

OUR STRATEGY

OUR AMBITION IS TO ESTABLISH SMITHS AS ONE OF THE WORLD'S LEADING TECHNOLOGY COMPANIES. WE WILL DO THIS BY DELIVERING ABOVE-MARKET SUSTAINABLE GROWTH IN OUR CHOSEN MARKETS AND WORLD-CLASS COMPETITIVENESS AND INNOVATION, SUPPORTED BY OUR STRONG FINANCIAL FRAMEWORK. DURING 2017 WE MADE SIGNIFICANT PROGRESS AGAINST OUR OBJECTIVES.

STRATEGIC OBJECTIVES

OUTPERFORMING OUR TARGET MARKETS

Focus the portfolio on our most attractive markets globally, where we can sustainably maintain a scalable top three leadership position.

REVENUE £M/% growth

2017	3,280 (1)%
2016	2,949 (2)%
2015	2,897 (2)%

DELIVERING WORLD-CLASS COMPETITIVENESS

Drive world-class competitiveness through:

- a shared operating model (SES) that drives speed and efficiency on a sustainable basis;
- investing in innovation for technological differentiation; and
- building a learning organisation that enables our people to be the best that they can be.

We call this our Smiths Way of working.

FOCUS

Reposition the portfolio for growth through organic investment and a highly disciplined approach to acquisitions and disposals

Increase our focus on higher-growth regions

Deliver the Smiths Excellence System (SES) – a shared operating model focused on continuous improvement, speed and efficiency

FY2017 PROGRESS

- Invested more and smarter in R&D and innovation
- Continued the realignment of the portfolio into profitable, higher-growth markets. Divestments included four non-core businesses – John Crane's Artificial Lift, Smiths Medical's Wallace product line, and Smiths Interconnect's Power and Microwave Telecoms
- Completed the acquisition of Morpho Detection, with integration on track, significantly enhancing our market-leading position and capabilities, without increasing net debt

- Appointed a new Group President of Asia Pacific to accelerate our growth in the region
- Prioritised plans for growth, with a new operating model and leadership team for the region

- Started the implementation of SES, with a focus on building capability to do what we do faster and better, whether it is designing new solutions, manufacturing, or getting products to our customers when they want it at the best levels of quality
- Good progress is being made on our key priorities across our six Excellence pillars of Customer, People, Technology, Production, Programme and Supply
- Reduced working capital, freeing up cash to invest in growth
- Continued to drive focus on safety, achieving our lowest annual Recordable Incident Rate (RIR) to date as we work towards a zero-harm workplace

WE USE A RANGE OF PERFORMANCE METRICS IN ORDER TO PROVIDE A CLEAR AND CONSISTENT MEASURE OF OUR UNDERLYING PERFORMANCE. WE FACE A NUMBER OF RISKS TO DELIVERING OUR STRATEGY AND OUR PRIORITIES SHOULD BE REVIEWED IN RELATION TO THESE. OUR PRINCIPAL RISKS AND MITIGATING ACTIONS ARE SET OUT ON PAGES 62 TO 67.

KEY PERFORMANCE INDICATORS

PORTFOLIO POSITIONING

75%

Around 75% of revenue now comes from well-positioned businesses in our attractive target markets (2016: 60%)

FY2018 PRIORITIES

- Drive market share growth in the c. 75% of businesses that are well-positioned
- Continue to improve or sell the remaining 25% of businesses
- Move forward with the integration of the former Morpho Detection business
- Maintain a disciplined approach to acquisitions that can materially enhance our capabilities and position

APAC REVENUE GROWTH AHEAD OF GROUP

(0.9)%

Incremental underlying growth in APAC less total underlying Group growth

- Continue to develop, embed and execute our new operating model and strategy for APAC

COST OF POOR QUALITY (COPQ)

2.1%

COPQ includes the cost of waste, corrective work, warranty claims, returns and penalties, measured as a % of annual revenue. We are treating FY2017 as our baseline year for measuring COPQ using a common methodology across the Group

- Implement our top priority processes across each pillar
- Continue to develop the next set of priorities across the pillars
- Further enhance our safety culture and performance as we work towards a zero-harm culture

PROCUREMENT SAVINGS £M/%

£42M/3.4%

Procurement savings measure the % saving achieved on potential spend during the year, including the cost impact of external market trends, negotiation with suppliers, changes in sourcing, value added value engineering and rebates

OUR STRATEGY
CONTINUED

STRATEGIC OBJECTIVES

DELIVERING WORLD-CLASS COMPETITIVENESS (CONTINUED)

STRONG FINANCIAL FRAMEWORK

Our strong financial framework underpins the delivery of our strategy and value creation by optimising cash generation and allocating capital to the best value creation opportunities.

