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bringing technology to life

SLIDE – ANNUAL RESULTS 2012/13

SLIDE – CAUTIONARY STATEMENT

SLIDE – PHILIP BOWMAN

Ladies and gentlemen, good morning and welcome to the annual results presentation for Smiths Group. To avoid interruptions, can I ask you to check that your wireless devices are turned off?

Peter Turner, our Finance Director, is alongside me. The divisional general managers and some senior members of the corporate team are seated in the front row. As usual, all of the team will join Peter and me in answering your questions at the end of the session.

SLIDE - AGENDA

I will start by giving a brief outline of the results before handing over to Peter to present the financials in more detail. Given the positive feedback from the Interims, I have decided again to ask some of the general managers to present their divisional results. Duncan Gillis has now had almost a year in post at John Crane, Srini is well placed to summarise both the progress and challenges at Medical and Mal Maginnis will update you on developments at Detection. I will review the operational progress in the remaining divisions and set out our priorities for the rest of the year after they have presented.

SLIDE – KEY MESSAGES

There are four key messages that I would like to highlight today.

First, the Company is significantly better positioned today as a result of the initiatives we have undertaken over the past five years or so. These are resilient results in a trading environment that has proved persistently difficult. We have grown sales, profit and increased returns despite sluggish economies in developed markets, government budget cuts, and sequestration and the medical devices tax in the US. At the same time, we have continued to invest to build medium to long term value.

The figures also reflect the benefit of the on-going repositioning of the Company. We have reduced our dependence on government contracts and developed economies by expanding our commercial customer base and our sales resources in high growth markets. We have also strengthened the management teams, their processes and data systems. This is a work in progress but there is no doubt these results would have been much weaker without this repositioning.

Second, we are investing significantly more in growth drivers. For example, we have continued to channel greater resources into sales and marketing in high growth markets such as China, India, the Middle East and Brazil. Emerging market sales grew 14% and now account for around 16% of Group revenues. At the same time we have increased our funding of new product development by a further 5% - to maintain our technology leadership. This investment has increased by almost 60% in the past six years and is delivering a much improved pipeline in new products – some of which will feature in today's presentation. These new products will support revenue and margin growth over the medium to long-term.

Third, we have continued to invest to improve operational efficiency despite the adverse short term impact on cash, margins and profitability. In these results we delivered a further £9m of savings from the Smiths Detection performance improvement programme. Other divisions have continued with a process of continuous improvement including initiatives such as value engineering and organisational change. However, to realise our ambition to further increase investment in growth enablers, we now need something more radical.

Following my challenge to the five Divisions, the management teams have identified further opportunities to address the cost base and build on the success of our drive to reposition and strengthen the Company. So today we are announcing a further significant Company-wide restructuring programme to be delivered over the next three to four years. We estimate the resultant savings at approximately £50 million and we will earmark the majority of this to support even greater investment for growth as we take Smiths into its next phase of development.

Fourth, we remain committed to the rigorous allocation of capital and balance sheet efficiency. Our businesses are strongly cash generative and, over the past five years, we have rebuilt the balance sheet while funding the material cash demands of our legacy obligations, investing £600m in bolt-on acquisitions and also paying a progressive dividend. The balance sheet is very much stronger than the one I inherited… but with no recent acquisitions it is becoming increasingly inefficient. To address this, we are recommending a one-off special dividend of 30p per share. I stress that the Divisions continue to evaluate opportunities for bolt-on acquisitions and I am disappointed that FY13 passed without any of them consummating a transaction.

SLIDE – RESULTS HIGHLIGHTS

So now to the highlights of today's results.

Revenue growth – at 2% – has been harder to achieve this year. Increases in Detection, Flex-Tek and John Crane were held back by pressures on healthcare spend in developed markets that affected Medical and defence budget cuts impacting Interconnect. John Crane's growth was constrained by a cyclical slowdown in its OEM business, although this is now improving earlier than expected.

Headline operating profit rose 1% as a result of volume leverage, better pricing, and our continued focus on operational improvements and restructuring. Margins were better in John Crane, Flex-Tek and Interconnect. However, the increased investment in growth and the US medical device tax weighed on Medical's margins. Smiths Detection made progress with its performance improvement programme but was hit by the need to recognise significant losses on three contracts signed more than three years ago. Mal will explain this in more detail later in the presentation.

EPS grew 0.1% - rather slower than operating profit because of the divestment of Crossmatch Technologies in the second half of last year. Peter will also allude to the impact of the cash build-up on the balance sheet.

Cash conversion remained strong at 98%, with free cash flow of £237m. Return on capital employed rose 10 basis points to 16.6%. The recommended total dividend for the year is up 4% to 39.5 pence, reflecting this strong cash conversion.

SLIDE – PROMOTING RESPONSIBILITY: AN INCREASED FOCUS IS DELIVERING IMPROVEMENTS

We have continued to make good progress on our key EHS measures. I believe that providing a safe working environment within all our facilities is one of my main priorities - and one shared and reviewed regularly by our Board. I am pleased to report today that the steady fall in recordable incident rate continued to its lowest ever level, benefiting from an enhanced safety culture and employee engagement as well as the use of leading indicators. We experienced only a marginal rise in the lost time rate as a result of two additional injuries in the period.

You will also see our excellent progress against a range of environmental metrics, reflecting increased investment in numerous projects over recent years. These investments have resulted in more effective EHS resources – both in terms of people and new energy-efficient plant.

So with that introduction, I will now hand over to Peter.

SLIDE – PETER TURNER

Thank you Philip and good morning everyone.

SLIDE – UNDERLYING HEADLINE SALES AND PROFIT PERFORMANCE

Philip has provided an overview of the results, so let me start by reviewing the underlying performance at a divisional level.

John Crane delivered further growth in both OEM and aftermarket revenue due to demand in the oil, gas and chemical sectors. As we all expected, the growth rate slowed in the second half, reflecting a relatively brief and muted cyclical slowdown where there are already signs of improvement. Profit grew strongly reflecting better volumes and pricing, as well as procurement and factory efficiencies more than offsetting cost inflation.

Revenue declined at Smiths Medical in the second half as a result of the tough trading environment in developed markets, with adverse pricing and pressure on healthcare budgets. The business also had a tough comparator period in the second half, when we launched Medfusion 4000. Margins declined reflecting our decision last year to step up our investment significantly in the emerging markets and new product development. We also saw the impact of the US medical device tax in the second half. These more than offset one-off benefits from insurance receipts.

As guided, Smiths Detection's growth slowed in the second half following a robust first half. Margins were very disappointing overall, due to initial under-recovery of overheads as the new manufacturing sites ramp up, unfavourable contract mix and the additional provisions for costs associated with certain low margin contracts. These headwinds have obscured the savings generated from the restructuring programme – which Mal will review in a moment.

Smiths Interconnect posted a small decline in full year revenue, driven by a 5% decline in the second half – against a strong comparator period. Margins increased reflecting benefits from on-going restructuring and productivity gains.

And finally Flex-Tek – a good performance, with growth driven by US residential construction and aerospace customer demand. Strong operational gearing and better pricing pushed up margins.

As before, we have provided margin causals for each of the divisions in the appendix.

SLIDE – PROFIT PROGRESSION 2012 TO 2013

Bringing all this together and looking at the profit progression for the Group… the next slide summarises the key movements.

We achieved volume growth across Detection, John Crane and Flex-Tek. There was pricing pressure in some businesses, although John Crane and Flex-Tek managed to offset this.

Operational efficiencies more than offset cost inflation and funded our deliberate steps to increase investment in the drivers of future sales growth. This is focused on building a pipeline of new product launches and increasing levels of sales and marketing, particularly in high growth markets.

As you know, we incurred £4m of additional cost from the US medical device tax and £15m of costs relating to contract execution within Smiths Detection.

We also saw a benefit from currency translation with the stronger US dollar.

The sale of our interest in Crossmatch Technologies in July last year reduced the profit from associates by £6m which resulted in a pre-tax profit of £498m.

SLIDE – GROUP CASH CONVERSION

Turning now to cash conversion – at 98% – this reflects a strong performance across all businesses.

