smiths
bringing technology to life

SMITHS GROUP PLC INTERIM RESULTS PRESENTATION 25 MARCH 2009 AT THE LONDON STOCK EXCHANGE

SPEAKERS

- Philip Bowman — Smiths Group plc, Chief Executive
- John Langston — Smiths Group plc, Finance Director
- Stephen Phipson — Smiths Detection, President
- Paul Cox — John Crane, President
- Srini Seshadri — Smiths Medical, President

PRESENTATION

PHILIP BOWMAN: Ladies and gentlemen, good morning and welcome to the interim results presentation for Smiths Group. I'm joined by John Langston, our Finance Director, and the divisional general managers who will join John and me in answering questions at the end of the presentation are assembled in the front row. Stephen Phipson, responsible for Smiths Detection; Paul Cox for John Crane; Srini Seshadri responsible for Smiths Medical; Ralph Phillips, Interconnect; and Ted Smith all the way from South Carolina for Flex-Tek. A number of other senior executives are also present in the audience.

To avoid interference with the sound system, can I make the customary plea for you to check your mobile phones and Blackberries are turned off.

I'd like to start by giving a brief overview of the interim results and some of the key developments before passing over to John to go through the detailed financials. Later I will come back to review the progress we've made in each of the divisions over the past six months and set out the priorities for the remainder of this year.

Since we announced our results in September we have seen a dramatic change in the financial and economic markets. Over all, I believe that we have made some good progress and are reporting a strong performance in the first half despite the most inclement conditions for business that I can remember. Our reported sales increased by 19% as we benefited from good organic growth at John Crane, recent acquisitions and significant currency translation benefits. These results demonstrate the benefits of our portfolio of businesses and their diversified exposure both to business sectors and to geographies.

On an underlying basis, revenues fell by 3% and the drivers of this decline were Detection, where the order flow has reduced in the ports and borders business, as previously guided in September and November, slower sales in Flex-Tek reflecting an increasing recession in the US housing and appliance markets, and slower

sales of hardware at Smiths Medical. Headline operating profit increased by 17% while on an underlying basis declined by 10% and John will go through the drivers of this movement in just a minute.

A keener focus on the capital base and working capital management delivered a significant improvement in cash generation. Free cash flow increased to £104 million from £26 million in the corresponding half last year. In line with previous guidance, the board has declared an unchanged interim dividend of 10.5 pence per ordinary share. Looking ahead, our focus will remain on rebuilding divided cover, reflecting a combination of the opportunities that we see to invest in our businesses and the current challenges in the financial markets that are affecting the financing of corporate and defined benefit pension funds.

Last September I set out the priorities for this year in terms of the operational improvements and the actions to drive Smiths forward. These are summarised on this slide, and we've made good progress against each of them. The restructuring initiatives are already delivering savings with the HQ rationalisation complete and the divisional programme well under way and on budget. We have extended our portfolio and presence through two further acquisitions. We continue to improve our data systems and information flow and have made good progress with the ERP

projects for Detection, John Crane and Medical. The portfolio profitability review we announced in Smiths Medical is well underway with the early conclusion to exit the diabetes business. Our investment in research and development has grown by 29% on a reported basis to support future growth.

Finally, one additional area that I did not highlight in September was financing. We have appointed a new group treasurer and reviewed our financing strategy and in February we extended the maturity profile of our debt through a $175 million issuance to the US private placement market. We'll come back to these themes in more detail in a moment. However, the key message is that we have continued to make good progress in managing those things that are within our control through reshaping the businesses and in driving operational efficiencies. Even in this challenging environment there are clear opportunities to improve performance progressively and to generate value for our shareholders.

With that brief introduction, I'd like to pass over to John.

JOHN LANGSTON: Thank you, Philip, and good morning to you all. In the first 6 months we achieved sales of almost £1.3 billion, up 19%. The results benefited strongly from currency translation and acquisitions, which gave a total benefit of some £239 million. On an underlying basis, sales fell by 3%. Reported headline

operating profit increased by 17% to £185 million with a benefit from currency translation of £36 million and acquisitions of £11 million. Underlying profits declined by 10%. In challenging markets, the margin of 14.3% is broadly in line with the prior year. As we guided at the year end, the benefit from pensions financing decreased by £18 million so that the underlying profit before tax fell by 17%. The tax rate was 24%, which is down from 25% in the prior period. For the coming year, we anticipate holding the effective rate at 24%. Headline earnings per share was 32.5 pence against 30.8 pence last year. As Philip has said, the dividend remains unchanged at 10.5 pence.

The next slide summarises the key drivers of our profit growth. We achieved an additional £8 million of pre-tax profit, so let's take a look at how we actually delivered this. Firstly, our overall volumes declined by £16 million, reflecting lower sales in Detection, Flex-Tek and Medical. There was a net rise in our operational expenses of £9 million which reflects higher research and development investment of £2 million. Some inflationary increases in labour and material costs were partly offset by efficiencies in freight costs and overheads.

We were able to offset the increase in operational costs through a rise in prices and a better mix, which totalled some £11 million. There was, of course, a benefit from acquisitions and the

incremental increase was £11 million. On currency this has been a strong positive with an additional £28 million, reflecting the relative strength of both the US dollar and the euro. As you can see from the charts, the average rates for the US dollar and the euro strengthened by 19% and 15% over the period. To remind you, 1 US cent is worth around £1.2 million of profit and for 1 euro cent it's £1.1 million. Finally, financing costs increased by £18 million due to the reduction in the pension credit. I will return to pensions later.

Let us now review each of the divisions in turn, starting firstly with Detection. Reported sales increased by 5% to £233 million driven by favourable currency. On an underlying basis, sales declined 11%, reflecting the lower sales in ports and borders. This is consistent with our previous guidance, but this business is a growth business but with a variable order profile. Underlying profit fell 45%, primarily reflecting £14 million of lower volumes and associated costs under recovery in our operations. We benefited from an improved contract mix of £3 million, which was offset by increased operational costs of £3 million from wage inflation and higher overheads.

As previously guided, we had a currency transaction impact of £5 million, which has been more than offset by £8 million of currency

translation giving a net impact of £3 million. Excluding this transaction impact, margins are closer to 12%.

Philip will talk more about the outlook for Detection and the other divisions in a moment, but let me move on and give you an update on John Crane's performance.

