

## **START OF TRANSCRIPT**

### **Pat McCaffrey**

Hello everyone, I am Pat McCaffrey, President of Flex-Tek. I started with Smiths 25 years ago and I've spent my time focusing on customers, in operation and business leadership roles for various groups within the Flex-Tek organisation. I've been fortunate to work in most of the key parts of this great business, so I understand how the pieces come together. I want to share some of this with you today.

I've been President since 2019, leading a great team, focused on value creation. We have built a highly successful and competitive business that has delivered strong consistent growth in revenue and profits over a great many years. The success has been driven by a very talented and experienced team in a winning and caring culture. For reasons that I will explain shortly, we are in a strong position to deliver further.

After the overview I gave of Flex-Tek at last year's Capital Markets Day, today I am excited to share a deeper dive into key parts of our business. I will cover each of our end market segments in more detail, explaining what our products are and why they are competitively advantaged, and update you on the growth drivers and opportunities that we are pursuing.

Last year, I told you that we were in the best position for future growth that we had ever been in our history. As you saw in Smiths fiscal year '22 results, Flex-Tek delivered a record year, with organic growth of 16 per cent and profitability up 22 per cent. This record year builds on our strong track record, with a five-year revenue CAGR of 14 per cent, and compounded profit growth of 15 per cent.

From the outset, I would like to stress that we continue to have high confidence in our growth prospects. Even though macro forecasts in some of our segments are softening, I am going to explain why we still feel really good about the future, over the next few slides.

Let me kick off and tell you a bit more about what we do at Flex-Tek. Broadly speaking, our solutions centre on three main categories. First, high performance tubing and ducting systems for residential and light commercial building. Second, we manufacture highly engineered tubing systems for the transfer of fuel, lubricants and hydraulic fluids across major aircraft and jet engine platforms. Third, we make sophisticated heating elements used in applications ranging from electrical process heating to HVAC systems, to various forms of electric mechanical equipment.

Those of you who have followed Smiths over time might remember Flex-Tek as being one of the smaller divisions. While that was once true, last year we achieved revenues of £650 million, roughly a quarter of the Group. Operating profit of over £130 million, almost 30 per cent of total Smiths. So we have a stable foundation, a track record of success, and strong forward momentum.

So let's start with the foundation – our core fundamental strengths. There are multiple market-growth drivers for our business, including continued demand for new housing construction. Yes, US mortgage rates have risen, and housing starts have begun to slow, and while we can't expect the record growth of fiscal year '22 to continue indefinitely, we are off to another strong start in fiscal year '23. There are unique features of our business that give us confidence that profitable growth will continue.

For example, our penetration is highest in the US sunbelt where housing growth is strongest. Further, we're competing in both single and multi-family segments. Softness in the single-family demand is typically mitigated by increased demand for the multi-family housing. In addition, there remains a housing deficit of at least two million units in the US, and persistent supply shortages across the industry have left inventory levels very low. So for all of these reasons, we forecast continued profitable growth for the construction portion of our business.

The macroeconomic outlook for aerospace remains positive. Revenue passenger miles have recovered quickly since COVID, and both Airbus and Boeing aircraft build projections support double-digit growth for the next two years. In a similar way, the global decarbonisation megatrend means many of our customers are moving aggressively to transition to low- or no-carbon solutions for their heating needs. Our existing portfolio of electric heating elements, coupled with our new product development capabilities, is enabling us to help our customers to meet their own sustainability goals.

The key to Flex-Tek success is that throughout our business we put the customers at the heart of everything we do. We pride ourselves on strong customer intimacy. We have successfully built strong, long-term relationships with many customers who have partnered with us for decades. Our key customers include global aerospace, defence, industrial OEMs, as well as established national and regional distributors.

Customers continue to choose Flex-Tek because of our people, and the technologies we develop. We have a world-class group of engineers that work with our customers to develop innovative solutions to help solve their problems. This approach is driven by a high-performance culture and great people. We serve our customers' needs with

engineering innovative products and we are highly responsive to their needs. Along with sustained organic growth, we have complemented with good choices in M&A, and we are proud of our competitive position where we are in the top three of most of our segments.

