Q3 Results

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Overview

Andrew Heath

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Introduction

Thank you and good morning and welcome to this the Spectris Q3 Trading Update. I am Andrew Heath and I am joined by Derek Harding our CFO to discuss our performance in the third quarter of 2021.

Thanks to the continued great work of the whole Spectris team, we delivered a solid trading performance in the third quarter, very much consistent with our expectations of the half year. All our businesses continue to performance well. A strong recovery in our end markets have continued and additionally the execution of our strategy growth businesses has helped us to grow ahead of the market that we focused on supporting our customers and launching new products and services.

We set up a time of our half year results the supply chain issues were frustrating but manageable but that we also foresaw the situation potentially becoming more challenging as we move into the second half. That is proving to be the case as many other businesses are reporting. We are now finding that in the short-term the supply chain is constraining our ability to translate our very strong order intake of sales. Now, we are, of course, working diligently to mitigate this impact and we continue to deliver for our customers.

Now, despite the short-term headwinds, we are maintaining our four-year guidance of 10-12% like-for-like sales growth. The strength of our order book gives us good visibility Q4 and support our outlook for the remain of the year and also provide further momentum heading into 2022.

Encouraging performance

Looking at our performance in more detail, we have seen our order book opportunity pipeline continue to expand, supported by the strong customer demand for our products. Orders grew 31% on a like-for-like basis in the quarter and 21% up year-to-date. The group as a whole like-for-like sales increase 12% in the third quarter and year-to-date we are 13% higher. Like-for-like sales are also higher and all our end market shares today. Our energy utilities is our only major end-market that were still lower likely to progressively improving.

Encouragingly, we saw in automotive a return to growth in Q3 and that has now recovered flat year-to-date. Like-for-like sales increased in all regions with the strongest performance in Asia and we saw continued strength both in China and South Korea. North America and Europe like-for-like sales were 11% and 9% higher respectively.

Business growth

Turning now to our businesses. In Malvern Panalytical, we recorded a 10% increase in like-for-like sales in the last quarter and that's up 80% year-to-date with particularly strong growth into Asia. Notably sales into academic research have recovered well after closures impacted demand last year. Our sales in pharma customers continue to be robust, especially, for our systems and, especially, to Europe. We are also experiencing good growth now in primary and advance materials.

HBK like-for-like sales increase 15% in the quarter, increasing their year-to-date growth to 11%. As I have mentioned the automotive sector returned to growth this quarter with like-for-like sales higher in all regions, especially, Asia. Since February, orders continue to rise every month across our product portfolio with machine manufacturing being a continued stand out performer as it has been since 2020.

At Omega, our strategic initiatives are helping driving recovery performance here with like-for-like sales 11% higher in Q3, 30% up year-to-date. The website improvements, new product launches and sales channel expansion strategy are all driving growth especially, North America ahead of the market and sales in Asia are also significantly up.

Industrial solutions

In industrial solutions here we posted a 9% like-for-like sales increase over the past three months with continued strong demands from pharmaceutical and the semi-conductor customers. After a lower first half, sales into energy and utilities did return to growth in the quarter. Overall, ISB is up 11% on sales year-to-date.

I just want to inform you that I was looking forward to sharing more about our ISD businesses later this afternoon with Mary Beth Siddons our President, Industrial Solutions. Unfortunately, Mary Beth has had to travel back to the US this morning on short notice due to urgent family reasons. Her mother is quite unwell. Accordingly, we will be rescheduling the presentation we were planning to make this afternoon to a later date as I am sure you will agree, family comes first.

Merger & Acquisitions

Turning now to our balance sheet in M&A. Our businesses remain highly cap generative and we ended the quarter with net cash of £58 million. This was after the payment with acquisitional Concurrent Real-Time which completed in July. In October, we also completed our £200 million share buyback programme. Over last few months, we have also made the small acquisition, an industrial analytic software acquisition from VIMANA. We will bring data analytics expertise and a proven data management technology platform helping to advance HBK software strategy and we will be forming a new engineering centre of excellence around this technology, focused on data management and IOT platforms.

