Spectris 2021 half year results

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Presentation

Andrew Heath

Chief Executive, Spectris

Good morning, everyone. I hope that you are all keeping safe and well at this time. Welcome to Spectris' half year results for 2020. I am Andrew Heath, chief executive, and I will go through the headlines and then you will hear from Derek Harding, our CFO, who will run through the numbers in more detail. I will then come back to talk about some of the operational and strategic developments in our businesses, before closing with our outlook, and move into Q&A.

Now, I am conscious you have a busy morning, so I will provide a quick run through of the main points of today's results announcement. But before I do, I really want to acknowledge the great work and support of the whole Spectris team once again over the past months. Although many of the challenges of COVID-19 are still with us as a society, we have developed as a business really well to our new operating environment.

Our priority remains safeguarding the welfare of our employees and their families, the communities in which we operate, and also to maintain high levels of service to our customers. Our operating companies have embraced new ways of working, as have our customers who continue to be supplied with the products, the services and the expertise they need. And it has been great to see this in person as more recent easing of restrictions has allowed me to visit a number of our facilities.

Now, you have heard me say before that at Spectris, we believe in being purpose driven, and very much true to our values as we execute on our strategy, delivering value beyond measure for all of our stakeholders. And I am really pleased with how we have been executing our strategy for profit or growth alongside the balanced and socially responsible approach we have taken to managing our business, it really is delivering for us. And we are emerging from the pandemic a more focused, leaner and stronger business. The last few years have been characterised by restructuring, cost reduction, but also investment for future growth, with less reliance on the macro economy.

But with a much brighter macro environment and many of our own markets now recovering strongly, we are benefiting from the high quality of the retained businesses within our portfolio, our profit improvement programme and our lower cost base.

Equally, we are seeing growth above the market because of our recent investments and concentration on higher growth segments.

And we can see these tangible improvements coming through in our strategy scorecard, with ticks across the board versus 2020. We have achieved strong operating leverage off the back of the expansion in our top line with adjusted operating profit and margins ahead of both this time last year and also 2019. The portfolio optimisation programme is well progressed and we fully expect to conclude the disposal programme we identified back in 2019 later on this year.

We have maintained our investment in R&D and capex last year, and we are increasing investment in new products and services through this year. And we can see this coming through in incremental sales growth.

The balance sheet has been further strengthened, providing considerable optionality, including for further M&A. And I am delighted that we have now completed the acquisition of Concurrent Real Time, which strengthens HBK's simulation offering and we continue to work on our pipeline of further acquisition opportunities.

And today we have announced an interim dividend of 23 pence per share, maintaining the dividend growth at 5% in line with our policy. And we now starting to move into the next phase of our strategy for profitable growth with an even greater focus on our purpose. Our ambition is to be a leading sustainable business, ensuring we have strong relationships with our employees, our customers, our suppliers and communities, and in turn delivering attractive returns for our shareholders.

Financial performance

So now let us look at our financial performance in the first half. We delivered like for like sales growth of 14%, above that of the market, which reflects the recovery in many of our end markets. And as I have said, also further supported by our new product and service launches. encouragingly, like for like sales are only 2% lower than in the first half of 2019.

Also, orders were 16% higher on a like for like basis, providing momentum going into the second half.

There was a 74% increase in adjusted operating profit, resulting in an operating margin of 12.8%, which reflects the growth in sales, but also the cost actions and the higher margin mix of the portfolio following the divestments.

And all this compares to an 11% margin in the first half of 2019. Again, a notable improvement and as guided we delivered strong operating leverage.

Our cash conversion also remained strong and 122% and in combination with our disposal proceeds resulted in a net cash position at the end of June of £272.8 million. I have to say, I am very pleased with the performance that we are delivering.

The new business environment that has emerged provides us with good prospects in many of our own markets. We play an important role in sectors that are transforming rapidly such as pharmaceutical, energy, automotive, and mining, which in turn offer significant opportunities for growth. Our current product offerings and new product development activities are very much aligned with our purpose. And that is to equip our customers to make the world cleaner, healthier and more productive, as well as frankly helping them address many of the sustainability challenges that they face.

And by focusing on sustainable solutions, it will not only make a difference to our planet, but also underpin our future growth.

We also recognise the importance of improving the sustainability of our own operations. And today, we have also announced the publication of our net zero ambition. We are committed to taking a leading role in minimising the emissions footprint of our own activity, and also the activity across our value chain. The net zero pledge we have announced today is appropriately ambitious, being aligned with a one and a half degrees centigrade climate warming scenario. And we are using 2020 as the baseline.

And I will come back and talk more about our targets and the other initiatives underway in support of the three UN Sustainability Development Goals that we have selected. Now I would like to hand over to Derek, who will run through the financials in more detail.

Financials

Derek Harding

CFO, Spectris

Good morning, everyone. For consistency, I am once again starting with our scorecard slide. Perhaps not surprisingly, we are showing a very positive performance compared to H1 2020, with ticks across the board. Given the nature of 2020, we have also included a comparison on this slide to H1 2019 to assess how we are performing compared to the pre COVID period. I will cover the specific numbers during my presentation, but overall we believe that our performance in H1 is a strong step forward and in many ways better than the pre COVID performance of 2019. Let me now take you through the specific details.

