Spirax-Sarco Engineering plc
www.spiraxsarcoengineering.com

News Release

Thursday 7th March 2019

Strong organic growth and full-year contributions from acquisitions

HIGHLIGHTS

Adjusted*	**2018**	**2017**	**Reported**	**Organic+**
Revenue	£1,153.3m	£998.7m	+15%	+7%
Adjusted operating profit*	£264.9m	£235.5m	+12%	+12%
Adjusted operating profit margin*	23.0%	23.6%	-60 bps	+120 bps
Adjusted profit before taxation*	£254.6m	£229.1m	+11%	
Adjusted basic earnings per share*	250.0p	220.5p	+13%	
Dividend per share	100.0p	87.5p	+14%	
Cash conversion**	91%	86%		

**All profit measures exclude certain items which totalled £34.2 million for the year ended 31st December 2018, as set out and explained in the Financial Review and in Note 2.*

***Cash conversion measures the percentage of adjusted cash from operations to adjusted operating profit as explained in the Financial Review and in Note 2.*

+ Organic percentage growth measures are at constant currency and exclude contributions from acquisitions and disposals.

Statutory	**2018**	**2017**	**Reported**
Revenue	£1,153.3m	£998.7m	+15%
Operating profit	£299.1m	£198.9m	+50%
Operating profit margin	25.9%	19.9%	+600 bps
Profit before taxation	£288.8m	£192.5m	+50%
Basic earnings per share	303.1p	214.4p	+41%

- Revenue growth of 15%, organic sales growth of 7%
- Adjusted operating margin of 23.0%, down 60 bps; organic margin up 120 bps to 25.2%
- Strong organic sales growth in Steam Specialties and Watson-Marlow
- Gestra and Chromalox performing well
- Net debt of £235.8 million as at 31st December 2018, 0.8x EBITDA
- Full Year dividend increased by 14%

Nicholas Anderson, Group Chief Executive, commenting on the results said:

"We are very pleased to report strong organic sales growth of over 7% in 2018, ahead of global industrial production growth, and organic adjusted operating profit growth of over 12%. We have seen strong organic sales growth across all three businesses, reflecting the benefits of the successful implementation of our strategies. The integration of the Gestra and Chromalox acquisitions progressed to schedule and their overall performance continues to be in line with our expectations. In 2019 we will continue to embed our strategies that enhance our ability to self-generate growth, in order to mitigate the effects of slowing global industrial production and increased market uncertainties. Assuming no significant deterioration in trading conditions, the Board expects to make further progress in 2019."

For further information, please contact:

Nicholas Anderson, Group Chief Executive
Kevin Boyd, Chief Financial Officer
Tel: 020 7638 9571 at Citigate Dewe Rogerson until 6.00 p.m.

The meeting with analysts will be available as a live audio webcast on the Company's website at www.spiraxsarcoengineering.com or via the following link: https://edge.media-server.com/m6/p/d3rcdbrr *at 9.00 a.m. and a recording will be posted on the website shortly after the meeting.*

About Spirax-Sarco Engineering plc
Spirax-Sarco Engineering plc is a thermal energy management and niche pumping specialist. It comprises three world-leading businesses: Steam Specialties (Spirax Sarco and Gestra), for the control and management of steam; Chromalox, for electrical thermal energy solutions; and Watson-Marlow, for peristaltic pumping and associated fluid path technologies. The Steam Specialties business and Chromalox provide a broad range of fluid control and electrical process heating products, engineered packages, site services and systems expertise for a diverse range of industrial and institutional customers. Both businesses help their end users to improve production efficiency, meet their environmental sustainability targets, improve product quality and enhance the safety of their operations. Watson-Marlow Fluid Technology Group offers the ideal solution for a wide variety of demanding fluid path applications with highly accurate, controllable and virtually maintenance free pumps and associated technologies.

The Group is headquartered in Cheltenham, England, has strategically located manufacturing plants around the world and employs over 7,500 people, of whom over 1,600 are direct sales and service engineers. Its shares have been listed on the London Stock Exchange since 1959 (symbol: SPX) and it is a constituent of the FTSE 100 index.

Further information can be found at www.spiraxsarcoengineering.com

Unless otherwise stated, the figures quoted in the text below are based on the adjusted Group results (see Note 2). Organic measures are at constant currency and exclude contributions from acquisitions and disposals.

Chair's statement

Introduction
Following the retirement of Bill Whiteley in May, I was delighted to take on the role of Chair of Spirax-Sarco Engineering plc. This is a remarkable company, with a strong record of growth and I look forward to being part of its further progress over the coming years.

During 2018, a number of events occurred that reflect the respect that our shareholders and others have for the Company. In November, our Spirax Sarco sales and manufacturing company in China won the prestigious "British Company of the Year Award" at a ceremony in Beijing, hosted by the British Chamber of Commerce in China. In early December, for the third consecutive year, the Group was voted top of its sector (Engineering and Machinery) in the "Britain's Most Admired Companies Awards" and, effective from 24th December 2018, the Group entered the FTSE 100 Index.

In addition to these external recognitions, an important internal milestone was reached as the Group's sales exceeded £1 billion for the first time in our history. Strong organic growth, combined with the incremental benefit of the acquisitions made in 2017, contributed to this significant result.

Financial highlights

Sales for the year were £1,153.3 million, an organic increase of over 7%; exceeding global industrial production growth of 3.3%.[1] Currency movements became a headwind in 2018, reducing sales on translation by 2%. The incremental impact of acquisitions made in 2017 increased sales by 12%, while the divestment of HygroMatik, on 30th November 2018, had a small impact on sales. As a result, reported sales were 15% higher than 2017. Our Watson-Marlow Fluid Technology business had another strong year, with organic sales up 9%. The Steam Specialties business also performed well with organic sales up almost 7% and gains in all segments. Gestra, which is reported within the Steam Specialties business, performed ahead of our expectations for sales growth, delivering a 10% increase in sales on a full year basis. Chromalox, which is reported as a separate business, delivered year-on-year sales growth of 9%.

On an organic basis, Group adjusted operating profit increased by over 12% to £264.9 million. Watson-Marlow delivered organic adjusted operating profit growth of 11% while the Steam Specialties business was up 12%. Translation and transaction currency movements reduced adjusted operating profit by 4%, while the incremental impact of acquisitions added 6%. Total adjusted operating profit was up 12%.

The Group adjusted operating margin fell by 60 bps, to 23.0%, due to currency impacts and the full-year dilutionary effect of the 2017 acquisitions. Excluding the effects of acquisitions and currency, the adjusted operating margin increased by 120 bps to 25.2%, aided by the growth in profits in Argentina as a result of the peso's devaluation.

The Group adjusted pre-tax profit was £254.6 million, 11% ahead. Adjusted basic earnings per share was 13% ahead at 250.0 pence (2017: 220.5 pence).

The pre-tax profit on a statutory basis was £288.8 million (2017: £192.5 million) and includes certain items explained in Note 2. The statutory basic earnings per share was 303.1 pence (2017: 214.4 pence).

Cash and dividends

Cash generation was robust throughout the year, with good cash conversion of 91% (2017: 86%). On 30th November we disposed of HygroMatik GmbH for a total cash consideration of €59.0 million (£52.3 million) on a debt-free, cash-free basis. At 31st December 2018 we had a net debt balance of £235.8 million, a net debt to EBITDA ratio of 0.8 times, compared with net debt of £373.6 million at 31st December 2017.

The interim dividend for 2018, paid on 9th November 2018, was raised by 14% to 29.0 pence per share (2017: 25.5 pence per share). The Board is recommending an increase in the final dividend of 15% to 71.0 pence per share (2017: 62.0 pence). Subject to approval of the final dividend by shareholders at the AGM on 15th May 2019, the total Ordinary dividend for the year will be 100.0 pence per share, an increase of 14% over the 87.5 pence per share for the prior year.

Corporate governance

Bill Whiteley retired at the conclusion of the Annual General Meeting (AGM) on 15th May 2018, having served as a Director for 16 years and as Chair for nine of those years. On behalf of the Board and

[1] Source for industrial production growth figures: Oxford Economics, *World Economic Prospects Monthly*, February 2019.

shareholders, I would like to thank Bill for his significant contribution to the Group's success during his tenure on the Board.

I took over as Chair at the close of the 2018 AGM, having joined the Board in 2014 as Senior Independent Director. In compliance with the UK Corporate Governance Code, following my appointment as Chair, I resigned as a member of the Audit and Remuneration Committees, and was appointed Chair of the Nomination Committee. I also stepped down as Chairman of Ibstock plc, to ensure that I have sufficient capacity to fulfil my duties at Spirax Sarco.

As a consequence of my appointment, Clive Watson was appointed Senior Independent Director, while maintaining his role as Chair of the Audit Committee.

On 6th March 2018, Peter France joined the Board. From 2008 to July 2017, Peter was Chief Executive at Rotork plc and brought with him a wealth of experience and expertise, enabling him to make an immediate contribution to the workings of the Board. Peter is a member of the Audit, Remuneration and Nomination Committees.

On 5th March 2019, Caroline Johnstone joined the Board. Caroline is a chartered accountant and was a partner in PricewaterhouseCoopers (PwC) until 2009. She is currently an Independent Non-Executive Director and Chair of the Audit Committee of Synthomer plc and Shepherd Group Ltd, a private company which owns Portakabin Limited. Caroline is a member of the Audit, Remuneration and Nomination Committees.

Employees
On behalf of the Board, I would like to thank all our employees throughout the world for their individual and collective contributions that have enabled us to deliver another strong set of results in 2018.

Summary and Outlook
Global industrial production growth rates, which are a good indicator of our market conditions, slowed throughout the year resulting in growth of 3.3% in 2018 compared with 3.6% in 2017.

There is a higher degree of uncertainty regarding industrial production growth rates in 2019, with the latest indications suggesting that global growth will be lower than seen in 2018, at around 2.6%. We will continue to focus on implementing our strategy which enhances our ability to outperform our markets and self-generate growth. Recent acquisitions have also expanded the platform for future organic growth as we invest in strengthening the direct sales models of those businesses and broadening their global presence.

Sterling strengthened modestly during the year against most of the currencies in which we trade. The currency outlook for 2019 is particularly uncertain, with Brexit negotiations continuing to cause volatility. If current exchange rates were to prevail for the remainder of the year there would be no material impact of translation and transaction on sales and operating profit for the full year, compared with the full year 2018. Movements in exchange rates are often volatile and unpredictable, therefore the actual impact could be significantly different.

Given the forecasted slowdown of industrial production growth in 2019, we anticipate organic sales growth for the Group to moderate, off a base adjusted for the divestment of HygroMatik and the devaluation-driven uplift in Argentina. We expect Watson-Marlow to continue to outperform the Group average with mid-to-high single-digit organic sales growth as its key Pharmaceutical and Biotechnology markets remain robust.

We anticipate that the Group adjusted operating profit margin in 2019 will be at a similar level to 2018 despite the absence of the higher margin HygroMatik and the devaluation-driven profit boost from Argentina.

Assuming no significant deterioration in trading conditions, the Board expects to make further progress in 2019.

Group Chief Executive's Statement

Introduction

Our Company's purpose is to create sustainable value for all our stakeholders, by helping the users of our products and services to increase operational efficiency, reduce environmental impacts, improve product quality, provide safer working environments and achieve regulatory compliance. We do this through a direct sales business model, which utilises an extensive global network of over 1,600 sales and service engineers. Unique in number and expertise amongst our competitors, these engineers understand our customers' operational and process challenges and have the applications knowledge to design bespoke engineered solutions to resolve them, while utilising our broad product range.

