INTERIM RESULTS 2016/2017

FULL TRANSCRIPT

Andrew Lappin – Smiths Group

Okay, well good morning ladies and gentlemen and thank you for joining us today for Smiths Group's Interim Results Presentation. I'm Andrew Lappin. I'm the head of corporate affairs here. In just a moment we'll hear from our Chief Executive Andrew Reynolds Smith, and our Chief Financial Officer Chris O'Shea. Couple of points of housekeeping before we get started: phones off please and no fire drills, so if the alarm does sound, exits to your left and your right. And I'd be grateful if you would read our disclaimer slide. Thank you.

Very important piece of kit, this. Okay don't worry, I've got it all under control, Andy. To give you a feel for this morning's proceedings, Andy will start by taking you through business performance in the first half of 2017 and then hand over to Chris for the financial review. Andy will then give you an update on how we're performing against our strategy before we open it up for your questions at the end. And so without further ado, it's my pleasure to pass you over to our Chief Executive Andrew Reynolds Smith.

Andy Reynolds Smith – Smiths Group

Thanks everyone and good morning. I must say that's made my Friday morning watching the face of our company secretary sitting at the back there and quickly Andrew flick through the disclaimer slide, but welcome to the Alan Turing Room. I'd like to take you through today the good progress that we're making on strategy, the specific actions that we're taking and the performance that we're achieving against our plan. We're really driving towards a bigger, better, more focused Smiths Group. Over the last six months, we've taken action on all of our strategic priorities.

Our objective has been, and it continues to be, to return Smiths to sustainable above-market growth. To meet that priority of outperforming the market we've initiated a programme of increased investment in innovative new products and services, and that programme is both well thought out and highly focused. We've also taken further actions to better position the portfolio for growth. We've increased our R&D spend in the half from 4% to 4.5%, and we've disposed further non-core businesses, including Artificial Lift, Wallace and the Interconnect Power business. We're also in the final stages of the regulatory approval for the Morpho Detection business transaction.

To meet our priority of achieving world-class competitiveness and more consistent execution, we've also rolled out the Smiths Excellence system across the group. We've strengthened our financial framework with the goal being to increase our firepower to give us the flexibility and ability to invest in growth. We've also started a rollout of a cultural change programme to develop the leadership capabilities that we're going to need to deliver on our dream for the future. So investing in growth, focusing our portfolio, running our businesses better and stronger cash conversion and a strengthened balance sheet; it's clearly going to take time for the benefits of our actions to start to come through. But I did want to be really clear. We're laying the foundations for real future growth across the group.

More on all of that later, but now I'd like to take a few minutes just to run through the first six months. We made a good start to the year. We produced group revenue up slightly by half a per cent, and it's up 18% on a reported basis. Smiths Detection delivered a strong revenue performance, and that offset declines in revenue we had expected in John Crane and some weakness in the Smiths Medical revenue. Headline operating profit was up 8% for the group overall, with all divisions contributing by delivering a solid trading performance, good cost control and generally running our businesses better.

Group operating margin was up 150 basis points, and headline earnings per share were up 45.7 pence. That's 30%. Cash conversion remains an absolute key focus for us, and that's an area where we want to see some real improvements continuing to embed across the business. So it was good to see that cash conversion hit 115%, and free cash flow up over 40% versus prior year. We also delivered a lower net debt number in the first half, and the board has declared an interim dividend of 13.55 pence, up 2.3. Now, I'll take you through the highlights of each division.

As we expected, John Crane continued to face some difficult trading conditions in the global energy markets and sales were down 4% on an underlying basis. But aftermarket revenues return to growth in the first half, up 3% as levels of activity stabilised, although at this stage first-fit contract activity showed no signs of recovery. The aftermarket at 64% of sales is really a key factor in the resilience of John Crane, and we continue to win some significant new contracts to feed the pipeline with the likes of Solvay and BASF.

First-fit sales were down 15%. This was due to continued low new project activity, and it was particularly true in North America. But we did have major new contract wins in Saudi Arabia, Oman and Kuwait, which were pleasing. Another factor in John Crane's quality is the range of end markets that we serve. We continued our efforts, as we said back in September, to diversify our non-oil and gas market revenue. And it was good to see that revenue was up 3% in this area as we won new contracts, particularly in chemical, mining and water treatment. To maintain John Crane's position in the future we've continued to focus on expanding the installed base also. And we continued to invest in strategic first-fit projects that produce good long-term returns on investment, but as expected, that did cost us a bit in margin.

The underlying headline operating profit at John Crane was down 4% year on year, but we continued to manage our costs, including making some further headcount reductions. As I've said before we're taking decisive action to strengthen John Crane during these tough times and that way we're much better positioned when the energy markets do start to recover. Back in November we sold the artificial lift business, and that sale combined with the other action that we've taken led to increased profitability. In fact, operating margins were up versus the same period last year at just over 20%.

Developing our research and development capabilities remains a very strong focus for me, and particularly in John Crane. We see significant areas of potential in areas like material science and condition monitoring. Back in September, we mentioned the sense predictive diagnostic platform. And I'm pleased to say that we're now in the process of ramping up installations across more than 30 refineries, which will be completed by the year-end.

Moving on to Smiths Medical. Overall Smiths Medical revenue in the first half was weaker than last year with sales down about 2%. Most of that drop was in Infusion Systems and Vascular Access, but despite lower sales, it was good to see the benefits of efficiency improvements, with profits up 7% and margins just going over 21%. Infusion System sales were down 2%, mostly because of softness in portable pump hardware, but in Infusion overall, we are revitalising our product portfolio to position it for growth and have launched new products including our Medfusion smart pump programming solutions in the half, which drove stronger sales in hospital data management. In Vascular Access, revenue was down 4% with some growth in cardio and port products, but also some declines in sharps.

We continued to bring new products to the market in this area, which is a really important part of our strategy. Vital Care sales were up 1%, driven by growth primarily in trach tubes and respiratory products. It was a bit of a mixed picture for Medical in Asia with strong growth in India at 24%, and 8% growth in South East Asia, but offset by a weaker performance in China. I'll come back to what we're doing later to re-energise our approach to Asia and China, but the simple fact is we're not well enough positioned today in Asian markets, and that's something we're going to fix.

We increased R&D investment in Medical to 6.8% of sales, and we made progress increasing our investment in new products for higher growth segments in Infusion and Vascular particularly, that we talked about at the full year results. I'm really pleased with the pipeline of products that we have and we've got more launches to come later in 2017 into 2018 and 2019. Finally, on Medical, it's worth noting the sale of the Wallace IVF business to Cooper Surgical in November; at only 2% of Medical's revenues and limited growth potential, it was very clear that divesting the business for £140 million would enable us to invest in building scalable top-three positions elsewhere in the portfolio.

Now let's turn to Detection, and Richard, nice to see here with Di today, the President and Strategy Director of the Detection businesses. Detection had a strong start to the year with revenues up 12%. We saw growth in all end markets apart from ports and borders. Airport revenues were up 12% driven by a strong performance in Europe and the Middle East, and large new projects such as Abu Dhabi and Berlin Brandenburg that we've mentioned. Today, it's also great to announce that we've won a major new contract with Schiphol, third largest airport in Europe. And they're buying 24 advanced computed tomography systems with an option for a further six as they upgrade their whole baggage screening. And that installation will really help Schiphol stay at the forefront at the latest certified technologies.

