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Half Year 2020 Smiths Group PLC Earnings Presentation

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CORPORATE PARTICIPANTS

Andrew Reynolds Smith *Smiths Group plc - Chief Executive & Executive Director*
John F. Shipsey *Smiths Group plc - CFO & Director*

CONFERENCE CALL PARTICIPANTS

Andre Kukhnin *Crédit Suisse AG, Research Division - Mechanical Engineering Capital Goods Analyst*
Andrew J. Wilson *JP Morgan Chase & Co, Research Division - Analyst*
Edward Maravanyika *Citigroup Inc, Research Division - Director*
Mark Davies Jones *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate*
William Turner *Goldman Sachs Group Inc., Research Division - Research Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the 2020 Interim Results for Smiths Group plc. (Operator Instructions) I must also advise you the conference is being recorded today, Monday, the 6th of April 2020.

I would now like to hand over to your first speaker today, Andy Reynolds Smith, Chief Executive. Please go ahead.

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

Thanks very much, Summer. And hey, good morning, everyone. I really appreciate you joining the call. I mean these are very difficult and uncertain times for us all, and I very much hope that you and your families are safe and well. And I do appreciate you taking the time to listen in this morning. I know there's a lot going on.

I'm going to give you an overview of our results, how COVID is affecting our business and the actions that we're taking to address the challenges that this brings us. John Shipsey, our CFO, will then explain our financial resilience and talk you through the numbers. And then I'm going to come back and conclude on why I believe we're well positioned and prepared for the future.

Turning to Slide 5. You will have seen our trading update last week. And today's results, let's go into some more detail. We made a strong start to the year with a good set of half year numbers, delivering another consecutive period of good growth and strong cash generation in Smiths' continuing operations and Smiths Medical. We've seen a positive start to the second half, too. But as we move through April, things are clearly getting tougher in many areas due to COVID-19. With this in mind, there are 3 things that are important to us right now. Number one, the safety and well-being of our people. Number two, business continuity for our customers. And number three, the resilient strength and preparedness of Smiths financially, operationally and strategically. In particular, I want to emphasize that we're planning comprehensively, making, when necessary, big prudent decisions, including the postponement of the separation of Smiths Medical and deferring our interim dividend to support this planned strength of our position and speed of reaction to this high business uncertainty. As you all know, it's developing fast and will likely get worse before it gets better, but it will pass, and we will emerge stronger and well positioned for long-term growth.

Before I talk further, it's important to be clear that throughout all of this, the safety of our people and their ongoing well-being is our #1 priority. We're working daily to ensure this in a coordinated way around the world with many actions in place, including infection control measures in operations, alternating shift patterns and working from home, where people can.

Moving on to how we're maintaining supply and service. The year so far for Smiths has really been about managing the growing disruption to our suppliers, our operations and our service network globally. This started earlier in the year in China, where we learned valuable lessons about maximizing business continuity, which we're now using throughout our business as the situation unfolds around the world. Our China operations and supply base are now fully online, but the disruption is now quickly rolling through the rest of the world.

Against this backdrop, we delivered good first half results growth in our continuing operations with 8% reported and 3% underlying, which would have been higher if it had not been for the disruption in China during the final month of the first half. Importantly, cash remain king for Smiths with overall cash conversion of 98% for the group overall and 109% for continuing operations.

As you heard in the trading statement last week, the first 2 months of the second half were equally good. In fact, revenue growth was stronger than the first half despite the clear expectation and indications of weakening over the next few months. John is going to give you a full rundown in a minute, but I wanted to highlight now that our liquidity and headroom to deal with the worst that may come is very strong.

Ensuring business continuity is a very complex task right now. As an example of this, our business continuity actions include global operations and supply chain leadership team, which is meeting daily to make the important decisions to get our products and services to customers to keep them running. As of yesterday, our 180 global service and manufacturing locations, that were a number that were closed or partially affected, and we're seeing a similar impact in our supply base. But we're maintaining business continuity, and many of our sites have been deemed critical by the governments and authorities. This is changing daily, however, as locations are closed or levels reduced temporarily for a few days. The team have been doing an amazing job to keep our customers running, most of whom are in critical and essential industries, which, in many cases, quite literally keep the lights on and people safe and healthy.

In the year so far, it's not really been about material demand reduction at Smiths. It's been about managing the significant supplier and operations disruption resulting from COVID. This is now beginning to combine with a weakening of demand in some areas, with the exception of medical and with the expectation of more to come.