Reported sales increased by point 5% to 601.8 million. If you adjust for the impact of disposals net of acquisitions, which reduced sales by 44.8 million or 8%, and foreign exchange movements reducing sales by 28.3 million or 5%, you see a growth of 13.7% on a like for like basis compared to 2020. On this basis, we are only 2.3% behind 2019.

Adjusted operating profit increased by 74.2% to 76.8 million on both a reported and like for like basis. Compared to 2019, our like for like operating profit is up 14% despite the lower sales.

Adjusted operating margins increased by 540 basis points with like for like adjusted operating margins up 450 basis points compared to H1 2020, and 190 basis points compared to H1 2019.

Improvements in the gross margin due to additional volume and favourable pricing, combined with our continued cost control have all contributed to the higher operating margin in the period.

Adjusted profit before tax was 73.7 million, up 82.4%. Our tax rate came in at 22%, which is in line with guidance. And adjusted earnings per share were 49.7 pence. The interim dividend per share of 23 pence represents a 5% increase over the prior year, consistent with the growth in dividend for 2020. We remain committed to paying a progressive dividend.

While adjusted cash conversion was lower than the 201% achieved in 2020, we were pleased to achieve 122% in the first half. Following receipt of funds from disposals, our net cash at the end of June was 272.8 million. Finally on this slide, the trend of our return on gross capital employed has now switched and increased from 11.3 to 12.2%.

P&L movements

This slide provides a graphical view of the main P&L movements that I have just discussed. I have used it in previous presentations, and I include it here for your future reference.

Moving on to cash, this slide shows how we generated cash in the period and illustrates what we have then done with that cash. Starting by adding back the 20.7 million of depreciation and amortisation charge to the adjusted operating profit brings you to 97.5 million of EBITDA.

Our continued focus on working capital management released 15 million of cash during the period and we spent 19.1 million on capex. This gives us our adjusted cash from which operating activities of 93.4 million, which we divide into the adjusted operating profit to get our cash conversion metric of 122%.

There was then a significant inflow of cash in H1 of 236.8 million, which is made up of 208.8 million net proceeds from disposals plus 38.3 million in relation to the US listed company shares, which we were holding at the year end. We received cash in the first half when the takeover of that company was completed, and these inflows are offset by 10.3 million of other transaction costs.

In the first half, we spent 79.7 million of the 200 million share buyback announced in March and paid 53.6 million in final dividend. We spent 6.8 million of cash in relation to restructuring.

Interest and tax had a combined cash impact of 19.7 million, with other movements of 3.7 million bringing us to the net increase in cash for H1 of 166.7 million.

In terms of our funding position during the period, the group took the opportunity to repay our €116 million EIB loan, which was due to mature in September 2022. And we are also in the process of reviewing the $800 million RCF with a view to agreeing a reduction in size to $500 million during the second half.

The reconciliation between our adjusted operating profit measures and our statutory profit measure down to statutory profit before tax is much simpler this year. There are no asset impairments to report and restructuring costs were limited to 3.8 million in the first half as we finished up the final aspects of activities started during 2020. And therefore the statutory operating profit is only 16.2 million lower than the adjusted operating profit at 60.6 million. The largest figure on this schedule for 2021 of 117.7 million primarily relates to the profit on disposal of B&K Vibro, which was completed in the first quarter.

Financial income in H1 relates to a 5.7 million interest credit following the positive settlement of an EU dividends tax claim and a 6.7 million FX gain on intercompany balances, which was a £10 million loss in the prior year and included in the finance cost line. This then brings you down to a statutory profit before tax of £187 million for the period.

Second half outlook

Looking ahead to the second half. This slide updates our view of things to consider when looking at 2021 on a full year basis. Starting with the headwinds, we still anticipate COVID related interruptions. We expect them to be localised, but clearly cannot predict the scale of any impact they may bring. We maintain our guidance regarding the reversal of £10 million of COVID related temporary cost savings and a similar amount of cost inflation.

If our growth is near the top end of the range, that will require some additional investment, as could responding to some of the supply chain constraints that we are experiencing. However, we will work to mitigate this where possible.

At the yearend we provided a pro forma set of numbers excluding BTG, Millbrook and B&K Vibro. Since then we have sold ESG which contributed 11 million of revenue in 2020, and 1 million of profit, which will of course not repeat in 2021.

We continue to experience a currency translation headwind compared to 2020. And following some of the disposals, the underlying currency shape of the group has changed slightly. So I have updated the sensitivity guidance that we normally provide to reflect this.

On the positive side, we have several tailwinds. We are clearly experiencing an economic recovery with markets improving as confidence builds in managing the pandemic. We have a strong order book as we enter the second half. Our organic growth continues to benefit from new products and services. And as a result, we anticipate like for like sales growth for the full year to be in the range of 10 to 12%.