As I mentioned, Ports and Borders revenue were down 14% really against a very tough comparative last year. It was a good performance in Europe and the Middle East, with deliveries in Kuwait and Italy. But that good news was more than offset by the completion of some large programmes last year in Latin America and Asia. Military sales were up 21% and Critical Infrastructure increased by 24%. That improvement was mostly driven by the US and the UK, but with also important progress on the Shanghai underground. Underlying headline operating profit grew by 51% with that improvement due mainly to stronger sales, stronger mix and continued progress on delivering efficiencies from our operations.

It's an impressive performance and whilst we expect margin progression for the full-year, we do expect some moderation in the second half due to product OE and aftermarket mix in those sales. Asia Pacific now represents 17% of the Detection business and we continued to grow the aftermarket also. R&D was increased to 6.3% of sales and we launched some exciting new products in the aviation market, including an advanced screening platform called Checkpoint Evo Plus which is a bit of kit that integrates different sensors into an intelligence search solution for remote screening at the checkpoint. And we stayed right at the cutting edge of applied technologies too, with our products being the first in the world to be certified under tough new European standards for automatic detection of explosives in hand baggage.

In April 2016, we announced the proposed acquisition of Morpho Detection and we're in the final stages of that regulatory process and expect to complete the deal shortly. It's a really important moment for us and for our customers and the industry as a whole. This is a really compelling combination of two complementary businesses creating best-in-class technology and solutions. The regulatory approval does require us to sell the Morpho explosives trace business however, and that process is now well underway. It will conclude after the acquisition is closed, and Smiths already owns a high-quality trace business which we will continue to develop, of course. The strategy and value potential from combining the two businesses remains really strong. The teams are really excited at this point and waiting to get going, delivering a really comprehensive global integration plan.

Moving now to Smiths Interconnect, revenue was down about 1% underlying with flat revenue at connectors and lower sales in microwave. Microwave revenue declined due to programme timing in the telecoms market, but we saw gains in the space market and we also increased content on satellite programmes and generated strong new orders in commercial aerospace, with our cutting-edge Ku-Band wireless technology.

Headline operating profit was up 15% thanks to the benefits of continued restructuring and procurement savings. As a result, margin was up 160 basis points in the half. So far this year we've invested a lot of time and effort into reorganising Smiths Interconnect, combining the business under a single brand and improving our account management to focus on core markets for the future, including space, commercial aerospace, and semiconductor test. We also sold the Power business in January for 162 million, which helped us focus the division on the markets and customers where our connector and microwave technologies have the most value and potential. We've made good progress to sharpen Interconnect's focus and this is starting to show through.

Finally Flex-Tek, sales grew 2% with growth mainly driven by the US housing market. Overall, and as usual, Flex-Tek continued to deliver stable performance and continued to deliver efficiencies and growth. Operating profit was up 7% and margins came in at 18.3.

I'll now hand it over to Chris who will take you through the financial review of the first half, and look forward to chatting again on the strategy little bit later. Thank you.

Chris O'Shea – Smiths Group

Thanks, Andy. Good morning everyone. Let me take you through the financial results for the six months ended 31st January 2017. Starting with the key financials for the half; revenue was £1.616 billion, an increase of 18% compared to the last year. Underlying performance excluding the positive impact of foreign exchange translation and the adverse impact of disposals was in line with 2016. Headline operating profit increased £60 million to £277 million, which resulted in an underlying margin increase of 150 basis points to 17.1%. Headline free cash flow performance is very strong with a 44% year-on-year increase to £252 million.

Return on capital employed increased by 90 basis points to 16.3% reflecting improved profitability and better working capital management. Headline earnings per share were 45.7 pence, a 30% increase from last year. This was driven by increased headline operating profit and favourable foreign exchange translation effects partially offset by half a point increase in our effective tax rate to 26.5%. As Andy mentioned, the board has proposed an interim dividend of 13.55 pence per share, a 2.3% increase on last year. I'll now take you through the results in some more detail.

As you can see here, positive impact of currency translation increased revenue by £251 million compared to the first half of 2016, partially offset by a £15 million impact from the disposal of the Artificial Lift and the Wallace businesses during the first half. Revenue performance benefited from particularly strong growth in Detection, but underlying revenue increased by 12%. This was counterbalanced by ongoing challenges in John Crane end markets leading to a reduction in revenue of £18 million, and weakness in Smiths Medical, where revenue fell by 2%. Smiths Interconnect revenue was down 1% while Flex-Tek grew by 2%. All in all, total revenue increased on an underlying basis by £8 million to just over 1.6 billion, with 53% of this revenue coming from aftermarket activities.

Let's look at operating profit now. Excluding the positive impact of currency translation and the effect of business disposals, profits increased by £22 million with improvements in all divisions with the exception of John Crane. We saw downward pricing pressure in Smiths Medical and Smiths Detection which was only partially offset by positive pricing in John Crane, and in the other two divisions the pricing was broadly stable. Cost reductions of £11 million were mainly driven by strong cost management across the divisions, partially offset by increases in central costs of £5 million as we build additional capabilities to execute our M&A programme, initiatives on people and talent, and introduce the Smiths Excellence system. Reported headline operating profit of £277 million was up 60% year on £60 million on a year-on-year. All in all, the Group's reported operating margin was up 130 basis points to 17.1%, with margin increases in all divisions. And on an underlying basis the margin increase was 150 basis points.

We'll have a look at the cash position now which, as you know, is something of a religion for me and an important focus for Smiths Group overall. Cash conversion was 115% in the first half compared to 101% in the same period last year and 102% in the full-year 2016. Capital investment of £51 million was up 21% versus last year, reflecting the effects of foreign exchange translation, and on an underlying basis, the increase was 6%. Our investment into the business lay the foundations for future growth. Cash inflow from working capital was £27 million which is a £37 million improvement on the position last year. As we said previously, there's ample opportunity to release more cash from working capital, and we expect to continue to make progress in future periods. Overall, headline operating cash flow of £320 million was up 47% on last year. Headline cash interest of £22 million was slightly up last year, principally driven by foreign exchange translation. And headline free cash flow was £252 million, an increase of 44%.

Looking now at net debt, this reduced by £343 million in the period, principally driven by increased free cash flow and the proceeds from asset disposals. The retranslation of our opening net debt, closing FX rates, and related fair value in FX hedge movements caused an increase in net debt of £17 million, principally due to the strengthening of the US dollar and the euro. A headline free cash flow of £252 million more than covered all cash outflows including pension contributions and the payment of the full-year dividend. For the first time in a long time we had an underlying reduction in net debt in the first half.

Overall, this underlying reduction of £40 million together with the £320 million disposal proceeds saw net debt fall to £635 million pounds at the end of the first half. This gives us a net debt to EBITDA ratio of one. With the completion of the Morpho acquisition and the related disposal of Morpho's Trace business, we would expect the ratio to move to around 1.7 times.

