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PRESENTATION

Jemma Spalton ***Smiths Group plc - Director of IR***

Good morning, everybody, and thank you very much for joining us for the Smiths Group 2019 annual results presentation. My name's Jemma Spalton, I'm the Director of Investor Relations. And as usual, if you wouldn't mind just spending a moment digesting the disclaimer slide. There aren't any planned fire alarms this morning. So if they do sound, you know where the exits are. And it's with my great pleasure that I hand over to Andy Reynolds Smith, Chief Executive.

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

Morning, everyone. Really nice to see you and thanks very much for being here. Much appreciated. I'm pleased to be joined by John Shipsey, our CFO; and also to introduce JehanZeb Noor, the new COO of Smiths Medical. So JehanZeb, welcome once again.

John's going to start by taking us through our 2019 results and also the outlook. JehanZeb would then give you an update on his initial impressions and plans for Medical, before I finish with a strategic update on Smiths' industrial technology.

2019 was a key year in the evolution of Smiths and another good year of growth. It was further evidenced of the progress that we're making against our strategic plan and the real potential of the business in the future. And we're off to a good start this year, too.

Building on our return to growth last year, we delivered underlying growth of 3%, 5% with M&A and 7% on a reported basis. Importantly for me, this growth was coupled with enhanced margins at 17.1%, up 40 basis points, continuing our improving margin trajectory.

Sustained above-market growth is, of course, key for us. Coupled with strong margins, attractive returns, they're the fundamental features of the leading industrial technology company that we've positioned ourselves to be.

I'll take you through our progress and the group's future in a bit more detail later on, if I may. But for now, I'll hand over to John to take us through the 2019 results and the outlook. John, please.

John F. Shipsey ***Smiths Group plc - CFO & Director***

Thanks, Andy, and good morning, everyone. As you can see, we've successfully delivered on expectations. And for me, that's significant for 2 reasons: We're building a track record of consistent execution and we're advancing on the bigger goal to outperform our markets. As Andy said, this is an important strategic year for Smiths, and you'll hear later about the good progress we are making towards demerger of Medical.

There's one presentational change I need to flag as a consequence. Medical's results are now accounted for as discontinued operations, businesses held for distribution to owners. That means you'll see one line in the group P&L for Medical's profit after tax. So with that clarification, let's move on to the financial highlights.

Sustainable growth was our stated ambition, and we delivered on that. Revenue grew by 3% underlying and 7% on a reported basis. Importantly, operating profit grew even faster, up 4% underlying and 10% on a reported basis. We increased operating margin up 40 basis points to 17.1%.

In Medical, we're successfully drawing a line under the disruption of last year. Whilst its profit after tax of GBP 112 million was down 3%, the key thing is that we returned to growth in the second half and we're setting up a strong platform for the future.

All of the above is evidenced in the bottom line performance with total group EPS up 3% underlying and 7% on a reported basis. On cash flow, we have continued to make good underlying progress, although this was obscured by year-end factors, which are already reversing. I'll talk more about these in a moment.

So overall, good results in line with expectations. And this, alongside our confidence for the future, is reflected in the proposed dividend increase of 3%.

Let's move on to look at the results in more detail. We're starting to demonstrate a track record of consistent top line growth. Overall reported revenue was up 7% or GBP 170 million to GBP 2.5 billion. Favorable translational FX contributed GBP 57 million with most of the impact coming from a stronger U.S. dollar.

Acquisitions and disposals added GBP 43 million or 2% to reported revenue. The principal elements were the disposal of bearings and the acquisitions of both Seebach and United Flexible. And most importantly, that left underlying revenue growth of GBP 70 million or 3%.

So let's take a closer look at how we delivered that by division. First off, you can see a standout performance from John Crane, up 8% for the year, including a remarkable 13% from original equipment, but also underpinned by consistent delivery of aftermarket revenue, up 5%.

In Detection, we saw a strong second half but not as strong as anticipated because of customer deferral of deliveries into the first half of 2020. Total revenue was down 2% for the year. Aviation, which makes up 2/3 of Detection, was down 6% against a very tough comparator of plus 20% last year.

Given the programmatic nature of this segment, you have to pull the lens back to properly read its performance. The compound annual growth rate for aviation over the last 2 years has been around 6%. But the really key thing for me is that from an orders perspective, aviation is in really strong health evidenced by significant wins, including the brand-new checkpoint CT conversion in the U.S. and hold baggage in Spain, Detection's largest single contract win ever. Meanwhile, revenue from other security systems rose 6%, primarily reflecting continued recovery in Ports & Borders.

Turning to Flex-Tek. It performed well and delivered as reliably as ever, with underlying revenue up 3% and 23% on a reported basis, including GBP 56 million of incremental revenue from United Flexible, which we acquired in February.

And finally, Interconnect also performed well, reinforcing its return to growth with underlying revenue up 3% driven by Defense and aerospace. So good underlying revenue growth which we then converted into higher profit growth, delivering again on expectations.

Overall reported operating profit was up 10% or GBP 39 million to a total of GBP 427 million. Favorable translational FX contributed GBP 11 million, thanks to the strong dollar, and acquisitions and disposals added GBP 13 million or a further 3% growth. That left underlying profit growth of 4%. We continue to evolve our center-light operating model as evidenced by the GBP 6 million reduction in central costs.

Let's turn to look at the rest of underlying profit growth by division. The performance of John Crane stands out strongly once again. Operating profit grew 6% at the margin of 23.3%, up 40 basis points. Profit conversion benefited from the disposal of bearings but was also held back by a higher mix of OE and investment in capacity to meet demand.

Detection delivered a robust 16% margin performance and this was despite customer deferral of deliveries into 2020 as well as the mix between aviation and other security systems, and competitive pricing in the latter stages of the European upgrade cycle.

Flex-Tek continued to deliver consistent good performance in terms of profitability, too, with operating profit increasing 4% and a margin of 19.2%, up 30 basis points.

Finally, Interconnect, built on the successful repositioning and restructuring of the past 2 years, with operating profit up 6% and margin up 60 basis points to 14.7%, a really strong performance.

Turning next to Medical. As I said at the start, we are successfully drawing a line under the disruption of last year. Full year revenue was flat, but critically, we delivered growth in the second half. Prior year comparators were favorable as the European regulatory issue broke in the fourth quarter of fiscal '18, but we also saw an increased contribution from new products and recovery of distribution for our COPD range.

