% with increased sales of specialty heating elements easily offsetting lower revenues from household appliance and HVAC components.

Flexible Solutions saw revenue rise slightly as the success of new sleep apnoea products more than offset the persistent weakness in shipments to the floor-care market.

SLIDE – FLEX-TEK: OUTLOOK

So looking ahead to FY2015, fluid management should return to growth reflecting the underlying strength of the aerospace and construction markets. Construction will continue to profit from further improvement in US residential housing numbers. Improved general economic conditions in the US are expected to benefit the Heat Solutions and Flexible Solutions growth in specialty applications. Benefits from higher volumes on margins will be balanced by pressure from increased R&D investment, competitive pricing and potential commodity inflation.

Returning then to conclude on the performance and prospects for the Group as a whole.

SLIDE – SMITHS GROUP – OPERATIONAL PRIORITIES FOR 2015

Looking ahead, we remain committed to building on the progress already made in rebalancing the Group towards commercial and higher growth markets whilst reducing dependence on government contracts and developed economies.

We will also focus on successfully executing the divisional improvement plans through greater investment in growth drivers. These include increased spend on new product development, sales and marketing and expansion into new markets. We will also focus on driving improvements in quality and service to better meet and exceed our customers' expectations.

Over the past six years, value engineering, site rationalisation and organisational change have all helped drive operational efficiencies across the Group. Significant opportunities still exist through the Fuel for Growth programme. As I said earlier, this has already generated £10m in savings and most of the projected £60m annual savings are earmarked for funding the investment capacity to accelerate our revenue growth.

In terms of outlook, we are still cautious about healthcare and homeland security -- both subject to ongoing government funding constraints. However there are signs that the defence market is beginning to stabilise. I am also encouraged by the growth in global energy demand, the need for new fuel-efficient aircraft, increased US residential construction and further investment in wireless networks. The Company is being been revitalised by focused growth investment, greater operational efficiencies and strengthened divisional management - some of whom you heard from today. I believe we are well placed to benefit from a combination of these positive market trends and our growth initiatives over the medium term.

SLIDE – QUESTIONS AND ANSWERS

That concludes the Smiths story for FY2014. Peter and I, along with other members of the senior management team, would be pleased to take any questions. In terms of housekeeping, may I just remind you to wait for the microphone and preface your questions with your name and the company you represent?

Once again, thank you for joining us this morning.

QUESTIONS AND ANSWERS

Philip Bowman ***- Smiths Group plc - Chief Executive***

So who wants to open proceedings?

Martin Wilkie ***- Deutsche Bank Research - Analyst***

Martin Wilkie, Deutsche Bank. A couple of questions on Detection.
Firstly, if you'd walk through what changed towards the end of the year? Obviously, you had a trading update back in May I think it was talking about some of these headwinds, but obviously, it seems that some of those costs got a lot more negative towards the end.

I was just trying to work out was that some contracts actually were worse than expected in terms of the operational execution, or was this more of a review by the new management team taking revised assumptions? Just to get some sort of sense as to what changed relative to May.

Philip Bowman *- Smiths Group plc - Chief Executive*

I think there are probably two observations I would make before passing that to Richard.

The first one is clearly that we did conclude, in the latter months of the year, that a number of the problem contracts were going to cost more to bring to a successful completion. Whether that was due to reassessing the basis of the estimate by different people, I think is an interesting question, but clearly, Peter's arrival did stimulate a further review.

The other area is that we became aware of a US Government audit of cost recovery dating back to 2005 to 2007, and we have taken a provision against possibility liability for that.

Those are the two major points that changed. Indeed, the major culprit in terms of contract delivery was one of the three contracts, which we talked about at some length in the course of fiscal 2013.

Richard, do you want to add anything to that?

Richard Ingram *- Smiths Group plc - President, Smiths Detection*

Yes. Thank you, Philip. Is this working? Yes.

Yes, just -- I think Philip's covered the key points here. Certainly, coming into the business, it's been a key focus of mine to spend quite a lot of time on the balance sheet and looking at the programs which have caused problems.

To put a bit more color on this, we have actually made progress on that handful I talked about, in closing out a couple of them, so they are clearly over the line and finished. But on the other side we reviewed one in particular and took a little more on that one, and I think that's just part of the review process.

So we are making progress, and when I talked earlier about the focus on program management, what we're trying to achieve here is to ensure that we have control.

So a process which enables us to pick up issues on complex multi-faceted programs quickly, and resolve those either by deploying appropriate specific resource to fixing them quickly, or actively negotiating with customers to resolve issues before they become major problems.

Philip Bowman ***- Smiths Group plc - Chief Executive***

Richard, thank you very much.

Martin Wilkie ***- Deutsche Bank Research - Analyst***

Sorry, to ask a follow-up as well on the margin improvement –

Obviously we can do the math of reversing the one-offs and looking at the cost savings and so forth, but obviously your margin target is obviously quite some way away from where you were earning last year.