Our direct sales business model is highly effective at uncovering opportunities to improve customers' steam systems, electrical heating and temperature management systems, or fluid path processes. As they walk our customers' facilities, our specialist engineers are able to identify unrecognised needs. The engineered solutions required to meet these needs generally have a relatively short payback period of around 24 months or less and, crucially, are typically paid for out of our customers' operational budgets. Purchasing decisions are therefore made at operational level from budgets which are less likely to be cut in times of recession. This "self-generated growth" element of our business, combined with the high proportion of sales that derive from end users' maintenance and operating budgets, and the wide diversity of the markets we serve, both geographically and by industry sector, makes our business highly resilient, although not immune, to economic downturns.

Strategy for growth

2018 marked five years since we undertook an extensive strategic review and developed our strategy, the aim of which is to deliver self-generated growth that outperforms our markets. We identified six Group strategic themes which help us to do better what we already do well:

- increase direct sales effectiveness through market sector focus;
- develop the knowledge and skills of our expert sales and service teams;
- broaden our global presence;
- leverage R&D investments;
- optimise supply chain effectiveness; and
- operate sustainably and help improve our customers' sustainability.

The strategy remains relevant and appropriate to our enlarged Group and, as we continue to focus on its rigorous implementation, we are seeing year-on-year benefits as we outperform our markets and achieve above industry growth rates in our target industries.

Strategic implementation

During 2018, progress continued on the implementation of our strategic priorities, which was a significant contributing factor to the strong financial results and good organic growth achieved during the year. Some examples of progress are outlined below.

We have continued to increase alignment between our direct sales force and our target industries, with Growth Programmes designed to increase sales in priority sectors. Within the Food & Beverage industry, for example, a Growth Programme is focusing on steam quality audits to raise customer awareness of, and develop growth opportunities for, our clean steam products. Within the Steam Specialties business Spirax Sarco and Gestra operate independently in the marketplace through a dual brand strategy with sectorisation enabling each brand to play to its strengths in core industries – for example, the Power Generation and Chemical industries for Gestra – while still offering customers the choice between the two brands.

Growth in all of our priority sectors in 2018 surpassed market growth rates. For example, within the Steam Specialties business, we achieved 9% growth in the Food & Beverage industry and we understand that the industry itself grew at around 4% globally. It is also important to note that growth in our priority sectors was not achieved at the expense of growth in other, non-focus, industries. In addition, sales of Thermal Energy Management products, solutions and services, which are the target of a number of Growth Programmes, grew at a faster rate than our more traditional Condensate Management products.

By December 2018, the Spirax Sarco Academy had been made available to over 1,200 sales engineers and sales support personnel globally. The Academy's programmes are structured in levels, called "belts", with each "belt" being allocated a colour and representing an increasing level of expertise. By the end of 2018, over 1,000 engineers had completed the "white belt", just under 1,000 the "yellow belt", and nearly 450 the "orange belt", which was created and rolled out in 16 languages during 2018. Towards the end of the year, "green belt" materials were created and made available in English, with 15 additional languages to follow in 2019. In September, the Steam Specialties business established a new five day "consultative selling" course for sales engineers. This will be rolled out to all English-speaking sales companies during 2019, and later made available to all non-English speaking companies.

Five new operating companies began trading in 2018: Spirax Sarco Maghreb, Spirax Sarco Hungary, Spirax Sarco Romania, Watson-Marlow UAE and Chromalox Brazil. Watson-Marlow also established a direct sales presence in the Philippines and a new sales company will commence trading in 2019. We broadened the direct sales footprint of Gestra, establishing a direct sales presence in Brazil, Indonesia, Malaysia, the Middle East, Thailand and South Korea, and set up an Operating Company in China (which will begin trading in 2019). We also established a Chromalox direct sales presence in Brazil, Chile, Norway, Spain, Sweden, the UAE and the western USA.

Investments in Research and Development (R&D) resulted in the continued expansion of our product portfolio across the Group, with product and range extensions as well as innovative new products developed. In January 2018 we purchased a small, pre-revenue company to continue expanding the technical capabilities of our peristaltic pumping technologies. Good progress has been made and we now have a product that is undergoing testing.

Our Steam Specialties Singapore Distribution Centre, established in 2017, has made a significant contribution to customer service improvements in the Asia Pacific region. A key customer service metric, On Time To Customer Request, improved across South East Asia, while air freighting to the region has been significantly reduced as improved stock management has decreased the need for expedited shipments.

The implementation of our Sustainability Strategy has continued, with a new Group-wide sustainability training programme rolled out, significant investment in machine guarding and engineering controls in Gestra and Chromalox, as well as improved data quality and reporting processes across the Group.

Acquisitions and disposal
During 2017, we acquired two outstanding businesses; steam specialist Gestra and electrical process heating and temperature management specialist Chromalox. Throughout 2018 we continued work on their integration into the Group.

Gestra, acquired in May 2017, is led by Maurizio Preziosa, an experienced Spirax Sarco steam business manager. Maurizio's deep understanding of the Steam Specialties business, its direct sales business model and our strategy for growth, as well as his excellent track record of strong performance, position him well to lead Gestra at this important time in its history. Having revived the Gestra brand in 2017, which had been subsumed under the group brand of the previous owners, in 2018 we launched a new, invigorated brand at the ACHEMA exhibition in Frankfurt. The new brand, which retains elements of Gestra's heritage, sends a strong message to customers that Gestra is around to stay and will continue to deliver expertise, products and engineered solutions to steam users.

The acquisition of Chromalox provided us with an excellent opportunity to expand our addressable markets through a related business also dedicated to transferring heat energy into industrial processes. Following acquisition, Chromalox's management team remained with the company, providing continuity at this time of change. Integration is relatively light, with the company adopting Group policies, reporting processes and HR programmes, and integrating with the Group Sustainability Strategy, while operating independently as a stand-alone business of the Group. We have invested in strengthening Chromalox's direct sales presence, supported the company's R&D programmes and focused on increasing Health and Safety performance and standards through a combination of engineered controls and behavioural based awareness campaigns.

On 18th February 2019 we announced that we had entered into exclusive negotiations with a view to acquiring Thermocoax Developpement and all of its group companies for €158 million (£139 million) on a cash-free, debt-free basis. The acquisition will be financed from existing cash and debt facilities and is expected to be accretive to Group earnings in 2019. Thermocoax will become part of our Chromalox business and will significantly enhance our electrical process heating capability, especially in Europe. The transaction will require certain regulatory approvals in France, Germany and the USA, which are expected to be satisfied during the second quarter of the year.

On 30th November 2018 we divested HygroMatik GmbH (HygroMatik) to Carel Industries S.p.A. HygroMatik joined the Spirax Sarco Group in 1988 but due to limited strategic fit has always operated separately from the Steam Specialties business in which it is reported. This low level of integration limited our ability to improve sales growth.

Engineering sustainable growth
As we outperformed our markets in 2018 we delivered sustainable value to our stakeholders, helping our more than 100,000 direct buying customers to increase their operational efficiency, delivering shareholder value through increased dividends and strong earnings per share, while investing in the business to ensure a strong foundation for continued, sustainable growth.

Group Chief Executive's Review of Operations

	2017 Base	2017 M&A	2017 Actual	Exchange	Organic	Acq's & disposal	2018	Organic	Reported
Revenue	£872.1m	£126.6m	£998.7m	(£21.4m)	£62.8m	£113.2m	£1,153.3m	+7%	+15%
Adjusted operating profit	£214.1m	£21.4m	£235.5m	(£9.7m)	£25.5m	£13.6m	£264.9m	+12%	+12%
Adjusted operating margin			23.6%				23.0%	+120 bps	-60 bps
Statutory operating profit			£198.9m				£299.1m		+50%
Statutory operating margin			19.9%				25.9%		+600 bps

Introduction
During 2018, the Group delivered record revenue and adjusted operating profit, achieved through a combination of strong organic growth and the incremental contribution of acquisitions made in 2017, set against a weaker global industrial production environment and a currency headwind. We saw progress in all geographical segments of the Steam Specialties business. The Watson-Marlow Fluid Technology business had another strong year while Gestra and Chromalox both performed in line with our overall expectations.

Market environment
Steam remains the most efficient medium for transferring large energy loads (in the form of heat) within industrial processes. Applications for steam are wide-ranging and include heating, curing, cooking, drying, cleaning, sterilising, space heating, humidification and on-demand hot water production. Electrical heating technologies are widely utilised for freeze protection, high temperature industrial applications and temperature management in mission critical industrial processes. Electrical heating is particularly appropriate where rapid "on-off" control is needed, high temperatures are required, easy installation is desired or zero-emissions at point of use are valued. Peristaltic and niche pumps and associated fluid path components are widely used across an extensive range of industries to address mission critical or difficult pumping problems. Peristaltic pumps are particularly suitable for hygienic applications (as the fluid is contained within a tube, sterile tubing creates a sterile pump), or for applications where corrosive or caustic materials would otherwise damage the pump.

The wide applicability of our products across a broad range of industries, combined with our extensive geographical presence and the large proportion of revenues that derive from end users' maintenance and operating budgets, mean that our markets closely correlate with industrial production growth. During 2018, global industrial production growth, at 3.3%, was slightly weaker than initially forecasted and was lower than the 3.6% of 2017. Growth in mature markets, at 2.3%, was lower than emerging markets, which saw 4.4% growth. The positive industrial production growth rate is reflected in the strong organic growth achieved in 2018 and once again, sales growth outperformed industrial production growth as we successfully self-generated sales through the effective use of our direct sales business model, strengthened by the implementation of our strategy.

As 93% of our sales and profits are made outside the UK, Brexit uncertainty had a limited impact on us and our customers in 2018. During the year we completed a Brexit contingency planning exercise and have put plans in place to manage the situation, as it continues to unfold. Further information on our Brexit contingency plans can be found in the Financial Review on page 24.

Global industrial production growth is currently expected to remain positive in 2019, although at a lower level than seen in 2018.

Progress in 2018

Sales

Overall the Group achieved organic sales growth of over 7%, with 7% organic growth in the Steam Specialties business and 9% organic growth in Watson-Marlow. Gestra saw year-on-year sales growth of 10% and Chromalox 9%. These acquisitions contributed £114.3 million incremental sales in 2018. HygroMatik was divested on 30th November 2018 and as a result contributed £1.1 million less sales than in 2017.

At £1,153.3 million, Group sales were up over 15% (2017: £998.7 million). Sterling was stronger on average across the year, than in 2017, and acted as a currency headwind, reducing sales on translation by 2%.

Geographically, the Steam Specialties business, which accounted for 64% of Group revenue in 2018, saw growth in all regions. Sales of £733.5 million, were up 9% and up 7% organically. Gestra added an incremental £33.1 million to revenue in 2018.

Chromalox, which accounted for 13% of Group revenue in 2018, saw strong year-on-year sales growth of 9%, benefiting from stronger market conditions in the USA, as well as initial contributions from our increased investments to strengthen direct sales activities across the world.

Watson-Marlow accounted for 23% of Group revenue in 2018 and saw organic growth of 9%, partially offset by negative currency movements. Growth was achieved across all geographic regions.

Adjusted operating profit

Group adjusted operating profit was more than 12% ahead of the prior year on an organic basis and, at £264.9 million, was up 12% at reported exchange rates. The strong growth reflects the increase in revenue, a net 6% positive impact from the full year effect of acquisitions and a disposal, and a boost from the Argentine currency devaluation in the Americas, partially off-set by a 4% negative translational and transactional exchange impact, due to the stronger sterling. Excluding the boost from Argentina, we saw organic adjusted operating profit growth of 10%.