Profit was down 6% for the full year, impacted by operational inefficiencies as we worked our way through the disruption of fiscal '18. But again, and importantly, the second half saw growth with profit up 2%. Margins also stabilized and represent an opportunity that JehanZeb will speak more to in a moment.

So stepping back, we're building a strong platform for the future. We're on an improving trajectory, and that's a key milestone on the road to demerger.

Turning next to cash flow. We've continued to make good underlying progress, although this was obscured by year-end factors which are already reversing. Let me explain.

Free cash flow of GBP 234 million was down GBP 68 million from GBP 302 million the previous year. A GBP 34 million increase in tax payments was primarily caused by timing differences in the U.S. But this was offset by other positives, including lower pension and nonheadline outflows. The real issue was a reduction of GBP 64 million in operating cash flow, and within that, a GBP 104 million increase in year-end working capital.

During the year, the average ratio of working capital to sales stayed constant at 26% and we made good progress, for example, in reducing the DSO/DPO gap by a further 3 days. However, the year-end position was negatively affected by 2 timing factors. Firstly and most importantly, strong sales in June and July caused an increase of over GBP 70 million in receivables, which did not fall due until after year-end. And secondly, we've built inventory in Detection for orders, including for U.S. checkpoint, which were unexpectedly deferred to the start of the new year; and in John Crane, for OE projects.

To be clear, both of these issues are now already reversing. Cash conversion has averaged above 100% for the past 4 years. This is still our benchmark. We will quickly revert to trend.

You can see here that we continue to maintain a strong balance sheet. Net debt was GBP 1.2 billion, and we ended the year with a net debt-to-EBITDA ratio of 1.8x after incorporating the United Flexible acquisition. We redeemed the last of our higher coupon notes at the start of fiscal '19, leaving an average debt coupon of 3.2% and no further maturities until 2022.

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 applied to all the investment opportunities that we face.

Reinvestment in organic growth remains priority 1, 2 and 3, as you will have heard Andy say many times. The clearest evidence of this is R&D spend, which grew to 4.5% of sales in the year, an increase of GBP 15 million. But it's not sufficient just to spend more. Higher R&D needs to translate into higher sales, hence our increasing focus on vitality as a measure of organic reinvestment.

We complement organic growth with disciplined M&A to create additional value. We're very mindful about acquisitions and look at them through strict strategic and financial lenses. During the year, we acquired United Flexible, thereby strengthening Flex-Tek's positions in aerospace and industrial end markets.

And finally, we use our cash generation to deliver a secure and progressive dividend to our shareholders. The dividend increase of 3% evidences our confidence for the medium term.

So to summarize and cover the outlook. In 2019, we delivered a good performance in line with expectations. Looking forward to 2020, we expect a year of further progress. Growth will be weighted more towards the first half, and in absolute terms, you will see a more even balance between H1 and H2.

Our view is supported by strong order books in Detection and John Crane, but we're also alert to external changes in the economic cycle with some early indications of a slowdown in U.S. housing for Flex-Tek and in semiconductor for Interconnect.

At current rates, foreign exchange is expected to provide a tailwind to revenue and profit. We will continue to improve operational excellence and cash generation. Recent performance underpins our confidence and progress towards the goal of outperforming our markets.

And on that note, let me now hand back to Andy who's going to share an update on the Medical demerger.

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

Thanks very much, John. As you can see, we believe the spinnaker is up and flying, and we're confident of another year of progress.

Based on the progress we've made and our confidence in the future, the timing was right to announce the separation -- the planned separation of Smiths Medical, with the overriding objective of maximizing value for shareholders and bringing strategic clarity to Smiths Group and Medical. The process is going well and we're on track to complete by the end of the first half 2020.

In March, I set out some key performance milestones for Medical, all of which we've achieved. We committed to delivering growth in the second half with a strengthening trend in margin, and we've delivered on both. This improved trajectory is what we're looking to build on as we prepare for the separation of the business.

Medical's improved second half revenue and margin performance was underpinned by the ongoing launch of new products and actions to improve sales effectiveness.

As you know, the most significant new product in the pipeline is our large-volume infusion pump. This has now been submitted to the FDA for their approval. The LVP market is going to be a big expansion to our total Infusion Systems market, increasing it by more than GBP 2 billion to close to GBP 10 billion overall.

And finally, having the right team in place for Medical is critical. I'm really pleased that JehanZeb joined in July and to have attracted such a high-caliber leader for the business. He's got an intimate understanding of the medtech market and a strong track record of delivering accelerated growth and enhanced performance.

As you will hear shortly, JehanZeb is formulating detailed plans to support Medical delivering on its full potential. We're making good progress on the key separation work streams, and we see no major roadblocks.

I'm now going to have hand you over to JehanZeb who's going to take you through the progress we're making on Medical's improvement plans and his future thoughts. Over to you, JehanZeb.

JehanZeb Noor ***Smiths Group plc - CEO of Smiths Medical***

Thanks very much, Andy. Be very happy to be here today. I would like to take a moment to introduce myself as this is our first time together.

So as Andy said, I joined as CEO of Smiths Medical in July of this year from Amcor Flexibles, where I head the Healthcare North America business as well as Global Sales for Medical totaling to about GBP 1.2 billion, serving device companies with their sterile packaging needs. At Amcor, I was able to build a strong team and transform their business, achieving 10% annual growth and 30% margin expansion. So you can think of me as someone who will help accelerate the transformation of Smiths Medical.

Before Amcor, I was at McKinsey & Company for about 9 years, and I left as a partner in the industrial's practice, also leading business transformations. My initial training was as an engineer and as an inventor of patented commercial technologies, so you would understand that being in this venue today also makes me very happy.

So what you get in me is a combination of rigor, creativity and the track record both to take Smiths Medical forward and also help the company meet its full potential.

At Smiths, like John mentioned, there has been a lot of good work done already to lay a solid foundation for the future. What I'm most excited about personally is my Medical team. We have strong talent and several areas of excellence to build on. And I've seen these areas of excellence in my visits to our R&D centers, over half of our production sites and several sales offices across 3 different continents. So let's talk a bit more about my view of the business.

There are 3 characteristics that I clearly see at Smiths Medical. First of all, we have standout brands in growing and attractive markets. Secondly, as you know, we have invested a lot in a healthy pipeline of new products. And thirdly, equally importantly, our business is underpinned by strong financials. I'm going to cover each of these in a bit of detail.

When I go and meet customers or our industry partners, I'm constantly reminded of our iconic brands that are clinically preferred by several providers. One example would be the CADD-Solis ambulatory pump, which is a world-leading product.

