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ANNUAL RESULTS 2017
FULL TRANSCRIPT

Jemma Spalton – Smiths Group

Good morning, ladies and gentlemen, and welcome to the 2017 Annual Results for Smiths Group. For those of you that I haven't had the opportunity to meet yet, my name is Jemma Spalton, and I am the new Investor Relations Director here. As part of that new role, the privilege lies with me to bring your attention to two housekeeping points. Firstly, there are no planned fire alarms this morning. So if there is a fire alarm, please exit from the exits at the front of the room. And secondly, if you could please take a moment to read and digest our disclaimer slide.

To give you a feel for this morning's proceedings, Andy will start by taking us through the business performance in 2017, and then Bill will take us through the financial review. Andy will then provide an update on how we're performing against our strategy before we open up to questions at the end.

And so without further ado, it's my pleasure to hand over to Chief Executive, Andy Reynolds Smith.

Andy Reynolds Smith - Chief Executive

Thanks, Jemma. Good morning, everyone, and thanks very much for being here on a beautiful Friday. Happy Friday, as the guy on our reception says to me every Friday, always makes me feel good anyway.

We believe we've got a set of results that we're reporting this morning that are showing really good progress on the execution of our strategy. As you know, we're really driving towards a bigger, better, more focused Smiths, but most importantly, one that's growing.

We spent the year doing what we said we were going to do, which is a really important part of our success for me. We've made significant progress and are positioning the group for growth for the future.

Last year, I set out our ambition to establish Smiths as one of the world's leading technology companies. The approach that we took was in a number of areas. First of all, to ensure that we outperformed our chosen markets and develop in those markets top three leadership positions; that we achieve world-class competitiveness as the absolute basis of keeping us ahead and keeping us ahead sustainably; and all, of course, supported by a strong and disciplined financial framework.

The goal is sustainable growth and attractive returns. And today, I wanted to talk a little bit more to you about some of the progress that we're making in achieving that. We've been progressively repositioning the group to outperform our chosen markets. Firstly, we're doing that through increased investment for organic growth. I've said it before and I'm going to say it again, that organic growth is priority #1, 2 and 3 for me. In parallel with that organic activity, however, we've been taking inorganic actions to upgrade the portfolio. We've divested four noncore businesses, and we've successfully completed the acquisition of the Morpho business, which is now in process of integrating into the Detection business overall. What we've done so far has driven significant improvement in the positioning of the quality of the Smiths portfolio. We've exchanged over GBP 200 million of our annual revenue that was declining for a similar amount of revenue that's growing and with better margin potential. And our acquisitions match the essential characteristics of what we call the characteristics of a Smiths business. We've also been laying the foundations in establishing the capabilities to deliver world-class competitiveness, something that's lived with me throughout my career. It's been a big focus for us during the year. And we think about that in three key areas: operational efficiency, innovation and the people to do it.

The Smiths Excellence System is our group-wide operating model. It's really focused on speed and efficiency throughout the business. We've successfully implemented it group-wide. And as you'll see throughout today, we're already delivering results that drive strong

cash conversion and speed, and importantly, help us generate the funds to invest in the business for the future without taking a step back in our overall returns. We're supercharging our innovation agenda through i3, that's our group-wide innovation framework. i3 has underpinned the acceleration of a number of important areas in the business, and they're all focused on enhancing the group's technology, and particularly digital capabilities.

And finally, maybe most importantly, we've continued to invest heavily in our people to make sure that we can attract, retain, develop, engage and inspire the very best business -- the very best people in our business to deliver on our plans. All of it is, of course, underpinned by our strong financial framework, to give us the investment capacity and the investment decision-making discipline to support the delivery of our ambitions.

I'd characterize 2017 as a year of significant progress. We've repositioned the group for future growth. We delivered a good performance. And our underlying revenue in the year was broadly in line with the prior year, but we've improved all return measures at the same time. We delivered good growth across the portfolio, with the exception of John Crane's OE oil and gas activities and Smiths Medical. The underlying quality of our businesses and the increasing impact of the Smiths Excellence System has helped us generate a strong operating profit performance, along with margin expansion in all five divisions, and at the same time, increasing investment in all five divisions and at a group level.

Our acute focus on operating efficiency and cash generation, which has been my lifeblood for many years, is delivering results. When Bill goes through the detail in a minute, you'll see some significant reductions in working capital and a strong cash conversion of 118%. And our good performance gives us the confidence to increase our dividend by 3% to 43.25p.

Now just to talk a little bit about the divisions.

John Crane's overall revenue was down 4%, largely reflecting some of the ongoing challenges in the energy markets, oil and gas particularly. However, despite the background of a weak OE oil and gas market, we did see a return to growth in the

aftermarket piece of the business. Aftermarket now represents 64% of the total business and is a key strength in the quality of the John Crane division. We've got over 200 John Crane service centres globally that respond and anticipate what the customer wants wherever he is. We continue to focus also on diversifying John Crane's end market focus with its non-oil and gas business including chemical, pharmaceutical, pulp and paper now at around 45% of the division's revenues, but importantly, that piece of the business growing 2% in the last financial year. John Crane's margin improvement was the result of continued operational and structural cost improvements, and of course, the divestment of the loss-making upstream Artificial Lift business. We've been focused on developing new ultra-high performance products to meet the efficiency demands of refineries of the future and expanding into digital technologies and making sure that we can really leverage our unmatched service network around the world.

R&D was up 17% for John Crane, supporting new launches, innovative seal systems, and of course, advanced surface coatings to meet some of the demands for the future.

We also focused on investment in Medical. 2017 was a year of significant increased investment in Medical's pipeline of new products. We're addressing areas of historical underinvestment in the division and repositioning the portfolio to support core market category leadership, which is a really important piece of the story going forward. That repositioning was further supported by the disposal of Wallace, our IVF business, in female health in November 2016.

Underlying revenue was down 3%, with some delays for new product launches during the year. However, operating profit at the same time grew 8%, with improved margins, all supported by operational efficiency improvements driven through the Smiths Excellence System.

We also increased R&D to 6.4% of sales, with over 20 new product lines and product families in the pipeline, which over the next number of years as they launch will refresh close to half of the entire portfolio of the division, so it's a big programme. Some of these products are just starting launch and that will start to accelerate as we move into and through 2018 and into 2019.

Turning to Smiths Detection.

I mean, it's really a leader in a market that has some really good long-term growth drivers. We delivered another good year of growth, up 4%, which was as expected weighted towards the first half due to some contract phasing. The Detection business is overall a large contract business, so OE will always be subject to some fluctuations depending on where the large contracts fall. This, in some cases, skews half-over-half comparisons, but most importantly, the business is one with strong long-term fundamentals.

Revenue in the key air transportation piece of the business, the airport bit, was up 9% in the year. And this included some significant orders for 85 advanced computer tomography, CT, systems for major airports, including Amsterdam and Gatwick, as well as more orders for the TSA in the United States.

We're also very pleased to announce new orders from Frankfurt and Narita in Tokyo for 55 CT scanners as they upgrade their whole baggage scanning capabilities. The large European orders are primarily driven by the European Civil Aviation regs calling for computer tomography scanning to be in place on all of hold baggage by 2022.