We continue to review and renew our opportunity pipeline for further acquisitions. On the divestment side, we expect to complete the NDC Technologies transaction before the year end and have advised the financial impact in today's press release.

Net zero commitment

At our H1 results, we set out our net zero targets. I am very pleased to say that they have now been validated by the science space target initiative. In support of our ambitious targets, we have implemented a group-wide energy management system and we are also undertaking a series of energy efficiency audits to monitor and report our energy data. Underlying our commitment to the race to zero, we have also signed 1.5-degree business pledge.

Miscellaneous

To support our employees and in recognition of world mental health day, we launched out be our Be Kind To Your Mind programme and hosted a series of presentations on mental health and well-being. In support of communities, our STEM programme is being advanced with numerous outreach events in the quarter.

Work also continues on the Spectris Foundation and we are on course to make our first donations before the end of the year which, clearly, an exciting development.

In conclusion

So, in summary, I am very pleased with our results in third quarter. As I said, we delivered a solid performance. Our order book has continued to expand, providing momentum through the end of the year and into 2022.

While striking issues are annoying, we are having to work hard to mitigate the impact. The order book provides good visibility for Q4 and we are affirming our outlook and our expectations for a 10-12% like-for-like sales growth for the full year. I am also very pleased with how the group has continued to deliver on our strategic objectives of organic growth and margin expansion. We have worked hard to get into this position and we are well positioned in attractive growth markets that are increasingly being supported by sustainability thematics to provide long-term value to our shareholders. With that, I will happily open up to questions.

Q&A

Mark Davies Jones (Stifel): Thank you. Morning, Andrew. The supply chain constraints, obviously, we are hearing an awful lot by this at the moment and encouragingly, you are sustaining the revenue guidance but any commentary on what it might mean for costs and profit drop throughs; is there any change to the picture there either in terms of more inflation that will take time to pass so on or just in terms of business mix as those impacts get felt in terms of what you can actually shed?

Andrew Heath: Morning, Mark, thanks for your question. As it is happening clearly, supply chain constraints, we are not immune. It is clearly annoying but I have seen they are working really hard to mitigate the situation as best we can and we are taking all sorts of action to keep our production lines going and they continue to serve our customers.

From a profit, cost perspective, our outlook remains unchanged from the half year and we always knew that we were looking at this larger second half and, therefore, anticipated the supply chain might struggle through the second half of the year to support what we were seeing in terms of our order book growing and sales expansion through the second half. That as I said is proving to be the case.

From a cost perspective, we are seeing input cost inflation. We are having to pay extra freight cost, etc., to get product ships. It is not just semi-conductors where we are seeing some price inflation; however, as you can see in our statement, from a pricing perspective, we are still being able to offset that input cost inflation through pricing. All of our businesses effectively implemented another price increase since June since with all the businesses effectively been reviewing their prices through the year and, clearly, we are looking at what we will be doing start the new year as well on pricing. So it is good that we are able to offset that.

We are also seeing some labour cost inflation. As we have said, this was the half year. Just depending on exact where but the sales end of this year we may see some extra costs having to support that, but we are being very disciplined right across the group in terms of where we let cost come back in. Because of that, our outlook remains the same as we anticipate through the half year.

Mark Davies Jones: Okay, great. Thank you very much.

Jonathan Hurn (Barclays): Hey guys, good morning. Just a few questions from me. I think, the first one; can you just talk a little bit more about the order intake? You see, maybe, just give us some colour in terms of order book, where it sits at the moment and how much visibility you have on that order book going into 2022, please?

Just lastly on that. Where is the margin of that order book currently sitting? I mean, obviously, you are pushing through price increases. That is, obviously, probably more relevant to new orders. In terms of that order book, are we seeing a higher margin now coming through there? That was the first one.

Andrew Heath: Thanks. So, I mean, see, on the order intake side, as I said, Jonathan, we are effectively seeing growth in all of our key end markets other than energy and utilities which is encouraging recovering. Automotive has gone back flat. Pharma is being one of the stand out areas. We are certainly seeing very strong recovery in pharma, it has already started from June last year and has carried on completely helping Malvern Panalytical, PMS, Servomex.