It was achieved through slightly better working capital management. Capital expenditure increased across all divisions, particularly in Smiths Medical to support manufacturing capacity and tooling for new products. The depreciation charge fell as assets, such as the ERP infrastructure, became fully depreciated. Overall, a consistently strong performance.

On the last of our four key financial metrics, we have included the usual divisional return of capital employed analysis in the appendix.

SLIDE – RECONCILATION: HEADLINE OPERATING PROFIT/STATUTORY PROFIT

I'll now give some detail on the items that reconcile headline operating profit to the statutory numbers.

Starting with the exceptionals at the operating profit level which amounted to a net charge of £20m in the period.

- The £8m restructuring charge primarily related to the Detection cost-saving programmes.

- There was also a £14m charge relating to the John Crane Inc. asbestos litigation. Overall, the litigation experience has been in line with that of recent years. As you know the charge is partly affected by US discount rates which this year helped mitigate the impact.

- We also rolled forward the provision for Titeflex litigation relating to product claims. Like the John Crane provision, this is a rolling 10-year discounted provision which is reviewed every six months.

- There was a £4m gain from the closure of two small non-UK pension schemes.

- We had a £6m profit on the disposal of properties and businesses.

- There were also various other transaction-related credits and charges which we have netted off here.

The amortisation of acquired intangible assets which we also exclude from headline profit was £47m.

I would also like to remind you that we are continuing to strip out the pension finance income from headline PBT. This amounted to £16m in the period. Also don't forget, this coming financial year we shall adopt the revised IAS 19. The main effect will be to restrict the expected return on assets in the income statement to the discount rate. As we've stated in the accounts this would have reduced the statutory, not headline, profit by £46m. There will be no change to the balance sheet position.

SLIDE – PENSIONS: DEFICIT IMPROVES TO £254M, DRIVEN BY ASSET PERFORMANCE

Moving to the balance sheet, and first turning to pensions, you will see the net deficit has fallen since last year by £366m to £254m. Partially offsetting this, we now have £83m built up in the escrow which is invested in gilts. Of course, you'll know that the net deficit is higher on both an actuarial and buy-out basis.

The deficit movement has been driven primarily by an improvement in UK asset performance, partly offset by higher inflation. It was also helped by higher US discount rates.

Cash contributions in the period totalled £71m – lower than anticipated as the phasing of contributions to the US schemes shifted slightly. As a result, cash contributions for this year are likely to amount to around £83m as detailed on the slide. In addition, we continue to invest £24m into the escrow.

These contributions also reflect the outcome of the latest triennial reviews for the UK schemes, which we announced in July. These contribution rates are unchanged, although they are over slightly reduced recovery periods.

Earlier this month, the TI pension trustees purchased a further tranche of around £160m in annuities as part of their on-going strategy to match assets to liabilities. This now brings their annuity assets to around £800m and covers the obligations for all TI members who are currently drawing a pension.

SLIDE – STRONG BALANCE SHEET SUPPORTS INVESTMENT

Now moving to net debt, free cash flow of £237m was offset by £152m of dividends and by £41m of foreign exchange translation. This resulted in a fall in net debt of £47m to £744m.

As you will recall, last October we issued a $400 million bond, with a 10-year maturity and a fixed coupon of 3.625%. This financed the repayment of the private placement of $250m in January 2013.

The Group regularly generates good cash flows and we have around £400m of cash on the balance sheet. These resources are more than sufficient to cover our short term financing and investment needs. Net debt to headline EBITDA has fallen to just below 1.2 times over recent years – well below our target range of 1.5 to 2 times.

SLIDE – GUIDANCE

So finally and looking ahead to the coming year. I thought I would pull together guidance on some of the key financial items.

The headline finance charge is expected to be around £60m – reflecting that three quarters of our debt is at fixed rate. Whilst we have refinanced the balance sheet at lower interest rates, the impact of 'cash drag' will be felt until the May 2014 bond is repaid.

The headline tax rate should be in the range of 26-28% for the coming year. The range reflects the upward pressure that we are experiencing on the tax rate over time.

I expect cash conversion will be between 90 and 100%.

I have already covered the pension contributions.

With the proposed special dividend, we expect net debt to be less than £850m at the year end, subject to M&A activity and future FX movements.

I will now hand you back to Philip.

SLIDE – PHILIP BOWMAN

Thank you, Peter.

SLIDE – DELIVERING SHAREHOLDER VALUE: OUR STRATEGIC THEMES

Today's results highlight the important opportunities that exist for us to deliver further shareholder value. We will exploit these by pursuing our strategic objectives as set out on this slide.

First, we will continue to invest heavily in accelerating revenue growth over the medium term. You will hear throughout this presentation of our increasing exposure to higher growth markets by investment in sales and manufacturing capabilities in China, Brazil, and India – as well as other developing markets. The rate of sales growth there easily outpaced the rest of the group's global markets. We are also increasing investment in new product development across the divisions. In addition, we will also seek growth through bolt-on acquisitions, a subject I will return to shortly.

Second, we have already made substantial progress through operational improvements. This has enhanced Group margins but also provided the essential 'fuel' for investment. The key point I want to highlight today is that we have identified another round of cost savings to be undertaken across all divisions.

SLIDE – NEXT PHASE OF GROUP-WIDE RESTRUCTURING

This next phase will concentrate on three areas: site rationalisation with a particular focus on manufacturing footprint to support future growth while cutting fixed costs; organisational effectiveness through streamlining management control; and the upgrading of information systems - particularly in John Crane - to improve decision-making and support their next stage of globalisation.

Each division has submitted a plan and these will be finalised over the coming weeks. The scale of the opportunity varies by division, but in aggregate we are expecting a run-rate of annualised savings of around £50m after four years.

Implementing these plans will cost around £100m over about three years. This will be charged as an exceptional item. Some additional capex will also be required.

The payback on this programme will be slightly longer than for our previous initiatives, reflecting that we are now addressing another level of structural costs which will be somewhat harder to achieve. However, we believe that this is the right approach in terms of funding growth and for the long-term competitiveness of our businesses.

We expect to provide further details at the interim results next March – and for John Crane at their capital markets day planned for December.

SLIDE – DELIVERING SHAREHOLDER VALUE: OUR STRATEGIC THEMES

Returning to our strategic themes.

Third, we are a journey to transform Smiths Group into a world-class organisation. This is about having the right people, processes and systems to deliver our strategy. We have progressively raised the bar in terms of talent and during the year we changed the leadership at John Crane and Smiths Interconnect; we also made a significant number of changes in the line-up reporting to members of the Divisional boards. This change is an on-going process – much has been achieved – more remains to be done.

Fourth, at the heart of what we do is our commitment to responsibility. Over the past five years, we have raised the profile of our sustainability agenda through a greater focus on health and safety, on ethics and on minimising our environmental impact. We have invested consistently and made good progress. Our priority is to push through further, sustained improvements.

The fifth and sixth strategic objectives I will address together on the next slide.

SLIDE – MANAGING A MULTI-INDUSTRY BUSINESS

In managing a multi-industry business like Smiths, we place great focus on cash generation and the effective allocation of capital. Our businesses are strongly cash generative with limited need for fixed capital.

This chart sets out how we approach capital allocation and the use of cash. Starting at the and working anti-clockwise, cash generation funds our investment in organic growth drivers, helps fund the considerable cash costs of our legacy liabilities and allows us to invest in restructuring initiatives.

At the same time, we manage the portfolio through a combination of acquisitions that satisfy our strategic and financial objectives and disposals that realise additional value for our shareholders. We see scope to grow this business more aggressively through targeted acquisitions.

During the year, we received an unsolicited approach for Smiths Medical, which the Board considered carefully. Regrettably, the discussions were leaked at a very early stage and we were required to issue an announcement. We explored many different options and structures with the counterparty, but after some months of discussion, it proved impossible to agree on terms that were satisfactory to both parties. In reaching this decision, the Board continued to take into account the quality and potential of Smiths Medical and its highly cash generative nature.

The Board also regularly reviews the structure and efficiency of the balance sheet, taking into account the investment needs for organic growth and acquisitions as well as the funding requirements of the legacy issues of pensions and litigation.