We've delivered strong reported sales and profit growth while increasing margins by 240 basis points. John Crane has made 4 acquisitions over the prior year, which have increased sales by £4 million and profit by £9 million. Excluding these benefits and FX, sales grew by 6% to £393 and profit increased by 18% to £66 million. This reflects higher volumes driven by a good performance in all segments, particularly in petrochemical, which accounts for around two-thirds of sales. We also benefited from better pricing by £5 million as we managed to pass on increases in raw material and input costs, something which may prove more challenging in the second half.

Our operational expenditure increased as we expanded our after-market service base in several markets. We also experienced inflation in wages and raw materials, but these were partially offset by cost-saving initiatives.

Turning now to Medical. Reported sales grew by 16% to £403 million while profit increased 15% to £77 million. On an underlying basis, sales declined 3% and profit fell 6%. Volumes declined by

£5 million, reflecting lower hardware sales in infusion pumps, temperature management and patient monitoring. Hardware sales have been affected by constraints on hospital capital budgets. However, 80% of sales is in single-use devices, which were broadly flat year on year. Labour inflation has been more than compensated by cost reduction initiatives, which have cut overheads. We also increased our R&D investment in Medical by some £2 million.

Margins benefited by £1 million from the acquisition of ZDMI, a Chinese syringe pump company. Medical has a large US business and the stronger dollar produced a translation benefit of £14 million, offset by a small transaction impact of £1 million, giving the reported profit increase of 15%.

At Interconnect reported sales increased by 25% to £152 million and operating profit increased by 3% to £24 million, reflecting currency translation of £6 million and the benefit of last year's acquisitions of £1 million. Underlying sales declined by 2%, while operating profit fell 20%. Roughly half of this deterioration in margin comprised £2 million of one-off restructuring costs which will not be repeated in the second half. These are separate from the major restructuring programmes announced last year for the headquarters, Crane, Flex-Tek and Medical and are not treated as an exceptional item. The remaining underlying decline was

caused by adverse mix as a result of lower wireless sales compared with the prior period, and £2 million of transactional losses.

Turning to Flex-Tek, reported sales increased by 12% to £111 million while profit increased by 3%. Underlying sales declined by 11% while operating profit fell 17%. While margins declined slightly, this very good performance should be seen in the context of the dire US housing and appliance market. These challenging end markets caused volumes to decline by £6 million, which offset growth in the aerospace sector. However, we achieved price increases in all business areas, which helped to offset the increase in costs. In addition, our cost reduction initiatives also helped to preserve the margins.

As you know, we use headline numbers, as we believe these show a more accurate portrayal of ongoing business performance. The key difference between headline operating profit and statutory is exceptionals and amortisation. Amortisation is self-explanatory, so I will focus on the exceptionals.

Exceptionals totalled £10.4 million in the period. This comprised £0.7 million for the profit on disposal of businesses, which represents adjustments to provisions in respect of disposals in prior years. £13.5 million was for the profit on the disposal of the former aerospace site at Basingstoke. Exceptionals also include

£8.6 million, which relates to the change in the US discount rate on the John Crane litigation provision and £7.6 million primarily in respect of changes in the assumptions underlying that provision based on advice from our independent experts. It also includes corporate and divisional restructuring that we announced last year of £8 million.

This next slide sets out the costs and benefits of this restructuring programme across the group. This is in line with the figures we presented at the year-end. We have added the costs incurred in the first 6 months, which amount to £8 million, as shown in the first column. The savings to date are also £8 million, as shown in the further column. We will continue to report against these figures, although clearly the actual outturn will be affected by exchange rates.

Turning now to cash, we achieved a significant improvement in operating cash in the period, with 83% of headline operating profit converted. The reduction in working capital outflow from £55 million to £35 million reflects better working capital management, particularly less growth in inventory, although improvement of inventory returns remains an objective for us. We have kept capex broadly in line with last year, while appreciation has increased by £6 million to £30 million, reflecting our recent investments in ERP and facilities with John Crane and Detection in

particular. Given the current economic environment, our intention is to manage our capex so that it is around 1 times depreciation for the full year, compared to 1.2 times last year.

On net debt. Net debt closed at £975 million. This primarily reflects the movement on the translation of net debt, financing and acquisitions. Free cash flow increased from £26 million to £104 million. We paid the final dividend of £91 million and had a net cash outflow from M&A activity of £41 million. There was a net cash outflow on financing of £41 million. This comprised £4 million of receipts from share capital issues and £45 million outflow on maturing net investment hedges arising from the settlement of debt swaps as exchange rates moved against us.

Foreign exchange, particularly the strengthening US dollar and euro has had a £118 million impact of re-translation of net debt. Together this has resulted in net increase in debt of £204 million. I anticipate that at current exchange rates, net debt will remain around £970 million at the year-end, subject to any acquisitions that we make during the remainder of the year.

After the period end, we raised $175 million of additional long-term debt capital through US private placement. This is in line with our strategy to extend the maturity profile of our debt and reduce our dependency on the bank market. This chart analyses what our period end debt would have looked like with this new debt capital

in place. I think the key messages are that we have extended our debt maturity so that the weighted average life of debt is over four years. We have a bank facility of £660 million until 2012 which, on this pro-forma basis- has committed undrawn facilities of some £370 million at the end of January. At the same time we remain committed to our solid investment-grade rating.

Moving on to pensions. On pensions, if we start by looking at the funding and balance sheet aspects, you will see that our deficit has increased to £464 million since July 2008. This increase in deficit is largely caused by the fall in global equity values. At the year-end, equities represented 46% of asset values compared with 43% at the end of January. Since then the Bank of England has announced its policy of quantitative easing, which will cause discount rates to fall and thus pension liabilities to increase further.

Looking to the P&L and cash, as previously guided our pension credit to the P&L has fallen from £21 million to £2 million. We made an overall cash contribution to £20 million in the period and I anticipate that these will be £52 million for the full year. A triennial review will begin next month and, given the increased deficit, our cash contributions will increase. I will be able to update you more on this in September.

To conclude, we have made good progress in what is a difficult economic environment. We have increased operating cash and

generated significantly greater free cash flow. We are investing selectively for the future in higher R&D, targeting acquisitions and restructuring projects. We have a strong balance sheet with good available credit facilities sufficient to fund our operating fund to support growth opportunities. This establishes a healthy platform for future growth and driving returns for shareholders.

