smiths

2020 Annual Results

Thursday, 24 September 2020

Introduction

Andy Reynolds Smith

CEO, Smiths Group Plc

Opening remarks

Thanks very much and good morning everyone. Really appreciate you joining us for the results call today. I very much hope that you and your loved ones have all been managing to stay safe and well since we last spoke.

Agenda

I'm joined here today by John Shipsey, our Chief Financial Officer. And I'd like to make a start by giving you an overview of our performance in FY 2020 and how we're feeling about how we did over the last 12 months, and of course about our confidence going forwards. I'll then let John take you through the numbers in a little bit more detail before talking about the work that we've been doing to further improve our potential for the future and the big value levers in the Smiths story.

Leading now and in the future

This all started with our dream to create a leading technology company that was growing sustainably, based on leading positions in attractive markets, technology solutions our customers valued, world-class execution, and the very best people inspired to win. All of our efforts over the last few years have been focussed on achieving that.

A robust FY 2020

2020 so far has been a year that none of us will forget, with profound, unprecedented, and broad-based impact on our lives, our societies, and our businesses. And much of that impact has become longer term or permanent in nature, with new approaches and answers to the challenges for the future emerging all the time.

As the crisis started to unfold in January, we resolved to ensure that we were one of the strong throughout – financially, operationally, and strategically – and importantly use the changes to adapt and better position ourselves to grab the business opportunities which present themselves for a better Smiths in the future.

We believe we achieved this objective in the last financial year. We delivered a robust overall performance, demonstrating the strength of our fundamental market positions, our business model, and ability to execute in the very best way through what, at times, was acute operational and service disruption. We're absolutely not complacent, however, about the future and the continuing uncertainty that we are managing today in the best possible way.

Leading now

Our leading positions in attractive market segments, a high proportion of aftermarket and service, coupled to strong OE order books, supported a good top line performance against a disrupted picture in some of our end markets. We also implemented and managed very disciplined profit protection and cash conservation measures across the Group to flex costs as revenues changed.

It was not possible to offset all the direct COVID-related inefficiency costs. But our underlying margin potential was protected through hundreds of ongoing individual actions and the previously announced strategically – strategic restructuring programme, to improve our underlying margin by 200 basis points for the long term.

The fundamental position and resilience of our overall business led us to a point where the Group grew 1% on an underlying basis and 3% on a reported basis, including acquisitions. Within this, Smiths' continuing operations revenue was down slightly on an underlying basis at 1%, but grew 2% on a reported basis. Smiths Medical had good growth at 4%.

Underpinning our performance in the year was our strong financial framework, our highly disciplined approach, and the excellent structural cash generation of our business. I was particularly pleased with the cash performance last year and the fundamentals which continue to underpin it.

Our cash conversion of 123% last year demonstrates our ongoing ability to maintain a strong balance sheet with plenty of liquidity. For calibration, we said at the half-year that we had liquidity headroom of £800 million, and we finished the year at more than £1 billion.

We also continued our portfolio upgrading with three targeted bolt-on acquisitions. We've now completed a total of 21 deals over the last four years, and we mean to continue on this path to complement our organic growth.

Leading in the future

Although none of us know when the disruptions will end and we face – continue to face uncertainty, we've performed well so far and the actions we're taking are giving us increasing confidence about the Group's position in the future and our ability to navigate the short term.

I'll now hand you over to John, who's going to take you a bit more through our FY 2020 performance and how this sets us up for the short and medium term.

Over to you, John.

FY 2020 Annual Results

John Shipsey

CFO, Smiths Group Plc

Opening remarks

Thanks, Andy. Good morning everyone and thank you for joining us. I hope that you're all keeping safe and well.

As Andy just said, our full-year results were a good, robust, and resilient performance. That's against the backdrop of a very challenging environment. We can be pleased with this performance. Smiths is resilient by design, and these results demonstrate that.

As Andy said, we're not complacent. Our end markets continue to face challenges and uncertainty. But so far, we have weathered the challenges well. We're taking the right actions and we can be more confident about how strongly we're positioned for the post-COVID world.

Demonstrating strong financial fundamentals

Top line resilience, active management, standout cash generation, and continued financial strength

Before diving into the results, I just want to highlight a few important points to orientate you. Firstly, these results reflect the top line resilience of the Smiths business model, active management from the outset of the crisis, and standout cash generation, with each one of the above reinforcing our financial strength.

Full-year results; only H2 impacted by COVID

Secondly, we are today reporting full-year numbers to 31st July, but it has been very much a year of two halves. So I'll spend more time explaining the second half, post the onset of COVID. And in the absence of forward guidance, I've used the four months through August to update you on the latest revenue trends.

Restructuring costs and write-downs recorded as headline

Thirdly, we have charged restructuring and write-downs to headline profit. We believe this is appropriate and emphasises our ownership of these costs, and I'll come on to explain them both in more detail shortly.

Smiths Medical classified as discontinued operations

And finally, Smiths Medical continues to be classified separately as discontinued operations. I remind you that, as a result, depreciation and amortisation are excluded from reported profit. However, we do add them back when we talk about underlying measures in order to ensure comparability with prior years.

With that context, let's go straight into the results.

A robust performance

So you can see here the highlights of our full-year results. A very resilient top line, with underlying revenue down only 1% for the year and 4% in the second half. That really reflects the quality of our businesses, technology-led products and services that our customers depend on. The acquisition of United Flexible added another 2% to annual growth and FX – mainly the US dollar – a further 1%. As a result, reported revenue was up 2% for the year.

Smiths – continuing operations

On this slide, we've highlighted two operating profits. The £382 million excludes restructuring and write-downs. On an underlying basis, that was a decline of 13%, all of which came in in the second half, reflecting the drop-through from lower revenues and higher costs to maintain business continuity.

Smiths Medical – discontinued operations

Smiths Medical ended the year strongly, with underlying revenue up 4% – a combination of continued underlying growth and the net positive COVID impact on some of our vital products. Part of that incremental volume was sold at cost to support the UK Ventilator Challenge, and Medical was also impacted by some one-off costs. Aside from that, Medical's margin performance was better and we can see a clear path of sustainable improvement ahead. As a result of the above, Group total profit was down 12%, translating into EPS of 84.8 pence, also down 12%.

Cash

On cash, we delivered a really standout performance, even by Smiths' high standards. Free cash flow of £273 million pounds was up 17% year-on-year. Of this, £163 million was delivered in the second half despite challenges to inventory management from pandemic disruption. Reflecting the Group's strong performance and financial position, the Board is now recommending a total dividend of 35 pence for the year.

Good top line performance

Let's now take a look at our performance in more detail, starting with revenue. Continuing revenue was down 4% for the second half, overall. In the third quarter, we maintained the top line exceptionally well, albeit through significant efforts in cost. In the fourth quarter we were able to reduce those costs, and we started to see a more stable top line decline.