Over the past six years, we have consistently increased our investment in organic growth drivers and have invested some £600m in bolt-on acquisitions to add complementary technologies and extend our geographic reach in high-growth markets. Although this investment remains our priority and we continue to evaluate potential acquisitions, as I commented earlier, I am disappointed that none of the Divisions found opportunities over the past 18 months that met their strategic and financial criteria. As Peter said, we now have surplus cash on the balance sheet, which is more than adequate to fund the immediate investment needs and other legacy obligations. The Board is therefore recommending a return of cash to shareholders of around £118m, in the form of a one-off special dividend of 30p per share.

Given the cash demands of the legacy liabilities, the Board continues to believe that it is appropriate to follow a progressive dividend policy with a pay-out ratio of around 40%.

Turning now to the operational review for the divisions, I will hand over first to Duncan, then to Srini and then Mal.

SLIDE – DUNCAN GILLIS

Thank you Philip.

SLIDE - JOHN CRANE: DELIVERING SALES GROWTH, IMPROVING MARGINS AND RETURNS

Underlying revenue rose 2% on the back of improved aftermarket and first-fit original equipment sales, primarily in the oil & gas and petrochemical sectors. Headline operating margin reached record levels even as we maintained investment in highly competitive first-fit original equipment projects and new product development to position the company for mid-term growth.

Aftermarket revenue grew 2% on increased demand for rotating equipment. Activity remained buoyant in North America, Asia and the Middle East and we signed a five-year seals supply and support agreement with Shell. In addition, a four-year contract extension was agreed with Petrom in Romania.

First-fit OEM sales were up 2% although customers remained cautious about investing in new projects.

SLIDE – JOHN CRANE: INVESTMENTS POSITION JOHN CRANE FOR FUTURE GROWTH

Revenue from high-growth emerging markets rose 7% and now represents more than 21% of John Crane sales. The increases included the Middle East up 12%, China up 15%, and Russia 21%.

The growth momentum in target markets will be maintained by continued investment in regional infrastructure to improve service capabilities and to broaden the company's product range. New service centres have already been opened in Busan, South Korea, and in Georgia in the US.

Investment in new products and engineering rose 9% as we maintained our focus on meeting customers' changing requirements. These often involve extreme operating conditions with extra demands on environmental impact and energy efficiency. Benefits range from expanded operating performance and lower energy consumption to extended product life cycles.

SLIDE – JOHN CRANE: OUTLOOK

John Crane's order book has continued to expand and is expected to support similar revenue growth rate for the first half compared to the same period last year. While we foresee reasonable trading conditions, growth will depend on sustained maintenance and repair activity in our key end markets as well as continued progression of capital projects in high-growth regions.

Margins should continue to benefit from on-going operational efficiency efforts, offset by strategic investments in longer-term growth opportunities. These include the expansion of our sales and service network, new product development, and growing our presence in high-growth markets.

Now I would like to leave you with a brief commercial for the investor day that we are hosting in Dubai on 17 December. We will be able to update on recent developments in John Crane and the steps we are taking to redeploy our resources and investments to accelerate growth. These include plans to upgrade our information systems to support the next phase of John Crane's globalisation. I hope you will be able to join us.

Thank you. I will now hand over to Srini and Medical.

SLIDE – SRINI SESHADRI

Thank you Duncan.

SLIDE – SMITHS MEDICAL: TOUGH TRADING; MARGINS HIT BY GROWTH INVESTMENT AND DEVICE TAX

Tough trading in Smiths Medical's developed markets led to a 1% fall in underlying revenue with hardware sales down 3% and a flat performance in consumables. The US medical device tax and significantly increased investment in sales and marketing in emerging markets and in new product development – both drivers of longer term growth – held back margins.

I explained at the Interims that margins in Medical would inevitably be squeezed in the short term as we stepped up investment to accelerate revenue growth over the longer term.

Sales of Safety devices declined 4%, mainly because of volume and price pressures in the United States. These were only partially offset by strong growth in China and SE Asia, markets where demand for safety-related medical products is increasing.

Medication delivery was unable to repeat last year's strong second half and sales fell slightly with capital budget constraints affecting demand for infusion pumps in particular. However ambulatory infusion revenue grew strongly helped by the launch of new models of our highly successful range of CADD Solis pumps. It is worth highlighting that many of our competitors are reporting negative trends and, if anything, we have outperformed our peers in this segment.

Sales in Vital care rose 3% despite continued sluggish procedure rates and pricing pressures in developed countries. The increase reflected improvements across most product ranges such as respiratory, anaesthesia and assisted reproduction.

SLIDE – SMITHS MEDICAL: INVESTING IN GROWTH OPPORTUNITIES

While mature markets are still tough, the rising aspirations of developing nations offer the opportunity to grow through leveraging our broad product portfolio. Emerging markets revenue rose 8% and now represents more than 11% of sales.

We took a decision two years ago to ramp up our investment. Since then, an extra £13m has been invested and we have added a net 230 people to help accelerate our operations in these markets.

Let me review what has gone well and where we need to do further work. We have seen good growth in the Middle East, Southeast Asia and Latin America. Distributor coverage has been increased in key markets. We have also made good progress at product introductions – such as temperature management in China and infusion in the Middle East.

However, progress in certain areas has been slower than we originally anticipated. For example, product registrations have been complex and lengthy. Delays occurred and growth slowed as we established new operating parameters with existing distributors. We have experienced some leadership gaps in key markets, like China, where there have also been issues with relatively high staff turnover. We also saw a slowdown in sales of our infusion products in China.

As I said at the interim results, the returns are anticipated over the medium rather than short term. We will pause on adding incremental investment until we have effectively executed on this first phase.

New product development also remains a priority, rising 12% last year to comprise 4.4% of revenues – a new high. We continued to narrow the number of pipeline projects to ensure adequate investment in the highest impact products.

Our CADD-Solis VIP platform received FDA clearance for the key US market and, while last year's strong start from Medfusion 4000 has slowed because of hospital budget constraints, it is well positioned for future growth.

Two new safety catheters have been successfully launched and the new Bivona model extends the range of our silicone tracheostomy products.

SLIDE – SMITHS MEDICAL: OUTLOOK

Looking to the current year, developed markets are likely to remain challenging for the immediate future, given the constraints on healthcare spending. In the US, the medical device tax of 2.3% is squeezing margins.

However much of the impact should be offset by cost savings through value engineering and operational improvements, combined with our increased focus on higher margin products and high-growth, emerging markets. For context, you will recall that five years ago our focus was on operational improvement, cutting costs, reducing back-orders and creating a robust foundation to take the business forward. Since then, we have improved margins by over 500 basis points and the business is in far better shape. In the past two years, we have increasingly redeployed the savings from these programmes into growth initiatives. The good news is that we still have a further list of efficiency projects that we can now implement to provide additional growth investment.

Thank you. I will now hand over to Mal and Detection.

SLIDE – MAL MAGINNIS

Thank you Srini.

SLIDE – SMITHS DETECTION: DELIVERING REVENUE GROWTH; MARGINS AFFECTED BY CONTRACT ISSUES

Sales grew 8%, driven by strong demand in the transportation, ports and borders and military sectors, more than offsetting slight declines in critical infrastructure and emergency responders. A very good performance considering our exposure to government customers and compared with that of our peers.

Margins are down, affected by the £15m charge, announced in July. This related mainly to complex multi-year contracts in ports and borders – where margins are typically lower. These were entered into before 2010 but our execution has been poor and we have identified further costs in the past year. This was very disappointing and we have been upgrading both our approach to negotiating and agreeing such contracts and our programme management overall. We need to be better at delivering these complex projects in the future.

In Transportation, underlying sales rose 17% reflecting contract wins from customers in Qatar, Spain, New Zealand and Canada. Smiths Detection was also chosen to equip the passenger checkpoints at Heathrow's new Terminal 2.

Sales in ports and borders rose 18%, helped by major cargo scanner contracts in Azerbaijan and Brazil. Although government spending was generally weak, enquiry levels remain encouragingly high.

Underlying Military sales grew an impressive 24% thanks to the continuation of follow-on and support contracts. These more than offset the general decline in military budgets as the US and its allies withdraw troops from major conflicts. The new orders included one from the US Army totalling $7m for chemical detectors and an £18m contract with the UK's MoD for biological consumables support.

Critical infrastructure sales came under pressure because of US budget constraints.