Despite the negative impact of supply and demand, there are also a number of counterbalancing positive factors across the group. It's perhaps worth reminding you that over 60% of our cost of sales is from our supply chain, meaning we have the ability to react quickly and flex our operations to variations in demand. But we are mindful that our supply chains will also be under high pressure during these times, and we're focused on managing this, too.

At this point, we're continuing to see more weakening of demand and an uncertain outlook across our continuing businesses, but with a strengthening picture in Medical. In John Crane, it's worth remembering that about half of the business is in oil and gas and the rest in chemical and pharma, et cetera, and we're making good progress growing these industries. Our oil and gas exposure is also almost entirely downstream, so we're not directly or immediately exposed to the large industry disruption expected in upstream extraction. Also, 70% of Crane is aftermarket and service.

For Crane in oil and gas, which is, of course, a small proportion of the total group revenues, it's always been about how many barrels of oil are refined each day and how many the world burns rather than the oil price, despite the positive or negative effects on investment sentiment, which the overall price has. However, the world demand for oil is now seem to be down by about a quarter as we burn less oil and refining production has remained at previous levels up until this point. This is meaning that the world storage facilities are filling fast, and the current capacity demand gap is growing and will likely have a knock-on effect in refining production soon. With this in mind, we're prepared to react and are already working with closely -- very closely with many of our customers around the world to support enabling them, to take positive advantage of this downtime for additional service, replacement and new equipment installations, which will also help them ramp up faster when necessary.

In Detection, we're starting to see the increasing effect of a large number of passenger airports closed or operating at significantly reduced capacity. This is driving our customers to reassess the timing of some new equipment installations and on how to maintain service and software upgrades in the best way so that when they reopen, they're instant on. Detection had a very strong first couple of months in the second half following a good first half, but we're now seeing equipment installations being pushed to the right. However, this is being somewhat offset by increasing discussions with customers where they want to use the quiet downtime to install new equipment to meet regulatory demands. So we're starting to see some push left, too.

Similarly, in Detection, service and software is essential that the equipment is maintained and remains in line with regulatory requirements. It's not just a matter of a big software update as it is on our computers when you want to switch this on again. It must be continuously serviced due to the hardware and software interactions. This will not be about order cancellations for detection as the market is driven by government regulatory requirements, which must be met on time for passenger and cargo safety.

As much of the customer base is government or government-related, we also have a number of major agreements already in place to maintain revenue streams throughout this period, but the next few months remain very uncertain as all of this comes together. I'm really pleased that we have a record order book in Detection right now, highlighting an excellent period of business wins and share gain.

In Flex-Tek, we saw good growth in the year-to-date, but it is getting harder. We saw a positive early contribution from the United Flexible acquisition to our existing aerospace business during the period, and this built on our aerospace position, enhancing our exposure to military platforms, including the Joint Strike Fighter, providing some additional resilience at the moment. We're also substantially stepping up capacity in Flex-Tek for medical tube sets, particularly those used with ventilators.

Interconnect was impacted in the period and continues to be by the previously communicated softness in the connectors market. It has a strong order book built over the last couple of years based on our technology-led customer strategy, but the next few months will continue to be difficult.

Medical continued its trajectory with a third-consecutive quarter of growth in the first half that would have been much better had it not been for a supply disruption to our syringe -- one of our syringe pumps. The results of our investment and improvement plans are beginning to bear fruit. We also started the first 2 months of the second half very well in Medical. A strengthened management team is in place and delivering on our plan for long-term growth and outperformance based on our leading-market positions. As you heard in our trading statement, the Board decided that we should postpone the separation of Medical due to the very high market uncertainty. This is the right thing to do, enabling us to focus all efforts on the moment and the demand the present situation brings and enable us to deliver the best shareholder value for Smiths and Medical at a time when things are clearer.

In the meantime, the Medical business is playing a very important role in the world, particularly in critical care devices. As part of this, you may have seen in the press the huge role that Smiths is playing in a massive ramp-up of demand for ventilators around the world. We must deliver on this life-saving mission in our battle against COVID. Our people are rising to the challenge in giving everything they humanly can. I'm so grateful to them for what they're doing. No one could ask for more.

I'll now turn it over to John to take you through our good first half numbers, and then I'll be back to talk in more detail on why I believe and we believe the Smiths' fundamentals, end markets and strong financial position give us confidence that we'll come through this strong and prepared for the future. Over to you, John. Thank you.