We are serving a market that's about GBP 7.5 billion and growing, helped by factors such as an aging population across the globe, the rise of chronic diseases and growth in emerging markets. As you well know, our markets are regulated and expertise in regulatory processes is critical. At Smiths Medical, we have built a strong regulatory team and we're in the process of strengthening this team and their capabilities further.

Let's now talk about how we are positioned for growth. You know that we have made a lot of investments into our future but our biggest talent starts with -- our biggest asset starts with our talent, and I'm committed to building a world-class leadership team supported by a well-functioning management process.

Foundations have been laid with significant increases in R&D to deliver a cadence of new products. As Andy mentioned, our large-volume pump takes our addressable market to about GBP 10 billion. And the FDA is reviewing our file as I speak, which is great news for us. So now it's all about targeted and flawless execution as we commercialize both new products and services.

And last but not least, as you know, over 80% of our revenue is from recurring consumables and the large-volume pump solidifies this revenue stream. We deliver healthy gross margins across all our product segments, averaging at about 50% or higher, and our cash conversion is strong at 90% or above, which continuously feeds the R&D engine.

I also clearly see additional upside beyond what I'm speaking about today, and overtime, we'll earn the right to capture that upside. Let's cover in a little bit more detail how we will sustain our growth trajectory.

Organic growth is our priority and as you would have heard Andy say multiple times, in the last 12 months, we have overcome several disruptions and focused on growth. Our business grew 2% in the second half of fiscal year '19, so the first step is to continue that trajectory and deliver full year growth followed by an acceleration of sustained growth to meet at or above market rates.

In order to drive market-level growth, we are focused on -- focusing on commercially-focused new product introductions and expanding our addressable market. There are 4 levers that I'm pulling to deliver on our growth strategy.

The first one is new product introductions and commercialization. As you well know, we have the right to play and the right to win in the infusion space. We are upgrading our suite of pumps. We are also seeing positive results from other new products, for example, our connected -- convective blanket warmers for Vital Care.

We are identifying unmet customer needs and applying a strong regulatory process in our new launches. I'm also delighted to share that we are exploring both technology and manufacturing partnerships to enhance our portfolio and meet unmet customer needs globally. We will update you on this progress in due course.

The second lever is general expansion, which is another way of expanding our horizon. We're starting to look at over-the-counter opportunities for sales. Moreover, we have been successful with new respiratory products by going direct in nonacute alternate sites for conditions such as chronic obstructive pulmonary disease, also known as COPD.

Furthermore, and this is quite exciting, we have seen double-digit growths in geographies like India by going direct, and we are now exploring where else could we take that model to see similar growth.

Which leads to geographic expansion. We are increasing our talent, our footprint and our entrepreneurship in emerging markets from Latin America to Asia. And number four, as the foundation, is commercial excellence, which is critical to growth and to fulfilling customer needs. We are sharpening our toolkit whether it's key account management, pricing or sales force productivity.

Now the additional good news is that we can go after this growth while strengthening our margins, as John alluded to. It is very clear to me that there are near-term tangible margin opportunities, and I strongly believe that we can return to operating margins of 20% or above, and we are ready to pursue this now.

My team is developing plans for efficiencies across procurement, manufacturing and supply chain processes. We have already started to improve our strategic sourcing process both across direct and indirect spend categories, and we are also starting to collaborate more with our supplier partners. We have kicked off pilots in our major production sites for lean manufacturing.

And when it comes to supply chain, we are relentlessly focused on reducing inventory levels, improving demand forecasting and improving our service levels to customers. But we are not stopping there. We are also enhancing accountability in our business unit P&Ls, while optimizing our G&A and organizational effectiveness. These are also levers that I have pulled in the past to deliver margin growth.

John talked about some of our operational inefficiencies that have affected margins over the last fiscal year. The good news is all of these are fixable. The key driver to fixing our inefficiencies is a tried and tested leadership team. As I mentioned, we have a strong talented team in Medical. I'm reorienting and refocusing this team. I've also recruited new talent to help deliver at pace. In addition, we now have a nimble transformation office set up to remove any hurdles.

Now all this work enables us to maximize operating leverage that will come from our improved volumes as we sustain growth. Of course, there might be some investments and costs to support this first phase of operational improvements. We will update you on these as our plans further develop. So let me provide you a recap of what I see and where we are.

We can say that Smiths Medical is a good business and a great industry. For me to get this business to great, I'm focused on structuring the enablers and some of these enablers were already underway before I joined Smiths Medical.

As I said, I'm reorienting and building a world-class leadership team to help drive Smiths Medical forward as a separate stand-alone company. I'm increasing the accountability of our P&L business units by establishing a decentralized general management structure in the regions. I'm ensuring that the organization is incentivized and supported to deliver the best performance that it can. And as we have said, we're also investing in our functional capabilities and organizational health to increase ownership and meet our tremendous potential.

So there's lots to go for and as you can see, there's lots going on. The one thing I can tell you is that the entire Smiths Medical team is super energized by the future, focused on delivering now. And most importantly, they're inspired by the mission of improving and saving several millions of lives from babies to the elderly. And this is why I am passionate about the medtech industry, it's due to this purpose.

So as I've shown today, I believe that at Smiths Medical, we have iconic products, a healthy pipeline, a talented team that's getting stronger and a line of sight to improving both our performance and our health. And I'm most focused on serving, first of all, our patients; second of all, my team and my extended team; and delivering on Smiths Medical's potential.

So in essence, I look forward to continuing this dialogue with you in the future as we continue this exciting journey.

I'll pass it back to Andy now. Thank you all very much.

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

Thanks, JehanZeb. Nice job. Very clear. As you can see, Smiths Medical is on track to deliver on its full potential but so is Smiths. Over the last 4 years, we've been through a program of extensive change and development at an operational and portfolio level, and I'm really pleased with the progress that we've made. And I'm feeling good.

Smiths is a focused market-leading industrial technology company, well positioned for elite performance. As you know, it starts with the characteristics of the businesses we like differentiated through technology, increasing digitization, operationally excellent and asset-light and a high proportion of aftermarket and service, which for me leads to high customer intimacy and through life support.

We actively manage our portfolio to make sure our businesses are targeted in growing markets where we can be competitive and achieve top leadership positions. Then it's all about operational excellence and relentless execution to maximize the value potential of the business. We drive that through the Smiths Excellence System. It's our group-wide operating model with innovation at the heart of everything we do.