I'd now like to spend a little bit of time in inventory demonstrating the progress that we've made so far. As you know we're looking for sustained and sustainable improvements in inventory management. Andy talked about inventory terms. I talk about inventory days, but it means the same thing; we want to reduce inventory. This is one of the charts that we use internally every month. The grey bar show inventory days at the end of each month and the line shows a 12-month rolling average. The rolling average is used as a performance measure, making sure that we don't encourage window dressing at period ends. So looking at the 12-month rolling average, you can see that over the past year we've taken seven days out of inventory. On an underlying basis that's £35 million in cash; most of this was recognised in the second half of 2016. You can see that we still have drops around the reporting period, and you can see there is a drop in January 2017 was less pronounced than in July 2016. And furthermore, you can see that it didn't suddenly rise back up in February, indicating a more sustained performance.

This is a good start, but is not enough. Our business heads, and two of them are here, deserve credit for responding to the challenges we set regarding inventory. The introduction of the Smiths Excellence system across the Group should increase the rate of reduction as we continue to look for systemic improvements in the flow of inventories throughout all of our divisions. Over the course of the next few years, I'm confident we can continue to make progress and we remain of the opinion that we can release a further £100 million or so from inventory over the next few financial years as in addition to the £35 million already.

Now, if you'll indulge me for a moment, I'd like to emphasise one of our great strengths which is our cash generation. The slide you see here shows the operating cash generated by Smiths by quarter over the past year. We are cash positive from day one. We generate cash continuously from the first month to the last. That means that we have a business that naturally deleverages every month, or alternatively, allows us to invest in growth opportunities. We've got a consistent financing strategy, we've got a well-diversified debt portfolio consisting principally of US dollar and euro bonds with a range of maturities and revolving credit facility.

Following the successful issue of our new 10-year 2% €650 million bond, our debt facilities have an increased weighted average life of 6.5 years. We've also reduced the interest rate of 3.5%. Part of the proceeds of this bond will be used to repay bonds in 2017, and €300 million in May this year, and 2018.

Moving now to pensions, you recall that the end of 2016 we had over 90% of the assets backing our UK pension schemes invested in matching investments. As you can see here, that percentage has gone up slightly, to 93%; however, the key point to take away from this slide is the quality of the hedges and how we continue to improve our risk management.

Corporate bonds provide a hedge against interest rate movements. As you move up into government bonds, you then add an inflation hedge to that interest rate hedge. And then if you move further into buy-in contracts you add a further hedge which is mortality. You also take away the potential duration mismatch of bonds and policies. We made further progress de-risking the pension liabilities in the first half of this year, with two further buy-in for the UK schemes, one for SIPs, one for TI; that covered more than £300 million of liabilities. And as a result of this we've increased by 7 percentage points to 26% the amount of the perfect hedge in our UK asset portfolio, so more than a quarter of our UK pension assets perfectly hedged the liabilities.

The total required cash contribution for this year is expected to be around £60 million following the triannual valuations in 2015. This is a significant reduction from the £124 million we paid last year. The cash contributions are impacted by foreign exchange because of the US contribution; that explains the rise in the £50 million I mentioned previously to the £60 million I mentioned today. We will continue to de-risk the group pension position wherever we can do so economically. And of 31st January on an accounting basis, our overall pension position was a net surplus of £51 million.

You see here the performance of the three businesses that we divested in the period. Had these businesses been sold on 1st August on a pro forma basis for the first half, the margin for the Group would have been 20 basis points higher at 17.3%. That demonstrates our ability to focus the portfolio on higher-performing assets over time. In addition, we would have seen a very small increase in a real revenue growth having disposed of these on 1st August.

Let’s move on to the Morpho Detection acquisition. Andy’s already given you an update and let’s have a look at the numbers.
The remedy we offered to the competition authorities requires Morpho’s Trace Detection business to be divested. Let me talk about the materiality of this remedy. Based on the 2015 numbers Morpho Detection’s Trace business represented about a quarter of this overall revenue. As a result of the agreement of the remedy, we revised our assumptions and synergies. We estimate that we can generate around $20 million of cost synergies down from 30 million mentioned previously. We expect the synergies to be fully generated by the third full year after closing at a fairly even phasing over the three-year period.

Based on what we expect to achieve the returns on this acquisition remain attractive and they remain above our hurdle rate, and the strategic case remains compelling.

Now we will look at our financial strategy now. Some of you may remember this slide from previous presentations and how the financial strategy supports the corporate strategy. I’d say I was reasonably happy with three quarters of our targets here which is a rather unusual exuberance for me. Headline revenue was flat on an underlying basis and Andy will give you some more colour in a moment on what we’re going to do to improve this, but is fair to say that neither of us is happy with the performance we have today.

Margins improved by 150 basis points on an underlying basis to 17.1% as a result of better mix operational improvements and cost savings. Return on capital employed was strong at 16.3% driven by improved profitability and lower working capital. ROCE was up in all of our divisions with the exception of John Crane, which reflected the lower profits in that business. Cash conversion, as I said, was very strong at 115%. At the core of our strategy, the straightforward financial framework, we will maintain a strong investment grade credit rating. We’ll invest in opportunities that create value and take a very disciplined approach to M&A. We’ll actively focus to strengthen and focus the portfolio and will deliver as competitive a tax rate as we can. All of this will do within a robust approach to enterprise risk management. I think this set of results is a testament to this approach. You see the three disposals, the increased investment in R&D, the progress we've made in the Morpho acquisition and the further de-risking of the pension portfolio.

Take a minute, you'll recall that at the full year results I mentioned that this would be our last year of taking small restructuring items below the line. From 2018 we'll change the reporting of exceptional items. Ongoing restructuring costs and pension administration costs will be above the line going forward. The final slide in your appendix details the impact this would have had on the results in the first half 2017 and we made the change now. We will do the same in the second half to give you a good base for 2018, and the 2018 models. We will however continue to separately report legacy litigation costs, amortisation of acquired intangibles and set another large one-off items where we think it will help the understanding of the accounts.

And finally, before I hand you back to Andy, good to take a look at the outlook for the rest of the year. Overall, the outlook is unchanged. John Crane's end markets are expected to remain challenging. And Detection's revenue growth is expected to moderate in the second half. However, we do expect Medical to claw back some of its underperformance during the second half. Group performance in 2017 is expected to be less weighted towards the second half compared to prior years, with Smiths Detection moderating somewhat during H2. We expect a continued strong performance and cash conversion in the second half, and if the depreciation of sterling continues, it will provide a further tailwind in the second-half results somewhat moderated than what we saw in the first half.

And the results of changes in global corporate tax regulatory environment, we expect our effective tax rate to increase to between 30% and 31% in 2018, which is also because the 2017 rate of between 26 and 27% reflects a number of positive one-offs that will not – rather than any significant structural change. On that, I'll hand you back to Andy for the strategy update.