Ports & Borders, however, was down a couple of percent against a very tough comparator last year. You might remember, it was up more than 70% in the last year, despite major deliveries into Africa, Italy and the Middle East, including deliveries for Italian gantries and into Kuwait customs.

Military sales decreased by 2% due to a number of U.S. programmes starting a natural wind-down cycle. New products are being developed and introduced that are going to detect a broader range of chemical warfare threats. As you can imagine, these threats continue to evolve very rapidly.

In urban security and critical infrastructure, the application of our technologies continue to develop, with a significant order for the Canadian police for narcotics detection, in this case, fentanyl, which is a great example of applying some of our technologies more broadly than they have been.

Our focus on capturing the aftermarket through increased service, software upgrade and attach rates also continued, which drove an increase in that revenue to more than 39% of the division as a whole.

Together with business improvement measures, Detection delivered further margin expansion, as we'd anticipated and signaled. R&D at the same time increased to an unprecedented 7.1% of sales. And we launched some pioneering new products in aviation and military, including some advanced artificial intelligence-based screening products that we'll talk about a little bit later.

It's also worth noting that the division's headline financials included a 4-month contribution, a stub period from the Morpho acquisition, which we successfully completed in April.

A couple of additional points on Morpho.

The acquisition really enhances our market leadership position and brings together 2 really complementary businesses. We've somewhat here created a best-in-class global technology and solutions provider. The regulatory approvals for the deal required us to sell the Morpho explosives trace business, as many of you may have heard, and we completed that process successfully in July. The integration is going really well and it brings with it a number of complementary products to enhance the portfolio, particularly in the computed tomography hold baggage market. Some of the major orders that we've seen in that period as a result have fed into the division's strong transportation sales in the second half.

Underlying margin for the business is expected to be similar to our existing business. And we're more and more confident that the value in the strategy from the combination of the two businesses is greater than we originally anticipated.

Moving to Interconnect.

We spent a lot of time and effort on Interconnect and its restructuring in the last 18 months, trying to streamline our approach to fewer higher growth end markets. The result of our refocusing has begun to come through.

Revenue from the ongoing core business after the divestitures was up 3%, driven by strong growth in space and commercial aerospace in particular. Headline revenue for the division was up 1%, with strong operating profit growth of 5%.

Following the sale of the Power and Microwave Telecoms businesses and the realignment of the business overall, we think we've now honed Interconnect into a very attractive and growing core. The results are simpler, more focused high-technology business that is positioned for better performance. And the proof of that is starting to come through with enhanced revenue growth and margin progress, which we expect to continue.

Our focus is to pursue both organic and inorganic opportunities to help accelerate execution of our strategy and enable Interconnect to achieve top three positions in its key markets. We've also increased investment in R&D to 6% of sales, and we are targeting improved speed to market for our new products.

Onto Flex-Tek.

Another strong performance. Sales were up 3% with good growth in most segments, in particular heating solutions. Operating profit was up 11%, with stronger margin driven by operational improvements. To further enhance Flex-Tek's leading positions, the Heat Solutions business recently signed an agreement to purchase the heating element division of Osram. It's small, but it's a great deal, which broadens our portfolio in engineering heating solutions, one of our big growth markets.

Overall, I'm very pleased with how the year has gone. There's more to be done and we'll return to that a little bit later.

I'm now delighted to hand over to Mr. Seeger, who some of you know very well, to cover the financial results. Bill, if you please?

Bill. Seeger - CFO

Thank you, Andy. Good morning, everyone, and thank you, Andy.

Strong progress has been delivered this year, both from an operational as well as a strategic perspective. Our financial framework is built to support continuous improvement and sustainable value. So our results not only demonstrate annual improvement, but positioning for the future.

Let's look at the numbers.

Revenue for the group of GBP 3.3 billion was up 11% on a reported basis, but down 1% on an underlying basis, excluding the positive impact of FX and the timing of our portfolio activities.

Operating profit of GBP 589 million was up 16% on a reported basis, but up 3% on an underlying basis, the result of driving our operational efficiency. That focus has delivered an operating margin improvement of 70 basis points to 18%.

The group generated excellent cash flow this year, with free cash flow up 52% to GBP 370 million. EPS of 97.6p reflects an increase of 15% on last year. This was supported by improvement in operating profit and favorable FX, partially offset by a 1.5 percentage point increase in our effective tax rate, consistent with our previous guidance.

As Andy mentioned, the total dividend for the year, at 43.25p, represents an increase of 3%.

I'll now review the results in more detail.

During this period of repositioning, underlying revenue decreased by GBP 25 million or less than 1%. The positive impact of currency translation increased revenue by GBP 421 million, partially offset by the net impact of divestitures and the 4-month ownership of the Morpho Detection business.

John Crane fell 4% as a result of challenges in the global oil and gas markets. Although down year-on-year, we are seeing some stability in the oil and gas OE markets and an

improving aftermarket, now 64% of our business. Non-oil and gas revenue, which represents about 45% of John Crane, showed a positive trend, growing 2%.

Smiths Medical declined 3% on an underlying basis with a gradual introduction of new products expected in H1. Infusion Systems, Vascular Access and Vital Care, each representing about 1/3 of our revenue, declined at roughly the same levels.

Smiths Detection improved 4%, with particular strength in air transportation, our largest segment, increased 9% in the year.

Smiths Interconnect grew 1%, but focusing on our core business, which excludes the divestiture of Power and Microwave Telecom businesses, we delivered a solid growth of 3% in 2017.

Flex-Tek grew 3%, reflecting strength in our Heat Solutions segment, which increased 12% in the year.

Turning now to operating profit.

Our profit accelerated this year, with underlying operating profit up GBP 18 million or 3%. This excludes the GBP 71 million positive impact of FX and the net effect of acquisitions and divestitures. The positive impact of our focus on operating efficiency is clear, which supports the ongoing discipline that has been a reliable element of our results over the years. Our increased investment in R&D, which I will discuss later, was also absorbed within our overall profit improvement.

Central costs were up GBP 13 million, the result of adding capability in our operations excellence, corporate development and professional leadership areas. On the other hand, our IT infrastructure costs were reduced, although those savings are allocated back into the divisions.

In 2018, we do not expect our central costs to significantly change. We do, however, plan to invest around GBP 8 million in a central fund that targets our digital product transformation across the group.

Our results reflect the group's balanced and focused execution this year, with improving margins in all divisions, while increasing investment that will grow revenue. This was supported by a combination of operational improvements, cost efficiency and the benefit from lower margin divestitures. The overall result was group operating margin increasing to 18%.

2017 was an excellent year in cash generation, reflecting the group's financial framework and focus, with operating cash flow up 34% and cash conversion at 118%.

As shown in the chart on the right, we have delivered continuous improvement in cash flow for the past 3 years. This was supported by our focus on working capital, which generated GBP 85 million in cash flow. Free cash flow of GBP 370 million, up 52%, provided not only solid cover for our dividend, but an overall reduction in net debt.

The focus on operational improvement is delivering results, with underlying inventory down GBP 52 million this year and stock turns at 3.5x. Our inventory improvement has, in fact, accelerated in H2, with a stock turn exit rate of 3.9x. However, we see scope for significant further improvement.