These operational and financial measures form the basis of our management plans, our drive for performance and our incentivization. Following the separation of Medical, these targets remain in place.

Over the next couple of slides, I'd like to take you through the evidence of the progress we've made and the significant ongoing potential that we're on track to deliver.

Starting with portfolio strength and positioning. We actively manage our organic and inorganic investment decisions to support this. 60% of our business was well positioned 3 years ago and now it's 90%. Portfolio review and disciplined capital allocation is a dynamic process and you can expect this to continue.

We've delivered this improvement through targeted organic investment paid for by ongoing operational improvement. The group's R&D has increased by 25% over the last 4 years. And we're measuring the effectiveness of this increased investment through our vitality index, which tracks revenue from products launched in recent years as a percentage of the total revenue across the group. It currently stands at 13%. Our aim is to get that to get better than 20%. Just as a reminder, it was mid-single digit only 3 or 4 years ago, which was one of the reasons that we failed to grow for so many years.

With an accelerated repositioning of the portfolio through our disciplined approach to acquisitions and disposals, we've completed 18 transactions since 2016 with a total value of GBP 1.4 billion. These have been accretive to growth in margins also. We look for acquisitions that can fill capability or technology gaps and gain us access to new markets or geographies, plus speeding up the delivery of our goals.

Flex-Tek's acquisition of United Flexible in the year is a good example of this. The deal strengthens Flex-Tek's position in commercial and military aerospace, creating a stronger product range. It also helped us grow our position faster in Europe where Flex-Tek has been historically very small. We have a pipeline of further opportunities across the group but we'll, of course, be remaining highly disciplined. Organic growth remains our top priority.

Positioning the portfolio to make sure we have leading businesses in attractive growing markets is clearly important, but a culture of operational excellence and innovation is what creates our competitive advantage. Our aim is simple: World-class operational excellence.

Central to this is a high cash flow yield on assets, which remains key to the investment case for Smiths and our ability to continue to invest in the future. We're committed to our medium-term target to improve working capital from 26% to 20%. This will yield around GBP 150 million of free cash flow. The single-biggest lever within this is improving stock turns to 6x.

There are a handful of large outlier plants still operating below our expectations, but elsewhere, we're making good progress with average turns of 4.7x in those plants in 2019. Key areas of focus to drive this includes our sales and operations planning processes, which really supports customer demand accuracy, which is matched to supplier scheduling and to production planning.

It's also critical we further develop our supplier network efficiency and capabilities. This improved efficiency, of course, reduces delivery times and improves quality for happier customers.

The real driver of these improvements is people. And we now have more than 300 green and black belts trained globally and graduated, and we've had some amazing graduation events, which will start to increase to more than 1,000 by the end of 2021. The start point 2 years ago was less than 20.

On innovation, we've launched some amazing new products in all divisions and have secured significant new business wins as a result. You may have heard the term CTiX, it's one of our most important product developments within Detection. And it's the new CT hand baggage scanner, which enables passengers to keep their liquids and laptops in their bags, and hopefully making your passage through the airport a little bit easier than it currently is. And it's fully integrated into the airport threat detection ecosystem.

It's a worldwide platform, too, and it's the best in the market. These systems have already been ordered by airports in Korea, Japan, Australia, and the TSA in the U.S. recently placed one of our biggest-ever orders valued at more than $100 million. Major trials are also underway at large airports in Europe, including Heathrow.

Many of our market-leading hardware platforms are increasingly developing as digital solutions. Our Digital Forge, a global center of excellence in San Francisco, is now an integral part of our global organization. And it's accelerating our digital agenda bringing world-class capabilities to complement our divisions on multiple programs in key areas such as artificial intelligence, cybersecurity and cloud data management.

An example of this is the John Crane Sense product, which improve efficiency of a refinery or processing plant through condition monitoring, but it also improves the environmental performance of our customers' operations. We now have more than 70 of these pilots running in large processing plants around the world. Our innovation is supporting ESG-focused product developments across the group.

John Crane has also developed seals that help to conserve water, energy and reduce methane emissions, including their Aura dry gas seal, which is targeted at substantially reducing the methane emissions currently burned off in flares at oil refineries.

Operational excellence and innovation are at the heart of everything we do, and those support the improvements that you can see in our financial performance. Our target is clear: It's to outperform the markets we serve. We're already growing in line with those markets, and we have a trajectory of improving growth.

Coupled with this growth is enhanced margins. Our margins are up 300 basis points since 2016 despite 100 basis point per year headwind of increased R&D during this period. We believe that the group can consistently deliver overall margins in the 18% to 20% range, and we can see a clear path how to get there. Crane and Flex-Tek already are, and Detection and Interconnect are making solid progress.

As you know, strong cash generation is central to Smiths. As John said, over the last 4 years, we've delivered an average of 102% cash conversion and this is set to continue, supported by our business fundamentals. Coupled with this are strong returns on investment. We're driving good underlying improvement in returns towards our goal of delivering ROCE between 16% and 18%, including offsetting the dilutive impact of acquisitions, such as United Flexible and Morpho, which are investments that will, over time, generate superior returns and growth. Over the last 4 years, our ROCE has improved 13.7% to 15.7%, all of which is helping us to drive long-term sustainable value.

If I step back, we've significantly improved the positioning of the business and the structure of business -- of the business in recent years, and I'm really pleased with the progress that we've made so far. But we do know there's an awful lot that still needs to be done. We're not finished. We're not complacent either to the global economic environment but our confidence in delivering on the group's potential long term is high.

Thank you. We're really happy to take questions now.

QUESTIONS AND ANSWERS

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

We've got 2 microphones on the either side. So we've got Mark down here, I believe.

Mark Davies Jones ***Stifel, Nicolaus & Company, Incorporated, Research Division - Associate***

Mark Davies Jones at Stifel. A few things, if I may. Can I start on Medical? Surprise, surprise. In terms of the operational outlook, I can see what I believe is you're referring to. But more structurally on that Medical business, it's still a very diverse set of specialisms. Do you think you all need to be bigger or more specialized in what you're focused on? Are you too broadly spread in that business?

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

Yes, go ahead JehanZeb, please.