Is there a required improvement in end-market dynamics, in terms of the pricing trends, things like that to get into your target range, or can the existing market dynamics still allow to get there through self-help, or -- just to try and understand what you need the market to do to get you where you want to be?

Richard Ingram ***- Smiths Group plc - President, Smiths Detection***

Yes, it's a good question; and I guess it brings us on to another question you might ask around pricing in the market.

We have seen, as I alluded to qualitatively in the presentation, some pricing pressure. Of course, we don't exactly know where that's going, but there's -- clearly, if I look at the order book I'm holding for delivery in 2015 and 2016, there is some pricing pressure in that backlog.

But assuming that pricing pressure will continue, I think that's where we're going. There will be some pricing pressure for a couple of years and beyond that we can't see.

We have cost improvement targets, which are pretty aggressive in place, both on the Fuel for Growth side and in terms of some value engineering of the products, which we think can enable us to get within that range. It will take some time, it's going to take a few years to get there, but we believe we can do that.

Martin Wilkie ***- Deutsche Bank Research - Analyst***

Thank you.

Alex Toms ***- BofA Merrill Lynch - Analyst***

Alex Toms, Bank of America Merrill Lynch; a question on Detection again actually.

Just can you give us a feel for how much large projects are a part of the Detection sales base, or operating profit base as a percentage or something like that?

And within those large contracts, how much of it is actually Smiths equipment and how much of it is pass through just general contracting you have to do around infrastructure, just to give us a feel for that? Thanks.

Richard Ingram ***- Smiths Group plc - President, Smiths Detection***

Okay, thank you. So as I suggested in the presentation at any one time we might be running 80 to 100 programs. Directionally, that could account for 35% to 50% of our revenues; that's the kind of area.

It very much depends on the type of program. But on a very complex program, we'd still be aiming to have the lion's share as our own content. But civil engineering, infrastructure, installation, I have to be careful in these areas, because if you take installation I would regard that as core competency. It's not factory material, it's not hardware, but it's something that we certainly want to do, and we have the competencies to do.

So really I would say 60% to 70% is the minimum target for our own content. Where a contract is offered, which is significantly lower than that then we're looking at what's the strategic benefit of taking that program on; where would it take us to in the future?

Alex Toms ***- BofA Merrill Lynch - Analyst***

Just as a follow-up, are there any targets? Do you want that 35% to 50% large projects to be more like 20%/25% or are you happy with that level, it's just about execution on those contracts?

Richard Ingram ***- Smiths Group plc - President, Smiths Detection***

Well, I think it's a reality of the business. I think if you take the air transportation sector it's 51% of our business. It will remain our key markets for the long while and there's significant long-term investment expected, as air transportation will continue to grow at about twice global GDP.

Airports have to keep up with that, so either airport renewals, or new airport builds will be a significant piece. Frankly, those who construct those airports are getting pretty canny at the way that they do that, and they're running key parts of the process as turnkey programs.

So if we want to achieve installed base, and benefit from the aftermarket in the long term, we have to play in that game. So I think that's where we'd want it.

At the same time, as I suggested, aftermarket revenue as a percentage of total has grown faster, around in line with our targets; we're at 30% now, which was the target that was set some years ago for this business. I think it can continue to grow, so that piece will bump up against the contracting piece as we go forward.

Philip Bowman ***- Smiths Group plc - Chief Executive***

I think the point on aftermarket is important, because certainly, I think it was four years ago, I said the objective was to get our aftermarket revenue to about 30%.

If you recall, certainly five or six years ago, it was down high single digits, low double digits and we have moved that one forward significantly, and all of that was part of a very clear strategy to attempt to counteract the volatility that we were seeing from the greater number of programs, and clearly the scale of those programs growing.

We have a great installed base. We still have a lot of that installed base which is not covered by service contracts, and that's something to go for, and I know Richard is fully focused on that.

Yes, a couple of --?

Matt Spurr ***- Espirito Santo - Analyst***

Matt Spurr, Espirito did have one more on Detection, which was: how aggressive have we been in the review on the assumptions on a comfort scale of one to 10? But are we assuming that the large contracts are all loss-making now, just to get an idea of how aggressive or conservative you've been on the assumptions?

I did have one on John Crane which was: the cost inflation, you had GBP17 million for the Group, most of that seemed to be in John Crane, is that a typical level of cost inflation, or is that related to the manufacturing capability restrictions you talked about? Thanks.

Philip Bowman ***- Smiths Group plc - Chief Executive***

Richard, do you want to talk first on the Detection question?

Richard Ingram ***- Smiths Group plc - President, Smiths Detection***

Yes, we'll stick with the Detection theme. So that's a difficult question, in terms of I wouldn't really characterize it as aggression.

The way that I would characterize this is taking it through to a pretty painstaking logical conclusion; so if I sit with a program manager: well, exactly how are you going to get this program over the line?