Within the Steam Specialties business, adjusted operating profit was 12% higher than the prior year on an organic basis, with the Americas and Asia Pacific delivering strong organic adjusted operating profit growth and a marginal decline in EMEA. All geographic segments benefited from the inclusion of Gestra which contributed 3% growth to the Steam Specialties business. For reference, on a constant currency, like-for-like basis, Gestra's sales rose 10% and adjusted operating profit was up 12%, despite significant investments in the business. HygroMatik was divested on 30th November 2018 and as a result contributed £0.3 million less adjusted operating profit than in 2017.

Chromalox added an incremental £9.4 million to adjusted operating profit and continues to perform in line with our overall expectations. For reference, on a constant currency, like-for-like basis, Chromalox's sales rose 9%, however adjusted operating profit reduced by 10% as we stepped up our investments for future growth and responded to manufacturing inefficiencies and bottlenecks exposed by the very strong sales growth.

Watson-Marlow's organic adjusted operating profit grew by 11%, despite increased levels of investment.

Statutory operating profit increased from £198.9 million to £299.1 million, with £47.4 million of the increase coming from the sale of HygroMatik, which was a constituent of the EMEA division within Steam Specialties.

Adjusted operating profit margin
At 23.0% the Group adjusted operating profit margin was 60 bps lower than the prior year, as the dilutionary impacts of 2017 acquisitions combined with an exchange headwind. Excluding the impact of acquisitions, the adjusted operating margin expanded by 120 bps to 25.2% at constant currency, despite increased investments for growth and an increase in material prices. Excluding HygroMatik and the devaluation-driven profit boost from Argentina, the adjusted operating profit margin was 22.5%. Within the Steam Specialties business, the operating margin increased by 30 bps to 23.2% with the dilutionary impact of Gestra and foreign currency being offset by the impact of devaluation in Argentina. Despite the increased investment and manufacturing inefficiencies described above, Chromalox maintained its first half margin of 14.7%. As expected, Watson-Marlow's operating margin was lower, although still very strong, at 32.0%, due to exchange.

Steam Specialties: overview

	2017 Base	2017 M&A	2017 Actual	Exchange	Organic	Acq's & disposal	2018	Organic	Reported
Revenue	£623.9m	£51.5m	£675.4m	(£15.2m)	£41.3m	£32.0m	£733.5m	+7%	+9%
Adjusted operating profit	£147.0m	£7.6m	£154.6m	(£5.7m)	£17.0m	£4.2m	£170.1m	+12%	+10%
Adjusted operating margin			22.9%				23.2%	+120 bps	+30 bps
Statutory operating profit			£141.0m				£222.5m		+58%
Statutory operating margin			20.9%				30.3%		+940 bps

Market overview
In Europe, Middle East and Africa (EMEA), industrial production was positive at 1.5%; falling back to broadly the same level as seen in 2016, following a stronger year in 2017. Excluding China, Asia Pacific saw industrial production growth of 2.6%. Including China, industrial production in Asia was 4.4%. In the Americas, North America's industrial production growth was up 3.8%, buoyed by improved conditions in the USA. Within Latin America, growth was 0.4%. With the exception of Argentina, which experienced industrial recession, all other countries in the region saw growth. For further information, see the Steam Specialties segmental reviews that follow.

Progress in 2018
Good progress was made in the Steam Specialties business during 2018. Organic revenue growth was up 7%, with reported revenues of £733.5 million. Adjusted operating profit was also strongly ahead; up 12% on an organic basis and 10% on a reported basis, at £170.1 million. Despite the full-year dilutionary impact of Gestra and currency headwinds, we achieved operating margin improvements. On an organic basis the margin was up 120 bps and was up 30 bps on a reported basis, to 23.2% (2017: 22.9%). Excluding Gestra, the operating margin for the Steam Specialties business was up 120 bps on an organic basis to 24.4%.

Gestra, which joined the Steam Specialties business in May 2017, had a strong year; performing ahead of its acquisition case in both sales and adjusted operating profit. The full year effect of Gestra's acquisition contributed an incremental £33.1 million to sales and £4.5 million to adjusted operating profits of the Steam Specialties business in 2018.

On 3rd December, we announced the disposal of HygroMatik GmbH for a total cash consideration of €59.0 million (£52.3 million) on a debt-free, cash-free basis. HygroMatik joined the Spirax Sarco Group in 1988 but due to limited strategic fit operated separately from the Steam Specialties business. This low level of integration limited our ability to improve sales growth while maintaining HygroMatik's excellent profitability. During the 11 months of our ownership in 2018, HygroMatik’s sales were £12.9 million with an operating profit of £3.8 million.

Statutory operating profit increased from £141.0 million to £222.5 million with £47.4 million of the increase coming from the sale of HygroMatik.

The Steam Specialties segmental reviews that follow provide detailed information on our progress in 2018.

Management changes

In September 2018 Neil Daws, Group Executive Director and Divisional Director for Spirax Sarco Steam Specialties EMEA, was promoted to the position of Managing Director for the Steam Specialties business. In his new role, Neil is responsible for the Steam Specialties business worldwide, including Gestra, and reports to the Group Chief Executive. As a result of Neil’s promotion, Sean Clay joined the Group in July 2018, taking the role of Divisional Director Spirax Sarco EMEA.

Historically, our Group Chief Executives have held the position of Managing Director for the Steam Specialties business, but with the Group's evolution in size and complexity, separating the two roles provides a more appropriate organisational structure to support the Group's continued growth. It will enable the Group Chief Executive to focus more on medium and longer-term growth opportunities, including the further development of our Watson-Marlow and Chromalox businesses, while the Steam Specialties Managing Director will manage the day-to-day operations of the steam business and oversee its strategic direction and implementation.

Strategy update

The Steam Specialties business strategy, “Customer First”, is delivering good growth in priority industry sectors and is strengthening the people, processes and performance of the business that will underpin long-term, sustainable growth. Our sales and service engineers are utilising and benefiting from the advanced training materials delivered through the Spirax Sarco Academy; key customer service metrics are improving, from an already strong base; strategic account management initiatives are strengthening our relationships with key customers, as we help them achieve their sustainability and process efficiency targets; and we have continued to strengthen our H&S culture and raise awareness of Group sustainability initiatives across our global operations.

Gestra, has integrated well; the “safe delivery” phase of the integration process is complete and we are now focusing on strategic implementation to deliver growth whilst continuing to review opportunities for synergies with the original Spirax Sarco steam business. During 2018, we invested to expand Gestra’s direct sales footprint, leveraging Spirax Sarco’s global presence for quick and easy access into new markets.

Further information about our strategic implementation, at a segmental level, can be found on the pages that follow.

Steam Specialties: Europe, Middle East and Africa (EMEA)

	2017 Base	2017 M&A	2017 Actual	Exchange	Organic	Acq's & disposal	2018	Organic	Reported
Revenue	£259.5m	£45.8m	£305.3m	£0.8m	£10.0m	£28.3m	£344.4m	+4%	+13%
Adjusted operating profit	£59.0m	£7.1m	£66.1m	£0.5m	(£0.9m)	£3.6m	£69.3m	-1%	+5%
Adjusted operating margin			21.7%				20.1%	-120 bps	-160 bps
Statutory operating profit			£58.7m				£111.5m		+90%
Statutory operating margin			19.2%				32.4%		+1320 bps

Market overview
In Europe, Middle East and Africa (EMEA), industrial production growth was positive at 1.5%, in line with that seen in 2016, following a stronger year in 2017. With the exception of South Africa and Portugal, all countries in EMEA, for which data is available, saw industrial production growth although, perhaps unsurprisingly, the UK had one of the lowest growth rates at 0.7% as Brexit negotiations created uncertainty. The markets in which Gestra operates, geographically and by industry, remained positive, with industrial production in Germany at 0.9%, OEM (original equipment manufacturer) boiler makers having a good year, the Chemical and Petrochemical industries growing and Power Generation bouncing back after a weak 2017.

Progress in 2018
Sales increased by 4% on an organic basis, with Gestra contributing an additional £29.4 million. The divestment of HygroMatik, on 30th November 2018, reduced sales by £1.1 million while currency movements provided a small tailwind, increasing sales by £0.8 million. Reported sales were therefore £344.4 million, up 13% on the prior year.

Organic sales growth in the region was variable, with progress in the UK, Germany, Italy, Spain, Turkey, the Middle East and across Africa, somewhat offsetting weaker performance in France and some smaller European operations. Our new operating companies in Egypt, Kenya, Hungary, Romania and Morocco delivered growth. Sales into the Food & Beverage, Healthcare, Pharmaceutical and OEM industries were robust, offsetting a small decline in Oil & Gas. In the second half of the year there was some softening of demand for large projects, although they came back strongly in the final quarter to end the year in line with our expectations. Maintenance, repair and baseload business remained robust throughout the year.

Gestra, whose sales in EMEA account for over 85% of its total revenue, saw strong sales growth of close to double digits, in the region, with good growth in Germany, where Gestra is the market leader, boosted by the strength of boiler OEM markets and Gestra's core industries. Gestra Italy, Spain and Portugal also performed well.

At £69.3 million, adjusted operating profit was ahead 5%. Organically, adjusted operating profit decreased 1% and there was a small impact following the divestment of HygroMatik; these were offset by an additional 6% from Gestra and a very small exchange gain. Growth in adjusted operating profit from operating leverage and price management initiatives was counteracted by increased revenue investments for future growth, including improvements in our Italian manufacturing operations, additional sales and service engineers, and investment in enhanced information systems and platforms. Strong improvements in gross profitability in Gestra were, in accordance with the acquisition plan, re-invested in the business to strengthen the company for future growth.

The adjusted operating margin reduced 160 bps to 20.1% due to the dilutionary impact of Gestra and increased revenue investment.

Statutory operating profit increased from £58.7 million to £111.5 million with £47.4 million of the increase coming from the sale of HygroMatik.

Strategy update

Three new Spirax Sarco operating companies began trading in the region during 2018, in the Maghreb (covering Morocco, Algeria and Tunisia), Hungary and Romania. Strategic value-based pricing tools and methodologies have been updated and rolled out across the region and we have continued to sectorise our sales teams, increasing alignment with our priority industries. The Spirax Sarco Academy is being widely used and is delivering class-leading technical and skills training to our sales and service engineers as well as sales support staff. Our safety culture continues to evolve, driven by activities such as safety awareness weeks, safety culture assessments, training and a "don't walk by" campaign. Good progress has been made in our employee engagement initiatives, with local actions identified and implemented across our operating companies.

Gestra's integration and strategy implementation are progressing well. During the year, Gestra Germany's operational structure was re-organised to mirror the successful structure used elsewhere within the Group, with Product Management and Product Development functions established. Gestra established a new sales company in China, which will begin trading in 2019, and broadened its direct sales presence, appointing sales engineers in Brazil, Indonesia, Malaysia, the Middle East, Thailand and South Korea, while also strengthening its presence in France.

Segment outlook

Softening forecasts suggest lower, but still positive, industrial production growth in the region throughout 2019. Uncertainty surrounding Britain's exit from the EU continues to cast a shadow over 2019, but our contingency plans are being executed in readiness for the scheduled exit on 29th March; we are well-positioned to continue to serve our customers throughout any transition period. While we remain cautious on the short-term economic outlook for the region, our self-generated growth initiatives, resilient business model and the large proportion of our revenue generated from customers' maintenance and repair needs give us confidence that we can make progress despite uncertain conditions.