JehanZeb Noor ***Smiths Group plc - CEO of Smiths Medical***

So thanks for the question. As we look at our portfolio, right, the underpinning strength is the growing nature of the market, the mega trends, et cetera. Now those driving factors are true across our portfolio, so that's helpful to us. Now if you look at it 3 different ways, Vascular Access and Infusion Systems are very complementary. They're basically products that go together to deliver medication to patients, and that's where we have leading brands and significant scale. If you look at Vital Care and specialty, they tend to be more stand-alone products that stand on their own feet and are successful in the market. Our immediate focus first is to improve the performance of the business, both margin and get it back to sustainable growth, and then down the line is when we will look at different portfolio decisions.

So to answer your question, to sum it up, we're happy at the portfolio as it is. We see a lot of potential organically and improving it, and we don't see any issues on the scale and what we have so far. So after we have achieved that improvement, we will look at more strategic decisions.

Mark Davies Jones ***Stifel, Nicolaus & Company, Incorporated, Research Division - Associate***

Okay. And elsewhere in the group, can I just ask a couple on margins? Firstly, Crane, there's has been some investment both to handle the growth and to step up R&D. Has that peaked out now? Do you think we see more operating leverage potentially at Crane from here? And then on Detection, you did refer to increased competition on some of these more recent European wins. There were some big chunky contracts you've recently won. What's the outlook for profitability at Detection?

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

Okay. Well, I'll take Crane first, and you're right, during 2019, we had 2 drags on margin despite the strong growth. The first of those was operational inefficiencies as the volume ramped strongly. And the second was investment in increased capability really to stay ahead on a product basis and a sales basis on a global basis. As we go forward, those inefficiencies operationally have now largely abated, so that drag has gone, which would lead to better gearing going forwards. The investments, we need to continue to pay for. So I mean I was very happy with the 23.3% that we came up with, very strong year. And that big chunk of drag has now largely finished from an operation perspective.

I mean the Detection one is a really interesting one because, I mean, it's an attractive market. We're the #1 in it, and the opportunities there are huge. But as you know, in the airports business, which is about 2/3 of the total, which we grew 6% over the last couple of years in, is now coming towards the end of the European upgrade cycle that finishes in -- CT upgrade cycle that finishes in 2021. And it's getting tough at the end, which is really what I was referring to and John was referring to. However, you also have noted the first tranche of the U.S. TSA upgrade cycle for Checkpoint CT has now started, and we won all of it despite a rather frustrating 90-day delay when a competitor appealed against us, which was part of the driver for the cash at the end of the year. But positively for me, there's also in prospect now an upgrade cycle on the checked baggage CT that got upgraded after 9/11. We don't know precisely when that'll start. So there are other layers coming in as the European cycle runs out, and that's a feature of that business going forwards. I think that would sum it for me. Alex?

Alexander Stuart Virgo ***BofA Merrill Lynch, Research Division - Director***

It's Alex Virgo, Bank of America Merrill Lynch. Couple of questions, one on Detection. Through last year, you had quite a lot of movement in Ports & Borders. You obviously had some market share issues. Do you think you're now fully through those? I think going forward, it's probably a mix, negative, but obviously we'd like to see you resolve the market positioning issues. So that's on Detection.

And then on cash, your ambition on inventory turns has been in place since you started. I think you had a good initial dent and then it looks like it's plateaued. Given you've got a -- you said a couple of those larger plants are responsible for that inventory turn, what exactly can you do to address that because as a somewhat removed observer, I suppose, GBP 150 million is something you've talked about for a while, and going from 4.7 to 6 is obviously quite a big ambition. What's the time frame? What can you do to deliver that? And perhaps just comment on that kind of lack -- loss of momentum.

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

Okay. Thanks, Alex. John, do you want to take the cash and inventory point and then I'll take Detection?

John F. Shipsey ***Smiths Group plc - CFO & Director***

Yes, absolutely. Yes, sure. So I think the context for the cash is absolutely -- is obscured by these year-end positions. We did, to remind you, we did start at 30% working capital to sales, so we're at 26%. As I say, we maintained it only in '19 and to me, personally, that's a disappointment. We really do see the potential to go to that 20%. I can't put a time frame on it, but we have plans in place both on -- it's not just inventory. Inventory is actually emblematically important for our operational efficiency and for customer satisfaction, all other things. And we will go -- and we are actually currently getting through that -- the year-end position in Detection and Crane. But we've also got big progress, and we -- but there is progress that you can see on the largest item actually on our balance sheet is receivables, and we closed the DSO/DPO gap by 3 during the year. We still got more to go on actually pretty much every division, so we're not coming off at all our 20% working capital as a percentage of sales. That is absolutely our target.

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

On the Detection point, the non-airports piece, as you know, is about 1/3 of the total within which Ports & Borders is about 1/4 or 1/3. As you also know, I was less than happy at the business losses that we saw a couple of years ago in Ports & Borders. I'm pleased to say that over the last 12 months, through a refocusing of the Detection team around Ports & Borders and the Urban Security space, we have now more than 100% recovered the losses and moved into a positive. We still have more work to do in that area. The piece that I'm most excited about, and if I put the military program that will come probably over the next 2 years, which is the single shop, it's in, it's out, is Urban Security because what we're seeing there is, and I wouldn't have to explain the increasing threat detection environment to you, whether it's a sports stadium or a government building or a school, there are lots of requirements. We see that being #1 in airports gives us the technology edge because we're spending more on R&D than the rest are. And what we've got the Detection team, and think Roland's in the audience here, really focused on is how do we cross-fertilize from airports and really focus organizationally and strategically on growing that non-airports piece because we have a clear #1 position in airports, which is playing out now. Sir?

Jonathan R. Mounsey ***Exane BNP Paribas, Research Division - Analyst of Capital Goods***

It's Jon Mounsey from Exane BNP Paribas. A couple of questions. So obviously once Medical goes, what are your thoughts on the portfolio as it all then stands? We still got 4 divisions to the fairly diverse group compared to most of the companies I cover. How do you feel about running such a diverse group? When we look at things at Interconnect, is the portfolio there now resolved? Flex-Tek as well? What are your thoughts beyond 2020 sort of end of the first half once Medical leaves?

And also as that's leaving, any sort of update on the nature of the balance sheet? It seems like Medical, highly cash generative, probably take more than its pro forma share of the debt. Do we have an idea about what that will look like now?

And then just finally back to Flex-Tek and thinking about end market outlook. I know that U.S. resi is a lot less than it used to be after recent acquisitions. But how do we feel about the outlook for that end market given how long the cycle has been and how the data is now trending? If you can give us an update on thoughts around there.

