

INTERIM RESULTS 2013/14

FULL TRANSCRIPT

SLIDE – INTERIM RESULTS 2013/14

SLIDE – CAUTIONARY STATEMENT

SLIDE – PHILIP BOWMAN

Ladies and gentlemen, good morning and welcome to the 2014 interim 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 Jeff McCaulley who took up his post as President of Smiths Medical earlier this month.

Jeff – perhaps you could stand up for a moment.

Thank you.

SLIDE – KEY MESSAGES

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

First, we have continued to make good progress in those businesses that face commercial end markets – like John Crane and Flex-Tek where revenues and margins are both ahead. However, we continue to face challenges in the businesses that serve the healthcare, homeland security and defence markets.

Much has been achieved in the past five years or so to rebalance the business towards growth markets. We have cut our dependence on government contracts and developed economies by expanding our commercial customer base and sales resources in high growth markets.

We have also continued to strengthen management teams, their processes and data systems. We have made changes to the senior leadership team as we have raised the talent bar at all levels throughout the Group. This is still work in progress but there is no doubt these results have benefited from the changes and would have been weaker otherwise.

Second, we continue to invest more in growth drivers. To strengthen our technology leadership, we increased our funding of research and new product development by a further 7%. This is delivering an improved pipeline of new products to support revenue and margin growth over the medium to long-term. We are also channelling greater resources into sales and marketing in higher growth markets such as China, India, the Middle East and Brazil. In the period, emerging market sales represented 15% of group revenues. Good growth in John Crane and Smiths Interconnect was offset by declines in Detection (a reflection of the “lumpy” nature of what is increasingly a programme rather than a run-rate business) and Medical (where performance was disappointing due to delays in product registration and the release of a new range of infusion pumps). Whilst acknowledging the long development cycle for some product franchises within our regulated businesses (particularly Medical and Detection), I am far from satisfied with our performance in driving revenue growth. Accordingly I have tasked the Divisional management teams to challenge aggressively the allocation and execution of new product investment and performance in emerging markets.

Third, we have continued to invest in enhancing operational efficiency across the Group. We have an ongoing programme of continuous improvement including initiatives such as value engineering and organisational change. However, to achieve a further step change in the Group’s growth profile, we have now launched our “Fuel for Growth” programme to address the cost base and provide scope for

more investment in growth drivers. We have upgraded this Company-wide programme through consultation with the divisions and now expect it to deliver £60m of savings, up from the £50m announced last September. This programme will be executed over the next four years and most of the savings will be earmarked for even greater investment in organic growth. This investment is designed to reposition and strengthen the Company further as we take Smiths into its next phase of development. Peter Turner will provide further details on the programme shortly.

Fourth, we have outlined medium term operating ranges to underline the organic potential of the divisions. We last set out such targets in September 2008, but this coincided with the start of a severe and prolonged economic recession. Nevertheless, the divisions generally fared well on margins which were more within our control as a result of the programmes we implemented. Perhaps unsurprisingly, revenue growth was far harder to achieve. We have been reluctant to revisit these operating ranges until we saw a degree of economic stability and forward visibility. We published new ranges for John Crane at its capital markets day in December and I will review the ranges for the other divisions later this morning.

I would also stress that we are continuing to seek acquisitions that accelerate our strategic ambitions and generate value. Although we have again screened a significant number of businesses over the past six months, we have failed to find any opportunities that meet both our strategic and financial return expectations. Prices of good businesses remain high and we may need to reconsider our short term value expectations if we are to add momentum through inorganic growth.

SLIDE – RESULTS HIGHLIGHTS

So now to today's results.....

Revenue declined 1% at constant currencies. Increases in John Crane and Flex-Tek were more than offset by pressures on the healthcare sector in developed markets that affected Smiths Medical. Medical still faces tough trading in developed markets with sluggish procedure volumes, supply chain destocking, adverse pricing and the burden of new taxes. Smiths Detection and Interconnect saw more modest declines

against strong comparators. Government funding constraints coupled with troop withdrawals from combat zones adversely impacted both volumes and pricing at Smiths Detection and Interconnect.

Headline operating profit fell 2% as weaker volume leverage, cost inflation and increased investment in growth initiatives more than offset the benefit of cost efficiencies. Margins improved in John Crane and Flex-Tek. However, the lower volumes and the US Medical device tax weighed on Medical's margins.

Earnings per share declined 4% but cash conversion remained strong for the half year at 86%, with free cash flow of £30m.

The interim dividend is up 2% to 12.75 pence per share despite the decline in earnings per share.

SLIDE – PROMOTING RESPONSIBILITY: AN INCREASED FOCUS IS DELIVERING IMPROVEMENTS

As in previous occasions, I will highlight the good progress we continue to make on our key safety and environment measures.

We continued to see a steady fall in lost time accidents whilst our recordable incident rate improved to a record low. We have benefited from an enhanced safety culture and greater employee engagement as well as the use of leading indicators.

We beat the multi-year targets for our environmental measures at the end of last year so we have now set new five-year targets. While it is early days, good progress is being made against these new goals. We expect to deliver further improvements as we invest more in people, improved manufacturing processes and new 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 for both OEM and aftermarket revenue, particularly in the energy services sector. Profit grew strongly reflecting better volumes and the benefit of a range of efficiency initiatives.

As Philip said, revenue declined at Smiths Medical as a result of the continued tough trading environment in developed markets, with adverse pricing and pressure on healthcare budgets affecting procedure volumes. We also experienced distributor destocking in the US during the period. Margins declined with the lower volumes and from the impact of the US Medical device tax.

At Smiths Detection, we entered the year with a slightly weaker order book which in turn led to slightly lower sales. Margins fell reflecting the decline in volumes and the impact of some low margin contracts.

Smiths Interconnect saw revenues fall 4%, again against a strong comparator period driven mainly by defence budget pressures. Margins also declined with the lower volumes, investment for growth, and mix effects due to the end of higher margin programmes. As we said in the outlook statement last September, we expect some improvement in the commercial markets in the second half.

And finally Flex-Tek – another good performance, with growth driven by US residential construction, specialty heating elements, and Medical hoses. Strong operational gearing and better pricing pushed up margins.

As before, we have provided margin causals for each of the divisions in the appendix.

SLIDE – PROFIT PROGRESSION 2013 to 2014

Pulling all this together and looking at the profit progression for the Group... this next slide summarises the key movements.

Volumes declined in Medical, Detection and Interconnect, offsetting the increases in John Crane and Flex-Tek. Positive price/mix and operational efficiencies more than offset cost inflation and funded our increased investment in new product development.

As expected, we incurred £3m of extra cost from the inclusion of five months of the US Medical device tax. We also have the comparison of £4m of one-off costs - not repeated in the period – mainly in Detection.

Foreign exchange had a negative impact given the strength of sterling against the US dollar and various other currencies. Translational and transactional effects resulted in a £7m headwind, leaving a pre-tax profit of £215m.