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

Thanks, Andy, and good morning. Let me start by adding my best wishes to everyone joining the call. Wherever you are, I hope that you are keeping safe and well.

As Andy has just said, we start from a position of strength operationally, financially and strategically. The financial results for the 6 months to January reflect that. These are good results. They demonstrate momentum and balance sheet strength. Smiths is well placed, both to deal with the near-term challenges of COVID and beyond that, to deliver consistently good growth and financial returns over the medium term.

So let's turn to Slide 10 and the results for the group beginning with continuing operations, where for the fourth-consecutive half, we delivered good top line revenue growth, up 3% on an underlying basis. Thanks to a maiden contribution from United Flexible, reported revenue was up 8% to GBP 1.2 billion. It was a similar story in terms of operating profit, up 1% on an underlying basis and 6%, including United Flexible.

Profit before tax grew 10%, thanks to a lower interest charge. Most of all, I was pleased by our excellent performance on cash with operating cash conversion of 109%. That really speaks to the strength of our business, even as the world enters a more challenging phase.

Turning to discontinued operations. We also delivered sustained improvement in Smiths Medical, up 1% on underlying revenue and profit. Please note that accounting rules require us to exclude depreciation and amortization from the reported profit of discontinued operations. However, for comparability, we have included them in calculating underlying profit growth.

Bringing all of the above together, group EPS was up 3% on an underlying basis and 7% including M&A. The results clearly demonstrate the quality of Smiths today. Together with our balance sheet strength, it's why I'm confident of our ability not just to withstand short-term challenges, but above and beyond them to deliver sustained outperformance.

Let's now move on to Slide 11 and take a look at revenue by division. John Crane, once again, led off with a strong performance, up 6% in the half. We were actually expecting more until COVID prevented our Chinese business from shipping in the second half of January. The aftermarket, which accounts for about 2/3 of John Crane, was up 5% and original equipment, up 8%. That's important and is the product of continued focus on growing the installed base in order to lock in aftermarket revenue for years to come.

May I also take the opportunity to reiterate that within the energy market, John Crane mostly operates downstream, and its performance is, therefore, more directly correlated with oil demand and with the oil price itself. And notwithstanding the external environment, John Crane started the second half with a very strong order book.

Detection also delivered a good first half with total revenue up 4%. As with John Crane, Detection is very focused on growing long-term aftermarket revenue through expansion of today's installed base. So I'm very pleased that we delivered 8% growth in original equipment. That's a strong result, especially given that previously flagged pricing pressures continued.

Aviation grew 5% overall, supported by the start of previously announced contracts for both checked and cabin baggage. Other security systems were up 3% with relatively even growth across all subsegments, not least ports and borders. Thanks to our leadership in both technology and aftermarket service, the forward order book for Detection stands at a record high.

Turning next to Flex-Tek. Revenue was up 3% on an underlying basis and 35% on a reported basis, including GBP 56 million of incremental revenue from United Flexible. Flex-Tek continued to deliver solid financial performance, thanks to an obsessive dedication to product development and customers.

And finally, Smiths Interconnect. As previously communicated, it was primarily impacted by a slowdown in its market linked to the trade dispute between the U.S. and China. The result was also affected by January disruption to its Chinese operations and the very strong prior year comparator. As a result, revenue was down 7%.

Let's now turn to Slide 12 and look at profit by division. Starting with John Crane, where operating profit broke through the GBP 100 million barrier and increased 4%. And that was in spite of higher investment in original equipment, which is lower margin, that brings with it valuable aftermarket revenues. Detection also grew profit 4%. As with John Crane, we're focused on long-term profitable growth, evidenced by the higher mix of original equipment and a record order book. Pricing pressure continues to be a feature of original equipment, but we nonetheless delivered a good 15% margin.

Firstly and most importantly, we have technology leadership, and we're investing to extend that leadership. Cash R&D increased to 10% of sales with 1/4 of that funded by customers. Secondly, we can use our scale to manage tightly the cost base, everything from design and procurement to productivity and overhead.

Turning next to Flex-Tek. Flex-Tek delivered an outstanding performance, growing profit by 9%. This result was driven primarily by volume growth with favorable mix and also the non-repeat of one-off costs in the prior year. Operating margin for the half stood at 18.4%. And finally, Interconnect, where operating profit was down 50%, driven by the expected lower volumes and the tough prior year comparator. But the lower profit also reflects actions to optimize the cost base, including specifically the relocation of production capacity. These actions hit current profitability, but they're absolutely the right thing for the longer term.

