# Smiths Group Trading Update

Tuesday, 30th June 2020

## Operator's Introduction

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Smiths Group PLC trading update. At this time, all participants are in a listen-only mode. After the speaker's presentation, there will be a question and answer session. To ask a question during the session, you will need to press star and one on your telephone. I would now like to hand the conference over to your speaker today, Andy Reynolds Smith. Please go ahead, sir.

## Smiths Group Trading Update

Andy Reynolds Smith

*Chief Executive, Smiths Group*

Hi, good morning everyone, it's Andy here and thanks very much for joining us today. I really do hope that you've all been managing to stay safe and well. I've got John Shipsey, our CFO, in the boardroom in London with me today, at a social distance, of course and we wanted to give you an update on how Smiths has been performing since the half-year, given the speed of change in these difficult and unprecedented times but also talk about an important business improvement initiative across the group.

I want to start by thanking the amazing people we have in Smiths around the world. Our focus and priority has been to keep our people safe, keep the business running and our customers satisfied and at the same time, continue to create opportunities and improvements for future growth and better returns. I could not have asked for more from any one of our team. The dedication and professionalism of our people has been incredible and has demonstrated the real strength and resilience of our company, so a huge thanks to everyone.

Smiths is proving itself to be strong financially, operationally and strategically. In the last couple of weeks the level of COVID-related disruption to our operations and supply chain has reduced substantially. As of yesterday, all of our plants, which is 75, were operational, versus around 15–20 of them being affected at any one time earlier in the crisis. We are certainly not complacent, however and infection control measures are in place right across our plants and increasingly our offices, as they start to come back to work.

We have been able to ensure excellent business continuity for our customers throughout the disruption so far and this has proved to be an important competitive advantage in maintaining and winning new business globally during the crisis. However, global market conditions and demand remain very uncertain and we remain extremely focused on ensuring all necessary measures and actions are in place to keep our people safe, manage business continuity, protect profits and conserve cash.

For Smiths' continuing operations, we've delivered reported revenue growth, including acquisition, for May year to date, of 6% and underlying growth of 2%. The first four months of the second half delivered 1% growth. We have not been entirely immune to additional operational costs driven by the COVID disruption across our global network, of course but I'm very pleased with our cash conversion, which has remained strong for the first ten months of the year. This is a testament to the fundamental, structural cash generation quality of all of our businesses and the highly-focused efforts of the team, day in and day out, in managing cash during the crisis and the ongoing underlying improvement plans we put in place.

This performance has contributed to an improvement in the group's liquidity headroom from the £850 million that we communicated at the half-year to around £950 million through May. Within this story, John Crane remains in growth on a May year-to-date basis and the aftermarket order book continues to be strong but the OE order book in Oil & Gas is showing signs of weakening. In non-Oil & Gas, Pharma and Pulp & Paper in particular are looking more positive due to some strong global market trends.

Overall, demand for oil, which is a very important factor for us, as you know, is growing again at a rate of around 6–8 million barrels per day per month and expected to reach somewhere in the order of 90 million plus after the summer, following a trough at around 75 million and a pre-COVID level of around 100 million. Crane has been winning new business, including some important market share gains resulting from our exceptional customer service to customers through the global supply chain difficulties.

For Detection, we grew strongly through May as momentum and strong order book cushioned the impact of reduced demand in airports. It is now facing tougher comparators for the balance of the year and we are seeing slower tender activity. We were delighted, however, to win a £47 million contract with Kuwait Airport in June.

Flex-Tek is down year to date, with the primary impact being commercial aerospace, which comprises about 20% of the division. US construction has also been very slow for the last few months but now appears to be picking up. The other Flex-Tek businesses, including military aerospace, have performed well.

In Smiths Interconnect, order and revenue trends are starting to improve following a very difficult first nine months due to the weak connectors market globally. Interconnect has been back in growth more recently and it's working hard to fulfil strengthening order books.

Moving to Smiths Medical, the division continued on its improvement path, with revenue growth in the first four months of the second half up 2%. The start of the second half saw a tailwind, with a spike in demand for critical care products and distributor restocking. This was then replaced by the headwind of lower numbers of non-COVID-related procedures and hospital admissions, although these are now growing again. Underlying improvement plans are progressing well, including the launch of new products.