Looking ahead, if current rates are maintained we would expect a full year translation impact on revenue of around £135m and on operating profit of £23m – the majority of which falls in the second half. Just to remind you, we have included the usual FX ready reckoner on the slide.

SLIDE – GROUP CASH CONVERSION

Turning now to cash conversion... At 86% – this is in line with our usual half year performance.

It was achieved through slightly better working capital management. Capital expenditure rose across the Group with increases in most divisions. 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 – RECONCILIATION: HEADLINE OPERATING PROFIT/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 £51m in the period...

The £14m restructuring charge related to the "Fuel for Growth" and Detection restructuring programmes. I will give some more detail on "Fuel for Growth" shortly.

There was also a £34m charge associated with the John Crane Inc. asbestos litigation -- higher than our normal run-rate. This reflects above trend cash expenditure this financial year caused by two large verdicts and higher legal costs. 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 around £20-25m a year.

We also rolled forward the provision for Titeflex litigation relating to 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 £2m gain from other small items.

The amortisation of acquired intangible assets, which we also exclude from headline profit, was £21m.

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

Philip mentioned that we have begun our Fuel for Growth programme and this slide presents the costs and savings by division.

Each division submitted a plan for another round of cost efficiencies that would support greater investment in future growth. We have been refining the programme in the past six months and the divisions have identified further opportunities which have expanded the programme to £60m of savings. The scale of the opportunity varies by division as shown here.

The programme is now expected to cost £120m – and these costs will be treated as exceptional. Some additional capex will be required to support the programme. The payback will be slightly longer than for our previous initiatives, because we are now addressing another level of structural costs which will be somewhat harder to achieve. However, we believe that this is the right approach in terms of funding growth and for the long-term competitiveness of our businesses.

In the first half, we incurred costs of £12m which has delivered initial savings of £1m in the period – reflecting that we are at the very start of the programme.

SLIDE – PENSIONS: DEFICIT IMPROVES TO £236M, DRIVEN BY CONTRIBUTIONS

Turning now to pensions... you will see the net deficit has fallen by £18m since July last year to £236m. Partially offsetting this, we now have built up £96m 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.

A higher return on assets and some foreign exchange was offset by an increase in liabilities caused by a slight fall in bond yields in both the UK and US. Contributions helped to improve the net funding position.

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

SLIDE – STRONG BALANCE SHEET SUPPORTS INVESTMENT

Now moving to net debt... free cash flow of £30m and a £50m benefit from foreign exchange translation was offset by £225m in final and special dividends. This resulted in an increase in net debt of £157m to £901m.

In February, we completed the refinancing of our existing bank facility with a new \$800m committed revolving credit facility that matures in February 2019 – with two one-year extension options. We decided to refinance the facility a little earlier than we needed to take advantage of currently attractive rates.

The Group continues to benefit from good cash flows and the strength of our balance sheet which is funded 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

So finally and looking to the rest of the year... here is a reminder on some of the key financial items.

The headline finance charge is expected to be around £60m – reflecting that three quarters of our debt is at fixed rate. Whilst we have refinanced the balance sheet at lower interest rates, the impact of 'cash drag' will be felt until the May 2014 bond is repaid.

We expect the headline tax rate to be in the range of 26-28% for the coming year and cash conversion will be between 90 and 100%.

I have already covered the pension contributions.

At current exchange rates, we foresee net debt of around £800m 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. Moving now to the operating performance and outlook for each of our businesses, I will also set out our new medium-term revenue and margin ranges.

SLIDE - JOHN CRANE: DELIVERING SALES GROWTH, IMPROVING MARGINS AND RETURNS

John Crane's sales growth was driven by healthy demand from both mid- and downstream energy customers. Operating margins remained high reflecting both improved revenues and operational efficiencies. Overall, a very good result.

Underlying aftermarket sales, excluding revenues from our upstream oil services business, rose 3% on the back of strong activity from energy services customers across the Middle East, Latin America and North America. High-value Performance Plus reliability contracts were secured in Singapore, Colombia, Australia, the U.S. and a number of other countries.

Underlying revenues from our upstream oil services business declined, reflecting the increasingly competitive environment in the US and the impact of the unusually severe winter across North America.

First-fit original equipment sales rose 6% as our customers continue to invest. Commercial activity again expanded in our high-growth markets, with multiple orders secured for large capital projects, including the Zubair Project to develop one of Iraq's largest oil fields.

SLIDE – JOHN CRANE: INVESTMENTS POSITION JOHN CRANE FOR FUTURE GROWTH

Emerging markets continued to provide a strong platform for growth. In the first half, emerging market revenue increased about 9% at constant currencies and made up some 23% of John Crane's overall revenue.

We continue to build infrastructure in select markets and invest in local technical service capabilities, preparing for future growth in China, ASEAN countries and the Middle East.

Developing new products and services is also expected to drive medium-term growth. Our focus remains firmly on providing engineered solutions that meet customers' processing needs, while at the same time reducing environmental impact and energy consumption. John Crane was awarded a patent for a breakthrough in real-time condition monitoring technology for gas seals.

SLIDE – JOHN CRANE: MEDIUM-TERM OPERATING RANGES

We used this slide when we set out medium-term operating ranges for John Crane at our capital markets day last December.

The business expects to achieve mid-single digit organic growth reflecting the positive demand for global energy and the expectations for investment in mid and downstream infrastructure. John Crane will also seek to leverage its global scale, while investing significantly more in new products and increasing its sales presence in high-growth markets and applications such as shale.

Margins are expected to be in the range of 22-25%, reflecting the benefit of volume leverage, productivity initiatives, pricing opportunities from increased service levels and further quality improvements. Margin growth will however be constrained by investment in growth opportunities and better information systems.

SLIDE – JOHN CRANE: OUTLOOK

A strong order book, up 9% on last year, should support solid second half revenue growth. However, we anticipate market conditions in our upstream segment to remain challenging. These combined effects should result in second half sales growth within our operating range. Margins are expected to be towards the higher end reflecting on-going improvements in operating efficiency, offset by strategic investment in longer-term growth opportunities. Overall, John Crane is very well placed to improve returns and generate value.

Turning to Smiths Medical...

SLIDE – SMITHS MEDICAL: TOUGH TRADING; VOLUME AND PRICE PRESSURE AMID DISTRIBUTOR DESTOCKING

Underlying revenue declined due to difficult trading conditions in the developed market for Medical devices. These included adverse pricing, hospital capital spending constraints and relatively flat procedure rates. Sales in our US business were down 6% in the period, accounting for over two-thirds of the division's decline and driven primarily by distributor destocking. Data shared with us by our US distributors gives us good visibility of end customer demand. Reassuringly, while we can see that our US sales in the period were materially affected by movements in distributor inventories, sales to end customers declined by only 1%, which is more in line with overall market performance.

Margins were hit by adverse factory cost absorption due to lower volumes coupled with the cost of the US Medical device tax introduced last year.

I also have absolutely no doubt the results were impacted by the disruption and uncertainty arising from the approach last year by a prospective purchaser.