Steam Specialties: Asia Pacific

	2017 Base	2017 M&A	2017 Actual	Exchange	Organic	Acq's	2018	Organic	Reported
Revenue	£215.9m	£2.1m	£218.0m	(£2.3m)	£15.7m	£1.3m	£232.7m	+7%	+7%
Adjusted operating profit	£56.9m	£0.0m	£56.9m	(£0.7m)	£7.6m	£0.1m	£63.9m	+13%	+12%
Adjusted operating margin			26.1%				27.5%	+150 bps	+140 bps
Statutory operating profit			£56.3m				£69.9m		+24%
Statutory operating margin			25.8%				30.0%		+420 bps

Market overview
Excluding China, Asia Pacific saw industrial production growth of 2.6%. Including China, industrial production in the region was up 4.4% in 2018 despite industrial production growth in China slowing to 5.8%. Elsewhere, our second largest market in the region, Korea, experienced almost zero growth and Japan was also relatively weak with growth of less than 1%, but most of our smaller markets saw good growth. After a strong first three quarters, across much of the region, market conditions began to soften in the final quarter of the year.

Progress in 2018
Sales of £232.7 million were up 7%. On an organic basis, sales were also ahead 7%, with a less than 1% incremental contribution from Gestra, which has a small local presence in the region. A currency headwind reduced sales on translation by 1%.

China saw very strong, double-digit growth. Korea was flat against a very tough compare, where the non-repeat of a particularly large order in 2017 was compensated for by an increase in smaller projects in 2018. Japan, Malaysia, the Philippines, Thailand, Australia and New Zealand all achieved record sales, Australia bounced back strongly from a difficult prior year, while our relatively new operating companies in Indonesia and Vietnam performed well.

Sales growth came mostly from a combination of smaller self-generated projects and base business, although large project orders also achieved growth. With the exception of Oil & Gas, which remained at similar levels to 2017, we saw growth in all our core sectors, with Food & Beverage doing particularly well. The new Distribution Centre in Singapore shortened lead times, contributing to sales growth. The availability of products from our new Indian factory helped us win a number of Oil & Gas projects and an increasing customer focus on safety, energy savings and productivity increased demand for small projects.

Sales in India grew very strongly, in line with our expectations. We are starting to realise the benefit from increased sales resource and a wider geographic presence in the sub-continent.

Gestra's sales in the region outperformed the market, with double-digit growth, driven by a combination of better distributor management and investment in direct sales.

Adjusted operating profit increased to £63.9 million, up 13% organically, with an additional small contribution from Gestra, partially off-set by exchange headwinds, which reduced reported adjusted operating profit by 1%. The adjusted operating margin was ahead 140 bps, to 27.5%, due to efficiency gains and reduced shipping costs from the new Distribution Centre, active price management and increased localisation of products from the expanded Chinese factory and India, all of which more than covered increased personnel and material costs and increased overheads.

Statutory operating profit increased from £56.3 million to £69.9 million.

Strategy update
Six new Regional Business Development Managers were appointed to oversee the deployment of key strategic projects and drive business improvements in the region and a Divisional Pricing Manager was appointed to provide the focus and expertise to maintain pricing discipline. Increased sector focus supported an increase in self-generated sales, while a focus on customer Energy Services (audits) uncovered a number of self-generated sales opportunities. We continued to roll-out the programmes of the Spirax Sarco Academy while improving customer service and growing our On Time To Request performance.

A key element of Gestra's strategy for growth is to broaden its direct sales presence, by leveraging Spirax Sarco's global presence. Historically, Gestra has primarily served Asia Pacific via distributors, and was missing out of the self-generated sales that expert sales engineers can win as they "walk the plant" and identify customers' unrecognised needs. During 2018 we established a direct sales presence in Indonesia, Malaysia, Thailand and South Korea to supplement distributor sales and established an operating company in China, which will become operational in the first half of 2019.

Segment outlook

Industrial production growth, for the region as a whole, looks likely to soften as a result of the reported slowdown in China. The slowdown and the wider uncertainty this will cause, may subdue capex spend in the region if customers delay large projects. Furthermore, US-China trade tensions continue to dampen the economic outlook and general elections in a number of countries (Australia, India, Indonesia, Japan and Thailand) may impact growth. Nevertheless, while the macro environment looks uncertain in the near-term, we will continue to derive revenue from our customers' on-going maintenance, repair and overhaul activities, from our large installed base and continue to see opportunities for self-generated growth as we provide bespoke, engineered solutions to help our customers meet their sustainability and productivity targets.

Steam Specialties: The Americas

	2017 Base	2017 M&A	2017 Actual	Exchange	Organic	Acq's	2018	Organic	Reported
Revenue	£148.5m	£3.6m	£152.1m	(£13.7m)	£15.6m	£2.4m	£156.4m	+12%	+3%
Adjusted operating profit	£31.1m	£0.5m	£31.6m	(£5.5m)	£10.3m	£0.5m	£36.9m	+40%	+17%
Adjusted operating margin			20.8%				23.6%	+490 bps	+280 bps
Statutory operating profit			£26.0m				£41.1m		+58%
Statutory operating margin			17.1%				26.3%		+920 bps

Market overview

In the Americas, North America's industrial production was up 3.8%, buoyed by improved conditions in the USA where, despite deteriorating relations with China, tax concessions and "business-friendly" policies have helped to stimulate growth of 4.0%. Within Latin America, industrial production growth was up 0.4%, with only Argentina experiencing contraction. In Mexico, a presidential election plus uncertainties regarding the re-negotiation of NAFTA, which led to the creation of USMCA, caused some market softness. Colombia, Peru and Brazil also saw presidential elections during the year, with a more business-friendly regime, that claims it will tackle corruption and economic malaise, established in Brazil. Conditions in Argentina have steadily worsened, despite the administration's efforts to stem the currency devaluation, with the country falling into a recession, which looks likely to continue into 2019. The rise and subsequent fall of oil prices during the year, broadly speaking, served as neither a stimulus nor a constraint in the region, as upstream investment remained subdued and downstream facilities continued with efficiency improvement projects.

Progress in 2018

On an organic basis, sales were ahead 12%, with an additional 2% incremental contribution from Gestra, partially offset by a 9% negative impact from currency movements. Sales, at £156.4 million, were up 3%. Excluding the impact of Argentina's unexpected currency devaluation, organic growth was 8%.

Organic sales were up 5% in North America. Within the USA, both our Spirax Sarco and Gestra companies delivered good growth, benefiting from investments in direct sales resource. We continue to work closely with our distribution partners in the USA and saw increased demand from them during the year. Additionally, direct sales through the other channels to market grew by double digits in the USA.

In Latin America, organic sales were up 22%, benefiting from Argentina's US dollar-denominated pricing. Excluding the £4.4 million sales benefit from Argentina's devaluation, organic sales growth was 14%. Hiter, our Brazilian controls business, which we acquired in 2016, saw double-digit growth, as it regained its former strong position in the Sugar & Ethanol and Oil & Gas markets, and our relatively new company in Colombia also performed strongly.   Improving market conditions in Brazil translated into growth, while our company in Argentina was not immune to the challenging conditions and sales were flat in real terms.

Food & Beverage sales have grown across the region as customers focused on safety, quality, productivity and energy efficiency improvements. Pharmaceuticals also delivered good growth, particularly in North America, with customers' operational and capital projects both providing opportunities for sales growth. Through our investments in direct sales resource, we self-generated growth as our sales engineers walked our customers' sites and conducted Steam System Audits, which uncovered sales opportunities for Thermal Energy Solutions.

Adjusted operating profit in the Americas was strongly ahead of the prior year; up 17% to £36.9 million. On an organic basis, adjusted operating profits were up 40%. Excluding the £5.2 million benefit from Argentina's exceptional currency devaluation, which saw large price increases and positive in-country foreign exchange gains, organic adjusted operating profit growth was 20%. The reported adjusted operating profit margin was also strongly ahead, up 280 bps to 23.6%. Excluding the impact of the Argentine currency devaluation, the adjusted operating margin increased by 200 bps to 21.0%, as a consequence of operational leverage from higher sales, pricing and purchasing discipline.

Statutory operating profit increased from £26.0 million to £41.1 million.

Strategy update

New modules of the Spirax Sarco Academy have been rolled-out, providing more advanced training in key areas such as Thermal Energy Management, which are increasing the confidence of our sales engineers when walking customer plants and their ability to identify improvement opportunities.

As well as training our own engineers, customer training remains an important focus, further strengthening our relationship with them and reinforcing our position as providers of expert knowledge and advice. During the year we opened a training facility in Guadalajara, Mexico, where customers can receive technical advice, world-class training in our Steam Laboratory, or collect Spirax Sarco parts.

The sectorisation of our direct sales teams is stimulating demand for our products and solutions from end users, while we maintain strong relationships with our distribution partners who will continue to provide a crucial role in supplying products to meet our customers' maintenance, repair and overhaul needs, in particular.

A focus on on-time delivery performance by our manufacturing companies in the region is starting to see returns, despite a particularly challenging year with incidents such as the Truck Strike in Brazil and a number of General Strikes in Argentina. Revenue investments in health and safety, quality and inventory management are improving the foundation for sustainable future growth.

Segment outlook
In North America, industrial production is expected to slow in 2019, although remain positive. Across Latin America a mixed picture is expected, with progress in Brazil, as a result of the new administration's policies to stimulate growth, being offset by continuing recessionary conditions in Argentina. To compound the problems in Argentina, a presidential election in October 2019 is likely to generate uncertainty and supress growth in the lead up to the election. Mexico should see improved market conditions as recent uncertainty has now been removed by the signing of the USMCA trade agreement.

Oil & Gas markets remain uncertain, with upstream investments likely to continue to be stagnant. In addition, National Oil Companies in Latin America face uncertainty as discussions continue regarding the possible privatisation of some of their assets, with the new governments in Colombia and Brazil not yet having made their positions on possible divestments clear. By contrast, the Food & Beverage and Pharmaceutical industries look set to remain buoyant, which, when combined with our wide geographic presence, stronger direct sales teams and our ability to self-generate growth leave us confident in our ability to make further progress in the region during 2019.

Chromalox

	2017 Actual	Exchange	Organic	Acq's	2018
Revenue	£75.1m	(£1.7m)	-	£81.2m	£154.6m
Adjusted operating profit	£13.8m	(£0.4m)	-	£9.4m	£22.8m
Adjusted operating margin	18.4%				14.7%
Statutory operating profit	£4.0m				£12.1m
Statutory operating margin	5.3%				7.8%

(For reference only) Full Year 2017*	
£142m	+9%
£25m	-10%
17.8%	-310 bps

** At constant currency*

Market overview
Towards the latter end of 2017, Chromalox saw a marked improvement in baseline business in the USA and Europe, in several key market sectors and across the company's three products segments. This trend continued throughout 2018 with an improved industrial production growth rate in the USA where Chromalox generates over 70% of its revenue, and relatively steady growth rates elsewhere provided a generally positive operating environment. The higher oil prices, which prevailed through much of the year, provided a stimulus for growth in this important industry which accounted for 16% of Chromalox's revenues during the year. The fall in the oil price towards the end of the year, increasing US-China trade tensions and the slowing Chinese economy cast a shadow over a number of markets in the final quarter.

Progress in 2018
Chromalox delivered £154.6 million of sales in 2018. For information only, on a comparable basis this was 9% higher than the full-year sales of 2017 at constant currency, with the order book expanding by 11%. We saw good maintenance, repair and overhaul demand and also strong project orders, with growth across all product sectors (Heat Trace; Industrial Heaters & Systems; and Component Technologies) and particularly strong growth in Heat Tracing in North America. We reinvigorated our efforts with OEM customers, which started to deliver results towards the end of the year as several new, or returning, OEM customers placed orders.

Having established a direct sales presence in Latin America (Brazil and Chile), we began to secure additional sales, which will grow in the coming years as we increase our product and service offering, as well as expert applications knowledge, to customers in this region and secure a greater proportion of self-generated sales.