Overall, Smiths is not standing still. We're managing the short term the very best way we can, with our eyes firmly on the future and we continue to invest. Our priority has been and remains organic growth but as you know, we do continue to execute on a very disciplined parallel path of acquisition to accelerate our progress. I'm delighted to announce this morning the completion of a small but highly-significant bolt-on technology acquisition called PathSensors. Welcome to the group.

It strengthens our biological detection capability, building on our existing expertise in other markets. It will enable us to accelerate the industrialisation and commercialisation of devices which can detect the presence of a virus in an individual and the viral load in the air in confined spaces. We're very excited about this addition, as you can imagine and the potential applications. It was a really good example of the sort of bolt-on thinking which can really drive us forwards, in this case externalising R&D investment, where it would have simply taken too long internally. It extends our market reach in the critical area of biological detection to provide solution to the challenges we're all going to be facing. Along with the recently-announced medical acquisition, it brings our deal total over the last three or four years to 21. The team does remain vigilant but highly disciplined and highly aware of the current market uncertainties that we face.

Organically, we're also very pleased to win, last month, an order for more than 100 million hypodermic needle sets in Medical to be produced in the US as part of preparations for what will be a vast inoculation program when a vaccine is found. We continue to execute against our strategic plan, taking the necessary actions and making the necessary investments to deliver long-term growth and outperformance.

As part of this, we're announcing today an important program which brings together a number of initiatives which have been under development across the group, aimed at ensuring we emerge stronger from the crisis and better positioned for long-term growth and outperformance. It will also accelerate our progress towards our target margin range of 18–20% in the long term. In addition, it will further improve our flexibility and speed to react in the uncertain demand outlook we see in some markets and continue to face in the coming months. It spans all of our businesses and includes a number of actions to improve the efficiency and speed of our support functions, as well as optimising further global footprint and supply chains. Total costs are £65 million, with annual benefits expected of more than – annualised benefits expected of more than £70 million, yielding an underlying margin improvement of 200 basis points. It will be completed by the end of our next financial year and the benefits are expected to offset the costs in FY2021. The program will support the delivery of long-term growth and outperformance and further strengthen Smiths for the future, ensuring we're strong financially, operationally and strategically.

Thanks very much for listening, I really appreciate it and both John and I are sitting ready for any questions that you might have.

## Q&A

**Operator:** Thank you. As a reminder, if you wish to ask a question, please press star and one on your telephone and wait for your name to be announced. If you wish to cancel your request, please press the hash key. Once again, please press star and one if you wish to ask a question.

The first question is coming from the line of Andrew Wilson from JP Morgan. Please go ahead.

**Andrew Wilson (JP Morgan):** Hi, good morning everyone, hopefully you can hear me okay. I've got a few questions, please. Maybe if I start with the restructuring programme, I think, given you're finished with it. I'm just interested, Andy, if you can maybe, at a very high level, kind of take us through the thinking on this because I guess a restructuring programme in this environment, sort of the inevitable assumption is that it's reacting to kind of pressures within the business and the numbers don't really, I guess, suggest that. So I'm interest in kind of if it is sort of a fixing a problem solution or whether this is something sort of bigger picture and longer term. Maybe if I kind of start there?

**Andy Reynolds Smith:** Okay, thanks Andrew. Thanks very much. I hope you're keeping well too. So, I think a couple of points of calibration from me. First of all, this is a global programme, spanning the entire business and it comprises and has brought together a number of initiatives that were under development, many of them on a pre-COVID basis, to ensure that Smiths is stronger in the future, it's leaner in the future, it's faster in the future and continues to optimise its operations.

So, in large part, you know, we're pre-dating, essentially, the COVID disruption that we're facing. What we have done is pulled those together in a concentrated way now because we felt it was really important to communicate it holistically but of course what it also does do, as we're creating a leaner, faster, structure, a more cost-efficient structure to support growth for the future, it does put us in a position where we're more easily able to flex and withstand and protect profit in the short term in this uncertain demand environment.