SLIDE – DELIVERING THE RESTRUCTURING BENEFITS

We continue to make progress with the Detection restructuring programme.

You will recall that the programme is targeting £36m of savings, with costs of £33m, completing at the end of fiscal 2015.

We achieved £9m of savings this year and incurred £7m of costs. We expect to deliver £5m savings in the coming financial year and the remaining £7m will come through in the FY15 year.

A key priority will be to deliver the agreed plan to take out 170 roles in Wiesbaden. At the same time we need to improve the throughput at our facilities in Malaysia and Edgewood.

Our margin performance has been disappointing this year, particularly given the strong revenue growth. I believe margins will improve as our execution gets better and we continue to deliver the efficiencies. We still have a lot of work to do.

SLIDE – SMITHS DETECTION: INVESTING IN FUTURE GROWTH THROUGH NEW PRODUCTS AND MARKETS

I do believe we have a good story to tell in terms of innovation. We have consistently invested to maintain our technology leadership and this is demonstrated by the number of recent product launches. Company funded new-product development held steady at £36m, a figure pushed up to £42m when customer funded projects are included. This equates to almost 8% of revenues.

Recently launched products included the CIP-300, a low energy X-ray scanner specifically designed for the fast and efficient screening of cars and light vehicles. And the XCT, a hybrid X-ray-Computed Tomography scanner for checked baggage which has been approved by the EU authorities. It has also received a key laboratory certification from the TSA in the US and this will help with sales around the world. However, sales to the TSA are also subject to additional testing at its TSA Systems Integration Facility and at a US airport. The next step of this exciting development is to co-ordinate the testing with the TSA.

Our increasing focus on faster-growing markets continues to pay off with revenue up 34% to account for more than 20% of total sales. The X-ray plant in Malaysia is now up and running and reduced lead times have already helped us secure significant new orders from Japan and South Korea.

Aftermarket revenue grew 8% – currently at 26% of sales – and is on track to achieve our target of 30% of revenues in the medium term. The growth has been spurred by improvements in distributor networks, training and contract renewal rates.

SLIDE – SMITHS DETECTION: OUTLOOK

The current order book is slightly behind last year, against a very strong comparator. We have some major transportation programmes to be delivered in the coming year. Governments continue to look at ways of improving ports and borders operations and tendering activity is high in this market. However, performance is still subject to the cycle of capital spending by governments. Detection is well-positioned for growth with the launch of several new products and the continued focus on increasing its aftermarket revenues.

Margins are expected to improve as a result of productivity initiatives and better contract execution.

Thank you. I will now hand back to Philip.

SLIDE – SMITHS INTERCONNECT: DEFENCE MARKET HEADWINDS; EFFICIENCES DRIVE MARGINS

Thank you Mal. Turning next to Smiths Interconnect.

Sales declined marginally with growth in Connectors offset by weakness in the Microwave and Power business units. Margins rose on the back of productivity initiatives.

In Connectors, underlying revenue increased 3% with good growth in the semiconductor test, medical, and commercial aerospace markets. However defence budgets declined and the Eurofighter programme, which represents an important part of Connectors revenue, began to slow given the lack of new export orders.

After exceptionally strong growth in 2012, Microwave sales fell 2% but consolidated its position despite significant headwinds. It was held back by delays in follow-on production awards for several defence projects, particularly in the second half, although good progress was made on a number of existing military programmes. Wireless telecoms saw continued traction in developing regions such as India and China where network operators are recognising the benefits of its advanced test equipment. We also significantly increased market share in the US.

Underlying sales in the Power business declined 6%, with some improvement in the second half offsetting the 21% first half decline. The turnaround was driven by better sales focus and execution, and strong demand from co-location data centres where customers particularly value our customisation and flexibility. Other markets such as alternative energy experienced declines on the back of continued weak demand.

SLIDE – SMITHS INTERCONNECT: INVESTING IN NEW PRODUCTS AND EMERGING MARKETS

Product development remains a priority at Interconnect with the focus again on opportunities in higher growth markets and those with the best returns. Company-funded R&D spend increased 5% to £24m, but the customer-funded portion fell because of cuts in US defence budgets.

Funds were channelled towards reinforcing Interconnect's market-leading position in specialist technologies. Some new product initiatives are listed on the slide. The vitality index, a measure of the sales from products launched in the past three years, was maintained at over 30%.

Our increased exposure to faster-growing, emerging markets was evidenced in a 5% rise in revenues, which now represent around 16% of total sales.

SLIDE – INTERCONNECT: OUTLOOK

Looking to the year ahead, improving trading conditions in some commercial end markets are likely to be offset by more difficult environments elsewhere, such as defence. The defence market is expected to remain challenging, although we are comparatively well-placed in key technologies and on some long-term programmes. The semiconductor test and data centre markets are expected to become more robust, dependent on macroeconomic conditions and consumer spending patterns. New product launches should help wireless telecoms sales, although it faces a tough comparator. This is expected to result in relatively modest revenue and profit growth overall, with a bias to the second half. Margins overall should benefit from continuing productivity initiatives.

Finally to Flex-Tek.

SLIDE – FLEX-TEK: STRONG GROWTH FROM FLUID MANAGEMENT & CONSTRUCTION; MARGINS BENEFIT

Flex-Tek's revenue rose 8%, driven by healthy sales growth in aerospace components and in US residential construction. Margins improved as a result of higher volumes and price increases, despite a 17% increase in R&D spend.

In Fluid Management, sales rose 9%, benefiting from a backlog of major airframe platforms and engines from companies like Airbus, Boeing, GE and Rolls-Royce. Revenues from the US automotive market for fuel and brake applications also experienced steady growth.

Construction revenue increased 18%, buoyed by strong sales of our flexible gas piping and HVAC ducting and a 15% increase in the annual rate of new single family home starts in the US market.

Revenues from Heat Solutions were flat with growth in specialty heating elements balanced by weaker HVAC sales for household appliances. Sales in Flexible Solutions were down 2% as the success of our new sleep apnoea products was offset by continued weakness in the floor-care market.

SLIDE – FLEX-TEK: OUTLOOK

The outlook for the commercial aerospace market remains positive and we expect this to continue. US residential construction has rebounded from historic lows and we foresee modest but steady improvement, although interest rates, higher home prices, and stricter lending may act as something of a drag. As the Heat Solutions and Flexible Solutions move to more bespoke, specialty applications, they will benefit from improved general economic conditions.

Returning then to the performance and prospects for the Group as a whole.

SLIDE – SOLID PROGRESS IN FINANCIAL METRICS DESPITE TOUGH TRADING CONDITIONS

First, let us look at what Smiths Group has achieved in the past few years, a period of great economic uncertainty and trading headwinds.

Compound annual revenue growth of 4% – a combination of organic and inorganic growth as well as currency movements - at a time when we also grew net operating margin by 230 basis points to 18.0%.

Cash conversion has greatly improved, averaging 102% over the period, while return on capital increased by 260 basis points to 16.6%. Our balance sheet is substantially stronger, supporting the payment of the special dividend.

We have radically changed the Company by the actions we have taken to improve performance and drive returns. A key driver of this was the decision to reverse many years of underinvestment in new product development. However increased investment to drive revenue growth is a medium to long-term strategy – especially in businesses such as Detection and Medical where the development and certification cycle for new products can last for over four years. Like it or not, we now live in a low growth world where competitive success requires not only operational efficiency but access to higher growth markets and a wider range of new products.

We have resisted updating the targets that we issued in 2008 because of the uncertain economic environment. We are currently evaluating some new medium-term targets against which our performance can be measured. Provided there is no major deterioration in economic conditions, we intend to publish these targets at our interim results in March 2014.

SLIDE – SMITHS GROUP – OPERATIONAL PRIORITIES FOR 2014

Looking ahead, the trading environment does not lack challenges. I remain cautious about sectors such as defence and healthcare, which are subject to government funding constraint. However, I do believe we remain well-placed to benefit from growth in energy demand, the need for new fuel-efficient aircraft, increased US residential construction, and the ever present need for improved security in an uncertain world.

Our focus on accelerating top-line growth will be underpinned by additional funding and more effective execution of new product development. Emerging markets now comprise a steadily increasing share of global revenues, a realignment that we will support through further targeted investment in sales and marketing.

