

John Crane Deep Dive – Transcript

Paul Keel, CEO, Smiths Group

30 November 2023



Slide 1: Cover slide – John Crane Deep Dive

Slide 2: Agenda

Good morning everyone and welcome. Thank you for joining us today.

You've heard me describe Smiths deep operational capabilities before, but today you'll see first hand how we create lasting value for our customers, colleagues, communities, and shareholders.

In terms of the agenda,
I'll kick things off with a recap of our strategy and progress.

I'll then turn it over to Bernard to walk us through how John Crane implements this model to serve their end markets.

Sook Won, who leads Sales & Aftermarket for John Crane, will cover key commercial aspects of the business – the markets we serve, the solutions we provide, and how, across more than 100 years and over 200 global locations, John Crane has earned an enviable position in some critical and very attractive markets.

Frank Ma will then take us deeper into one of those markets. Frank is our VP of New Energy Solutions, and he will help us understand the exciting journey the world is on to transition from fossil fuels to lower carbon energy sources.

We'll wrap up the presentation part of today's agenda with Rob Sharman, our VP of customer operations, who has responsibility for scaling supply and shortening lead times to meet ever-rising customer needs.

Slide 3: Executive summary

Three thoughts by way of introduction: first - our strategy, which we capture in the Smiths Value Engine, is delivering value for all of our stakeholders. Everything begins with our Purpose. Guided by it now for more than 172 years has enabled Smiths to build distinctive and compelling strengths in engineering, market position, global reach, and financial performance. We focus these strengths on our three key priorities of accelerating growth, improving execution, and investing in our people. Our progress in delivering this strategy has been encouraging. We had a record year in FY23, delivering year-over-year improvement on all five of the financial commitments we make to all of you.

My second topic focuses on synergies across the Group. With 14 divestitures over the past 10 years, we've honed our portfolio down to four industrial technology businesses who share common purpose and business models. They leverage group-wide capabilities in areas like safety, talent, sustainability, M&A, and new product development. They often serve the same end markets, like general industrial, safety & security, and aerospace. In many cases they share common infrastructure, and in all cases, they benefit from the same strong balance sheet and access to capital.

I'll wrap up my comments this morning by setting the stage for today's focus on John Crane. At last November's Capital Markets event, we highlighted how two of our businesses – Flex-Tek and Interconnect – leverage the Smiths Value Engine to serve customers in their markets. Today we'll do the

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smiths

same for John Crane. We hope you find the event engaging and valuable. Let me now go a click or two deeper on each of these topics.

Slide 4: Smiths Value Engine

The Smiths Value Engine connects the three key components of our success – our purpose, our strengths, and our priorities. Our purpose is compelling. It is both timely and timeless, authentically describing who've been for close to two centuries, what we are today, and where we aspire to be tomorrow. We live this purpose every day, all around the world – for example, we heat and cool more than half the homes in North America. We're in three-quarters of all geo-stationary satellites launched in the US and Europe. We enable 80% of all carbon capture projects on the planet, and we secure 90% of the world's largest airports. Simply put - we improve our world through smarter engineering

Slide 5: Our fundamental strengths

Consistently living this purpose has led to the four fundamental strengths you see in here in green

Slide 6: World-class engineering

First and foremost, Smiths is an engineering business. We have 3,000 highly-skilled engineers working in new product development, operations, and after-market service. Today we have more than 2,700 patents to our name, and we make a meaningful investment each year to build on this strength – over £100m in FY23 alone, or about 4% of sales. This is roughly twice the investment of our typical competitor. We invest at these levels because it makes a big difference for our customers. Nearly a third of our revenue today comes from products that didn't even exist five years ago. Smiths' world class engineering is fundamental to building the strong and defensible market positions that we've earned over time. Let's turn to those now.

Slide 7: Leading, defensible positions in structurally attractive markets

Smiths serves the four primary end markets you see here, in most cases through multiple businesses. General Industrial is our largest end market at roughly 40% of Group Sales, and we serve it through John Crane, Flex-Tek, and Interconnect. Across the cycle, this market grows at GDP rates of 2-3%. Last year, though, we grew close to 8% in this market, behind particularly strength in John Crane. Here in FY24, while the strength continues in Crane, it is partially offset by softness in parts of Flex-Tek and Interconnect.

Just under a third of our revenues come in safety and security, which consistently grows around 3-4%, buoyed by the world's ever-rising needs. We grew nearly 12% in this market last year as airports around the world are upgrading their checkpoint security systems from 2D to 3D scanning, an area of particular strength for us. We were also awarded two very large defense contracts for chemical detection that will provide additional high-margin growth over the medium-term.