The semi-conductor market is very strong which again is supporting Malvern Panalytical, PMS, Servomex in particular. The machine building within HBK was strong all the way through 2020 and the momentum there has continue through this year. So, overall, feeling really good about the way the markets have responded. They are coming back. Additionally, as I said, also the academic research that remain was 11% of our revenue back in '19 dropped to 7 percent last year. That is now back in double digit growth territory.

So, we are seeing very strong demand, really, across the board; and one of the questions will be, is that just a post-pandemic rebound or is it people restocking? We do not see either of that. You can see in our Q3 order intake, 30% up on orders in Q3. We feel this is very much sustained demand coming through. And as I said before, really from a restocking perspective, other than a bit of exposure in Omega and Red Lion, all of our other businesses, their orders are very discreet to specific customer projects or specific customer requirements. Typically, our customers just don't buy our equipment to put it on the shelf. So, we feel certainly very good about the level of order growth that we are seeing.

Jonathan Hurn: Okay, great. Very clear. Thank you. Thank you. Second one is just on the bottleneck. You are seeing, well, obviously, the supply chain constraints. Can you just give us a little bit more colour, a little bit more depth just in terms of, essentially, where that is coming through on the business-basis, please?

Derek Harding: Yeah, so, hey, Jon, it's Derek here. Where that really presents itself is probably similar across the wider sector, say, electronic chips as an example of things that are causing difficulty, and it is often just one or two components that either stuck in a port somewhere or stuck on a container and/or in short supply or maybe other people are hoarding them or over ordering them or whatever. It is just that a shortage of things like that, that really presents itself in our ISD division with some of the products that we are building so the clean air purity work either in semi-con or in clean-room technology. It also has an impact on some of our parts within Malvern Panalytical. So, those are examples where that comes through. However, even down to simple things like cardboards since we are heading to Christmas, and packaging, resins, across the board, there are things just not flowing in the way that they would normally flow, so I guess it just makes life a little more complicated than normal. So, it is a range of things.

I guess in the US, labour is well documented, labour is a challenge as well, getting people back to work and getting people particularly on the distribution side of things or the shop floor side of things, that is also a challenge but manageable.

Jonathan Hurn: Very clear. Maybe, just one last quick one. Just in terms of that 12% like-for-like growth we saw in Q3, can you just tell us how much of that is pricing? Obviously, you are pushing through price rises. How much of that is coming through from that, please?

Andrew Heath: You say how much is down to price –

Jonathan Hurn: Sorry, so, basically, what I was just trying to understand – trying to get a feel for, obviously, you are pushing through price increase. You are saying that you managed to get them away, obviously, seeing 12% in the quarter. How much of that 12% was, essentially, volume and how much are you currently getting through in price, please?

Andrew Heath: Well, the majority is volume. I mean, we put in there in our trading update that the net pricing benefit we are receiving which is the 7 million year-to-date, so that is really the delta on the pricing over and above the offset against the input cost inflation. The vast majority in reality is volume with a little bit of price on top, just off, which is net above the cost inflation pressures coming through.

Jonathan Hurn: That's very clear. Thank you, guys.

Andrew Heath: Okay, good. Thank you.

Harry Phillips (Peel Hunt): Yeah, good morning, everyone. Just a few questions on Omega, if I may. Just in terms of how Omega sources from overseas and domestic, if you could just maybe shed some light on that? I am just curious around the comment on the sales channel expansion. I know you touched on it as a half year but just maybe a little more detail on that. Is there anything in particular that is driving, well, very solid growth 11% in Q3?

Then lastly, again, I know it is something you touched on in the past, but what really gets Omega going here beyond maybe an acquisition? What is the catalyst because it has been bobbing along, if you like, and I know you put a lot of time and effort into it and resource into it; but as you say, are we any near of that defining moment where it steps into gear?