The kind of issues we had are around very onerous terms, which have been signed up to; missing milestones; and how much it's really going to cost to get sub-contractors to complete programs.

So I would say exhaustive rather than aggressive. On those 20-odd programs which make up the Pareto of our cost and delivery, pretty exhaustive.

Philip Bowman ***- Smiths Group plc - Chief Executive***

Okay, Richard, thank you for that; don't try sitting down. Duncan?

Duncan Gillis ***- Smiths Group plc - President, John Crane***

The cost inflation numbers are up a little bit, driven by outsourced manufacturing costs due to some of the capacity constraints.

Philip Bowman ***- Smiths Group plc - Chief Executive***

Thank you for that. Next question.

Mark Davies Jones ***- Agency Partners - Analyst***

Mark Davies Jones, Agency Partners. I'll let Richard stay sitting down for a minute and ask a question on Medical, if I may.

Nice acceleration in the top line in the second half, but still a very muted outlook for 2015. I was wondering about that, because there does seem to be some sign of things picking up a little more generally in the healthcare markets in the US, some of the hospital groups speaking their numbers; overall healthcare spending re-accelerating somewhat in the budgets.

You don't seem to be seeing that. Is that something about the specific parts of the market you're playing in, or is it a market share and pricing issue? Why aren't you seeing any upturn?

Jeff McCaulley ***- Smiths Group plc - President, Smiths Medical***

It's a good question. So, I think it's really a mix of some of those things. I wouldn't say the markets have improved materially anywhere in the world. So we continue to see relatively muted procedure volumes; low single-digit volume growth generally; continued price pressures generally.

I would say that our portfolio is not positioned in the highest growth segments of healthcare, so there is a bit of a portfolio mix at play.

And then, certainly, we've underperformed in the market. So if you really break it down by franchise, seeing great performance in medication delivery, clearly outperforming the market and expect that to continue.

I think we have stabilized vital care and would expect vital care to perform in line with the market.

And clearly, underperforming in safety. So the real focus of the business is to stabilize the safety franchise. I think as we do that we'll see the other franchises providing the kind of lift that's in line or better than the market.

Philip Bowman ***- Smiths Group plc - Chief Executive***

Jeff, thank you very much. Next question towards the back on the left.

Jonathan Mounsey ***- Exane BNP Paribas - Analyst***

Jonathan Mounsey, Exane BNP Paribas. The final slide in the pack on asbestos, just a question really. I know you've said the higher costs this year are unusual, above trend, but expecting things to come back.

If we look at the chart it is quite a bit above trend and I do notice that the picture on the right shows that for the last two years the number of claim dismissals are slowing as well. I just wonder whether we're getting to a point where there's a sort of a core of remaining claims where maybe the outlook in terms of judgments is somewhat different to the history.

Then in terms of Medical, maybe just a few words on China and what's gone wrong. It seems like you've been spending on, investing in China and you've talked about that over recent years.

What's actually happened now is sales are going backwards, and it sounds as if you're now restructuring in terms of how you approach China. What exactly were you doing wrong and how will it be different now?

Philip Bowman ***- Smiths Group plc - Chief Executive***

Thank you for the two questions. I know our General Counsel will be delighted to have the opportunity to talk about asbestos so, Michael, if you would do that; and then, Jeff, if you're prepared for the next one, please?

Michael Herlihy ***- Smiths Group plc - General Counsel***

Okay, thank you. I think two points in your question.

So firstly, fiscal 2014 and the two historic verdicts that Peter mentioned. If you put those aside, and I know this may sound a bit like the football manager, you know, the team played really well, we just lost three nil. But actually, put those two judgments aside, fiscal 2014 was actually a pretty good year for John Crane Inc., and asbestos.

We don't talk about the individual cases, but what I can tell you is that if you, of the 10 cases that the slide shows were settled in the year, if you took out the two that Peter mentioned, the other eight would all have been well within the trend line.

So I don't see that as a sign of things to come, I see that as a historic one-off, or two-off, perhaps.

In terms of the number of claims, it is true that both the number of dismissals have slowed in the last couple of years and the number of new claims has increased. Actually, JCI is not too bothered about either of those trends.

The new claims we're seeing are generally not in diseases or in parts of the US that are troublesome for JCI. And, although the rate of dismissals has come down, it moves up and down, if you look back over 10 years. Our expectation is the rate of dismissals may go up a bit again, actually, in the latter part of 2015.

We did say a couple of years ago, I think in response to a question, that when it looked like the line was coming down very steeply that we were not expecting that to continue. Indeed, it hasn't; it's flattened. But again, we don't see anything materially different for JCI, at least looking forward.

Philip Bowman ***- Smiths Group plc - Chief Executive***

Very good, thank you, Michael. Jeff, please.

Jeff McCaulley ***- Smiths Group plc - President, Smiths Medical***

Great, so a couple of things in China. I think the primary issue in China has been getting products on the market. Some of that was initially a choice.