As highlighted in the blue circle in the bottom right, an increase in stock turns of 1x releases about GBP 100 million in cash flow. At the working capital level, the opportunity is even greater. Of course, this will not be delivered in a single year. The size of the benefit is not only significant from a cash flow perspective, but is central in operating a dynamic company.

Investing for sustainable growth has not been at the expense of constraining the business. In fact, we continue to execute initiatives to deploy R&D and capital that optimize our opportunities and deliver a strong sustainable return, both in the short and long term. R&D as a percentage of sales has reached 4.6%, up 60 basis points on last year. About 60% of this increase was expense.

Examples that highlight our investment this year includes new products for Medical and further capability in our Detection business.

Looking at 2018, we expect R&D as a percent of sales to be at least similar to this year, mainly driven by Detection.

Capital investment is expected to be broadly flat, consistent with our asset-light business model.

Looking at returns. ROCE has increased to 16.2%, with improvement in each division. This performance was driven by improved margin, with a modest decrease in our underlying asset base.

As seen in the chart on the left, the Morpho acquisition adversely impacted the group return by 50 basis points in 2017.

Moving on to pensions.

As shown in the table, we have made further progress during the year on the legacy pension position of the group, with the accounting balance in a surplus position.

In 2017, we have de-risked our pension liabilities by executing two buy-in agreements totaling GBP 380 million. We have 95% of our assets matched with liabilities, insulating us from interest rate and inflation movement. In the year, we have also made a cash payment into our U.S. scheme, which is now 91% funded. As shown on the right of the page, our cash payments into the funded U.K. and U.S. schemes continued to decline. For 2018, we expect the cash contribution to be about GBP 50 million.

Let's now review the tax status and outlook.

Our tax rate is increasing. As shown in the table on the left, over 52% of our revenue by origin is in the U.S., where the combination of the federal and state tax rate combines to about 38%. We do, however, continue to investigate opportunities that can mitigate the increased rate. Our guidance for 2018 is a tax rate of 29.5% to 30%. This is improved from the half year position, where we guided to 30% to 31% rate.

As Andy indicated, the board is recommending a final dividend of 29.7p, bringing the total year to 43.25p, up 3%. This increase reflects our progressive dividend policy, the

underlying improvement in EPS and a free cash flow payout ratio of 45%. As indicated, our cash generation continues to be healthy and our balance sheet is in very good shape. We are optimistic about future opportunities for the group and our recommendation reflects that view.

Our financial discipline and long-term planning is reflected in our balance sheet. As shown, the acquisition of Morpho was self-funded. With cash conversion at 118% of operating profit, we have healthy coverage for the dividend, and we're able to show an improvement year-on-year in our net debt.

Just a few comments about our debt structure. In August 2017, we prepaid our $175 million U.S. notes due February 2018. After adjusting for this prepayment, our average debt maturity profile stands at 6.5 years with a weighted average cost of debt at 3.2%. We continue to have a strong investment-grade rating and believe our balance sheet fundamentals are sound. And finally, with our net debt-to-EBITDA ratio at 1.4x, we are positioned to support the long-term plans of the group.

I would now like to discuss our financial framework that supports the group.

Our inherent business characteristics creates an asset-light model, with healthy, sustainable margins. The underpin is a strong balance sheet. We are disciplined in how we use cash. We invest for growth, both organic as well as through value-creative M&A. We follow a progressive dividend policy to properly reward our shareholders. And finally, the debt structure of our balance sheet supports our strategic requirements. Our framework is effective because it is balanced and comprehensive.

Looking to 2018. The progress we have made in executing our strategy through portfolio repositioning and organic investment supports a return to growth in 2018. We expect group performance to be weighted towards the second half. Growth in John Crane's nonoil and gas business, as well as an increase in aftermarket, is expected to more than offset the oil and gas challenges. We expect the gradual introduction of new products during the year to support an improvement in Smiths Medical. In Smiths Detection, we anticipate a strong second half, driven by our air transportation business, which should

generate good growth for the year as a whole. In Smiths Interconnect, our focus on fewer higher-growth markets supports further improvement. Flex-Tek is expected to deliver steady growth as well, supported by several new products. Finally, we anticipate continued strong cash flow.

Thank you. Now back to Andy.

Andy Reynolds Smith - Chief Executive
Thanks, Bill. Very clear.

Okay. Just before I get started on the strategy update, just wanted to confirm we're really pleased we're going to be holding a Capital Markets Day on December 6. So really looking forward to welcoming those who like to be there to learn a bit more about the strategy and the detail behind the strategy, and probably very importantly, meet some of the great folks that we've got around and give them a bit of a grilling as well. So looking forward to seeing those of you who think you can make it.

I wanted to spend a little bit of time on what we've done, some of the evidence behind what we've done and where we're headed going forward in our strategic objectives.

One of our key focuses, as you know, is positioning ourselves to outperform the markets that we serve in. You'll all be familiar with this slide. And as we continue to position Smiths for sustainable growth and value creation, we're trying to build top three market-leading positions in those markets that we choose to serve. We want a more focused portfolio that captures the characteristics of a Smiths business that, again, you'll be familiar with now, which are a strength in technology and differentiated technology, increasing digitization, a high proportion of aftermarket and recurring revenues, an asset-light operations that is sustainably competitive, and of course, all of those businesses positioned -- well positioned in attractive markets, which means with good long-term growth drivers.

We've made some significant strides in repositioning and upgrading the portfolio for future growth. And we've done that through organic investment and a highly disciplined and surgical approach to acquisitions and disposals.

Following our detailed strategic review about 18 months ago, we'd looked at 55 market sub-segments within the business. And we established that around 60% of our revenue at that time came from businesses that were both well positioned in terms of market attractiveness and also competitive. That left about 1/3 of our revenue which required improvement to achieve top three leadership positions or, in some cases, businesses, which although of good quality, lack scalability or, in some other cases, were simply too far from achieving leadership and we felt that we should be focusing our efforts in other higher priority areas so they would find their way to a better home.

This year, we completed the sale of the Artificial Lift business in John Crane; Wallace, the IVF business in Medical; and the Power and Microwave Telecoms businesses, generating around GBP 400 million of proceeds. And we then added Morpho Detection into the equation and you can see how the shape of the portfolio is starting to change. As I said earlier, this portfolio exchange and reallocation of capital left us with more than GBP 200 million of revenue that had a declining top line being replaced by a similar amount of revenue which is growing and with stronger sustainable margin potential also.

Through both our organic and inorganic actions, we've now got 75% of the portfolio that comes from businesses that are well positioned and that we plan to build on for the future. You can reasonably expect that this process will continue in parallel with our organic investment path, especially if we see some ways where we can accelerate our global market and technology repositioning at the right price. We bought well and we sold well so far and that discipline will absolutely continue to guide us as we work to deliver shareholder value.

A very good example of our strategy in action with both organic and inorganic portfolio repositioning was the portfolio moves that I mentioned earlier in Interconnect.

Interconnect has undergone a ton of change in the last 18 months. We completed a major structural reorganization, reducing complexity and improving key customer management. We've divested just over 40% of the division's revenues with the sale of the businesses that I mentioned and focused the remaining business on fewer higher-growth markets with value -- which really value advanced technology.