John Crane

Turning to revenue by division, John Crane revenue was up 2%. A strong first half with revenue up 6% was followed by second half decline of 2%, reflecting the downturn in Energy and also COVID disruption. Original Equipment was impacted more strongly, declining by 6% in the second half whilst aftermarket continued to demonstrate its resilience and was flat in the same period.

Our ability to maintain service in the most challenging circumstances has not gone unnoticed by our customers. We're seeing this converted to new contract wins, partially offsetting lower tenders in the market as a whole.

Smiths Detection

Moving on to Detection, Detection entered COVID with a strong order book. The delivery of previously-announced OE wins underpinned performance, despite a very challenging environment in its main end market. As a result, Aviation grew 6% for the full year and 8% in the second half. Other Security Systems were more immediately exposed to the downturn in activity and were down 13% for the year.

Aftermarket was resilient, but not immune, as lower activity reduced demand for parts and service. Aftermarket was down 2% for the year and 5% for the second half. In the current environment, OE tenders are fewer and harder fought. But importantly, our technology, global installed base, and order book continue to underpin performance.

Flex-Tek

After a good start to the year, Flex-Tek end markets were impacted by COVID. The Industrial segment accounts for the majority of Flex-Tek revenues. It was down 2% in the year and 5% in the second half.

The US construction market was impacted badly by the sudden pandemic but has since recovered. Around a quarter of Flex-Tek is exposed to aerospace, which was down 18% in the year and 31% in the second half. The downturn in aerospace is expected to last a few years, and we are not planning for a quick rebound.

Smiths Interconnect

And finally, Interconnect. After a challenging first half, Interconnect revenue trends improved in the second half and the division returned to growth in the fourth quarter. Overall revenue was down 5% for the year. But importantly, orders are now showing positive momentum.

So in summary, the top line performance reflects the quality of the underlying businesses and our successful efforts to maintain business continuity.

Operating profit bridge

Let's turn now to operating profit. Breaking up the different elements, foreign exchange and the acquisition of United Flexible contributed growth of £2 million and £9 million respectively. For continuing operations, we booked £31 million of costs under the strategic restructuring programme announced in June and a further £24 million of write-downs. I'll provide further details on both of these in the next slide.

Excluding these items, underlying operating profits declined by 13% or £56 million. All of that decline came in the second half. More than half of it was direct drop-through from lower revenues – the 4% decline that I covered earlier. The rest was a blend of COVID-driven cost increases, plant closures, social distancing and expedited freight etc., and negative margin effects from, for example, higher and more competitive OE and lower aftermarket activity both offset by disciplined management of discretionary costs. Therefore, excluding restructuring costs and write-downs, underlying operating margin was 15% – a strong performance in the current environment.

Underpinning future performance

Turning next to restructuring and write-downs, all of which reflect a proactive and disciplined approach to managing our costs. As I said earlier, these have been charged to headline profit to ensure transparency and ownership of the costs booked and promote accountability for delivery of the savings. Please note that both restructuring costs and write-downs are excluded from the underlying calculation to ensure comparability.

Although Group underlying margin of 15% is a strong result in the current context, it's not where we want it to be. Our goal is to deliver operating margins of 18–20%. The restructuring programme brings together a number of pre-existing initiatives, hence our ability to action quickly.

Over 80% of the costs represent headcount reduction. The remainder relates to footprint rationalisation in Smiths Detection and Interconnect. Of the £35 million charged in FY 2020, £12 million was paid out before year-end and the remaining cost of the programme will be £30 million. Importantly, we expect it to be margin-neutral for the year overall.

Although there will be a mismatch between the first and second half, the cost will be evenly spread, but the savings will be weighted 70% of the second half. By FY 2022, we expect full delivery of £70 million in savings, contributing a 200 basis points improvement and progressing achievement of our target 18–20% operating margin.

As mentioned previously, we also recorded £24 million of write-downs. £12 million came from cancellation of capitalised development projects in Smiths Detection, and another £12 million from trade receivables that were written off in John Crane, Smiths Detection, and Smiths Interconnect.

Resilient operating profit and margin despite H2 disruptions

John Crane

Let's now move to the operating profit and margin by division, starting with John Crane, who delivered a very strong margin of 21.5% in challenging operating conditions. Operating profit was down 6%, with volume growth impacted by the pandemic and the downturn in the energy markets, and higher costs to support the business continuity that our customers demand and value.

Smiths Detection

Detection's margin was 13.9%. It experienced higher operating costs during the pandemic and lower mix of aftermarket services, as customer activity failed. Original Equipment comprised a higher proportion of revenue. OE continues to be hard-fought, but our technology and service offering are real differentiators. And I don't need to remind you of the importance of winning OE orders that bring with them a long tail of aftermarket revenues.

Flex-Tek

Flex-Tek adapted very well to the downturn in its end markets, with revenue down 6% in the year. Profit was down 14% and margin hit a very robust 17.6%, demonstrating its ability to deliver very strong cost controls in a limited timeframe.

Smiths Interconnect

Similar to the revenue picture, Interconnect delivered an improved performance in the second half. Profit was still down 35% for the year, but margin improved to 13.2% in the second half, moving closer to its mid-teens target margin.

Smiths Medical

Revenue

Let's now review the performance of Smiths Medical. Smiths Medical reinforced its growth trajectory in the year with revenue up 4%. Overall, COVID translated into a net positive for the business. In the second half, Smiths Medical grew by 7%, or 2% excluding the UK Ventilator Challenge.

Let me give you more colour on what COVID has meant for Medical. On the one hand, it has driven revenue for critical care products, such as infusion pumps, ventilators, and tracheostomy tubes, resulting in Infusion Systems being up 4% and Vital Care 13% in the year. On the other hand, elective procedures have declined, leading to reduced demand for other elements of the portfolio in, for example, Vascular Access, which was down 5% in the year.

Operating profit and margin

Operating profit was down 3% in the year, despite the volume growth, for three reasons: UK Ventilator Challenge products sold at cost; a one-off legal settlement; and, finally, similar to other divisions, Smiths Medical incurred additional costs and inefficiencies associated with COVID. The result was an underlying margin of 15.5%. Overall, we're very pleased that Smiths Medical consolidated its growth trajectory for another half.

Strong operating and free cash flow (Total Group)

Turning next to cash flow. Smiths has a proud track record of cash generation. It reflects the quality of the businesses and the way they are run. So I'm particularly pleased by what we delivered in FY 2020.

Working capital contributed a £53 million inflow despite the challenges that COVID presented, not least in terms of inventory management to maintain topline resilience. Notwithstanding lower EBITDA, we increased operating cash to £575 million in the year, compared with £474 million in FY 2019.

Cash conversion was 123%, including some benefit from IFRS 16 and restructuring. Cash tax did increase temporarily to £113 million due to timing differences and the repatriation of foreign dividends.

Finally, and most importantly, we increased free cash flow for the year to £273 million pounds, of which £163 million came in the second half. This further evidences our capacity to generate cash even under the most challenging circumstances, and it's why we're able to recommend a full-year dividend of 35 pence per share.

