Spectris 2022 Full Year Results

Thursday, 23rd February 2023

Introduction

Andrew Heath

CEO, Spectris

Welcome

Hello, everyone, and thank you very much for joining us this morning. Can I just start by saying what a pleasure it is to be with so many of you in person, particularly after COVID stopped me from seeing you back at our Capital Markets Day in October last year. So it is great to see you. So thank you for coming. You will have already seen the results we posted this morning, and Derek will take you through this in more detail shortly.

Delivering the Strategy for Sustainable Growth

But by way of opening, I just want to start by saying how very pleased I am with our financial performance with very strong sales growth, good margin expansion and much enhanced returns on capital employed, driven by continued excellent strategy execution.

Since 2019, Spectris has been transformed into a more focused and high-quality business, well-positioned in attractive markets with structural growth drivers that are closely aligned to our ambition to be a leading sustainable business, and as evidenced by our record order book.

We have a strong balance sheet to support our growth ambitions, both organic and in continuing to strengthen and expand our portfolio through M&A. We are investing for growth and attractive returns. We again increased the investment in R&D last year. We completed three acquisitions, and we also formed a joint venture.

All this gives us conviction in our ability to compound growth and expand margins into the future. And this performance is wholly consistent with our strategy for sustainable growth that we set out at our Capital Markets Day in October, and it provides the confidence in our outlook for 2023.

Importantly, we have carried real momentum from last year, and we are excited by the significant opportunities that lie ahead for us. Trading at the start of the year has been very strong, with double-digit like-for-like sales growth and strong order intake with a book-to-bill ratio greater than 1.

Consequently, in 2023, we expect to deliver organic growth consistent with our medium-term objectives of 6% to 7%, and that is alongside strong progress on expanding margins and also driving forward our ambitions as a leading sustainable business.

Medium term performance

At the Capital Markets Day, we looked back to how the work we have been doing in recent years has fundamentally reshaped and refocused the Group. We also provided you with a medium-term performance framework, a set of ambitious targets that this strategy will deliver against as we set out on this slide. And we made a great start on this journey with our 2022 results.

Organic sales growth of 14% last year reflects excellent execution from our teams right across the Group, and this builds on a 10% growth that we achieved in 2021. Our reported growth last year was also very strong. It was also up 14%, and that is despite disposals removing £66 million of sales during the year.

Reported growth is supported by acquisitions that we completed in 2021 and 2022, and I think helps demonstrate how we are compounding growth through M&A. Against the backdrop of high material inflation and constrained supply chains, we delivered good operating margin progression of 50 basis points, but there is more to come as the conditions in the markets ease, and we will talk much more about this later.

Cash flow was robust. We invested in a new facility for our PMS business, and we also invested in inventory to support our record order book, which is a third higher than the end of 2021. And for the whole of last year, 2022, the book to bill ratio was 1.1 for the full year.

Return on gross capital employed was very strong, improving from 13.2% in '21 to 16%, and we made important progress on our sustainability initiatives. In 2022, we reduced our Scope 1, 2 and 3 emissions ahead of plan, and we also improved our employee engagement scores. So that is why today, as we look forward, we have confidence in our ability to compound growth into the future, delivering 6-7% organic growth while expanding margins to above 20% and generating attractive cash flow and returns.

I am sure you all agree that these characteristics are a hallmark of a great business.

Great progress delivered by great people – thank you to all our Spectris colleagues

And before handing to Derek, I want to acknowledge that great progress is delivered by great people. So I want to take a moment to thank all of my Spectris colleagues around the world.

I passionately believe that uniting brilliant people behind a common purpose can change the world for the better. And my confidence in achieving our goals is very much rooted in our people. Right across Spectris, we have exceptional leaders, deep technical experts, innovative minds, out-of-the-box thinkers, a truly diverse team of people performing at a very top level.

They have delivered for our customers. They have improved our business. They have supported each other in what has been a challenging macroeconomic environment, always aiming high and getting excellent results. So my sincere thanks to all of you for your continued hard work and support.

I will now hand you over to Derek to take you through our 2022 performance in more detail. Thank you.

Financial Review & Business Overview

Derek Harding

CFO, Spectris

Financial performance overview

Thank you, Andrew, and good morning, everyone. So my first slide summarises the key numbers for the year. And I would not repeat all the points that Andrew has already covered, but instead, I will draw your attention to a couple of the key metrics not already mentioned.

But before I do that, I want to remind you that Omega as an operating segment was disposed during the year, and that is treated as discontinued. So therefore, it is reclassified from the income statement for both 2022 and 2021 and therefore, is no longer in any of these numbers that you see.

The adjusted operating profit of £222.4 million represents a like-for-like increase of 14% and it is 17% on a reported basis, and adjusted operating margins increased by 50 basis points to 16.8%.

Tax rate came in just below 22%, in line with our guidance. And our adjusted earnings per share were 159.9p, and that is a 26% increase over prior year. The full year dividend per share of 75.4p represents a 5% increase over the prior year, and that is consistent with the growth in dividend over the recent years, and we remain committed to paying a progressive dividend. And our net cash at the end of December was £228 million.

Sales & Margin bridges

So I have a slide now that provides you with a graphical view of the main P&L movements in the year. Sales are shown across the top and operating margin at the bottom. I have adjusted 2021 to remove sales and the profit relating to the disposals from 2021 so that you can get an organic baseline. And again, remember, Omega is treated as discontinued, so it does not appear anywhere in this analysis.