Our governance framework is supported by robust risk management and strong financial control to help maintain our investment-grade credit rating.

FOCUS

FY2017 PROGRESS

Create a culture of innovation

- i³, our Group-wide innovation framework, is fully operational and driving our innovation agenda
- First projects approved under our central Innovation Fund to accelerate key projects to build technological capabilities that can be leveraged across Smiths
- Completed 20-year horizon scans and roadmaps, developed key external partnership, and introduced a standardised New Product Introduction process across the Group
- Appointed a new Group Head of Innovation and Chief Digital Officer

Build a learning organisation

- Launched the Smiths Way to help embed a common way of working across Smiths
- Launched a new leadership development programme in partnership with UCLA Anderson Executive Education to further enhance our leadership capabilities
- Revised our incentive programmes to better align with our strategic priorities
- Introduced a new approach to measuring employee engagement

Deliver profitable growth with sustainable margins

- Achieved operating profit margin increases in all divisions
- The divestment of four non-core businesses and acquisition of Morpho Detection exchanged similar revenue that was declining for growing revenue with a higher margin
- Drove operational excellence to protect margins and fund investment for growth

Focus the portfolio on sustainably competitive and asset-light businesses

- Focus on cash generation and conversion enabled investment and value creation

Apply strong financial discipline to the way we manage the business and invest

- Invested in value creation opportunities
- Managed the balance sheet effectively, reducing working capital
- Maintained an investment-grade credit rating
- Morpho Detection acquisition was self-funded and will be accretive to growth, returns and EPS

KEY PERFORMANCE INDICATORS

INVESTMENT IN R&D AS A
PERCENTAGE OF REVENUE %

2017	4.6
2016	4.0
2015	3.8

R&D expenditure includes the cost of projects that are being capitalised and customer-funded

FY2018 PRIORITIES

- Invest more and smarter in R&D, and convert it into new business faster
- Launch our first digital centre of excellence – or 'forge' – in the US, with a second planned in Europe, to accelerate our digital agenda across the Group
- Use the central Innovation Fund to support additional projects to drive technological differentiation
- Continue to build a culture of innovation through our i³ innovation framework

EMPLOYEE ENGAGEMENT

71

Employee engagement FY2017 My Say survey score, based on an average score for two questions assessing how happy employees are working at Smiths

- Continue to embed our values, strategy and operating model across Smiths, so that everyone understands their role
- Continue to progress on our people plan and improve attraction, retention and engagement through enhanced communication, development opportunities and employer branding
- Increase our focus on diversity and inclusion at all levels

HEADLINE OPERATING MARGIN %

2017	18.0
2016	17.3
2015	17.6

Operating margin is headline operating profit as a proportion of revenue. See note 3 to the accounts for the calculation of headline operating profit

REVENUE £M/% growth

2017	3,280 (1)%
2016	2,949 (2)%
2015	2,897 (2)%

Underlying excludes the effects of foreign exchange translation and acquisitions but includes divested business for the period they were owned in the reported financial year and adjusts the prior financial year comparator as if the divested business were owned for the same period in that financial year to aid comparability

CASH CONVERSION %

2017	118%
2016	102%
2015	95%

Cash conversion is headline operating cash-flow divided by headline operating profit

PORTFOLIO POSITIONING

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Around 75% of revenue now comes from well-positioned businesses in attractive target markets (2016: 60%)

RETURN ON CAPITAL EMPLOYED %

2017	16.2
2016	15.3
2015	16.0

The calculation of ROCE is defined in note 30 to the accounts

CREDIT RATING

BBB+/Baa2

STABLE OUTLOOK

As issued by Standard and Poor's and Moody's

REDUCTION IN WORKING CAPITAL £M

2017	85
2016	9
2015	(38)

Cash generated from the change in working capital