I will now hand you back to Philip for his operational review.

PHILIP BOWMAN: John, thank you very much. I'll begin by reviewing developments at group level and within the corporate centre and then move on to over each of the divisions in turn. The headquarters restructuring is now largely complete, with the headcount reduced to around 40 people. The group is run now from a modern office in Victoria which is about an eighth of the size of the old Finchley Road offices and these initiatives have already delivered savings of over £3 million in the first half of this year.

We continue to improve the business systems with all the current ERP programmes on schedule and within the budget that we presented last September. We've also made good progress with the implementation of a group-wide information platform and this enables us to identify opportunities to leverage the group's scale, especially across procurement. For example, we have now established that some 15,000 suppliers serve more than one

division, and 60 suppliers serve every division, often with spends well in excess of £1 million. Over the coming months we will use this data to examine our supply agreements for freight, raw materials, utilities and in other areas.

Moving on to each division, and starting with Smiths Detection, underlying sales declined by 11%. As previously signalled, this reflects the increasingly variable nature of the order flow of this largely government-contracting business. The sales performance is driven primarily by declines in the ports and borders segment which have been partly offset by good growth in the military area. Sales and transportation were in line with last year, which reflects healthy growth in the US, while sales in Europe, Middle East and Africa were down. US sales benefited from the introduction of the new generation of checkpoint explosive detection systems, aTiX. Airports in Europe have been slower to adopt the new technology while trials are underway and projects are being delayed due to government funding constraints. However, a total of in excess of 400 aTiX systems are now operational in the UK and the USA.

The ports and borders market has seen a decline in sales following a large contract in Russia last year. Average contract sizes increased in recent years and governments have become more co-ordinated in their approach to border security and customers' revenue protection. As a result, the sales profile in this

business has become much more variable. We're actively engaged in tendering on substantial projects in several markets. Last week the European Commission announced a full investigation into concerns that the Chinese company NucTech had been dumping advanced cargo-screening systems in EU markets. We welcome this investigation as a first step towards restoring free and open competition in these markets.

In military we received further orders for JCAD from the Department of Defense, amounting to some $65 million during the period, taking total orders to date to approximately $125 million for this product. We've also won a contract for approximately $20 million from the US army for our Meteorological Measuring Set-Profiler, an advanced data collection system that improves targeting accuracy in military operations. The military facility in Edgewood is being expanded by almost 50% to meet the demand created by several contract wins over the past 2 years.

We've reorganised the business into two areas: security and inspection, and military and emergency response. A new chief operating officer was recruited from Thales to drive improvements in operations management and efficiencies in manufacturing and logistics.

Finally, the implementation of the new ERP system is on track with 14 sites representing 50% of divisional sales now live. The project

is expected to conclude by the end of 2009. A strong focused research and development programme is a key contributor to our market-leading position. Company-funded research and development was increased by 2% to £15 million or 6.5% of sales. This includes £5 million of capitalised projects. We actively seek customers' support of research and development, which totalled £7 million in the period, bringing total R&D investment to £22 million.

X-ray screening continues to be a focus for our investment, supporting the development of a new generation of cargo-screening equipment. We have now launched eqo, an advanced people screener, which is on display in the foyer outside. This uses patented millimetre-wave technology to detect weapons or explosives concealed under layers of clothing. This new system is able to reveal a far wider range of weapons and threats than is possible with existing, non-ionising technologies.

Some of you will have seen the veterinary diagnostics tool in Wiesbaden. Field trials will soon be underway for a foot and mouth test with the UN Food and Agricultural Organisation, while tests for bird flu will begin laboratory validation with two government veterinary agencies. The same technology is nowt being developed and tested for clinical applications such as MRSA.

The operational priorities for Smiths Detection for the remainder of the year are the further rollout of new aviation checkpoint and cargo-screening equipment, the launch of some further new products, implementation of cost reduction initiatives and completion of the ERP programme to drive future efficiencies.

We continue to see a healthy level of tender activity and new business interest. In the longer term, Detection will benefit from the market leadership, advanced technologies, cost-reduction opportunities and the ever-increasing need for security solutions to meet evolving threats. However, it is hard to predict short-term results, given the variable nature of a government contracting business and the impacts of the economic disruption.

Turning now to John Crane, underlying sales grew by 6%. This growth was driven both by the continued demand for original equipment orders and after-market servicing. The petrochemical industry remained the principal driver and, given the recent sharp drop in crude prices, it is perhaps worth noting here that John Crane is exposed to both the upstream and the downstream. Some 60% of its petrochemical sales are downstream. Periods of low prices and the ensuing lower feed costs are used by refiners and processors to invest in growth areas and efficiencies, so John Crane benefits.

Conversely, high prices encourage upstream investment where it then benefits from higher OEM sales. We have continued to invest in building our network of sales and service centres so that we now have 132 sited in 54 countries. Recent additions have been focused in growth markets. Four centres have opened in the Middle East, including a wet seal service centre in Bahrain. Three new facilities have opened in Asia Pacific, serving the petrochemical markets in Thailand, oil and gas and mining in Australia and a state of the art wet and gas seal service centre in the People's Republic of China.

We are implementing a new ERP system across Europe with ten markets now live, and the project is on schedule and within budget. Last year we made four acquisitions in John Crane and I'm pleased to be able to report that all are performing well. John Crane Production Solutions was formed at the start of the year from the two acquisitions of CDI and Fiberod. Both are delivering double-digit growth in a competitive market. CDI has recently completed a major refit of pumping wells in Romania and JCPS also announced the first solar-powered pumping system, which has been made possible through Fiberod's lightweight sucker rods which provide an economic means of accessing wells in remote areas.

The integration of Indufil and Sartorius Bearing Technology are both on track and we're beginning to leverage John Crane's global sales network for their product ranges. Indufil continued to see solid growth in the first half and John Crane Bearing Technology delivered good growth, particularly to support compressors and turbines.

At the start of the fiscal year we launched a restructuring programme to create one global John Crane division by integrating the two existing regional organisations. Strategy and planning are now co-ordinated globally while other functions have a consistent global approach. This is improving not only customer focus but also communications both in and outside the business. The programme has already generated savings of £3 million from the target total of £25 million a year and we spent £5 million to date out of a total restructuring budget of £24 million.