These fundamental strengths have translated into an impressive track record. Flex-Tek has a proven history of continuous profitable growth. We have delivered a five-year revenue CAGR of 14 per cent, and profit growth of over 15 per cent. Organically, we have grown revenue at six per cent, and operating profit by seven per cent over the same period. We compete in attractive markets with demanding customers, and as such, we have developed good financial discipline to maintain efficiencies and cost control. We are able to deliver operating margins around 20 per cent by keeping our SG&A around eight per cent of sales.

Let me now outline our plan for continued success moving forward. We are focused on maximising growth opportunities from our core markets, the addition of exciting new products, building out attractive adjacencies, and adding strategic, value-creative, bolt-on acquisitions to our business. Over the last year, we have made good progress on each of these. We have gained share in fast-growing markets, launched significant new products, penetrated attractive adjacencies and integrated multiple, accretive acquisitions. Over the next few slides, I will explain how we have done this in more detail.

Our largest end market is construction, representing two-thirds of our revenues. The lion share comes from our products sold to the residential market, with the remaining 10 per cent from commercial construction. Our main products in this segment are flex duct, metal duct, corrugated stainless steel tubing, and residential heat kits. Our products deliver heat and air to your home and office, with more than 50 per cent of the homes in the US having at least one of our products. We are a top three competitor in all of the segments we serve.

Our manufacturing footprint of nine plants across Canada, the US and Mexico enables us to quickly respond to our customers' changing needs. As mentioned, we are in the right part of the market geographically, as our footprint is focused on regions of fastest housing growth, and heaviest use of central HVAC systems. Sales of our construction products grew 26 per cent last year, which was outstanding. As I will explain a bit later, we expect growth in this segment to continue, although at a more measured rate.

One of the reasons for our confidence looking forward is our launching of new products and exciting initiatives within our construction segment. I'd like to discuss two of them.

First, providing innovative solutions to our customers is a key driver of our growth, and Python line sets is a good example of that. Python was designed to replace copper tubing lines in HVAC systems, building on our gas-tight, multilayer pipe technology. It offers our customers several advantages. Better pricing stability and security than copper tubing, which is exposed to commodity, variability, and job site theft.

It's easier to install and it's a fit-for-measure system to gas-tight customers and it doesn't kink, which is a persistent problem with all metal systems. With the product launch in Q4 of the last fiscal year, we estimate that the penetration will be similar to [CSS2] in the £300 million market, which will give us an expected £150 million serve market. Margins are similar to Flex-Tek overall margin and other applications of our Flexible Multi-layered technology are in various stages of development.

Secondly, we quickly built on our Royal Metal acquisition by opening a new ducting plant in Houston, Texas. At this site we will supply both flexible and metal ducting in the Southern US. The plant is 120,000 square feet and it has capacity for around £50 million in revenue once we ramp up to full production levels. We are confident of continuing to grow in the construction segment in FY23 and beyond. This is because of a number of key factors.

First, we know we are resilient. As you can see from the chart on the right-hand side, although we are not immune to the impact of cycles in the US national housing starts, the business has a track record of resilient performance. This is partly because of the new business initiatives that have continued to add incremental growth, despite underlying market cycles.

Then we still see the deficit in the US housing market being evident and we have strong positions and are best placed geographically in key regions in the South and the West, where the demand is greatest, and where the majority of the new housing starts are at the moment. More recently, our exposure to multi-unit housing has helped. As starts have remained strong, up 18 per cent year-to-date, and up over 37 per cent since the pandemic.

Next, let's take a look at our Industrial segment. Industrial hoses and electrical heaters represent 15 per cent of our business. Our main products are hoses for various medical and industrial applications, as well as engineered heaters used in a wide array of applications, such as packaging in aviation. We have nine manufacturing facilities, five are in the US, three in Europe, and one in China. The majority of our Industrial sales are to OEMs, and we hold the top one or two position in the segments we compete in.

As mentioned previously, we are well positioned to help our customers transition from carbon-based to electric heating systems. Similar to construction, we have a number of exciting new initiatives underway in our industrial business. In October we announced a strategic partnership with Midrex Technologies to deliver a heating element solution used in the production of green steel. Steel production has traditionally been a major source of greenhouse gases because of its reliance on fossil fuels. The Midrex process uses hydrogen as a primary fuel source. Because of its volatility, hydrogen must be pre-heated before combustion and this is where our electric heating solutions come into play.