**Andrew Wilson:** Great, so that's helpful. Switching, kind of, across to John Crane and I think one of the, I guess, big questions we've got in the sort of near term and I guess over the next six months as well is just thinking about the aftermarket side of John Crane and because it’s been very resilient historically and I guess the unique features of the downturn in terms of access to customer sites, etcetera, that perhaps make it a little bit different. I'm just trying to get an understanding of sort of what you've seen at the moment, whether you think there's potential for catch up, whether you're seeing some customers take advantage of sort of where they've got, perhaps, some downtime, just to get a better feel of that and I guess sort of give us a bit of confidence in terms of how that's developing.

**Andy Reynolds Smith:** Okay, well, a couple of comments from me and then, John, perhaps you can – you could add your views as well. So, I mean, just a reminder on it, as everyone knows, we are essentially downstream and 70% aftermarket and as we said, you know, that position has remained strong from an order book perspective but has been impacted, to some extent by, simply, this reduction in demand that we talked about earlier. But you know, continuing, as you've heard, through the year to date in a very solid way.

Access to sites has been tough and it's not really very much easier right now, which is a little bit the discussion earlier on, you know, some of the COVID-related drag that we've seen on some costs, that are – you know, it's been harder to get to places, it's been more important to ship stuff by air freight, for example, when supply chain is disrupted, so we have been seeing that.

**John Shipsey:** Yeah, I mean I think Andy has covered a lot of it. We entered with very strong order books, so that has cushioned us. To date it has been about trying to meet customer demand while navigating a fair amount of disruption. If you look at past cycles – and I guess, in some ways, it's not necessarily that they're a good guide to this current one but in past cycles there's been relatively little impact on aftermarket. A little bit – we do get a bit of push-out but basically, customers need to do their maintenance, they can push us a little bit out but not much. What we have seen in the past is a delayed impact on OE. OE projects that are in flight, you know, we complete and then we can see a dip, so that would be, I guess, if we look back to previous cycles.

**Andrew Wilson:** And maybe just a final one on the Detection side: obviously you made the acquisition today and I think you've touched – it seems to be a little bit more on kind of the biological side and the biological opportunities, maybe, in Detection than, perhaps, certainly I'd realised and clearly not claiming to be an expert on COVID-19: I guess how much of what you're seeing in terms of COVID and the areas that, I guess, authorities are looking to spend and develop products, how much of that fits under sort of the Detection umbrella and how much – I guess, in short, how much of an opportunity do you think is going to result from COVID for the Detection business, because it feels to me that it's a much more significant opportunity than, perhaps, I kind of previously appreciated?

**Andy Reynolds Smith:** Yeah. Well, I think, at the highest level, so Smiths in the past has been very much involved in biological detection but predominantly in military. As we've looked at this, we see that the world post-COVID is going to be a very different place and we're engaged with a number of authorities on how the world returns to work and returns to travel and pleasure in the best possible way, which drives you, you know, down a path of how do you better identify viral threat? It fits, I think, really quite well with our ability to commercialise and industrialise at scale solutions that are used for passenger flow, so there is the broader core solutions competence here that I think comes into play but we did not have the viral detection, or the pathogen detection, capability. It was more broadly biologically based. So this acquisition really enables us to take a technology which can be applied to both individuals and groups of people with the viral load in the air. It applies and it is adaptable to other viruses, also, you know, not easily because these things are tough but it isn't like developing a new vaccine every time. So, you know, we're really excited about the opportunities but it's a very big market opportunity. It would be impossible to scale it at this time but what we're trying to do is put sort of the core technology capability in place so that we can package as part of a Smiths solution.

**John Shipsey:** I think it's a great example of where we should be placing bets on things that have a great strategic fit with our capability. Clearly this is not an existing market and it's uncertain how it will progress but we think it's very exciting. It makes sense for us to make this acquisition, to acquire the technology, put it together with our existing capability and develop the value of that and explore the opportunities that arise.

**Andrew Wilson:** Super. Thanks Andy, thanks John. I appreciate the time.

**Andy Reynolds Smith:** Thank you Andrew, as always, I appreciate it.

**Operator:** The next question comes from the line of Mark Davies Jones from Stifel. Please go ahead.

**Mark Davies Jones (Stifel):** Thank you very much, good morning both, a couple of questions firstly on Detection, please: clearly a very robust performance so far, particularly given what's been going on in the airline sector but to what extent is that backlog now depleting and is that tied to the completion of those big European upgrades? How much longer do we have of that sort of support and is there anything coming on the horizon that keeps the momentum going thereafter, or should we be expecting a quieter period from Detection for quite a while?