And as with our other businesses, we continue to invest in technology leadership, both organically, with R&D up to 8% of sales; and inorganically, for example, with the acquisition of Reflex Photonics, which I'm very excited about. So the half looks unfairly negative when

Interconnect is actually better positioned to deliver technology-led growth.

Let's turn now to Slide 13 on Smiths Medical. As I said at the start, we continue to build momentum. First half revenue was up 1%. Ambulatory pumps, COPD and new products, such as the convective warmer, all contributed good growth. Revenue would actually have been higher if it were not for some disruption affecting our syringe pump. On an underlying basis, profit was also up 1%. Importantly, the gross margin remained strong, and as you know, that's one of the great qualities of Smiths Medical. Below gross margin, costs were up due to a combination of restructuring and other one-off costs. As I mentioned earlier, reported profit excludes depreciation and amortization as required by accounting standards for discontinued operations. Putting depreciation and amortization back in, leaves margins broadly stable at 16.4%.

Turning next to cash flow on Slide 14. As I said at the start, for me, the most pleasing aspect of our performance was cash. We were strongly cash generative. I would particularly highlight operating cash conversion of 109% for continuing operations. And for the group, 98% with free cash flow of GBP 132 million. As promised, we collected the abnormally high receivables from year-end, and we continue to make structural improvements to both receivables and payables, all of which will serve us well in the current environment. But we can still achieve more. In particular, high order books meant that we had to prioritize customer commitments over inventory in Detection. But right now, our clear priority is to exercise very careful oversight of working capital and CapEx to safeguard both revenue and cash, which leads nicely on to Slide 15 and our balance sheet.

You will have seen from our trading statement that we're in a strong position. We have balance sheet strength and significant liquidity. On pensions, we've worked hard for a number of years such that, today, our 2 U.K. plans are well funded and largely derisked. Taken together, they have an accounting surplus of almost GBP 500 million. But more importantly, they were fully funded on a technical provision basis of the last valuation. We've executed buy-ins, covering 35% of liabilities. And buy-ins, government bonds and investment-grade credit comprised 90% of assets with equities only 1%. All of that means that our plans are well funded, well hedged and well invested.

Moving to the Smiths' balance sheet. Together with high cash conversion, our conservative balance sheet means that we are well placed to withstand external shocks. We finished the half with net debt of GBP 1.3 billion, including GBP 134 million of leases. EBITDA for the last 12 months was GBP 699 million across continuing and discontinued operations. And please don't forget the almost GBP 200 million of EBITDA from discontinued operations when calculating our leverage. And so the ratio of net debt-to-EBITDA was 1.8x, including leases. Our debt has a weighted average maturity of 4.6 years with no maturities before October 2022. Against that, stood about GBP 250 million of cash and an undrawn revolving credit facility of $800 million, extending to 2023 and beyond. We have no leverage covenants on any of our debt. The undrawn RCF includes our 1 financial covenant, interest cover of 3x or more. By comparison, that measure stands today at 13x. So at the half year, our total liquidity headroom was over GBP 850 million. Furthermore, based on our credit rating, Smiths should also be eligible to access up to GBP 600 million via the Bank of England's Covid Corporate Financing Facility.

I'm confident in the strength of the group's financial position. However, as we announced in our trading statement last week and at this time of unprecedented uncertainty, the Board considers it prudent not to declare an interim dividend. We fully recognize the importance of the dividend to shareholders, and we'll review this decision again later in the financial year as trading conditions become clearer.

So to conclude, our first half results give us confidence in these uncertain times. We have the operational and financial strength to face down the short-term challenges of COVID. And beyond that, the strategic foundations on which to build consistent outperformance.

And on that note, let me hand you back to Andy.

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

Thanks, John. Very clear.

Turning to Slide 17. As you can see and you've just heard, we've made a good start to the year, having started strong, and we have a strong financial position as we navigate through the second half and beyond. We've got critical products in many markets in these difficult times, a flexible and resilient business model and all necessary short-term actions in place and plan to deal with worsening conditions if they occur and the opportunities, which the crisis presents.

