

IMI plc
Interim Management
Statement

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Introduction

Roy Twite

CEO, IMI plc

Welcome

Thank you, and good morning, everybody. Thank you for taking the time to join us today. I am joined here, as usual, by Dan, our Finance Director.

Strong organic growth and margin improvement in all three divisions

I will just take a moment to summarise the highlights from our IMS before we move to Q&A. And I would obviously like to begin with a very big thank you to all of our employees for their continued support, commitment and contribution towards delivering our purpose-led strategy, Breakthrough Engineering for a better world.

It has been another excellent performance as we recorded our ninth consecutive quarter of organic growth. Group revenues were up 16% versus the first quarter of last year and up 8% organically, with all three divisions delivering improved margins.

Integration of our recent acquisitions is progressing well and it is unlocking exciting new opportunities for growth and delivering synergies in line with our business cases.

Our restructuring programme continues to reduce complexity and remain firmly focused and on track to deliver the expected benefits.

In Precision Engineering, lead indicators have continued to be resilient, particularly in Industrial Automation. Organic revenue for Precision Engineering grew by 4% in the quarter, with Industrial Automation organic revenues 3% higher than the same period last year. While Life Sciences delivered organic growth of 2% and Transportation was up 10% on the same basis.

Critical Engineering had another excellent quarter. A real highlight for me has been the organic order intake, which was up 50% on the prior year, including a £26 million order within our Marine sector, which covers deliveries in the coming years.

We set out a plan to accelerate Aftermarket growth when we launched our strategy in 2019, and the hard work from Jackie and the team over the last three years is clear to see. Organic orders grew by 47% in the period for Aftermarket. And this Aftermarket growth has been driven by many of the division's self-help initiatives, with upgrade orders up 87% to nearly £50 million in the quarter. A number of the Aftermarket orders are Nuclear and Petrochemical and will not be shipped until 2024.

The good momentum in New Construction has also continued, with 55% growth in organic orders during the first quarter. The order book is 36% higher than the same period last year, reflecting the continued strong demand in our Energy and Marine end markets. We now expect the Critical organic revenues will be up low double digits, slightly increasing from our previous high-single digit guidance.

Hydronic Engineering organic revenue was up 12% as we continue to see demand for our energy saving products. Adjusted revenue was 25% higher than the same period last year, with Heatmiser integrating really well and providing a positive contribution to performance in the quarter, slightly ahead of our business case.

Following a strong first quarter performance and based on current market conditions, we now expect 2023 full year adjusted EPS to be in the range of 112p to 117p. We continue to expect that IMI Critical and IMI Hydronic 2023 organic revenues and margins will be higher than 2022.

But based on the latest market indicators, we now expect that IMI Precision's 2023 organic revenue will be broadly in line with 2022 with margins higher than last year.

We remain confident in delivering our growth targets and the 20% operating margin target through the cycle and over time.

Okay. With that, I am going to hand you back to the operator who will manage the Q&A session for us. Thank you.

Q&A

George Featherstone (Bank of America): First one would just be on the strong start of the year in Critical. How should we think about the visibility that you now have in this business from that very strong order book?

Roy Twite: Morning, George. Yes, I think that the whole environment for process automation, Critical's environment, has obviously taken a step up. I think probably, George, we have been surprised at how quickly some of the orders that are coming through to improve energy security and around LNG and things like that for countries. So yes, it is a strong environment and we are feeling very good obviously about this year, which is why we raised the guidance now to low double-digit growth in Critical.

But George, I mean, the other good news for us is we are already building next year's order book. And we would think that all things being equal, that the order book at the end of this year in Critical will be double-digit up again. So we are feeling very good about the environment. Our win rates are high. Actually, every market now in Critical - Power, Oil and Gas, obviously LNG, obviously defence, you have seen that £26 million order that we have won in there, every single market now a strong tailwind. And that Jackie and the team are just doing really well in terms of winning.

So yes, we feel good about this year and we are starting to feel better about next year. On the other thing I should add actually, George, is that Aftermarket orders are up as high as they are. Obviously, you have seen a big part of those are upgrade valve orders, which has been the strategy for a while. But now it has been helped by the market as well.

Those upgrade valves are obviously on a similar lead time as a new valve. So they are actually shipped, the ones that we won in the first quarter, most of that will ship next year as well. So yes, we are feeling good about this year and increasingly good about next year. George.

George Featherstone: And then maybe one on Precision. Your outlook is for a bit more positive than it was at the full year results. What is driving this? And has the business decoupled in any way from the lead indicators that you would normally track in this particular cycle?

Roy Twite: I think I would be very brave to say that, George. It is decoupled, right? But I think the positive news is Industrial Automation sales were up in the first quarter 3% that was really good to see that come through.