We are continuing to deploy the Spectris business system to reduce waste and further build on our self-help activities and remain confident of continued margin progression.

Finally, the acquisition of Concurrent Real Time which completed slightly later than previously anticipated is expected to contribute around £15 million of revenue and £3 million of profit in 2021.

In terms of other guidance, capex will be around £50 million, and we expect our tax rate to be 22%. We think working capital will remain around the 11% level experienced for the first half. And we do not anticipate any new restructuring programmes, but there are some costs in the second half relating to 2020 programmes, but they will be less than £5 million. And with that, I will hand you back to Andrew.

Andrew Heath

Chief Executive, Spectris

Thank you, Derek. Now let us take a quick look at our end markets before turning to our businesses. We have seen a good recovery in many of our end markets, pharmaceutical, semiconductor and machine manufacturing stand out as the strongest performers. In pharma, we are seeing a significant uplift in support of vaccine and viral vector development and manufacturing, as well as an increase in the onshoring of production. And the onshoring trend is also supporting growth in semiconductors, as is the rising demand for chips, which is driving an increase in global fabricated equipment spending.

And in machine manufacturing, the positive outlook for agriculture, food and medical equipment supported by the strong fit of our sensor applications is also driving growth.

Automotive, energy and utilities do remain weaker than last year, albeit the rate of decline is easing with growth posted in the second quarter.

Academic research, which was notably impacted in 2020, with research institutes being closed has seen a steady recovery.

Businesses

So now turning to our businesses, I will start with Malvern Panalytical. Here, sales increased 23% on a like for like basis, supported by both a strong market recovery and the impact of new products like the Zetasizer Advance and Omnitrust launched in 2020. They had a strong performance in Asia, especially China and also in the pharmaceutical market. And this volume growth combined with cost management, pricing movements, and higher service revenues helped drive a 186% like for like increase in adjusted operating profit. And that is a 730 basis points rise in adjusted operating margin.

Compared to 2019, Malvern Panalytical sales are now only 3% lower on a like for like basis, showing that our recent product launches are really helping to drive growth above that of the market.

And our like for like adjusted operating profit is 28% higher, reflecting the strong operating leverage on the back of cost management over the past two years.

Malvern Panalytical's programme of launching new and enhanced product offerings, with a focus on software, services and analytics is also being well received by customers. In the first half, Malvern Panalytical released Smart Manager, and that is a cloud-based control room that connects and monitors its X-ray fluorescence systems. It provides insights into the real time utilisation and also the health of their instruments, continuing analysing data to help improve both process and also team productivity. And we expect this to be particularly attractive to primary materials customers.

They also launched enhanced versions of their Aeris Compact X-Ray Diffractor and the Epsilon XRF Analyser, both with superior new capabilities. And these new products are allowing us to tap into key growth trends in our markets.

Being late to cycle, HBK saw 8% higher like for like sales, with a very strong second quarter, especially in Europe and Asia, with notable growth in the latter. Machine manufacturing was the strongest market. Adjusted operating profit increased 44% on a like for like basis, while adjusted operating margin increased 310 basis points. And compared to 2019, HBK's like for like sales are broadly flat, but adjusted operating profit is 40% higher, and that reflects the operational improvements and merger benefits that continue to be delivered. I think this clearly demonstrates the enhancement the HBK team has been driving to improve margins and also operating leverage.

Alongside the operational improvements, HBK has also been investing in organic growth projects aligned to the strongest market growth opportunities such as electrification, simulation, and also digitisation. And these focus on virtual testing and simulation, but also physical testing, including electric powertrain development, smart sensors, and also software. New products launched this year include a new NVH simulator and the latest software version of the Tescia repetitive testing system.

And as mentioned earlier, the acquisition of Concurrent Real Time significantly strengthens HBK's simulation offering.

We were pleased to complete the acquisition of Concurrent Real Time, and I would like to show a short video with an overview of what it does and what it brings to HBK.

Video

Customers need to reduce the number of physical prototypes and time to market while increasing innovation. Simulators are a great platform to develop innovative vehicles in a faster and safer way. VI-grade provides a scalable and upgradable product line. Realism and immersion are very important for the driver experience. Hard real time computation is key for a successful driving simulator. Concurrent Real Time provides simulation solutions, delivering hard real time performance for the most sophisticated hardware in the loop and human in the loop simulations. It is used by VI-grade today.

Customers need to test components of a vehicle under real life conditions. With driving simulators powered by hard real time technology, components can be tested as if they were in a real prototype. By combining VI-grade's and Concurrent Real Time's technology, the resulting hardware in the loop testing solutions meets this currently unmet need. The innovative offline and real time simulation solutions from HBK's virtual test division, therefore help customers accelerate innovation, reduce time to market and improve their competitive advantage in a sustainable way.

Businesses

Andrew Heath

Chief Executive, Spectris

The acquisition of Concurrent completed earlier in July and we are delighted to welcome the team to Spectris and HBK. This acquisition is a further step in building a position of scale and provides the opportunity to meet a real unmet customer need, that of hardware in the loop testing.