Finally, we have a strong balance sheet -- financially, we have a strong balance sheet. We're operationally highly cash generative, giving us the firepower for now and for the future. Although we're confident in our financial, operational and strategic positions, the next few months are difficult to predict, and we're being very prudent as part of our focus on preserving cash and reducing costs. Measures are either already underway or planned for deployment when necessary, and we're confident that we can implement quickly and effectively.

Moving to Slide 18. Beyond the short term, we have positioned Smiths to outperform long term. I'd like to talk about why we're confident of this. The Smiths business brings resilience through our global footprint and key market breadth. Over the last 4 years, we've been through a program of extensive transformation, both at an operational and portfolio level, to position us for long-term growth and returns outperformance. Our businesses are leaders in their fields, and we're well positioned with more than 90% in long-term growth markets where we're able to bring value to our customers through our competitive differentiation operationally, through our innovative technology and services, and our people, bringing solutions which serve through sustainability and efficiency, higher safety and security and the connectivity of the world in all its forms.

Over the longer term, as we revert to more normalized conditions, we will also continue to accelerate our progress through our ongoing disciplined and complementary M&A to improve our market, customer and technology positions faster. We are strong financially, operationally and strategically. We have options, and we're completely focused on coming through this in the best possible way.

I'd like to finish but with the most important thing, by thanking the amazing Smiths people who I have the privilege to work with. I'm inspired by them every day. They are the difference for Smiths in the short and long term. My sincere thanks to all of you for everything you're doing, and please stay safe.

Thanks very much for listening, and John and I would now be delighted to take any questions you may have. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Andy Wilson from JPMorgan.

Andrew J. Wilson ***JP Morgan Chase & Co, Research Division - Analyst***

I've got a few questions, if that's okay. If we could start on the John Crane side. You made some comments, Andy, very helpfully around particularly refinery and downstream oil and gas. Could you just sort of give us a little bit of the similar color around the non-oil and gas part of John Crane and just how we should think about those in the second half, obviously, appreciating the uncertainty, but just in terms of a framework to think about those as well, please?

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

Yes, absolutely. And yes, you are loud and clear, Andy. Thanks for that. So just as a reminder there, the non-oil and gas piece is predominantly chemical, pharmaceutical and pulp and paper. And as you know, over the last several years, we've really refocused on those industries as well as oil and gas. And in total now, they're just under about a half of Crane, and in the chemical business is not dissimilar to an oil refinery. So a lot of the technology and the capabilities are super. I mean as we look at those, I mean, clearly, pharmaceutical is in the current situation continuing to run strongly. Parts of the chemical industry are a little weaker at the moment, but we're really focused on our market share gain right now as the most important thing rather than trying to call exactly where those markets will go. And the same thing probably applies to pulp and paper, so a little bit more difficult to predict how the market is going. It's continuing to run currently. And as you can probably see from the 8 months of results that we've talked about, with Crane that has continued in good growth throughout that period, and again, we're very much focused in the aftermarket piece. So this is all about how do we outperform the rest right now rather than where exactly those markets will go.

Andrew J. Wilson ***JP Morgan Chase & Co, Research Division - Analyst***

That's great. And switching across to Detection, there's a couple of, obviously, very helpful comments in terms of thinking about the, I guess, the aftermarket side and also the confidence around orders being deferred rather than canceled. Again, it's a positive. But just wanted to think about -- and I think John touched on it, the flexibility and the cost base Detection because that feels like that's going to be the challenge in terms of protecting the capability for when those orders do complete. Can you just give us a little bit more help around just where that flexibility comes from the Detection?

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

Yes, well it's really the feature that I talked about with the group overall that the Detection business is really all about designing great products, customer intimacy and assembly, essentially. So putting a building to solution. So a large proportion of its cost base is the supply base. That's obviously brought some challenges as that gets disrupted, but our ability to flex it, as I mentioned earlier, is very good. So if you take your mind back a little bit to some of the previous years when Detection was a bit more lumpy, in several cases, we have, for example, revenue down double-digit in the first half and up double-digit in the second half. But within that, we were able to keep the margin within a tight band of 15% to 17%, and I think that really shows that flexibility of that cost base to react.

Andrew J. Wilson ***JP Morgan Chase & Co, Research Division - Analyst***

And maybe just a final quick one for John, just in terms of the cash flow in the second half. I guess, I understand, John, you particularly flagged we need to be considering. I mean the net debt EBITDA seems to have come in a little bit better when we included Medical, particularly that I was expecting. But sort of as we look into the second half, appreciating there's a lot of uncertainty on where the profit number ends up, but just in terms of the mechanics for the cash flow anything we should be -- we're thinking about or would we expect another good period?