These end markets all have positive long-term drivers, and they're markets with a rapidly increasing demand for secure high-speed, high-reliability connectivity. A great example of this is commercial satellites and one particular customer with this increased focus is resulting in a threefold increase in Smiths' content per satellite. It's going to reach close to $1 million per unit over the coming couple of years. The market for high-reliability, low earth orbit satellites is also expected to develop very quickly as programmes to connect more of the global population come to fruition.

This organic refocus has also supported the return to revenue growth in the ongoing business, from minus 3% last year to plus 3% on a like-for-like basis this year -- or in the financial year gone. And that means the business is well placed to pursue further organic and inorganic investment opportunities to support an acceleration of the growth.

As we increasingly focus our businesses in attractive end markets, it's absolutely critical for us to establish the capabilities to achieve strong execution and continuous improvement. As I've said a lot of times, we've been driving progress in three areas: operational excellence, innovation and people.

From an operational excellence point of view, many years in the fiercely competitive and sometimes fun automotive market have really thought me that whatever the industry, they value speed and efficiency and everything that, that brings with it. And that's really the essence of the Smiths Excellence System, instilling a culture of continuous improvement and sharing best practice globally, all with the aim of achieving world-class competitiveness.

It was clear to me from the beginning that there was a real opportunity to run this business better, and the good news is we're starting to see the results. Bill had mentioned some improvements in speed and efficiency with working capital reductions delivering GBP 85 million in FY '17, with more than GBP 50 million of that coming from inventory. And there's opportunity for material, incremental and ongoing benefits. All of these improvements allow us to fund future growth in the group.

Looking at innovation, in simple terms, we're investing more, and we're trying to do that more intelligently.

Our spend has increased to 4.6%, which is the highest level it's been for more than a decade in the group. We're targeting also more commercially focused product development with faster times to market. We've appointed a group head of innovation and a Chief Digital Officer to improve the focus and pace of our innovation. It's really essential that Smiths is a technology leader, defining new ways to bring value to our customers, and at the same time, developing new business models for the future.

I mentioned our group-wide innovation framework, i3, earlier. It's really helping us to develop a culture of innovation. It's also supported the launch of our first 6 projects in a number of areas including 3D printing, nano-coatings, but particularly, increased digitization, as we continue our digital transformation.

One example of that is a product line called CORSYS in Detection. It's a cutting-edge approach to digital detection that allows you to control entire ports and border security operations and also potentially airport operations through one enterprise platform that's accessible on handheld devices. We're piloting Narita with this technology. It connects all of the security systems and data sources and supports a more comprehensive and efficient approach to screening goods through the hubs. It's a first of a kind software, and as I said, it's being piloted in three locations around the world currently.

To support this leading-edge software solution and the group's overall digital transformation, I'm really pleased to announce that we're going to be partnering with Microsoft to help us accelerate progress in this area. Look out for some fuller details on that very soon.

We're also announcing today the opening of two Digital Forges. Now what's a digital forge? It's essentially a global centre of excellence. The first will be established in the San Francisco Bay Area. In fact, it's already up and running. And the second is planned for London. They're really development centres for software technologies that help to underpin some of the rapid acceleration that's needed in each of our divisions for our

digital business models. The locations will really bring together great people and capabilities and help cross-functional development across the group to develop better, new products faster, including in the areas of artificial intelligence, augmented reality, analytics, data security and algorithm development. They'll also give us the added benefit of being able to attract some of the highly skilled talent in some of these quite specialist and critical and high demand areas for the future.

It's important to emphasize, however, that digital technology is not about complementing in parallel our existing businesses. It's really about defining new business models for the future and making absolutely assure that we're ahead on the capabilities that enable those models.

A small example would be the John Crane Sense product that we've spoken to you about in some cases that enables you to sell a contract versus a part and replace it, so an uptime contract.

For me, the key part of excellence is our people and leadership. We want to be able to attract, retain, develop, engage and inspire the best. Investing in our people and nurturing talent through the group is absolutely central to that. We've launched a leadership development programme, partnering with UCLA in Los Angeles, with all of our top 100 leaders going through the programme in the first year. We've successfully implemented a common group-wide talent review process aligned with our strategy. And we're making sure that our top leaders across the business are also incentivized much more closely on operational and strategic metrics from a financial point of view.

Earlier in the year, we launched the Smiths Way, a culture change programme and a set of values and ways of working that really define what you can expect when you work with us, potentially work with us or do business with us.

We've made really good progress on our strategic priorities and building for growth future. We've got the structure in place to drive that growth. We've got an increasingly well-positioned business portfolio, and we are building on that. And we're confident in our ability to outperform our chosen markets.

We have a strong, sustainable margin base, supported by our common operating model, the Smiths Excellence System. And our relentless focus on cash is ingraining within the business to give us the capacity to fund significant further investment to enhance our capabilities for the future. All of this ensuring that we can achieve world-class competitiveness.

We've got a strong financial framework, and we're really disciplined in how we're using the cash to generate our investments, whether they're organic or nonorganic, to pursue growth and opportunity. And all of this supports our ability to deliver long-term attractive, sustainable returns for our shareholders. And I'm really looking forward to giving you some further updates in the coming months of how we're doing.

Thanks very much for listening on a Friday morning. I appreciate it. Thank you.

Question and Answers

Andy Reynolds Smith - Chief Executive

Delighted to take any questions that you may have. Right. Okay, so we start down here, and we've got two here as well.

Mark Davies Jones - Stifel, Nicolaus & Company

Mark Davies Jones from Stifel. Lots of things to ask about. But I'll stick to two. Firstly, on Medical, you talk about a big repositioning there. Not a lot of that is visible from the outside, yet. Is new product introductions on the existing kind of range sufficient, or is that a key area where you going to look at more portfolio pruning? And you're talking about being top three, it's very easy to see the other divisions being top three as rather more difficult than Medical, so if you could just talk about that briefly.

Andy Reynolds Smith - Chief Executive

Yes. Well, I think, well, first of all, it has been a really big programme of repositioning, one that we've had to step up in the last 1.5 years or so. As I mentioned earlier, over the next several years, the programmes that we've now got in place replace half of the entire business, but that's very focused in areas where we think we can achieve category leadership, that top three piece. The Wallace business sale in IVF was an example of one

of those that we just felt didn't have the scalability, and whilst it was a very good business, we were able to sell it for a very good price. It didn't have the scalability or the ability to get it where we wanted it to be. I was a tinge unhappy in the second half because we got a really big programme coming through, but I'm also very confident that that trend of revenue is turning, and we'll continue to see that bite as we move into the first half and into the second half, so we've got a really solid set of products that are much more focused in those areas where we can be category leaders.

Mark Davies Jones - Stifel, Nicolaus & Company

Okay. The other area was on the incremental investments you are making. Firstly, how much of the step-up in R&D is coming at that central level within those central costs, it's a total, 21 uplift over the couple of years isn't it between the central costs and the ... And so is a big chunk of that R&D? And there are some fairly hard-won savings coming out of the divisions and quite a big step-up in the centre. Is that effectively a one-time adjustment in the level of central costs, or is that the beginning of a trend?