Priorities for the rest of the year are continued implementation of the global restructuring and margin improvement programme, further development of a footprint of our network of service centres, rollout of the ERP systems across Europe and Asia and building the franchise to further acquisitions should appropriate opportunities arise at attractive prices. While the current economic downturn is likely to test the resilience of John Crane's growth, after-market sales appear stable and a strong order book for

original equipment in the first half should underpin growth in the second. However, we have seen some softening in OEM order intake over the past three months as a result of lower capital investment by customers. Despite this impact, further cost reduction initiatives should underpin margin improvements.

Turning now to Smiths Medical, underlying sales fell by 3%. Looking across the medical devise market as a whole, it's important to draw a distinction between hardware and capital items and single-use consumable items. Some 80% of our sales are from disposable items where demand has held up better than for capital items. The economic downturn has hit hospital capital budgets as it has affected hospital income. Purchases of major capital equipment such as MRI scanners started to be deferred many months ago, a trend that has now extended to lower-cost items.

The disposable market has proved considerably more stable and in some segments we have achieved market-share growth. However, we are now seeing delays in elective procedures as prospective patients lose jobs and associate health insurance coverage. These dynamics are reflected in the performance of the three parts of Smiths Medical portfolio. Medication delivery, which includes infusion pumps, was down 3.8% and most competitors have seen significant sales decline in the corresponding period.

There is competitive pressure in diabetes, in part due to the age of the Cozmo pump, although sales of consumables in this market have held up well. Delays in hospital purchases have directly affected other pump sales. Whilst CADD-Solis has been very well received by clinicians, current conditions and budget pressures have constrained sales.

Vital Care was down 4.5%, primarily because of spending deferrals affecting hardware sales in patient monitoring and temperature management. Other parts involving single-use items such as airways have performed much better, particularly with the supply chain improvements. Sales of safety devices grew by 1.7%, driven by new access product launches and good growth in needle safety products.

We have continued to make significant progress in addressing the historic supply chain issues. Customer backorders have continued to be reduced and are now at a five-year low. Inventory levels for both finished goods and raw materials have also reduced since the year-end, and these improvements have benefited sales in our North America business. The contracting cycle in other markets, particularly within Europe, means that the international business is taking longer to win back customers that it lost during the earlier supply interruptions.

Our ERP implementation remains on schedule and within budget. A further three markets and a major manufacturing site have now gone live, bringing more than 60% of sales and sites on to the new system. We are also delivering savings for the consolidation of our North America operations. We have reduced from four operating units to two, and cut overheads while introducing a shared service centre. Delivering this programme and improving the supply chain remains a key priority. It will support further improvements in customer service and further reductions in inventory levels.

I announced in September that we were beginning a review of SKU and customer profitability in Smiths Medical. While this project is still underway, it has already highlighted some significant opportunities in terms of pricing, minimum order quantities, customer management and the reduction of complexity in the supply chain. Our initial focus is on rationalising some of our low-volume products and in a first phase we intend to eliminate some 3,000 SKUs from a total of some 13,000 slow-moving items. The first reductions will take place before the end of April. The review has also identified pricing opportunities and we will report further on this at the year-end.

An early conclusion from this review is a decision to exit the diabetes business. The insulin-delivery pump Cozmo was

launched some seven years ago in 2002. Sales of the product grew well initially but have since slowed. There are three key drivers to our decision to exit this business: first, there is the need to develop a new product with continuous glucose monitoring, electronically linked to insulin delivery. However, a considerable amount of the intellectual property in the diabetes segment makes the development of next-generation products not only very costly but also risky in terms of the potential for future patent disputes. Second, our modest share in the face of two large, well-resourced players, Medtronic and Johnson & Johnson, would result in a declining and increasing less profitable business. Third, our margins from this business are constrained by a combination of the impact of an adverse legal settlement some years ago and the extent of a dedicated customer support infrastructure which we cannot leverage across any other parts of Smiths Medical business.

In 2008 diabetes contributed £36 million of sales and an operating profit of just under £6 million. We will cease sales of new pumps with immediate effect but continue to sell disposables to support the installed base over the life of a four-year warranty, which is an industry standard in North America. Clearly, we expect sales of those consumables to progressively decline over that period.

We invested £14 million in research and development, or 3.4% of sales, and we're focusing more of our investment on specific growth areas. SmartX - a unique wireless blood pressure monitoring system which many of you may have seen displayed outside - has been rolled out to new markets, as has UniPerc, a tracheostomy tube for obese patients. We've now launched CADD-Solis in all English-speaking markets and a multi-language variant will be available later this year.

We have also expanded our portfolio and presence in China to the acquisition of ZUMI, which manufactures syringes pumps and enteral feeding devices, primarily for the domestic market. Integration is well underway; it consolidates our presence in the large, faster-growing market and provides a low-cost research and development base for the development of hospital infusion products for other markets around the world.

The key areas of focus for Medical in the rest of the year are to exploit more opportunities from the SKU and customer profitability review, to implement an orderly exit from the diabetes business at minimum cost whilst remaining support to existing customers, to continue the ERP implement and improve the supply chain and to optimise the R&D process and to launch a number of further new products. Looking to the next six months, we believe that margins will benefit from the recent cost reduction initiatives. While sales

will be affected by the SKU profitability review and the decision to exit diabetes, the focus will be on driving new sales in developing markets and new products.

Looking to Smiths Interconnect, underlying sales declined by 2%, reflecting slower sales to the wireless infrastructure market. Margins were squeezed by some one-off restructuring charges and from a mixed shift to some lower-margin products. Interconnect's largest single market is the military and aerospace. This sector performed well through several US military programmes, as shown on the slide. These programmes provide reliable, secure, high-bandwidth communication in areas of conflict.

The wireless infrastructure market has become tougher in recent months. Sales declined, although this was in part due to some unusually large contracts for lightning and surge protection equipment which benefited the first half of last year. We also experienced a shift to lower-margin products in the protection area. Last year we made two acquisitions in Asia to expand our radio frequency filter footprint in the region. Both have been successfully integrated and their combined trading performance is ahead of expectations from strong sales of interference testing devices. We will add to this growing base through the acquisition of Dowin, which is agreed subject to regulatory approvals. Dowin

is a Chinese manufacturer of power and signal protection devices, mainly for the wireless telecoms market, which will complement our existing portfolio and increase our presence in Asia where further infrastructure investment has already been announced, particularly in the People's Republic of China.