Andy Reynolds Smith – Smiths Group

Thanks, Chris, great job. I noted that cash has morphed now from cash is God to cash is religion, so I'm not sure. But super presentation, thank you, Chris. We've made some really great progress in building the strong financial framework to support our overall strategy for growth and value creation. With a strengthened balance sheet, improved cash conversion and further progress on pensions, we're trying to give ourselves the financial firepower to invest in growth for the future. As I said in September, the two key components for future value creation come down to two strategic priorities. Outperforming our chosen markets by focusing our portfolio and investing to increase our exposure to higher growth market segments, and achieving world class competitiveness by implementing the Smiths Excellence system to drive speed, efficiency and solid, consistent execution across the

Group. It's an ambitious and far-reaching programme of change so I'd like to try and highlight some of the key areas where we've made some real progress in the last six months, if I may.

First, we've begun to reposition and high-grade the portfolio for future growth. We're doing that through organic investment and a highly disciplined and surgical approach to acquisition and disposals. During our strategy review, we worked out that around two-thirds of our revenue comes from businesses that are well positioned both in terms of market competitiveness and market attractiveness. That left something of the order of one-third of our revenue which required improvement to achieve top three leadership positions, or businesses which, while of high quality, lacked scalability, or in some cases we're just too far from achieving market leadership and will be better off in a good home somewhere else.

So far this year, we've moved decisively to complete the sale of the three businesses I mentioned earlier, and together they accounted for £150 million of revenue and generated more than £300 million from their sale. When we added the acquisition of Morpho Detection to this equation, the shape of the portfolio is starting to change. And we've now got better growth and return potential. After these transactions are complete, more than 70% of our revenue will come from well positioned businesses. We can either work to improve the remainder or look at further disposals. We've started to buy well and sell well. And that discipline will continue as we continue to work to deliver value. You could reasonably expect that there will be some more activity in this space as we continue to build the bigger, better, more focused Smiths that we desire.

Organic activity, like more acquisitions, can clearly be complementary or accelerate our progress. For me, organic growth is priority number one, two and three. Outperforming in our chosen markets and achieving top three leadership positions really means trying to drive our businesses towards the characteristics of the Smiths business that we talked about back in September.

Firstly, technology differentiation, some of the examples that we talked about earlier with increasing R&D in Medical to strong–fund the pipeline for innovation, or Detection taking industry-leading positions in new standards for automatic threat detection. A strong aftermarket in recurring revenue is really important to build resilience and greater predictability into our earnings, and the aftermarket also helps us to build closer relationships with our customers over the long term. We're seeing John Crane's aftermarket revenue return to growth, and the acquisition of Morpho Detection which will further extend Detection's aftermarket profile from well less than 20% a few years ago with a target of getting to more than 50% of revenues in aftermarket and service offerings.

Asset light and sustainably competitive businesses, with more than half of our cost of sales bought in, we have and we expect to maintain a low capital base that makes us adaptable and flexible as we change and grow, all of course underpinned by world-class operational excellence. And increasing digitalisation; more and more of our revenue is coming from digital, including Smart infusion pump for the future, intelligent threat detection and condition monitoring. It's an area that we're investing in significantly in the divisions. And also, the first of the projects from the £10 million central R&D fund that we announced back in September, which is designed to leverage group critical mass, and those include the focus on ultra high-speed data transmission projects, digital security, analytics and machine learning. There'll be more to come on those in the coming months.

Our I^3Group-wide Innovation Forum is now also fully operational, bringing together the divisional CTOs and business people to drive our agenda and make absolutely sure we're leading-edge on technology rather than defensive. We've implemented a group-wide process for new product introduction too, to make sure that we increase and focus our investments for growth in the market sub-segments where we can achieve leadership positions. As I said earlier we've increased our R&D spend in the half to 4.5% and expect that trend to continue over time. But in short, the aim is to invest smarter and manage the conversion of the ideas into sales more quickly with better leverage of group-wide muscle.

We're also focusing on new business models as we try to bring together our physical and virtual capabilities. Today, it's also great to announce a new partnership between Smiths Detection and Duke University on a Deep Learning Digital Solution project for advanced airport screening capabilities; really exciting stuff. Technology and innovation is a lifelong passion of mine and it's great to see the potential in this business as we build our future. As we focus our investments in high growth markets globally, we see potential for market outperformance in all regions. But clearly, our Asia exposure is too low at less than 10% Group revenues. Growth in Asia is not new to me. And as I've said before, we're too small. I've also said that we were trying to evaluate the best way to fundamentally shift our approach. I'm delighted to report today that we've appointed Roland Carter, the current President of Smiths Interconnect, as our new Group Asia President based in Shanghai. Roland will sit on the Group Executive Committee and report directly to me. In fact, Roland's sitting at the back there and perhaps if you could just make yourself known to the folks. Thanks, Roland.

Roland is going to lead some really important work of focusing and accelerating our strategy and people focus in the region, and most importantly, the actions necessary to get us moving. We've done a lot of talking in the past on this subject. I've no doubt that Roland's broad international experience and heavy previous focus on Asia, together with a really intimate knowledge of most of Smiths, is going to really help us and serve us well as we raise our ambitions in the region.

I’d now like to turn to the progress that we’re making against the second of our strategic priorities, achieving world-class operational performance. It’s not about cost cutting programmes. It’s about making sustainable improvements in efficiency by building process capability to do what we do faster and better, whether it’s designing new product or whether it’s manufacturing or getting things to our customers when they want it at the best levels of quality. These are the things that really create, in my mind, competitive differentiation which the customers value, and of course also, in the processs, create great value for us. Right from the beginning, I’ve been consistent and insistent on the importance of embedding excellence across our organisation in really everything we do. We’ve introduced the Smiths Excellence system with six pillars across customer, people, programme, production, supply chain and technology. It is an ambitious plan and it’s a long-term plan of continuous improvement and change, focusing on Smiths businesses and Smiths people and making sure we’re the best at what we do. Achieving world-class competitiveness is however an ongoing journey. It is taking time. It will take time. But by delivering on this agenda relentlessly step-by-step, there is material opportunity to improve our competitiveness and achieve material benefits. Take how we manage our approach to inventory. With my automotive background it’s something that’s always front of mind, much as Chris said earlier.

Speed and efficiency of flows through the business are for me a really important proxy as to how well the business is run. Speed from order to cash with development through to cash. There’s no doubt that there’s scope for improvement across all of our businesses. As we’ve said before, one stock turn is worth £150 million to us for reinvestment back in the business elsewhere. We’ve made some modest, but importantly systemic, improvements over the course of the past year. Inventory turns have started to improve on a consistent and systemic basis, translating into the seven inventory days of £35 million of progress so far that Chris mentioned earlier. The journey has started and we now expect this trend to continue. At the same time we’re taking action to manage our supplier base, deepening and developing our relationships with strategic suppliers. But we’re also being disciplined and selective about the partnerships to make they make sure they work for us. An example is in Interconnect, where they’ve achieved far more than a 50% reduction in their supply base to less than 350 from the number in the thousands previously, and £4 million of procurement savings in the first half. We’ve also been reviewing our sales effectiveness across the Group, and we’re in the process of reviewing sales incentives and channels to market

Detection, we’re making some good progress developing tools to evaluate how to best capture aftermarket service revenues in its different markets. It’s an approach that’s working well in Europe with its distributors and is now being rolled out in Asia and Latin America. Back to Interconnect, who have already moved well down the road with our distribution network review and have now reduced the number of distributors to – from 114 to 57, they are now much better aligned and incentivised with our growth plans.