**Andy Reynolds Smith:** Okay, well, yeah, super question. How are you Mark, are you okay?

**Mark Davies Jones:** Yeah, very good, thanks.

**Andy Reynolds Smith:** Good, good. So, you know, for me the European programme, the upgrade programme, is coming to an end, as you rightly say. It's probably somewhere between maybe 80–85% complete at this stage. The important thing for me is the upgrade cycles which layer on top of it, so there's a further European upgrade cycle coming at the checkpoint. You have, in the US, now, an upgrade cycle already running on the checkpoint and that will also be complimented by a checked baggage programme that moves it to next generation, given the last upgrade was a long time ago, very soon. We've already got initial communications going on around that. So you really have four layers that are staggered over quite an extended period of time now. I mean the European programme that's just coming to an end now was actually quite compressed. In the US, the checkpoint upgrade, we won the first 15% of that. The further tranches are going to be coming out probably at 10% or 15% in each chunk but this is going to play out over a number of years. So, you know, there are a number of upgrade cycles to achieve regulatory cycles and keep up with the threat emergence coming over a long period of time here.

So I'm not expecting a fallow period from an upgrade cycle perspective but as we said, we are facing, for the balance of this year and into next, tougher comparators for the balance of this year plus tendering has dropped right now. So, you know, we continue to run. There are a number of tailwinds and headwinds. People are still trying to pull stuff forward to take advantage of downtime. They are pushing out, where they are more constrained right now. We're also seeing, of course, a number of airports, you know, scrabbling to get back online now and the question is, at which operational level will they be back online?

So, you know, it's going to be, with now the catch up of airport closure, you know, a more challenging few months but the long-term trends, as you move into, you know, back of next year, notwithstanding whether there's a second wave and further disruption, are very strong.

**Mark Davies Jones:** Thanks. Thank you very much and just to be double sure, no mention in today's statement about the medical spin off, obviously we know that's on hold for now but there's no change in thinking around that, particularly as you start growing the biological side in detection or whatever. It's not any change in the longer-term thinking around the separation there?

**Andy Reynolds Smith:** No, we paused for the right reason, so no change in the position there, it was always about value for medical and for Smiths in the long term. That remains the case and since we're in a position that we feel we can achieve that, achieve our objectives, we'll continue as we said.

**Mark Davies Jones:** Excellent, thank you.

**Operator:** Next question is coming from the line of Andre Kukhnin from Credit Suisse. Please go ahead.

**Andre Kukhnin (Credit Suisse):** Good morning Andy, good morning John, I hope you're both very well. I want to start off with a question on the restructuring programme you launched, the £70 million of savings you qualified as 200 basis points, which seems to be a bit lower than, say, your 2019 reported revenues were. I think, on that basis, it implies closer to 300 basis points. Is this your kind of implied expectation of the retention ratio on the savings that you expect to generate? And could you maybe give us a bit more detail on what kind of activities will you be undertaking? Will this be kind of all the way down to site closures and consolidations, or is more of a kind of SG&A cost-cutting programme?

**John Shipsey:** Good morning Andre, it's John. Just to clarify, obviously our revenue, I think you're quoting, is continuing operations but actually the programme covers all of the group, including the £900 million odd of Medical, so that's how we get to the 200 basis points.

On the extent of it, it is – it does involve some element of Network but it's really across our whole organisation. It's about – as Andy said, it's about uprating our productivity, it's not about – in no large part, it's not about shrinking capacity, it's actually about uprating our productivity across both direct and indirect elements of the organisation.

**Andy Reynolds Smith:** I mean it's really about a flatter, leaner and faster structure, so we're selling more effectively, we're bringing new product to market more effectively, we have our backroom administration operating more effectively to support more efficiently and of course, therefore, at a lower cost to keep customers happy.

So there is a little amount of continued footprint, or network but, as you know, we don't have a vast – we don't really have a sub-optimal manufacturing footprint at the moment. This isn't about wholesale manufacturing footprint changes at all, this is just some refinement activity in that area.