Looking to the next six months, our focus will be on managing the cost base, geographic expansion in Asia Pacific and delivering the key commitments on major military projects. Looking further ahead, we believe that military communications will be an area for continued investment even if overall defence budgets plateau or indeed decline. Capital investment in wireless infrastructure has slowed but growth is expected to return in 2010 as Western operators introduce the next generation of high-speed networks and new networks are rolled out in developing markets.

Finally, turning to Flex-Tek, Flex-Tek performed well in some extremely challenging market conditions. Revenues fell by 11% but margins were broadly preserved at 10%. Flex-Tek is organised into three separate technology groups: Aerospace, Heat Solutions and Flexible Solutions. The Aerospace group delivered good sales growth in components and services for both civil and military aircraft, helping offset the declines caused by the recession in US residential construction and the domestic appliances market.

Flexible Solutions provides flexible hose assemblies to domestic appliance manufacturers and supplies ducting for the industrial market. The group has experienced declines in sales and profits as a result of continued pressure in the household appliances and general industrial sectors.

The Heat Solutions group supplies heating components for tumble driers, and HVAC ducting and related equipment to the US construction market. There has been a 36% fall in housing starts in the half year. Sales declined at a lower rate, indicating that Flex-Tek successfully gained share in an exceptionally tough trading environment. In addition, a focus on production efficiency, cost management and tactical pricing has helped preserve margins. Our presence in Asia continues to grow. We have expanded the range of products delivered from our Changshu, China facility to include gas delivery tubing, and we're in the process of gaining federal aviation authority approval for our aerospace overhaul and repair facility in the Philippines.

Flex-Tek's restructuring programme is well underway, with £2 million spent in the period. We've announced the closures of a ducting factory near Glasgow and a heating element facility in Illinois. The programme is part of a wider group restructuring and is expected to cost £5 million in total and, once complete, will deliver annualised savings of £7 million. These initiatives will

make Flex-Tek a stronger business and better leveraged into recovery in the US housing and appliance markets when this occurs.

Turning to the current fiscal year, the housing and appliance markets are likely to remain extremely challenging, so we will look to expand the business in other business such as aerospace and medical. There is also scope for growth in Asia to support the industrial and appliance markets. At the same time, we will continue to restructure and remove costs through site rationalisation.

Last September we set our ranges for sales growth and margins for each of the divisions based on what we believed the businesses could achieve over the medium term in a financial and commercial environment consistent with that of recent years. Since then there has been a serious discontinuity in the global markets and, while our businesses are comparatively well placed, if current conditions persist it will be harder to operate within these ranges in the near term. However, we remain committed to aggressively managing everything that is within our control and improving performance consistent with these ranges as the financial markets stabilise and when world economies return to growth.

We face a period of significant turmoil and uncertainty, but I still believe that the Smiths portfolio of businesses is better placed than many to withstand the pressures of a downturn. Our exposure to diversified markets and geographies is proving to be a real strength. There remain many opportunities to improve the performance of the business through tighter cost control and an extensive programme of self-help. We are restructuring to deliver efficiencies and leverage our scale more effectively. To support this, our business systems are being upgraded to provide faster data-based decision making.

In parallel there are opportunities to deliver faster top-line growth through pricing, product innovation and especially through better penetration of developing markets. We are increasing our research and development investment to deliver new products and there is also the opportunity to grow businesses through bolt-on acquisitions to bring complementary technologies and to support geographic expansion into faster-growing markets.

To conclude, in spite of the economic challenges, we have made good progress on the operational improvements which provide a more solid foundation for the business going forward. Absent further deterioration in world economies and assuming current exchange rates, we remain on track to deliver full-year results in line with expectations.

In the long term I remain confident that we will deliver value for shareholders through the improved performance of our five divisions and ultimately the reallocation of capital within our portfolio of businesses.

That, ladies and gentlemen, takes me to the end of the formal presentation. John and I, along with other members of the senior management team, will be very happy to take any questions. If I could just ask that when you do ask a question, would you please wait for the microphone, otherwise we probably won't hear you, and could you please remind us who you are and the company you are working for.

Thank you very much. In the third row towards the middle, please.

AVI HODDES: Hi, it's Avi Hoddes at UBS. Could you comment on whether you've identified any further costs savings since you spoke to us in September and, if you have, if you could put some scale order of magnitude on those?

Second, John, on the same topic I think you touched on currency sensitivity to the savings which you mentioned. Could you remind me what your currency assumptions are with those savings numbers?

PHILIP BOWMAN: In terms of your first question - have we identified further cost-saving opportunities - clearly part of our task is to continually look for such savings, and the answer to your question is yes, we have identified further savings. We have not quantified them at this time but the comments that I made in the presentation on procurement and the data we have now got to analyse our procurement gives you a hint as to one of the areas we are looking at. It is a subject, as I said, we will speak about more when we come to the end of this financial year and report in September. But rest assured there is a lot of activity, particularly given the weakening economic outlook in terms of looking for further cost-saving opportunities.

JOHN LANGSTON: Basically, we have a combination of costs, as you know, in both euros and dollars and the rates will be what the rates will be when we incur that cost, obviously, but if you want to use something for planning purposes, it's around 1.54 in the dollar and it's around 1.16 on the euro.

PHILIP BOWMAN: Yes, fourth row.

MALE SPEAKER: Two questions, please, one on John Crane and one on Detection. On Detection you are quite vague on the second half, given the

lumpiness of the business, I guess, but we are now mid March and the year-end is July. Maybe you can give us a little bit more guidance - how much of the first-half decline you could make up in the second half.

On John Crane, historically the business had quite big profitability declines and downturns - sometimes half of the profitability. This time around you have the cost-savings programme, but what else has changed to give you the confidence that margins could continue to increase despite the expected declines in oil and gas capex.

PHILIP BOWMAN: I think I will pass both of those questions across to the respective division general managers. Stephen, would you like to talk about the outlook of H2, given volatile orders?