FX translation movements increased sales by £53 million and operating profit by £12.5 million. And we saw excellent like-for-like growth in revenue, up 14%. And that added £67.5 million of additional gross profit. Like-for-like adjusted overheads increased by £41.9 million in the year, but we are actually 170 basis points lower as a percentage of sales because we held headcount broadly flat, particularly in the second half of the year. And it is also worth noting that within this increase is an additional £20.3 million of R&D investment.

When you actually look in the full year, in total, we expensed £103.8 million on R&D. That is almost 8% of sales.

Acquisitions added £27.6 million of revenue and £200,000 of operating profit, and that reflects the developmental nature of the Creoptix acquisition. And that brings us back to the £222.4 million of adjusted operating profit. That is a margin of 16.8% compared to 16.3% in the prior year.

Cash flow bridge

So looking at how we generated cash and then what we did with that cash. Starting by adding about £39.6 million of depreciation and amortisation charge to get to EBITDA of £262 million. And then during the year, as Andrew mentioned, we continue to invest in safety stock to support customer deliveries despite the continuing supply chain challenges, and that resulted in working capital cash utilisation of £54.1 million.

At the end of the year, our working capital was 15% as a percentage of sales, which is at the top end of the range that I typically guide to, and we expect this percentage will reduce in 2023.

CapEx of £44.1 million was slightly higher than normal due to £15.3 million of expenditure on a new manufacturing facility for PMS in Boulder, Colorado. And that then gives us our adjusted cash from operating activities of £163.8 million, which we then divide into the operating profit to get our cash conversion metric of 74%.

Now that is lower than our targeted range, but that is because of the incremental working capital and the incremental CapEx I just mentioned. We had a net cash inflow of £241 million relating to transactions. And of this, this is £365 million of net cash received from the disposal of Omega, offset by £124 million of cash outflow for acquisitions completed in the year.

Spent £191 million, including costs on the share buyback, which we announced in April. And the remaining £110 million of the £300 million announced will be completed over the course of this year. We paid £78.6 million in dividends, £7.6 million on restructuring that was previously announced. And interest and tax had a combined cash impact of £46.3 million with other movements of £21.4 million gets you to the net increase in the year of £60.2 million.

Adjusted and statutory operating profit and Profit for the year

The technical accountants in the room, this slide is included for completeness. So you can easily bridge from our adjusted operating profit measures right down to the statutory measures. I would not go through every line, but I am going to draw your attention to a couple.

So as previously guided, there were no new P&L restructuring costs in the year. We made significant progress on our business transformation programme, and therefore, we spent £21.7 million relating to material SaaS projects. And the finance charge of £19.2 million includes £14.6 million of net loss on retranslation of short-term intercompany loan balances. And that is because the volatility of sterling against the dollar and euro, particularly in the second half. As you all know, under IAS 21, that is classified as a finance cost, and there is actually an offsetting gain on the other side going through reserves.

Profit on disposal and the operating profit of the final six months of ownership relating to Omega in total £287 million is classified as profit from discontinued operations and is reported below the tax line. And that then gives you a statutory profit for the year of £401.5 million.

So let us move on now and look a little bit more at the divisions.

Spectris Scientific – 2022 performance

Spectris Scientific delivered an excellent financial performance in 2022. The division achieved sales growth of 24% to £657.8 million. And after taking into account foreign exchange movements of roughly 5% and the impact of acquisitions was broadly marginal, that gets you to 18% like-for-like growth for Scientific.

We saw continued strong customer demand and market share gains in all our sectors, particularly semiconductors, life sciences and pharmaceuticals as well as energy technologies like batteries and fuel cell development. There was particularly strong demand for our products in Asia.

Order intake increased by 12%, and Andrew will provide more colour on some of the key developments for the division shortly, but I wanted to pause for a moment on the improved operating margin.

So the adjusted operating profit increased 25% to £140 million and the adjusted operating margin improved to 21.3%, which is a year-on-year increase of 20 basis points. But if you actually look at it like-for-like, it is 90 basis points up. And that reflects the volume increase and the impact of both price rises and new products, offset by the higher investment in R&D and the acquisition of Creoptix.

Our business transformation programme to simplify, standardise and automate processes and simplify the ways of working is on track, and that includes the enterprise-wide ERP solution, which will provide better access to data, offer scalability to support our growth ambitions and help deliver on further margin expansion.

Spectris Dynamics – 2022 performance

Spectris Dynamics delivered a solid financial performance in 2022. Sales were up 16% to £492.2 million and £15.6 million of this delta, 4% came from acquisitions, demonstrating our desire to compound growth through M&A.

FX movements were 5%, and that gives you then a 7% like-for-like sales growth. Orders in Dynamics increased 20%, resulting in a 40% year-on-year increase in the order book, and that gives us real confidence of momentum as we enter 2023.

During the year, this division was impacted by higher cost input inflation associated with its disproportionate exposure to low volume, high performance electronics and semiconductors. And that did result in a reduction in the gross margin. So consequently, the adjusted operating profit of £73.6 million is a reported increase of 5%, which is actually 7% lower on a like-for-like basis.

Overheads, however, did reduce by 140 basis points, but that was not enough to offset the gross margin decline, and therefore, you see an adjusted operating margin of 15%. Price increases, though, particularly in the second half, helped reverse some of that margin decline. And further pricing implemented in Q4 and improving material supply and easing inflationary pressures, all of those combined gives us real confidence for improved profitability in this division in 2023.