**Testimonial: Stephen Montague:**

About one year ago Midrex travelled to New Hampshire to meet with the top management of Flex-Tek and Tutco SureHeat. Our teams had already been talking for several months and we knew there was a strong technical foundation for cooperation on hydrogen – a marriage, if you will, between the world’s leading direct reduced iron technology and the leading technology for electrical heaters. The main question from Midrex side was about fit. We were really wondering if we did business and looked at it the same way, and we wanted to answer questions like do we trust and respect these folks?

That question is about culture. It may be even deeper than culture; it’s about personal relationships. I’m reminded of a well-known study that was conducted several years ago from a major car manufacturer to look at customer satisfaction. Surprisingly, they found out that the highest customer satisfaction was not linked to the absence of problems; dealing with problems is just part of life. The most satisfied customers were those who had their problems quickly resolved, and completely resolved. That’s really what we were looking for.

You see we know that we have a strong technical foundation for cooperation, but we’re not naïve. Creating new technologies will bring, not only opportunities, but also a lot of challenges along with it. It’s going to be hard, and we need to have a strategic partner standing beside us to persevere and to push through the challenges ahead. So after the meetings in New Hampshire, Midrex could see that Flex-Tek shared a similar culture, and we’re confident that they’ll stand by us, even during the tough times.

So here we are one year later – what happened? Well, Midrex just finalised a contract with H2 Green Steel for the world’s first commercial 100 per cent hydrogen direct

reduced iron plant. It will be built in Boden, Sweden, to produce more than two million tonnes per year of green iron and steel, that has about 95 per cent less CO2 emissions than traditional technologies. That's something to really be proud of.

We know that we're making a difference in our world and we're also building a lighthouse for the industry to show the technologies of the future. We're proud to be partnered with Flex-Tek and look forward to the journey ahead. Thank you for also having the confidence in Midrex.

### **Pat McCaffrey**

This is a great example of how our technology leadership in vertically integrated engineering design allows us to quickly respond to customer needs and market opportunities. This is just one of a number of similar growing opportunities that we are pursuing.

Aerospace represents about 18 per cent of Flex-Tek's revenue, and this business grew 14 per cent for us last fiscal year. We offer a broad array of both fixed and flexible tubing systems that are used in aircraft engines and for the distribution of gas and fluids around the airframe. We sell globally to most major airframe and engine OEMs, such as Boeing, Airbus, Pratt & Whitney, GE, and others. Our business is well balanced between commercial and military platforms, and we have five manufacturing facilities – three are in the US, one in France, and one in India.

The Aerospace market is in the early days of what is expected to be a multi-year expansion, driven both by near-term post-COVID demand, as well as the longer-term sustained growth of passenger and cargo volume. Our acquisition of United Flexible in 2018 enabled us to unify all of our aerospace activities into one end-to-end global team, providing integrated R&D, manufacturing and service operations to our customers. We recently won nine development hoses for GE 9X, which is the primary engine system on the Boeing 777x. We also won two major retrofits for Airbus on the A350 and A320, and we won an important contract to support the fuel systems on the F100 engine.

At Flex-Tek we are building an incredible track record of employing disciplined M&A to complement our primary organic growth focus. Acquisitions help us move with greater pace. Like United Flexible, that accelerated our extension into aerospace. Our Royal Metal – that expanded our HVAC offerings and customer reach.

As you can see on this slide, acquisitions bring a number of additional benefits, such as revenue and cost synergies, expanded skill in existing market positions, and access to new geographic and market adjacencies. Through careful screening, and disciplined integration, our acquisitions have performed both financially and competitively.

Royal Metal for instance has grown 48 per cent since acquisition. United Flexible has improved our position on key aerospace platforms. SureHeat landed both BSI aviation test project and the upcoming Midrex project.

I'll leave you with a few closing thoughts. In keeping with our strong record of consistent growth and margin expansion, we are confident in our continued growth moving forward. We're driven to innovate, and this has earned us strong customer relationships in attractive global markets. The foundation of all of this is our lean structure, our strong culture, and our great people. We have a great future ahead. Thank you.

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