Despite the substantial cash demands of our legacy liabilities, our balance sheet has strengthened materially over the past five years. We continue to scan the horizon for acquisitions that will further optimise capital allocation across our portfolio and generate more value for our shareholders.

So in summary, we have used the prolonged downturn to strengthen the Company. Delivering the new cost savings identified in the planned restructuring will provide additional investment to grow the business organically whist our strong cash generation will support growth through acquisition. We are not short of attractive opportunities to drive value for our shareholders in the medium term.

SLIDE – QUESTIONS AND ANSWERS

That brings the formal presentation to an end. Peter and I, along with other members of the senior management team, would be pleased to take any questions. In terms of housekeeping, may I just remind you to wait for the microphone and preface your questions with your name and the company you represent?

Once again, thank you for joining us this morning.

Andre Kukhnin ***- Credit Suisse - Analyst***

Andre, Credit Suisse. A couple of questions please, firstly, on investment and growth, obviously something that's an area of focus. And no doubt it's the right thing to do and we can see R&D going up faster than the sales or EBIT growth, but could you share some maybe KPIs on the product investment; i.e., something like sales from new products, products less than 3 years old? And where you can think you could get that number with that investment over the next 3 years that -- reinvesting the proceeds from cost savings?

And also, is there a Smith's-wide process for innovation with gate process and thresholds? And are there targets and what are they, if possible?

Philip Bowman ***- Smiths Group plc - Chief Executive***

Okay. I think in terms of your first question, we haven't given any specific guidance on that. We have talked at a number of presentations about vitality indexes, but it's not something where we've given any formal guidance.

In terms of the process, I'm going to ask Mark Reckitt to address that, because he did lead an initiative a couple of years ago where we have standardized our NPD processes across the Group.

Mark Reckitt ***- Smiths Group plc – Group Strategy Director***

We launched a very consistent stage gate process across Group followed by each division. Gate 1 is the end of the ideation process. At the end of the ideation process, we expect the product ideas to be pretty well checked out from a market point of view. And then what remains on the remaining gates through to launch is actually moving from that product idea, making sure the technology works, that a product can actually be put into a form that looks attractive, can be sold, and that the target margin can be hit.

Our focus is very much on making sure that the number of ideas at Gate 1 are relatively small in number so that we can focus on each and get them through all the gates as quickly as possible, because obviously, the sooner we get a product to launch, the sooner we can get some return on the NPD investment that we've put into it.

Obviously, you have to bear in mind that particularly for the medical business and the Detection business, a lot of our products have to be approved by the various regulatory authorities, and that puts an extra timeline into that. And for that reason, as Philip said, we'd be cautious about offering any guidance as to what sort of percentages we're going to hit.

We do talk about our vitality rates. We have the same method of calculating the vitality rates which is sales from products that have been launched in the last 3 years. And for Interconnect, you'll note that that vitality index is around 30%. So that just indicates the degree of invention that we have to keep going each year in return for the 5% of sales that we invest in NPD.

Philip Bowman *- Smiths Group plc - Chief Executive*

Thank you, Mark, very much.

Andre Kukhnin *- Credit Suisse - Analyst*

Great. Can I just have another question on balance sheet for Peter? The guidance of up to GBP850 million, and that -- obviously, that sets the top, but I couldn't add up to more than GBP800 million, including the payments for legacy liabilities and some CapEx and working capital ramp up, as well as other items. Are you expecting to take much of that GBP100 million cost of restructuring up front, or is there a substantial ramp up in CapEx, working capital? Should be expecting above the usual?

Peter Turner *- Smiths Group plc - Finance Director*

No. I think we've guided that there will be a slightly higher level of CapEx this year given the restructuring program. Clearly, some of the costs of the restructuring program will fall in this year. We'll provide more details of that at the interims. But as you say, that sets the ceiling in terms of our current expectations on net debt.

Andre Kukhnin *- Credit Suisse - Analyst*

But there's nothing unusual there to guide you to GBP850 million?

Peter Turner - Smiths Group plc - Finance Director

Nothing beyond that, no.

Andre Kukhnin - Credit Suisse - Analyst

Thank you very much.

Jonathan Mounsey ***- Exane BNP Paribas - Analyst***

Jonathan Mounsey, Exane BNP Paribas. Three questions, please.

On John Crane, in terms of margins, it looks like maybe there's a bit of a change in focus here. So we've had a very strong period of operating leverage. I think margins were up 180 basis points. As you start reinvesting for growth, does this really see the operating leverage come to an end now? Is it going to be taking the benefits of further leverage and reinvesting them and margins have reached their peak? Or is there further to go?

On acquisitions, where's the focus right now? Detection, you're obviously a little disappointed. I think you said at the beginning on the failure to land any deals this year. You used to be signing deals off generally in Interconnect. Is it more around John Crane now? And if so, what adjacencies are you looking at?

And then finally, just in Detection, on the XCT, previously, we've had some of a feeling of when we hoped to see the TSA give final sign off on that machine. Is there any guidance as to when that's likely to be, or a feeling for when we might see that machine marketed to the TSA and start to see some sales?

Philip Bowman ***- Smiths Group plc - Chief Executive***

Okay, three questions. Mal, would you like to pick up the easiest of those to just outline the timetable for TSIF and operational testing?

Mal Maginnis *- Smiths Group plc - President, Smiths Detection*

XCT, we're doing the testing this year, as you know, and powerful laboratory testing, which is the most complex and the most critical first gate. It then goes through three other tests within the TSA to get through to the final operations. I'm anticipating that process will be finished by about the end of the fiscal year.

You can't go any tendering work or any commercial work with the TSA until the end of that process, but we're well into that process at the moment and the plans are in train. In fact, I'm delighted at the pace of this program.

Jonathan Mounsey *- Exane BNP Paribas - Analyst*

Before you sit down, and on that, once you can tender, what's the lead time? Is this really then a 2016 sales story?

Mal Maginnis *- Smiths Group plc - President, Smiths Detection*

The US has a slightly different tendering process than the rest of the world, and the rest of the world, they go through very lengthy processes to get to the award and then [the build of] the airport. Because the US, the TSA actually does the build and the work with the airports, once you are certified, you can go immediately into the award of contracts and deliveries.

So if everything goes through to the end of this year and we get into the contract period in September, next year, I would see impact in that financial year.

Philip Bowman *- Smiths Group plc - Chief Executive*

Okay. Thank you for that, Mal. Duncan, margins in John Crane, please.

Duncan Gillis *- Smiths Group plc - CEO & President, John Crane*

As you can infer from the results, our second-half margins expanded about 270 basis points on a constant FX basis, constant foreign exchange rate basis.

We did some things in the second half in reaction to the anticipated downturn in our original equipment business that we would classify as not sustainable. And we reckon that about 100 basis points of the 270 basis points fall into that category. So if you back that our on a full-year basis, that's about a 50 basis point reduction in the operating margin.

We would expect going forward that we'll be shooting to hold that level and then invest to accelerate top line growth as we move forward. And we'll talk more about that when we get together in Dubai in December.

Philip Bowman ***- Smiths Group plc - Chief Executive***

Duncan, thank you for that. Final question was in connection with acquisitions. I think we've been very consistent over the period in saying we have three non-financial criteria.

One is clearly to add technology that fills the gap in our technology or IT portfolio. The second one is businesses that give us increased exposure to higher growing markets. And the third one is where there is the opportunity to leverage an existing infrastructure that we have; for example John Crane's global network of customer sales and service and support centers.

In terms of focus, I think the Board takes a fairly agnostic view. It will look at proposals on their merits from any of the businesses. That said, the track record over the past 5/6 years has been that most of the acquisitions have been focused around John Crane and historically Interconnect.

That will not necessarily always be the case, but I think certainly John Crane is an area where we see the opportunity to widen our addressable revenue and profit opportunity, but there are opportunities in other areas which we are looking at; for example, for one particular area in Flex-Tek as well.

Next question.

Mark Davies-Jones ***- Agency Partners - Analyst***

Mark Davies-Jones, Agency Partners. Can I return to the subject of Medical in China? It sounds from what you were saying there that perhaps sales in China are actually down during the period. It's been a very strong market for a lot of other large western medical equipment companies over the last year and, obviously, it's a fairly key market if you're trying to rebalance geographically within that business. So could you just [put] a little more detail what's gone wrong there and how quickly that situation might be capable of being improved?