While sales growth in North America and EMEA was strong, Asia Pacific was more subdued due to the sales phasing of its significantly increased order book.

On a comparable basis at constant currency, adjusted operating profit of £22.8 million was 10% lower than the prior year, as we accelerated revenue and capital investments in the business. Investments included, but were not limited to, the establishment of a company in Brazil and six new sales offices with an attendant increase in headcount; safety upgrades undertaken at several facilities; improved information systems; and talent development. In addition, the very strong growth in sales and even stronger growth in orders in a company that had experienced shrinkage in recent years placed significant stress on the manufacturing process, exposing some bottlenecks and inefficient working practices. These processes are being strengthened to enable more effective capacity expansion going forward. As a result of the above factors the operating margin, at 14.7%, was 310 bps lower than the prior year, although in line with that seen in the first half of the year.

Statutory operating profit increased from £4.0 million to £12.1 million.

Strategy update
A core component of Chromalox's strategy and a key element of the acquisition plan is the development of the company's direct sales presence. In addition to strengthening the direct sales team in the western region of the USA, we established new offices in Spain, Norway, Sweden, Brazil, Chile and the UAE leveraging Spirax Sarco's presence in these countries for ease of access into these markets.

New product development continued apace and key international certifications (such as IECEx/ATEX) were secured for a number of recently developed products, notably the DirectConnect™ medium voltage heating systems and Self-Regulating High Temperature heat trace cable, enabling these product ranges to be sold in a wider range of countries. An example of a product launched in 2018 is the "ITC Fire Sprinkler System Control" for use on freeze protection of fire suppression systems. This product is the first fire sprinkler control that is certified to key standards IEEE 515.1 and UL 864. A robust product pipeline is also under development for launch in 2019.

Throughout the year we invested in Chromalox's manufacturing facilities, carrying out important safety upgrades, expanding the Mexico plant, and launching a series of improvements to increase the capability and performance of the manufacturing plant in France, which includes implementing our global-standard ERP (Enterprise Resource Planning) system that will go live in early 2019.

A sustainability management structure has been embedded within the organisation and the Group's programmes and policies have been adopted.

On 18th February 2019 we announced that we had entered into exclusive negotiations with a view to acquiring Thermocoax Developpement and all of its group companies in France, Germany and the USA. This acquisition, which will be reported within Chromalox, will significantly enhance our electrical process heating business in Europe and the USA, while also strengthening our organic growth platform in Asia.

Outlook
The stronger industrial production growth rates experienced in 2018 are expected to soften slightly in 2019, although we anticipate that they will remain broadly positive for the geographic territories in

which we directly trade. Nevertheless, there are a number of gathering macroeconomic headwinds, not least US-China trade tensions, the Chinese economic slowdown and the lower oil price, which may impact in 2019. However, our differentiating technologies combined with our direct sales business model, our broad industry base and the large proportion of our revenue that is generated from our customers' operational and maintenance budgets, position us well to continue to outperform our markets, while our strategy for growth is laying the foundation for a more robust and sustainable business in the medium to long term.

Watson-Marlow Fluid Technology Group (WMFTG)

	2017 Base	2017 M&A	2017 Actual	Exchange	Organic	Acq's	2018	Organic	Reported
Revenue	£248.2m	-	£248.2m	(£4.5m)	£21.5m	-	£265.2m	+9%	+7%
Adjusted operating profit	£80.3m	-	£80.3m	(£3.6m)	£8.1m	-	£84.8m	+11%	+6%
Adjusted operating margin			32.4%				32.0%	+50 bps	-40 bps
Statutory operating profit			£74.8m				£77.5m		+4%
Statutory operating margin			30.1%				29.2%		-90 bps

Market Overview
Watson-Marlow is subject to similar economic conditions and industrial production growth rates as those experienced by the Steam Specialties business, due to its wide geographical spread and the broad diversity of its end user markets. However, Watson-Marlow's greater exposure (c.40% of sales) to the Pharmaceutical & Biotechnology industry means that it is more affected by conditions in that market, than is the Group as a whole. Throughout the year, the Pharmaceutical & Biotechnology market remained buoyant, as did the Clinical Diagnostics and Food & Beverage industries, two other important markets for Watson-Marlow. The Water & Wastewater (environmental) market was generally robust globally and Mining and General Industry were both broadly positive on a global scale.

Progress in 2018
Watson-Marlow delivered sales of £265.2 million in 2018, with 9% organic growth partially offset by exchange headwinds of 2%. Strong organic sales growth was delivered across all geographical regions.

Within Europe and the Middle East we achieved strong growth across most of our territories, including the UK. Our new company in the UAE, which was established during the year, performed ahead of plan while Watson-Marlow Ireland achieved very strong growth. In Asia Pacific, China performed exceptionally well against a very tough compare, notably with strong growth in base business, while India and South Korea also performed strongly. Within North America, investments in the USA's east and west coast direct sales initiatives, where we moved from reps to direct sales teams, have fuelled excellent growth, while our new company in Canada made good progress during the year. Latin America performed very strongly, with Mexico delivering outstanding growth against a tough compare, and Brazil and Chile also having a good year.

Sales into the Pharmaceutical & Biotechnology industry continue to be strong, with BioPure, FlowSmart and Watson-Marlow Tubing, in particular, all contributing strongly to growth. Sales into the Food & Beverage sector were good as the Certa Sine™ (Certa) pump, launched by Watson-Marlow in 2016, continued to underpin growth.

Aflex, which was acquired at the end of November 2016, delivered double-digit growth as the Aflex product range began to be sold through the Watson-Marlow direct sales channels during the year. Due to above-plan progress, we have brought forward the consolidation of Aflex's four UK manufacturing sites into one purpose-built factory. Work on this £21 million facility began towards the end of the year and is scheduled for completion in 2020.

Watson-Marlow's adjusted operating profit was £84.8 million, up 6% and up 11% organically, with a 5% exchange headwind. At 32.0% the reported adjusted operating profit margin was down 40 bps, due to exchange. On an organic basis, the margin increased 50 bps.

Statutory operating profit increased from £74.8 million to £77.5 million.

Strategy update

Watson-Marlow's geographic expansion continued in 2018, with a direct sales presence installed in the Philippines and a company established there that will began trading in 2019, as well as a new company which began trading in the UAE.

During the year we broadened our direct sales product portfolio as our sales operations in the USA, Korea, South Africa and the UAE began selling Aflex products directly to their customer base, with discernible sales growth resulting.

New product development remains a key strategic priority, with several product launches during the year, including a new platform for the Flexicon FP60 small batch fully automated filling machine, which utilises a modular concept that will reduce lead times and broadens the machine's capabilities; range extensions to the Watson-Marlow Qdos chemical metering pump; new valve actuators from ASEPCO; and hose range extensions from Bredel. Throughout the year we made good progress developing an innovative product following the acquisition of a small, pre-revenue company in January 2018, which will expand the technical capabilities of our peristaltic pumping technologies.

During 2018 we added a sixth element to the Watson-Marlow business strategy: "Creating environments where people thrive", focused on our people, talent management, culture and working environment.

Outlook

Industrial production is generally expected to remain positive during 2019, although at lower levels than seen in 2018, as various political and economic events and circumstances potentially subdue growth rates. Nevertheless, the market drivers in Watson-Marlow's core industries, notably Pharmaceutical & Biotechnology, as well as Food & Beverage, Clinical Diagnostic OEMs and Environmental, all remain strong. Our strategic investments in our direct sales force, geographical expansion, new product innovation and manufacturing efficiencies, to name but a few, position us well to continue to see good, above-market organic sales growth.

Financial Review

The Group reports under International Financial Reporting Standards (IFRS) and also uses adjusted and organic figures where the Board believe that they help to effectively monitor the performance of the Group and help users of the Financial Statements to draw comparisons with our peers. Certain alternative performance measures also form a meaningful element of Executive Directors' annual bonuses. Unless otherwise stated, adjusted figures are used throughout this section. A reconciliation of adjusted operating profit to statutory operating profit is given below and more detail can be found in Note 2 to the Financial Statements.

As we are a multi-national Group of companies that trade in a large number of foreign currencies and regularly acquire and sometimes dispose of companies, we also refer to organic performance measures. Organic measures strip out the effects of the movement of foreign currency exchange rates and of acquisitions and disposals. The percentage organic growth or decline is measured as the constant currency movement in those businesses that were part of the Group at the end of the current year and the beginning of the prior year, i.e. excluding the effects of any acquisitions or disposals made in either year. The Board believe that this allows users of the Financial Statements to gain a further understanding of how the Group has performed.

	Adjusted operating profit 2018 £m	**Adjusted operating margin 2018 %**	Adjusted operating profit 2017 £m	Adjusted operating margin 2017 %
Europe, Middle East and Africa	69.3	20.1%	66.1	21.7%
Asia Pacific	63.9	27.5%	56.9	26.1%
Americas	36.9	23.6%	31.6	20.8%
Steam Specialties	**170.1**	**23.2%**	**154.6**	**22.9%**
Chromalox	22.8	14.7%	13.8	18.4%
Watson-Marlow	84.8	32.0%	80.3	32.4%
Corporate expenses	(12.8)		(13.2)	
Adjusted operating profit	**264.9**	**23.0%**	**235.5**	**23.6%**
Profit on disposal of businesses	47.4		-	
Profit on disposal of property	6.5		-	
Post-retirement benefit plan in the USA being frozen to future accrual	6.0		-	
Equalising guaranteed minimum pensions for the UK post-retirement benefit plans	(0.7)		-	
Amortisation and impairment of acquisition-related intangible assets	(25.2)		(21.6)	
Acquisition related items	0.2		(7.8)	
Reversal of acquisition related fair value adjustments to inventory	-		(7.2)	
Statutory operating profit	**299.1**		**198.9**	

A good financial result was achieved in 2018 against the background of continuing industrial production growth, albeit at a lower rate than was seen in 2017. Sales grew over 15% to £1,153.3 million (2017: £998.7 million). Organic sales grew by over 7%. Watson-Marlow had another excellent year, delivering 9% organic growth, with all regions performing well. Organic sales grew by 7% in the Steam Specialties business, with a 4% advance in EMEA, 7% gain in Asia Pacific and 12% growth in the Americas. The net effect of the acquisition of Gestra in May 2017, Chromalox in July 2017 and the divestment of HygroMatik at the end of November 2018, added 12% to sales.

Following two years of currency tailwinds, the trend reversed this year with the general strengthening of sterling resulting in a 2% fall in revenue. If recent exchange rates were to prevail for the whole of 2019 we would not expect to see a material exchange impact to sales on translation when compared to 2018.

Adjusted operating profit of £264.9 million (2017: £235.5 million) was over 12% ahead at reported exchange rates and 12% ahead on an organic basis (constant currency, excluding acquisitions and a disposal). On an organic basis the Steam Specialties business saw adjusted operating profits increase by

12% with a 1% decline in EMEA being more than offset by 13% growth in Asia Pacific and 40% growth in the Americas. Watson-Marlow's adjusted operating profits grew 11% on an organic basis.

Currency movements depressed adjusted operating profit by 4%, a mixture of translational and transactional losses. The net transactional loss was £3.4 million. The main transactional exposure flow affecting the Group is the export of products from our factories in the UK, invoiced in sterling, less the import of goods from overseas Group factories and third parties priced predominately in euros and US dollars. The net exposure is approximately £100 million. If recent exchange rates prevail for the whole of 2019 we would not expect to see a material impact to profit due to transactional and translation foreign exchange movements.

The net effect of the acquisitions made in 2017 and disposal in 2018 was to add 6% to adjusted operating profit on a constant currency basis.