We focused initially on infusion, that was really our entry into the China market, and then subsequently we started to expand and bring other products in our portfolio into the market.

But it's taken us much more time to get the right products registered in the market and then it's taken us time to get new products registered to continue to bolster our competitiveness.

So if you peel back this year, the story line is really about infusion. We've started to drive good growth in the other lines of business, namely vital care and safety. But the infusion business has really begun to suffer as we've been late bringing new products to market against some pretty strong local national competitors.

So we will start to launch a series of new products this year and over the next couple of years. We're in the process of launching a product as we speak and will launch a subsequent [co-product] in the spring of next year. And then we've got a couple of products coming forward in our multi-generational product plan over the next couple of years.

So believe that we'll turn around infusion in China as these products gain traction. They usually take a little time to gain traction as you launch in these markets. But, nonetheless, that's been the primary driver within China.

We always look -- or are certainly taking a fresh look at our sales channel and our distributor partners in China to make sure those are most effective. We are looking at bringing on some new distributor partnerships that we think will help us to reach some of the tier 3 and tier 4 cities in China more effectively than we've done in the past.

Philip Bowman ***- Smiths Group plc - Chief Executive***

Jeff, thank you for that comprehensive response. Yes, next question going to the third row.

Sash Tusa ***- Edison Investment Research - Analyst***

Sash Tusa, Edison. A question about Medical; a broader one. If you'd known 18 months ago/24 months ago, what you know now about the medical markets and about the performance of the division, would you have made a different decision about the approach you got for that division?

Philip Bowman ***- Smiths Group plc - Chief Executive***

I don't deal in hypotheticals.

Nick Wilson ***- Espirito Santo - Analyst***

Nick Wilson, Espirito. Sorry to labor the point on this JCI asbestos thing, but 80,000 cases still outstanding and that's plateau-ing, at the moment, at that number.

Why aren't more of those cases more likely to go to court, given they're more sticky in nature? And therefore, if you do assume that more of those cases go to court, isn't the likelihood that the payout awarded by a judge actually goes up? So I'm just trying to understand the confidence that, don't worry, everything goes back to trend, when actually it may not.

Michael Herlihy ***- Smiths Group plc - General Counsel***

I understand the question. I think one thing, one point to make about this is that I think our evidence indicates that cases that haven't come to court within, say, five years of being filed, virtually never come to court. There will be a huge number of cases within that 80,000 that are more than five years old.

Now you may say: so why don't we go and clear those out? But actually, the practicality is that cases can sit on the docket for years and years and years, never go anywhere. Although as soon as you turn up and you ask the plaintiff's lawyer who's filed them: please could we get these struck out so we can make our 80,000 number look better? They'll immediately say: well, yes, but of course it's going to cost you.

So as a matter of policy, JCI doesn't do that. We, therefore, do sit with this backlog.

The more relevant metric I would say for a company like JCI, which has a policy of not settling cases, is how many cases go to trial. That number moves up and down. But it's not materially moved in terms of trend in either direction. In fact, this year we had probably fewer trials than we've had for the past several years. So although it's a number we do track, and we do follow, that backlog figure is really not hugely relevant to what we pay.

And, as I think we said at the half-year, we have had a couple of historic judgments that were out of -- above the trend line. That trend line itself, of course, is made up of over 100 judgments that can be way above or way below. It just happens to be -- as Peter said, over the long term, it tends to come out at that $1 million figure.

Philip Bowman ***- Smiths Group plc - Chief Executive***

When we both arrived here, there was, I seem to remember, some 350,000 cases in the backlog, which has come down clearly very materially. Perhaps it just might be helpful to explain what the major reason for that reduction was, and what was perhaps not going to be repeated in that.

Michael Herlihy ***- Smiths Group plc - General Counsel***

Certainly, Philip. At the risk of giving you a longer answer than you might have wished for, if you go back 10 years, so in 2005 to 2007, roughly, the number of cases was coming down very steeply, the number of claims. That was all about the US Court judge, Janis Jack, sorting out some of the abuses, where people, particularly in parts of the Southern US, would file cases with hundreds of claimants.

Following her decision in the Silica case, that abuse was tackled. So you saw for a period of years lots of cases with hundreds and hundreds of claimants being struck out; the line coming down very steeply at the result.

In 2008 and 2009, that flattened off quite a lot. So you went from, order of magnitude, striking out 20,000 claims per year to 8,000 or maybe 10,000.

In 2011/2012 it went back up again. That was a different factor; that was the multi-district federal litigation, and the Judge Robreno clearing that mess up, which again resulted and followed by the Mardoc shipping case, which followed in large number of claims being dismissed.

In the last couple of years those factors have waned and, therefore, the line has flattened again.

But the thing I would really stress is it is something we watch. It does go up and down. It really doesn't translate in any direct way at all to JCI's claims experience and what we pay.

Philip Bowman ***- Smiths Group plc - Chief Executive***

Michael, thank you very much indeed. Next question.