And in addition, the ongoing rollout of the Spectris Business System continues to deliver improvements to the operational effectiveness of the division and provides further confidence in margin expansion.

Reportable segments summary

I have included a slide here for your ease of reference, which summarises the segmental performance of the Group. And it also gives me the opportunity to speak briefly about the performance of Servomex and Red Lion.

On a like-for-like basis, sales increased by 14% from increased volume and strong price discipline. And the adjusted operating profit for the segment was £27.2 million, an increase of 16% like-for-like, and an adjusted operating margin of 15.3%. Group costs were down slightly in the year at £18.4 million.

2023 modelling considerations

So finally, to help you with some modelling, I have set out a slide for some broad areas of technical guidance. As we've already said today, we expect sales growth to be in the region of 6-7%, and we expect our operating margins to expand.

Working capital should reduce over the year and will be back in the middle of our guided range of 11% to 15%. CapEx should be in the region of £40 million. We will continue to invest in the ERP. So our SaaS cost will be around £25 million, and the effective tax rate should be 22%. The remaining £110 million of the buyback will be completed over the next 12 months.

Finally, our assumed exchange rates for 2023 are 1.24 for the dollar and 1.17 for the euro. And if that proves to be incorrect, then for every cent change in the dollar, it is a £3.5 million impact on sales, £600,000 impact on profit. And for every euro cent change, it is £2.8 million on sales and 0.5 million on profit.

And with that, I will hand you back to Andrew.

Strategy for Sustainable Growth

Andrew Heath

CEO, Spectris

Strategy for Sustainable Growth

Thank you, Derek. I am now going to take you through our strategic progress and outlook. But I think as you know, everything begins with our purpose, and that is what being a purpose-led business means. It is the essential ingredient for galvanising engagement and also excitement for our strategy.

At Spectris, our purpose is to deliver value beyond measure, creating a cleaner, healthier and more productive world. And this informs everything we do from strategic decisions around the Board table, to day-to-day operational decisions within our businesses. And over the coming slides, I am going to cover the key elements of our strategy for sustainable growth, our delivery plan, if you like, as a leading sustainable compound growth business.

Great businesses: Leaders in premium, precision management

So firstly, great businesses. We have simplified Spectris into two high-quality divisions: Spectris Scientific and Spectris Dynamics are asset-light businesses, both focused on premium precision measurement solutions with industry-leading products and domain expertise. Both are high growth and high margin businesses with exciting potential.

As Derek highlighted, Scientific is firing on all cylinders. It is delivering an excellent performance, 18% like-for-like revenue growth, adjusted operating margin of 21.3% and strong order intake up 13%. I mean, these are world-class metrics.

Despite the disruption from COVID, Scientific delivered compound growth of over 5% since 2019, and we see significant opportunities to deliver even more value through our customers' workflows and to drive greater market share.

Spectris Dynamics delivered a solid performance in 2022. Sales up 16% on a reported basis, and that reflects the contribution from recent acquisitions in exciting high growth markets. We saw a strong order growth of 20% with a closing order book up 40% on 2021, demonstrating that both the high demand and the momentum underpinning the future for that division.

Now while the performance was a disappointment in terms of the margin, this was caused by exceptional material inflation, and we see this as a purely transitory issue. As such, we are confident in delivering much improved profitability for the business in 2023. And to be clear, Dynamics is a great business and can deliver much more. And since 2019, we have compounded growth at almost 5%, and we are confident of improving this in the coming years, and that is alongside having a clear path to achieve 20% plus margins over time.

To be clear, margin progression in Dynamics is one of the strongest opportunities for the Group and it is a core focus for all of us.

Portfolio aligned to structural growth drivers

Now on to structural growth markets. We are more aligned than ever to markets with a strong sustainability focus and attractive growth trajectories. We are positioned in technology-driven end segments with really strong fundamentals. Demand for our products and services is really being amplified by these trends, supporting structural end market growth rates of 5% to 6% across the Group.

Our 2022 growth rates gives me the confidence we are both seizing the market opportunity and also taking share. We are seeing strong growth across all our target markets, and academia is also growing well again. But to pick out some specific areas.

Life sciences continue to power ahead in 2022 and particularly in North America and also driven by investment in biologics, along with high demand for our facility environmental monitoring products.

I would also highlight automotive. Here, we are seeing good order momentum in both physical and virtual test, including some significant large orders for our full scale simulation solutions from some of the world's leading auto OEMs. And we continue to expect growing demand for automotive testing supporting the increasing pace of new EV model launches.

Sales in advanced materials grew strongly, especially in the energy, battery and hydrogen and semiconductor segments, where we are seeing above-market performance.

And finally, we continue to see strong growth at our semicon and electronics customers, notably in Asia, with advanced semiconductor manufacturing playing to our strengths in higher accuracy, metrology and ultraclean environments.

Customer centricity: Solving key customer challenges

Next, customer centricity. Solving our customers' challenges with leading differentiated solutions is absolutely core to our model. Over the last four years, we have been successful in shifting from the largely transactional selling of hardware to concentrating on solutions, adding value throughout our customers' workflows and processes. And we continue to equip customers to make the world cleaner, healthier and more productive true to our purpose.

And a few highlights of some of the significant customer wins over the last year will include the huge success of our end of line testing solutions for electric motors and also our smart analytical laboratory solution helping the likes of the Geological Survey of Finland to accelerate the green transition to carbon neutral mining.