Moving on to Omega, Omega has demonstrated a much-improved performance in the first half of the year, with like for like sales 14% higher. It really is benefiting from the focus being brought by the new management team. In North America, growth was above that of the market, with semicon demand supporting growth in Asia. Adjusted operating profit improved 145% on a like for like basis, reflecting the higher sales, higher gross margins and flat overheads. As such, like for like operating margins increased 550 basis points.

Versus 2019, like for like sales are now only 2% lower. However, we recognise that the adjusted operating profit is 30% lower, given the higher cost base following the website investment. As such, the priority remains to scale the business to improve profitability.

And as previously identified, four focus initiatives have been enacted to achieve this and it is pleasing to see the impact of these coming through. Web orders have returned to 2018 levels, achieving record average order values and an improved conversion rate. Growth has been above that of the market. And the partnership with Newark has been particularly successful, with sales doubling year over year. And Omega is now working to extend this relationship to Europe and Asia.

The new product innovation strategy has shifted to fewer, more impactful launches in key growth areas. And one such example is Hani, the high accuracy non-invasive temperature sensor. This clamp on sensor achieves the same accuracy and response times as invasive in pipe sensors without the cost and risk.

Food and beverage is a key initial target market. But we are also planning for other applications too.

Now there is clearly more to do, but it is good to see progress being made under the new management team.

Industrial Solutions

Turning now to Industrial Solutions, like for like sales here increased 12% with a very strong performance in Asia. The sales growth was strongest in the semiconductor and

pharmaceutical customers, reflecting a strong market recovery and also the impact of our product launches in 2020 such as Servomex's ultra-oxygen and moisture product range and Red Lion's FlexEdge product, with PMS launching their Lasair Pro Airborne and IsoAir Pro Plus particle counters in the first half of this year.

In ISD, like for like adjusted operating profit increased 41% and operating margins increased 320 basis points. And compared with 2019 sales are just 4% lower and adjusted operating profit is 4% higher on a like for like basis. Good progress is clearly being made in executing each of the operating company's strategies, improving the performance of the businesses in parallel with the divestment programme.

For the retained businesses, the strategic direction will be centred around being a leading provider of high precision in line sensing and monitoring solutions.

Net Zero Targets

Now climate change is one of the greatest challenges we face as a society. We at Spectris are determined not only to equip our customers on their journeys to net zero, but also to play our part in minimising our own carbon footprint as well as limiting the impact from our supply chain.

As such, I am delighted today to announce our net zero targets. Following an extensive piece of work to understand our baseline emissions position, and the roadmap that we might adopt to achieve them, we have set stretching, but also realistic targets encompassing scope one, two and three emissions. And that is all from a baseline of 2020.

So today, we are pledging to reduce absolute scope one and two emissions by 85% and achieving net zero by 2030. And we are also pledging to reduce absolute scope three emissions by 42% by 2030, and achieving net zero by 2040. To achieve the scope one and two targets, we have a roadmap underpinned by numerous initiatives, such as sourcing 100% renewable electricity across our operations by 2030, and accelerating our transition to an all-electric business and fleet vehicles by 2030 as well.

To address scope three emissions, we will prioritise a reduction in our own emissions, for example, through the efficiency and also circularity of our products, and we will also be engaging with our supply chain on their environmental and wider sustainability commitments.

I am excited by the innovation that this will drive within our businesses to deliver this ambition. And in support of both targets, we have submitted a commitment letter to the Science Based Targets Initiative. In parallel, we have also made considerable progress in our alignment with TCFD.

Being a sustainable business also means that Spectris is generally known as a great place to work. We remain fully committed to the continued support of our mental health, wellbeing and resilience activities. We also want to ensure that everyone here feels that they belong. Our work on building greater diversity, inclusion and equity continues. And we recently initiated our belonging programme. I am also very pleased to announce that the Charities Commission has now approved the Spectris Foundation, where we will be supporting STEM projects in education, and we fully expect the first investments to be made later this year.

All these activities help embed sustainable thinking in our operations, and also our business aims. That helps mitigate risks but also helps us capture opportunities from the increasing focus on sustainability by all of our stakeholders.

We looked earlier at how the combination of Concurrent RT and VI-grade helps accelerate also development cycles, and virtual testing is also part of our sustainability strategy. As an example, Aston Martin Lagonda has adopted VI-grade's compact simulator, and is now able to conduct numerous tests on a virtual vehicle model at an early stage well before building a first prototype, and this leads to higher reliability and confidence in the prototypes, with more effective testing, resulting in a higher quality vehicle. But ultimately, it saves costs and resources in the development of new vehicles, thereby helping in the reduction of emissions compared to building numerous prototypes, and testing these on physical proving grounds.

Summary

So in summary, we have adapted to the new operating environment. The actions and approach taken in the last two years have positioned as well to benefit from the market recovery and from our investment in product innovation. We delivered a strong financial performance in the first half, with our order book providing good momentum going into the second half, and we expect full year like for like sales growth of between 10 to 12%.