Everywhere I'm going at the moment I'm really impressed with the examples of best practice to continually improve our production processes. But our Group-wide best practice and know-how sharing is poor. And this must be addressed by the Excellence system. Here's a great example of how Smiths Detection have optimised their layout in their facility in Malaysia, cutting lead times and work in progress by more than 50%. These examples of operational excellence across the supply chain, customer and production give you some sort of sense of some of the things that are underway at Smiths in this comprehensive programme. But for me, the key part of Excellence is our people in leadership. We set out to build an organisation that nurtures its talent and attracts the best. And we're doing that by focusing the Group around a cultural change programme and a set of values, and a sense of belief. We call this the Smiths Way. The values we live by and what you can expect when you work for us or do business with us. We want to be able to attract, retain, develop, engage and inspire the very best people to deliver on our dream. We've launched a number of new leadership programmes, including a partnership with UCLA and others to develop the best leaders. And we're making sure that our top leaders across the business are incentivised much more closely on operational and strategic metrics.

So I hope this is giving you some view of the solid progress we're making and how good I'm feeling about the future potential. Actions underway to focus the business for growth, achieve world-class competitiveness, invest in differentiation, increase financial firepower and develop leaders to deliver on our plan for a bigger better Smiths that counts itself as one of the world's leading technology companies. Thanks very much, and Chris and I now will be delighted to take any questions that you have. I really appreciate your attention. Thank you.

Q&A

Mark Davies-Jones - Stifel

Thank you very much. Mark Davies-Jones from Stifel. Can I ask two Detection-related questions please? Clearly you know, very strong performance in the first half, particularly the topline I guess is a big surprise. I seem to remember at the end of last year there was some businesses pulled forward and you explained an acceleration in the topline then on that basis. And we've got a similar message I think at the half year that we shouldn't get overexcited about how fast the growth is coming through. But is there something going on in that marketplace in terms of the upgrade cycle in Europe particularly the move to the CT-based systems, which is leading to an acceleration in market growth?

Andy Reynolds Smith – Smiths Group

Yeah, I think it would be difficult to judge something by half. Certainly the European upgrade to CT for check baggage which has to be implemented by 2022 is a big pull coming through the system now. I mean, the Schiphol thing that I mentioned earlier. But I think in the half year, what we're really seeing is this is really about the mix of product and the mix between OE and aftermarket. Now over time, we expect the differences by period to smooth, particularly as our aftermarket percentage grows. But at the moment, still some of that is visible. As I said in the – I think in the second half, we are expecting that mix to continue to move but progress for the year overall.

Jack O'Brien – Goldman Sachs

Hi. It's Jack O'Brien from Goldman Sachs. A couple of questions, firstly I noticed in John Crane you saw some positive pricing so just interested to see if that was sort of driven largely by the aftermarket and what you're seeing on the first-fit side? And then the Medical side you- clearly you talked going to make here lot of efforts about product development and that coming through the product launches. But would you consider sort of M&A on that side, particularly perhaps on the large infusion pump and what are the opportunities there? And then thirdly just on efficiency savings, again you saw some good progress in H1 totting up the numbers. How should we think about that for the sort of full-year and then into 2018? Thank you.

Andy Reynolds Smith – Smiths Group

Okay. Perhaps I'll have a go at the John Crane and efficiency. I think with the Crane business, if we split it into aftermarket and first-fit, we're definitely seeing pressure on first-fit pricing. I think simply because there are fewer projects and more people fighting for those projects. Really pleasingly, however, that pressure is not in the aftermarket, and that's partly due to the fact that refineries are running flat-out. Refining 92 and 93 million barrels a day, and they've got to keep running.

So as I mentioned just briefly, we're still trying to maintain that installed base which has touched our margin a little bit because of that pricing pressure, but not in aftermarket. On the efficiency piece most of our focus at the moment has been to generate funds for investment rather than take margin forward. We are making progress on that. We expect to see continued progress, but this is a long journey. And for me it's all about embedding the systemic processes to get away from these period-end type activities or single point cost saving initiatives. So I'm pleased with the progress that we're making on efficiency. It's small so far, but it's consistent and systemic, which is the important thing so we expect to that to move on. But I would see that translating into ability to invest more than the expectation of material movements forward from the margin point of view, at this stage in our development at least.

Chris O'Shea – Smiths Group

On the Medical side Jack, it's amazing that when you commit to buy something as we did with Morpho Detection, that simply pushes some of your other divisions to come up with lots of ideas. So we're not short of ideas as to what to buy. I wouldn't be averse to buy something in the Medical division. But the question is always can you create value out of it? Are we better owners than other people? So there's no real preference there. We always ask questions. We've got an acquisition opportunity, we always ask why can't we do it ourselves, and so we look at the time to deliver. We look at the value, so if something was there we would be quite happy to.

You mentioned large volume pumps, I mean the big one was ICU Medical bought Hospira Pumps from Pfizer. And that was a big transaction; it doesn't seem to be something that is going gangbusters just now, but that's a deal that I hope for ICU medical worked so well. And I think that's probably the last big large volume pump manufacturer that was available. We think we can do that organically. It's taking slightly longer than we would like. But we're convinced that we will have a good product.

Glen Liddy – JP Morgan Cazenove

Good morning. It's Glen Liddy from JP Morgan. You're focusing now on investing more in Asia. Your vision, you laid out a while ago, was that you're going to invest in growth. Can you still fund the investment in Asia from internally generated savings across the business? Cash conversion, 115%, is pretty impressive. If you start to grow does that slip back very much or can you still stay at 100 or better with moderate growth? And then finally on Detection, you're pointing to things being not so buoyant the second half. Is there much by way of lay margin business in the backlog and is the margin on the new business that you're capturing, improving and the capture rate service in the new business would be interesting to track?

Andy Reynolds Smith – Smiths Group

We've got some clear views on cash which Chris will articulate. I think with Asia, it's important to remember that we're actually really quite small by division in Asia right now, which is part of the problem. If you look at our sales in China we're at about £120-130 million. The rest of Asia combined is about the same again. So you spread that across five divisions in all of the countries and you've got some quite small positions. And I think therein lies the problem with our growth, partly. Our strategic focus and our critical mass, whether it's people or getting things done, is not high enough. I think this move now with Roland will make a very big difference so he'll be there sitting around the ExCo table, he's based in the region and will bring a new focus.
I think this will come as a combination of organic. I mean organic is one, two and three for me. But I think in order to accelerate there will be some acquisition here as well. It will be a dual path of getting ourselves moving in the right areas. But we have to move this one. There's been a lot of

talk on this one in the past. I think with Detection we had a really super first half, which I'm really pleased about. It does mean it's likely to moderate in the second half, but it's still moving forward if you take that great – that gangbusters first half out. So the year as a whole will continue to move forward.

As we said earlier a lot of focus now on trying to free up the capacity to invest in Detection as well, and it's up at high levels of investment again. So I'm very positive about it, the longer-term cycle trends for the market, and we do expect progress for the year as a whole.