Medication delivery revenues were flat, with strong ambulatory infusion sales offset by weaker revenues from our syringe pump systems which were affected by the squeeze on hospital capital budgets.

Vital care sales declined in the face of continued sluggish procedure volumes, pricing pressures in developed countries and distributor destocking. The assisted reproduction and invasive blood pressure management businesses both grew strongly.

Revenue from the safety franchise also fell amid growing price competition in sharps safety, PIVC and vascular access channels. However, market volume trends are positive, particularly in developing markets, with the current emphasis on improved provider and patient safety.

SLIDE – SMITHS MEDICAL: INVESTING IN GROWTH OPPORTUNITIES; NEW PRODUCTS/EMERGING MARKETS

New product investment is at a new high – equivalent to almost 5% of sales. The CADD Solis PIB pump recently gained FDA clearance and was launched in the US in February.

We also continue to benefit from some launches from last financial year such as the new Bivona model which extends the range of our silicone tracheostomy products and the US launch of CADD-Solis VIP.

Developed markets remain sluggish and we continue our investment programme to rebalance the business towards the faster growing emerging economies. We have seen good growth with Brazil (up 15%) and India (up 27%) with local sales networks strengthened and new products introduced. Total emerging market sales now represent around 10% of the business.

However, emerging market revenue declined overall as regulatory approvals of a new infusion pump in China were delayed and we experienced lower distributor demand in several smaller markets. As previously signalled, it typically takes up to five years to reach our targeted returns as new products are registered and market presence is built.

Nevertheless, we continue to believe that this focus on expanding our emerging market exposure is the right strategy to counter the challenges in developed economies.

SLIDE – SMITHS MEDICAL: MEDIUM-TERM OPERATING RANGES

Looking at the medium-term potential for the business... we believe that Medical products will continue to face tough trading conditions in developed markets. Growth will come through greater focus on emerging markets, alternate care sites, and investment in new products. However, we know from experience that all these take time to implement. This, coupled with the tough market conditions, has meant we have not achieved the growth levels set out in 2008. As a result, we now expect average annual revenue growth to be in the range of 0-3%.

We still see plenty of opportunities to improve efficiencies in the business which should sustain margins in the range of 20-24%.

SLIDE – SMITHS MEDICAL: OUTLOOK

Looking to the rest of this year, we anticipate that the challenging trading conditions in developed economies will result in second half revenue and profit below the equivalent period last year, at constant currencies. But the rate of decline should be lower compared with the first half.

The Smiths Medical team continues to drive operational efficiency initiatives, such as our operation in the Czech Republic – the first new factory location in Medical in 16 years.

I am delighted that Jeff McCaulley has joined us to lead Smiths Medical. He brings a wealth of experience from a long career in Medical devices. In his prior roles, he successfully took underperforming businesses and reshaped them to deliver a much improved growth profile.

Whilst still early days for Jeff at Smiths, I have given him four initial priorities:

- One, to improve the competitiveness and vitality of the portfolio with a continued focus on new product development and better marketing. In particular, we will look at ways to accelerate our speed to market and achieve some quick wins.
- Two, as I commented earlier, to accelerate and execute better our emerging market strategy.
- Three, to focus on delivering the Fuel for Growth programme as well as other successful efficiency initiatives such as value engineering.
- And four, to further improve product quality and on-time delivery to customers.

Jeff will update me on progress on a regular basis in next six months.

Turning now to Smiths Detection...

SLIDE – SMITHS DETECTION: GOVERNMENT BUDGET PRESSURES AGAINST A STRONG COMPARATOR

Revenue declined 1% against a very strong comparator period with growth in the critical infrastructure market more than offset by decreases in transportation, military, and ports and borders. Margins were affected by the lower volumes and competitive pricing pressures.

Overall, this is a good result considering that the prior year was boosted significantly by some very large airport contracts such as Doha International Airport. As a result, transportation sales fell only 3% as we won smaller orders to replace this major programme. Ports and borders revenue declined due to increased competitor activity and associated pricing pressures. As a result, Smiths Detection management elected to “no bid” on a number of significant opportunities. However, we continue to see growing demand for our advanced scanners from customs authorities.

Underlying Military sales fell as the squeeze on defence budgets continued. However, a steady revenue stream from the DOD and other US agencies for JCAD and the chemical biological mobile shelter was maintained.

Revenue from critical infrastructure rose 17% on an underlying basis, primarily driven by growth in emerging markets such as Brazil, Singapore, Russia and India.

SLIDE – SMITHS DETECTION: INVESTING IN FUTURE GROWTH THROUGH NEW PRODUCTS AND MARKETS

Our commitment to maintaining technology leadership is seen in our increased investment in new products and the number of recent product launches, most of which are now funded internally. Company funded R&D increased 13% to £19m, rising as a percentage of sales to 7.5%. However I am not satisfied that our targeting of NPD investment is optimised sufficiently or that enough of our new products are delivered on time and on budget. I have asked the Detection management to make this a priority.

You can see some of the recent product launches on this slide....

Our continued focus on the aftermarket is paying off with a 15% increase in revenues, although this increase was boosted by some consumables contracts which are unlikely to be repeated in the near term. Excluding these contracts, revenue still increased and now represents 27% of divisional sales -- close to our 30% target. We have also made good progress with improvements in distributor networks, training and contract renewal rates. Put simply, our drive, announced a little over two years ago, to generate a much stronger annuity style revenue stream from this business is now really delivering.

SLIDE – SMITHS DETECTION: MEDIUM-TERM OPERATING RANGES

Smiths Detection operates in a growth market supported by increased demand for international travel and global trade combined with the ever-present threat of terrorism. Still largely a government contracting business, Smiths Detection can

experience variability in its revenue and margin profile particularly when affected by contract delays and government budget deferrals.

A focus on new product development more closely linked to customer needs and market demands, as well as a drive for a greater proportion of aftermarket revenues will – we believe -- support a mid-single digit growth rate of 4-6%. However, growth will continue to be volatile year on year as programmes get larger. Despite pressure on pricing, which must be met with further reductions in unit production cost, there remains significant scope to improve margins over time, which leads Detection management to forecast a margin range of 14-20%.

SLIDE – SMITHS DETECTION: OUTLOOK

The order book is slightly below the very strong comparator. This is expected to result in lower revenue in the second half compared to last year. Encouragingly, tender activity and enquiry levels are high which should support growth in the order book for fiscal 2015. Headline operating margins will benefit from our restructuring initiatives and on-going site rationalisation plans. New product launches and full certification of existing products (including the XCT) should allow the business to enter new end markets and provide additional opportunities in existing ones. However, this remains a difficult business to forecast accurately given the increasingly unpredictable behaviour of government customers.

SLIDE – SMITHS INTERCONNECT: DEFENCE MARKET HEADWINDS AGAINST A STRONG COMPARATOR PERIOD

Turning next to Smiths Interconnect...