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

Okay. Well, I'll take the portfolio piece. Perhaps you -- and then I'll talk about Flex-Tek as well in the midst of the portfolio discussion. Now first of all, I think the diversity of Smiths post separation of Medical is actually one of its strengths. We have a nice range of markets that are not all tied to the same factors, so Detection is not tied to GDP, for example. The real issue for me was having the businesses highly well positioned within those markets and consistent execution. So I see that very much as a strength. It's from a -- I guess your question was a bit from a management perspective. I actually don't see it as very complicated at all because we have businesses, which all share similar characteristics, and we have a common thread of technology, operational excellence and the way we manage and lead people right across the piece. So the big job of work really for me was getting our portfolio better positioned and then executing on it.

I think on the Interconnect question, it's really been a great story over the last 3 years. They've sold 40% of the business. They've refocused around technology-seeking markets. And that's really what's driving the results that you're now seeing in Interconnect, and we're seeing more opportunity to come right across Interconnect. Within Flex-Tek and it's a relatively small piece of Flex-Tek, particularly after the acquisition of United Flexible, the U.S. construction or residential construction business, that's getting softer at the moment I think in -- even if I have time to read through all the detail yet, but I think the high-level messages were not complacent about uncertainties in the market. Our order books continue to look strong, but we are flagging that in U.S. residential. And also in Interconnect, semiconductor, we're seeing weakening, along with others. But those 2 businesses are quite small within the Smiths portfolio overall. Thanks, Jonathan.

John F. Shipsey ***Smiths Group plc - CFO & Director***

And then to your second question, I can answer it at the principal level. I can't give you too many specifics at this stage. But really, the principles that will guide us are strong cash generation on both sides of the house and strong balance sheet that will not constrain the reinvestment and the growth on either side. Okay. A little bit further I would agree with you that Medical has probably higher debt capacity. At the moment, for total Smith, we have a 2x net debt-to-EBITDA, self-imposed ceiling. I think Medical could actually move a little higher, 2.5, for example, that would make sense. So that would probably be where we're expecting to end up.

Jonathan R. Mounsey ***Exane BNP Paribas, Research Division - Analyst of Capital Goods***

Maybe just one follow-up. On the portfolio, looking at the other way around, so maybe not disposing of anything post Medical being spun, which areas of that 4 divisional portfolio might we look to invest in?

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

Well, you've seen over the last 3 years, I've said again and again, that organic has been my priority because -- and it remains so. But at the same time, we've been quietly, in parallel, doing a quite significant amount of disposal and M&A, which I think has been highly complementary to us and it's been a big driver of that repositioning for the group overall. And we have a good pipeline of ongoing further opportunities against the backdrop of that organic prioritization. We've worked hard. We know what's out there, and our aim has been to create enough strength in the financial position to enable us to continue to grow organically and nonorganically.

As far as areas I'm excited about particularly, I think I'd say all of the above. Our aim has been to create leadership positions, such that they are good platforms for continued development, and I think you'll see -- start to see that play out. Then we've got Sandy.

Sandy Morris ***Jefferies LLC, Research Division - Equity Analyst***

Top of the morning. Bad news. Just as we get on to this net debt stuff. At the moment, our gross debt is big slugs, some of it looking really attractive in terms of the eurobond. Are those rates that are stated actually what we're paying after swaps or whatever, dare I ask?

John F. Shipsey ***Smiths Group plc - CFO & Director***

No. Those are the -- so we have swapped our debt. So those are the rates that are issued, so I think I mentioned we have an average coupon of 3.2%. The rates that are published and the accounts you'll see in detail are the rates which we issued those bonds. We have hedged those, so we have swapped them both in terms of their currency risk that we swapped into dollars, which is a higher rate to match our dollar investments or dollar assets, and we also swapped from fixed to floating, to some extent, so we have about a 50-50 of that order, fixed to floating.

Sandy Morris ***Jefferies LLC, Research Division - Equity Analyst***

So whilst it's all slightly hypothetical about debt structures and everything, I could assume that this gross debt is going to have to stay in the group, otherwise it's complicating things enormously?

John F. Shipsey ***Smiths Group plc - CFO & Director***

I think we have -- we do -- no, you're actually touching on a complicated area, as you do normally. So we will need to look at. As we demerge Medical, Medical will need to take on its own debt capacity, and we will need to restructure both within Medical and I think within Smiths as a whole. But I can't actually give you details of that today because we're working through that.

Sandy Morris ***Jefferies LLC, Research Division - Equity Analyst***

Yes. I was coming at it and my funny little way of people are pressing you for details when it looks less tricky.

John F. Shipsey ***Smiths Group plc - CFO & Director***

Right. Not tricky, but just I don't see any kind of roadblocks around this. It's just mechanical, we need to work through that.

Sandy Morris ***Jefferies LLC, Research Division - Equity Analyst***

Right. And the bad news is that once upon a time, I used to cover Rexam so I used to know something about packaging for the pharmaceutical industry. And then I suppose just if I can ask a very broad question, which is fine, that, that was a challenging, immensely high-quality business. I imagine the packaging plants at Amcor are very similar to what we see if we visit Smiths Medical. But the routes to market, completely different, no? So how much of this Medical business do you actually recognize? I can get that the manufacturing might look similar, but does it stop there? If I can be so bold.

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

Yes, absolutely. JehanZeb, do you want to comment?

JehanZeb Noor ***Smiths Group plc - CEO of Smiths Medical***

Yes. There's multiple facets to that, how much of the Medical industry do I recognize. So first of all, if you look at primary packaging, it's in most med device situations, it's part of the regulatory filing and it's a product that, in certain cases, we did our own filing. So when it comes to the regulatory process, the quality, patient safety, et cetera, it's the same. If you look at specific areas like Vascular Access, the package and the product is even more intimate. And then as you look at some of the trends that we need to manage on the macroeconomic demand, they're also the same.

And most importantly, the whole product development cycle, if you look at R&D and innovation in packaging, we work upstream with device manufacturers like Smiths Medical. In fact, Smiths Medical was a significant customer of Amcor. We went through the development cycle together. So I would say there's a significant amount of overlap. And also prior to Amcor, I have experience from my McKinsey & Company days serving medtech companies who I obviously cannot name for confidentiality reasons. So I see a lot of similarities, a lot of overlaps and also opportunities to learn, of course, that's why I have a strong team around me.

