Smiths Group plc: Trading update & delay to the separation of Smiths Medical

London, Tuesday 31 March 2020

Smiths Group plc ("Smiths" or "the Group") releases a trading update covering good growth for the six months ended 31 January 2020 ("HY2020") and the current impact of COVID-19; and announces a delay to the separation of Smiths Medical. This announcement contains inside information.

Smiths was ready to publish its interim financial results today. However, it is complying with regulatory guidance to all UK-listed companies not to publish results before 6 April 2020.

The key focus remains the safety of staff, business continuity, and actions to ensure resilience in the context of market uncertainty.

Good growth in the half

- Continuing Operations[1] delivered underlying[2] revenue growth for the 4th consecutive period, up +3%. Reported revenue increased +8%, including the acquisition of United Flexible.
    - John Crane revenue was up +6% on an underlying[2] basis, with Original Equipment ("OE") up +8% as we continued to invest in growing the installed base.
    - Smiths Detection revenue grew +4% on an underlying[2] basis, with OE up +8% as we started to deliver previously announced contract wins.
    - Flex-Tek revenue increased +3% on an underlying[2] basis, with growth in both aerospace and industrial end markets.
    - Smiths Interconnect revenue declined (7)% on an underlying[2] basis, driven by previously communicated market weakness and a strong comparative period. Lower volumes, plus the relocation of production capacity, temporarily impacted margins.

- Smiths Medical[1] sustained its return to growth, with revenue up +1% on an underlying[2] basis.

Financial strength and resilience

In HY2020 the Group again delivered strong cash generation, driven by operating cash conversion of 98%.

The Group has a strong balance sheet. At the end of HY2020;

- Net debt was £1.3bn (including £134m of leases following the adoption of IFRS16). The ratio of net debt to EBITDA was 1.8 times. The average debt maturity is 4.6 years, with no maturities until October 2022 and no covenant obligations.
- Total liquidity headroom was in excess of £850m, including c.£250m of cash and an undrawn Revolving Credit Facility ("RCF") of $800m (c.£600m), which does not mature before November 2023. The RCF carries one financial covenant: interest cover equal to or greater than 3 times (HY2020 13 times).

It is our understanding that Smiths should also be eligible to access up to £600m in funding via the Bank of England's Covid Corporate Finance Facility (CCFF).

The Group's pension plans are well funded, hedged and invested. Taken together, the two large UK defined benefit plans[3] had a surplus of £343m on an accounting basis at the half year, and were fully funded on a technical provisions basis at the last valuation.

Smiths also benefits from a purposefully resilient business model;

- Leading positions in attractive markets
- Capex-light, with a significant proportion of recurring aftermarket and service revenues
- A flexible cost base with c.60% of cost of sales being materials and other variable costs
- Serving critical industries with sustainable growth characteristics
- Operational excellence
- High structural cash conversion and strong balance sheet

COVID-19

Smiths activated its central crisis management team in January 2020 to drive the Smiths response, first in China and now globally.

People
The health and safety of our people is paramount and we have put measures in place to ensure that they remain safe. These measures include working from home for employees who can, alternating shift schedules and infection controls in manufacturing sites.

Impact on trading year-to-date
Group trading to the end of March was affected to some extent by early COVID-19 disruption, which is now accelerating. In HY2020 only the Chinese operations of John Crane and Interconnect were disrupted. Orders that were due to ship in January slipped into the second half. All our sites in China have now reopened and are operating at close to normal levels.

For the 8 weeks ended 28 March 2020, percentage revenue growth for Continuing Operations and for Smiths Medical was mid-single digit.

We have adopted measures to reduce cost and conserve cash including hiring freezes, cancellation of discretionary expenditure and, postponement of non-essential capex. We have reinforced controls around receivables and payables, including cash tax (corporate, indirect and payroll).

Demand
We are now seeing generally weaker demand, but with some mitigating factors;

- Some customers have temporarily closed their facilities and have not been able to accept delivery of equipment and services.
- Together with lower oil prices, energy customers have announced reductions in capital expenditure. John Crane is not exposed to upstream oil & gas and has a very strong order book, two thirds of which is aftermarket.
- Passenger airports are closing or operating at significantly reduced capacity, with knock-on impact on both OE and aftermarket revenue. However, Smiths Detection has a record order book.
- Smiths is making a significant contribution to meeting the global demand for ventilators and other critical care devices. Smiths Medical is contracting with the UK Government for a significant ramp-up in production of its paraPAC plus™ ventilator.

Supply
We have experienced some disruption to supply chain and production;

- As of 30 March 2020, sites accounting for more than 90% of manufacturing capacity were open. However, because of infection control measures, sites are not running at full capacity.
- We are pre-emptively obtaining government authorisation for sites to remain open where applicable, given the critical nature of our products.
- A central coordination team is working in real time with operating units and suppliers, to identify and resolve potential operations and supply chain issues.

Forward guidance
We are moving decisively on a number of fronts to address the near-term challenges. Although we believe that we are in a strong position, it is too early to assess the full impact of COVID-19. Therefore we are withdrawing forward guidance for FY2020.

Delay to the separation of Smiths Medical

The previously announced separation of Smiths Medical was on track to be delivered by the end of the first half of 2020. However, it is simply not practicable to complete the separation in current circumstances. Moreover, Smiths and Smiths Medical need to focus on navigating the external challenges – including the delivery of ventilators and other critical care devices. Therefore, the Board has decided to delay separation until conditions improve. The intent to separate remains unchanged.

Dividend

We remain confident in the strength of the Group's financial position. However, at this time of unprecedented uncertainty, the Board considers it prudent not to declare an interim dividend for HY2020. Recognising the importance of the dividend to shareholders, the Board will review this decision again later in the financial year as trading conditions become clearer.

Strategic strength

Beyond the near-term challenges of COVID-19, the Group is well placed to deliver consistent outperformance;

- Businesses well-positioned in long term, attractive growth markets
- Products and services differentiated by market-leading, innovative technology
- World-class operational excellence
- A culture of innovation, entrepreneurship and relentless execution
- Organic growth complemented by disciplined M&A

Andy Reynolds Smith, Group Chief Executive, commented:

"I have been inspired and am so proud of everything our people are doing around the world as we navigate Smiths through these unprecedented and challenging times. Smiths is a strong and naturally resilient business and we will come through this period well positioned for the future. Our business benefits from financial strength, flexibility and a strong balance sheet with significant liquidity. We are keeping our customers running, whilst staying safe and looking out for each other through the disruption. I'm very grateful to our global team for all their efforts."

Definitions
[1] Continuing Operations exclude Smiths Medical which is accounted for as 'discontinued operations – businesses held for distribution to owners'.
[2] Underlying modifies headline performance to adjust prior year to reflect an equivalent period of ownership for divested businesses, and excludes the effects of foreign exchange and acquisitions.
[3] Smiths Industries Pension Scheme (SIPS) and TI Group Pension Scheme (TIGPS).

Contact details

Investor enquiries

Marion Le Bot, Smiths Group
+44 (0)20 7004 1672
+44 (0)75 8315 4386
marion.lebot@smiths.com

Media enquiries

Deborah Scott, FTI Consulting
+44 (0)20 3727 1459
+44 (0)797 953 7449
smiths@fticonsulting.com

Alex Le May, FTI Consulting
+44 (0)20 3727 1308
+44 (0)770 244 3312
smiths@fticonsulting.com

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