Underlying sales declined on the back of expected lower demand from military programmes which offset a more general improvement in commercial markets such as telecoms and data centres.

Margins were affected by operational leverage on volume reductions, investment for growth, and mix effects due to the end of higher margin programmes. Productivity

initiatives generated savings of almost £2m, which was mainly reinvested in business development.

In Connectors, underlying sales fell 3%. Defence was weak particularly in Europe with the continued decline in Eurofighter production. The US saw similarly lower overall defence spend and delays in funding of new programmes. However, commercial aviation and Medical segments remained robust and revenues from Asia continued to grow.

Underlying revenue from the Microwave business unit declined against a strong comparator as we saw reductions in major US defence programmes despite new contract wins.

Both wireless telecoms and Test & Measurement performed strongly, particularly in Asia and the Middle East. More recently we were selected as the sole source PIM instrument supplier for two network management contractors of a major US wireless operator.

Underlying sales in the Power business fell slightly despite positive data centre demand with strong international growth and robust performance in the US. This was offset by declines in the sale of power protection products.

SLIDE – SMITHS INTERCONNECT: INVESTING IN NEW PRODUCTS AND EMERGING MARKETS

Company-funded investment in R&D rose 8% to support the transition from defence to commercial markets, and to position the business for growth. The customer-funded portion, related mainly to defence, remained flat.

A selection of new products across different segments is listed on the slide.

Our increased exposure to faster-growing, emerging markets, particularly China and India, delivered an 8% rise in revenues. Emerging markets now represent more than 16% of Interconnect's sales.

SLIDE – INTERCONNECT: MEDIUM-TERM OPERATING RANGES

We remain optimistic about the growth opportunities in data centres, mobile telecoms, semiconductor testing and commercial aerospace. Demand from defence customers, representing around 25% of revenues, is likely to be weak as developed government budgets remain under pressure. We will continue to drive the repositioning of the business over time towards higher growth commercial and emerging markets. We also see scope to drive further productivity initiatives through value engineering and site efficiencies. Over the medium term, we believe the business should deliver average annual growth of 3-5% with an improving margin trend in the range of 16-18%.

SLIDE – INTERCONNECT: OUTLOOK

The outlook is for a gradual improvement in commercial markets while defence budgets are likely to remain challenging. An improved second half performance is expected with growth in revenues from wireless telecoms, semiconductor test and data centres coupled with the introduction of new products and a stronger commercial order backlog.

Margins should improve as the year progresses, benefiting from volume increases, pricing initiatives and efficiency savings.

Finally to Flex-Tek...

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

Flex-Tek's revenues grew again, helped by a further improvement in the US residential construction market and growth in specialty heating elements and Medical hoses. Margins rose 160 basis points, reflecting operating leverage from higher volumes.

Fluid Management revenues were flat. Growth in commercial airframe and automotive applications was offset by lower sales for satellite launch vehicles, military gas turbines and paid development on next generation aerospace engines.

Construction sales rose 10%, buoyed by improved demand for HVAC ducting and flexible gas piping products, and a 7% rise in single family home starts.

Revenues from Heat Solutions remained flat with increased sales of specialty heating elements offset by lower revenues from household appliance and HVAC components.

Sales in Flexible Solutions rose 2% as the success of our new sleep apnoea products more than offset the continued weakness in the floor-care market.

SLIDE – FLEX-TEK: MEDIUM TERM OPERATING RANGES

Flex-Tek is well-positioned to benefit from further growth in US residential construction and demand for new fuel-efficient commercial aircraft. We also expect to see ongoing benefits from its investment in product innovation – particularly in the move to adjacent markets in technologies such as specialty heating elements.

Tedd Smith and his team expect to see annual growth in the range of 3-6% with headline operating margins in the range of 15-20%.

SLIDE – FLEX-TEK: OUTLOOK

Looking to the second half, we expect the positive trends to be maintained. The US residential construction market should also experience continued growth after some disruption from adverse weather in the latter months of the first half. There is ongoing demand from commercial aerospace as airframes need new lighter-weight, high pressure hydraulic hose assemblies. Margins will benefit from higher volumes but face pressure from increased investment in R&D, inflation and competition.

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

SLIDE – SMITHS GROUP – OPERATIONAL PRIORITIES FOR 2014

Looking ahead, we remain committed to building on the good progress already made by our businesses that serve commercial markets. At the same time, we will continue rebalancing our exposure towards high growth markets and customers while reducing dependence on government contracts and developed economies.

We will continue to invest more in growth drivers including new product development, building positions in new markets and enhancing quality and service to better meet the expectations of our customers.

Over the past six years, we have successfully driven operational efficiencies across the Group through value engineering, site rationalisation and organisational change. We still have significant opportunities through the expanded Fuel for Growth programme – with the majority of these £60m annual savings providing the investment capacity to accelerate revenue growth.

This can fund a step change in growth investment. The improved organic growth can be augmented by acquisitions that will further optimise capital allocation across our portfolio, generate value for shareholders, and accelerate our strategic goals.

Despite the cash demands of our legacy liabilities, our strong balance sheet allows us to fund these acquisitions and returns to shareholders.

We are also further strengthening management teams, business development processes and information systems. Senior leadership continues to be transformed as we strive to raise the talent bar at all levels in order to take Smiths into the next stage of its development.

While cautious about sectors such as defence and healthcare, we remain well-placed to benefit from a range of positive market dynamics. These include growth in energy demand, the ever-present need for improved security in an uncertain world, the requirements of new fuel-efficient aircraft, and increased US residential construction.

In conclusion, I am far from satisfied with our performance in H1. Delivering consistent organic revenue growth in these economic conditions has proven a much tougher challenge than driving operational efficiency in an engineering led culture. Supported by the passion and track record of our new Chairman in driving organic growth, the teams in each Division, several under new leadership, will redouble their efforts.

SLIDE – QUESTIONS AND ANSWERS

That brings the formal presentation to an end. 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.

QUESTION AND ANSWER

Nick Wilson - *Espirito Santo* - Analyst

Three related questions to John Crane, please. Firstly, could you tell us what the order book actually is; or alternatively, how many months forward cover?

Second related question is the weather effect on H1. Roughly what did that reduce organic growth by?

And then the third one just returning to asbestos. Thanks for putting the chart in at the back so I can see from that over the last 10 years the number of outstanding cases has actually come down by a half, but at the moment, your litigation provisions keep on going up. So am I right to draw the very simplistic conclusion that the payout on individual cases is going up at the moment?

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

Okay. Three good questions there. I'm going to start with Tedd Smith and talk about the impact of the weather on Flex-Tek. Please.

Tedd Smith - *President, Flex-Tek*

Thank you. The weather clearly in the second quarter, if you look at the first quarter run rate in the construction group, caused very obvious changes in order patterns in the two key segments we have there. So I'm cautiously optimistic about quarters 3 and 4. There's just no doubt it didn't hurt.

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

Duncan, would you like to comment on the impact on John Crane, particularly the upstream business?

