

## CHIEF EXECUTIVE'S Q&A

### A SIGNIFICANT YEAR IN THE EVOLUTION OF SMITHS



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FY2019 was a significant year in the evolution of Smiths. We made further progress on our strategic plan – delivering continued, sustainable growth on the way to outperforming our markets. In this context of progress and confidence in the future, we announced plans to separate Smiths Medical to create two stronger, industry-leading companies with distinct strategies and focus.

In this review of the year I address some of the key questions our stakeholders have been asking us during this important time for the Group, and the exciting value creation potential we have at both Smiths and Smiths Medical.

**Q For those new to the Smiths story, or who haven't followed the Group that closely, can you set this year's results in context?**

**A** Back in 2016 we set out our vision to transform Smiths and, since then, we've been through a programme of extensive change and development. We defined the types of businesses we believe we're good at running and targeted them in attractive markets where we can achieve a top three leadership position. We put in place the building blocks that will support sustainable growth above our markets. We focused on driving relentless execution through our Smiths Excellence System (SES) shared operating model, and sustainable competitiveness through targeted investment in innovation. Through our global People Plan, we are investing the right way in our people – our most valuable resource – to deliver best performance.

Last year, we returned Smiths to growth for the first time in five years. We have built on that return to growth this year with underlying revenue growth of 3%. Our growth is now in line with the markets that we serve which, in aggregate, grow around 3% per year; and we are on our way to outperformance.

Importantly, this growth is coupled with enhanced margins. Our margins have improved by 300bps since 2016 and we strongly believe that, in time, Smiths can deliver margins of between 18 and 20%.

It was against this context of progress, and our confidence in the future, that we announced plans to separate Smiths Medical.

**Q Why have you chosen to separate Smiths Medical now?**

**A** There are three fundamental beliefs driving the separation of Smiths Medical.

Firstly, it will create two stronger, industry-leading companies with distinct strategies, focus, and management teams. Secondly, it will enable us to concentrate on growing the Smiths business as a leading industrial technology group, united by its shared business characteristics and common operating model. And, thirdly it will allow Smiths Medical to capitalise on its leading positions, large programme of new product launches, and value creating opportunities in what is a rapidly changing market.

> Our plan will provide immediate clarity through a separation of the two businesses, with the overriding objective of maximising value for all our stakeholders.

Smiths Medical has some great leading brands, positioned in attractive markets. Approximately 80% of its revenue is recurring; it has gross margins of over 50% in all segments; and it routinely delivers high cash conversion. Its challenge had been underinvestment, but we've been working hard to address that, with average investment in new products up 40% in the last four years.

This targeted innovation spend has driven the launch of 33 new products in the last 24 months, and their increasing contribution is a key factor in Smiths Medical's successful return to growth in the second half of FY2019.



**OUR PLAN WILL PROVIDE IMMEDIATE CLARITY THROUGH A CLEAN SEPARATION OF THE TWO BUSINESSES, WITH THE OVERRIDING OBJECTIVE OF MAXIMISING VALUE FOR ALL OUR STAKEHOLDERS."**

Returning to growth was a key milestone for Smiths Medical, as was the appointment of JehanZeb Noor as CEO. JehanZeb is an impressive leader, with an intimate understanding of the MedTech industry and a strong track record of delivering growth and enhanced performance. I'm sure that he will be a great success as the company builds a strong, sustainable future.

The other significant point of progress achieved by Smiths Medical this year was the submission of its new large volume pump to the US regulators for first phase review. This has been a long-term project that represents a significant opportunity. Global sales of large volume pumps and dedicated consumables are approximately £2bn per year and Smiths Medical currently does not participate in this segment.

I am sure you can see why I have such a strong conviction in Smiths Medical's attractive future as a standalone business.

#### **What is your strategy for future Smiths?**

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Our ambition is to count ourselves amongst the world's elite industrial technology companies. Based on the superior quality of our businesses I believe that is eminently achievable.