We also designed and installed a measurement system for the Hornsea 2 project. That is the world's largest operational wind farm to ensure safe and profitable generation. We saw continued strong growth for our particle size analysers and particularly for developing battery materials as well as new drugs. But also great demand for our clean room solutions with leading life science and high-tech manufacturing companies, including a monitoring solution for Excelitas, who are a leading photonics manufacturer.

And we are also getting strong order intake for our virtual testing solutions, which are being selected to accelerate innovation and deliver huge efficiencies for our automotive customers such as Ford and Myra. And the Ford CEO, Jim Farley, recently went on social media, having driven one of our simulators, praising its ability to recreate the feel of different vehicles and different driving scenarios to improve safety and quality for their customers.

And these are just a few examples from across our business where we are partnering with industry leaders solving some of their toughest challenges.

Investing in growth: Accelerating organic growth

So this brings us nicely to R&D. Customers see us as a long-term partner, serving their needs today and helping them meet the challenges of tomorrow. R&D breeds collaboration, it breeds customer embeddedness and future opportunity. And that is what innovating for growth is all about.

Our strong sales performance over the past few years have been significantly supported by both new and enhanced products. Product vitality, which we measure as current year revenue from products released over the previous five years, is increasing, and it will continue to do so. And this is being driven by our increase in investment, up £20 million last year. So R&D today is close to 8% of revenue, and we expect to maintain that level going forward.

In 2022, we launched some significant new innovations, really just too many to mention here, unfortunately. But by way of another great example, in Spectris Dynamics, we completed our largest ever development project, a powerful open source hardware and software data acquisition platform with very broad applications. And this will revolutionise how both automotive, aerospace and other customers gather and analyse their data, bringing their disparate existing data acquisition systems together into one place.

It is called FUSION/ADVANTAGE, and we are very excited by it. So I thought it would be great if we could just show you a short video.

[Video]

Investing in growth: Creating value through M&A

In addition to R&D, value-enhancing, M&A remains an important part of our compounding growth strategy. And over the last two years, we have acquired five businesses, further building out our leading positions across key end markets. We maintain an active pipeline of potential acquisition targets from early-stage technologies, such as the acquisition of Creoptix in Spectris Scientific last year, to bolt-on acquisitions such as Dytran Instruments.

The acquisition of Creoptix strengthened our affinity offering for early-stage drug development. And that is really important to our pharma customers, but also to our workflow strategy. And Dytran strengthened our piezoelectric and member sensor offering whilst also expanding our sales into North America.

And we also formed a joint venture with DEWESoft to develop a new industry open standard in data acquisition hardware.

Now we also consider large scale opportunities where we see a compelling strategic and financial logic. But while organic growth will always be our first priority, we continue to see strong and significant opportunities for targeted M&A growth.

Operational excellence

We also continue to drive operational excellence to improve productivity and also strengthen our competitiveness. The Spectris Business System, or SBS, if you like, formed as the basis for our continuous improvement mindset, where everybody in Spectris is empowered to improve the business every day.

In 2022, we reduced our like-for-like adjusted overheads by 170 basis points, as Derek mentioned. And these savings have enabled the Group to offset gross margin pressure and deliver an increased operating margin for the year. So SBS really supports our expectation of delivering strong progress on expanding margins in 2023 and into the future.

And last year, we also deployed SBS on reducing lead times to support customer order fulfilment clearly in the face of supply constraints. And for a number of our products, that resulted in us being able to offer much greater availability than our competitors and also, therefore, enabled us to also gain share.

And in addition to SBS, we are also driving forward with a number of business transformation projects such as the ERP installations that is happening in both divisions. And this will enable our businesses to become leaner, more efficient and also more scalable for growth. And we expect the benefits to start being delivered from 2024, and that will ultimately deliver 150 basis points of margin improvement at the Group level.

So the key takeaway here is really our constant focus on driving improvement and making progress towards delivering that 20% plus margin target for the Group in the medium term.

Leading Sustainable Business

Now, as you know, sustainability is very much at the heart of our purpose. We have a clear ambition to create a positive and lasting impact for the environment and for our communities. And we break this down into the four areas on this slide, areas where we are building a sustainable future. So just to pick up on a few here.

For our planet, we have made excellent progress on our sustainability initiatives. We reduced our Scope 1 and 2 emissions by over 20% in 2022. And we also made important early progress on our Scope 3 ambitions with over a 30% reduction in our category 4 emissions. We also extended our EcoVadis supplier assurance to over 30% of our supply chain. And we have also commenced the development of our product sustainability work streams.

But also, we improved our operational energy efficiency last year by 21%, and that is a 37% improvement since 2020. And clearly, that is helping to mitigate against energy cost inflation. So just as a reminder, we have committed to net zero across Scope 1 and 2 by 2030 and across Scope 3 emissions by 2040.

For our society, we are really proud to be engineering brighter futures for students across the world through the Spectris Foundation. And during 2022, the foundation made grants of almost £0.5 million reaching more than 21,000 students in over 15 countries to support wider access to a quality STEM education. The foundation also granted £100,000 to community projects that were selected by Spectris employees.

Delivering the Strategy for Sustainable Growth

So in summary, we delivered a very strong performance last year. We entered 2023 with momentum and a very healthy order book, and we have started the year strongly. We will continue to deploy our strong balance sheet to support our organic growth initiatives and to compound growth through M&A. We expect to maintain this momentum in 2023, delivering organic growth of 6% to 7% and making strong progress on expanding margins and really grasping the margin opportunity that we have in Dynamics.