The adjusted operating profit margin in the Steam Specialties business grew 30 bps to 23.2% despite the dilutionary impact of an additional four months of trading from Gestra and one month less from HygroMatik in 2018. Excluding these effects, the margin would have been 120 bps higher at 24.4% at constant currency. Watson-Marlow's reported margin fell 40 bps to 32.0%, although increased by 50 bps at constant currency. Investment in Chromalox continued in the second half of the year with margin remaining constant at 14.7%, a fall of 310 bps on the full year 2017 result. Overall the Group's reported margin fell by 60 bps to 23.0% due to the dilutionary impacts of an additional four months contribution from of Gestra, six months from Chromalox and one month less from HygroMatik combined with adverse currency movements. The adjusted operating profit margin, excluding these effects, improved 120 bps to 25.2% on an organic basis.

Statutory operating profit was £299.1 million (2017: £198.9 million), the increase was primarily due to the profit on disposal of HygroMatik in the year.

Interest

Net interest rose from £6.4 million to £10.3 million. Net bank interest increased from £3.9 million in 2017 to £8.3 million reflecting a full year of the additional debt taken on in 2017 to fund the Gestra and Chromalox acquisitions. We anticipate net bank interest charges in the region of £7 million in 2019 after taking account of the additional debt required to fund the acquisition of Thermocoax.

Net finance costs under IAS19 in respect of the Group's defined benefit pension schemes reduced to £2.0 million (2017: £2.5 million). We anticipate a similar cost in 2019.

In 2019, the Group will adopt IFRS 16 (*Leases*). As a result on transition we anticipate an increase in Property, plant and equipment in the region of £36 million, increase in liabilities of £40 million and an adjustment to opening retained earnings of £4 million. Interest charges are expected to rise by approximately £1 million with a corresponding increase in adjusted operating profit.

Associates

The Group has only one Associate holding, a 26.3% interest in Econotherm, a heat pipe technology business. Econotherm's performance in 2018 was similar to 2017, with our share, net of tax, reflecting a break-even position.

Profit before tax

The adjusted profit before tax of £254.6 million (2017: £229.1 million) was 11% ahead. As outlined earlier, currency movements were negative in the year. At constant currency, adjusted profit before tax increased by 14%.

The statutory profit before tax was £288.8 million (2017: £192.5 million) and includes the items listed below that have been excluded from the adjusted profit:

- profit on disposal of businesses £47.4 million (2017: £nil);
- a charge of £25.2 million (2017: £21.6 million) for the amortisation of acquisition-related intangible assets;
- profit on disposal of property £6.5 million (2017: £nil);
- a credit of £6.0 million resulting from the post-retirement benefit plan in the USA being frozen to future accrual (2017: £nil);
- a charge of £0.7 million for equalising guaranteed minimum pensions in the UK post-retirement benefit plans (2017: £nil);
- a credit of £0.2 million for acquisition related items (2017: £7.8 million charge); and
- reversal of acquisition related fair value adjustments to inventory, £nil (2017: £7.2 million charge).

Taxation
The tax charge on the adjusted profit before tax fell by 150 bps to 27.6% (2017: 29.1%), due primarily to the reduction in the US federal corporate income tax rate from 35% to 21% from 1st January 2018. The Group's overall tax rate reflects the blended average of the tax rates in over 40 tax jurisdictions around the world in which our operations trade and generate profit. The Group comprises over 120, mainly small, operating units reflecting our local direct sales business model. On a statutory basis the Group's effective tax rate was 22.6%.

For the year to 31st December 2019 we currently anticipate that, as a result of changes to our internal financing structures and forecasted mix of adjusted profits, the Group effective tax rate on adjusted profits will increase to approximately 29%.

Earnings per share
Adjusted basic earnings per share increased by 13% to 250.0 pence (2017: 220.5 pence). Statutory earnings per share was 303.1 pence (2017: 214.4 pence). The fully diluted earnings per share was not materially different in either year.

Dividends
The Group has a progressive dividend policy where dividend payments follow underlying earnings per share growth while maintaining prudent levels of dividend cover. The aim is to provide sustainable, affordable dividend growth, building on our 51 year record of dividend progress, with a compound annual increase of 11.0% over that period; in line with the 12% per annum increase over the last 10 years. The Board is proposing a final dividend of 71.0 pence per share for 2018 (2017: 62.0 pence) payable on 24th May 2019 to shareholders on the register at 26th April 2019. Together with the interim dividend of 29.0 pence per share (2017: 25.5 pence), the total Ordinary dividend is therefore 100.0 pence per share, which is an increase of 14% on the Ordinary dividend of 87.5 pence per share in 2017.

The total amount paid in dividends during the year was £67.3 million, 16% above the £58.4 million paid in 2017.

Acquisitions and disposal
Acquisitions are an important complement to our strategy for organic growth. In 2017 we made two relatively large acquisitions, Gestra and Chromalox. When we announced the acquisition of Chromalox in May 2017 we declared a self-imposed moratorium on significant acquisitions for 12-18 months so as to maintain management's focus on the integration and safe delivery of the new companies. As a result,

the only acquisition in 2018 was a small pre-revenue company for the Watson-Marlow business in January for consideration on a cash-free, debt-free basis of €3.0 million with up to a further €6.5 million to be paid if the company achieves certain technical specifications.

Dedicated resource remains focused on identifying opportunities to add attractive businesses that closely match our strategic, industrial and commercial requirements. Our three broad acquisition criteria are:

- geographic expansion, typically through the acquisition of a distributor in a developing market;
- products that can be integrated into our existing businesses; and
- related acquisitions that fit alongside our existing Steam Specialties, Watson-Marlow or Chromalox businesses.

The two acquisitions that were made in 2017, Gestra and Chromalox, have been integrated successfully into the Group and are performing in line with expectations in their first full year in our Group.

On 30th November 2018 we divested HygroMatik GmbH (HygroMatik) to Carel Industries S.p.A. for a total cash consideration of €59.0 million (£52.3 million) on a debt-free, cash-free basis and including working capital adjustments, representing a trailing EBITDA multiple of 12.5.

HygroMatik joined the Spirax Sarco Group in 1988 but due to limited strategic fit has always operated separately from the Steam Specialties business in which it was reported. This low level of integration limited our ability to improve sales growth while maintaining HygroMatik's excellent profitability.

The profit on disposal of £47.4 million, after relevant fees, has been excluded from adjusted operating profit but included in statutory operating profit. In the year ended 31st December 2017, HygroMatik's sales were £13.0 million and operating profit was £3.9 million all translated at the 2017 average euro exchange rate of 1.15 euro to the pound.

On 18th February 2019 we announced that we had entered into exclusive negotiations with a view to acquiring Thermocoax Developpement (Thermocoax), based in France, for a cash-free, debt-free consideration of €158 million (£139 million).
Thermocoax is a leading designer and manufacturer of highly engineered electrical thermal solutions for critical applications in high added value industries.

We anticipate that Thermocoax will become part of our Chromalox business and will significantly enhance our electrical process heating business, especially in Europe. Thermocoax enables us to address critical high value applications where product cost is a secondary concern to reliability and performance and allows for cross-selling opportunities for both businesses, strengthening Thermocoax's presence in North America and Chromalox's presence in Europe.

In the year ended 31st December 2018, Thermocoax recorded revenues of €49.8 million (£43.9 million), EBITDA of €12.9 million (£11.4 million) and adjusted operating profit of €12.1 million (£10.7 million). In 2018, 54% of the company's revenues were in EMEA with 32% in the Americas and 14% in Asia Pacific. At 31st December 2018, Thermocoax's gross assets were €94.6 million (£83.0 million).
The purchase will be financed from existing cash and debt facilities and is expected to be accretive to Group earnings in 2019.

Upon completion of the exclusive negotiations, the transaction will require certain regulatory approvals in France, Germany and the USA. These regulatory approvals are expected to be satisfied during the second quarter of 2019.

Brexit
93% of the Group's sales and operating profit are made outside the UK, reducing the risk to the Group from the United Kingdom's decision to leave the European Union. That said, we are net exporters from the UK, importing approximately £50 million raw materials and components and exporting in the region of £150 million of finished goods to our sales companies around the world. To mitigate the risk of delays at ports we have made the decision to build a month's buffer stock of raw materials and components in the UK and finished goods outside the UK equating to an additional two weeks usage. Assuming an orderly Brexit we would expect inventory levels to return to normal levels by the end of the year. The additional cost of building and maintaining these inventories is expected to be in the region of £0.8 million in 2019.

We have modelled potential tariff impacts and believe that these would be more than compensated for by a devaluation in sterling following a "no-deal" Brexit.

We are well prepared and well placed to take on the challenges and identify the opportunities resulting from a UK exit from the EU. We have navigated periods of economic and political uncertainty in many different places around the world and have a long and successful history of doing so.

Research and development
The development of innovative new products, and getting those products to market faster and sold more effectively, is an important element of our strategy for growth. Overall the Group's total spend in research and development in 2018 was £12.4 million (2017: £14.4 million) of which £1.6 million was capitalised (2017: £2.9 million).

Capital employed

Capital employed	**2018 £m**	2017 £m
Property, plant and equipment	230.8	227.5
Inventories	160.6	145.4
Trade receivables	245.1	237.5
Prepayments and other current assets	43.7	46.3
Trade, other payables, current provisions and current tax	(195.7)	(176.9)
Capital employed	**484.5**	**479.8**
Intangibles including goodwill	645.2	631.3
Post-retirement benefits	(85.1)	(85.6)
Net deferred tax	(35.5)	(36.9)
Non-current provisions and long-term payables	(6.4)	(5.5)
Net debt	(235.8)	(373.6)
Net assets	**766.9**	**609.5**
Adjusted operating profit	**264.9**	**235.5**
Average capital employed	**482.2**	**444.9**
Return on capital employed	**54.9%**	**52.9%**

Total capital employed has increased by 1% at reported exchange rates. If the effects of currency and the sale of HygroMatik are excluded growth was also 1%. This compares with organic sales growth of 7%.

Tangible fixed assets (PPE) increased by £3.3 million to £230.8 million. Changes in exchange rates increased fixed assets by £1.0 million and £0.2 million came from the acquisition in the year while £1.3 million left the Group with the sale of HygroMatik, giving an organic increase of £3.4 million, around 1%.

There were no significant plant expansion projects in 2018 with spend being spread over a number of investment categories including continuation of the "Future Factory" programme at our Steam facility in Cheltenham to upgrade machine tools and an implementation of a Global Order Entry System in Chromalox. Looking forward, we would expect capital expenditure to increase in 2019 to approximately £65 million as we continue to invest in the Group and, in particular, £18 million in the year for a new factory for Aflex Hose. This new site will consolidate the existing four locations into a purpose-built facility giving capacity for future growth while increasing efficiencies and providing a dedicated production line for Pharmaceutical products. We generate significant cash and our first priority is to reinvest in the business, taking opportunities to generate good returns from increased efficiency, reduced costs and flexibility.

Total working capital increased by £1.4 million. The ratio of working capital to sales reduced by 330 bps to 22.0% (2017: 25.3%) due to higher sales from the inclusion of a full year's sales for the acquisitions made during the prior year and organic sales growth of 7% while working capital remained similar to 2017. On a constant currency basis, excluding acquisitions and disposals, working capital as a percentage of sales reduced by 270 bps. Going forward, we would expect working capital as a percentage of sales to increase slowly as Gestra and Chromalox expand the proportion of their revenue that goes through direct sales channels.

Return on capital employed (ROCE)
ROCE measures effective management of fixed assets and working capital relative to the profitability of the business. ROCE increased to 54.9% (2017: 52.9%), an increase of 200 bps due to the high growth in adjusted operating profit and our close control of the various components of capital employed. At constant currency, excluding acquisitions and disposals, ROCE increased by 470 bps. ROCE is defined in Note 2.