Financial strength

You've heard me mentioning the strength of our balance sheet many times this year, but allow me to reiterate the key messages.

Pension plans are well-funded, hedged, and largely de-risked

Pensions are well-funded, hedged, and largely de-risked. In our two UK plans, buy-ins, government bonds, and investment-grade credit comprise 90% of assets, with equities only 2%. And just last week we completed another buy-in, covering 1,200 pensioners in the UK.

£1 billion of liquidity headroom

As regards the balance sheet, our debt has a weighted average maturity of 4.2 years, with no maturities before October 2022. Against that stood about £390 million of cash, and then undrawn revolving credit facility of over £600 million extending to 2023 and beyond.

We have no leverage covenants on any of our debt. The undrawn RCF includes one financial covenant: interest cover of three times or more. By comparison, that measure stands today at 11x. So at the full-year, our total liquidity headroom was £1 billion against £850 million at the half-year. We finished the year with net debt of £1.1 billion, including £148 million of leases.

Net debt/EBITDA at 1.7x (1.9x including restructuring and write-downs)

EBITDA for the last 12 months was £610 million across continuing and discontinued operations – and please don't forget discontinued operations when calculating leverage. And so the ratio of net debt/EBITDA was 1.7x, excluding restructuring and write-downs.

This financial strength means that we can face the challenges of the present crisis with our eyes firmly fixed on creating sustainable long-term shareholder value.

Latest trend and outlook: resilience by design

Guidance remains withdrawn

We have weathered the challenges well so far, but we're not complacent. The depth and duration of the present crisis are uncertain; hence, we are unable to reinstate guidance. But I would still like to provide some hopefully useful context on FY 2021.

First, because of our fiscal year, the first half of FY 2020 was pre-COVID and, therefore, will constitute a much stronger comparative than the second half. And also, I remind you that the Group seasonality normally results in a second half weighted revenue profile.

First and second half considerations

Secondly, in the absence of forward guidance, the most up-to-date benchmark that I can provide is the last four months – i.e., from May through the end of August – where we saw revenue decline stabilising at around -8% for continuing operations, -5% including Smiths Medical.

Stabilisation of latest revenue trends

Our flexible business model means that around 60% of cost of sales move in line with volumes. Tight operational management and the strategic restructuring programme will improve our fixed cost base. And in the absence of unforeseen events, we are steadily reducing COVID-related costs.

Phasing of the restructuring programme

And finally, as mentioned previously, the restructuring programme is expected to be margin-neutral for the year as a whole, but the cost will be evenly split between the two halves and the benefits will be weighted towards H2.

In summary, then, the Group has delivered solid results in the most challenging times, demonstrating its resilience by design.

And with that, let me hand back to Andy.

FY 2021 and Beyond

Andy Reynolds Smith

CEO, Smiths Group Plc

Thanks very much indeed, John. Very clear.

Putting our people and customers first

Safety of our people.

Throughout the pandemic, our priorities have been the safety of our people, first; keeping our business running; and outstanding support for our customers, which has increasingly become a competitive differentiator.

Smiths Excellence System supporting very strong business continuity throughout the pandemic and exceptional customer service

Since the start of the crisis our operational response globally, with close collaboration across the Group, has been enabled by the Smiths Excellence System, which is our engine room. It supported very strong business continuity and exceptional customer service.

Supporting the fight against COVID-19

Our people have worked relentlessly to create and distribute products and support our customers, including many medical critical care devices for the fight against COVID. I've been awestruck and inspired by the incredible individual and collective work which has been done, and continues to be done, throughout the Group in the most difficult of circumstances. Thank you to our team. I cannot tell you how proud and privileged I feel to be working with you.

Strong position to navigate uncertainty

John Crane

Moving to the divisions, John Crane's fundamental characteristics underpinned its good performance last year and will continue to do so. Its strength comes from its market-leading positions, an unmatched global service network, and over two-thirds of revenues coming from aftermarket services in critical industries where the cost of failure far outweighs the cost of maintenance and upgrades.

John Crane's proximity to their customers globally and their exemplary customer service has positioned them well to secure many new contracts, maintaining and growing our market share and critical installed base worldwide. There has been a lower rate of OE tenders recently in oil and gas, particularly. But John Crane's' contract win rate has increased and many of the contracts signed during the year were in our higher-growth regions of Asia and the Middle East, with strength in end markets such as pharma balancing somewhat the weakness in its largest market, oil and gas.

Smiths Detection

Smiths Detection entered the crisis from a position of strength as a market leader with a record order book that supported a good performance in Aviation last year. Our Other Security Systems were more immediately impacted, with reductions in the number of large gatherings and events around the world negatively affecting bids and activity in urban security.

Ports and borders activity was also, not surprisingly, lower, as land and sea borders were closed. Aviation activity is expected to remain at lower levels for some time and this will impact Smiths Detection in the short-term with a lower rate of OE tenders, but continuing aftermarket and service activity.

The business continued to strengthen its market-leading positions with new wins, including two very important contracts during the year for Kuwait International and Singapore Changi. These build our all-important installed base, which is critical to the lucrative long-term service and software revenue stream, which represents about half of the business.

Detection are committed to delivering innovative solutions for our customers to support a safer return post-COVID. An example of this is our innovative automatic baggage disinfection system using UVC light, which is fully integrated into the lane management software and has already been installed at two leading airports in the UK and is being trialled at multiple airports globally.

In Other Security Systems, new contract wins include an order from the US Customs and Border Protection for high-energy X-Ray inspections scanners used to screen railway carriages for dangerous or illegal cargo whilst they're still moving. This could be worth over $300 million in time.

In Defence, we have won a further contract for our solid liquid adapters, bringing new capabilities to our existing chemical agent detectors and securing Smiths Detection as the global leading supplier of this technology to the US Department of Defense.

Flex-Tek

In Flex-Tek, more recently, we've seen improving demand in the industrial segment and a resurgence in US construction to pre-COVID levels. This is helping to mitigate some of the impact from an extended period of depressed sales in commercial aerospace, which represents around 15% of Flex-Tek's business in total.

Smiths Interconnect

For Interconnect, following a very difficult six months for the global connectors market in the first half of last year, Smiths Interconnect returned to growth in the fourth quarter with an uptick in orders, including a significant contract to supply connectors for use on NASA's Orion space aircraft and continued success with advanced optical connectors in the very high-growth low Earth orbit satellite segment.

We are most certainly not complacent about the ongoing uncertainty, but this strong pipeline of contract wins and orders gives us confidence in our continuing position for the short and long term.

Executing the strategic restructuring programme: continued focus on optimising performance

Pulls together existing initiatives across the Group

We continue to execute against our strategic plan overall, taking the necessary actions and investing to deliver long-term growth and outperformance. As I said earlier, we announced an important strategic restructuring programme in June that pulled together existing initiatives across the Group.

Further improving efficiency and speed

I'm pleased to say the programme is making good progress and is well underway, at around two-thirds complete. It is designed to improve operational speed and efficiency throughout the Group and to reap the financial benefits long-term.