We will always remain true to our purpose, sustainably delivering these results, driven by our values based healthy, high-performance culture, delivering value beyond measure for all of our stakeholders.

So thank you very much for coming, and thank you very much for listening. And with that, let us move to questions.

Q&A

Andrew Douglas (Jefferies): Three questions, please. The 36% order book growth, just working through that, you got five to six months' visibility I am sure you are not going to grow at 6% organic in the first half. But yes, you have a good first half. I am just trying to figure out how much you are putting in for that second half growth rate, because it feels to me like you are not assuming a huge amount of growth in the second half within your guidance. I guess that can be taking a positive or negatively depending on your view of the world. But is that a fair assumption in terms of how we get to that 6-7% organic?

Andrew Heath: So look, we are absolutely confident in delivering that 6-7% growth. I mean, we are only in February, so we got 10.5 months of the year to go. I think in the last two, three years thought us that events can conspire to happen.

But we clearly finished the year with a record order book. I mean almost six months of order cover. January started well, book to bill above 1 for January. Now against Q4, Q1 is an easier comp in that regard. So I would expect maybe a slightly more levelled year than we have historically seen. But it all depends on how much the order demand continues to hold up through the first half of this year, because clearly, over the next five, six months, we will be building our order book for the second half.

Andrew Douglas: Sure. But it does not feel like you are expecting a massive second half to hit your guidance in terms of how you have positioned the year in terms of first half order book and what you need to do in the second half?

Andrew Heath: Yes.

Andrew Douglas: We have seen elsewhere in the sector, life sciences has come under a bit of pressure. Clearly, we have had a massive boost from COVID. Any signs that any of your customers are stopping ordering or pushing ordering out or double ordered or anything like that in terms of the life sciences division?

Andrew Heath: Yes. So certainly no double ordering, destocking, I mean, into life sciences. Really for all of our businesses, we do not sell into a stocking model into distribution network. So what is purchased from us goes directly to specific projects. So we have never really been worried about that destocking phenomenon. I think some of our suppliers may be more worried about that as the broader supply chain.

So we do not see any destocking. I think it is fair to say that life sciences and pharma has normalised back to that longer 4-6% through cycle growth rates and was the first of our sectors to do so.

But we were growing at phenomenal rates through 2021 in the first half of 2022. So we never anticipated that, that could continue anyway. So we have seen the life science and pharma normalising to that 4-6% growth rate.

Andrew Douglas: I have got most questions, but one more. In terms of the acquisition spend, you spent £125 million of acquisitions. Can you just help us with our modelling in terms of the EBITDA contribution from that £125 million last year?

Derek Harding: Yes. So I mean, a good chunk of that is in the Creoptix business, which is still in its development stage. So when you take the 6-7% growth number, that includes all of that in the top line.

And then in terms of contribution, it is not going to be a huge number. You need to take that into account in the margin guidance we have given.

Andrew Douglas: Okay. So not a huge amount of benefit from [inaudible]

Andy Wilson (JP Morgan): I have got three as well, actually. I wanted to ask on pricing. In terms of pricing carryover that you are, I guess, embedding into that 6% to 7% for 2023. And also, I guess, expectations on price in 2023, I guess, stand-alone in terms of going forward.

Andrew Heath: Yes. So I mean, I think as we said at the half year, clearly, we have been playing to some extent catch-up on pricing versus inflation. I think it is inevitable as our order book grew that became progressively more of a challenge. At six months' order cover any pricing we put through, it is going to take six months really to start to have any material impact. So we are carrying some pricing in the order book, unrealised pricing through into this year. So we will see some pricing benefit from what is already in the order book from Q4 that has been occurred in January, flowing through into the rest of the year.

I think in terms of the price-volume ratio last year, we were 8% volume, 6% price, and we would expect that to invert through this year. So it will skew more to price over volume.

Andy Wilson: In terms of just order, I guess it is a similar question to one of Andrew's, which is just around, you do not sell alone to distribution, if anything, and I do not think there is really anything that goes into channel partners. So I am assuming that cancellations are just a very rare event, if at all, seemingly because everything is just application specific. Just to check, is that right?

Andrew Heath: That is correct. Yes. I mean I think we have been a record in these events over the past two years. We have been tracking cancellations ever since that sort of COVID rebound happened and where we are just seeing some speculative buying. And our cancellation rate is very, very small and has not changed over that period and still has not changed.

Andy Wilson: And then just a quick one just on M&A. I noted your comment, I do not know whether it was deliberate or not in terms of interest in early-stage technology and then bolt-ons. And I do not think you extended to larger deals. I do not know if that was deliberate. I guess that is question, whether that, well, no longer forms part of the thoughts on M&A given that the –

Andrew Heath: I did actually say we absolutely will consider larger transformational deals as well in my speech, unless I missed that line out, but I think I did.

Andy Wilson: It is probably more likely I missed it.

Andrew Heath: So look, as we said all along, we look at everything from early stage technology businesses through bolt-ons through to businesses that are equivalent in the size of our current divisions are slightly larger. But we maintain a very active pipeline, as I said. That pipeline is still healthy. Clearly, it has been very much a seller's market over the last two years. We have not seen really much sign of that shifting.

I mean, clearly, the cost of debt has gone up quite significantly, which has changed the complexion in terms of affordability of deals, for us and for everyone else, particularly PE. So if anything, we have seen the market quiet and down over the last six months and not seeing a huge amount of price multiple valuation shift as of yet. Now maybe they will become more of a biased opportunity over the next 12, 18 months, but I think it is still too early to say.