Andy Reynolds Smith - Chief Executive

Okay. Well, a couple of things there. I mean, first of all, I'm by nature a centre-light kind of person, probably borne out of having spent a lot of my career in the divisions receiving central help. So I've got a pretty good idea of what's effective and what's not. Where we've really focused our central cost increases is around driving the Excellence System, the innovation agenda and our people plan. I'm not expecting that to increase meaningfully going forward. We've done that. And it's already starting to be deployed out into the businesses. The model is the divisions execute, the group defines the framework and the objectives, and then drives the performance through that common framework. So I felt it was essential because we had a lot of disparate ways of doing things across the group. As far as the R&D piece, we are stepping it up. If I look at it as far as what we're doing from a central perspective, it's a bit of a moving piece because some stuff that we'll do centrally is to give it a kick-start in the first year and then it becomes a divisional deal. Some of it sustained centrally. So a lot of the digital capabilities where we're putting experts in on A.I. for example, will be a central resource. And in answer to the quantum piece, it's about 10% of the total is central at the moment versus divisional, and that will

move up and down a little bit, but I would expect a little bit more in the centre as we strengthen these Digital Forges to really give some horsepower.

Matthew Spurr - RBC Capital Markets
Matt Spurr at RBC. Can I have one coming back to Medical. Essentially, it looks like a year delay from your expectation, at least in terms of the benefits manifesting as growth. Can you give a bit more colour on what happened in terms of getting the new products to market? Is it not developed and not approving, not been accepted? Just a bit more colour there to help understand what's going on and how we can sort of look at it going forward?

Andy Reynolds Smith - Chief Executive
Yes. Well, as I said, there was a tinge of unhappiness because it's such a big programme. It's a bit of all of the above actually, Matt. I mean this is getting new products approved through the regulatory processes is never a precise science in any case, so there's a piece of that. There's a piece of our own execution in this as well given the scale of the programme launches. We've now got an absolute lock on that going forwards, which is why I'm in a position to express the fact that I think that corner of margin revenue deterioration we're turning towards that positive trend now. And it's a big programme and a great one as well if I look at the stuff that's coming through.

Matthew Spurr - RBC Capital Markets
Okay. And then can I switch to John Crane? So it looks like aftermarket declined in the second half. Can you give it a little bit more colour on that?

Bill Seeger - CFO
I mean the timing of the OE is altogether not different than the aftermarket. Now there is projects and programmes that come along that caused that. But overall, aftermarket increased, but it did decline slightly in the second half, but not in a material way.

Matthew Spurr - RBC Capital Markets
And then one smaller one. You talked about the synergy expectations changing with Morpho. So I think previously, you had $30 million and then $21 million, you couldn't keep Trace, so what do you expect it to be now?

Andy Reynolds Smith - Chief Executive

Yes. Well, just to clarify for everyone. When we came out with our initial estimates pre the regulatory review, we set about $30 million of benefit, we were then forced to sell the Trace business, and we took that number down to $20 million. The team's now been doing a lot of work over the last three months to get to grips with all the operational, sales, selling channel, technology synergies. And the number is back at $30 million, which I'm really pleased about because it's a smaller business or the Morpho business, but the synergies are higher than we expected proportionally.

Michael Blogg - Investec

Perhaps I'll fire away. On the nice pie charts that you have, going from 60% to 75% of the business with good prospects, if we look at the GBP 200 million of revenue going out as noncore and GBP 200 million roughly coming in, that more or less accounts for the move from 60% to 75%, I think, given roundings, suggesting that there's no sort of organic progress during the last year. What is a sensible realistic expectation for organic progress to the fixed businesses?

Andy Reynolds Smith - Chief Executive

Yes. What -- I think the way I'd answer that is the progression of the portfolio to better-positioned is both organic and nonorganic. And now obviously, the non-organic bit happen quicker and is kind of really visible. And the organic piece is going on over a period of time. All of the decisions that were taken -- or we're taking now are based on the Smiths' characteristics and getting ourselves better positioned. So progressively, over time, the organic piece of that gets bigger and faster, but will always be complemented by some ongoing parallel path non-organic. If I think about that remaining piece, the 25% that's there, I mean I'd said a couple of times before that, whilst don't hold me to the absolute precision because we're constantly assessing which businesses we think we can improve organically and which we just say, let's send them somewhere else. But if you thought about that roughly in half-on-half terms, as far as those that we think will get there in that organic and non-organic parallel path.

Jack O'Brien - Goldman Sachs

It's Jack O'Brien at Goldman Sachs. I just wanted to clarify the potential benefits going forward from the Smiths Excellence System, and we've obviously, seen quite good progress, procurement savings, et cetera, helping the margins. If you could help us sort of quantify going forward what you still see? And just back on to that portfolio rationalization point, obviously, four disposals in the last 12 months, but some great progress. Would you expect some more in the next 12 months?

Andy Reynolds Smith - Chief Executive

Okay. Well, I'll have a go at the first piece and perhaps you can have a go at the second piece, Bill. Well I think as we -- you have a go at the first piece first. The second piece first. No, I think as we drive the business forward, it's all about growth for me really. I said at the beginning that I was -- I wanted to be in a position that I could increase the investment for growth, but not materially take margins backwards. And I was pretty confident from what I saw in the business early on that we could do that, and we are. In fact, we've increased investment, and we've managed to push margin forward a little bit. And importantly, push it forward on the basis of efficiency improvement, not short-term cost cutting-type programmes. As we go forward now, I'm expecting short-term stability in margins as opposed to the focus being driving margins forward, because I want the growth. As we go forward in the medium and longer term, I think there's a lot of opportunity just to continually improve the performance of the business overall. Perhaps if you talk about the portfolio piece?

Bill Seeger - CFO

Sure. About the ops excellence impact?

Andy Reynolds Smith - Chief Executive

Can we expect more on divestitures?

Bill Seeger - CFO

All right, okay. I think this year, you saw maybe a bit of coincidence of selling four businesses and acquiring one. I'm not sure we can pull that off every single year. But as Andy said, with the 25% focused on the remaining piece of the portfolio, there will be divestitures, but you have to pick the right time, and the right price and the right

counterparty to join the deal. So the timing is a bit uncertain, but there will be further divestitures. How many in 2018 is unclear, but there will be.

Jack O'Brien - Goldman Sachs
And perhaps just one follow-up on Detection. You've talked in the past about some opportunities in Asia. What are you seeing there at the moment also in terms of competition and also the opportunities in critical infrastructure?

Andy Reynolds Smith - Chief Executive
Yes, that's a good question. We've said before we're too small in Asia. I don't think that needs saying again. We did make a really important move putting in an Executive Committee member over there. He is now in Sichuan in China looking at the regions, supporting the divisions. My concern with Asia was you can't wish growth, we're relatively small in many cases, so we're lacking the critical mass, either in leadership horsepower or strategic thinking to get as where we needed to be. It just wasn't on the priority list highly enough. This will bring that focus. I think it is going to be a combination of both organic and nonorganic activity, a few challenges coming along with that. That will be very clear. But I expect to start to see some of the clarity on what we can do and how we can do it. One thing I do know is that, we have to be flexible to the demands of some of those markets, particularly whether it's in terms of specific products or business models. And competition is really tough, but it's such a crucial piece, not just for the region and the growth in and of itself for the region, but for the global influence that that region has around the world. So that clarity is coming.