Andrew Carter *- RBC - Analyst*

Andrew Carter, RBC. I have just a couple of questions on John Crane, if I could.

I guess going back to what you said at the half-year, I think you then talked quite positively about the growth rate in the second half. I think you again mentioned the quite high order book.

I wondered if there was anything that had particularly changed, because I think compared to your comments at the half-year the growth rate in the second half does seem to have been a little bit lower than what I would have thought that you were flagging to. So that was question one.

Then the second one was can you help us understand a little bit, if the growth at that business hasn't been particularly great for two years, why have you got manufacturing capacity utilization issues?

And finally, just in terms of the upstream business, which I understand is now starting to stabilize, but can you give me a couple of numbers just to understand how important that is in the whole to help us with our modeling.

Philip Bowman *- Smiths Group plc - Chief Executive*

Duncan, please.

Duncan Gillis *- Smiths Group plc - President, John Crane*

A lot of questions, let me take them one at a time here.

Second-half growth, as I said, the downstream and midstream part of our business, which, back in December, I said was about 85% of our business, grew at 4%.

In the second half the aftermarket part of that business grew at 6%. So when I look at the second-half results, they were largely in line with what we were expecting with one exception, which goes back to the point about capacity.

Our order book is at record levels right now. There's about 1 point of growth that's in that order book right now. It's driven by the capacity constraints we have in that part of the business. So it all ties out. We've starting adding capacity, and as we continue to ramp up capacity, we expect to see that start to flow through to the P&L.

In terms of the -- so that's that part of the business. It's a separate part of the business from the upstream piece, which is a different set of products.

On the upstream part of the business, when we gave the second-half guidance, we were still a little bit uncertain in terms of what we were going to see coming out of that business. We were still a bit in the winter piece of this, which saw some declines, as well as the competitive situation. That's now come back and stabilized. But I would say the outlook for that business is less certain than the rest of the business.

To get to your modeling question, it's pretty simple math. I said 85/15 back in December for fiscal year 2013. The 85 has grown by 4%. The whole business has grown by 2%. So you can do the math on the rest of the business. Therefore, the mix is shifting closer to 90/10, than 85/15, for the downstream/midstream versus the upstream.

I think that should get back to, for those who were there in December, remember Sandy Morris's question to me, which some of you were dissatisfied with the answer. At that time, we were still experiencing that decline in our upstream business, and weren't really sure what was going to happen at that point. Since, it's come back up and stabilized on a sequential monthly basis.

Philip Bowman *- Smiths Group plc - Chief Executive*

Duncan, thank you very much. Please, third row in the middle.

Sean McLoughlin *- HSBC - Analyst*

Sean McLoughlin, HSBC. Just a question on M&A. The focus of the presentation, I sense, has been about rebalancing, repositioning the portfolio. I'm just wondering has M&A effectively taken a back burner; you're looking very much internally at how to drive your opportunities.

And on a divisional basis as well, historically you've talked about John Crane being the most likely beneficiary of M&A. With Flex-Tek, Interconnect showing good performance is this -- could this be at a wider level?

I wonder if Mr. Bracone, on a strategic level, could contribute anything to that. Thank you.

Philip Bowman ***- Smiths Group plc - Chief Executive***

I would start by saying that I have consistently said that our approach to driving growth should be two pronged. One is to invest in the drivers of organic growth, which we are doing; and the other is to make bolt-on acquisitions. Certainly, I have commented about the desire of doing that in John Crane, and potentially Flex-Tek and Interconnect. Detection there may be opportunities, but I don't think the time is now.

We evaluated a material number of possible bolt-on acquisitions during the course of 2014. With the exception of two very small acquisitions, one in Interconnect and one in Flex-Tek, we did not consummate any. There are, as always, when looking at this, a variety of reasons. One they did not stand up to due diligence; so what was, as it were, written -- not on the menu, it was delivered by the kitchen. Or alternatively, we found that the value proposition did not work. And in some cases we came up against our usual nemesis, private equity, who have a great deal of money and are prepared to take a different approach to valuation.

So the comment I would make is, first, we certainly did not abandon looking for bolt-on acquisitions and we were, in fact, pretty active.

Secondly, we have bolstered the amount of resource, particularly within John Crane in terms of the division, in terms of M&A resource within that business, to evaluate opportunities and to focus on that.

So overall, it is very much on the agenda and we believe we have adequate capacity clearly in the balance sheet to be able to support that going forward.

Frankly, and I said this a year ago, I was disappointed we didn't make any significant bolt-on acquisitions in fiscal 2013.

I'm equally, if not more, disappointed in fiscal 2014. But ultimately, this has to come up from the individual businesses. We can't drive that corporately. We only have a very small corporate team. We can provide support, but ultimately, the guys running the businesses are accountable for identifying and, clearly, integrating any acquisitions that are made. But it's very much still on the agenda.

Silvio, anything you'd like to add?

Silvio Bracone ***- Smiths Group plc - Group Strategy Director***

Thank you, Philip. I think Philip answered most of the key points.