Andrew Heath: Yeah, okay, alright. That is three questions around Omega and I will take them in turn. Just on the sourcing, we source globally into Omega. Clearly, it has more reliance on a local supply chain as some of our other businesses, but we do buy quite a lot of components out of China and Asia in support of Omega. But fortunately, they are less dependent on electronics and semi-conductors versus maybe any of our other businesses at the moment. They are seeing less disruption from that perspective which is helpful.

There are bigger challenges, as Derek mentioned, this has been actually labour, shop floor, warehousing labour, where in the US the social benefits programme coming off out of COVID to a lot people out of the workforce and has put constraints locally, so it has made the labour market much tighter, particularly, in the New Jersey area where they operate. We have had to do some extraordinary recruiting activities, brought in dedicated recruiters to make sure we have got the right stuff in levels. However, at the same time, we are also implementing some automation and also improved systems that are automated or simplify what we are doing so that we can, to some extent, reduce the skill level which is helpful. So, we are managing it, as Derek mentioned, but it is one of things we are having to manage on top of everything else.

In terms of the sales channel expansion, I am really pleased with the relationship with Newark. Omega sales into Newark grew up to about 80% year-over-year and that is on top of the high growth as well as in 2020. So, the relationship with Newark is going really, really well. We are also in the process of expanding that relationship into Newark parents company to sell into Europe and into Asia. I mean, they are large preparations globally, so the next step of that story is expanding through Newark parents, say into the European market and Asian markets. That has been one of the big drivers as to why sales are up this year. However, overall, a 13% growth for Omega is up well above North American IP for the year. So, it is certainly responding to the treatment that Amit and his team are bringing there, which leads onto your last point about what is the catalyst.

Well, our focus is all about how we scale and we go up the cost base. The fixed cost base increases as a lot of investments surrounding the new e-commerce site, and we have talked about that previously. And, therefore, to get the margins back to where they have been before up in the high teens does require the business to be scaled up. There are, as always, opportunities to improve operational efficiency but it is not a huge amount. That in on itself is not going to solve the situation. We absolutely need to be really driving the top line scale in the business and it is really around the four things we talked about in the past; around making sure we have a really good website experience, refreshing the product line up, continually driving the sales channel expansion and looking at some of the international opportunities via North America. So, that strategy is working for us at the moment. Good to see the growth coming through, but clearly we need to be convinced that that growth rate can continue for at least a couple of years in terms of getting the business to the scale it needs to be to deliver the margins we want out of it.

Harry Phillips: Fantastic, thanks very much indeed.

Robert Davies (Morgan Stanley): Yes, thanks for taking my question. My first one is just around again, some of the supply chain disruptions. You mentioned the chips shortages being an issue. What are you hearing from your customers in terms of potential timeline for resolving some of these things? Is it [inaudible] territory, nobody really knows at this stage and best guess? Did they give you some guidance on when things should normalise?

Andrew Heath: Well, Robert, I am not sure we are necessarily the experts here in terms of being able to predict when this is going to turn, but certainly we are talking to a lot of industry outlets, talking to suppliers, talking to our customer base. I think the general feeling is that the supply chain constraints are going to carry on into next year into the first half. Then for semi-conductors there are going to be specific constraints, I think, all the way through next year, potentially, the beginning of '23 for certain chains of things, so it should progressively ease from next year, through next year. That is really the premise under which we are working. As such, we are taking steps in terms of forward ordering, protection stock, looking at various scenarios to make sure that from an inventory perspective we are protected. I mean, fortunately, while the chips are really essential from a product functionality perspective, from a cost point of view, they are typically not a high part of our billable material. So, from an inventory perspective, it is not overly expensive for us.

However, equally, we are also looking at where we need to redesign some of the printed circuit boards to, basically, put alternative chips in. I mean, one of the phenomena we are seeing is that the rate of obsolescence effectively has increased because you always get obsolescence within semi-conductors which is the chip technology moves so fast and they make so many before they go onto the next generation, but we are seeing clearly happening is that some of the lower volume chips just being end of life, whilst the focus is on driving the volume for the many. Our engineering team are having to spend more time on practically managing obsolescence and redesigning and designing some of these chips out. Now, and as we have said before, that is nothing new for us, we know how to do it. It is just the volume has increased, so the workload has increased on it.