Alasdair Leslie - Societe Generale
Alasdair Leslie, SocGen. You've obviously made it very clear that growth's a priority perhaps 2018 and certainly going forward. So you've obviously got a very strong margin in John Crane. I was just wondering how willing you are to use that strategically maybe in terms of the OE project business in terms of pushing growth, particularly if the market recovers and more opportunities come through, so maybe some colour, some comments around the sort of growth margin dynamic in John Crane. And then also, just a follow-up on Medical. Just for clarity -- do you actually think Medical will grow organically this year? Because, obviously, the commentary is around gradual improvement, but from a lower

base, obviously that gives you a lower comp, an easier comp, but you're coming off a lower level. And then just a final question, just around the new product launches, a usual question about will they be instantly accretive to margins? Or as you obviously replace more old and more commoditized products or are there launch costs, et cetera?

Andy Reynolds Smith - Chief Executive

Okay. Well, Crane, as we said before, it's a really high-quality business, Crane. Overall, now we're seeing the aftermarket piece going back into growth. We've got an increasing proportion of non-oil and gas, and that piece is already growing. But we should also -- we also do very clearly remember that the OE fit provides the annuity of aftermarket. So you absolutely have to manage your installed base and grow your installed base. So we're very mindful of that in the current circumstances, and in fact, have taken some decisions around margin to the negative detriment of margin to take business on the OE in the installed base, which is pretty hard-fought at the moment because the pie is smaller, to ensure that we grow and develop that installed base. As far as margin going forward there, we've got a strong margin. We continue to make progress in that margin, but we also need to step up the investment. So I'd mentioned last time around that we were investing much more heavily in the digital stuff in Crane, and particularly in some of the ultra-high performance products because as stuff is renewing, a refinery, for example, runs at much higher temperatures and pressures. Now it's got much higher demands on the product itself, so the nano coatings that I mentioned in the speech there, those sorts of things become crucial, plus developing some of the specific products for non-oil and gas, like pharmaceutical, is going to be a big focus for us. So maintaining those strong margins, but investing more for growth, I think is the general position around Crane. Do you want to have a crack at the next one there, Bill?

Bill Seeger - CFO

On the Medical organic growth, the answer is yes, but we have to work through the time phasing of that pending different approvals and so forth. As I indicated, we will be putting into kind of the bloodstream, if you forgive that point, on Medical. Beginning in the first half, you'll see new product introductions. And then as Andy said, nearly 50% of the product portfolio in one shape or another changes over time, so that's all designed to not

only inject technology into the equation, but to build the growth agenda that we're looking for. So absolutely, time phasing, depends on a number of things, but clearly, the new products will drive growth. On your second point, it's really around those new products, and we really felt that the breadth that we needed to focus on Medical and the money we're spending, as you saw on the R&D comments, heavily focused on Medical, in fact, it was all coming together such that we can say with a bit of a confidence as we go forward that that business will grow. Timing is difficult to predict, but it should grow.

Sash Tusa – Agency Partners

Sash Tusa from Agency Partners. I've got a question about Detection and how growth in that division is compatible with your wish to remain an asset-light business. Clearly, there are some parts of that. Ports & Borders is an area where Smiths has sort of blown hot and cold on that over the last decade or so, but where you could grow the business, but you'd end up owning an awful lot of stuff on behalf of your customers, that possibly have the potential that you'd have a similar issue in airport as well with new technologies. What's your tolerance for that sort of trade-off?

Andy Reynolds Smith - Chief Executive

Well, in the airport piece, the Detection business overall is somewhere between 50% and 60% bought in, not too dissimilar to the group overall, actually. It is a very asset-light model. The Ports & Borders piece typically in the past has been higher-owned content on the basis that it typically tends to be the Ports & Borders product tends to be big upside-down U-shaped gantries that trucks and containers go through, so it's a lot of metal essentially, so that does drive a bigger chunk of content. Where I think that's changing because Ports & Borders also was typically a much lower spec-type product, lower spec x-ray, so it's a lower-tech product in general. What is changing now, and I mentioned the CORSYS product, is that the intelligence with which you do the detection is increasing significantly, so the example around CORSYS would be that you're actually using artificial intelligence to identify all of the history of every container on every containership. So that rather than just selecting two out of 1,000 by chance and hoping you find the bad things, actually tracking all of the routings for all of the product that's inside every container and doing the probabilities on where to look. So the value in our offering in Ports & Borders is

changing as it is in the other side, so -- there's potentially a conflict now, but I think the model for Ports & Borders in the future reduces that conflict, in fact, improves it from our perspective.

Bill Seeger - CFO

Don't forget if I could just add there, Andy, and don't forget that software is part of the equation, too. I mean, yes, it's a blue box, it says Smiths Detection on them that we see as all of us go through airports and so forth. But it's software-driven, its algorithms that are improving, it's technology that's finding its way into the ability to find threats, and that's not a hardware, entirely a hardware position, that's a software position as well.

Alex Virgo - BofA Merrill Lynch

Alex Virgo, Bank of America. Just on first on cash flow. Is it fair to assume that cash conversion in '18 is going to be around the 120% level as we've seen this year? And obviously, with the pension contribution declining significantly, so presumably more of it is going to drop through as well, further down?

Andy Reynolds Smith - Chief Executive

Okay, I'll let Bill answer that one, and then I'll tell you what I think. Yes.

Bill Seeger - CFO

Right. Do I get to go last? Go ahead.

Andy Reynolds Smith - Chief Executive

Okay. We've been really pleased with the progress on cash flow. The most important thing about improving cash flow for me is doing it systemically. There are ways and means of improving cash flow at period-end, but that doesn't get you where you want to be. So the big focus has been systemic improvement through the Excellence System. The real improvements are starting to show, in fact, quite significantly so, we had a good level. As a business goes into a growth phase, I wouldn't expect necessarily to be up at the 120% forever, because we won't. However, I think there is enough continued opportunity in the business that I'm thinking about this in terms of north of 100% on an ongoing basis through cycle through growth phases. And the key thing is you just -- when you add the sales, you add as little working capital as possible, and you can only do that if it's systemic.

Bill Seeger - CFO
Okay. That was really good answer.

Alex Virgo - BofA Merrill Lynch
Okay, thank you. A second question...

Andy Reynolds Smith - Chief Executive
By the way, we think exactly the same thing on cash, so I can confirm that, the 100%.

Bill Seeger - CFO
I will add a point though, I think. It's a huge focus. And we realize it's sort of the lifeblood of what runs the engine room, whether it's feeding acquisitions or helping in terms of generating more R&D opportunities. And there's a framework that is quite disciplined, as I talked about. Whether we can pull off another 118%, I don't know. But there's huge opportunity, again, as I talked about in working capital, which can only help.

Andy Reynolds Smith - Chief Executive
Absolutely.

Bill Seeger - CFO
So the focus is quite intense, relentless as Andy calls it. And I assure you that, that's -- that is real. We're quite focused on that.

Alex Virgo - BofA Merrill Lynch
Good. It sounds good. The second question is maybe, can you just clarify what's in and what's not in headline EBITA when you talk about sustaining the 18% margin in '18 versus '17, because my feeling is that there is probably more headwinds in the '18 number than then there was in the '17, implying an underlying margin actually better than that in '18?