**Andre Kukhnin:** Got it, thank you and thanks for clarification on the base of sales. Can I then ask the question on the retention ratio? How much of that 200 basis points at the whole-group level would you expect to be retained structurally?

**John Shipsey:** I'm sorry, I'm not sure if I fully understood the question but effectively, you know, this is – so in terms of phasing, we expect £70 million to flow through in full in FY 2022, so we will have a charge and a cash cost that spans the end of this year and FY 2021 with, broadly, a neutral impact on FY 2021 and then FY 2022 the full savings to flow through.

**Andy Reynolds Smith:** Yeah, yeah and it was really important for me – and this is not an ongoing restructuring programme, this is executed within the confines of the balance of 2020 and FY 2021. It has a broadly net margin neutral impact in 2021 and then flows through in 2022. And that was really important. So we will be expressing this as an exceptional not from an accounting treatment perspective but as an exceptional restructuring activity and communicating sort of underlying margin improvement on an ongoing basis, so you will see that flow through versus the costs.

**Andre Kukhnin:** Got it, thank you. I was just thinking, in terms of the impact to bottom line in 2022 and how we think about it at the moment, that £70 million is clearly savings you expect to generate and we don't expect the costs to generate those savings to reoccur but in the meanwhile, we're likely to have ongoing kind of COGS inflation, labour-driven most likely. So are there kind of ongoing efforts going on in parallel to this programme to offset those so that we can offset the whole of £70 million to land in the bottom line in 2022 or should we think about £70 million versus other kind of – the internal inflation items and the profit bridge?

**John Shipsey:** I guess I think we see this as – this is what's getting us towards our 18–20% margin goal. We cannot – you know, we can't speak completely to forward guidance we've withdrawn forward guidance, so I can't really speak to the rest of it but essentially this is – as Andy has highlighted, this is positive productivity; this isn't designed as offset.

**Andy Reynolds Smith:** Yeah and it's – you know, it's very clear to me this is not about predicting future margin pressure and finding ways to offset it. This has been designed in order to improve the underlying margin and speed our progress into the 18–20% range. Of course, there are a number of programmes, underlying productivity and purchasing, which continue to run to maintain sort of that base inflation offset position. This is intended to speed us into that range, rather than be, you know, solving for margin pressures. We have other levers and tools that we have to be pulling to do that.

**Andre Kukhnin:** That's very clear. Thank you very much. That's exactly what I wanted to check. May I just ask one last question? On, again, actually, profitability development but in the first four months that you cover in the trading statement, because there's so many moving parts of, you know, growth in the first two months, decline in the next two months, extra costs, mix effect, could you give us some ballpark on where the profitability is trending those four months year on year?

**Andy Reynolds Smith:** I cannot. This is – you know, this is a trading statement update. As you know, I'm not in a position to talk through profit evolution. Of course, that will be extremely clear when we get to the September results.

**Andre Kukhnin:** Got it. Okay.

**Andy Reynolds Smith:** But I hope you're getting some sense from the words and the positioning of this.

**Andre Kukhnin:** Yes, yes, we do indeed. Thank you very much to both of you, thank you.

**Andy Reynolds Smith:** No, thanks as always and I look forward to seeing you sometime soon.

**Andre Kukhnin:** Same here. Same here, thank you.

**Operator:** The next question is coming from the line of Ed Malamanika[?] from Citi, please go ahead.

**Ed Maravanyika (Citi):** Good morning Andy. Just asking on the COVID-related impact on Smiths Medical, the sort of increase in activity: how much of that do you see remaining sort of beyond the current sort of immediate vicinity of the pandemic?

**Andy Reynolds Smith:** Yeah. Yeah, I mean so it's a very good question indeed. So, in the first part of the pandemic, as you know, we definitely saw, in common with others in the industry, a big spike in what people viewed was COVID-related product, or what they thought would be – excuse me – COVID-related product. There was an element of restocking and increasing of stocks that went on, given the unpredictability of the whole thing. So people were trying to prepare for something that they didn't know how big, or how difficult, it would be.

That restocking, let me call it, as the situation and demands on the health services has become clearer, has effectively ended. What is happening in the background is people are reconsidering their ongoing view of what stock levels are necessary in the event of, either recurrence or something different happening because there's, I think, a general view that people feel they've been left wanting in some areas.