Robert Davies: Yeah. That's great. Thank you. I have a couple of others. One was one was just on raw materials and hedging. Is there any hedging you do on raw materials? I guess I am asking in the context of your price increases. Is that something that happens in the step you use and there is a bit of a lag between when you see a hit and then you put the prices through? Is it fairly instantaneous? How often do you have these pricing discussions or price changes with customers?

Andrew Heath: Yeah, that is more in terms of a capacity question. I mean, typically, we do not hedge on raw materials. I mean, we hedge translational FX level. We clearly look from where, which countries we are buying in, what currencies versus what currency we are receiving as much as everything else. Typically we are not buying of a volume that either that would warrant us doing that.

Andrew Heath: So, I mean, typically, for a lot of things we do, we are running on either long-term contracts or blanket contracts where inevitably they are a defined period of time when they come to the end and that is where you end up with a price discussions. So, we are not immune from this. We are seeing prices going up; but as I said, so far positive to see we are being able to offset that through our own pricing, and customers are being very accepting of that situation. I think, I mean, the important thing that we are not giving out more detailed numbers today but from a margins perspective, a gross margin perspective, we are able to hold our own. I think that is the key.

Robert Davies: I see, okay, thank you. Then my final one was just around, I guess the medium to longer-term potential of the group and what you are thinking about from portfolio. You have, obviously, done quite a lot of tidying up over the last couple of years. Is there coming out of COVID a different view from the management team around potential targets or end markets that look more or less interesting than maybe they did six or 12 months ago, or is it the original plan is still in place and nothing has really changed looking for small bolt on and that kind of thing?

Andrew Heath: Yeah, well, it is more the latter than the former. I mean, we can, clearly, keep up, with the strategy under review and as I said before, all of our businesses have to continue to earn their right to stay within the portfolio. I think, you are right. We are looking at the assets we have and their potential to deliver value going forward. If at any time, we see things have changed and we are taking a different view. However, I think in terms of our end markets, as I said before, five markets that we have talked about since the 2019 Capital Markets Day around pharma, automotive, semi-con electronics, primary advanced materials and tech-led industrials, we are seeing all of those company back strongly, which is good. However, beyond that, as I said right at the end my opening, that we are seeing that a lot of our end markets really fit with our purpose around enhancing the power of precision measurement to equip our customers to make a little cleaner, healthier and more productive, and there is quite a number of sustainability thematics which are playing strongly now into those end markets; mobility within automotive, electrification of transport, the whole energy transition, managing both in terms of new energy sources as well managing emissions, carbon capture, etc., associated with fossil fuels, through to food, agriculture. Then, I think, for us, one area that we naturally we are starting to look at is around water purity, water quality where a lot of our technology actually might be a good fit for that market. So, not only do we see for those environmental sustainability thematics underpinning the markets that we have been targeting on and very much supporting our R&D strategy but also, I think, there are new adjacencies and opportunities for the group as a whole. So, we will be talking more about this next year as we go through our strategy refresh in 2022.

Robert Davies: Interesting, that is great. Thank you very much.

Andrew Heath: Yeah, pleasure.

Richard Paige (Numis): Thank you. Morning all. Just a couple of questions from me please. First of all, obviously, you have highlighted the academic spend recovery we have seen in particularly Asia. I was just wondering more regionally what are you seeing in the governmental policy pushing that agenda.

Then secondly, hope all is well with Mary on industrial solutions. I was just wondering given what you said and, particularly, I would highlight PMS has done really well, just wondering if you could give a bit more colour around the mix of performance within those businesses within that division. Thank you.