Over the last four years we've been gradually reshaping the Group, organically and inorganically. Our businesses share the same four characteristics which embody how we create value – differentiated by their technology; with increasing digitisation; that are asset light; have a high proportion of aftermarket and services; and are targeted in growing markets where we can achieve a top three leadership position.

We actively manage our investment decisions with these business characteristics in mind and, over the last three years, we have completed 18 transactions with a total value of £1.4bn, supporting the continued strengthening of the portfolio. As a result of the organic and inorganic actions we have taken, over 90% of the Group is now well positioned.

Having honed the portfolio, we then focus on running our assets as effectively as we can through excellence, innovation and people. Consistent and robust execution is the difference between just a set of good assets and a good set of assets delivering consistently great performance. This is at the heart of SES, which is driving tangible improvements in our working capital, productivity and cost metrics; with significant potential still to come.



**CONSISTENT AND ROBUST EXECUTION IS THE DIFFERENCE BETWEEN JUST A SET OF GOOD ASSETS AND A GOOD SET OF ASSETS DELIVERING CONSISTENTLY GREAT PERFORMANCE."**

- > As a technology company, innovation is critical to our sustained success. To support that we've increased Group-wide R&D spend by 25% in the last four years. To be effective and drive higher sales, investment needs to be commercially targeted and quick to market. We use our Vitality Index as a barometer for new product introduction success. The index currently stands at 13% and our ambition is to reach 20% in the medium term.



**I PASSIONATELY BELIEVE THAT PEOPLE AND LEADERSHIP IS OUR SINGLE MOST SUSTAINABLE DIFFERENTIATOR. WE'RE BUILDING A LEARNING ORGANISATION AND ARE FOCUSED ON DIVERSITY AND INCLUSION AT ALL LEVELS TO MAKE SURE WE ATTRACT, RETAIN, DEVELOP, ENGAGE AND INSPIRE THE VERY BEST PEOPLE."**

As I've said before, I passionately believe that people and leadership is our single most sustainable differentiator. We're building a learning organisation and are focused on diversity and inclusion at all levels to make sure we attract, retain, develop, engage and inspire the very best people. At the end of the day, it is Smiths people who drive excellence and innovation. Without the very best, our strategy just isn't achievable.

Our approach is underpinned by a strong financial framework. We're an asset light business, which is highly cash generative, and has a disciplined approach to leverage, and all capital allocation decisions. This supports our ability to generate long-term sustainable growth and superior returns.

**Q What are the capital allocation priorities for the Group going forwards?**

**A** Cash generation and a strong balance sheet are both trademarks of Smiths, but they're not ends in themselves. They go hand in hand with disciplined capital allocation, which we apply to all the investment opportunities we have.

Re-investment in organic growth remains priorities one, two and three. We will then complement organic growth with disciplined M&A to create additional value. Our most recent example was the acquisition of United Flexible, which strengthened Flex-Tek's position in aerospace and industrial markets globally. Acquisitions such as United Flexible can help us to access new technologies or new markets which we may not be able to reach as quickly through organic investment channels.

And we will continue to use our cash generation to pay a secure and progressive dividend.

**Q What could derail your strategy?**

**A** Our biggest challenge remains pace. We're pulling a lot of levers throughout the Group to enact change but seeing the full effect of that change takes time. I'm very pleased with the progress that we've made so far, and I am excited about our continued trajectory of improvement and the huge potential we still have to go; but, as with any Chief Executive, I'm keen to see the full effect of our transformational strategy coming through as fast as it can.

**Q How is the Group positioned for FY2020?**

**A** In FY2020 we expect to make further progress, with year on year growth weighted towards the first half and resulting in a more even balance in overall performance between the first and second halves. At current rates, foreign exchange will provide a tailwind to revenue and profit.

We remain on course to grow faster than our markets over the medium term. Our strategy is to focus the portfolio for growth and deliver world-class competitiveness, within a strong financial framework. The Board remains confident that this will drive long-term sustainable growth and attractive returns.

**Andy Reynolds Smith**  
CHIEF EXECUTIVE