Actually, the order book at the end of the first quarter in Industrial Automation was up slightly as well, George. So that was good. Talking to customers, and we said the market-leading indicators, even the PMIs did not come off as much as some feared. So we definitely feel better about the second quarter. And I suppose the third and fourth quarter, we have not got brilliant visibility.

And actually within our guidance, so within the 112p to 117p, we are still forecasting that the second half will be worse for Precision than the first half. So hopefully, George, there is a level of decoupling, right? And actually we do better than even that. But we still being a little bit conservative, hopefully because consumers will still come under pressure. We know with interest rates continuing to rise with energy costs higher. So at some point, we are not forecasting a decoupling. We would certainly like to see a decoupling, though, George, and that would be great news.

And I suppose the other thing to say is that certainly in the market, the reason why we think we are doing a bit better than we thought is all around the pressure on automation because of the higher labour costs, and the need to automate supply chain. So that underlying driver is still strong.

Christian Hinderaker (Goldman Sachs): First, I want to talk about your thoughts on the sustainability of the current demand. I guess within Critical in particular and as it relates to New Construction, I think if we back out the £26 million Marine order, it looks like Critical order growth was around 20%, but that is without sight of the 1Q 2022 comp. I just want to understand the context here in terms of price-cost, but also what is fundamentally driving that in terms of customer behaviour?

You talked about lead times now being more than nine months. I guess wonder how that change versus history and whether that extended lead time is effectively meaning that your order intake is growing at a higher pace. And then I will come back to the other two.

Roy Twite: Brilliant question. Yes, on sustainability, I mean, we feel very good about the Critical market. And I think there is a lot of activity, Christian, I would say right now. And as we continued into April, we are still seeing very strong activity in Critical. And I think most people feel that LNG in particular is going to be strong for the foreseeable future. For the medium term, it is going to be strong.

And it certainly feels like that. And particularly investment activity in the Middle East particularly is very, very high. And that is good because we mentioned that we have put our own facility into the Middle East, which was completed third quarter of last year. And now Jackie and the team are starting to reap the rewards of that as well.

So we feel very well positioned for the Middle East. Our win rates are really high. And then you have got the receiving terminals obviously going into Europe, China and our win rates in China have been very, very high as well.

So LNG, I think, Christian feels very, very good to us at the moment and good for the foreseeable future. The rest of Oil and Gas is also strong and you can see that across some of

our peers as well. So we think that is in a good position. Actually, if you look at the comparator, it was not a weak comparator for Critical by any means.

And we called out that defence order because we will deliver that over the next few years rather than in our normal 12 to 18 months. But you would have to put some of that order back in, right? You cannot just strip the whole thing out.

So I think, yes, New Construction feels strong. Aftermarket still feels very strong. As I said on the last call. Operators working their facilities hard, in conjunction with our Aftermarket strategy, which is firing on all cylinders. So I think we feel pretty good about the next periods, if you like, in terms of Critical demand, Christian.

Christian Hinderaker: Maybe we can come on to the supply chain side, I guess, both on your side of the business. I think the full year results we were talking that you would have some customer destocking and issues with component supply and electronics and also freight. I just wonder how that has developed in the quarter.

Roy Twite: Yes, it is gradually getting better, I would say, Christian. So how has it affected us? Well, I think in Hydronic, we have benefited actually in the first quarter from some wholesaler restocking. And so if you probably looked at underlying sales in the first quarter, they would be 2%, 3% lower if it was not for some something like that, Christian, if it was not for some wholesaler restocking.

So I think that has obviously hit us in the fourth quarter last year. As you know, it is slow growth. I think it was down at 2% in the fourth quarter, but it came back strongly, as you can see in the first quarter.

The other areas affected us is in Life Sciences, so we only grew at 2% and that is definitely customer destocking. Underlying demand is the opposite there. It is up sort of mid to high-single digits in terms of our customer sell-out. So we feel good about our Life Science recovery second half.

And then more generally, I think we are starting to see much better supply now of electronic components. We have seen that into Heatmiser now, which is reassuring. And Heatmiser grew double-digit first quarter. So we are starting to see that ease. So I think generally things are getting better. Boats are getting into ports faster. And even electronics is starting to improve, Christian. So yes, I think we feel better about supply chains right now.

Andrew Douglas (Jefferies): The obligatory three questions from me, please. You have kind of answered this, but I would not mind just going into a bit more detail on LNG. In terms of the progress that you are making there, do you think this year is when you win all of your awards for the next two to three years, or do we still see awards coming through in LNG over the next two to three years, which means that we have four to five years visibility, if that makes sense.

And just on that, the win rate comment, my understanding is particularly with one of your larger customers that you pretty much win all of their LNG work. Is that still fair? So that is my first question.