Philip Bowman *- Smiths Group plc - Chief Executive*

Srini, do you want to address that?

Srini Seshadri *- Smiths Group plc - President, Smiths Medical*

Sure. Well, keep in context over the last 5 to 6 years we've grown our China business by 7 times, so that's a pretty good track record.

We went through in fiscal year 2013 two issues that I believe are totally temporary. One is a transition from an existing infusion pump product line to a new one. We had some hiccups in there. Those are now well under control. We will in fiscal year 2014 be able to launch those and keep going.

And the second one was just holding onto key people. It's just -- it's one of those [lifting] markets where people are stolen all the time. We've almost, probably in the next two days, should be announcing a replacement for the leadership, and as soon as those two issues are under control, I think we'll be back to our growth track.

Again, our presence there from the point of view of products that we have introduced into China from outside China continue the pace. We've grown that business very, very well, and that will continue.

Philip Bowman *- Smiths Group plc - Chief Executive*

Thank you, Srini. Next question over there on the right, please.

Rami Myerson *- UBS - Analyst*

Rami Myerson, UBS; three questions. On the discussions on the sale of Smith medical, could you provide some further color on why for the second time a sale has not come through and what was supposed to be one of the more attractive buyers of that asset?

Second question on the Smiths Medical. The decline in revenues, was that more volume or pricing, particularly in the US with the medical taxes?

And on Interconnect, what is currently the percentage of revenues from institutional defense and government? And do you expect that to decline by how much over the next couple of years?

Thanks.

Philip Bowman *- Smiths Group plc - Chief Executive*

Okay. I'll pick up the first question of that and then pass the next ones to Srini and to Mark.

I think in terms of the sale process as you described it for medical, let me just be quite clear. I've said this before. We haven't been through two sales processes. We had a kite flown by Apax a couple of years ago. We did not engage with them. There was no process.

In terms of the discussion that took place this year, I said it was unsolicited. I said it was unfortunate that the details were leaked and we were forced to put it out into the public domain, and that that was unhelpful.

I'm not prepared to comment any further. I don't think that would inure to us the benefit of either ourselves or the counterparty.

So over to you, Srini.

Srini Seshadri *- Smiths Group plc - President, Smiths Medical*

It has been a combination of volume and price. From the point of view of volume in the infusion business, we've had a real slowdown and delay in large customers placing orders for infusion pumps.

If you look at the budgets and capital constraints that are on US hospital market, a lot of the capital which has been constrained has been going towards IT and infrastructure.

So we know exactly where we rank in each hospital on their list of infusion -- on their list of capital investment. We're tracking that very, very closely. If you go and look at the usual suspects list, you will find that medication delivery has been slow across the board. You can compare it to other competitors. We do all the time.

With regards to pricing, it's been more of an issue in the safety business, and that's a game where with the transition now to a new set of product lines, there is a bit of a war going on. We've chosen not to participate in that kind of a war and, therefore, volumes declined in relation to our ability to hold on to the kind of price that we believe our products actually deserve.

Philip Bowman *- Smiths Group plc - Chief Executive*

And finally, Mark.

Mark Reckitt *- Smiths Group plc - Group Strategy Director*

The defense proportion of Interconnect sales is 28%, and that's split about three-quarters long-cycle business, programs that are long running, relatively predictable. The issues in the long-cycle programs are that the existing programs continue very well. There's obviously a bit of a delay in the agreement of new programs at the moment because of the impacts of sequestration in the US.

The remaining short-cycle business is a bit choppier, but when we look forward, we're not expecting our defense sales to decline. Equally, we're not expecting them to grow hugely overall.

Philip Bowman *- Smiths Group plc - Chief Executive*

Thank you, Mark, for that. Next question, please. Yes, in the second row.

Alexander Virgo *- Berenberg - Analyst*

Alexander Virgo, Berenberg. You just talked a little bit about delays in product registrations, or product registrations taking longer in medical. I was just wondering if that is something we should expect to continue to happen as we go forward and whether that is about more money or just more time.

And then secondly on Interconnect, the delays in the military business. Is that something we should expect to catch up next year?

And then lastly just on PDI and the data center business, do you think that you've got a proper understanding of that business now given the problems you had at the time of the close of the acquisition?

Thank you.

Philip Bowman *- Smiths Group plc - Chief Executive*

The second of those two questions, the second two I'll pass to Mark. In terms of -- well, Mark, why don't you go first with those two?

Mark Reckitt *- Smiths Group plc - Group Strategy Director*

Well, we're not really expecting any catch-up in defense. You heard me say to Rami that we're not expecting any decline in our defense business. Equally, we're not expecting a lot of growth in that business. So you can infer from that that there isn't really any catch-up that's likely to come.

In terms of PDI, yes, we have a much better understanding of PDI now than we did a year and a half ago. What I take very positively from PDI in the last year, although the first half of last year was not a great first half, particularly in the alternative energy and the industrial businesses, in the second half of last year, we had strong growth in the data center business.

We focus on co-location, customers in the data center business. These are companies like [Sirus 1] maybe who provide data centers for third parties. And in fact, they're providing the cloud. They are taking an increasing share of the market and we have a decent market share with those customers.

Philip Bowman ***- Smiths Group plc - Chief Executive***

In terms of your question about product registrations, I think it's probably fair to highlight three things.

The first one is that, clearly, developing markets increasingly, are moving towards developed market standards in terms of assessing medical devices and medical consumables. And that process has happened relatively quickly and clearly is imposing additional burden in terms of a registration process and the time.

I think the second one I would say is that a number of the products that we are seeking to register are products that we've manufactured for a long time. And indeed, were we to apply to reregister those in developed markets, we would have to do quite a lot of work to get our files in order to do that because they were developed and registered in a much easier environment.

And I think the final one, which is more insidious, is there is no doubt that there is a degree of protectionism creeping into this in terms of trying to favor local manufacturers.

It's an issue. It is not an insoluble issue, but there does seem to be a dual-track timetable in some countries. If you're a local indigenous manufacturer, you seem to get through the process rather quicker than if you are bringing products in and manufacturing them outside and they're foreign owned.

Next question? Yes, right at the back in the middle.

Ben Uglow ***- Morgan Stanley - Analyst***

Ben Uglow, Morgan Stanley. I had a couple of just very general questions on how you saw the end markets at the moment.

If we look at Medical, CapEx has actually been depressed for a few years. This isn't something that just occurred in the last 12 months. Some of the big companies in the space, large capital equipment players, have actually seen quite a rebound in the last three months in terms of their order books. I wondered if you had seen any signs at all in your business of any improvement. I saw that obviously the developed market outlook is still difficult, but are there any little signs that things in that vertical are turning around?

And then secondly, on the oil and gas side, you did see some slowdown in the second half. Perhaps you could elaborate a little bit on what that was about.

And then going forward in oil and gas, are we going to continue to see the growth rates that we've seen over the last couple of years? Because some of the largest companies in this space at the moment seem to be getting more cautious about their own CapEx.

Philip Bowman ***- Smiths Group plc - Chief Executive***

Okay. Thank you for those questions. Srini, do you want to address the first one, please?

Srini Seshadri ***- Smiths Group plc - President, Smiths Medical***

Sure. I think when you look at the very large companies that you may be referring to, for example, in diagnostic imaging, they saw a significant collapse and then a bit of a rebound, certainly.

Our product line by and large, almost across the board, is very heavily surgery related, and therefore is very sensitive to procedure growth. So if you go and look at procedure growth over the last, say, 5 years, you get a pretty good view of our own performance.

So keep that in mind. Our product line tends to be very surgery procedures oriented. And those are relatively easy to track in the US; certainly a little bit in Western Europe. And then, of course, a lot of growth across [around] in emerging markets.

Philip Bowman ***- Smiths Group plc - Chief Executive***

Thank you for that, Srini. Duncan, please.

Duncan Gillis ***- Smiths Group plc - CEO & President, John Crane***

There was a pause in our original equipment business in the second half of last year, and we've kind of covered some of that. Our backlog suggests that that's coming back. And market investment, it of course depends what part of the world you're talking about, is generally looking more positive. There are several emerging markets where a number of projects have been either announced or are on the drawing boards, and we're aware of them.