Chris O'Shea – Smiths Group

To add a little bit to that, there is still some more business to come through in Detection. We are seeing good attachment rates in the aftermarket. But when we sell the kit there is usually a two-year warranty period, so there's a two-year lag between the OEM sales and then any aftermarket revenue coming in. So we see the benefit of the increased OEM sales in this half, in the first half of fiscal year 2019.

On cash conversion, we still think there's over a £100 million to come out of inventory. We also believe that we've got about 65 days now of sales outstanding and about 45 days of purchases outstanding. If you equalise those two, that's £150 million. Now, I don't think we'll be able to equalise them. But even if you get halfway there then combine it with we've got an inventory they're still closer to £200 and £100 million, everything we can take out of working capital over the next few years. I'd say that with moderate growth we should still aim to be over 100% cash conversion. And the last one, on your Asia growth question, even if we have to acquire we still have internal funds, so we still have available funds within our capital structure to invest in acquisition. So we could have acquisitive growth in Asia with the existing resources that we've got today now.

Andy Reynolds Smith – Smiths Group

And I think just in very simple terms on cash 90-95% is nothing to celebrate when you're flat. I frankly expect it to be where it is now given our growth profile. Inevitably, as we grow, I don't expect to maintain it at the 115% level. I just expect it to be stronger on an underlying basis commensurate with the cycle that we're in or the stage that we're in.

Robert Davies – Morgan Stanley

Yes, Robert from Morgan Stanley. Just a few questions; first one was around John Crane and the oil and gas business. Maybe you could give us a little more colour on the margin mix on oil and gas versus some of the other segments you said you were looking to move into like the mining and the chemical segment. How should we think of that mix change? What impact that would have on margins? Second was just around your strategy to accelerate growth. So it's something that comes up quite often when you talk to shareholders that, you know, previous management teams have made an effort to accelerate growth before from a kind of cost saving programme, struggled to kind of get it done; I guess on the ground what is going to be different and what you're assuming your end markets are doing in that environment, i.e. if you could just give a little more colour what's going on there?

And then the final one which is around the comments you made on digital. How are you kind of thinking about the digital offering? Are you doing that across group; is each individual division separately thinking about their own digital bucket? How are you kind of going down that road? Thanks.

Chris O'Shea – Smiths Group

The margin differential we see in the different markets is there's very little there, so we wouldn't expect to see margin dilution by going heavier into chemicals pulp and paper, etc. We are – I think our guys are pleasantly surprised that they can get the same margin, so people pay good money for good quality kit and top quality service, so you shouldn't see much change.

Andy Reynolds Smith – Smiths Group

I think the strategy for me, it comes back to a couple of things, like the competitiveness and the positioning. And as we talked before, we've now got a much more granular view of markets by sub-segment and within markets; we've used a lot of examples whether it's vascular access or in some of the Crane business or Interconnect business. So what we're really trying to do is target our investments now with a much more precise knowledge of the market segments that we want to lead in rather than looking at them more holistically. So without saying, the devil's in the detail really, it is; we've now got a view of some of between 50 and 60 segments across the business within our main markets. And we're focusing investment both organic, and are thinking non-organic around those areas where we think we can be sustainably competitive and in segments that are growing because they've got good drivers, whether that's technology or something else.

I think on the digital piece, and you hit on exactly the point there. We've got about 350 software engineers across the Group, some of them in John Crane, some of them in Detection, some of them in Interconnect, Medical, on Smart Infusion pumps. A lot of them doing a lot of the same things. Data security, clouded data, focusing on analytics, writing algorithms, AI or machine learning, so we'll continue to strengthen what we're doing in the divisions simply because the pull is, the business model is moving that way. Richard's digital piece grows to 30% over the next five years in Detection for example, but we're introducing this cross-group approach and we'll be making some announcements around that soon.

But in the areas where we need to get critical mass where we're subscale for example in analytics or in machine learning, we will pull that together to create group capability to try and accelerate the digital plan.

David Larkam - Numis

David Larkam, Numis. I'll start with Medical. Can you just talk about China? You didn't really expand on why that was quite so weak in the first half, anything getting on there? And secondly, North America with the potential removal of ObamaCare, are you seeing any changes in purchasing patterns there?

And secondly can you just talk about Mexico with Trump, your manufacturing that you got, quite a lot of sort of manufacturing there. And then finally one on Chris, just on the restructuring charges going forward, what should we think about that as a sort of headwind number for next year? Is that an additional number we should just sort of think about going now above the line?

Chris O'Shea – Smiths Group

What we'll do is, we will show you for the full-year 2017 what the results would have been with the restructuring charge above the line. That gives you a base off which to work for 2018. We will strive to beat that base. So we will strive for it to lower next year. A lot of the things that we've done over the past two years in the future growth programme are exactly the right thing to be done, so lots of small things that made the business better, more profitable and leaner. And so we would expect to continue to do that, so the question is not whether we should have had the future growth programme. The question is whether we feel comfortable to do similar things below the line in the future; the answer is no, those are recurring activities.

And you talked about the China Medical. I mean the ObamaCare obviously, we didn't see a peak from Obamacare coming in and we don't expect to see degradation from it being repealed, but we have to see the legislation.

And I'll talk a bit about Mexico. We have plants in Mexico, like many companies. Key thing is we are a net exporter from the United States, so whilst we have plants in Mexico which will supply some things into the United States, we're a net exporter. We have a very broad manufacturing base across the globe; we have more than 400 different locations, and so we are not unduly worried by what's going on in the States. We watch and whatever the President wishes to do then we will act and react accordingly, so no huge concentration in Mexico.

Andy Reynolds Smith – Smiths Group

Okay. Thanks Chris. China, China Medical, I think is really a very good illustration of the fact that we're just too small. I mean, our China Medical sales are about 20 million, so up and down by 10%

is the difference of two million. So it's almost on a pinhead, which really emphasises to me, well, first of all, we need to do a lot more, because in this case, Medical was down due to one large distribution contract that didn't come in the period we thought it was going to come in. And, you know, I see a headline of 'More than 10% down in China,' but that's what it is. So for me it just underlines how important it is to get some significant scale quickly. So I'm not overly concerned about the immediate down in China because I know exactly what it was; I am concerned that I'm too small there.

I think on Medical and the Obamacare thing, more or less whatever happens people want more for less in the future. So, for me, the reaction to that is very much technology's the enabler in a lot of cases, and that's how we're trying to focus our portfolio in Medical for the future. So everyone's going to feel that pressure of 'more for less'; the more innovative you are, the less pressure you'll feel and you're also the solution provider to a lot of the issues. And getting people out and into home care is one of the big ones, so getting you out of the hospital and at home. So, for example, connected infusion pump platforms from the sort of thing you'd be hooked up to in a hospital to the sort of thing that you'd be using at home is really important. So I think just this increased investment in innovation to address the 'more for less' challenge.

And Mexico, just to echo Chris's comment really, the net exporter from the US. We employ three or four times more people, actually, in the United States than we do in Mexico. So we do produce product, but most of what we produce is components shipped for then more value added north of the border. So we're keeping a really close eye on it, it's important to us, but structurally we're in a reasonable start point place.
Did that get everything, David? And thanks.