Just to give you a little bit more details. It's a very active part of the activities done both by the division and at corporate level. So we average about -- we look about one company a day; this is about the average that we have in terms of activities -- of M&A activities.

Unfortunately, this hasn't materialized. But at the same time, as I said, we do a lot of work behind the scenes. The divisions have clear plan on where to grow and how to grow. They have a clear funnel on opportunities they're looking at and they are actively looking into these opportunities.

So unfortunately, this hasn't materialized yet, but I think we are doing the right things in order to get there, and I trust that this will bring soon results.

Unfortunately, M&A, this is not -- this is a binary result: you acquire a company; you do not acquire a company.

Sometimes you would like to acquire a company and because you are in a competitive environment, or because this is not the right time, or because maybe the financial expectations might be different, it doesn't happen. But important is that we do the right things in order to get there and I think the divisions, both at the division and at corporate level, we are doing the right things.

Philip Bowman ***- Smiths Group plc - Chief Executive***

Silvio, thank you very much. Yes, Sandy? I'm hoping you're going to ask Mr. Smith a question to justify his airfare all the way from South Carolina.

Sandy Morris ***- Jefferies & Co. - Analyst***

I was going to say I don't deal in hypotheticals, but (laughter) – I'll remember that answer, it's a very good one. I actually did have a question for Tedd, but it's a real dumb one, which is: what on earth is a specialty heating element, if it isn't going in HVAC?

And then the next thing is we talked about this little timing issue in aerospace, where we know we've got lots of -- I believe we've got a really good presence on things like the new LEAP engine, and I don't know about the GTF from Pratt, but this little timing issue was just a surprise to me. But the specialty heating element has got me intrigued.

Philip Bowman ***- Smiths Group plc - Chief Executive***

Okay. Tedd, two questions.

Tedd Smith ***- Smiths Group plc - President, Flex-Tek***

The specialty heating elements or cartridge heating elements, flexible heating elements, basically, they're not traditional, repetitious open-coil heating elements for our plants. They also go into aftermarket products that are sold into the HVAC industry; so they complement other brands we have, so part of them do go there.

When we're talking about aerospace, I think we're in the middle of the old cycle where the business didn't really invest and some of those engines were really not on those platforms. I think we've talked about that before.

We are in the current situation, where, in the newer engines, we're winning our fair share and most of them start coming online late 2016, 2017, 2018. I feel good about it; it's reinforced by our expansion of our facility in North America to support that. We've had the largest capital investment ever in Flex-Tek that was just approved.

Okay? Do I still need to help you out with HVAC heating elements?

Sandy Morris ***- Jefferies & Co. - Analyst***

Well, one of these days (laughter). Cartridge heating element. Anyway, a new one.

Philip Bowman ***- Smiths Group plc - Chief Executive***

You might like to send Sandy one, just so he can get to know it better.

Tedd Smith ***- Smiths Group plc - President, Flex-Tek***

Okay.

Sandy Morris ***- Jefferies & Co. - Analyst***

And swiftly. Then this is -- I'm trying to couch this carefully. We're not getting the bang for our buck in R&D, although we've been pushing R&D up. Clearly, Fuel for Growth is all about reinvesting in R&D and I'm just going to -- I'm not particularly nasty about Medical, I'm just going to pick on Medical.

We're -- the heart of the business used to be vital care and we neglected it, arguably, perhaps while we were dallying in infusion pumps. Now we've hit infusion pumps nicely.

I don't -- we were losing market share in the States because we admitted that once upon a time. So, as we chuck this R&D in, how confident are we that the Vitality Index, where we had a whole stream of new products, is actually going to work?

And then the second one is a bit nasty and a bit backward-looking, that this alternative care thing, I thought we were quite early on as a Company. And yet, Richard's just saying we're actually not where we should be. Perhaps he wouldn't mind just elaborating a little bit for me.

Philip Bowman ***- Smiths Group plc - Chief Executive***

Jeff?

Jeff McCaulley ***- Smiths Group plc - President, Smiths Medical***

Great. So I really do think we're investing adequately now in the business. I think if you roll back four or five years our percent of revenue invested in R&D was 2.5%; that's now going to be north of 5%, so I think the investment level is adequate.

I would agree with you that we've not necessarily balanced that across the portfolio fairly. So we have let vital care become less competitive in some areas and certainly our safety franchise has become less competitive. So we absolutely need to rebalance our program focus in that area.

I think we have seen good results in the infusion franchise. I think there's more to do in infusion as well, but clearly, we're going to begin to shift and rebalance that investment in other portfolios.

I think it's clear that when we launch new products, we do well. We've seen that in infusion, we've seen that in our tracheostomy line. We've seen that with our recent EchoGlo Catheters. So it's clear that innovation still works in health care and is a driver of growth.