And we are now starting to move into the next phase of our strategy. Our ambition is to be a leading sustainable business, improving the sustainability in our operations, and to be more focused on our purpose, equipping our customers to make the world cleaner, healthier, and more productive.

And in support of this, we have set ambitious net zero targets. We are absolutely committed to taking a leading role in minimising emissions of our own activity and across our value chain. We are placing sustainability at the very core of our strategy and embedding a sustainable approach in our operations.

As such, I believe we are well positioned to deliver long term sustainable financial progress. Thank you. We will be happy to take your questions.

Q&A

Andrew Douglas (Jefferies): Good morning, gents. I have got a few questions, please, if I may. Can I start with organic growth? Clearly a very strong performance in the first half, orderbook is up, I think was it 28% I think in the second quarter, yet we still got a 10 to 12% organic sales guidance for the full year. Can I just double check I am not missing anything? Appreciate you have got a big second half weighting and there is uncertainty around that. I just want to make sure that I am not missing anything specific there.

The ESG target is clearly very, very punchy. Can you just give me an indication whether you think customers now kind of really properly care about this thing? It has been developing quite strongly over the last couple of months, but it feels like customers are now caring and it really makes it an important differentiator for you guys.

Third question is on working capital, and just how sustainable that working capital improvement is if we are thinking over the next couple of years.

And then last but by no means least, can you just give us a bit of a feel for the M&A outlook as you currently see it? Thank you.

Andrew Heath: With organic growth, you are correct. The order book grew 28% in Q2. So we have seen strong order intake coming through, really over the last four quarters starting in Q3 last year. The 10 to 12% sales growth guidance for the full year really sort of brings into our thinking around potential supply chain constraints, obviously, some inflationary pressure, but also some labour capacity issues in terms of actually meeting the growth.

So you know, we are absolutely seeing strong order intake, there are some headwinds there. But clearly, we are battling well against them at the moment. But, you know, we are equally mindful that there are some levels of uncertainty out there that we have got to sort of factor in too. And frankly, you know, I think the top end of the sales range is going to be naturally a bit muted by just how much the supply chain can respond, and our ability to actually build the capacity to ship as well. So our teams are working really hard with our suppliers and internally to make sure we obviously do the best we can this year.

Then just on ESG targets and customers. Absolutely, the trend is a lot of our larger customers are very much asking for what we are doing in relation to ESG targets and sustainability. That is an active dialogue with a number of them where we get requests to complete questionnaires, etc. And as we have seen, I think like with cyber security, where there are standards emerging around the level of security, I am sure equally there are going to be requirements and standards that are going to be set around supply chain partners to meeting ESG requirements. So we certainly see this is not just a societal shift, or a legislative shift by government, but also, our customers are also going to drive hard in this direction. And we have to recognise we are part of their scope three emissions. So they are going to be looking to us to play our part, which in turn is why we set suitably and appropriately ambitious targets around sustainability and net zero.

I will hand over to Derek on the working capital point.

Derek Harding: On working capital, what you are seeing now is the sort of the results of the systematic work we have been doing over the last 18 months, focusing on collecting receivables, managing our payables in the right way, and a real hard focus on inventory. So our guidance is that we will sustain this level of around about 11% of sales for the remainder of this year, and I will give a bit more guidance beyond that. But you know, it is not a one off. So in that sense, we are in a better control of the working capital, managing it a little tighter, so I would anticipate the range I have given in the past to tighten and for us to not see a rebound from this. So in that sense, it is positive and sustainable.

And then M&A is your fourth question. You can see on the balance sheet, we have a good amount of cash. We are not looking to have that burn a hole in our pocket, but at the same time, we are keen to execute on that part of the strategy. Obviously we have done Concurrent, that is a start, but we are not slowing up. We are focusing on the pipeline and looking across all of our core platforms to find acquisition opportunities to complement what we do today. So there is no change on the M&A strategy at all. If anything, we are doubling down our work and our focus is building the pipeline.

Andrew Douglas (Jefferies): Okay, that is really well done. Thank you.

Michael Tyndall (HSBC): Morning, hi there gents. Just a couple from me, I think I might have asked this once before but if we think about this very strong performance, is it possible at all just to split it out in terms of what is new product that you have developed maybe over the last 12 to 18 months, and what is underlying market improvement? And I guess within that, can you then give us a sense of what the pipeline for new product looks like going forward? I guess some sense of the vitality index within the business.

And then the second question is around Omega. Interestingly, you mentioned Asia and Europe. Is there any change in the thinking of this business with the new management in terms of those international opportunities? Is that something that perhaps, given the strong growth you have seen in Asia that you might think to invest a bit more into? Thanks.

Andrew Heath: Morning, Michael, thanks for your questions. As you said, we are really pleased with the performance in the first half, seeing strong organic growth coming through. I mean, it is difficult to sort of be precise in trying to parse out how much the growth is coming from new products. But I think if you read through our statements consistent with, with our statement of the full year back in February, I think you can just see the number of new products and services that we are putting out there. And we are getting very good traction with our customers.