Duncan Gillis - *President and CEO, John Crane*

Would you also like me to talk about the backlog? The weather impacted us by the tune of about GBP1 million, primarily in our upstream business between November and call it February, primarily in the Williston Basin and in the Permian Basin.

In terms of the order book, the total book at the end of the half was north of GBP200 million, around GBP215 million, and about 90% of that was deliverable in the half. Obviously, that can move around a bit as we get towards the back end of the half.

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

Duncan, thank you for that. Michael, would you like to talk about asbestos?

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

Yes. A couple of thoughts on asbestos, if I may. Firstly, in terms of what's going on with the number of claims, there are two things I think which are occurring. One is the rate of decline has slowed. The decline over the last year/two years has been less than the previous five or six years. That is partly because the five/six-year

period was inflated by a couple of one-off events, so the average was running higher than we would expect going forwards.

The second point is that there have been some increased filings in the last year or 18 months associated largely with a couple of specific initiatives from particular plaintiffs' firms.

The more important issue candidly for JCI is not the number of claims. It's the number of trials. That number has come down. If you look at the last three years or so, the number of trials is running at a lower rate than it had over the previous three or four years.

And as to the question about the cost of claims, putting aside the two large verdicts that Peter referenced earlier, I wouldn't say necessarily that the cost per claim had changed materially, but what I would say is that we've seen a decline in the number of lower-value claims coming to court. I think crudely what has happened is that plaintiffs have to some degree given up trying to take JCI to trial for lower-value claims so we see a higher proportion of higher-value claims coming through.

But in terms of overall experience, no real change; and perhaps, Philip, whilst I'm on my feet, I could address the two cases that Peter mentioned.

The John Crane Inc. strategy, as I say to Philip occasionally, is undoubtedly the right strategy, but it is a relatively high-stress strategy.

So if you could imagine for a moment that we're off to court this morning, we're off, say, to the LA County Superior Court in downtown Los Angeles and we have an elected state court judge who's sitting with a panel of his electorate, 6/12 jurors, I don't want to over-generalize, but probably in most cases not particularly highly educated, certainly not particularly high income, and some of whom at least will be pretty angry about corporate America.

Over in the corner, you have a dying plaintiff lying on a stretcher with an oxygen mask, and addressing the jury, you have a pretty persuasive plaintiff's bar lawyer

inviting them to conclude lots of bad things about JCI. So this is an environment where bad things without doubt can happen and occasionally do.

The good news is that as far as JCI is concerned, they're pretty rare. We've had a few bad verdicts over the years, but not many, and certainly two together, as in this period, is very unusual. We've had none since these. And additionally, where we have incurred bad verdicts, JCI's generally been pretty successful in mitigating those via appeal processes, which sadly we weren't able to do here.

But the points I would leave you with I think in relation to these two cases are, firstly, they are very unusual. Secondly, they are quite unrelated; so different judges, different issues, different plaintiffs, different jurisdictions; not part of any kind of a trend. And thirdly, these are not binding precedents. These are not judgments that will be determinative of future cases.

So as Peter said, we would expect with a reasonable level of confidence as I stand here to be back on trend next year.

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

Michael, thank you for very comprehensive teaching. Next question.

Martin Wilkie - *Deutsche Bank* - *Analyst*

Martin Wilkie, Deutsche Bank. You mentioned that you've not really done any acquisitions, partly because of the price of targets. But obviously, the flipside of that could be that it might be a nice time to sell some assets. And if you could just talk through as you set the growth targets, the margin targets, was there a review of businesses that perhaps don't meet your return aspirations and growth aspirations and perhaps you could look at exiting?

And just related to that, I think you mentioned on Medical that the approach you had last year had in some way impacted performance during the year, and if you could just clarify what you meant by that.

Thank you.

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

I think in terms of the second question, I had the pleasure or the pain of running a number of businesses over the years where there have been approaches to buy them, and inevitably, that causes disruption in the business. It causes disruption because of what people read in the press.

The approach for Medical was leaked at a very early stage before anything had happened. That's a great tactic to try and destabilize a target business. And clearly, the process was ongoing for a significant period of time because the Board wanted to be sure that it had investigated the opportunity fully. And I think I said last September if there was any lesson to be learned from what happened that probably to have terminated discussions sooner rather than later would have been appropriate.

So I think it's a question of people were clearly focused on do we need to prepare material for due diligence. There's a lot of work if that is done. They were focused also on what's going to happen to me if the transaction goes through. So I think it's entirely normal and entirely expected, and in line with previous experience that you get a 6 to 12-month blip in performance after that sort of approach.

I think your other question in terms of when we were setting these targets, clearly, these targets originated with the individual divisions. They were reviewed by the corporate team and then they were clearly debated at length by the Board. The Board's very clear that it desires to grow the businesses the Company has. That doesn't mean it would never sell them. But nevertheless, the focus is on long-term growth.

And much of what we have been doing and much of what I have said over the last several years has been about making increased investments, which has clearly impacted, for example, the margins of Medical where we talked about investing something between GBP15 million and GBP20 million in emerging markets on an

ongoing basis. We've seen a significant increase in new product development. We've put more marketing resources in some of our businesses. And that is on the basis that we are building businesses for the long term.

It doesn't mean we will never sell businesses, but on the other hand, I think the focus that the Board has is one of building long-term sustainable growth and value.

Alex Toms - BofA Merrill Lynch - Analyst

Alex Toms, Bank of America, Merrill Lynch. Two questions from me. Firstly, on Medical, you talked about one of the targets improving quality and delivery. I'm not sure you've talked about that before. Maybe I've missed it. Could you just maybe highlight what -- if there's been an issue, what the issue has been and what the solution is?

And the second question, Detection. You also talked about low-margin contracts and you weren't bidding on them. Could you just maybe flesh that out a little bit where the pressure has been; what the differentials have been; what the impact is on longer term; where there's been a change in competitor environment?

Thanks.

Philip Bowman - Smiths Group plc - Chief Executive

Okay. I think the first one in Medical, if I wind the reel of tape back to when I first came to this Company, I think probably the biggest problem we had was within Medical, and a large part of that problem was caused by the fact that the order backlog was very high.

And the root cause analysis of that really goes back to the fact that the site footprint and the supply chain for Medical is extremely convoluted. And we have been working our way through over the course of the past years a process to simplify, to rationalize the number of sites. Hence, for example, building a new site in the Czech Republic to serve largely Europe, and to simplify the supply chain.

What we have continued to find over the period is that in some cases, we have quality issues. Some of that is perhaps related to the age of some of the equipment, but some of it is simply due to the complexity of the supply chain. And it is clear when you talk to customers that we are not always the best that we could be in terms of giving them on-time delivery. So I think that is an area that needs to have great focus, and I think Jeff has seized that opportunity.

Sorry, the second question?

Alex Toms - BofA Merrill Lynch - Analyst

The second question was just on Detection in terms of you talked about the low-margin business. Has there been a change in competitive environment?