Post-retirement benefits
The net post-retirement benefit liability under IAS19 fell to £85.1 million (2017: £85.6 million). Liabilities fell by £16.9m despite further small reductions in the AA corporate bond rates used to discount future cash flows. Assets fell by £16.4 million (4%) reflecting returns on plan assets that were less than the discount rate.

The main UK schemes, which constitute 88% of assets, were closed to new members in 2001 but have remained open to future service accrual. These schemes continue to be managed under a dynamic de-risking strategy whereby asset and liability values are monitored on a daily basis by the asset manager and appropriate asset allocation decisions taken as the funding level improves against pre-agreed trigger points. Following the outcome of the Lloyds judgement in October 2018, UK pension schemes are required to provide for any liability arising from equalising guaranteed minimum pensions (GMP). Our assessment resulted in an increase in liabilities of £0.7 million. Following actuarial valuations of the three UK schemes, we agreed deficit reduction programmes with the Trustees and additional contributions of £4.8 million were made during the year. Further contributions at the rate of £3.9 million per annum have been agreed until 2021.

The pension plan in the USA was frozen to future accrual with effect from 31st December 2018. This led to a reduction in liabilities of £6 million as benefits are no longer linked to future salary increases.

Cash flow and treasury

Adjusted cash flow	**2018 £m**	2017 £m
Adjusted operating profit	264.9	235.5
Depreciation and amortisation	32.9	31.6
Adjusted earnings before interest, tax, depreciation and amortisation	**297.8**	**267.1**
Cash payments to pension schemes (more)/less than the charge to adjusted operating profit	(4.6)	0.1
Equity settled share plans	5.7	4.6
Working capital changes	(23.3)	(34.2)
Capital additions (including software and development)	(43.4)	(38.4)
Capital disposals	9.9	3.4
Adjusted cash from operations	**242.1**	**202.6**
Net interest	(6.7)	(6.4)
Income taxes paid	(61.6)	(61.0)
Free cash flow	**173.8**	**135.2**
Net dividends paid	(67.3)	(58.4)
Movement in provisions	0.8	1.2
Purchase of employee benefit trust shares / Proceeds from issue of shares	(5.0)	2.4
Disposals/(Acquisitions) (including costs)	48.8	(484.3)
Cash flow for the year	**151.1**	**(403.9)**
Exchange movements	(13.3)	2.9
Opening net (debt)/cash	(373.6)	27.4
Net debt at 31st December	**(235.8)**	**(373.6)**

Adjusted cash from operations increased to £242.1 million (2017: £202.6 million) representing 91% cash conversion. There was an outflow of working capital in the year of £23.3 million. However, on a constant currency basis, excluding acquisitions and disposals, working capital as a percentage of sales reduced by 270 bps.

Capital expenditure increased to £43.4 million (2017: £38.4 million), in part reflecting investment in the acquisitions. Capital disposals were higher than usual in the year at £9.9 million as we disposed of our facility in Singapore having moved the operation into more suitable leased accommodation. We would expect capital expenditure in 2019 to increase to around £65 million as we continue to invest across the Group. In particular, we expect to complete construction of a new facility for Aflex that will combine the four existing UK sites into one. We estimate that this will cost £18 million in 2019. We also expect work to complete on the expansion of our Belgium operating company and to continue the accelerated equipment upgrade programme for some of our manufacturing facilities.

Tax paid in the year benefited from the reduction in corporate tax rates in the USA and at £61.6 million was similar to the £61.0 million paid in the prior year. Free cash flow rose to £173.8 million (2017: £135.2 million).

Dividend payments were £67.3 million, including payments to minorities, (2017: £58.4 million) and represent the final dividend for 2017 and the interim dividend for 2018.

There was a cash inflow, including fees, of £48.8 million as the net of disposals and acquisitions in the year compared with an outflow of £484.3 million in the prior year. The net of share purchases and new shares issued for the Group's various employee share schemes gave a cash outflow of £5.0 million (2017: inflow of £2.4 million).

Net debt at the start of the year reduced from £373.6 million to a net debt figure of £235.8 million at 31st December 2018, a reduction of £137.8 million. This equates to a net debt to EBITDA ratio of 0.8x. Following completion of the Thermocoax acquisition we would expect the ratio of EBITDA to net debt to increase to approximately 1.0x by 31st December 2019. EBITDA is defined in Note 2 and the components of net debt are disclosed in Note 8.

The Group's Income Statement and Statement of Financial Position are exposed to movements in a wide range of different currencies. This stems from our direct sales business model, with a large number of local operating units. These currency exposures and risks are managed through a rigorously applied Treasury Policy, typically using centrally managed and approved simple forward contracts to mitigate exposures to known cash flows and avoiding the use of complex derivative transactions. The largest exposures are to the euro, US dollar, Chinese renminbi and Korean won. Whilst currency effects can be significant, the structure of the Group provides some mitigation through our regional manufacturing strategy, diverse spread of geographic locations and through the natural hedge of having a high proportion of our overhead costs in the local currencies of our direct sales operating units.

Capital structure
The Board keeps the capital requirements of the Group under regular review, maintaining a strong financial position to protect the business and provide flexibility of funding for growth. The Group earns a high return on capital, which is reflected in strong cash generation over time. Our capital allocation policy remains unchanged. Our first priority is to maximise investment in the business to generate further good returns in the future, aligned with our strategy for growth and targeting improvement in our key performance indicators. Next, we prioritise finding suitable acquisitions that can expand our addressable market through increasing our geographic reach, deepening our market penetration or broadening our product range. Acquisition targets need to exhibit a good strategic fit and meet strict commercial, economic and return on investment criteria. When cash resources significantly exceed expected future requirements, we would look to return capital to shareholders, as evidenced by special dividends declared in respect of 2010, 2012 and 2014. However, in the near term, we will look to reduce our financial leverage prior to considering new returns of capital to shareholders.

Spirax-Sarco Engineering plc

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AT 31ST DECEMBER 2018

	Note	2018 £m	2017 £m
ASSETS			
Non-current assets			
Property, plant and equipment		230.8	227.5
Goodwill		368.0	351.3
Other intangible assets		277.2	280.0
Prepayments		6.2	6.1
Investment in Associate		-	-
Deferred tax assets		41.3	36.4
		923.5	901.3
Current assets			
Inventories		160.6	145.4
Trade receivables		245.1	237.5
Other current assets		32.9	27.5
Taxation recoverable		4.6	12.7
Cash and cash equivalents	8	187.1	152.1
		630.3	575.2
Total assets		**1,553.8**	**1,476.5**
EQUITY AND LIABILITIES			
Current liabilities			
Trade and other payables		167.0	147.1
Provisions		5.0	6.7
Bank overdrafts	8	0.4	0.5
Short-term borrowing	8	15.7	20.0
Current portion of long-term borrowings	8	41.5	49.3
Current tax payable		23.7	23.1
		253.3	246.7
Net current assets		**377.0**	**328.5**
Non-current liabilities			
Long-term borrowings	8	365.3	455.9
Deferred tax liabilities		76.8	73.3
Post-retirement benefits		85.1	85.6
Provisions		3.7	3.2
Long-term payables		2.7	2.3
		533.6	620.3
Total liabilities		**786.9**	**867.0**
Net assets	3	**766.9**	**609.5**
Equity			
Share capital		19.8	19.8
Share premium account		77.8	75.1
Other reserves		22.2	19.3
Retained earnings		646.0	494.2
Equity shareholders' funds		765.8	608.4
Non-controlling interest		1.1	1.1
Total equity		**766.9**	**609.5**
Total equity and liabilities		**1,553.8**	**1,476.5**

Spirax-Sarco Engineering plc

CONSOLIDATED INCOME STATEMENT FOR THE YEAR ENDED 31ST DECEMBER 2018

	Note	Adjusted 2018 £m	Adj't 2018 £m	Total 2018 £m	Adjusted 2017 £m	Adj't 2017 £m	Total 2017 £m
Revenue	2/3	**1,153.3**	**-**	**1,153.3**	**998.7**	**-**	**998.7**
Operating costs		(888.4)	34.2	(854.2)	(763.2)	(36.6)	(799.8)
Operating profit	2/3	**264.9**	**34.2**	**299.1**	**235.5**	**(36.6)**	**198.9**
Financial expenses		(11.4)	-	(11.4)	(8.1)	-	(8.1)
Financial income		1.1	-	1.1	1.7	-	1.7
Net financing expense	4	(10.3)	-	(10.3)	(6.4)	-	(6.4)
Share of profit of Associates		-	-	-	-	-	-
Profit before taxation		**254.6**	**34.2**	**288.8**	**229.1**	**(36.6)**	**192.5**
Taxation	5	(70.4)	5.0	(65.4)	(66.7)	32.1	(34.6)
Profit for the period		**184.2**	**39.2**	**223.4**	**162.4**	**(4.5)**	**157.9**
Attributable to:							
Equity shareholders	2	183.9	39.2	223.1	162.1	(4.5)	157.6
Non-controlling interest		0.3	-	0.3	0.3	-	0.3
Profit for the period		**184.2**	**39.2**	**223.4**	**162.4**	**(4.5)**	**157.9**
Earnings per share	2/6						
Basic earnings per share		250.0p		303.1p	220.5p		214.4p
Diluted earnings per share		249.1p		302.0p	219.7p		213.6p
Dividends	7						
Dividends per share				100.0p			87.5p
Dividends paid during the year (per share)				91.0p			79.0p

Adjusted figures exclude certain items, as set out and explained in the Financial Review and as detailed in Note 2. All amounts relate to continuing operations.

Spirax-Sarco Engineering plc

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31ST DECEMBER 2018

	2018 £m	2017 £m
Profit for the year	**223.4**	**157.9**
Items that will not be reclassified to profit or loss:		
Remeasurement (loss)/gain on post-retirement benefits	(5.9)	11.8
Deferred tax on remeasurement loss/(gain) on post-retirement benefits and the tax impact of the change in tax rates	1.2	(5.1)
	(4.7)	6.7
Items that may be reclassified subsequently to profit or loss:		
Foreign exchange translation differences	4.2	(27.4)
Non-controlling interest foreign exchange translation differences	-	0.1
(Loss)/Profit on cash flow hedges net of tax	(0.1)	0.2
	4.1	(27.1)
Total comprehensive income for the year	**222.8**	**137.5**
Attributable to:		
Equity shareholders	222.5	137.1
Non-controlling interest	0.3	0.4
Total comprehensive income for the year	**222.8**	**137.5**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31ST DECEMBER 2018

	Share Capital £m	Share Premium account £m	Other reserves £m	Retained Earnings £m	Equity shareholders' funds £m	Non-controlling interest £m	Total Equity £m
Balance at 1st January 2018	**19.8**	**75.1**	**19.3**	**494.2**	**608.4**	**1.1**	**609.5**
Adoption of IFRS 15	-	-	-	0.7	0.7	-	0.7
Balance at 1st January 2018 (restated)	**19.8**	**75.1**	**19.3**	**494.9**	**609.1**	**1.1**	**610.2**
Profit for the year	**-**	**-**	**-**	**223.1**	**223.1**	**0.3**	**223.4**
Other comprehensive (expense)/income:							
Foreign exchange translation differences	-	-	4.2	-	4.2	-	4.2
Remeasurement loss on post-retirement benefits	-	-	-	(5.9)	(5.9)	-	(5.9)
Deferred tax on remeasurement loss on post-retirement benefits	-	-	-	1.2	1.2	-	1.2
Loss on cash flow hedges reserve	-	-	(0.1)	-	(0.1)	-	(0.1)
Total other comprehensive (expense)/income for the year	-	-	4.1	(4.7)	(0.6)	-	(0.6)
Total comprehensive income for the year	-	-	4.1	218.4	222.5	0.3	222.8
Contributions by and distributions to owners of the Company:							
Dividends paid	-	-	-	(67.0)	(67.0)	(0.3)	(67.3)
Equity settled share plans net of tax	-	-	-	(0.3)	(0.3)	-	(0.3)
Issue of share capital	-	2.7	-	-	2.7	-	2.7
Employee Benefit Trust shares	-	-	(1.2)	-	(1.2)	-	(1.2)
Balance at 31st December 2018	**19.8**	**77.8**	**22.2**	**646.0**	**765.8**	**1.1**	**766.9**

Included in foreign exchange translation differences is £0.3m for historic currency translation gains transferred to the income statement during 2018 relating to the disposal of a subsidiary. See Note 10 for further detail.