Bill Seeger - CFO
Right. Just point maybe to one example, it's restructuring, which we talked about at the half year. It's just as an example. We've taken historically the four-year programme that we called Fuel for Growth to help drive margins and so forth below the line benefits you've seen in the improvement in margin. At the half year, we signaled that we would take an ongoing restructuring above the line, and we will. We're not going to be spending the

amount that was roughly GBP 30 million below the line in 2017. And it will be roughly half of that, let's say, in 2018, but that will move to be above the line.

Alex Virgo - BofA Merrill Lynch
Okay. And then, Andy, maybe one last question just on John Crane. Would you mind talking a little bit about what you're seeing in terms of the seasonal maintenance plans from the refinery owners?

Andy Reynolds Smith - Chief Executive
Yes, okay. We're starting to see a more positive trend in the aftermarket, which reflects directly into that maintenance story. The order books are strengthening there, and that's returning to growth.

Jonathan Hurn – Deutsche Bank
This is Jonathan Hurn from Deutsche Bank. Just two questions, please. Just following up on the comments on John Crane. Obviously, we've seen a lot of downstream outages in Houston over recent weeks. What are the implications for John Crane in H1, both positive and negative, on that?

Andy Reynolds Smith - Chief Executive
So we've seen a lot of downstream...

Jonathan Hurn – Deutsche Bank
Outages in Houston. In the back of the hurricane, what are the potential H1 implications of it?

Andy Reynolds Smith - Chief Executive
Yes. Okay. With lots of telephone calls after hurricane Harvey, as you'd imagine. Almost no, to my knowledge, impact in terms of flooding, but many refineries were taken down. There was one notable chemical plant that you probably saw in the news that there was -- they were really concerned about -- that suffered some real flooding problems, but the oil refineries didn't. But inevitably, when you're bringing up a multibillion-dollar installation, I mean they don't shut these things down at the end of the week for the weekend. These things run hard and hard and long. You bring them up again, there are problems. We currently redeployed about 80 service folks from other parts of the U.S. down into the

region to handle bringing all those back online. I couldn't quantify it, but on the whole, it's going to be more positive for us. The timing in that and the scale of it, I can't put a number on yet, but this is positive, not negative in general terms, but it's not a needle mover.

Jonathan Hurn – Deutsche Bank

And the second question is just on Detection. I think when we heard from you in the first half, you said there were some pricing headwinds in that business. Have those headwinds gone away in the second half?

Andy Reynolds Smith - Chief Executive

I think it's the same position we see in the aftermarkets and service piece, the same scenario as we outlined, I think, at the half year. More and more of that revenue stream is specific equipment, dedicated software and algorithms. So the margin pressure there, we're not seeing margin pressure there. We do see continued, but similar margin pressure on those first wins, because when you're in, you then have that longer-term contract to support some increasingly sophisticated kit.

Glen Liddy - JP Morgan

It's Glen Liddy from JPMorgan. Just three questions. On the Medical business, sticking with price, it's always been a bit of a challenge on price when you haven't had the product range revitalized. Is that getting better now you've got the stream of new products coming through?

Andy Reynolds Smith - Chief Executive

Well, our average price down across the division is little bit under 1.5%. It was 17%, it was 16%. And what we see within that is that where there are new products, the pricing pressure is much lower. In fact, you have opportunity. And as they get older, the pricing pressure ratchets up, so perhaps not a surprising phenomenon. Too early to say precisely to correlate it with the new product launches, but when it follows that trend, we expect that will just give ongoing insulation from the overall market pricing challenges. The more innovative and sophisticated the product, the better.

Glen Liddy - JP Morgan
And on Detection, I know you don't give an order backlog number, but you seemed to have won quite a few projects during the course of last year, I mean big ones like Amsterdam and others. Is that giving you a stronger position as you look into this year, albeit probably second half loaded in terms of the revenue progression than you had at this point last year?

Andy Reynolds Smith - Chief Executive
Yes, yes. I'm not so concerned about the revenue timing because it comes. It doesn't matter, does it fall in the last month of the period or the first month of a period. I think as we think about the pressure on delivery for that, we're winning at least our fair share. And I think that the strength of those two businesses together, being able to offer the checked baggage and above ground bring together systems will increasingly add benefit and strengthen our position, Glen. And I couldn't put directional numbers on it yet, but increasing confidence in the benefit that it's going to bring.

Glen Liddy - JP Morgan
And coming back to the sort of weather in the U.S. And with Flex-Tek when they do a lot of AC-related things, flexible hoses, I mean given the devastation to homes, is that an incremental opportunity for the near-term?

Andy Reynolds Smith - Chief Executive
I think it's a similar position that, on the whole, it will likely be positive. Obviously, it's a tragic situation, lots of homes destroyed or roofs taken off, therefore, the air conditioning, and also the gas tubing, don't forget, because there's a big piece of domestic, flexible gas tubing in Flex-Tek. So it will likely be a positive for us, but the precise timing of that, I think people are just getting to grips with how to start rebuilding. And that will play out over the next few months. Thank you, Glen.

Robert Davies – Morgan Stanley
It's Robert from Morgan Stanley. Just a couple of questions. First one was on the John Crane business. You mentioned the non-oil and gas piece up 2%, versus the oil and gas down 7%. I guess going forward, over the next few years, how do you think about the through-cycle growth of that non-oil and gas part of that business? And where do you

expect that as a percentage of the overall Crane business to get to? That was the first one. And then the second was just around the Medical portfolio and the changes. So you're spending 6.4% on R&D, 50% of the products being revitalized or changed. That's fairly kind of dramatic. What is it really fundamentally that when you look at that portfolio, you're kind of missing? Is it that the products you got are a little outdated? Are they in the wrong part? Is it that everything just needs an upgrade to address the pricing? What was the thought process behind that?

Andy Reynolds Smith - Chief Executive

Okay. Well, I'll have a go at the Medical piece, Bill, do you want to chat about the non-oil and gas piece. I think from a Medical perspective now, we're really investing in what the industry calls category leadership, but the sophistication of the products is increasing significantly as well. So the example -- our biggest area of spend by a quite a way at the moment is on any large-volume pump, we call INTELLIFUSE, which is really a new generation smart connected pump, which creates an in-hospital and to home care ecosystem effectively between the wristband with the latest diagnosis and vitals for the patient, their electronic medical records and that loop with the dosing. So a chunk of investment going in there. We're also investing in the broader range of infusion pump technology, and also, Vascular Access, which complements it in many ways. And Vascular Access is really the story of market sub-segmentation and how important it is. Because there are certain technologies that are advancing much quicker, particularly the anti-thrombogenic antimicrobial-type products which much improve patient outcomes, so we're just redirecting investment in areas where there's much higher growth on a sub-segment level. There are some examples in the Vital Care area where we think we've got a good -- very good growth prospects, which are larger and more scalable. But the majority is focused around infusion and Vascular Access.

Bill Seeger - CFO

Right. On the non-oil and gas, certainly, it could move a bit as the oil and gas improves, so that mix will shift slightly. 55%, 45% is the approximate view of the oil and gas versus non-oil and gas. But I think maybe the takeaway point for me, let's say, is the breadth of the product and the capability of the products that we produce, that it's not just an oil and

gas product. It can handle other situations as it does. So I mean, we highlight that in part because of the breadth of the product and the capability of the technology. It's the same thing, if you will, a large non-oil and gas installation, to manage, and monitor, and sense and understand the flow of whatever it may be, as it would be in an oil and gas situation. So yes, the answer would be it could move a bit as oil and gas recovers, as I said.