When we really looked hard at the strategy back in 2090, we identified which end markets we really felt were the most attractive, which had the best growth prospects where we could have the strongest fit. And we have been very focused over the last two years to make sure that our whole product development service development activity is targeting on those attractive sectors. And we are certainly benefiting from that. But if you look at it really against any measure, you know, GDP, industrial production growth, we are clearly outperforming both of those measures by some distance. So we are confident that we are growing faster than the market.

And then your second question just about product pipeline vitality. I will go back to what I said when I came into Spectris. My initial observation was that we were spending too much of our R&D budget on sustaining and maintaining older products. And again, as part of the sort of profit improvement programme, we did a lot of work looking at the portfolio, we have ended up with, you know, we sold some business lines, we discontinued an end of licence product line, to really make sure we had a higher quality of products in the portfolio, as well as making sure we then put in more of our engineering effort onto those new products and services that I have just spoken about.

So our vitality index, if you like, has sort of inflected in the last sort of six to 12 months, because we are driving that R&D investment that we maintained through last year, you know, we are starting to see the benefits coming through.

And then lastly, on Omega, it is pleasing to see the impact the new management team is having. The business is responding to their treatment and the focus that they are bringing there. As I said before, the priority for Omega is to scale that business, and it is so encouraging to see the top line growth coming in. The margin progression we still need to sort out because of the higher cost base as a consequence of the website investment. So we need that trend to continue. And as I said before, all of our businesses will have to justify their place in the portfolio. So encouraging to see the progress, but clearly, we need to the

business to carry on progressing at the pace it is going at, and seeing a similar sort of second half performance.

Michael Tyndall (HSBC): Got it. Thank you very much.

Jonathan Hurn (Barclays): Hey guys, good morning. Just a few questions for me, please. Firstly, can we just come back to the order book? Obviously, you saw strong order growth in in Q2, but can you just give us a little bit of flavour about the order book by division? You know, where is it strongest, which division has the greatest visibility in terms of orders? And also, just in terms of that margin of that order book, are we starting to see the margin of the order book increase? That was the first question.

Andrew Heath: Okay, so good to hear from you, Jonathan. I mean, all our businesses are seeing strong order growth, so it is sort of hard to just pull out any one in particular. I mean, clearly Malvern Panalytical has come back very strongly, which is great to see. They had some headwinds going into 2020 before COVID hit, we talked about that before. It is great to see the markets responding.

There, predominantly pharmaceutical life science applications have really driven a lot of that growth and is still powering the order intake. And that is both in terms of obviously vaccine development, viral vector manufacturing of the new drugs as well as a lot of government money going into pharmaceuticals. And that is starting to feed through into some of the academic research, and we are starting to see a pickup there, which, again, is encouraging.

And I think the other part of that is the onshoring trend, a lot of countries within pharma are looking to bring activities back onshore. And again, that is sort of helping from an order demand perspective.

But equally we are seeing that within semiconductors, a similar trend, which again, is helping our semi offering within Malvern Panalytical.

That same sort of onshoring trend in semi and pharma is certainly helping some of the ISD businesses, particularly PMS within Servomex, so again, you know, seeing very strong order intake in ISD, around pharma life science, aseptic lab development, as well as electronics. And then within HBK, again, the order book actually has been, or the order intake has been strong over the last 12 months, it has outstripped sales. Machine manufacturing is the standout there, our range of sensors in HBK is very well matched to a lot of new applications around process industries in drug manufacturing, food, chemical production, where our weighing technologies are a great fit.

And even within Omega there is some order intake in Asia in semi but also a strong order intake in North America, as you know, which is way ahead of sort of the industrial production in the first half, which we talked about.

So that is sort of a general flavour. In automotive, it is good to see some of that decline easing now. We would have done better on the auto side if it had not been for some of the customer access restriction issues in the first half, because of COVID, particularly around VI-grade, because a lot of their high-end simulators that they sell are sort €0.5 million up to over €1 million for the larger simulators. And you know, for some of these larger ticket items, clearly customers want to come and sort of touch the product, you know, feel it, drive it, and you know, they have not been able to get to our facilities or to our simulation centres around

the world to do that. So we certainly feel we have got some sort of pent-up demand, which will hopefully start to come through in the second half in VI-grade for HBK.

Hopefully that gives you a bit of a feel for what is going on.

Jonathan Hurn (Barclays): Yeah, that is very helpful. Thank you. The second one is, just staying on automotive, I think if you look over the recent months, obviously, you know, we have seen a lot more news flow from auto OEMs about going fully electric, obviously setting timelines, increasing targets. I mean, how would that impact HBK? Do we see from here essentially increasing momentum and growth rates for HBK, sort of benefiting from those sorts of targets that have been brought forward by some of the auto OEMs?

Andrew Heath: I mean, I think in simple terms, yes. But we have been benefiting really, for the last 12-18 months from all of that hybrid platform, electric vehicle platform development. One of the big target areas for HBK is around the electric powertrain testing and electric grid testing, battery development testing equipment that they are providing. Again, it is one of the biggest strategic growth initiatives HBK identified back in 2019 and has been pursuing and we have had very strong uptake from customers.