Philip Bowman - Smiths Group plc - Chief Executive

In terms of Detection, what we've seen over the past four years since really the market started to turn down is that the percentage of our revenue coming from what I would refer to as historic customers, so for example the TSA in the US, has fallen off significantly, and we have, therefore, been forced to protect our revenues by generating opportunities in other markets. And of course, many of those markets are much more complex to do business in. There is a greater degree of risk.

And on the side of cargo screening, one is looking very often to be required to take responsibility for infrastructure works and other areas. And as you saw last year where we wrote off GBP15 million on some relatively old contracts, it is easy to make a mistake which is very, very costly.

So for example, we have seen one or two significant opportunities in developing markets, and when we have looked at those opportunities, we have said, actually, the benefit of entering into these contracts is not sufficiently great to justify the enlarged amount of risk we would be taking. So I think that is really the situation on that.

Alex Toms - BofA Merrill Lynch - Analyst

Thanks.

Philip Bowman - Smiths Group plc - Chief Executive

Next question.

Sean McLoughlin - HSBC Global Research - Analyst

Sean McLoughlin, HSBC. I have two questions, firstly, on your comments around M&A. Please correct me if I'm wrong, but I got the impression that you've looked at a lot of opportunities but it's only the pricing that's holding you back. And if that is the case, how quickly do you think you can re-state the criteria to possibly allow some of these acquisitions to come through?

Secondly, on emerging markets. Looking at your medium-term target, how much of your sales do you anticipate would come in the medium term from emerging markets?

Philip Bowman - Smiths Group plc - Chief Executive

I think if you look at emerging market revenue five or six years ago, the figure was around 6%. We're currently at 15%. And I think by the end of what I would refer to as the five-year plan, we're 18 months or so into that, I would want to see that figure somewhere between 20% and 25%.

I think that to my mind is the crucial thing. If we can do better than that, I would like to do that, but that certainly is the sort of level of increase we're looking for.

I think in terms of the M&A activity, it's not fair to say that the only reason we did not consummate transactions was price. Very often when you undertake due diligence, you do not find that everything is quite as rosy as set out in the very nice document generated by an investment bank or some other person and, therefore, you decide at that point you're not going to go ahead.

I think what is important is that we need to be competitive in the marketplace, and it's quite clear if you look at the various statements that have been made by other industrial companies, their criteria in terms of returns are less challenging than ours are.

And I think I'm simply flagging here that we will take a pragmatic view. Clearly, this has to generate value for shareholders, but we may be prepared to take a slightly longer-term view that we have been before.

In terms of when that could impact things, it could impact things now. It's a matter than has been debated by the Board, and the Board is content with going down that path.

Mark Davies-Jones - *Agency Partners* - Analyst

Mark Davies-Jones, Agency Partners. Can I go back to the emerging market business within Medical? Because clearly, it has been a big focus and an area of recent disappointment.

Particularly in areas like China, do you think you need to re-think the way you enter that market? Do you need more local partnerships, even local acquisition in order to secure the business there? Or is it simply specific delays in getting projects registered?

Philip Bowman - *Smiths Group plc* - Chief Executive

I think I'm going to ask Rob White, who's the CFO of Medical to make a few comments, but before I do that, what I would say would be this.

Firstly, I think we were over-optimistic in terms of the speed of product registrations. I think that was partly lack of experience, but it was partly also that the product registration process has been changing under our feet within China. So I think there is an issue very clearly there.

I think in products where we have got registrations in place, by and large we are succeeding in selling those, and we're getting some good growth from those products.

The area where we have struggled has been in the infusion pump side. You'll remember some four/five years ago, we bought a local manufacturing business there. We have used that, its NPD facilities, to generate a new range of products, and we've experienced delays in getting those certified by the Chinese FDA.

Rob, do you want to add a little bit?

Rob White - CFO, Medical

I think what I would say on the China issue in particular, the infusion business has held us back disproportionately in the first half. And although we have made some progress in bringing new products to market, we are not moving as quickly as local competition. And the fact of the matter is that our local competitors are bringing out pumps at a faster and faster rate and we have yet to establish that pace.

However, we have invested in a new R&D facility in Shanghai over the past two years and we're expecting that team to up the pace in terms of future developments; and we do have multiple ranges of new products in the hopper for the next three or four years.

Philip Bowman - Smiths Group plc - Chief Executive

Rob, thank you for that. Any other questions?

Sandy Morris - Jefferies & Co. - Analyst

Can I --? Just trying to dig down into the businesses a little bit. Sorry for being slightly layman-ish but -- I hate to go back to asbestos, but I think we were braced for some tricky cases coming up, because when I [went to] the thing I can never pronounce, but we knew we were going to have some tough ones. Just to double

check that what we're seeing is just that washing through. We knew the costs were going to go up a bit, I think, didn't we?

Philip Bowman - *Smiths Group plc* - Chief Executive

I think there are two things, Sandy. Firstly, I think we did flag that there were some difficult cases, and as Michael said, a very straightforward strategy in dealing with these is we appeal them until the last possible avenue of appeal. And if that fails, then you are into clearly settling whatever the judgment is or negotiation a settlement.

We provide, as you know, 10 years ahead, an estimate of 10 years. The actuaries think they can only look 10 years ahead. I think they're doing quite well to do that. Clearly, if you have two adverse judgments of the scale that these were, that goes into the model and it causes a blip in the model, an increase in provisioning, but clearly over time, that data will be smoothed out.

I think the other observation would be that we have continued to invest in our legal defense. I think it's served us well. And I think the comment that I would make is that the majority of what we spend on asbestos, if you look back, is not actually paying judgments to the plaintiff's bar, it's actually in paying attorneys and experts to defend us against these cases.

Sandy Morris - *Jefferies & Co.* - Analyst

Quite. So there's a sort of good news/bad news thing, isn't there?

Philip Bowman - *Smiths Group plc* - Chief Executive

Yes.

Sandy Morris - *Jefferies & Co.* - Analyst

And then, and this is just grubbing around, it appears to me that most of what we saw in the second half of FY 2013, so the last financial year, has continued into the

first half of this year, and I'm just trying to make sure that there were no aberrations other than weather between the two quarters.

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

Peter, do you want to comment on that?

Peter Turner - *Smiths Group plc* - *Finance Director*

I don't think there are any significant variations. Clearly, I think the only other trend I'd highlight, Sandy, is that new, if you like, going from the second half of last year into this year is the US distributor de-stocking in Medical. But I think beyond that, the trends, as you say, have broadly continued.

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

And this is the big general layman's type question. I've ploughed through the FY 2015 budget and there's loads of changes coming, Affordable Care Act and driving for efficiencies, but there's a whole bunch of more people coming into the system. And just at this point, our distributors decided to de-stock, which we've seen in Japan, but we've never really seen in the United States, from memory. Is that driven by the device tax? Is there some sort of anomaly there that caused them to do that? And I know they'll get a lower rebate; at least I assume they will. But why did they do that?

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

Jeff, do you want to give a view on that, please?