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

Thanks, Andy. Well, yes, certainly, you're right. First important point is definitely to make sure that everybody gets our leverage correct. Sometimes it's automatically calculated, and the machines don't necessarily pick up on the discontinued EBITDA, which, as I said, is close to GBP 200 million. So we do have a very strong position. I mean in terms of forward guidance, I can't offer you too much right now as I'm sure you'll understand. But what I can say is, we're absolutely focused on managing cash, both across working capital, and I think we're well placed to do that -- it -- and the CapEx. I think the disruption that we'll need to manage is, if you like, when the sales line, if and when that's -- not if -- as that moves down because we can see that it will, making sure that we manage our working capital well.

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

Yes. And Andy, I think on your point there around order cancellations and push-right, this is very clearly not a cancellation story because, as you know, it's driven so strongly by the regulatory demands and the times by which those have to be met. This is really about what gets pushed right from an OE equipment installation point of view as airports are down and terminals are down. But also this increasing trend, which I couldn't argue, is a complete counterbalance at the moment, but it is an increasing trend with airports and terminals wanting to use that downtime effectively. So there's a push-left starting to develop here as well. The aftermarket and service piece, as I said a bit earlier, is something that is coming through strongly. They have to keep running, they have to keep dry running in many cases lines because you can't just switch them off and hope they come on again when they start. And this constant upgrading of the software around new threats as they emerge is so interrelated to the hardware itself. It isn't something you can do over-the-air for example. So this feature of customers wanting to work out, how to keep running on the aftermarket and service and software upgrades continuously and actually putting their money where their mouth is on that as well with commitments in place already with big customers to keep that happening. So you need to think about this really as there is some -- there is push-right, there is also push-left occurring on equipment installations and the need to keep airports running or ready to run during the time that they're down.

Operator

And your next question comes from Mark Davies Jones from Stifel.

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

Also a couple of things from me, if I may. Firstly, coming back to Detection and that regulatory underpinning. Can you just remind us of the timings around that in terms of the flexibility of your customers to move things back a bit? As I recall, some of those European regulations were due by September this year. Are those going to be allowed to flip a bit?

And then the second question was on Interconnect. John referred to some cost of moving some production around. Can you give us some more detail of that, both in terms of some indication of the scale of the cost involved and whether the process is now complete, and we should see some removal of that overhang in the second half?

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

Okay. Well, I'll take the first piece on timing, and then, John, do you want to take the second part?

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

Obviously.

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

So from a timing perspective, there are really 3 pieces of it. There's the European cycle, which ends -- the target is April 2021. We have heard no signals or signs that, that is changing, or there's any view that, that may change. I think it extends enough beyond the COVID -- people's view of when COVID may be stabilizing. So nothing we're hearing there at all. So everyone is still working to that target. And in fact, some of the push-left that we're getting now is about using this time to ensure that people do meet that because, you might remember, this was kind of 70% through this installation cycle. And there were a few latecomers who were expecting a bit of a rush for the line on it, concerned that the airports are very busy during the summer, ordinarily with vacation and stuff. So trying to use that opportunity now to ensure that they hit the target. In the U.S., then you've got the TSA baggage checkpoint programs both running. You might remember that we won the first tranche of the U.S. checkpoint with our CTiX kit, which is a world leader, 100% of the first tranche. They haven't put fixed timings on when it will be 100% complete, but we're now running on the first tranche. So the second tranche will be coming sometime soon. Will that be delayed based on the current situation? I don't know. There are certainly no signals of it. And then there's still in prospect the checked baggage, the underground piece, which is now quite old in the U.S., having been upgraded back in post-9/11 effectively. So that is still running. And then you have really the rest of the world, which has to meet in many cases for international flights in and out of Europe and the U.S., similar standards. And then you have the domestic airports in Asia. So we're not seeing anything around signaling of any change or delays as we go through COVID at all. And the timings will remain intact at the moment.

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

Thanks, Mark. It's John. Just to answer your question on Interconnect. So what we've been doing was relocating production and actually duplicating capacity, in particular, associated with tariffs between China and the U.S. And so the costs, which, overall, would be low single-digit millions in the half relate to both the cost of moving and operating duplicate capacity and also the tariffs, which -- the tariffs are now dropping away because we've relocated the production. Looking forward to the second half, that process of relocation is largely complete or at least complete. But what we have continued to do in the second half and, obviously, in the context of COVID, this becomes even more real, is that we've continued to rationalize that production capacity to eliminate the duplication.