And in terms of routes to market, a lot of the packaging sales were B2B. If you look at our growth opportunities, such as micro infusion, those are business-to-business direct sales. We also sold packaging to big distributors like Cardinal Health who are also intimately involved with Smiths Medical. So I would say, Sandy, there's more similar there than meets the eye. And I would again say I have a very strong team that supports me as the leader of a business whose focused on transforming its performance.

Sandy Morris ***Jefferies LLC, Research Division - Equity Analyst***

Got it. (expletive), you do know who I am.

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

Nice one, JehanZeb.

Sandy Morris ***Jefferies LLC, Research Division - Equity Analyst***

Right. I mean, I can see Medical, by the way, did pretty much have 100% cash conversion and it was better than last year, which was encouraging. If just dumba** question about large-volume infusion pumps, that market looks to me very fragmented. I always worry when you launch new products that we're going to bump into B. Braun or Baxter or someone, but that actually looks incredibly fragmented. Is that right?

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

No. No. Do you want to, I think, JehanZeb?

JehanZeb Noor ***Smiths Group plc - CEO of Smiths Medical***

No. The answer is somewhere in the middle. There's 2 competitors that have significant share and then it gets fragmented, so the answer is again somewhere in the middle. The most important thing is customer needs have evolved over time such as interoperability between different kinds of pumps, electronic medical records, having predefined software suites for drug delivery and drug packages. Yet the innovation cycle and that competition hasn't got up to those needs. And what we are excited about in the large-volume pump is we're coming out with a product that serves unmet customer needs and competes well. So to answer your question, if you're asking me if the opportunity is exciting, yes, very much so because of the structure of the market. But most importantly, there's a bit of a disconnect today on what's available versus what customers need, and our product and our package around it helps close that gap.

Sandy Morris ***Jefferies LLC, Research Division - Equity Analyst***

And then 2 very quick ones and I'll push off. Did we actually manage to grow in Asia this year thinking about China? That's been a shaggy dog story for Medical for many years.

And the second one is completely different one, which is John Crane's aftermarket looked really quite strong in the second half. I was just curious why.

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

Okay. Do you want to take that one? I can help a little bit. We did grow.

John F. Shipsey ***Smiths Group plc - CFO & Director***

You were asking for Smiths as a whole, I think, isn't it?

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

No, no, Smiths Medical.

JehanZeb Noor ***Smiths Group plc - CEO of Smiths Medical***

Medical. Yes. So I do know we grew, which is exciting and Asia will continue to be our focus because of the demand there. We survey just 5 subregions. 4 out of 5 grew. In China, we are revamping a lot of our underlying processes and other things. So China will continue to be a focus area, but I wouldn't forget about India, Southeast Asia and even mature markets like Australia and New Zealand that are very complementary to what we do in EMEA, North America. So Asia for us, as a whole, is a positive story and it's about to become even more positive.

Sandy Morris ***Jefferies LLC, Research Division - Equity Analyst***

So China still getting -- we're still trying to get it, right?

JehanZeb Noor ***Smiths Group plc - CEO of Smiths Medical***

We are, yes.

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

Yes.

JehanZeb Noor ***Smiths Group plc - CEO of Smiths Medical***

And we will. It's all very -- we see it in front of us and it's more about execution discipline at this stage.

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

And just to scale China for Medical, it's somewhere in the GBP 15 million to GBP 20 million range so it's relatively small and should be much larger. And there's a lot to be done.

JehanZeb Noor ***Smiths Group plc - CEO of Smiths Medical***

Yes, we have an R&D center there. We have a production site. We have a good direct sales team. It's about unlocking a couple of elements that we are focusing on, and we'll see more growth there.

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

On John Crane, Sandy, you're right. We had a very good year last year on aftermarket, stronger on OE actually, which is always a positive sign. And that was off the back of the real strengthening as we went through the back end of the year before. We still see order books strong, some would say really quite strong going forward, some we've got reasonable visibility through a good portion of the first half. So I think our optimism around the order books in Crane continues to be good. And again, just a reminder, we are 100% downstream so we're not affected by anything that's happening in the upstream. There is a bit of oil price and crack spread sentiment that goes on and what gets done in the refineries but demand is high right now.

Sandy Morris ***Jefferies LLC, Research Division - Equity Analyst***

I think there's some big projects coming through on the vine.

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

Oh yes. Yes, very much so. And it's -- I mean (inaudible) So I mean, the main trend that we're keeping a very close eye on with Crane at the moment is there's a lot of new refinery capacity, major refurbishment coming through and most of that is Middle East and Asia. So as we've said before, over the next 10 to 15 years, something like 70% of all the investment that's going into oil and gas but also chemical plants is going into Asia and the Middle East, and that's really a function of aligning point of consumption to point of production, which is horribly mismatched around the world at the moment. So that's a really important megatrend that we're working very hard. The good news is we've got strong market share positions preexisting in Asia and the Middle East, but we have to ensure that as they ramp up more quickly, then investments that are going to Europe and the U.S., that we stay on top of that. Thanks, Sandy. Thank you, John.

David Alexander Larkam ***Numis Securities Limited, Research Division - Analyst***

Dave Larkam from Numis. On Detection, can you say how much was rolled over into this year, i.e. not delivered last year? And then on your outlook statement, obviously, you read very positive for the first half. I'm just making sure there's not something you're seeing negative in the second half or are you just sort of rebalancing?

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

Okay. John, do you want to take that?

John F. Shipsey ***Smiths Group plc - CFO & Director***

So I don't think we discussed specifically how much was moved across it. It just -- that was the -- and that's what accounted for. We had expected to be actually in growth in the second half so it's that kind of element. I'm sorry, I didn't catch your second question. It was?

David Alexander Larkam ***Numis Securities Limited, Research Division - Analyst***

Your outlook statement. I'm just -- you're just rebalancing expectations for the year. You're not sort of seeing something really negative in the second half of the year at the moment?

John F. Shipsey ***Smiths Group plc - CFO & Director***

No, no, we're not. No. It's we've had 2 years where we have moved to a more heavily weighted second half, and I think this is now more of a reversion in that trend. That's simply what's we're guiding.

David Alexander Larkam ***Numis Securities Limited, Research Division - Analyst***

And then finally, IFRS 16, talk us through what the impact is. I saw an EBIT impact in the -- about the...

John F. Shipsey ***Smiths Group plc - CFO & Director***

Yes. So you'll see in the accounting policy, there's actually quite a good disclosure in the accounting policies. But basically, we'll have of the order of GBP 140 million to GBP 160 million of assets coming onto the balance sheet and then a liability representing the future obligations, if you like. The impact will be -- it'll be neutral to net profit but there will be a higher interest charge and a lower operating charge, but that's -- it nets out at PBT and PAT.