Accelerating progress towards 18–20% target margin range

This is a key programme for Smiths and an important value lever. It will enhance underlying margin potential for the long term by 200 basis points and accelerate our progress into our target margin range of 18–20%.

Ensuring we are better positioned for long-term growth and outperformance

We are confident that the benefits will at least offset costs in financial year 2021 and the programme will be largely complete – completed as we move into FY 2022, and the benefits are flowing.

Smiths Medical: two stronger companies

Uninterrupted focus supporting accelerated growth

At the outset of the global health pandemic, we postponed the separation of Medical to ensure our full focus was on responding to these unprecedented conditions across the Group. The underlying improvement plans at Smiths Medical are continuing, with growth in the year of 4% and further organisational development to increase efficiency coupled to ongoing actions focussed on new product launch and commercial excellence.

Significant agreement with US government for syringe and needle production to support COVID-19 vaccine efforts

In addition to the ramp-up of critical care devices during FY 2020, Smiths Medical also won, as an example, a large contract with the US government to supply syringe and needle devices to support the COVID-19 vaccination efforts in the United States in 2021. They're going to help vaccinate around a third of the American population.

Underlying improvements progressing well; separation delayed

These improvements all help the positioning of the business as we go through separation, and the strategic intent and rationale for separation remains unchanged.

Continued portfolio strengthening

Organic growth complemented by disciplined M&A

We're moving fast and with purpose. We're managing the short term the very best way we can and with our eyes firmly on the future, and we continue to invest in opportunities for organic and inorganic growth. Our priority has been, and remains, organic growth. But, as you know, we continue to execute on a disciplined parallel path of acquisition to complement our progress. And we have a good pipeline of options, which is improving due to the crisis.

Of the 21 deals we've done – about half of them acquisitions, and the other half divestitures – we've recycled capital into growth investments with around £530 million in proceeds and £960 million spent. The acquisitions we completed last year are great examples of the sort of neat bolt-on technology additions that we can use to drive the business forwards and accelerate our progress.

Smiths Detection – PathSensors

Smiths Detection's acquisition of PathSensors substantially strengthens our existing biological detection capability, particularly for pathogens such as COVID. It will enable us to accelerate the commercialisation of devices which can detect the presence of virus in an individual, but also the viral load in the air in confined spaces. It's a really good example of externalising R&D investment, where it would simply have taken too long internally.

Smiths Interconnect – Reflex Photonics

Likewise for Interconnect, the Reflex Photonics acquisition brought advanced optical connectors for space applications.

Smiths Medical – Access Scientific

And in Medical, the Access Scientific acquisition brings anti-thrombogenic vascular access devices, which are complementary to our existing portfolio of products.

Designed to outperform

The Group has executed well so far, demonstrating its resilience by design. Over the last few years we've focussed Smiths on businesses with attractive core characteristics:

- The ones we like and value for the long-term, and we're good at;
- Technology solutions, many of them software-based; and
- A high proportion of aftermarket and service.

The strong positions our businesses have in attractive growth market segments, and the culture of innovation and relentless execution, have come to the fore when adaptability and agility have been key. We continue to enhance our market-leading positions for our business with continued portfolio optimisation and investment for future growth. We've designed Smiths for the long term: sustainable growth and outperformance.

Summary

So, in summary, the Group's characteristics, its market-leading positions, and strong financial fundamentals have been tested and continue to prove to be resilient. We're now focussed on managing through the ongoing uncertainty the very best way we can and continuing to optimise the Group's performance. The actions we're taking to enhance the Group's growth and returns potential gives us further confidence for the Group's position post-COVID for consistent outperformance and long-term value creation.

Thanks very much indeed to – for listening to us this morning, and we're very happy to take any questions you may have.

Q&A

Operator: Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. If you wish to ask a question, please press star and one on your telephone keypad.

The first question comes from the line of Mark Davies Jones. Please ask your question.

Mark Davies Jones (Stifel): Morning Andy, morning John. A couple of things, if I can. Firstly, clearly after the end of June we were expecting the restructuring charges. I guess the write-downs was slightly less expected. Can you give us some comfort that that's a sort of one-off tightening-up exercise? Should we expect more of that to come as you go through the restructuring, or the write-off is effectively just a one-time event?

Andy Reynolds Smith: Okay. Well, I'll have a crack at that one, Mark. And nice to speak to you this morning, hope you're doing well.

So for me, the – as a reminder, the £24 million of write-offs that you've described really split into two categories, one of them a write-down of investments made in certain projects in Detection which had become unviable. And those are really just part of the ongoing R&D cycle of introducing new projects and killing them when they don't work and pushing them harder when they do work.

The second piece, then, is largely around receivables – the other £12 million – in a couple of categories not COVID or COVID environment related, one of them in South America with John Crane with a long-term customer receivable, but we have taken some write-down against already but we decided it was right, from a risk perspective, to write it down entirely. And the second one, an airport customer which has, you know, become a more challenging receivable for us to collect. So I think, Mark, really what are, you know, kind of one-off in nature.

Will there be further R&D projects potentially over time that we decide? I can't really speak to that. But you shouldn't read anything into ongoing concern with those.

Mark Davies Jones: Okay. Thanks. And the other is just around timing and restructuring benefits and costs and so forth. I take the message that it should be broadly neutral next year, but I think you just said that you're two-thirds of the way through executing the programme. So that would sort of imply that we should be into net-benefit territory at least by the second half of next year, doesn't it?

Andy Reynolds Smith: Yeah. John, do you want to take it?

John Shipsey: Yeah. Mark, we're – so, we're saying that actually we'll be neutral this FY 2021, but it will be – the cost will be 50/50 this – the balance of the cost – the balance, being £30 million, will be spread evenly half on half. The savings are kicking in right now. 30% of them will hit the first half, 70% in the second half. And we are going to deliver the full annualised saving of £70 million from FY 2022. So from not this year, but next year.

Mark Davies Jones: Yeah. Sure. Okay. Final one, if I may. A £1 billion of liquidity and obviously some disruption going on in your end markets. Are there any areas where you might be looking at bigger acquisitions? Obviously you've done some very small technology bolt-ons which look attractive, but they're quite modest in scale. Are there any parts of the business where you might be looking at something more strategic?

Andy Reynolds Smith: Well, we continue to focus organically, as you know. We have consistently run a parallel path of looking for nice complementary acquisitions that can accelerate our position from a market, technology, or customer perspective. But, more recently, those have been on the smaller side.

We are keeping our eyes continually open for the very best opportunities right across our business. So, you know, forgive me for not answering directly, 'Small, medium, large.' But, you know, we continue to look at all options to take the Group forward and accelerate progress. But we remain very, very disciplined.

Mark Davies Jones: Okay. Thank you.

Andy Reynolds Smith: Thanks, Mark.

Operator: Thank you. The next question comes from the line of Andrew Wilson from JP Morgan. Please ask your question.