Mark Davies Jones (Stifel): Can you just run us through the moving parts of the margin progress you are expecting this year? Is that mostly going to be out of Dynamics? Can Scientific go even higher than it is at the moment? And is that about gross margin recovering? Or is that more squeezing of overheads?

Andrew Heath: Yes. Well, I will make a few comments, and I will pass to Derek. So I mean clearly, the Dynamics presents the biggest opportunity for us. As I said, we absolutely see no reason at all why Dynamics cannot get to 20% margins. That is not going to happen overnight, but we are driving continuous improvement through our SBS initiatives. We will be installing the new ERP and process transformation within Dynamics in 2024. So they will get the benefit of that coming through in 2025.

In terms of their gross margins, that is really what hit them last year. As Derek said, it was the disproportionate exposure to low volume, high performance computing chips and high performance PCBA boards for their simulators, for their real-time computing, for the advanced data acquisition systems that we provide. And in terms of availability, we were having to pay extremely high input prices.

We have been putting prices up. But as I said to Andy, it takes time in terms of flowing through those prices that is going into the order book to actually realise in terms of the sales line. So we have got some pricing benefit. So I mean with that, I mean, I will let Derek.

Derek Harding: I mean the only thing I would add to that, I totally agree Dynamics is where the bigger opportunity lies, but Scientific can do better. And we are not so much in a question of squeezing overheads, but just focusing on good costs and bad costs. So where we think we can get a good return and it is good spend, we are not afraid to spend.

It is also worth noting in that overhead line how much is R&D. So there is a big chunk of spend there that we are expecting that is R&D, and that brings the margin down, but it obviously gives us opportunity in the future.

And the only other thing I would observe on the overheads is the Spectris Business System, which we have now been talking about for three, four years is delivering. So we are improving process efficiency. We are improving the way we do things. We are simplifying the way we do things. That means that when we grow the top line, 6-7%, we are not having to put in the same level of cost as we would have done in the past, and that operational leverage comes through.

So all of those factors will come through and that all gives us confidence towards the 20% plus that we guided to in the Capital Markets Day.

Mark Davies Jones: Okay. One slightly easy one, if I may. What are you expecting for wage cost inflation this year? Some people have suggested that is harder to pass through than higher material costs in terms of pricing.

Derek Harding: Yes. I mean it is a slightly tricky one because it differs by territory and differs by person, if you like, and differs by dynamics within the organisation. So if you were to take a kind of a planning assumption of around 5%, that is not a bad planning assumption.

Andrew Heath: Yes. But in term, Mark, as your point about passing it through, I mean, clearly, as we looked at pricing through the end of last year, we were anticipating what we would be paying in terms of wage inflation and cost of living supplements this year. So we have factored that into our thinking and our guidance for this year already.

Rory Smith (UBS): Just to come back to Andy's question, the 6% to 7% organic growth for this year, how much of that is underpinned do you think by the carry-through on pricing in the order book? If you’re thinking that that volume price SKU mix turn inverts this year, just trying to work out if you are actually maybe being slightly too conservative on that guidance. And if the world is not as awful as some of us believe that it will be that that could actually be a low number.

Andrew Heath: Yes, I will refer back to my earlier response, Rory. I think we are too early in the year to be able to talk about all of the moving parts. I mean there are a number of moving parts in both the top line growth and the margin that we are clearly working through. We do have a record order book six months cover, started the year strongly, but we certainly anticipate that our end markets, like we talked about pharma and life sciences will progressively normalise to the sort of the 4-6% through cycle growth rates average.

And it is just at what point does that happen? I mean we are butting up against some very tough comps now. We grew very strongly in the back end of 2021 and for the first half of 2022. And I think we will be updating you another three times this year. And as we go through the year, we will clearly provide more colour.

Rory Smith: And then just a follow-up on that six months stock visibility. Do you know what the range is? Or what is the range across your businesses thinking more about the short cycle of the lower end?

Andrew Heath: Yes. So I mean, for both the two divisions, Scientific and Dynamics, it is very similar in terms of the order cover. Dynamics has actually got slightly more because they had a very stronger order intake through the second half of last year. But they are slightly later cycle compared to the Scientific division. But again, it is quite nuanced. If you want to buy a wafer analyser in semiconductor, you will join the queue for 2024 at the moment. I mean we're rapidly increasing capacity and supply chain, but the moment we go out over 12 months in terms of availability on that product.

Some of our particle analysers, again, in semiconductor, it is eight, nine months' order times at the moment, which, again, we are trying to actively work down. But it does depend within the business as well. And within the other side, it is really only Red Lion that sells into the distribution network. And there, I mean, they have got quite a high backlog, much higher backlog than ever they had historically because of all the electronics.

I mean, basically everything they sell has got stuff with electronics. So they are doing very well at the moment, and you see that come through in the other results that Derek showed strong operational performance from both companies. They are definitely responding to the treatment we wanted there. But it is really only the Red Lion business that is on shorter lead times.

Tom Fraine (Shore Capital): Just one very quick question initially. Is any of the R&D spend, is any of that capitalised at all? And then in terms of M&A, have you seen a greater pipeline, more opportunities since interest rates have come up and there is potentially less competition from PE now?

Andrew Heath: Yes. So to answer the questions. I mean in terms of R&D, we are not capitalising any R&D. I think we have a few trail projects still because when I joined the policy had been changed to capitalise some R&D. And so, some of those projects are just running out now, but it is a very small amount. But our policy going forward is that we do not really want to capitalise R&D. We would much rather expense it and have a clean set of numbers.