And then, of course, in the US, we see an increasing amount of investment behind some of the impact of upstream work that's been going on in shale gas and tight oil now moving into the downstream sector. That will play out over the next 5 to 10 years.

And I think last time we were together, I said that we expected revenues over the next few years in kind of $25 million to $30 million of projects that we had visibility to. That's moving very, very quickly, and we're reevaluating what we think those numbers will look like over the next 5 and 10 years.

And I didn't really give you visibility into the upstream component of that as well for our John Crane production solutions business. When we get together in Dubai, I think I'll be in a much better position to share what think that's going to mean for us as we go forward. Generally, pretty decent markets it looks like as we move forward.

Philip Bowman ***- Smiths Group plc - Chief Executive***

Duncan, great. Thank you for that. Another question.

Alasdair Leslie ***- Societe Generale - Analyst***

Alasdair Leslie, SocGen. Just one question on emerging markets. I suppose ex Detection, the growth rates across most of the businesses were mid to high singledigit growth. But given the low market penetration and perhaps the low base as well, I guess that's maybe the least you're hoping for and we should expect some acceleration going forward.

So I appreciate the color that we had on medical in China, but could we kind of get an update on market conditions for the other businesses, and perhaps where the greatest acceleration going forward, where that will come from?

Philip Bowman ***- Smiths Group plc - Chief Executive***

Yes. I think it would be -- perhaps I'll ask Mal to talk about Detection, and then Duncan perhaps a little bit more color on that, please.

Mal Maginnis ***- Smiths Group plc - President, Smiths Detection***

Emerging markets are obviously pretty important to the way we look, and you can see the growth rates that we've focused on. And establishing the factory base out in Asia has been a fundamental part of addressing to be able to get the lead times into those markets, and that's helped a lot. I would continue to see growth in that.

You see certain emerging market economies shifting from security, for example, into revenue gathering, which is where we're seeing a lot of the ports and borders work. And that's been a definite shift in focus by some of those governments; obviously, revenue pretty critical to them as they grow their economies. So overall, I see the continued development in the developed markets as critical to us.

One point I would make is that my developed markets are slightly different to the rest. China is not a fundamental market to me for various reasons due to security and [the new] relationships, but I look very closely at a lot of the others. Africa is an enormous market for us at the moment and continues to grow strongly.

Philip Bowman ***- Smiths Group plc - Chief Executive***

One observation, I think, just to build on that in terms of Detection is 5 or 6 years ago, we could more or less guarantee a significant percentage of Detection's revenue would be covered by orders out of the US, whether it was from the TSA, ports and border protection, customs and border protection, or the DOD.

Over the last 2 years, we've seen virtually no significant purchase orders cut by the TSA on any of our competitors or ourselves. So over that period, we've effectively had to rebuild our revenue base, and a lot of that has come from the developing markets.

So I think it's been a story of repositioning, but it's been a successful repositioning as we've done that.

Duncan, John Crane, please.

Duncan Gillis *- Smiths Group plc - CEO & President, John Crane*

I talked a little bit about the results in some of our key emerging markets earlier. Middle East is obviously very important to us, particularly the Kingdom of Saudi Arabia which is really driving much of the growth in Middle East.

China, we've seen -- we saw 15% growth, and I think we've seen that fairly consistently over the past few years. So if you play that out, a compound annual growth rate, you double the business every 5 years.

China's the second largest market and fastest growing market for many of our products on a go-forward basis, and we'll continue to make investments there.

I didn't talk about South East Asia. I was a little disappointed with our results in South East Asia last year. It's an important market for us. We've recently had a change in leadership there, and I'm expecting to see better growth coming out of South East Asia as we move forward.

Similarly, Latin America was a little bit depressed last year, primarily due to some issues in Mexico related to Pemex and some changes going on in Pemex. We expect that to change, and in fact, August results suggest that Latin America is starting to bounce back as well. So I think pretty good there.

Philip Bowman *- Smiths Group plc - Chief Executive*

Duncan, thank you for that. Yes.

Glenn Liddy *- JPMorgan - Analyst*

Glenn Liddy, JPMorgan Cazenove. For the XCT, you've gone past the first gate for the US, but in Europe, you've got approval. So can you sell the machine outside of the US? And with regulation changes on the horizon in Europe, are we seeing people buy the new machine, or are they rushing to buy the old machine before the changes come in?

On Flex-Tek, growth was very strong last year. We've seen the turning point hopefully in the construction market. So going forward, should we expect a moderation of growth and relative stability in the margin as you invest in new products?

Philip Bowman *- Smiths Group plc - Chief Executive*

Okay. Mal, first question about the XCT.

Mal Maginnis *- Smiths Group plc - President, Smiths Detection*

Thank you for that. XCT has obviously certified Level 3 in Europe. Remember, in Europe, there is also a Level 2 certification which is still approved for purchase until the end of next year.

We have a very good Level 2 machine, so we're in a really ideal position at the moment. What you see is new airport construction is shifting towards Level 3, whereas I thought you elegantly put it about the dash to complete Level 2 by those who are probably in a more mature environment.

So I'm in a very interesting position. One of our biggest markets this year has been Spain, which I mentioned in the growth part, and that was all Level 2 EDS going into Spain. So we are very well positioned in that at the moment.

Internationally, the EU standard is tremendously helpful. We do tend to find though people would like to see a confidence in both, and we're just getting that confidence out of the TSA laboratory. We're now in a much stronger position internationally as well. And given our incumbency, I just see strength out of it. So we're very well balanced at the moment in EDS machines.

Philip Bowman *- Smiths Group plc - Chief Executive*

But I think the important thing is I believe this will be a sales story in 2015 rather than 2014. I think we may sell a few units in 2014, but I think given the lead time on these projects, we're really 2015.

But I still continue to believe if we get this right, and all the signs at the moment are that we have, this passed through the TSL at its first attempt which I think is probably a record since the testing protocols were put in after 9/11.

We have not been able to address the US market for checked baggage before. When we're able to do that, clearly, there is significant upside. And as Mal said, I think incumbency in the European airports is important, particularly as I've commented before that this is essentially a drop-in replacement in physical form for the existing machines, and therefore saves the cost of modifying baggage conveyor systems and other changes.

So that was that one. Flex-Tek, Tedd, your moment to answer everything that people want to know about US domestic housing.

Tedd Smith *- Smiths Group - President Flex-Tek*

I think as long as the right structure stays reasonably tame, we're pretty optimistic about construction and our two products in that category.

I think in the air space cycle, we feel really good about the plane [bills] in 2015, 2016 and 2017, especially as the newer models come out.

I think in our other two businesses, the groups that showed no growth, we've actually done really well in those two groups to offset what I've alluded to before; the decline in the appliance industry, which has traditionally been the larger part of those groups.

Philip Bowman *- Smiths Group plc - Chief Executive*

Thanks, Tedd. Any other questions?

Sean McLoughlin *- HSBC - Analyst*

Sean McLoughlin, HSBC. I have two questions, firstly on your long-term targets. What's stopped you issuing long-term guidance today? Is this anything to do with your past statements that you assumed stable market conditions before doing so?

Secondly on Detection, the three contracts that have negatively impacted margins. You've highlighted they were signed several years ago. There's new management now. I wonder what lessons have been learned and how confident you are you don't face similar execution risks on the current contract portfolio.

Philip Bowman *- Smiths Group plc - Chief Executive*

I think in terms of targets, we set out targets in 2008, and I was profoundly grateful for an asterisk and a line of small print at the bottom which said that they had been prepared predicated on consistent economic conditions from the previous 5 years. And almost as soon as we issued the targets we all know what happened, and we've been living through that ever since.

Circumstances like that make one, I think if one is sensible, somewhat conservative about issuing new targets. And I've said very consistently that we need to see where we get to in terms of an economic recovery and some degree of stability.

I am still far from sanguine in terms particularly of the eurozone, where I still think there are dominos which are going to fall. I am more confident in what is happening in the US. But I think if we go another 6 months and we see a continuation of the current trends, then I think we're prepared to give it a go. But if we do have some unexpected and unpleasant surprises, which I wouldn't rule out, then we probably won't.