Alexander Virgo - BAML

Morning. Thanks. Alexander Virgo, Bank of America Merrill Lynch. Could you just talk about the Detection margin in little bit more detail, please? Because I think, unless I misread it, the aftermarket mix was down and your R&D was up, so you'd normally expect mix to be negative if aftermarket's down. So, obviously – well, maybe, how much was the margin driven by completion of contracts, perhaps, so you know, releasing provisions made for completion of contracts or something? I'm just to get a feel for the actual underlying improvement there, because we haven't seen 17 for a long time.

And then, similar sort of question, I think, on John Crane. I think last H1 you talked about the 90 bps headwind from strategic first-fit contracts, what does that look like this year? I'm guessing, if you did fewer, then it's obviously a positive in the bridge, but just a comment around that. And then, lastly, I'll ask the question on tax. Can you just give us some detail on why it's going up to 31%? I think, again, the last seven or eight years it's been around 25-26%. So I appreciate your point on one-offs this year; it would otherwise have been higher this year, but, obviously, that's still quite a big bridge, so if you could bridge the gap for us that would be great. Thank you.

Chris O'Shea – Smiths Group

I'll start with the interesting topic, so tax. I think our tax rate has been creeping up over the last five to seven years, from about 23% up to 26%, to 27% just now. There are a whole number of things that are in there, but in general the global tax environment is getting more challenging. The OECD BEPS initiative is – basically means that whenever you earn your profits you pay your tax; that's a natural upward pressure on the tax rate. You then have to look at the mix of profits. So we have over 50% of our profits in the United States, where the tax rate is about 40%. We don't have unrelieved losses in the States, so we pay tax on day one. So it's a cash tax output, and the effective rate is the same as the actual rate for the United States. We have seen good growth in our US market. The US economy's doing well, so there's a mix impact from having more of your profit around 40%. Germany's a very strong market for us; very high tax rate. Japan's a reasonably strong market; they've brought the tax rate down, but it's still higher than our average. So you see these natural upward pressure points.

We, as with many companies, also fund our operations across the globe through a mix of debt and equity, and the debt – if you put debt in ten years ago, the interest rate – and it's the arm's length price on the interest rate is 7% to 10%. This is all very plain, vanilla tax. If you refinance that now the arm's length rate is 3%. And so if you're paying interest in the United States, or in Japan or in Germany, wherever it is, and you're receiving it in the UK where the tax rate is 17% or 18%, you have a tax arbitrage. But if your interest rate comes down that arbitrage reduces, so there's an effect of that. And there's also – we have had a number of – as the tax environment progresses more towards one of more simplifications you have fewer of these contentious issues. So we have a number of issues that we've had contentious issues over the previous however many years and we've been quite successful at resolving them, and we have provided for those cases. And when we've resolved them, it's better; that gives you a benefit in your rates, so we see a benefit in the rate this year on that. As we knock those things off, they won't recur. So, I mean, the 30% to 31%, let me stress, that is based on company and active tax legislation. Should President Trump implement his plans, then we would expect to be lower than 30% to 31%. So, if nothing changes, that's what we would expect next year.

In the related part on Detection, there's no big boost to Detection's profits based on provisional releases. The differential between the margin on the first-fit and the margin on the aftermarket in

Detection is that differential's lower than you find in John Crane. So the differential might be up to 10 percentage points on a regular contract, whereas in John Crane it could be quite a bit higher than that. So the mix impact is not much – is not as pronounced in Detection as it is in John Crane. So it's a very clean set of results. We were as pleasantly surprised as you were to see those margins in the first half.

Andy Reynolds Smith – Smiths Group

Thanks Chris. Just some comments on John Crane. We said we had a drag from winning those new pipeline projects; as I mentioned earlier, they're very hard fought at the moment. It's crucial that we maintain that installed base because that's where we get our 25-year annuity of service from. I think the drag is a similar drag; we've mentioned 90 bps before, something similar. We're, however, not kicking stuff out; the drag's a little bit more than that at the moment because the IRR on the project, going forward, remains compellingly attractive. So for this half, similar, but as we said, we're not seeing anything pick up in those first-fit projects, particularly at that moment, whereas we have seen the pick-up in aftermarket. So we're watching that really carefully.

The other things around the Crane margin, the JCPS business, the sucker rod business that we've sold came out, and also we continue to do some work on network optimisation and efficiency. But, I think, as I mentioned last time, we haven't done as much as I would have done in previous lives because of the value, the really important thing about Crane is that network, and that customer intimacy and that service. So we've have some headcount reduction but we could have probably done more, but this is about preparing it to come back.

Matthew Spurr - RBC

It's Matt Spurr from RBC. I had two. First one on Detection on the Morpho deal, what you can say. It sounds as though Trace was reasonably, sort of, important for the value case there. You lose, or you have to dispose of, 25% of the sales, yet you lose a third of the synergies, is that right? And then you're probably not going to be in the best position. Just your thoughts on how you think about that deal and its, sort of, value-creating possibilities now?

Chris O'Shea – Smiths Group

So on that, the Morpho Trace business is a very good business, as is our Trace business. It's a reasonable chunk of the revenue to sell but it doesn't change the value case for us. When you're up against a timeline to sell a business in an antitrust case then you don't have the same flexibility as when it's a voluntary sale. That said, good-quality businesses are achieving good-quality prices just now, so we will hope to generate good value from that. But it doesn't change our view of the overall deal.

Andy Reynolds Smith – Smiths Group
Just a couple of points to add to that. I think it was a business that I would have preferred to have kept, but I'm not irritated to have to sell it. I think, in summary, we see a really strong case around the products remaining and those that combine with us, which is the majority of the business. And of course, as we've said before, we're focusing our value thinking here on cost synergies, we aren't taking it further, and clearly the aim is to take it further.

Matthew Spurr - RBC
Thanks. And then the second one was on the dividend. It's got earnings up 30%, cash flow 40%; looks like we should get good cash going forward. It's only up – dividend's only up two?

Chris O'Shea – Smiths Group
Our EPS was down last year and the dividend was up 2.4%, and so what we've said is we will aim to have a smooth upward trajectory. So in very good years, the rate of increase in dividend will be lower; in not so good years, the increase in the dividend will exceed the EPS movement, and we'd like to continue that way. We look like we'll rebuild cover at the current rate, about 2.2%, for the full year, and who knows where sterling is going to go, so it's strengthened in the past few days. So, hopefully, people are happy with this.

Sandy Morris - Jefferies
A very simple question. When, in November, the underlying sales were down three and we end the half year flat, is it Detection that just swung or was there some volatility in the other businesses?

Chris O'Shea – Smiths Group
John Crane was a bit better as well. So we traditionally finish each of our six-month periods very strongly, so January and July are our two strongest months. And we saw a very strong Detection. We saw a stronger – so John Crane increasing its revenue in aftermarket over the second quarter, so that contributed as well.

Sandy Morris - Jefferies
Right. So I suppose where I'm obliquely coming from is at the end of FY16, the John Crane aftermarket order book had gone up. We didn't quite see that in the -3% in the first quarter, if you see what I mean, but it came through in the second quarter, or the order book has continued to strengthen in John Crane aftermarket. I don't quite get it, in a way,that it's even got an order book, if you see what I'm driving at?