It's very difficult to put a sort of ongoing, underlying gross impact number on that. We'll certainly know more over the next –

**Ed Maravanyika: Yeah.**

**Andy Reynolds Smith:** – few months, as things become clearer and more stable. From a headwind perspective, at the moment, it's kind of not surprising. There was a huge drop in the number of non-COVID-related procedures and hospital admissions that were going on. That is coming back now and starting to catch up. You're probably hearing, you know, something similar right across the press at the moment. Procedures were delayed, or people simply didn't go to the hospitals. That is picking up but there's still that lag on that – or that tailwind – or that headwind of, you know, simply procedures, non-COVID, were at a very low level for quite an extended period.

**Ed Maravanyika:** Understood, thank you.

**Operator:** Next question is coming from the line of George Featherstone from Bank of America. Please go ahead.

**George Featherstone (Bank of America):** Morning, I hope all is well and thanks for taking my question. I guess we've seen a lot of OE delivery in Detection recently and in the near term, one would assume that that is dilutive to margins but what I'd quite like to understand is how quickly that turns into service and recurring revenue and perhaps higher aftermarket revenues – higher aftermarket revenues and higher aftermarket margin? That would be great, thanks.

**Andy Reynolds Smith:** Okay, yeah, thank you and hope you're doing well. I mean, look, so, overall, the ongoing recurring revenue associated with an OE programme is, as you know, in the range of 40–45% recurring. That approximately splits half and half between ongoing contractual maintenance, mechanical maintenance, keeping, you know, replacements, preventative maintenance, keeping it going. A proportion of that is typically contractual for the first couple of years, so included in the – very much like a warranty, so you've got, probably, 30% of that total, the 50%, which is an ongoing warranty for two years but then turns into you pay to get your car serviced. You then – layered on top of that, you have software upgrades, which typically start very quickly after the OE installation. In some cases, there are contracts that allow for those to be paid for, for the first year but more typically, you know, they start quickly.

So if you kind of thought about this as two-thirds of it happens quite quickly after, a third of the after – or the recurring revenue is normally delayed for the warranty period of 2–3 years.

**George Featherstone:** Okay, thanks. And then maybe then, in that context, how should we think about margin progress for Detection as you look to kind of 2021 and beyond, given the level of OE that you've been delivering in 2020 so far?

**John Shipsey:** Yeah, I mean we can't give forward guidance on the margins, I'm afraid but what we can say, absolutely is that, you know, we still have a very strong OE order book and that is – and you're absolutely right, OE is lower margin than aftermarket, so I'm not sure I can say too much more.

**Andy Reynolds Smith:** No, I mean Detection very much remains a mid-high-teens-return margin business. The aftermarket is more profitable. When we're shipping large amounts of OE, that of course does suppress the margin but it's all about that long-term, profitable, software-related recurring revenue. So, no change in our view of the long-term underlying margin potential of Detection.

**George Featherstone:** I guess the question was more – sorry, to maybe reclarify a little bit, if you've been delivering a lot of OE this year, are you expecting, or were you already expecting to see an inflection driven by the aftermarket increase in, maybe, 1–2 years' time?

**John Shipsey:** I mean it is a fact – sorry, I'm trying to be helpful but it is a fact that high OE mix will lower margin and then if the aftermarket mix recovers, then that will be beneficial.

**Andy Reynolds Smith:** Yeah, although you shouldn't be thinking about this as in 2–3 years there's some sort of digital event by any means. There is, in the shorter term, some mix impact of OE versus aftermarket but I mean this is a series – this is hundreds of programmes running on a phased basis globally, so this isn't a matter that one big programme comes to an end and then you live with it and then the next one starts. There are multiple programmes, at multiple levels, running which sort of smooth that situation.