Andy Reynolds Smith - Chief Executive

Yes. And just one addition to that. If we think about the categories, chemical, pharmaceutical, pulp and paper, they're all slightly different in nature where, in general, the short, medium on chemical investments, chemical plant investment is increasing at a fair rate at the moment. Pharmaceutical production is getting more sophisticated, so that there are positive trends there. Pulp and paper is just kind of a GDP thing, really.

Sandy Morris - Jefferies

All right. I'm going to be really quick. We've gone through this different comparative for free cash flows, so the GBP 243, up to GBP 370, whereas last year, we spoke of GBP 400. The all-in number is sometimes influenced by derivatives maturing in cash flows, so the GBP 370 , Bill, is a proper trading number or... ?

Bill Seeger - CFO

Yes. The FX-type driven points are down below that level. I mean, what I wanted to do, on the focus on free cash flow, Sandy, it was really to say this is all-in in terms of operating the company. So this is the operating results of the company. This includes paying taxes, paying our pension obligation, paying our interest costs on our debt and so forth, including, what we would call the statutory items in 2017, as an example, statutory items: Fuel for Growth, restructuring, those are all cash flow items. And the whole concept of focusing on free cash flow incorporates all of those. So the only remaining items as a result would be M&A activities, paying the dividend cash flow piece and any cash move because of the derivatives and so forth that you talk about related to what FX management.

Sandy Morris - Jefferies

So we get a genuine number for the first time really.

Bill Seeger - CFO
And that's what I want to do, yes.

Sandy Morris - Jefferies
And then just as we've hacked through the brush on John Crane. I mean, I've been attributing the three-point decline in margin from the peak to what we're having to incur and lower OE or first-fit, wherever we're calling it prices, is that fair? It's not mix because of the drive into other markets, it's literally OE price to preserve our share?

Andy Reynolds Smith - Chief Executive
It's the -- because the question I get a lot is the non-oil and gas bit less profitable, and should we be worried about that? And the answer is, no, because the critical applications within non-oil and gas share very similar characteristics and margin to the oil and gas bit. There are bits in non-oil and gas that are less demanding, but then, that we're not targeting those.

Sandy Morris - Jefferies
So my three points that are gone since 2015 is just first part, first fit OE price pressure?

Andy Reynolds Smith - Chief Executive
It's volume, Sandy. If you look at the volume overall and you track the last three years in aftermarket and you track -- in fact, all of the categories, they're down so as that volume recovers, there will be some benefit, but then we're expecting to invest more in R&D as well. So I couldn't put it precisely in one area. There's definitely more pressure in OE first fit, for sure, but that doesn't…

Sandy Morris - Jefferies
They get a bit of [indiscernible] gearing if we go back up. And then a tedious one. The asbestos case is outstanding. Have actually done something positive for a while -- first time for a while.

Bill Seeger - CFO
Meaning gone down?

Sandy Morris - Jefferies
Yes. I mean, one -- if you look at this thing with -- carefully but that's the first significant step down we've had for a long time.

Bill Seeger - CFO
Yes.

Andy Reynolds Smith - Chief Executive
Yes. And that's largely due to -- there's a time limit rule that after submission if they haven't been brought to trial within a certain period, so a number have been dismissed over the period.

Bill Seeger - CFO
If you look at the notes, Sandy, you'll see there's a table in there that has a big increase in dismissals, which is why it's down to the 50,000 level of...

Andy Reynolds Smith - Chief Executive
If that's what you meant on it. Is -- was that what you meant?

Sandy Morris - Jefferies
I'm not trying to be funny, because -- it's just a number of your, you can't call them peers in the states, have gone to a, "Here's a provision, bang" because they think they've got a 10-year view, and I keep sort of asking when you think you might get there and keep getting sort of fobbed, not fobbed off, I keep getting sensible answers. All right, okay?

And then just one last thing, because I love the way that we go through urban security and then the note says, see Page 29, but that's sort of presumably the forthcoming annual report, so I've got something to look forward to. Then that changes...

Andy Reynolds Smith - Chief Executive
You've got me there, Sandy, I don't know what that was, so...

Sandy Morris - Jefferies
I mean I hate to ask this because we refused to really go here. A big chunk of the group, whether it's 25% or 30%, can be a bunch of small businesses, or there could be one significant business in there. And at some point in time, I guess, we're going to have to

press you on things like, we're never going to be the volume in terms of units produced leader in, say, infusion pumps, but it's not in there, is it?

Andy Reynolds Smith - Chief Executive
Well, if you take infusion pumps as an example, and this is a case where the devil is in the detail, of course, the whole point, which is why we looked at it on a much more granular level than we had before. I mean infusion pumps, we're the leader in portable and ambulatory. We aren't the leader in the large-volume pumps. And that's -- there's a lot of investment, in fact, our largest piece of investment going into large volume, as we believe that we really do need a complete broad range, because you get common operating protocols, particularly as they're becoming connected across the range now. It was a bit less important when it was all discrete items. You could be the leader in one and not in the other. Now it's common protocols, common software, common connection systems. So we are looking building -- we're building up to strengthen through the large volume from a leadership position in a big chunk of the lower – smaller-sized end, versus some of the others who are much stronger in the large volume, but less strong in the smaller pump end.

Sandy Morris - Jefferies
Yes. But we got way behind them in connectivity side of things, our competitors were some way ahead of us for a while, but...

Andy Reynolds Smith - Chief Executive
Yes. I mean the interesting thing, but certainly, there was a lot of noise because it's not dissimilar to the car industry in some ways, but you tend to get some trickle-down effect, people fit stuff on a BMW 7 Series before it hits the 1 series. The difference here is that it's all driven by the hospitals and the regulatory risk factor, how they assess, how quickly they want to introduce. So it's not just a matter of launching the latest software and technology, it's got to be adopted and improved. So the actual uptake of fully-connected pumps of any size in the market is currently very low indeed, because it does open a lot of questions about any connected system and the implications around it. So a lot of noise, yes. Actual uptake is not dissimilar to the electric vehicle market currently. It will be very big, but currently, a relatively small portion of the total.

Sandy Morris - Jefferies

Yes, you see, so I don't mean to labor this, but I can understand why the timing of when these things arrive in Medical is slightly fluid, because there's been serious regulatory issues in terms of cyber security, and we need the hospitals to invest in their IT to get the appropriate security.

Andy Reynolds Smith - Chief Executive

We do, we do. Yes.

Sandy Morris - Jefferies

That was the question.

Andy Reynolds Smith - Chief Executive

Was it? For me, yes, you're right. And the point I was trying to make is that there are lots of players who've talked about connected pumps, talked about the entire cyber environment for a hospital, but the actual installed base being used passed regulation, whether -- where it's being done is still very small, so we think that we could very definitely, we think our large-volume pump, which will be the halo definer of connectivity in the protocols, is the best out there. And you've got a lot of visibility because we're going through a process which is public, an approval process which is public. So we started slower, but we've really caught up in terms of that technology, we believe, at the moment.

Fantastic. Any others? Well, I really appreciate lots of great questions. Thank you. I really appreciate everyone taking the time on a Friday morning. Much appreciate it. And have a great weekend, and enjoy it. Thank you.