I hope that answers your question.

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

Yes. I mean, it removes 1 overhang, but obviously, the demand side is the other part of the picture.

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

Exactly in the COVID context, absolutely.

Operator

And your next question comes from Andre Kukhnin from Crédit Suisse.

Andre Kukhnin ***Crédit Suisse AG, Research Division - Mechanical Engineering Capital Goods Analyst***

Yes. It's Andre from Crédit Suisse. Can I just start with Medical? Your comments on February and March, up mid-single digit, are very helpful. I also sense that you see scope for acceleration from that level going into April. Did that -- did I read that right? And I guess related to that, how was the order performance in Medical in the kind of last few weeks?

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

Okay. Well, the Medical business is a big focus at the moment for obvious reasons, and we're really pleased with how it performed both from an order book and demand perspective or revenue perspective in the first couple of months. We don't see that changing at the moment because it's still playing out as now there's such an intensity around demand for certain critical care products and how that will balance with demand for the other products. And I emphasize, when I say critical care, I don't mean our Vital Care segment, which is about 1/3 of the business. There are a range of critical care products throughout, including infusion and Vascular Access. So this is playing out. I see this as more moving positively than negatively, though. If I could answer it that way, but we need a few more weeks as people are waking up and realizing what they need and what they've got to do.

Andre Kukhnin ***Crédit Suisse AG, Research Division - Mechanical Engineering Capital Goods Analyst***

That's very helpful. And just a much broader question on Medical. Obviously, you've delayed the separation, but what is the plan now? And are there still strategic options there?

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

Okay. Well, it was -- I mean, it's definitely clearly the right thing for us to do now for both practical and strategic reasons. I mean, we've got a lot of demand that's starting to emerge. It's clear that the investments that we've made and the improvement plan that we have in place is starting to bear fruit. So for practical and strategic reasons, it's the right thing to do right now. One of the clear focuses for us was our ability to create best shareholder value in Smiths and Medical. So -- and we've made our position clear around how we're handling that. It's not unhelpful, by the way, right now, that Medical performing the way it is, pretty much opposite to many other markets is not a bad thing for Smiths right now, however.

Andre Kukhnin ***Crédit Suisse AG, Research Division - Mechanical Engineering Capital Goods Analyst***

No, no, not at all. I was just wondering if that changes your thought process at all fundamentally on Medical.

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

Well, what was -- thing for me is, this is really showing the value of the Medical business for us. And our job is to maximize the value of all of our businesses. So -- but right now, we're very much focused on doing everything we can in the current circumstances and continuing to try to achieve getting maximum value for shareholders from all of our businesses.

Andre Kukhnin ***Crédit Suisse AG, Research Division - Mechanical Engineering Capital Goods Analyst***

Got it. And if I may, just a very quick one on Detection. Is there any chance you could give us an indication on what percentage of your customers are the government-backed airports as opposed to private?

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

Well, those are -- yes, that's a very good question. I mean those are sort of ongoing and, what, fluid and sensitive conversations as you can imagine. So forgive me for not being precise about it, but I can tell you that major customers and governments are moving in that direction at the moment. But forgive me for not giving you an exact number because it's fluid and developing day-by-day at the moment.

Operator

And your next question comes from Ed Maravanyika from Citigroup.

Edward Maravanyika ***Citigroup Inc, Research Division - Director***

It's Ed from Citi. Thanks so much for the color on Detection just in terms of how you see something being pushed to the right and some to the left. Could you also maybe kind of give us something similar for John Crane, especially with regards to maybe some of the oil and gas projects? Are you seeing any big deferrals or cancellations already? Or just what color can you provide there?

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

Okay. Well, Crane is actually quite similar to Detection right now and that our job is primarily in the aftermarket and service. And as I mentioned earlier, there's quite a big intensity at the moment around how did they -- how the customers used this opportunity to do more so that they're really ready to go again if they do start cutting back production, that they're ready to go again because these things are really hard to turn on and off. In fact, one of the biggest challenges that we have right now is actually getting our service engineers where they need to be. Talking to the #2 in Crane there, couple of days ago, and he was telling me about situation in the Middle East at the moment where the crew arrive and what would normally have been arrived and driving the car for 4 hours turned into a 3-day trip because they had to go through various blockades as part of the COVID enforcement. But we're keeping it all going. So it's -- I mean, the team is doing an amazing job at the moment. On big new OE, we still have a very strong order book. You'll have seen the revenue versus aftermarket in the first half remain very strong. We aren't seeing that changing. But people are looking a bit at the timing, some push-left, some push-right. But overall, we aren't seeing that. The big feature is going to be how much short-term refining capacity reduces as this capacity demand gap develops.