**George Featherstone:** Okay, great. Thank you.

**Andy Reynolds Smith:** No, thank you. Thank you.

**Operator:** The next question is coming from the line of Jonathan Hall[?] from Barclays. Please go ahead.

**Jonathan Hurn (Barclays):** Hey guys, good morning, just a few questions from me, just firstly on John Crane, just coming back to margins here. Obviously you're seeing a beneficial mix there, in terms of order intake, obviously getting more aftermarket versus the OE. So, as that starts to feed through, a similar kind of question: do you think we can get the John Crane margins up to the sort of historic levels, the sort of 24–25%? That was the first question. Do you want to do one by one, or –

**Andy Reynolds Smith:** Yeah, yeah, okay, can do. That's probably easier. So, I mean, John Crane is a through-cycle 20% plus margin return business as you know. You're right, over time it has moved between that 20% and 25%. I think something that we've spoken about before is in the last big downturn it never dropped below 20%. You know, it's a remarkably margin-resilient business. We then went through a period, as you know, where we invested, additionally, in new product, which had been probably neglected in the Smiths of old and the Crane of old a little bit and also repositioning the division towards non-oil-and-gas markets in a much more aggressive way, so there are some short-term additional investments that tend to run this.

But if I think about that margin potential over time, you know, for me this is very much a business that you can expect to see in that 20–25% range, with potentially some, you know, movement on an annual basis, if there's a particular investment or a particular change being made. You know, the really nice thing about this is the gross margin is extremely strong. You know and particularly so in aftermarket, which really supports and nothing has changed there in terms of that gross margin that has you feeling the ultimate bottom line margin gets negatively affected over time.

**Jonathan Hurn:** Okay, very interesting, thank you. The second one, just on Detection: obviously you've talked about the order win there, can you just give us a feel of where the order book is right now in terms of Detection, in terms of size? That would be really helpful.

And then, just also, can you just talk a little bit about the non-air-transportation markets? What are we seeing there in terms of sort of infrastructure and so forth? That would be helpful.

**Andy Reynolds Smith:** Yeah, yeah, okay. So, on the non-air-transportation markets, I mean ports has obviously taken a similar pause to the airports business, with a number of ports being closed down for extended periods, or not running for extended periods. They're coming back online now.

I mean, borders is a bit of a different story and we're deeply involved now with the European border force organisations, with border organisations around the world. We're not yet seeing – this is for the return to the new normal and also the agreements that are being – you know, changing. So we're involved with the Schengen authorities at the moment around what the new travel cross-border of land borders is going to look like. You're not seeing that yet in the immediate term but we think there's a very positive trend there going forwards.

We continue to make good progress on the military product as well, although, as we've said, that sits out in 2022. As a general feature, you've probably heard that we remain extremely focused on maximising the opportunities that this crisis is shining a light on, post-COVID, in what we call urban security, so outside airports in more general environments of travel: crowded places, for example.

**Jonathan Hurn:** Okay.

**John Shipsey:** Just to your question on the order book, we don't disclose the size of the order book, we haven't set that precedent. What we did say at the half-year is we entered this half with the strongest order book we've ever had.

**Jonathan Hurn:** Yeah.

**John Shipsey:** It is of the order of – you know, it does extend towards a year, in terms of the size of it and we still have substantial backlog – or, sorry, orders in place for previously-announced contract wins for the likes of TSA in Spain and we still have a lot of deliveries to complete.

**Andy Reynolds Smith:** We do. Indeed, you can be clear that the order book and our market share wins remain very positive and strong.

**John Shipsey:** Yeah. And the two things that we'd highlight to temper any exuberance is that, you know, we do have very big comparators. We had a very big year end in the last couple of months for Detection in the prior year. And the thing that, you know, we've obviously got our eye on is, unsurprisingly, in this last period, the number of tenders being issued has dropped. You know, we look forward to that recovering, there was regulation and there's new projects that, you know, have to move forward but we certainly have seen a hiatus in tender activity, which makes the Kuwait win, you know, all the more important for us.

**Jonathan Hurn:** Great, very helpful, thanks. And then the last one was just on Medical. Obviously, looking out there right now, sort of Medical is very much in focus, I mean, over the last sort of couple of months, have you seen any sort of revived interest in your Medical business from trade buyers? Have you had sort of more sort of incoming inquiries? Thanks.

**Andy Reynolds Smith:** Well, you'll forgive me for not commenting on that. As we said at the last update, I do think, you know, this is shining a light on the value of Medical but you'll forgive me for not discussing any further what that might mean.