STEPHEN PHIPSON: We're seeing tender activity much higher for the second half; we're seeing opportunities with -- particularly in some of the aviation markets that are coming back. We've had delays there; I think Philip explained it quite clearly. We've seen very good growth in the first half in the US business, particularly in commercial aviation and in the military business. We expect that to continue for the second half, and we've seen a virtual sort of grinding to a halt of government-sponsored programmes or

privately-backed programmes when we look at private aviation airports, etc, in Europe and the Middle East in the first half. Some of these are starting to come back. This is definitely not a long-term phenomenon; it's about short-term cash conservation in these economic difficult times. The fundamental drivers to the business are still strong.

So, how much of that gets recovered in the second half, I think was the question. I don't think we're going to recover the short falls of the first half; I think we're going to have a stronger second half than we had in the first half, basically.

MALE SPEAKER: Still negative growth for the full year, effectively?

STEPHEN PHIPSON: We shall see.

PHILIP BOWMAN: Stephen, thank you for that. Paul, do you want to talk about the longer-term outlook for John Crane?

PAUL COX: Well, I think the question that was raised is why is this downturn different from the previous downturns. I would say - I think I've told a few of you in the room this morning - I would rather be sometimes lucky than good. The fact that we actually started this restructuring activity back, effectively, last June, has given us a

jump on this change. That's the first thing. So the restructuring activity we got underway, we targeted it and we've retargeted as we've seen conditions change, which should support our margins. The other side of it is we do have a very good installed base in terms of the -- installed base today has now expanded in terms of our filtration systems, in terms of the bearing systems, so we actually have a broader reach in the after market which will help us in times when the OEM markets are down.

MALE SPEAKER: Was there historically big price pressure that drove production down a lot in down times? Because, I mean, you always had a good after-market business which was stable. Was just the OE business much more price competitive than in downturns which resulted in historical margin collapses?

PAUL COX: I would say our cost base was significantly different at that time than it will be going forward, so there's some of that. There's always price pressure. I mean, it's a competitive environment and most of the projects we're seeing right now are in some sort of delay generally because the end user is looking for a better deal because raw material prices are down or it's a more competitive environment. So far, at least in our order book, we're not seeing

cancellations, we're seeing delays. But we are seeing a softening in the overall OEM first-hit market right now.

MALE SPEAKER: Thank you.

PHILIP BOWMAN: Thank you, Paul. Yes, towards the back on my left, over there.

STEVE EAST: Thanks, it's Steve East, Credit Suisse. Just on Medical I was wondering if you could just expand a little bit in terms of the hardware side of Medical is obviously declining. Is that continuing into the second half and what is the outlook on that side?

Secondly, in terms of the products that you've identified that you want to get out of, what's the time horizon on that and how big is that as a part of the business?

PHILIP BOWMAN: Srini, I'm going to ask you to answer those, but it might be useful to preface your answer with just a little bit of what we see as the pressures on the hospital system at the US.

SRINI SESHADRI: Well, what we see, if you look at the American Hospital Association published data, for example, plus what we get organically through our own direct contact with customers is our customers are having a tough time. I mean, with declining

endowments and so on and so forth, the pressures on them to conserve their cash as well as look at declining margins due to discretionary spending on procedures is an issue. It's not dramatic, as usually things aren't in the medical world, because there is a strong underpinning of underlying demand that is always there due to demographics.

Given all that, there is a softening and one of the places where they can take immediate action is in the purchase of large quantities of new hardware. So the 20% of our business that is hardware based is facing that pressure. I don't believe that pressure is going to go away in the second half. Beyond that, it's like asking what's going to happen to the economy, so don't ask me to answer that.

Having said that, we have a very strong installed base of both hardware already in place for which consumables have to be purchased anyway, as well as a strong basis of single-use disposable products, so we expect that part of the business to continue.

The most important thing I think is, given how much we bit off four years ago due to which we eyed up in supply chain issues, and the fact that we have now fixed all of those issues really puts us on a very strong footing to regain customer confidence. We already see that happening and our customers are in fact confirming that

what we see in our own internal KPIs is in fact what they experience as well. So I think that should put us in a pretty good space.

PHILIP BOWMAN: Do you want to talk, Srini, just a little bit also about the SKU rationalisation programme and the timeframe, at least for the initial part of that?

SRINI SESHADRI: Certainly. As Philip pointed out, out of about 13,000 SKUs in what we call the tail, we're going after a first tranche of about 3,000. Probably around 2,000 of those by the end of April and then there are another 1,000 that are in what I call a contracts review, just making sure that there are no long-term contracts that are affected by us deleting those. So you can imagine that's a very orderly process that we have to follow to do the right thing with our customers. So that will follow and I expect that that will be done within our financial year.

Now, having said that, I think the most important value to come out of this profitability review is in fact pricing opportunities and other margin improvement opportunities. This is not so much about revenue deletion as it is about margin improvement. So we are focusing very, very heavily on how can we change the mix of our

business. And then if that permits us to consolidate manufacturing and other costs, then that's a bonus.

PHILIP BOWMAN: Srini, thank you very much. Yes, in the second row, please.

COLIN CROOK: It's Colin Crook at UBS. Can I just stay on the same point as Srini. The 3,000 SKUs, what is the revenue or those 3,000 SKUs? I mean, what are we talking about here? Are we talking 1%, are we talking 10%? Just give us an idea of what, over time, you would expect to lose in terms of revenue.

The second question relates to presumably there is a margin impact - a positive margin impact - of getting out sort of low-margin business. So what would you expect to happen to margin? I mean, you've got a lot of volume that presumably has some sort of negative -- some operational gearing impact, but just give us a feel for that.

More particularly also, the diabetes business you're getting out of, the £36 million of sales last year. Can you just give us a feel for what he hardware sales were in the first half which are presumably not going to happen in the second half so we can then have a feel for what the consumable element will be which will presumably roll over, over the next four years. I'll stop there; I've got another question.

PHILIP BOWMAN: I think Srini needs a microphone.

SRINI SESHADRI: Do you want to take the numbers down or shall I? The first question I believe was about the 3,000 SKUs and the revenue impact. We're going through that right now, so I don't think I can give you a very solid steer on exactly how much. Some of this contract review actually screws up that process of giving you an answer. We're going through that process right now; I wish I could give an answer.

COLIN CROOK: (overspeaking)

SRINI SESHADRI: I'm not prepared to do that right now. I can answer the diabetes question in a lot more clarity in terms of numbers.