Energy, which represents just under a quarter of our business, also grows about 3-4% a year across the cycle. It was Smiths' fastest-growing end market last year at nearly 20%. We are seeing very strong demand in John Crane for both traditional and new energy applications, of which the team will say much more in just a moment.

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30 November 2023



Aerospace is currently our smallest but fastest-growing end market, and we serve it across two divisions. Propelled by strong demand for commercial, defence, and space applications, we expect this to remain an exciting segment for us for years to come.

As you can see, we operate in fast-growing, global markets and we enjoy leading positions in each.

Slide 8: Global capabilities

In the same way that our portfolio is well-diversified by industry, we've built good geographic balance as well, with no country aside from the US accounting for more than 5% of total sales. In order to serve demanding global customers, we have to be global as well. Our customers want to source the same solutions, with the same specifications, often through the same supply agreements everywhere that they compete. The turbulence of the last few years has taught all of us that supplying the world from just a handful of factories – typically in Mexico or Southeast Asia - is simply no longer a viable strategy.

Fortunately, Smiths has long architected our global supply chains with a local-for-local design. We source where we manufacture. And we manufacture where we sell. As you can see from the map on the right, we have operations in over 50 countries, with more than 100 manufacturing plants paired with over 200 service centres. Our global presence uniquely allows us to deliver real-time, mission-critical support to our customers.

Slide 9: Robust financial framework

World class engineering, leading positions in critical markets and global capabilities all support the robust financial framework that is a hallmark of Smiths.

It all begins with accelerating growth, +12% organically in FY23. With the structural economies of scale that exist in our business, faster growth drives expanding margins – ours are up 100 bps in 2 years – which results in even faster profit growth, +20% in FY23.

And with our low asset intensity – capex under 3% of sales – profit growth converts to even more operating cash, +30% last year. Free cash flow, was up 37%.

Growth is the gear that makes our Value Engine hum. Smiths has long had high margins and low capital needs. Indeed, we've averaged over 100% cash conversion for the last 4 years. In the past, though, Growth had been the missing cog. Now with 10 straight quarters of growth including our fastest year on record in FY23, our strong financial framework is delivering smoothly and consistently.

Slide 10: Our priorities

Let's now turn to how we focus these strengths to advance our three key priorities. As just mentioned, Growth powers our Engine. Execution translates growth into profit and cash. And our people make all the progress possible.

Slide 11: Delivering consistent growth

John Crane Deep Dive – Transcript

Paul Keel, CEO, Smiths Group

30 November 2023

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The four layers you see here have all played a role in our now-consistent growth. Roughly half of our acceleration has come from better accessing the many opportunities available to us in the attractive core markets I outlined earlier. We're gaining share across most of our portfolio, and consistently capturing more price for our solutions than we're absorbing in input costs.

New products are also contributing meaningfully with roughly a quarter of our growth last year coming from products launched during fiscal 23. We're aggressively penetrating high priority adjacencies like process electrification and energy transition. Helping to build the world's first zero-emission steel mill is an example of the first. Participating in the world's largest green city and blue hydrogen projects are examples of the latter.

In a high-margin, high-return business like ours, the strongest risk-adjusted return will usually come from organic growth. Nonetheless, we typically generate more cash than we can deploy internally, which makes M&A an attractive option for amplifying organic strategies. We completed two bolt-on acquisitions in the past 12 months – Plastronics in Interconnect, and HCP in Flex-Tek. Both were funded from operating cash, both were completed at accretive multiples, and both accelerate our penetration into prioritized, strategically aligned adjacencies.

Slide 12: Q1 adds to our growing track record

As you saw in our trading statement earlier this month, we've now delivered 10 consecutive quarters of growth. As expected, Interconnect declined sharply in Q1. Flex-Tek declined modestly, as strength in our aerospace business was not enough to offset weakness in US construction. More than offsetting these, however, growth remains strong in both John Crane and Detection. With record order books in both businesses, we expect this strength to continue throughout the year.

For Smiths Group in total then, Q1 organic growth came in at 3.5%. As we face our steepest comps in the first half, this is where we expected to be. And as such, we reaffirmed our guidance of 4-6% organic revenue growth for Fiscal 24.

Slide 13: SES delivers results, develops talent, and advances our culture

Let's turn now to how we're further improving execution across our company. The Smiths Excellence System is central to how we deliver results, develop our talent, and advance our culture. We launched the program in early calendar 2022 by putting in place 29 full-time Black Belts and Master Black Belts.

In our first full year, SES delivered £14 million of earnings benefit. We now have close to 40 full-time SES resources in place and with impact scaling quickly, we expect the contribution from SES to grow to £20m for Fiscal 24.