**Jonathan Hurn:** Sure, no. Okay, so obviously it's still on the table as a possibility if the right offer comes across.

**Andy Reynolds Smith:** Our rationale is [inaudible] –

**Jonathan Hurn:** Okay, fair enough, fair enough then. Okay, let's leave it there. Great, thank you guys. Thanks for your help.

**Andy Reynolds Smith:** Thank you.

**Operator:** And the last question is coming from the line of Robert Davis from Morgan Stanley. Please go ahead.

**Robert Davis (Morgan Stanley):** Yes, good morning, thanks for taking my questions. I just had a few. One was maybe you could flush out some of the regional trends within the Crane business. I'd be quite interested in the cost of sort of different regions and for oil and gas specifically, what you're seeing.

The second one was just around if you could flesh out a little bit more the details of – you highlighted, in the release, some of the trends, or weakness, you were seeing on, obviously, the aero and construction market as well. I'd be interested to get a little bit more detail there.

And then the final one was just around how you're managing and kind of controlling, I guess, the execution of the projects on the Detection side. It's obviously been much better in the last couple of years but just given the record pipeline, I just wanted to know what you had sort of been doing to ensure that that sort of keeps moving smoothly? Thank you.

**Andy Reynolds Smith:** Okay, okay, yeah. Yeah, thanks very much Robert for those questions. So, just talking about the regional position from a Crane perspective, the Middle East and Asia remains very strong, very active. As you know, there's a large amount of product moving around the world and the majority of the investments that will continue to go in over time now are really around Middle East and Asia.

The US is – probably not surprisingly, the upstream side of the US is really very difficult at the moment. We're not exposed, as you know, to that any longer and Europe is in a similar situation. That – sort of that upstream OE sentiment in the US and Europe is really difficult right now. What we're firmly fixed on is the return to demand that seems to be coming through as the world continues to – or gets travelling again.

I think, on the Detection contract side, I mean, as you know, the – you know, back in the bad old days, you know, contract management and programme management was not the forte of the Detection business, this, you know, dating back to sort of 2012, 2013. We have a completely different position now in terms of both our ability to negotiate the contract but get the right contracts and to programme manage the execution against it and it's something that's been top of my list from the very beginning, actually: programme excellence, programme excellence and contractual excellence is right at the top of the list. So – and we have very regular, detailed, investment committees against all of the main contracts and reviews: post-programme reviews and during-programme reviews on the execution side. So I guess, in short, I mean life can be tough sometimes but I mean we're in a very different, much more robust position now contractually and from a programme execution perspective.

I'm sorry, you had a question on [inaudible] –

**Robert Davis:** There was one just fleshing out some of the aero and construction trends you were seeing.

**Andy Reynolds Smith:** Okay. Okay. So, from an aero perspective, as you know, Flex-Tek is – probably about a third of its aero is military, which is currently remaining very strong. Most of that is the Joint Strike Fighter, so that's not a big surprise to people. On the commercial aero side, we are seeing, essentially, what everyone else is seeing at the moment. So, you know, demand is down in the order of 25% going forwards. We do not see that changing in the short term. There may be a surprise behind it but essentially we're modelling out that for a longer period of time.

The US – because our business is almost – on construction is almost entirely US. We do have some increasing offsets in Europe but that was down for sort of the first three months of the second half and down quite a lot, which is why, you know, Flex-Tek is under most pressure at the moment. But we are seeing, you know, some pick up and in fact quite some pick up in US construction right now. I mean, they're essentially back at it but I guess I've got a note of caution in my mind around, you know, increasing occurrences and spikes that appear to be, you know, coming out around the US at the moment.

But that order book in US construction was coming back quickly.

**Robert Davis:** That's great. Thank you for the colour. Thank you.

**Andy Reynolds Smith:** Okay. Okay. Well, thank you very much everyone. I really appreciate you joining. I know and I understand today is a bit of a busy day for you all so, yeah, much appreciated, really looking forward to seeing everyone. I'm no longer enjoying the confinement that – at my end, so very much looking forward to seeing people when it's possible. Thanks again to everyone, appreciate it.

**John Shipsey:** Thank you.

**Operator:** That does conclude our conference for today. Thank you for participating; you may all disconnect.

[END OF TRANSCRIPT]