It's going to take a little time to restart this pipeline in some of the other franchises. So it's not going to be a current-year impact; I think you will see the funnel build over the next couple of years. But we're going to be very focused in our programs and I think much quicker in our cycle times than we've been historically.

So fair on R&D?

Sandy Morris *- Jefferies & Co. - Analyst*

Yes. Well, sort of. It's just are we still going to use this Vitality Index? Is it still a valid thing in Medical?

Jeff McCaulley *- Smiths Group plc - President, Smiths Medical*

Well, it's absolutely valid. I think if you look at where we are today, at about 7%, it's clearly low. Now, our industry is one with a lot of follow-on consumables, so there's a big tail period to a lot of what we do. So if you look at healthcare generally, you'll see Vitality Index is all over the board.

I think our stated goal of getting above 15% is a good goal. I'd actually like to see it push closer to 20% over time, but we're going to need to build our way into that.

So I do think it's a relevant metric, because it keeps us focused on getting products in the market more quickly than we have historically.

Sandy Morris *- Jefferies & Co. - Analyst*

Right. And I'm not being funny, because that 20% number is something that rings a bell from 10 years or 20 years ago in Medical, and we were striving to get closer to it then, and then we went off into infusion and ambulatory pumps and everything and maybe got distracted.

Jeff McCaulley *- Smiths Group plc - President, Smiths Medical*

I'll maybe let others -- I don't think we got distracted; I just don't think the productivity's been there. I think the investments in infusion have been the right investments. I think it's taken us too long to get some products to market.

That's a clear focus of the business today; is to make sure we're much more productive with the R&D investment that we are making, making sure that it's more balanced across the portfolio. That should drive this Vitality metric.

Philip Bowman *- Smiths Group plc - Chief Executive*

I think the other thing, Sandy, I would just add, and I think I fully agree, and I said in my opening remarks that I think we are just too slow, not only in Medical, but in other places, Detection also, in getting new products to market.

But what we have had in Medical on the infusion side of a business is a regulator in the form of the FDA, which has been exceedingly slow in going through the approval process.

That has consumed more and more resource as the FDA have come back and demanded more and more questions, which we've had to answer. If you think of some of the approval times for CADD-Solis and the FDA, they went on probably three times longer than historically they would have done.

Now on the other hand, that was actually quite a win, because most of our competitors have not had a new infusion product approved by the FDA over that period.

But that certainly has sapped a lot of engineering resources as we've responded to that. It's not an excuse, but it is a factor that has impacted, certainly, the last three years because of that change in attitude of the FDA following product recalls by our competitors in that space.

Sandy Morris *- Jefferies & Co. - Analyst*

Yes, quite. I'm not unhappy about that, because they've (inaudible). Sorry, thank you very much.

And then I am going to stop. John Crane; this Indufil thing, which is now down to 10%. It basically was -- we had a brand new product, carbon fiber lifting rods, and then in came some competitors. It just got horrible. Our sales fell; our prices came down; and now, we're seeing relative stability, which strikes me as a pretty good thing, because the rest of the business is doing just hunky dory. Is that roughly -- or is that too simplistic?

Duncan Gillis ***- Smiths Group plc - President, John Crane***

Indufil is the filtration business, which has actually grown very aggressively. It's John Crane Production Solutions is the part you're referring to.

Fiberod was the acquisition. And so the fiber glass rods are a proprietary technology, but competitors have entered the market and, in fact, recently we've saw the first Chinese competitor come into the market as well, so it's highly competitive market.

I just want to be clear. The stabilization is average monthly revenue. These are annual contracts, so there's going to be a little bit of a tail for the first part of this year, in terms of the year-on-year piece of that being down. But again, the stability is there month on month, which is important.

Your point is right, Sandy, to the extent that business has stabilized, the rest of the business is quite buoyant, and so we ought to be in pretty good shape. However, we've got to get the capacity online for the rest of the business, and that's why we're going to see a little bit lower growth.

The capacity -- we're in process of adding the capacity. It will ramp up over time, but it won't be at full run rates until -- I plan to report to all of you when we get back together in March that we have about achieved full run rates.

March 2015 is the timing, just because of the time it takes to order the machines; install the machines; commission the machines; get the operators in, and get them fully trained up and at normal production levels.

Sandy Morris ***- Jefferies & Co. - Analyst***

And just on that last one, because there are nasty people here, who might take issue with you being out of capacity, but this depends which products or product we've run out of capacity on. So it could actually disguise some good news, does it?

Duncan Gillis ***- Smiths Group plc - President, John Crane***

Well, it's our fundamental machining capacity. So when you think about what we do; we have a core further upstream machining capability that we do for our -- this is primarily in our mechanical seals business as well as in our bearings business. And that's where the capacity issues have occurred, in our low-cost manufacturing area; so in the Czech Republic; in China; in Mexico and in India. Those are the places where we're adding the capacity.

Sandy Morris ***- Jefferies & Co. - Analyst***

Not unhelpful eventually.