Jeff McCaulley - *President, Smiths Medical*

Good morning, everyone. Look forward to meeting all of you in time. So my comment would be I think there -- if you look broadly across healthcare, there's headwinds and there's certainly a lot of tailwinds. I think the tailwind of demographics is going to carry this market for a long time.

In the short term, I don't think the Affordable Care Act had anything to do with distributors because that's really on the original equipment manufacturer. I just think those distributors are trying to be incredibly efficient with their supply chains.

I think the good news is we've seen them reach all-time lows in their days on hand so we don't see further destocking of those distributors. But they're going to continue to try to optimized their business, just like we're going to continue to optimize our business, but I don't think there's anything more structural that's tied to the Affordable Care Act or anything else that's taking place in the US. I just think it's them trying to run highly efficient businesses like we are.

Sandy Morris - Jefferies & Co. - Analyst

Okay. So it is cash. And, sorry, you'll get fed up with me very soon, but the device tax, how long will that impact do you think before the industry sorts itself out?

Jeff McCaulley - President, Smiths Medical

Well, I think once you get 12 months of it, it's in your financials, so the year-over-year effect is going to be gone, but as long as it's there, we're going to have to deal with it. But I don't think you'll see it as adverse effect once we get through the first 12 months.

Sandy Morris - Jefferies & Co. - Analyst

Yes. We'll [swap] that. What I meant was do we just take this hit and move on, i.e., it rolls forward, or will the industry gradually do something to try and --?

Jeff McCaulley - President, Smiths Medical

Well, the industry has been fighting it a lot. If you look at the forces behind Advomed, in particular, which is the biggest Medical device advocacy group, they're fighting it. There's been a lot of debate within Congress about whether or not we should keep the tax. There's provisions in a lot of legislation that's trying to get rid of the tax, but I don't think we can hang our hat on any of those.

So what we can do is control our own destiny and that's what Fuel for Growth is about; so doing everything we can to offset that tax and more so that we can have more investment to plough back in the business.

Sandy Morris - Jefferies & Co. - Analyst

Okay. Super. And one last one; not for you, so a different target, target of opportunity sort of thing. John Crane suddenly has burst into life on the OE side, which we learnt at the Investor Day is all jolly good news going forward for the aftermarket, but suddenly 6% growth is a hell of an acceleration. So maybe Duncan will tell us a little bit.

Philip Bowman - Smiths Group plc - Chief Executive

I'm sure he will. Duncan, please.

Duncan Gillis - President and CEO, John Crane

Sandy, I did tell you that we were going to focus on that going forward. It's important for the long-term health of the business. Keep in mind there's two components to our original equipment business. There's our engineered OEM business, and that was -- that increased in the low single digits. And then there's our commercial OEM business which is not as focused on energy. It goes into a variety of businesses.

And I think you asked this last time in a roundabout way, Sandy, when we were in Dubai around businesses outside of energy. That part of the business goes into things like HVAC industry; it goes into beverage dispensing; it goes into things like pools, hot tubs. And that business had mid single-digit growth in the first half of the year.

Now will that continue? We'll see. I think we're pretty optimistic about the engineered OEM component which really delivers that aftermarket piece going forward. Backlog looks pretty good there; projects looks pretty good there. There's some delay of larger projects going into next year, but we're also winning projects now which will

impact our business next year. So overall, we're feeling pretty good there. The team's doing a nice job.

Sandy Morris - Jefferies & Co. - Analyst

Okay. Thanks very much.

Nick Webster - Barclays Capital - Analyst

Nick Webster, Barclays. Two questions, firstly, on the Detection contracts. You mentioned you're not bidding on potentially lower-margin future ones, but there were some that impacted these numbers. Is that the end of the ones that are in the backlog? When do they date from and are we through that?

And the second one is on John Crane and the upstream market and the competitive environment there. Can you just give a bit more color on that; what the dynamic is and is that a pricing element, a product element, or just the general market condition?

Philip Bowman - Smiths Group plc - Chief Executive

I'm going to ask Duncan to respond to the question on the upstream market and give Brian Jones an opportunity to think about the first question on Detection.

Duncan Gillis - President and CEO, John Crane

So when we talk about the component of the upstream business, that struggle, that's our production solutions business. For everyone, there's three components to that business.

There's a piece of the business that is centered around Eastern Europe. That business is growing in the high single digits.

There's a component of that business which is focused on chemical analysis globally, primarily water analysis as it mixes with oil, and that business is growing in the single digits.

And then there's the US business, and the US business is a business where we saw the declines and where we're seeing two components. One is the weather that I talked about earlier, and the second is the competitiveness.

Competitiveness is driven by really two different things. There's a piece of that business, the US business, which focuses on steel and fiberglass rods downhole in the artificial lift segment, primarily fracking. There, we've seen competition come in in fiberglass rods which has driven -- taken some volume and put some pressure on pricing. We've also seen some pressure on steel rods, on the steel rod component in terms of pricing and also increased competitiveness.

The other part of the business is a business that repairs the pumps above ground, the nodding donkeys that you see. There, we've got one particular competitor that has been very aggressive. Some of the tactics have been in our view outside the boundaries, and we're taking the appropriate actions legally to try to stop some of the actions that that competitor has taken. In addition, we are improving the strength of the management team in that business to deal with the competitive threats.

Philip Bowman - *Smiths Group plc* - Chief Executive

Duncan, thank you. If you could pass the microphone to Brian.

Brian Jones – *Interim President* - *Smiths Detection*

Thank you, Philip. Morning, everybody. I think it's important to observe that the transition from product sales-orientated business to largely a program execution business is non-trivial. Having spent a number of years in the IT industry, there was an analogous transition in the IT industry probably 15 years ago where it moved from product sales, box-shifting as it was somewhat disrespectfully called, to solution delivery, and ultimately to outsourcing and the service component becoming absolutely critical.

In our business, which is actually simpler in large respects to the IT business, a similar but yet difficult transition has been taking place, and it would be unsurprising, I think, if we were to have accomplished that transition flawlessly.

Those three contracts that we referenced just prior to the year-end last year, one of those has worked through completely and is now complete. The other two will be completing over the next few months and are on track. They are repaired and we are delivering according to customer expectations.

Philip referenced some of the up-skilling that we're doing both in terms of our processes and our talent, and that refers specifically to this move from simply shifting equipment to executing large-scale programs. And it begins right at the beginning. It begins at opportunity qualification, which he's already referenced, making the tough decision about is this a set of promises that we can confidently make and deliver on, and does it provide us with the appropriate benefit to warrant any risk that's in there.

Then, of course, it's the contracting piece and what are we actually signing up for. Then, of course, it's how we manage changes in those programs which both represent opportunity to take on more risk, but also opportunity to increase and improve margins, because any change represents a new sales opportunity in many ways.

And then of course, finally, it's the program execution itself which is something that we have been investing in, both in terms of our methodologies, but also in terms of the up-rating of our talent. It's been quite striking that that latter point has been a real difference-maker on those troubled contracts where we've appointed extremely experienced, dyed-in-the-wool, hardnosed program directors to take these troubled contracts and get them under control. That, above everything, actually, has made the fundamental difference.