So, you know, that has definitely helped. But clearly the continuing acceleration of development into electric vehicles, we only see all that is positive. And again, it is also good news for the VI-grade simulation and virtual test capability, because of the sort of the ride and handling dynamics loading of battery vehicles is quite different from internal combustion powered vehicles, just given the mass of the batteries versus the mass of the engine.

So that is leading to a whole, again, good demand for our simulator products.

Jonathan Hurn (Barclays): Good. Thank you. And then maybe one last one, just a very quick one, just in terms of pricing, and apologies if I missed that, but can you just sort of flesh out what you saw in terms of pricing? I think you mentioned it was positive, it was good. But just in terms of sort of the increases in pricing, and maybe where that sits relative to the cost inflation in the business.

Andrew Heath: In the first half, our businesses saw somewhere between sort of 0.5%, 1.5% pricing coming through. So generally, we are still seeing, you know, we have good pricing power, and we are able to offset a lot of the supply input inflationary cost increases that we have been seeing.

We are considering or have indeed, actually implemented a second round of price increases in some of our businesses already this year. We are clearly seeing input costs going up, but so far, you know, we have been able to pretty much offset most of that.

Jonathan Hurn (Barclays): Thank you guys.

Mark Davies Jones (Stifel): Thank you very much. Morning, Andrew. Morning, Derek. Can I go back to the potential risks around this very strong growth, or the challenges that come out of the very strong growth? Are there any particular business lines or areas where things are particularly tight in terms of supply, or any of your more specialised products that are dependent on specific components that might be particularly at risk, in Malvern Panalytical for instance, given how strongly that is bouncing back, is there stuff down the supply chain that could hold you back materially there?

Andrew Heath: Morning, Mark. I mean there are clearly risks, and we are managing them on a day-to-day basis, the team is working really hard. I think I said it back in February around the full year results that it was frustrating, but manageable.

It is still frustrating, but manageable, maybe more frustrating getting to the irritating. We are still being able to manage it.

Your question involved Panalytical, I mean, we have some product lines at the moment that are being throttled on growth by supply chain constraints. We have got a particular power supply unit issue that we are working through, and we are looking at developing an alternative source for that as we speak.

But I think, you know, generally speaking, we are able, because fundamentally, most of what we do is assembly, and therefore we have supply chains around the world providing the components, and we are set up with suppliers, you know, if we end up with a constraint, we are fairly well set up to be able to go and find an alternative supplier to be able to create a second source reasonably quickly. And that is really what we have been doing.

I would say semiconductor chips, electronics is the single biggest hotspot. All our businesses are wrestling with finding constraints there and having to some extent redesign printed circuit boards, or go and find alternative sources for chips.

But, you know, generally manageable. The business that has had the most impact is Redline, which is stuffing a lot of chips and electronics into its components. And there, we are seeing that it is sort of impacting the growth prospects of Redline this year. But as I say, you know, we are working hard, and within our sales guidance range for the full year 10 to 12%, we have factored that into the guidance we have given.

Mark Davies Jones (Stiefel): Okay, understood. Do you think those pressures are getting worse in the second half, or are they just running at the same level? Because I think there was hope that things would ease but that seems to be pushed back well into next year from a lot of companies now.

Andrew Heath: Yeah, I think that assessment gels with our view. I mean, clearly, we hope it does not get much worse from where it is today. I mean, I do wonder in certain areas whether a bubble is being created in reality, because lead times just keep going out, and therefore companies like ourselves place orders further and further, you know, put more short-term orders in to compensate.

And we are building inventory to protect ourselves. We are not the only ones doing that, and at some point we will all turn around and find we have got a lot of inventory on our hands, but that is just how it goes.

Mark Davies Jones (Stifel): Okay, can I ask you one more possibly, slightly unfair question? On Omega, it is great to see the numbers go in the right way, but what can you point to prove that you are really fixing the issues and the business rather than just effectively being bailed out by an exceptionally strong electronics market?

Andrew Heath: Well, I mean, electronics is a key part of Omega's end markets, but it is certainly not the only part of the customer base that they serve. If you look at industrial production in North America, which is 65% to 70% of Omega's revenue, it has not grown anything as like as strongly as Omega in the first half, so that points to us taking share.

Certainly the relationship with Newark has been very successful. We are certainly taking more of the share of Newark sales into our process engineering space versus competitors that also sell to Newark. And we are looking to expand that relationship as we said into Europe and Asia.

And in terms of the web performance, it is good to see it coming back in terms of, you know, our web performance in June of this year was better than it was in 2018, before we implemented the new website.

So there are a number of touch points that clearly are testimony to the work that is going on by the management team there. But clearly, as I said earlier, there is more to do, and focus on delivering that.

Mark Davies Jones (Stifel): Great, thanks very much.