Second question is just on Transportation inside Precision, plus 10% is a good number, given the backdrop. Can you just give us a little bit of help from a regional perspective, US, Europe and China, just to see where the strength is there?

And then, Dan, no free pass for you, I am afraid. Can you just talk to us about cash? How cash is doing in the first half, or I guess first quarter, first half. And any thoughts full year would be great.

Roy Twite: Well, Andy, good morning to you and thanks for bringing Dan into the conversation. So the one question I missed, Andy, was the one about 10% you said. Was that Transport?

Andrew Douglas: For Transport, that is a nice number.

Roy Twite: Yes. Got it. It is very good. And again, Beth, Steve and the team doing a great job actually in that segment. Really pleased.

Yes. So LNG awards, I was talking to a customer very recently, a big customer in the last week, Andy, on LNG. And they feel that there will be further awards, right? The LNG contribution to energy security is going to be pretty significant, right?

So yes, I think awards over the next two to three years, as you said is the base case. It is the most probable outcome. And I still think we are really only seeing the beginning of this. There is going to be more receiving terminals, more compression terminals. And yes, I think LNG is a vital part of energy transition as well.

Win rates, yes high, Andy. And again Jackie and the team, and this is, as you know, years' worth of work, years' worth of value engineering, making sure we are competitive, make sure what Jackie has added is really strong customer coverage. Obviously, as you know, into the Aftermarket, really we implemented CRM. It was a big and difficult investment, as you can remember, but all done a few years ago. And now our mapping of the installed base is, well, very strong.

And then we throw on top of that Growth Hub and the innovations with things like Retrofit3D, EroSolve and those teams. And so win rates are really high. Yes, we are strong in LNG exactly as you indicated, Andy.

Transport, yes, interesting. So Transport, so actually within that, Rail was the strongest as you probably expected, Andy. So Rail really strong. And that is actually very strong globally.

In terms of Commercial Vehicles, we are obviously seeing a China rebound, as we expected, and that is probably the biggest call out, I would say, in terms of the regions.

And then, Dan, on cash, anything particularly on cash? I mean, a good quarter, right?

Daniel Shook (Group Finance Director, IMI plc): Yes, good first quarter, Andy. And as Roy already said, the supply chains are getting a bit better. So we are getting at some of the stock and bringing that down.

Now with the orders coming in with Critical, there will be an offset there because we will need to start building for those orders. But overall, I think we are still on track for a good first half, but I would still say we will probably see more of the cash delivery in the second half of the year as we go through.

Roy Twite: Yes. And probably the only thing I would add is that CV was up across all the regions. And so China's strong rebound is the big standout but up across all the regions.

Jonathan Hurn (Barclays): Just a few questions for me, please. Firstly, just starting on Critical. Can you just talk a little bit about the margin within the order book for Critical? Obviously, you have had a bump up in terms of New Construction. Can you just tell us how that margin is trending year-on-year in the order book, please? That was the first one.

Daniel Shook: Yes. Thanks, Jonathan. Yes. Margins about the same place as they were this time last year, which is good. And as you know, we are expecting to be up on margin this year in terms of our guidance. And then we have still got some restructuring benefits to come through next year as well, Jonathan, as you know.

So as we said on the last call, we are pausing any footprint changes while we absolutely prioritise the order intake and obviously the shipment of all the orders and customer service and win rates ultimately. But that will come through.

Next year and the year after we see, as we mapped out for you, Jonathan, more benefits from that restructuring programme into Critical.

Jonathan Hurn: Great. It is very clear. And secondly, just staying on Critical. Can you just talk us about the capacity there within that business? Are you fully booked for 2023 for Critical, or is there still some more availability if things continue to come through from the order book?

Roy Twite: Yes. I mean, in terms of New Construction, as you know, Jonathan, 12 to 18 months lead time, right? So yes, we are pretty much fully booked on New Construction. In terms of Aftermarket book to ship, still Aftermarket book to ship to go. And in terms of capacity, we are fine in terms of Aftermarket capacity.

In terms of New Construction capacity, actually, two of our bigger plants, two of our best plants as well actually, India, South Korea still only working on just over a ship, Jonathan. So in terms of our own internal capacity, we are in pretty good shape in Critical. Obviously, supply chains we expect will come under pressure, though, obviously, because most people in process automation are seeing a lift. So there is larger castings.

We have done a lot of work on the supply chain, as you know, and we have reduced the number of single source suppliers from, I think it is about 60 to about six. So we have got more options. But at some point, if things continues at anything close to this rate, I would expect the supply chain to start to see some slightly longer delivery times.

But yes, so far internal capacity looking good. And so far supply chain holding up well.

Jonathan Hurn: Maybe just one final one on Precision just in terms of Industrial Automation. Can you just give us a feel for the progress of Aftermarket within that within Q1? Is that where most of the demand has been, or has it been more on the OE side?