And then in terms of M&A, as I said, I mean, we have really not seen any sort of shift in behaviour within the market other than the fact that the number of the deal flow has dropped dramatically. I think a lot of assets that people are thinking of potentially selling have just been put on hold or put on ice for the moment and waiting and seeing. So there has been a lot less activity from PE at the moment because of all the cost of capital and the access to debt, but they are sitting on a lot of those assets, and there is not much happening.

Bruno Gjani (Exane BNP Paribas): Just coming back to the backlog. I appreciate it is the longest it has been ever. So it is six months. Normally, you operate with a backlog that is close towards four months' worth of revenue coverage. So I am just wondering if we look out over the next 12, 24 months, would you expect that normalisation back to around four months? Or is there some structural reason or otherwise, that it should remain really at these abnormally elevated levels?

Andrew Heath: Yes. So we do not anticipate sustaining a six-month backlog forever, Bruno. The timing of that will obviously just depend really just on that whole book to bill ratio and how we see demand flowing through. But as our end markets normalise back to that 4-6% growth, I think it is important to reflect on the micro trends that is driving our business rather than a macro. We are definitely benefiting from the sustainability thematics, the electrification, demand for healthcare, life sciences, automation, greater levels of productivity, particularly in a high inflation environment.

I mean that is all helping drive our business on a micro level. So we expect that our end markets to normalise back to that more 4-6% growth rate, and then we are doing 100 basis points better as our minimum target. And it is just when does that happen? So I would expect to see some of that happening this year. But the extent to which it is, I think it is still too early to say.

Bruno Gjani: And just a quick follow-up on that. I guess if you put semi market to the side and if we look at orders at the Group level, lead times that you are quoting to customers today. Are they closer towards those historic average levels? Or are they still quite –

Andrew Heath: So relatively, they are still elevated, but we are actively working to bring them down. And as I said in my speech, certainly for our particle analysers out of the Malvern Panalytical business, where a number of you visited last year, and you saw the SBS flow line there. We have deployed more flow lines through that business and deployed the similar methodology with our suppliers. And we have actually now almost back to making to stock, which is for that product line is where we want to be because we historically used to book and turn a number of those units in the month.

Now that seems like diminished in history, but we are getting back to that level. But that, as I said, has made us much more competitive in the market. So if you want a master size of these, you want to particle analyser, we can offer greater availability than most of our competition. So that is a really helpful place to be.

Bruno Gjani: And just a final one. So the revenue outlook is quite encouraging. On the order front, particularly as we look towards H1 of this year, the comps look incredibly tough. So should we expect really quite a divergent trend between like-for-like revenue growth and like-for-like order growth as we look towards H1 of this year?

Andrew Heath: Again, I think it is too early to say. I mean, January, we had a book to bill greater than 1 in January. So we are maintaining, and our sales were up over 10% in January. So we are still seeing strong demand.

Now we keep coming back to this question of when will we see things normalise? My sense is it is going to be progressive through this year. Just how fast that happens and the extent to which it happens, I think it is best that we update you as we go through our quarterly and half yearly trading statements.

George Featherstone (Bank of America): I just want to come back to the comment you made, Andrew, on the other businesses. So they have shown some encouraging improvement towards the back end of the year, responding to treatment as you put it. How much further can you improve them? And has there been any change in your longer-term view on these businesses?

Andrew Heath: Yes. So as we have always said there, I mean, they are high quality businesses. Historically, they have had margins higher than we achieved last year. So we are really pleased with the progress on the margins last year, much better operational execution. We replaced the leadership in both businesses through last year. I am very pleased with the progress they are making. We certainly see opportunities for them to further progress their margins through this year and going forward. The question is that they are niche in nature, and it is really a question of scale. And are we the best people to scale them? Or effectively, are they going to be the best owner for those assets?

But for the moment, we are very pleased with the performance, and we will continue to drive the operational and strategy execution forward.

George Featherstone: Then on the R&D spend, clearly stepping up again a little bit this year. When we think about the medium-term operating margin, can you give us a sense, I guess, in terms of what you expect the ongoing beyond this year R&D share of sales will be? Will it continue to step up? Or will there be a bit of a reduction as you go through a new product cycle?

Andrew Heath: I mean our guidance is 8%. So we are getting into 8% and then holding at 8%. I mean, year-to-year, it could fluctuate a little bit, but I think 8% is a guidance, is a good level. And certainly, our vitality index, you can see it is ticking up nicely as we have ramped up the R&D. We are accelerating the vitality index. And we have finished 25% last year. It is up on the previous year and get that to 30-33% over time.

Richard Paige (Numis): Just a couple for me. On the like-for-like end market breakout you gave us, the one that stood out to me was the automotive, very strong. Can you just give us an idea of how much that is new customers versus growth with existing customers, please?

Andrew Heath: Yes. Well, Rich, I mean, a lot of the growth is actually in our virtual test division. So as we highlighted is the Capital Markets Day a little bit of a case study on the acquisitions that we have made there in terms of concurrent RT, the IMTEC acquisition we did back in 2019, the RightHook we did in 2019, IMTEC in 2021, I think it was, in a really strengthening the VI-grade acquisition we made in 2018. So by the end of last year, we actually we doubled the sales over the last four, five years for virtual test. So gone from about €40 million to almost €80 million. So very strong growth there.