Philip Bowman - Smiths Group plc - Chief Executive

Brian, thank you very much indeed.

Glen Liddy – JPMorgan Cazenove - Analyst

Glen Liddy, JPMorgan Cazenove. For John Crane, it's good to see the growth in OE coming through quite strongly. What's being done to ensure that you lock in the aftermarket so they actually come back directly to you rather than through an intermediary? And what's the lag? Is it going to change because the products are going into slightly different applications?

And then on Detection, can you give us an update where we are on the regulatory approval for the baggage scanning in the US and how the take-up of that machine is going outside the US?

Thank you.

Philip Bowman - Smiths Group plc - Chief Executive

Thank you for those questions. Duncan, please.

Duncan Gillis - President and CEO, John Crane

A couple of things. On the engineered OEM business, for the larger projects. we actually commit to build service centers close to the construction project' in many cases a refinery or petrochemical facility in remote areas. And so that's how we lock in our aftermarket business there.

In addition, with our new structure, we're much better connected globally between the first-fit that we're selling in and then ensuring that the aftermarket is there, not only to capture the initial spares which are a big component of that, but then to be there for the ongoing servicing.

Remember that when a project is commissioned, it's actually our aftermarket team that's doing the commissioning so they're on site and aware of what's going on.

Relative to the split I gave you, there is much less of an aftermarket for that commercial OEM business. And the aftermarket that we typically see with the higher

margins typically comes from that engineered OEM business. So we will have some follow-on flow orders, but it's not a big piece of our business.

Philip Bowman - *Smiths Group plc - Chief Executive*

Duncan, thank you. Brian.

Brian Jones – *Interim President, Group CIO*

Regulatory certification in the US for XCT, as you know, it's already laboratory certified and it's going through what they call TSIF and OT&E, which essentially is the practical testing of the machine in the field.

The timetable for that is not under our control, as you'll appreciate, but based on previous experience, and based on the strong start we've made in the process, our expectations are that November/December timeframe -- again have to be heavily qualified by the fact that it's their decision not ours -- but assuming all continues to go well, November/December timeframe we should get full certification of XCT.

The opportunity outside the US is active. The checked baggage arena is really just beginning its refresh cycle, so this is a long period of opportunity for us. The opportunities are beginning to emerge. We are in active dialog with airport architects, baggage handlers, the airport authorities themselves; a great deal of interest in the machine, particularly in its throughput capability which is outstanding in the marketplace.

It's tough; it's a competitive landscape. We certainly won't win everything we bid for. And we are right at the beginning of it so there is plenty of opportunity, lots to go for. And the US certification, assuming it goes well towards the end of the year, will be helpful in all of that.

Philip Bowman - *Smiths Group plc - Chief Executive*

Brian, thank you very much.

Andrew Carter - RBC Capital Markets - Analyst

Andrew Carter, RBC. Most of my questions have actually been covered, but just a couple, if I could. In terms of the growth targets for Medical, I wondered what your volume assumption was within that.

The next one was just in terms of the M&A opportunity. If I think back a year/couple of years ago, there was a little bit of pressure on the balance sheet, I think, from rating agencies and things. I was wondering if you could just give a bit of an update on that and give us an idea as to how much firepower that you think that you might have to acquire things.

And then just could you please remind us a bit on transaction and what the issues are that we need to be thinking about going into the second half of next year.

Philip Bowman - Smiths Group plc - Chief Executive

Thank you for the questions. Peter, would you like to answer the two finance ones; and then Rob White, I think you'll pick up the Medical one.

Peter Turner - Smiths Group plc - Finance Director

In terms of the transactional rather than translational flows, the key pieces to think about is in essence we are slightly overweight manufacturing in North America for Medical. Part of the rationale for opening the new Czech plant is to rebalance that over time. But today, we're slightly overweight manufacturing in the US relative to the sales footprint of the business.

Then I think we've got the flipside in Detection where we've historically been overweight manufacturing in Europe relative to the sales base, and in essence, the shift of manufacturing out of Europe into Johor Bahru in Malaysia and into the US attempting to rebalance that. But that process is still ongoing. So those are the two big picture transactional flows to think about across the Group.

In terms of ratings, I think we have reasonably good headroom right now with the rating agencies against our current rating bands. I think, as we talked about earlier, we believe we've got a good balance sheet with the strength to fund suitable bolt-on acquisitions that we'd want to make. So I don't see finance being a constraint in terms of the M&A opportunities in front of us right now.

Philip Bowman - *Smiths Group plc* - Chief Executive

Okay. Rob.

Rob White - *CFO, Medical*

Yes. Well, as Philip mentioned earlier, our organic growth targets are for zero to 3% top line growth. Now as a backdrop, we've mentioned previously, Medical faces a somewhat persistent pricing headwind; it typically averages in the range of 50 to 100 basis points per year and isn't getting any easier. If anything, it's probably increasing slightly.

So that really does imply that the top line target is really all about volume, and we see that being driven primarily by fast and new product development and further expansion in the emerging markets.

Philip Bowman - *Smiths Group plc* - Chief Executive

Rob, thank you. Any further questions?

Robert Davies - *Morgan Stanley* - Analyst

Robert Davies, Morgan Stanley. Just on the overall environment in oil and gas, we hear lots of varying news flows on the up, mid and downstream CapEx spend. I'd be quite interested to hear your view on what's going on on the downstream side of things in terms of CapEx.

And then just secondly on M&A, is there a particular division you're looking at or are looking to avoid in terms of M&A? Is it products that you're looking to pad out? When you look at your portfolio, are you trying to rebalance your divisions to be more

evenly weighted? Or is there a particular area, such as John Crane, you're looking to build out?

Thanks.

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

Well, I'll ask Duncan to at least answer the first question and part of the second question in terms of M&A insofar as it pertains to John Crane.

Duncan Gillis - *President and CEO, John Crane*

Robert, there's really no change from what I said in December in terms of CapEx. We're seeing continued investment in mid and downstream. Pipeline projects are strong around the world. Downstream projects are continuing to ramp up. We've had a couple of large projects delayed, but nothing really being canceled; in fact more coming on line.

And the other side of that is OpEx in oil and gas downstream continues to look pretty good. So we're feeling quite good there.

In terms of M&A, Mr. Bowman and the Board have made it very clear that we need to step up the pace. We have a pretty strong acquisition committee in place. We're evaluating a lot of opportunities, both downstream and upstream and in a variety of product of segments. Haven't come across anything that has historic criteria, but as Mr. Bowman mentioned, there are some adjustments that we're thinking about as a company which could help as well.

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

Duncan, thank you very much. Any other questions? Don't see any hands. Okay. I think it just remains to thank you all for coming here this morning. Thank you for your time. Thank you for some good questions. And we'll be back here again I guess in six months' time or so, towards the end of September. So thanks very much.