Roy Twite: It has been pretty balanced, actually. I mean, Aftermarket is still running around 40% of the overall for Industrial Automation. So a nice strong Aftermarket. But yes, OE holding up as well, Jonathan. It is pretty balanced at the moment.

So as I said, we are still seeing strong demand for automation. But you talk to some customers, particularly in North America, and the feedback we are getting is that still, I suppose, uncertainty around Q3, Q4, right, in terms of Industrial Automation. So that is why

we are still forecasting, as I said, a slight tapering off when you compare half one of this year to half two.

Mark Fielding (RBC): Can I just ask a bit about pricing and the impact it has had? Could you maybe talk about pricing in the overall number and by division? And that implication, I suppose, that are we actually in positive volumes in Precision, or is it still more in a steady state in that area? And then obviously, how big a kicker it was in something like that very strong Hydronic number as well?

Roy Twite: Yes, I mean, just give you a rough idea, Mark, without getting too commercially sensitive. So pricing overall is now moving back towards more 50% of the overall 8% growth Mark. So unit volumes up now across the piece. And as you know, in Hydronic, we had more inflation and we passed more of that through. So that is a bit more price than that average and Critical is a bit less. So to give you an overall picture, it is nice now to see the unit volume coming through again.

Mark Fielding: Great. And just quickly on Hydronic. I mean, obviously you are already flagged that 2% to 3% wholesale restocking benefit. Just how do you think about the pattern through this year, as the supply chain generally is a bit more normal in the world, should this stop being such a sort of changing factor as well? But what do we think about specifically for Q2, H2 on that impact?

Roy Twite: Yes. So what we think is that Hydronic will grow mid to high single digits this year. That is where we still see underlying demand with some of these ups and downs. And we are pretty encouraged because well, Dan and I, well, Mark we saw you there, at the ISH Show and we talked to a lot of customers there.

And Germany, where the show was, is 25% of the overall business, but it is backed up by other customer visits that they see strong demand for energy saving product. So I know a lot of other people are calling out reduced demand on residential construction. But at the moment, our customers are saying, yes, but demand for energy saving products is still there. So that is why we think mid to high single digits, Mark.

Mark Fielding: And actually just one follow-up linked to my first question. When we think about the full year comments you have made there and obviously Critical as well, as the year goes, I assume that that pricing input takes us further from 50% to just, I suppose how much of that is priced in the full year number?

Daniel Shook: Yes, that is right. It will start to taper for sure because as you know, we were very early on pricing. As soon as those inflation indicators were going the wrong way, Mark. So, yes, our pricing will start to taper.

Mark Davies Jones (Stifel): I was just asking on the Aftermarket side and Critical. Are you seeing on the Power side a benefit from life extension on some of those fossil power plants? Is that one of the things supporting activity at the moment, or is that just in the round?

Roy Twite: I think certainly, we are seeing a good benefit in terms of Power Aftermarket. So if we look at our gas power Aftermarket, Q1 up 40%, Mark. So I think there is all sorts of things going on here, are not there? And probably part of it is that but part of it is more cycling, part of it with renewables and all of those effects. Part of it is things around just making sure that the power grids are actually in good working order.

I mean, it is incredible, Mark, what is happening. We were talking to Jackie and Critical about China and the sheer amount of electric vehicles going into China is, on a global scale, unbelievable. And Jackie was explaining, what that is doing in terms of electrical outlets, electrical grid in China. And even, as I said earlier, even coal power going in just to enable the grid to keep up.

So yes, I think EVs are having an effect, particularly in China, but obviously in other parts of the world as well. So I think it is not as simple as one effect. There is lots of effects going on, but electrification is obviously a very strong trend and that will be met through all sorts of means, I am sure.

Richard Page (Numis): Just one simple one from me. Obviously, Q1 performance better than I have put in. With your commentary on Industrial Automation in the second half just wondering how we should think about the shape of profits in your full year guidance. I think traditionally EBIT is 44%, 45% H1 weighted. How are you thinking about the year at the moment, please?

Roy Twite: Yes, I think we are probably similar to a pretty normal sort of pattern, I think, Richard.

So we are thinking about, I would say, within the bounds of reasonable normal sort of pattern. So normal things that affect that, Richard, Critical second half-weighted, heating season in Hydronic. Similar patterns we think this year to sort of traditional ones.

Operator: Thank you, we have no further questions. I will hand back to Roy for any closing comments.

Roy Twite: Excellent. Well, thanks for your time this morning. As you can see, we are really proud of the team, really proud of the work that they are doing. And I literally cannot remember a stronger first quarter for IMI. So we feel good about, where the markets are and where our business is right now. Thank you very much.

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