The importance of SES in building an ever-stronger Smiths extends beyond financial benefits. For example, it's a key program for accelerating talent development across our company. Our first wave of BBs and MBBs will re-enter into high-impact leadership roles in our company in the second half of this fiscal; backfilled by an even larger cohort of Wave 2 talent. This cycle helps to lock-in operational gains and further embed SES culturally as the way we work at Smiths. You will see several examples of the benefits that SES brings throughout the day today.

Slide 14: People – delivering for all our stakeholders

John Crane Deep Dive – Transcript

Paul Keel, CEO, Smiths Group

30 November 2023



Next let's turn to people - this slide shows the four main stakeholder groups we serve:

Firstly, our customers. We help them achieve their financial, operational and sustainability goals through the innovative solutions we bring to market and the responsive and agile service we provide through our extensive global footprint.

Second - my colleagues around the world. We realigned our incentive programs to match our financial and sustainability commitments. In FY23 we saw record high employee engagement and a reduction in attrition of over 3 points.

Third comes our communities - governments partners, the charitable organizations we support, and the towns & cities where we've lived and worked for close to 200 years. We know that for Smiths to prosper over the long term, as we have, our communities must do as well.

And of course there is all of you - our shareholders. We're working hard to build a track record of consistent performance and value creation. We've returned over £1bn of capital in the last 2 years, and FY23 marked our 72nd straight year of paying a dividend, one of the longest track records in the FTSE.

Slide 15: Sustainability underpins our growth, execution, and people priorities

Having provided an update on Growth, Execution and People, let's now turn to sustainability which underpins all three. With respect to growth, our sustainability efforts centre on developing high-value green solutions that help our customers meet their ESG objectives. The work we're doing in industrial electrification and green energy are important examples and Frank will say much more about these later in the agenda.

In terms of execution, we've committed to NetZero from Scopes 1&2 by 2040 and Scope 3 by 2050. While we have much more to do in this regard, we are encouraged by our progress with an 8% improvement in energy efficiency last year, a 10% reduction in non-recyclable waste, a 12% reduction in Green House Gases, and a 13% reduction in water use.

And when it comes to People, we live our purpose each and every day. Hopefully you see, that for Smiths this is much more than lip service. Indeed, we've repeatedly put our money where our mouths are, linking both short and long-term incentive comp to delivery of our ESG commitments, and reinvesting a portion of last year's gains back into our communities with the launch of our new Smiths Foundation.

Slide 16: Delivering significant progress against all medium-term targets

Wrapping up my comments on Strategy, our results have been encouraging. Record sales and EPS growth in FY23, 100 basis points of margin expansion and 180 basis points of ROCE growth over the past two years And good progress on cash, up 6 points year-on-year. As supply chains continue to normalise, we expect to return to our traditional levels of 100% or better operating cash conversion. Let me now say a bit more about our portfolio, in particular how strong individual businesses are made even stronger by a common Purpose, business model and Group-wide capabilities.

John Crane Deep Dive – Transcript

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30 November 2023



Slide 17: Shared Purpose, strengths, and Group-wide capabilities are woven across Smiths

We go to market around the world through the four businesses you see here - Each with a unique portfolio of products and services, discrete financial statements, and fully-accountable management teams. This gives these businesses the autonomy and agility they need to move at the speed of our customers. At the same time, our businesses are knit together through a shared purpose, similar business models and end market overlap. We often share infrastructure and together have access to lower cost capital. Through group-wide capabilities in areas like talent, SES, new product development and M&A, we share learnings and improve faster together. Let me close with an overview of how John Crane employs the Value Engine to create value for its stakeholders

Slide 18: How John Crane employs the Value Engine to create value for its stakeholders

John Crane represents just over a third of Smiths' revenues. It wasn't our fastest-growing business in FY23, that honour went to Smiths Detection, but it was our most profitable, with margins approaching 23%. Like the rest of Smiths, John Crane is very much an engineering business, leveraging its deep expertise in mechanical sealing across its 106 year history to build the largest installed base in its markets.

Like the rest of Smiths, John Crane has manufacturing on every continent except Antarctica, enabling us to serve demanding global customers across multiple end markets – like Shell and ExxonMobil in energy, BASF and Dow in chemicals, and Pfizer and GSK in pharma.

And like the rest of Smiths, John Crane has a robust financial framework characterized by a 30/70 split of OE and After-market revenues, margins and ROCE consistently above 20%, and cash conversion averaging 95% across the past 5 years.

Slide 19: Closing remarks

To wrap-up my comments on the Group, Smiths is a fundamentally strong business with excellent positions in secularly attractive markets. Our businesses share a common Purpose, similar business models, and Group-wide capabilities. And we have a clear strategy that is delivering value for all of our stakeholders. Let's now take a closer look at John Crane's important role in all of this.

Bernard – I'll leave it in your capable hands to take it from here. Thank you everyone