Andrew Heath: Yes. Okay, morning, Richard. I mean, on the academia point, as I said, I mean, really good to see that market recovering. I mean, we are about, I think, it is high single digits now in terms of the market recovery for the year. We've, typically, seen it come back regionally as the economies have opened up. However, typically, it is being supported by, again, a lot of the areas that we are focused on around pharma, healthcare, certainly the whole vaccine, anti-viral drug development, has been a big part of that; but equally so has electrification of transport, electric vehicles, hybrid vehicles, battery technologies, advanced materials there but also in terms of advanced materials in research for semi-conductors are all powering that recovery in the academic research area. We certainly saw the China, Asia come back first then into North America and Europe. So, it has pretty much come back as the economies have reopened.

Then on your question about ISD, yes, apologies that we have had to postpone this afternoon. We did consider just carrying on, but I thought it was part of the real value of having the session was just to introduce you personally to Mary Beth and to allow you to ask her questions and to get her direct views on the business she is now leading. I think, in terms of protecting the quality of that, we decide to postpone it, but hopefully, we will be able to reorganise it in the next few weeks.

In terms of mix of performance, I mean, PMS has certainly been a stand out performer. Its revenues is split 50-50 between aseptics, pharma, life science, food, applications and 50% into semi-conductors. Both markets have been going very strongly and we have leading products that are able to measure the highest fidelity in terms of inaccuracy around impurities and maybe characterised particles. So, it is certainly a great fit for what is going on the market.

Servomex have seen a very good recovery in purity, high purity, gas analysis and that side of business, the healthcare side, the oxygen sensors have actually held up quite well. I mean, we did have a real boost last year through oxygen sensors demand for ventilators that has tailed off but other oxygen applications have come through to replace them, so that market has been pretty robust. Then as we talked about that 60% exposure for Servomex into industrial process and energy applications, that market has just been slower to recover but it is recovering now, so that will give Servomex momentum going into next year.

Red Lion is seeing good demand in terms of the industrial automations suite of products it supports. However, all the products it sells are stuck with chips, so they are wrestling day-to-day with getting products out to customers; so they are one of the businesses that is really being constraint in terms of being able to transfer their order book the sales at the moment. However, again, we talked about that.

Richard Paige: Nice. Thank you. One more, if I may. Just on employee cost, just coming back to the cost equation. I assume you do most of your contract negotiations at the beginning of the year. So, therefore, do you see that more as a headwind into '22? You have, obviously, spoken by the impacting Q4 in terms of getting people onboard; but I was just wondering what headwind we might see '22 relative to '21?

Andrew Heath: Yeah, so we, typically, across our businesses, the pay increment goes in at the end of Q1. What we saw at the half year has already had a quarter of that impact in the half year. We are certainly not anticipating doing an extraordinary pay rise between now and the end of Q1 next year but, obviously, it will be key part of our budget consideration as we put the numbers together for next year in terms of what we are seeing on the labour inflation front. I mean, we have made some adjustments in some of businesses where just the market rates have moved, so we have had to make some adjustments; but, again, I think, most of that we did in the first half so, yeah, that comes through the first half runway.

Derek Harding: I think the other thing I have add, Richard, is, obviously, with the Spectris business system, the focus that we have on improving efficiency. We do not necessarily accept that labour inflation is something that flies straight through, so there are conversations to be had to make sure that we continue to be effective and efficient to try and get some of those headwinds as well.

Richard Paige: Okay, excellent, thank you very much. That is very clear.

Andrew Heath: Well, I will thank you very much everyone again for joining. We will be announcing a revised date for the ISD market presentation shortly. Thank you for your questions. Always appreciate your interest in us and the questions you ask. So, just to summarise then as I said earlier, I am really pleased with our performance in the third quarter. It was a solid performance, very much in line with our expectation of half year. We talked our order book. It is very robust. It provides momentum for the rest of the year and also going into 2022. As I said, I believe we are well-positioned off the back of the market recovery with all the investments that we have been making and our strategic growth initiatives. So, thank you very much for participating in the call today and I look forward to speaking to you at our Industrial Solutions Presentation when we reschedule it and, obviously, next February along with our full year results. So, thank you very much and stay well. Be safe.

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