PHILIP BOWMAN: Colin, the answer in the numbers, it is a very small percentage of revenues and the challenge that Srini has is that a lot of these SKUs we believe we can effectively transition our customers onto another SKU that fulfils the same purpose. So the approach to this is not simply saying we are going to discontinue these and accept the revenue loss, it is we are going to discontinue these but we have other products which are very similar. They may be as

similar as being the same product in a different colour, and we are going to transition, or try and transition, our customers on to those different products to minimise the revenue loss. But, you know, we are really up at what I would refer to as a couple of percentage points rather than a bigger number at this stage.

SRINI SESHADRI: It's not a massive number for a revenue-deletion point of view. With regards to diabetes, of the £36 million, £16 million is hardware and £20 million is the follow-on consumables associated with that. If I remember correctly, about £7 million is the impact in the second half. That's what we expect to lose in revenue.

PHILIP BOWMAN: In terms of loss of hardware sales.

SRINI SESHADRI: Yes, and of course the consumable volume will proceed and then we have modelled a steady decline in that over time, obviously, as the four-year warranty runs out.

COLIN CROOK: Is there any write-off or anything associated with the exit from diabetes? Is there any provision for …?

PHILIP BOWMAN: We've taken nothing in the first half of the year. There will be a small net charge in the second half of the year, which will be treated as exceptional.

COLIN CROOK: Okay. The second question is related to cash flow. John, you said that the debt at the end of the year will be roughly the same as the half year, which implies you're not going to generate any cash in H2 - you haven't got the dividend payment. The working capital should be a bit better in H23 - why?

JOHN LANGSTON: We do have exceptional payments that go out for restructuring, as you know, with some of the asbestos payments; we have tax payments. It's the usual list, actually, Colin, that I've given to you in the past. There's pension payments as well that go out. I think there's about £30 million to go out in the second half on pension payments.

PHILIP BOWMAN: That's easy, pass the microphone.

MARTIN WILKIE: Martin Wilkie from Deutsche Bank. Just going back to the Detection business. Obviously you've got this cargo detection investigation by the European Union from the Chinese competitors. Could you just give us an idea of how much of the

European Detection business was impacted by that, just to give us a scale and percentage of revenues. Also, are you worried that this could become a threat across other parts of the business? If this equipment or technology -- are we going to see some other issues over the coming years in other parts of that business?

PHILIP BOWMAN: Stephen.

STEPHEN PHIPSON: I think we should divorce what's going on with the complaint with what's going on in the market. So if we think about the market for cargo scanning at the moment, largely we have a very strong US markets with a CVP programmes there. We have implementation of HR1, the US 9/11 Act, which requires 100% screening by 2012, although I suspect that in terms of physical screening that will result in about 25% and the rest will be done through registered shipper programmes and that sort of thing.

We have Latin America, which is not quite there yet, but building large tender processes to go and build infrastructure out there, which is not impacted by what's been going on in the particular complaint that you referred to with the Chinese manufacturer. What happened in Europe is a number of initial deployments of Chinese equipment was done at, we believe, extremely low if not almost free prices and we believe that was unfair competition and

so therefore the commissioner is investigating it. We think that's a specific action. Do they try the same tactics in other markets? Of course they do. Many people won't allow them to do that. I think that this complaint actually tries to level the playing field, not just for Smiths Detection but for all of the competition that play in that particular segment of the market.

So I see that as somewhat a separate issue and I see the market generally looking quite good. The small problem we have at the moment in the economic climate that we have is that many of those infrastructure products have been put on hold. I'm actually going to Russia next week to see if the Russian Government -- I think they're just about to restart again after the first half of our year of doing absolutely zero, so we're going to start to see that picking up again.

So they've been through a reassessment period, but in many cases the fundamentals of that business are strong. There is the driver from the US, there's the driver to improve security at the borders and there is this harmonisation of border security and customs going on, which results in the use of non-intrusive inspection systems going forward, so we think the future is still strong, which is why we continue to invest in the research and development part of that business.

PHILIP BOWMAN: Stephen, thank you. Yes, in the second row here, thank you.

SANDY MORRIS: It's Sandy Morris speaking from RBS. A few things: just on the cash flow, which gets slightly convoluted because of the exchange rate movements, but on the balance sheet there's a bit increase in inventories, a big increase in trade debtors and no increase in trade creditors, which looks a little odd. You know, it's almost like you've been buying less because your activity levels are still quite subdued. Is that a fair assumption?

PHILIP BOWMAN: Yes. I mean, I think if you look at the trade creditors on the balance sheet, Sandy, at least one of the reasons is -- Stephen was talking about the lack of activity in the cargo-screening business within the EU and there is no doubt, you know, we are not buying at the moment the trucks that are necessary, we're not buying the linear accelerators that are necessary to do that. Whereas if you go back to this time last year there were substantial creditors for those sorts of purchases in there. So in terms of inventory we have a sufficient inventory to meet quite a number of future orders when those come around to being delivered.

We have looked very carefully at our purchasing and clearly, at this stage, we have cut back where we're able to.

SANDY MORRIS: That's what it looked like. The second thing -- that John Crane question earlier slightly foxed me because John Crane has changed. The only bit of Crane that I can remember bombing, so to speak, in the past - a technical RBS term - was actually the automative business that it ventured into. I always saw petrochem being quite robust.

JOHN LANGSTON: Maybe I could expand upon that a little bit for you, Sandy and Andreas. The old John Crane had quite a big automotive component. It also had a marine component and both of those we've sold off, actually, and they were more susceptible to the downturn than the core business that Paul now runs. In addition to that we've done a lot of restructuring of John Crane since the merger with Smiths, which wasn't really carried out under the TI ownership towards the end there. So we've made a lot of progress in changing the fundamentals of the business and Paul has now taken that a step further with further cost reductions.

The other thing I would add is the market has changed. In the late 1990s when it came up some of the OE business was actually given away. We don't do that any more, we actually charge for OE. So the fundamentals of the business are quite substantially different from the previous downturn to which you indicated the

substantial decline in margin. I don't believe that will happen this time.

SANDY MORRIS: Which actually just leads onto the next thing. The after market is described as stable and yet, in my dreams perhaps, I kind of imagined after all the OE stuff we'd shipped out in the last couple of years or three that maybe the after market might actually have some latent growth in it?

JOHN LANGSTON: Do you want to answer that, or Paul?