And we are riding the shift of certainly in automotive by large automotive OEM customers trying to accelerate time to market, reduce development costs. Also, it is a big part of their sustainability agenda. I mentioned the Myra during my speech. I mean, they bought one of our live simulators. And part of that was accelerating development times with their customers but also from a sustainability perspective.

It is a nice case study in our Annual Report. You can read where we actually modelled the CO2 savings and the environmental impact savings from actually designing through simulation. It is not just a digital twin. It is actually the hardware in the loop driver, in the loop software and the loop capabilities that we offer that is allowing customers to be to develop products far more sustainably, including reducing the number of tyres using the prototype vehicle by about 3,000 sets of tyres. I mean, it is a lot of rubber not being produced.

So it is actually quite impactful. So we are seeing huge demand. And quote from Jim Farley, that was a nice post on LinkedIn that he put up there, is driving one of our simulators with him in the cockpit. So it is a great testimony.

Richard Paige: And just the second one. You mentioned in the statement, obviously, the US orders softening in the second half. Can you just elaborate a bit more on that? Is that where the pharma impact?

Andrew Heath: Yes. So pharma normalisation was happening in North America. But I think generally, we have seen North America just sort of normalised faster or slipped a bit. But to me, that is a fairly normal behaviour for North America. I mean typically, North American companies are much quicker to act on the macro signals than maybe European or Asian companies are. So it is not unexpected and we do not see it as problematic.

Harry Philips (Peel Hunt): Just a question on capital allocation because just if you run your cash flow number and you run circa 90%, let us say, £200 million just to pick a number. You have got some of the buyback left to do £230 million net cash. You start to the mass quite quickly, clearly. I am just surprised. When do you pull the trigger on a buyback or something like that? Because unless you do some significant M&A, you are clearly going to be very inefficient. So what is the trigger for deciding to go down that route rather than doing it now or whatever?

Derek Harding: I mean there is never one trigger, Harry, in reality. I mean so we are very clear that we look at our capital that we have. Our primary desire is to invest organically, grow the business that way, and we are doing that.

Our second desire is to grow inorganically and make acquisitions, and we are doing that and have done that. And if we think we have got excess then we give it back to shareholders, either through a buyback or special div. So we are in the middle of giving money back to shareholders, the £300 million. So that is in train.

Look, I mean, we will continue to monitor the balance sheet and look at the options to see those three options and decide which makes most sense. Obviously, we would like to make some more M&A. We have undertaken £124 million last year spend on acquisitions. You do not have to do significant acquisitions to eat into that balance, but equally, having the money available if there is something bigger that comes along and there is a good opportunity to take it, then we will.

So we kind of look at it in the round. We have a buyback that is in train at the moment. We did not feel the need to extend it. There are acquisition opportunities that we would like to take. So we will keep it monitored. There is not a specific trigger or a specific balance sheet data or anything in reality. We look at it at the time, looking across the whole spectrum of what is in front of us and try and get the balance right. And I mean, obviously, I would say this because we have made this decision. We feel like we have got the balance about right.

It is also quite nice to increase the ordinary dividend. That sits outside our capital allocation. It is a 33rd year that we have increased that. That is quite a nice trend as well, I think. We do have a couple of questions. Andrew, that have come in online.

So let me just fire a couple of these. So just when you look at Dynamics and the mix of the growth, the 7% growth between physical test, virtual test and software, is there any interesting story there?

Andrew Heath: I mean, yes. So there is nothing really, I would say, that I would call out that differentiates the split between physical, virtual or software sales. Within physical tests, I highlighted our end of line testing for electric motors has been particularly strong. I mean we almost doubled the revenue of that product line over the last 18 months.

Virtual test, I have spoken about. Software, some of our material analysis, durability analysis software, again, is selling very well. So broadly, broadly, it is a pretty common growth across the whole of Dynamics we are seeing.

Derek Harding: And then also how much additional capacity does the new facility for PMS?

Andrew Heath: So the new facility in PMS is we are doubling the size of their existing footprint. The existing footprint is getting quite tight in fairness. So we have been looking for some time at a new facility and found a building last year, which we bought out right because we believe that gives us greater flexibility over time in terms of how we use it. But we are also looking at it with an eye to acting as a distribution centre towards the West Coast for our Scientific division in North America as well.

Any other questions? We are about at time. All right. Well, let me draw to a close. So thank you again for coming. Great to see so many of you in the room. It is great to be back to doing these things physically.

Just so, as a summary, we delivered a very strong performance in 2022. We are very pleased with how we performed. But equally, we are very pleased with the momentum that we have carried over from last year into the start of this year with both a very healthy order book, but also continuing strong demand and a book to bill above 1. That gives us the confidence in terms of the guidance that we have given today in terms of 6-7% organic growth this year with strong margin progression.

And we look forward to updating you through our trading update in April. Clearly, some of the questions that you asked today will go maybe give a bit more colour.

Just as a way of pre-advert, if you like, we are organising a dynamics mini-Capital Markets Day teaching at our virtual test facility in Italy in June. It would be the week of 19th June. We have just got it land on the day. And we may extend that to a broader dynamics investor roadshow in Europe if there is sufficient interest as well. But the facility in Italy is where we design, build our full-scale simulators, and it really will showcase not just the virtual test vision within Dynamics, but we will also be bringing in some of our other software solutions and physical test and smart sensor solutions that we will showcase on the day. So we will advise you the date as soon as possible. But if you want to ride on simulator book early.

With that, look forward to seeing you again in April. Thanks very much for coming.

[END OF TRANSCRIPT]