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

Thanks, David.

Unidentified Analyst

It's [James Mainwring] from Stifel. Just one quick one on Medical. We've talked a lot about the sort of the margin target of 20%-plus. Just want to get the sort of quick view on the progression of that. You've obviously talked about the kind of manufacturing improvement, but just kind of 2 other trains of thought. One is consumables in Medical tend to be higher margin and just a thought on whether there will be more consumables with newer products and particularly, the large bump.

And then the second one, you talked a lot about kind of really expanding the geographic reach of the Medical division. I mean that to me kind of sounds like there's going to be a lot more fixed cost to you kind of set up in sales, you kind of reach are distribution agreements to begin with which would tend to offset that distribution so just kind of view of progression over time.

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

Okay. Well, I'll take the first overall margin piece and then perhaps, JehanZeb, you can comment on the consumables and the geographic piece. I always look at gross margin when I'm thinking about bottom line margin potential. And 2 years ago, Medical was running above 20% and that was supported by gross margins in the mid-50s. And we're now at 17% but gross margins still in the mid-50s, which for me is always a bit of a litmus test because it speaks to pricing, market competitiveness, launching new products as they come in and out. And at the same time, we've suffered more operational inefficiencies than we would like. So our confidence that this is very definitely a 20% plus business over time is high. The main drivers of getting there are a continuing strong gross margin, which will continue to be supported by new products at better margin, eliminating the operational inefficiencies that we have. And then, of course, ongoing gearing as we return to growth and get out of a downward cycle on revenue. So for me, I sit here extremely confident that we've got both short and medium and long-term actions that are in place that will get us back north of 20%. JehanZeb?

JehanZeb Noor ***Smiths Group plc - CEO of Smiths Medical***

Yes. Thanks, Andy. So on the consumables question, the 80-20 mix we have, I believe, is very healthy and sustainable in the long-term because you need about 20% of the market being seeded each year and then the consumables follow through. As we look at the large-volume pump, we are focused as much on developing the software and the set as much as we have on the actual hardware because we are selling a solution. And as I was talking to Sandy, that's one of our differentiators as well.

As we evolve our portfolio to expand our addressable market, it's not the percentage that shifts. It's the profile. So for example, in the large-volume pump, software is equally important for us and the customer as is the set, so you will see us shift more towards software, and we continue to build our capabilities there as well.

And on the question of expansion, there's about 3 levers that we look at. The first one starts with partnerships because, as you can imagine, there's maturing capabilities in countries like India, Thailand, Vietnam for contract manufacturers. So we do not have to own the asset. And as I said earlier, we are exploring partnerships. The second is for us to go from an indirect sales force to a direct sales force. It's typically a 2-year process where we have developed a track record of delivering that in a country like India. And today, we are direct, whether it's certain Latin American countries, India, Japan, Australia, New Zealand. So it's more a question of selecting the right geography and focusing on 1 or 2 at the same time. So that's achievable.

And the last point around asset footprint. There's 2 aspects to that. Only 6 of our 14 sites globally are in North America, and we're not averse to CapEx and expansion. However, we have so much near-term opportunity and just kind of expanding margins and getting our own operations to a better state that there's a little bit of sequence of prioritization over here. So expansion is possible, and frankly, with the growth drivers we have, we would be looking at that in the future.

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

Is that okay? What's on your mind, Robert?

Robert John Davies ***Morgan Stanley, Research Division - Equity Analyst***

It's Robert from Morgan Stanley. Two things. One was just the recent news out of Saudi. Obviously, the damage to the Aramco plants. Is there any exposure for you there? Any potential, what are customers telling you?

And then the second one was around your central costs. I saw that had come down year-on-year. I guess what's driven it more to your sort of forward expectations for next year? Is that a one-off? Is that a normalized level? Where do we go from here?

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

Okay. Well, perhaps you take the second point there. I mean the weekend was full of calls for me, as you can imagine, because both of those refineries were 100% John Crane, and our first concern was for our crews of folks in the refineries. We're in the midst of assessing what the impact will be. Obviously, it's diverting capacity and production is running elsewhere because it's at 5% out of the global daily consumption, which is a huge, huge number. On a positive note, they have a lot of rebuilding and refurbishment work to do. And as we go forward, we don't see immediate impact. Will there be some wrinkles along the way? Possibly. But most of the areas that are being redirected to are also Crane, and I'm pleased to say none of our folks were injured.

John F. Shipsey ***Smiths Group plc - CFO & Director***

And so on central costs, it's really a reflection of 2 things: one, we're very mindful of our central costs and the need to be very disciplined about them. But that's in the context of the second, which is that we're evolving our operating model. So I think maybe back in 2016, we saw the need to invest in capabilities that weren't there to, if you like, prime the pump. We are now moving through that and evolving it and that gives us the opportunity to become more efficient and more effective. I would say the -- it's not a onetime change, but the rate of that change was probably a bit exceptional -- was exceptional for this year. But we will continue to be cost efficient, and we will continue to evolve our operating model in the future.

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

Thank you, Robert.

Mark Lewis Fielding ***RBC Capital Markets, LLC, Research Division - Analyst***

Mark Fielding from RBC. Just a quick follow-up on that actually in terms of the central costs and whether you have any sort of thoughts about the evolution as we head to the demerger as well as and whether there was already -- I don't know if anything has shifted in here to do with Medical in this report as well or anything?

John F. Shipsey ***Smiths Group plc - CFO & Director***

No. I mean it's slightly -- the presentation isn't -- the future presentation in the sense is that we've taken 100% of the group costs and allocated them to continuing operations. In reality, as we spoke about earlier in the year, we expect to allocate some of those costs to Medical in the future. And overall, with 2 separate companies, we expect the total cost in the future to be kind of low single-digit millions higher than for Smiths as one entity. So that's relative, too, at the whole. But as I say, we will continue to evolve the operating model so that total will come down of itself.

Andrew Reynolds Smith ***Smiths Group plc - Chief Executive & Executive Director***

Good. Any -- it looks like it. Then well, from me, thank you very much for turning out on a Friday. Thanks, as always, for the support, interest and thoughtful questions. And have a great weekend, everyone. Thank you.

JehanZeb Noor ***Smiths Group plc - CEO of Smiths Medical***

Thank you.

John F. Shipsey ***Smiths Group plc - CFO & Director***

Thank you.