Andrew Wilson (JP Morgan): Hi. Good morning everyone and thanks for taking the questions. I've got three, I guess, in different areas.

Maybe starting with Detection. Just interested – appreciating the uncertainty around the kind of the OE backdrop and particularly I guess the timing of orders on that side of the business –

but interested if you are – can you – I guess interested on the indications you're getting from customers on the aftermarket side. I guess particularly thinking about the Aviation side and just what – I guess what indication you're getting from customers in terms of their funds on maintenance schedules as we go through obviously what's been quite a disruptive period. Maybe if I – let's just start there.

Andy Reynolds Smith: Sure. Okay. So as I look at the maintenance upgrade, software upgrade side of things, as you know, that's largely driven by the regulatory environment that has to be achieved and the requirement to continually keep the equipment upgraded with software at the right levels. So the level of activity does have some impact toward the passenger foot – or does have some impact. As you know, that's starting to come back now from very, very low levels a few months ago.

We also have a number of agreements in place with our larger customers in particular, to maintain throughout revenues on aftermarket and service. So the TSA, for example, and a couple of the larger airport authorities in Europe. But there is too some impact from simply lower activity driving lower use of consumables, that they get damaged or burnt through as you run lanes very hard versus running them at lower levels right now.

So there is an ongoing, you know, stable and predictable stream driven by regulatory upgrades and, you know, keeping everything moving in the right way. But the – there is some drag from just simply lower levels of activity.

Andrew Wilson: And I guess this is sort of the base case, is that you start to see some of those I guess, well, utilisation numbers improving, and the real reason why, you know, Detection shouldn't be benefiting from that then, you know, if we could sort of think that we're probably at the trough or past the trough, in terms of those kind of activity levels?

Andy Reynolds Smith: Yeah. I mean, the passenger air miles numbers are increasing progressively. There are a few fits and starts going on there as different things happen around the world, as you know, but they are progressively increasing the number of hours flown at the moment. But we're also seeing it's – continuing increases in air cargo versus passenger, partly where people are using air cargo more than other transportation and partly because there's a lot more cargo moving in the air at the moment than previously.

So we're working with a number of the big freight forwarders and – you know, FedEx and DHL – on opportunities to do more with them as air cargo and very fast-moving parcel detection becomes much more important.

Andrew Wilson: Perfect. And maybe as the kind of second one, I guess, on Detection. Just interested – you mentioned around the kind of PathSensors acquisition and what that might open up. And I think the way this phrase was when you made the acquisition was it was kind of complementary or accelerating technology on something that Smiths Detection already was working on or had similar technologies?

Andy Reynolds Smith: Yeah.

Andrew Wilson: I guess interested on what other opportunities, if any, there are in terms of – for Detection. So if we think about, kind of topically, the fight against COVID –

Andy Reynolds Smith: Yeah.

Andrew Wilson: – what kind of opportunities might we see coming through on the Detection side?

Andy Reynolds Smith: Yeah. That's a super question, thank you. I mean, it's an area that I'm very excited about and have been for some time, that is you look at the different ways of working, the different flows of people to keep them safe in the future as a result of what COVID has started and created here. When people are moving in crowded spaces, when people are moving through airports, when people are moving through underground systems, there are lots of opportunities. So the PathSensors acquisition really is about virus detection.

I talked before about the potential application as a COVID breathalyser, so to speak, for individuals to see whether you were infected. We continue to work that route. But quite excitingly, we're now working with one major customer – an airline customer – on a viral load detector that would effectively measure the viral load in a – in an aircraft cabin, either on arrival or pre-departure. So this works by basically sniffing what's in the air. There are – there is a way that you can swap seats and measure as well. But then you can judge that level of viral load and the level of threat that it presents and therefore how to treat and deal with passengers and improve flow.

So, you know, you can imagine very similar applications in other areas becoming possible. And I emphasise, maybe acquisition isn't just about COVID either. So it was – I mean, the company has been around for a little while and they – they've got already a bit, you know, the SARS application, which was working. So this is very adaptable to other threats, not pathogen threats, not just COVID.

So is it something, I think I've said before, that is going to start netting large dollars in the next couple of months? No. Is it something that has huge potential in the future and we want to be defining the market as opposed to following the market? Yes, it is.

Andrew Wilson: That's very clear. Maybe I can just squeeze one quick one in just on the John Crane side. Just interested I guess obviously around the comments on OEM tenders, I guess, on the oil and gas side. But just noticing that sort of, you know, barrels have started to increase again past the trough –

Andy Reynolds Smith: Yeah.

Andrew Wilson: – not back to where they were, but kind of off the trough.

Andy Reynolds Smith: Yeah.

Andrew Wilson: Just if there's any kind of signs of – well, in terms of lifestyle improvement, in terms of just some indications on some of the activity picking up just as, you know, we kind of look forward?

Andy Reynolds Smith: Okay. So, just to give you a sense of it – and just a reminder with Crane, it's largely driven by the amount of oil that's refined every day – how many barrels per day, as you mentioned, as opposed to the oil price, although the oil price does of course have an impact on new investment sentiment with the energy companies overall.

The pre-COVID barrels per day, which is our key driver, was about 100 million barrels. That dropped in the midst of – in the depths of the COVID crisis down to the low 70s, which was a really big reduction. But that is now back in the mid-80s million barrels per day and expected to climb over the next few months back north of 90 million barrels a day. So that fundamental activity of refineries is climbing back up progressively at the moment, which is a supporting trend for us.

On the OE side, as I say, that overall oil price does – is a drag on investment sentiment when energy companies are looking at, you know, investments in new plant and major refurbishments, which we are starting to see a bit of that, as John said in his breakdown of numbers. But that underlying resilience of the – that the plants is kind of showing through.

And we're just, you know, focussing really hard in areas like pharmaceutical now, which is a pretty small piece of our, you know, end market business at the moment but, you know, an area that's growing substantially and perfectly suited to the sort of products and the capabilities that Crane has. So we're – you know, we're pushing all of the things that can be positives as well as trying to compensate for some of the areas where we see weakness.

Andrew Wilson: That's great. Thanks, Andy. Thanks for the time.

Andy Reynolds Smith: Yeah, thank you very much. Nice to talk again. Thanks.

Operator: Thank you. The next question comes from the line of Andre Kukhnin from Credit Suisse. Please ask your question.

Andre Kukhnin (Credit Suisse): Good morning. Thanks so much for taking my questions and I hope you also are very well.

I wanted to start with just kind of reconciling the back end of the second half on what you've reported with some trading update. I'm just looking at John Crane and Detection as the two key businesses and it seems that your result now implies that kind of the last two months run rate fell off to something like over 10% negative for John Crane and nearly 20% for Detection, if I look at just kind of June/July implied in your H2 versus the trading update. Is that kind of right, or am I reading into this wrongly?

And just related to that, the drop-through rates for the second half on those kind of volume declines seem to be kind of over 100%, in terms of kind of size of profit decline versus size of revenue decline. Could you help us reconcile that kind of versus operational gearing and the COVID-specific costs?