Chris O'Shea – Smiths Group
It does have an order book but it's cancellable, so it's a flexible order book I would say. And the order book in John Crane has improved in the second quarter. But, much as it had improved at the end of 2016 and we expected to see a bit of improvement in Q1 and we didn't see it, we don't rely

– so we like to see the order book, we like to see what people want, but we don't take that as a firm basis on which to forecast when the revenue will come in.

Sandy Morris - Jefferies

Right, okay. It's a curious thing that if the second quarter was appreciably stronger than the first quarter, then the reduction in debtors, which is the biggest part of the working capital improvement, is a bit out of sync with that. So I feel there's something going on that I'm not quite getting a grip of, if you see where I'm coming from again?

Chris O'Shea – Smiths Group

I mean, I'd say rest assured that the pressure that we put the businesses under on working capital is not limited to inventory, so I think we can improve our debtor position. So that's a lot of work that the businesses have done to recover debts more quickly.

So you're right, the debtor reduction is on the back of having an exceptionally strong January. So the underlying reduction in debtors is actually a bit better than you see in the numbers.

Sandy Morris - Jefferies

Well, that's the kind of point I'm, sort of, laboriously getting at; it's a funny old first quarter, second quarter, isn't it? Moving swiftly on – stop me when you get bored – why are we even bothering to qualify Detection machinery in China? Have we ever sold anything to a Chinese airport since Nuctech popped up?

Andy Reynolds Smith – Smiths Group

Indeed, it's a very good question. I mean, the interesting situation in China is that you've got such a wide range of different regulatory and legislative situations, whether it's from the Chinese underground through to the airports. I think it's fair to say that in the domestic airports we do almost nothing. In the international airports, where standards go cross-border or increasingly starting to move cross-border, potentially some opportunity could open up, but right now we're very small, as you say. So a lot of our focus in China right now is around critical infrastructure, more than from an airport perspective, but that is changing as the legislative environment changes over time. So today, very little; in the future, potentially something.

Sandy Morris - Jefferies

I mean, it would be fascinating if we finally do manage to do some business there. I'm mean, I'm not saying that it's not a bit unfair or anything, but it's a bit suspicious we haven't sold anything.

Andy Reynolds Smith – Smiths Group

We've been too weak in China in general.

Sandy Morris - Jefferies

Right. And last one, just to make tax look interesting. We've had a few other companies decide that they can look 25 years ahead on asbestos and box it. Are we getting to a point, and should I take any, sort of, comfort from this £8 million release in Titeflex, that maybe we can make this lightning-strike stuff go away too? I mean, is there much encouragement there?

Chris O'Shea – Smiths Group

So we have a very different, somewhat unique asbestos position. We defend every case that we don't settle, these other companies settle, and we defend on the basis that we made a safe product. We have a provision for ten years and we provide a sensitivity in the annual report to say, if that provision was shortened to nine years, this would be the delta in the provision, so that people can make a judgement as to – or they can see the build-out of the provision. The reason that we only provide ten years is that we believe that the asbestos environment is going to change. We believe passionately our product was safe, and therefore we shouldn't be paying anything; it's what one of our lawyers refers to as the search for the solvent bystander. So we're one of the few companies that haven't gone bankrupt, or been in bankruptcy protection, that has sizable asbestos liabilities. A lot of companies have been setting up bankruptcy trusts. Once those trusts are set up, we expect that they will take a bit more of the load on the asbestos liability, so we do expect a changeover – who knows over what period. You know, tort reform has been spoken about in the US for many years, but that's why ours is this. So we don't settle and we do expect a change in the environment where other companies, companies that actually did supply dangerous product, will take more of the load, as they should.

We defend our cases and sometimes you have a good day in court, sometimes you don't. I would say it's too early for us to tell whether – or to say that this liability will diminish. We have won a few cases, we've had a few cases struck out on the basis of various statutes of limitation; that gives us a bit more comfort, but we'd like to see the more positive news before we are able to give some more comfort.

Andre Kukhnin – Credit Suisse

Hi. It's Andre from Credit Suisse. A couple of questions. Firstly, on Asia growth, it sounds like acquired growth will be quite an important part of that. Could you talk a bit about is there a higher appetite to acquire in certain parts of the product portfolio or business portfolio than in the others? Just thinking about what divisions are more likely versus less likely to acquire in Asia? And a third, in context of that, would your process be different at all, in terms of how you look for businesses, how you sift through them? Would your hurdles be any different for acquiring in China; do you need to invest in a team capability there to be able to do that?

And then, just a couple of quick follow-ups. In Medical and Infusion Systems, you had decline in aftermarket as well as new equipment. Could you comment on why aftermarket declined as well?

And then, finally, on the tax; I'm sorry to bring that up. But Chris, could you quantify how much were those one-offs, credits, in 2017, or any idea on what that is in terms of either basis points or absolute amounts, so that we can take that out? Thank you.

Chris O'Shea – Smiths Group

Sure. So maybe I can start on tax. It's always sensitive when you're asked to disclose things on tax, so I could but I won't. There will be some disclosure in our full-year results, which will show any material one-offs there, but I'd prefer not to because some of these provision movements may well be in things that either we've won or things we think we're winning, so I'd rather not say there.

On the M&A in China, it's very – and Andy would give you the same answer, our hurdle rates are the same wherever we go. So there is no such thing as a strategic investment, other than an investment which doesn't meet your hurdle rate, so we would not invest in something that didn't meet our hurdle rates in China. We do have an M&A team member based in Singapore who handles Asia. He is Chinese, spends a lot of time in there, so we've got good capability there. It will be for Roland, when he goes to China, to decide whether we need to have more there; he and I will discuss that, but we're already, I think, quite well covered there. But rest assured, we maintain our discipline no matter where we buy.

Andy Reynolds Smith – Smiths Group

And one qualifier on the investments. Our risk assessment remains robust and comprehensive, so when we talk about hurdle rates the same wherever we are, our risk assessment very definitely is taking into account what we're doing in different parts with different risks. We are stepping up our capability to take a closer look at things over time, inevitably; it's a key part of the divisional strategies and the regional strategy. As I mentioned earlier, I do think there will be a combination of organic and non-organic. Making the numbers work is the hard bit of that, because there's some pretty racy values on assets around Asia. So, for that reason, there needs to be very compelling value when we look at this by market sub-segment, with some really complementary repositioning, whether it's technology or operational, where we can see some real value. But what we do with it has got to be really clear here. I think it'll be very helpful having the capability on the ground and the horsepower on the ground to help with all of that. Thank you.

Chris O'Shea – Smiths Group

On the Medical question, as I say, there's a latency with Detection. So you sell a piece of kit, you've got a two-year warranty, and then you get the aftermarket with Medical; when you sell the pump, the disposables are one-time use only. You might use several cartridges in a day, so if your hardware sales go down in day one, then your disposable sales would go down, that would explain the drop in the aftermarket revenue.

Andy Reynolds Smith – Smiths Group

Well, thanks very, very much everyone for coming out on a Friday and for your attention, much appreciated, and have a great weekend. Thank you very much.