Operator

And your next question comes from Will Turner from Goldman Sachs.

William Turner ***Goldman Sachs Group Inc., Research Division - Research Analyst***

Just a few questions for me. Firstly, on Flex-Tek. So obviously, Flex-Tek is exposed to some U.S. construction and commercial aerospace, where the demand, that outlook is certain to weaken over the next 6 months or so. Yes. However, you spoke about some medical and defense exposure. How big is that as a share of Flex-Tek? And is that at least to -- at least partially offset the commercial aerospace and U.S. construction exposures?

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

Yes. Will, commercial aerospace is clearly in a challenged place at the moment and was before COVID in some situations. I mean, as a reference point there, the 737 MAX, which has well published challenges at the moment. We have a very, very small exposure to that. Our biggest program on the defense side is the Joint Strike Fighter, which is increasing day by day at the moment. Within Flex-Tek, the aerospace piece is about 1/3 following the acquisition of United Flexible. So it was a sizable piece of the story.

The medical tubes piece was much smaller previously, mostly because the demand for ventilators and other products that need cheap systems was relatively low in a steady state form. I mean that's increasing massively, and we're converting over some of our operations. So again, I can't put a precise number on it right now, but we're converting over some of our capacity in other tubing industries to supply that. So again, in the coming weeks, that will become clearer because, at the moment, customers are just getting to grips with their increasing demand. I mean you probably have noted that we've been from 0% to 100% on the U.K. ventilator story, which goes from hundreds a month to thousands a month, but this is all playing through at different paces. So I won't put a precise number on it, but I think the size of the defense exposure in aerospace, I mean, it's very sizable as a percentage of the total. And also Medical is starting to flow through now. So the team are working with all the global ventilator manufacturers to see what we can do to ramp production.

William Turner ***Goldman Sachs Group Inc., Research Division - Research Analyst***

Great. And then another question, sort of I think about is that in Detection, do you have any exposures to any form of biohazard scanners or health care checks? The reason why I'm asking is because, obviously, one of the impacts from coronavirus or COVID-19 is that we could see investments in airports for scanning people with high temperatures or any like flu-like symptoms. So I know you do prioritize baggage, but you do have similar exposures as well. So that will be interesting to know.

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

Yes. Well, and again, that's a really good question. We're -- I mean, as you know, we're world leaders in biosensing, but that has been predominantly used for us in the world of defense up until this point, that we are focusing very strongly now on a number of things. We have a program running that we call Clean Air, which is essentially detecting bad things in air conditioning systems in sports stadia, that sort of thing. We have the ability to sense pathogens. So we're working really hard at the moment on the applicability of our technology and the sort of the integrated system solution to adapt some of our capability to being able to sense, well, viruses and antigens. But it's too early right now to start to put any projections on it clearly because it's playing out fast around the world. But I kind of think that this isn't just about how do we get through the next few months, it's also about how the world will operate in the future and the need to know whether people are infected or not or have been infected. So we're thinking hard on that one at the moment and working hard on that one along with many companies. But we have the base sort of capability in place to do what's necessary as just specific testing for specific things that we're working hard on. So you'll be hearing more about that from us.

Operator

Thank you. And we have no further questions, so I'd like to hand back to Andy for closing remarks.

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

Okay. Well, thank you, again, everyone, very much for joining. Really appreciate it. I do know times are very challenging. And just to reiterate, keep yourselves safe and keep your families safe. We feel we're in a strong position right now. As we said, financially, we're in a strong position to react and take the opportunities operationally, and we believe most of all, our eyes are fixed firmly on the future and realizing the potential of Smiths as we come through this. So all of our short-term decisions are driven such that they aren't damaging, but they're going to enhance our long-term position.

But thanks very much, everyone, for joining. Really appreciate it. Take care of yourselves. And I look forward to seeing you when the isolation lifts. Take care. Thanks, everyone.

Operator

Thank you. That does conclude our conference. Thank you all for joining. You may now disconnect.