John Shipsey: Yeah. So, shall I take that one, Andy? Yeah?

Andy Reynolds Smith: Yeah.

John Shipsey: So I'm not sure – I don't recognise your data for it. So, we gave trading updates for the Group as a whole. I don't recognise your data for that, so maybe we can take that offline. But for the second half, John Crane was down 2% on the top line, and Detection 3%. So yeah, there was a – the – what I would say is Crane has programmatic – sorry, Detection has a programmatic profile, but there wasn't anything unusual in the year-end for that.

In terms of margin, I mean, we were – as I said, there were three factors in H2 that affected the drop-through. The primary one, over half of it was due to the volume effect. So we do have operating leverage. 60% of our cost of sales are variable. But we had operating leverage, which accounted for over half of the margin decline of around £56 million–57 million. The rest was that blend.

We did have COVID-related costs and they were probably at – highest in Q3, when we were really – you know, we were hit by this. And I think, rightly, we invested in business continuity. You know, our customers have had their own problems, but we didn't want to be the cause of additional problems. So we invested in those additional costs.

There's a mix effect of OE versus aftermarket. And then, going the other way, there's our discretionary cost. So we – you know, we did take advantage – I think, like many companies, we took the tactical advantage of cost reduction in H2 and we were able to squeeze them quite hard. We continue to do that going into FY 2021. Plus we have the benefit of the restructuring programme, tackling our fixed cost base.

Andre Kukhnin: Yeah. Just to clarify in terms of the run rates, I was just looking at the trading update where you talked about these businesses growing through to end of May and then ending up with the – those kind of declines. So that's where I was just working out the implied June/July numbers. But I appreciate it could be imprecise, so we'll – yeah, we'll take it offline.

And in terms of business continuity costs, could you help quantifying this across the Group in the second half? And as we kind of go into the first half of 2021, should we use that as a run rate or should that come down now that we've been dealing with the situation for longer and more operations are coming back to normal?

John Shipsey: Yeah. The – so those costs were about £15 million in the second half, and as I say, they were weighted towards Q3. Particularly, you know, as an example, ones which we – which hit us hard were the site closures or where we were having to shelter vulnerable people correctly in those sites but having to bring in other labour to substitute them. That – so those kinds of costs were more extreme in the more – in the deeper kind of lockdowns around the world.

So it's – it – I can't predict the evolution of the pandemic, but if – you know, as things stand, we are – we're learning, we're adapting, and we are being able to modify the majority of those costs. There are ongoing ones – you know, equipment, social distancing, shift patterns. Those ones, you know, we will continue to maintain, because they're the right thing to do to protect our people. But overall, we've – we probably got hit hard and had to adapt very quickly in Q3, but we do see them stabilised.

Andy Reynolds Smith: Yeah. And just to add to that, Andre, in Q3, which was really the peak of what I call the operational and service centre disruption, we got in total 100 – about 180 plants and service centres of which, in Q3 and running into the beginning of Q4, at any one time we had 15–25 of those either plants or service centres closed or partially closed for a period of time for disinfection, for example.

So there was a great deal of rebalancing of work that went on, leaning on other parts of the network, transferring work. And then, as John says, there were very much direct costs with simply additional freighting from suppliers, because we have suppliers going through the same sort of shutdown cycles. And we had judged the most important priority for us was to keep customer – customers supplied. So business continuity and customer service was our priority, but there were inevitable costs incurred with that.

To fast-forward to today, we are pretty much close to 100% open from a plant and a service centre network perspective. I mean, there is still some additional costs being incurred to run those smoothly and still some spikes of issues occurring around the world, but we're in a very different place, from a disruption perspective.

I don't want in any way for that to make it sound like it's getting easier, because our employees are just doing an amazing job of keeping our customers served in difficult circumstances and making product in difficult circumstances. But that core disruption is much lower than it was some months ago. Therefore, the bit – the costs related reduce.

Andre Kukhnin: Great. Thank you. I appreciate the detail there. And just finally on Medical, could you help us a bit with the outlook for this business? The kind of run rate – the growth run rate –

Andy Reynolds Smith: Yeah.

Andre Kukhnin: – it achieved in second half, is that –

Andy Reynolds Smith: Yeah.

Andre Kukhnin: – something that's sort of sustainable?

And also, do you have a timeline for separation, or is it just really too early to think about when exactly you restart that process given how busy the business is?

Andy Reynolds Smith: Okay. Well, so just to give you some colour on the outlook for Medical revenue then, because they continue to execute on their underlying plans, as you know. And the – sort of the back half of last year for Medical was a – was very much a game of two halves, as someone once famously said. The first part of that half was very much a tailwind from a spike of COVID critical care device demand and, to some extent, hoarding and panic buying where people just weren't quite clear. Distributors were stocking up heavily. And then in the latter part of the half, that turned into a headwind where the amount of elective surgeries dropped. The amount of people for non-COVID-related reasons in hospitals, even for critical, reduced substantially, particularly in the US.

So, you know, we were really pleased to deliver that 4% for the year, which was a stronger second half. I mean, you've seen the – you saw the first half numbers.

Andre Kukhnin: Yeah.

Andy Reynolds Smith: As we cast forward now into the beginning of this half, you know, we've got a positive outlook for continuation of that good revenue performance as elective surgeries are coming back, as people are just simply getting more comfortable going to hospital for other ailments. So there are more tailwinds starting to flow.

And then there are some of these larger projects, like the hypodermic needle project, that are starting to occur, so a ventilator-type programme that will progressively occur over time. So, you know, feeling pretty good about that top line as we look forward into the next period.

From a timing perspective, I mean – but just very briefly, because we've said that the intent to separate remains unchanged. I think we sensibly paused it for the reasons that you're very familiar with. That was absolutely the right thing to do. Our expectation is that the separation would be completed during the financial year 2021. But we'll – you know, please allow us to, you know, judge the timing and the precision of the timing to, you know, deliver on our objectives for that separation.

Andre Kukhnin: Absolutely. Thank you very much to both of you, Andy and John.

Andy Reynolds Smith: Thanks, Andre. Appreciate it.

John Shipsey: Thanks, Andre.

Andy Reynolds Smith: Speak soon. Thanks.

Operator: Thank you. The next question comes from the line of Robert Davis from Morgan Stanley. Please ask your question.

Robert Davis (Morgan Stanley): So, hello. Morning both. Thanks for taking my questions. The first one was just maybe diving into the Detection business a little more. Can you just give us a little more colour around sort of typical contract lens capture rates on your sort of aftermarket?

I guess I'm just kind of coming at it from the angle of if things are sort of tough at the moment, do you – are you sort of struggling to get the same kind of levels of pricing or capture rates on some of the service and aftermarket contracts? And –

Andy Reynolds Smith: Yeah.

Robert Davis: – is there kind of a particular year or – you know, over the next few years where, you know, disproportionate number of those contracts roll off, or is it sort of fairly steady progression on a – on an annual basis? That was my first question. Thank you.