Duncan Gillis ***- Smiths Group plc - President, John Crane***

No, it will be -- it's a high-quality problem, but a problem nonetheless, and one that we've got to make sure we stay out in front of going forward.

Philip Bowman ***- Smiths Group plc - Chief Executive***

And one of the key things from it, Sandy, clearly is we've had to pull production back from low-cost areas of the world into North America or into Europe. So not only have we had delays, but we've also had a significant cost disadvantage.

Duncan Gillis ***- Smiths Group plc - President, John Crane***

And sometimes when we did that, we had to then outsource in the high-cost markets, which is why I gave the answer I gave to the earlier question about the cost data's that we had talked about, because you get a double hit. You're going low cost to high cost and then you're going outsourced as well.

Philip Bowman ***- Smiths Group plc - Chief Executive***

Okay, thank you. Someone right at the back. I'm afraid I've got the light in my eyes.

Robert Davies ***- Morgan Stanley - Analyst***

Robert Davies, Morgan Stanley. Two questions.

First one just around oil and gas. I would just be interested to get a little more detail around some of the trends you're seeing in terms of CapEx changes, maybe since the beginning of the year. Oil and gas CapEx obviously being a fairly hotly debated topic, I'd be quite interested to hear the different dynamics in the up, mid and downstream what you're seeing.

Secondly, just around your targets to improve growth over the long term. How much opportunity is there for Smiths from exiting maybe some of your lower-growth businesses versus your internal metric for fixing those businesses? What's the opportunity to exit some of those low-growth businesses?

Philip Bowman ***- Smiths Group plc - Chief Executive***

Duncan, do you want to talk about oil and gas CapEx please?

Duncan Gillis ***- Smiths Group plc - President, John Crane***

Robert, when we were together in Dubai I said that we weren't seeing the impact of a reduction in the investment rate in upstream CapEx. In fact, what we typically saw was an increase in the midstream and downstream, and that's exactly what we're seeing.

Pipelines are very strong, particularly in the United States, behind what's going on with shale, both shale gas and shale oil, so gas lines and pipelines.

Then the downstream component remains robust. When you look at our growth over the past year, the Americas and the Middle East were -- in a currency basis were both growing at about the same amount, contributing to the growth we saw overall; and then Asia was about half of that amount. So strong growth throughout most of the world; Europe more flattish as many businesses have seen.

On the upstream side, we're not really seeing an impact from slowdowns in the rate of growth of CapEx in our business, but again it's a smaller part of our business.

Philip Bowman ***- Smiths Group plc - Chief Executive***

Duncan, thank you for that. The question about accelerating revenue growth by disposing of businesses is, clearly, one to which there is no finite answer.

If I take the example of Flex-Tek, the first two years I was with Smiths we lost 60% roughly of our volume in the US domestic construction market and the top-line numbers went down. I think the message I said at that stage is we're going to embark on some aggressive cost cutting. And at such time as people start building more domestic houses again, and that day will come, we can't say exactly when it will be but it won't be that long, watch the operational leverage.

And my, Flex-Tek over the last four years in terms of margin growth, in terms of revenue growth and particularly in terms of return on capital, has delivered that. So I think one has to look at a different issue and that is whether you believe you can sustainably, over the course of a business cycle, actually grow a particular business.

Now, we did take a decision in Medical to discontinue a significant number of thousand of SKUs three or four years ago. We continue to look at the portfolio within Medical, and we continue to look at where we focus our money in terms of R&D.

But I think there is always, at any point in the business cycle, you can say well this business has got low revenue growth we'll sell it. And then five years later you find that, if it's basically a fundamentally sound business, that the situation can change.

I've made a lot this morning about what we've had to do over the last few years. If I had been at Smiths 15 years ago, our high exposure to government revenue would have been a tremendous asset; it's been actually a tremendous liability over the last five years.

On the other hands, governments are still the major customers for goods and services around the world; generally, their credit ratings are pretty good and they do ultimately pay.

And while we have been through a very lean period over the last five years and we've had to adapt our business model accordingly, that's not to say as time goes forward. Certainly, I share Richard's view that the secular trend for security in this uncertain world, and I've said this many times, is a positive.

So I think one has to be a little careful in simply saying these businesses are growing slowly, we need to divest them, because if we end up with a very small business, which has got a very high growth rate, that necessarily is a good thing.

We look at it. We have taken a number of decisions. We will continue to take more decisions. But we do look at it over the business cycle and we look at the quality of the underlying business, the competitive advantage.

We have significantly increased our investment. It is, as I've said before, a frustration that it's not come through in terms of new products to market.

But then we are still sitting here nearly 3.5 years after starting the investment in the new XCT and Detection, where we have not actually finished the approval process in the US. That's not because we've failed. We've been the only product that has actually gone through the TSL first time, but nevertheless the lead time in some of these regulated businesses is extremely long.

Any other questions? If not, can I once again thank you for joining us this morning? Thank you for some good questions. Thank you indeed, and enjoy the rest of the day.