Andrew Wilson (JP Morgan): Hi, good morning, everyone. Thanks for taking my question. It is just one, just one left. Just looking at some of the markets where the recovery does not look quite as full if you kind of look at your sort of pie chart of sales, and kind of looking at the likes of, I guess, academia, energy, we have touched a little bit on automotive. It is probably quite a straightforward question, but just interested in terms of when you look out those markets, is a full recovery just a passage of time? Or is there anything that is changed in those markets which would give you I guess a bit more caution on them recovering to previous levels, or, I guess conversely, you have been a bit more optimistic that there is sort of even more than the 2019 level to come? Just interested in terms of, you know, the markets that maybe have lagged a little bit.

Andrew Heath: Morning, Andy. I mean, we have talked a lot about auto, and it is good to see the decline easing there. As I said, we would have done better in the first half, if it had not been for some of the customer access issues for VI-grade. That pulled back some of the sales for HBK in auto, which is our biggest exposure there, and we certainly see some pent-up demand coming through.

Our assessment is that with some of the production constraints that the automotive companies have had, that is holding them back a little bit at the moment in terms of spending that bit extra on capex or new programmes. So, as we look at it, as supply chain constraints ease, production rates go up, they are selling more new cars, then we will see that continue to improve.

On the academia front, I think we have had four months now of sequential progress. So that is good to see that coming back. And a lot of the areas of interest in academic research, particularly in pharma, drug development, particularly large molecules within, you know, semiconductor development, new materials, fine chemicals, advanced additive layer manufacturing, those areas are still high interest. Battery materials and technologies, all the things that we are focused on across our businesses. So we are in the sweet spot of a lot of the areas of most interest by the research institutes.

So our view is that will progressively come back as societies and economies reopen.

On the energy side, interestingly, oil and gas prices are going back up, which I think will inevitably support some of our customers there. But most of our portfolio is more really

attuned to sort of either sort of specialty purity around gases and liquids, and the refining and the measurement of those, which, again, as the macro improves, we will see flowing through.

And the other area that we are really exposed on is emissions control and compliance. So again, as production ramps up in a number of facilities off the macro environment, we expect demand to pick up there as well.

So we certainly see there is more to come in those in those markets, which will be helpful to maintain momentum.

Andrew Wilson (JP Morgan): Great to hear. I will leave it there. Thank you.

Richard Paige (Numis): Morning all. Just a couple of questions from me if possible. If I am interpreting your sales and profit bridge slide correctly, I reckon you managed 46% operational gearing on a like for like basis in the first half. Now obviously, you have mentioned some constraints or hold ups for trade in the second half, but I guess I am just thinking on the longer term as well, so some products being held up, we should look at that for the second half and then into 2022.

Derek Harding: Hi Richard, this is Derek speaking. So your maths is right for the first half. We anticipate that we probably will not repeat that necessarily in the second half. But we are not giving specific guidance on exactly how the second half will play through in terms of operational leverage. And indeed, we are not giving guidance beyond 2021, either.

The reason for that is because as we continue to drive the business forward, we are investing, we are looking to double down on some of the areas that we see real growth opportunities, and therefore, that kind of makes the drop through move around a little bit and make it difficult to give specific guidance on.

Nevertheless, what we are seeing, and you can see this in the first half, is an operating margin improvement, and we expect that to continue. You know, in our previous comments on operating margin, and believing that we can get the business back to historical highs remains intact.

Richard Paige (Numis): Okay, thank you. Just a second one, probably just more on a reporting or strategic basis, obviously, you are expecting to complete the disposable programme in the second half of this year. With the IS businesses, are you going to continue leave those in that industrial solutions division? Are we going to see those move into their own segments or attached to the platform business?

Andrew Heath: Richard, it is a great question. As I said earlier, our focus for Industrial Solutions is to build that into or really focus on being a specialty in line measurement and control business, really sort of leveraging the capabilities that we have within PMS, and Servomex in particular.

So, as we go forward, clearly the strategy remains in terms of trying to find good M&A bolt-on opportunities to scale up ISD and we are obviously targeted both at looking at suitable acquisitions for the individual operating companies, as well as acquisitions that could help more than one of the businesses directly.

So that is really our focus. And then it really comes down to one of just the timing of being able to execute on some of those bolt-on acquisitions.

Richard Paige (Numis): Understood, thank you very much.

Andrew Heath: My pleasure. Thanks for your question.

Andrew Heath: Yes, well, thank you, everyone, for joining us today. As I said earlier, look, I am really pleased with the performance we have delivered in the first half of the year. The actions and the approach that we have taken over the past two years have really positioned us very well to benefit from the faster than anticipated economic recovery that we are clearly now experiencing.

And as I said at the outset, we are emerging from the pandemic a more focused, leaner and stronger business. And that gives us the opportunity now to focus on moving into the next phase of our strategy for profitable growth, with an even greater focus on our purpose, and very much placing sustainability at the very core of our strategy.

And as I said at the full year, I felt we were well positioned coming into 2021. We are starting to absolutely see the benefits of our strategy that we have executed coming through in the results in the first half. And I completely still stand by what I said that we are well positioned to deliver long term sustainable financial progress.

So thank you again for joining today. We will report our Q3 trading update in October. Until then, I wish you well and have an enjoyable summer. Thanks very much.

[END OF TRANSCRIPT]