Andy Reynolds Smith: Okay. Very good question, actually. I'll – perhaps I'll just try and give you some of the highlight points. So the Airports business, as you know, is about two-thirds of Detection. So – but I'll speak to the Airports piece, which is almost entirely driven by regulatory upgrade cycles to the latest equipment that can find the latest threats more effectively.

And there are a number of those regulatory upgrade cycles running on a global basis, which give you the support for that business over the next 10 or 20 years. So the – there is a European upgrade cycle for the checkpoint going on to CT scanning – sorry, the checked baggage. There's then a checkpoint upgrade cycle that is just about to start.

In the US, you've got a checkpoint upgrade cycle which has just – this is the one that you and I walked through – has just started. We won the first tranche by 15% and the rest of that will play out in the coming years. But they're also imminently going to be starting a checked baggage upgrade cycle very soon. We think there's initial noises being made around that.

And then you've got, following the European and the US lead, the international airports and the countries around the world that want to fly into those airports have to achieve broadly the same standards on similar timeframes. So there's very good underlying fundamental need, over an extended period of time, to upgrade in order to continue to fly and meet regulatory cycles and keep people safe.

The installed base is critical in the business. Once you've won the installed base it is very difficult, if not impossible, for that aftermarket stream to be carried out by a competitor, particularly around the software. I mean, there – there's some instances where you get, you know, a bit of – the sort of the mechanical oiling the gears type stuff going on. But in general, you have a secure revenue stream which represents about 40–50% of total revenues.

Most of it is software or increasingly software over time which you secure along with that OE order. Now, a bit like Crane, what that does is it makes it an extremely intense battle to win that installed base. And that will always be the case. It's critical to be the best, from a technology perspective.

Right now, people are very focussed on cost as well, not surprisingly. And it's so important to win share right now in installed base right now that, you know, the battle ebbs and flows. It's just always a tough one. This is never an easy battle. But the lucrative aftermarket streams, you know, justify, you know, in the long-term, in much the same way as they do with John Crane.

So we see a good regulatory underpinning. We see an increasingly positive aftermarket stream as more and more of it becomes software. But it's, you know, kind of tougher in the short-term, particularly as people are looking at their pocketbooks a bit more closely – the main airport authorities – than they were, although they still have to achieve regulatory requirements.

Robert Davis: Clear. Thank you. And then sort of two follow-ups, maybe just give them both the same time.

One I think was just on your Oil & Gas business. Just a bit curious, amongst your customer base, do you – would you describe the sort of COVID description of the period where they've done more activity because they're sort of operating less, or is this, you know, from a maintenance and service standpoint, or do you feel like that's the sort of tailwind, I think, going forward, and i.e. is there any catch-up to come?

And then the other question was just on Medical. I just wanted to talk, did – have you sort of thought twice about sort of going ahead with the separation, given you obviously had the boost from ventilators? You mentioned the sort of injection of money for the needles related to the COVID vaccination. Has there been any point when you said, 'Maybe we should change course,' or is that – you mentioned you were still on track, but I guess I just wondered if you sort of flip-flopped on that at all over the last few months.

Andy Reynolds Smith: Okay. Well, John, do you want to talk on the Crane question?

John Shipsey: Yeah.

Andy Reynolds Smith: And then I'll pick up on the Medical question.

John Shipsey: I think it's a mixed picture. I think particularly in H2 our customers saw quite significant disruption to, for example, access to sites. And so, we have seen – you know, where our – we have a fantastic network. It's one of the – you know, besides the technology, one of the great strengths of John Crane is their customer service network. But even we saw quite significant disruption to getting to site – you know, teams having to quarantine in one country, and then quarantine again so – if they wanted to go to another customer. So that was disruptive. I think we handled it pretty well, but I – it certainly wasn't – our customers weren't immune from it, either.

I think probably there – there's a sense that the oil price and the kind of lower demand put, you know, customers at the margin. They will defer maintenance, if they – so I think there is an element of probably still a little bit in the market of deferring discretionary expenditure, if they can. There's only so long that they can do that for. In the kind of installations that we serve, they are critical. And safety certainly comes to – I think pretty much all our customers say safety comes first.

So I'm sorry, it's a – it's not a – that specific an answer, but I hope that gives you a flavour of what we're seeing out there in the world.

Robert Davis: Yes. Thank you.

Andy Reynolds Smith: As far as Medical, I mean, we've always felt that Medical was a great business with future value, you know, that to some extent in the midst of a global health pandemic does have a bit of a brighter light shone on it. But I think we see that as a very positive feature of the value story as we think about Medical and Smiths going forwards.

So am I happy that there's a light being shone on it right now and opportunities, they're – are coming? Absolutely. Because we're also helping the fight against COVID. Has our strategic rationale of positioning two stronger companies changed as a result, and that focus on future value for both changed as a result? We said our rationale and intent is unchanged. But, you know, delighted that that business is – sort of got in the limelight right now, for lots of reasons.

Robert Davis: Right. Okay. Great. Thank you both.

Operator: Thank you. Dear participants, once again, if you wish to ask a question, please star and one on your telephone keypads.

The next question comes from the line of William Turner from Goldman Sachs. Please ask your question.

William Turner (Goldman Sachs): Hi everyone. Most of my questions that I was going to ask have been asked in some form or another, so just a quick one on your free cash flow generation, which is obviously very strong in the year. I noticed that working capital, as a percentage of sales, has come down quite a lot. Do you think you've now reached a level which – at the trough level for that number?

And then also just touching on one of the first questions that was asked on the write-down of some receivables, do you feel confident that there won't be any further write-downs of receivables? Obviously like for – some of your aerospace customers were not out of the woods yet with – in terms of that market.

So, two separate questions that – yeah, thank you.

Andy Reynolds Smith: Okay. Well, I'll – John is going to take most of that answer. Will, nice to talk to you.

But just on the working capital – I mean, this has been a big point for me for some time, as you know, to drive the overall reduction in our working capital. And I think the – you know, the performance through the crisis has been simply exceptional. I would say within it, the inventory, in order to maintain business continuity, is at a – it's still at a higher level than we want.

So I still see significant continued improvement potential in the inventory number. And I think the teams everywhere have been doing just a wonderful job on payables and receivables. So we see a lot of runway. There's where, you know – yes, improvement, we're delighted about it. It's really supported a very strong cash position now and as we look forward. But we still have some, you know, real levers to pull to do even better on this as we go forwards.

John, over to you.

John Shipsey: No, I mean, I've – I really agree with that. I mean, actually our inventory improvement, you know, had to take second priority to business continuity in the last six months. So we hope to get back on that track. But certainly, you know, we're not resting on our laurels there.

On our receivables, I mean, I just want to emphasise that the – these were things that we felt we had to provide for, but it's not a systemic risk. There is absolutely in the world – you know, that we're alert. Because of the situation, we are very alert to any receivable risk. We're managing that very actively. We – I think our credit control is stronger than ever.