I think in terms of Detection, some of these contracts were signed a long time ago. And I think if I just give you an example of one, it would be probably quite sensible.

One of them relates to a project in India. It's in the CIS category as Mal said. At the time the tender took place, there was expectation I'm sure from the Government, who was ultimately the sponsoring party and ourselves, that the work would be undertaken probably over a period of 12 to 18 months. The reality is the work didn't start for 5 years.

Over that period, there has been substantial cost inflation in terms of the infrastructure work in India, and it will not be a surprise to anyone here to note that the Indian rupee is looking exceedingly a pale imitation of what it was 5 or 6 years ago. And the challenge I think we had very simply is we should have been very clear with that contract that when we signed it, if the works didn't start within a set period of time, all bets were off. It didn't do that, I think that's one of the lessons that has clearly been learnt from this.

I think what you see in my assessment is that this is a business, and I've said this before, that went from a box manufacturer to a contracting business. And it's some of the painful lessons that you learn with taking on long-term contracts in terms of documentation and execution.

And I think the lessons are fairly straightforward. The first one is understand that there are times when the conditions are sufficiently onerous you should be prepared to walk away.

It's quite entertaining; we've started doing that more. And in cases where we have walked away, quite often, we've found that the counterparty canceled the tender, and then that tender comes back with rather more acceptable terms at a later date.

So that's the first one.

The second one is program management. Our program management skills when we were manufacturing boxes were not great. They are still not all they ought to be, but they're a damn site better than they were. And I think that is very important.

The third point is a key one which is when you negotiate these contracts and afterwards, you need to be very clear that you not only have sufficient progress payments, but you do actually collect them. Do not send large chunks of expensive equipment off into developing markets and believe that the check is going to follow in the mail, because it doesn't. So there's a big lesson there.

I think just finally, it's a question of [bench] strength of people. I don't view that any different to any other contracting business. And if I talked to my counterpart at British Aerospace, he would tell me exactly the same. And if I look at the UK construction business, exactly the same lessons are there all the time.

So I think we have made significant progress. The legal team has been ramped up within Detection. The program management team has been ramped up, and we're not afraid to walk away where the terms are too onerous.

So I think from that perspective, lessons have been learnt. It's unfortunate. I don't like it. But we were those stuck with those contractual liabilities, and the one I'm talking about was signed at least 5 or 6 years ago.

Any other questions?

Sandy.

Sandy Morris *- Jefferies & Co. - Analyst*

Sandy, Jefferies. There, I've done it for once. I'd love to do it --

Philip Bowman *- Smiths Group plc - Chief Executive*

You've got the right name.

Sandy Morris *- Jefferies & Co. - Analyst*

You see I'm improving; it's better than 2 years ago.

On pensions, all of this is asset. We've had no help at all in either half this year from the real discount rate, and we're now within a 0.5 point change of having no deficit. Yes?

Philip Bowman *- Smiths Group plc - Chief Executive*

Yes. We did have help in the US. The discount rate in the US clearly did help. But otherwise, you're right. It was asset performance.

Sandy Morris ***- Jefferies & Co. - Analyst***

Right. And now we've got this visibility, albeit it's beginning to look a tad generous in terms of the future contributions, so as a legacy issue, God willing, pensions were beginning to go away, particularly if we've got all these annuities too. So we've kind of boxed that, have we now, do we think?

Philip Bowman ***- Smiths Group plc - Chief Executive***

I think, Sandy, we've still got a way to go. I think on the TI scheme, which is the more mature scheme as you say, we've now converted all our people who are drawing pensions onto an annuity basis. That's very helpful.

We of course have the deferred pensioners where buying annuities is a much more difficult issue in terms of the Smiths industry scheme. We are in a less mature position in terms of hedging the liabilities.

All I would say to you is that I think we are in a better position. And if ultimately we look with some interest at Mr. Carney's guidance as to what the Government is going to do to hold down interest rates, I still believe, and I know I sound like a warn record, that real interests rates will go up. We're seeing it in the US very clearly. I believe it will happen over here. And I think that will clearly ameliorate the problem.

But we've got a long way to go before we can completely [diffuse] the risk, and ultimately that I think has to be our objective to do that.

Peter.

Peter Turner ***- Smiths Group plc - Finance Director***

The only other thing I wanted to add, Sandy, was really just to remind everyone that in the accounting, IAS 19, we're using an AA corporate bond to discount the liabilities, whereas clearly, in the actuarial valuations, we're using something that's spread over gilts. And clearly, that drives a big differential between the two.

You've seen from our latest triennial valuation that the actuarial deficits as of March 2012 for the two UK schemes were still over GBP650 million, so still some way to go.

Sandy Morris *- Jefferies & Co. - Analyst*

Which wasn't -- sorry, I'm not going to start a debate on pensions, but that wasn't a million miles away from the accounting, GBP620 million.

Peter Turner *- Smiths Group plc - Finance Director*

GBP620 million, yes, but you've got the US on top as well, and the [unfunded] scheme.

Sandy Morris *- Jefferies & Co. - Analyst*

And then one for Tedd. It's nice to see, although it started last year, this increased R&D in Flex-Tek, and I'm just curious about the opportunities that now exist. Because if the ducting on aircraft and engines goes to Kevlar and you get there first, then in a relatively fragmented industry, you've got quite a lot to shoot at, haven't you, on these LEAP engines and GTFs. Would you agree?

Tedd Smith *- Smiths Group - President Flex-Tek*

Yes.

Sandy Morris *- Jefferies & Co. - Analyst*

I knew you were going to say that (laughter).

Philip Bowman *- Smiths Group plc - Chief Executive*

As I have said before, Tedd is a man of few words.

Sandy Morris *- Jefferies & Co. - Analyst*

I'm learning. And last, and this is a horrible general question for poor old Srini, the US is intriguing me because the -- [parking] the CapEx side, surgical procedures went down because we had the global financial crisis. People lost their jobs; elective surgery was deferred. And these procedures seem to have carried on getting deferred for longer -- how people must be suffering, longer than I would have thought feasible.

And then we have this big picture budget debate that says if ever Congress could pass a budget, the medical system could get going again with Obama-care and everything.

Now call me stubborn, but my view is that you shouldn't be rushing to sell this business or of taking average price until we get clarity, because it strikes me there's quite a lot pent up in the States.

Philip Bowman ***- Smiths Group plc - Chief Executive***

Yes. I think, Sandy, one observation I would make is I still -- and maybe call me an optimist, few people generally do, but I still believe that there is a deal that could be done in DC which would see the medical devices tax repealed. And certainly, we're continuing to lobby actively to that and we have had broad bipartisan support in principle for that. Now that, clearly, if you take what the annualized cost is and you capitalize that, that's worth a fair amount of change.

I think Srini is better positioned to talk on the general outlook. So, Srini, you have a few comments.

Srini Seshadri ***- Smiths Group plc - President, Smiths Medical***

Sure. I think in general you're right, Sandy. The issue I think has been one of -- at least my self-serving position is there's a very foolish austerity. This putting the squeeze on middle-class people and deferring all kinds of procedures which otherwise they should have had done, is going to be a foolish thing in the long run. Now when that all comes back, it may come back as surgeries that we should be involved with.

So it can't be put off forever. And even the capital constraints, we're talking about infusion pumps here; we're not talking about something that you can just defer forever because that physical plant is getting old. We have something line 250,000 pumps in the fleet. Sooner or later they're going to have to upgrade to smart pumps. And that's -- we've got two of the best ones, and I think we're in pretty good shape.

Philip Bowman ***- Smiths Group plc - Chief Executive***

Okay, Srini. Anything else, Sandy?

Sandy Morris ***- Jefferies & Co. - Analyst***

I love the way that non-security sales in Detection went negative in the second half. Sorry, it's a trivial number. It was [GBP7 million], and then for some reason we go negative [GBP4 million] in the second half. Maybe we had to reverse some sales out, or maybe we just stuck it somewhere else, but that was a trivial one that I wasn't going to test you with.

Philip Bowman ***- Smiths Group plc - Chief Executive***

I think you probably get the I-spy award, Sandy (laughter).

Good. Any other questions? If there are not, thank you very much for sharing your time with us this morning. I hope you found the session useful, and I look forward to seeing as many of you as possible in Dubai in December.

So thanks very much.