PAUL COX: I think, Sandy, the point would be that, yes, we've had a good burst of activity. It takes two to three years for us to see new products showing up in the after market stream, but you have to think of the installed base we've got. Most of these products are actually designed for a 20-year life. In practice they end up getting in excess of 20 years' worth of service out of them, so we're working against a fairly large installed base. So even with the uptake in activity we've seen in the OEM in the last couple of years, we're not talking about moving any grand percentages. In other words, you shouldn't expect the after market to be able to grow in double-digits rates unless you're getting a lot of price where you're taking a lot of share. And share is something you

have to work on progressively, so my answer to you would be, yes, we've had a nice burst of activity, but I think of this as kind of like a big water tank. We've got a spigot on the top and we're putting new stuff in but it's a very big water tank of installed base. It's hard to move that water tank in a tremendous way. So the word "stable" is intuitionally -- you know, it's low growth, and we still see growth in the after market.

PHILIP BOWMAN: I think, Sandy, maybe the choice of words, with hindsight, wasn't the best. What it was intended to indicate is that contrary to the OEM market where we have seen a recent weakness in the order profile, we're not seeing the same thing in the after-market part of the business, so stable mean no change really from what we were seeing before.

SANDY MORRIS: Okay, thanks. The other one is back to Medical - it's more idle curiosity. We're trying to get rid of 3,000 out of 13,000 slow-moving line items. How many line items have we actually got?

PHILIP BOWMAN: About 25,000.

SANDY MORRIS: Bloody hell.

PHILIP BOWMAN: Yes, that was rather my view, Sandy. The good news is we now know how many we've got, we now know what their profitability is and it's a challenge to start addressing this. You know, there's no point in trying to do the whole thing at once. We've started with what we regard as the e-SKUs, which are the slow-moving ones, and certainly we will make progress on that. But, you know, what I find is it's actually rather exciting because, you know, you save 25,000. At that point you really say there must be a lot of opportunity here over time, and there is, but we have to go through it systematically and we have to do it in the way -- particularly, Sandy, after the bad experience we've given our customers for the last two or three years with poor delivery. We have to do it in a way that doesn't upset them. So the data has been very revealing; let us leave it at that.

COLIN CAMPBELL: Colin Campbell at Société Générale. Just maybe start with your statement of current expectations being good -- just to check what they are. Are you believing an EBIT of £430 million for this year is consensus?

Secondly, just looking at the -- I'm a bit worried about -- you know, tendering activity is high. I just fear that it's purchasing managers trying to keep their jobs. When you look a your OE and hardware

backlogs at Medical and Crane and Detection, have you got sufficient backlogs to cover your expectations for H2 or do you still need more orders?

PHILIP BOWMAN: I think in terms of the order backlog, it depends how you look across divisions. I mean, if you look at John Crane, clearly we run an order book which is generally more than sufficient to cover you across the half year, so that is not a material issue. If you talk about a business like Medical, Medical does not tend to run a long-term order book. Orders come in and they get shipped almost immediately.

In the case of Detection, as Stephen has been at pains to emphasise, it is volatile. When we get orders in we build the kit, unless we have it in stock, and we ship it out as quickly as we can. So the bottom line from that is Crane we're well covered, but that's the only business really we have, with the exception of a military part of Interconnect, long-term order books that we can look to.

In terms of the consensus, John?

JOHN LANGSTON: Yes, the data is on our website, actually, so you can see all the information there if you take a look.

PHILIP BOWMAN: And the answer is?

JOHN LANGSTON: I think it's actually slightly higher than that. It's between £430 million to £440 million, I think.

COLIN CAMPBELL: Just one last point on asbestos. I thought we'd seen the end of that. There seems to be some readjustment on last year's number. There seems to be some readjustment on the asbestos provision from last year. I thought we had capped that. Is this generally another one-off?

PHILIP BOWMAN: No, what we said last year was we, for the first time, in addition to a historical provision for the litigation costs of asbestos, put on balance sheet what was an actuarial estimate of what was the liability in terms of adverse judgements might be on a discounted basis over the next ten years. The reason ten years was selected is that was as far as the crystal ball, or presumably the actuarial model of the experts who provided the analysis, would run. So there was an expectation that every six months we would do two things. Firstly we would true up the discount rate in terms of what was happening in terms of the US bond market, and clearly that hit us quite hard in the first half, but I don't believe the current bond spreads are going to be sustainable for a particularly long time, so that, I believe, will reverse. Secondly, the assumptions that get

into the model get updated each time and that process, I'm afraid is going to be with us every six months going forward.

What happens is we give our experts details of any new claims filed, any claims where we've had adverse judgements, claims where we've been struck out as plaintiffs. They put them into their model and they come back with a new answer.

Yes, in the fourth row.

SCOTT BABKA: Thanks, it's Scott Babka with Morgan Stanley. Philip, I was wondering if you could just talk a bit -- obviously some of these divisions are showing a bit more cyclicality than maybe initially presented. Do you look at this and look at contingency plans to be taking capacity out of certain end markets if the demand does not pick up in the second half, for instance, of 2010, because the margin targets are obviously much higher than where you're operating at currently?

PHILIP BOWMAN: Yes. I would go back and reiterate one of the comments I made in the presentation which is certainly in the best part of 30 years in business I can't remember economic conditions anything like as bad as this before. I would love to say things are going to get better in the next 6 months or even in the next 18 months, but I'm pretty sceptical at this stage. I think we are focused very much on

what I would refer to as the basic blocking and tackling to improve the efficiency of a business and bring down the cost base.

We talked a little bit in the presentation about the fact that we had closed a couple of facilities, for example, in Flex-Tek. We have other facilities that we will almost certainly be closing down as we look forward. So there is an ongoing process. We said last September £47 million of cost savings. Yes, of course we want to do better than that. What I think is encouraging is we are on track to deliver that. We've got very clear, well-documented plans to deliver it, and actually the amount of money we're spending to deliver it is probably a bit less than we had bargained on when we sat in September last year.

So I think the answer is : are we going to radically reshape the business. I think you have to believe at some point economic activity picks up. Our decision to continue to increase our investment in research and development is predicated on that assumption, but I personally am not expecting to see any great joy in the second half of this fiscal year or indeed in the next fiscal year. I'd love to be proved wrong.

Any other questions? If not, thank you all very much for coming here today, thank you for your questions and we will see you again in September.