So I'm not – you know, I'm clearly aware of a higher risk profile in the world, but I'm confident in what we are doing in terms of our credit management. So you can't rule out anything, but we're definitely very proactive on that right now.

William Turner: Okay. Thanks.

Andy Reynolds Smith: Thanks Will.

Operator: Thank you. The next question comes from the line of Jonathan Hurn from Barclays. Please ask your question.

Jonathan Hurn (Barclays): Hey guys. Good morning. Just a few questions from me, please.

Firstly, just coming back to that restructuring savings of £70 million – apologies if I've missed this – but can you just give us a feel for the breakout of the savings by division, please? That was the first one.

John Shipsey: We haven't actually broken out the savings by division. But we do break out the cost, if you look in the – and that will probably be the best indicator, if you like.

Jonathan Hurn: Sure.

John Shipsey: So – but it's – I think it's in page six of the press release. So you can see where they – they're broken down by division.

Jonathan Hurn: Sure.

Andy Reynolds Smith: Yeah. It does –

Jonathan Hurn: Sure. And then, just maybe –

Andy Reynolds Smith: It does apply across the Group, Jonathan, as you know, because it is vital to long-term improvement everywhere in our SG&A – you know, leaner, flatter structures to mean that we can do things more quickly and also with reduced costs with better margins. So you should be able to deduce. But as John said, we haven't broken out the benefits by division as yet. But you'll be able to deduce some rough paybacks if you look at those totals.

Jonathan Hurn: Sure. And £30 million in 2021, can you just remind me where the – that – those restructuring costs are coming through?

John Shipsey: In terms of by division or…?

Jonathan Hurn: Yeah. Just you know – yeah, just a sort of a rough –

John Shipsey: I mean –

Jonathan Hurn: – estimate.

Andy Reynolds Smith: [Inaudible].

John Shipsey: – I haven't got – we don't break it out by division. What I can say is that there are – so within it, the vast majority are headcount deductions. About 80% of the cost is directed at headcount reduction. More of the longer lead time items – I mean, there is a geographic effect. So it's some – in some cases, headcount is more immediately flexible than others. So there's that – there's a geographic bias.

And the other is that the 20% of this footprint rationalisation, that does have a slightly longer tail. So that takes slightly longer – that footprint rationalisation in Smiths Detection and in Interconnect.

Andy Reynolds Smith: I think the key thing is the vast majority of this is going to be complete as we go through FY 2021. As I said earlier, we're already two-thirds through. We'll be a lot further through by the half-year. Benefits are flowing 30% in the first half, 70% in the second half, and full benefits FY 2022.

So the objective with this plan is do it, move decisively, get it implemented, and get the benefits flowing. And we're making very good progress against that objective, which underpins our – kind of our confidence in the benefits of the plan, the phasing of the plan, and the flow in FY 2022.

Jonathan Hurn: Right. Very helpful, thank you. Second question was just on Flex-Tek. Obviously two parts have been – so aero, obviously, and particularly, civil struggling –

Andy Reynolds Smith: Yeah.

Jonathan Hurn: – and you've got this construction side that's obviously doing better. When we look at those sort of product lines, is there a big difference in margin between the stuff that you sell into aero and the stuff that you sell into construction? Just thinking about mix, really.

Andy Reynolds Smith: Not a huge difference between the two. I mean, you have about 15% or so. Bear in mind that a chunk of the aerospace in Flex-Tek is military, which is not under pressure at the moment. So – and that's almost entirely on the Joint Strike Fighter.

So this is really only about the commercial aero piece that's under pressure, as it is for everyone right now. But I wouldn't point to particular margin differences between a commercial aero and the balance. I mean, they're all good businesses for us. You see Flex-Tek numbers, they continue to deliver. And, you know, just really pleased that some of those industrial markets are improving and have improved the way they have.

Jonathan Hurn: And just a final question as – again, on margin, but this time on Interconnect. Obviously you saw a good recovery in that margin in the second half. The volume outlook of – for that business obviously is getting better. As we look to 2021, do you think that that division can get to that sort of mid-teen – that kind of 15% margin in 2021? Is that a possibility?

John Shipsey: Well, I can't answer quite such a direct question without giving –

Jonathan Hurn: Sure.

John Shipsey: – forward guidance, I'm afraid. But certainly, you know, we're – FY 2020 was a – you know, a year to put behind us on Interconnect, frankly. And we're pleased that – you know, we are really pleased that they are entering FY 2021 in much better shape with momentum. And we've – and so, we – you know, we certainly believe they are capable of mid-teen margin.

They do have – they always seem to have because – partly because of the semiconductor customers, they have an H2 [inaudible]. But they have quite stronger volumes always in H2. So that helps the 13% margin achievement in FY 2020 H2.

But yeah – no, I'm – I don't have any doubt that they can get to mid-teens margins. What I can't say is that – without giving forward guidance, I can't tell you whether that's FY – I can't put a timeframe on it, but I'm confident about it. That's it.

Andy Reynolds Smith: We absolutely have not changed our mid-teens target margin range for Interconnect. In fact, I'm gaining increasing confidence, particularly some of the successes that the team are having now in the space market, particularly with a – that great acquisition I mentioned earlier, Reflex Photonics. Fantastic.

Jonathan Hurn: Actually, maybe could I just have one final one? Just a very quick one, just on Detection and maybe just the order book.

I mean, as we look at that, could you give us some feel of how much of that has been delayed and if you've actually seen some cancellations coming through in that order book, if at all, please?

John Shipsey: Yeah. So – I mean, the order book is strong. It – you know, it goes out a long way. We don't tend to see cancellations in Detection. So I – you know, I can't – I cannot say never, but we don't see cancellations of orders.

What we do see is tenders being put out. And then, you know, sometimes installation is disrupted. So it – it's – you know, Andre was asking about kind of the programme nature of – well, in effect, is talking about the end of FY 2020. Detection is a programmatic business. You know, it performed very, very well in FY 2020.

The – I guess the theme that we would say is that there will be probably fewer tenders or that they'll be stretched out a little bit and, obviously, are hard-fought. But we've got a very substantial order book that will cushion us. I don't see that being cancelled at all. But it's possible that installation will, you know, be pushed out a little bit.

Jonathan Hurn: Great. Thank you, guys. Thank you. Thanks very much.

Operator: Thank you. There are no further questions at this time. I would like now to hand over to Andy Reynolds Smith for closing remarks.

Conclusion

Andy Reynolds Smith

CEO, Smiths Group Plc

Closing remarks

Okay. Well, thank you very much indeed, everyone, for joining and taking the time with us today and for all the questions. As you can hear, you know, we are feeling, you know, positive about the way we have managed through this so far, but really building confidence around the actions that are in place for the future to move us to the direction that we want.

So thanks very much again, everyone, for listening. Really look forward to getting together with some people soon on a face-to-face basis. And in the meantime, please stay safe everyone. Keep you and yours safe. Thanks, everyone.

[END OF TRANSCRIPT]