Other reserves represent the Group's translation, cash flow hedge, capital redemption and Employee Benefit Trust reserves.

The non-controlling interest is a 2.5% share of Spirax-Sarco (Korea) Ltd held by employee shareholders.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31ST DECEMBER 2017

	Share Capital	Share Premium account	Other reserves	Retained Earnings	Equity shareholders' funds	Non-controlling interest	Total Equity
	£m	£m	£m	£m	£m	£m	£m
Balance at 1st January 2017	**19.8**	**72.7**	**44.6**	**386.3**	**523.4**	**1.0**	**524.4**
Profit for the year	**-**	**-**	**-**	**157.6**	**157.6**	**0.3**	**157.9**
Other comprehensive (expense)/income:							
Foreign exchange translation differences	-	-	(27.4)	-	(27.4)	0.1	(27.3)
Remeasurement gain on post-retirement benefits	-	-	-	11.8	11.8	-	11.8
Deferred tax on remeasurement gain on post-retirement benefits	-	-	-	(5.1)	(5.1)	-	(5.1)
Profit on cash flow hedges reserve	-	-	0.2	-	0.2	-	0.2
Total other comprehensive (expense)/income for the year	-	-	(27.2)	6.7	(20.5)	0.1	(20.4)
Total comprehensive (expense)/income for the year	-	-	(27.2)	164.3	137.1	0.4	137.5
Contributions by and distributions to owners of the Company:							
Dividends paid	-	-	-	(58.1)	(58.1)	(0.3)	(58.4)
Equity settled share plans net of tax	-	-	-	1.7	1.7	-	1.7
Issue of share capital		2.4	-	-	2.4	-	2.4
Employee Benefit Trust shares	-	-	1.9	-	1.9	-	1.9
Balance at 31st December 2017	**19.8**	**75.1**	**19.3**	**494.2**	**608.4**	**1.1**	**609.5**

Spirax-Sarco Engineering plc

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31ST DECEMBER 2018

	Note	2018 £m	2017 £m
Cash flows from operating activities			
Profit before taxation		288.8	192.5
Depreciation, amortisation and impairment		58.1	54.2
Profit on disposal of fixed assets		(8.6)	(1.0)
Profit on disposal of subsidiary	10	(47.4)	-
Acquisition related fair value adjustments to inventory/exchange gain on acquisition funding		-	4.7
Cash payments to the pension schemes (greater)/less than the charge to operating profit		(10.1)	0.1
Equity settled share plans		5.7	4.6
Net finance expense		10.3	6.4
Operating cash flow before changes in working capital and provisions		**296.8**	**261.5**
Change in trade and other receivables		(16.0)	(21.7)
Change in inventories		(15.5)	(10.2)
Change in provisions		0.8	1.2
Change in trade and other payables		8.1	(2.3)
Cash generated from operations		274.2	228.5
Interest paid		(7.7)	(8.1)
Income taxes paid		(61.6)	(61.0)
Net cash from operating activities	2	**204.9**	**159.4**
Cash flows from investing activities			
Purchase of property, plant and equipment		(33.5)	(29.7)
Proceeds from sale of property, plant and equipment		11.9	3.4
Purchase of software and other intangibles		(8.3)	(5.8)
Development expenditure capitalised		(1.6)	(2.9)
Disposal of subsidiary	10	51.5	-
Acquisition of businesses net of cash acquired		(2.7)	(342.6)
Interest received		1.1	1.7
Net cash from/(used) in investing activities		**18.4**	**(375.9)**
Cash flows from financing activities			
Proceeds from issue of share capital		1.8	2.4
Employee Benefit Trust share purchase		(6.7)	-
Repaid borrowings	8	(111.6)	(415.9)
New borrowings	8	0.1	714.4
Repayment of finance lease liabilities	8	-	(0.1)
Dividends paid (including minorities)	7	(67.3)	(58.4)
Net cash from/(used) in financing activities		**(183.7)**	**242.4**
Net change in cash and cash equivalents	8	**39.6**	**25.9**
Net cash and cash equivalents at beginning of period		**151.6**	**118.8**
Exchange movement		(4.5)	6.9
Net cash and cash equivalents at end of period	8	**186.7**	**151.6**
Borrowings and finance leases		(422.5)	(525.2)
Net debt at end of period	8	**(235.8)**	**(373.6)**

1. NOTES TO THE ACCOUNTS

The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS) adopted for use in the European Union (EU) and therefore comply with Article 4 of the EU IAS legislation and with those parts of the Companies Act 2006 that are applicable to companies reporting under IFRS. IFRS includes the standards and interpretations approved by the IASB including International Accounting Standards ("IAS") and interpretations issued by the IFRS Interpretations Committee ("IFRIC"). With the exception of IFRS 15 and IFRS 9 as noted below there have been no significant changes in accounting policies from those set out in the 2017 Annual Report.

The financial information included in this News Release does not constitute statutory accounts of the Group for the years ended 31st December 2018 and 2017, but is derived from those accounts. Statutory accounts for the year ended 31st December 2017 have been reported on by the Group's auditor and delivered to the Registrar of Companies. Statutory accounts for the year ended 31st December 2018 have been audited and will be delivered to the Registrar of Companies following the Company's Annual General Meeting. The report of the auditors for both years was (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report, and (iii) did not contain a statement under Section 498 (2) or (3) of the Companies Act 2006.

If approved at the Annual General Meeting on 15th May 2019, the final dividend will be paid on 24th May 2019 to shareholders on the register at 26th April 2019. No scrip alternative to the cash dividends is being offered.

Copies of the Annual Report will be sent on 22nd March 2019 to shareholders who have requested a hard copy and can be obtained from our registered office at Charlton House, Cirencester Road, Cheltenham, Gloucestershire, GL53 8ER. The Report will also be available on our website at www.spiraxsarcoengineering.com.

With the exception of the new standards adopted in the current year, as discussed below, there have been no significant changes in accounting policies from those set out in the Spirax-Sarco Engineering plc 2017 Annual Report. The accounting policies have been applied consistently throughout the years ended 31st December 2017 and 31st December 2018.

NEW STANDARDS ADOPTED IN THE CURRENT YEAR

The Group adopted IFRS 15 (Revenue from contracts with customers) using the modified retrospective approach on 1st January 2018. Comparative information has not been restated. IFRS 15 establishes a single five-step model for recognising revenue from contracts with customers and supersedes IAS 18 (Revenue) and IAS 11 (Construction contracts).

IFRS 15 introduces principles to allocate the transaction price to performance obligations and recognise revenue as those performance obligations are satisfied and control of the goods or services are transferred to the customer.

The five steps of the model are:

Step 1: Identify the contracts with customers
Step 2: Identify the performance obligations in the contract
Step 3: Determine the transaction price

Step 4: Allocate the transaction price to the performance obligations in the contract
Step 5: Recognise revenue when (or as) the entity satisfies a performance.

All revenue recognised by the Group is generated through contracts with customers.

The impact of adoption of IFRS 15 on these Financial Statements is:

- At 1st January 2018 an increase in opening retained earnings of £0.7m;
- For the 12 months ending 31st December 2018 an increase in revenue of £0.9m, increase in operating costs of £0.4m, increase in profit before tax of £0.5m, increase in taxation of £0.1m and increase in profit after tax for the period of £0.4; and
- At 31st December 2018 an increase in contract assets of £3.3m, reduction in inventories of £2.1m and increase in current tax payable of £0.1m.

IFRS 9 (Financial instruments) was adopted on 1st January 2018, replacing IAS 39 (Financial instruments: recognition and measurement). IFRS 9 includes requirements for the classification and measurement of financial instruments, impairment of financial assets and hedge accounting.

An assessment was performed and the adoption of IFRS 9 has not had a material impact on the financial results of the Group. The assessment included an analysis of the Group's hedge accounting policy and existing hedge accounting relationships, and it was determined that those relationships designated under IAS 39 are still effective under IFRS 9. The Group has adopted the simplified approach to recognise lifetime expected credit losses for trade receivables and contract assets as permitted by IFRS 9. The change in approach has not had a material impact on the trade receivables provision.

NEW STANDARDS AND INTERPRETATIONS NOT YET ADOPTED

There are a number of new standards, amendments to standards and interpretations that are not yet effective for the year ending 31st December 2018 and have, therefore, not been applied in preparing these Consolidated Financial Statements.

IFRS 16 introduces new requirements for lessee and lessor accounting, with the distinction between operating lease and finance lease no longer applying for lessees. Under IFRS 16, a lessee is required to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of a low value when new. The new standard also requires depreciation of the asset to be recognised separately from the interest expense on the lease liability. As at 31st December 2018, the Group had total operating lease obligations of £39.8m and an operating lease charge of £11.2m for the year ended 31st December 2018. The date of initial application of IFRS 16 for the Group is 1st January 2019.

An assessment of the impact of transitioning to IFRS 16 on 1st January 2019 has been completed. The estimated impact on the Financial Statements on transitioning is as follows:

<u>Statement of Financial Position</u>

a) Right-of-use assets will be capitalised, totalling approximately £36m. The vast majority of this value (£28m) results from leased property where the Group leases a number of office and warehouse sites in a number of geographical locations. The remaining £8m is largely made up of leased motor vehicles, where the Group makes use of leasing cars for sales and service engineers at a number of operating company locations.

b) Lease liabilities will be recognised totalling approximately £40m, split between £10m relating to amounts due within 12 months from 1st January 2019 and £30m relating to amounts due after 1st January 2020.
c) As a result of the Group using the modified-retrospective approach, all property lease assets were valued as if IFRS 16 had always applied since the commencement of those leases. This led to a difference between the right-of-use asset capitalised and the corresponding lease liability. The difference between these values of approximately £4m will be recognised as an adjustment to opening retained earnings.

Income Statement
The impacts on the Income Statement are expected to result in an increase in operating profit of approximately £1m compared to the operating profit had IAS 17 continued to apply. This is made up of a reduction in operating lease rentals of approximately £11m offset by a depreciation charge of approximately £10m. Once taking into account an additional £1m of expected lease liability interest, the overall impact on profit before tax in 2019 is expected to be nil.

The total expense relating to exempt leases is expected to be approximately £2m. Exempt leases include:

a) Short term leases with a lease length remaining at 1st January 2019 of less than 12 months
b) Low value leases, for assets leased with a value of less than £5,000
c) Variable lease payments not based on an index or rate

Cash Flow Statement

a) Net cash inflow from operating activities is expected to increase by approximately £10m as a result of the principal payments made on lease liabilities being reclassified from cash generated from operations to financing activities
b) Net cash outflow from financing activities is expected to increase by approximately £10m as a result of the above
c) There is no impact on the net change in cash and cash equivalents as a result of IFRS 16

Of the other new standards, none are anticipated to have a significant impact on the Financial Statements.

As reported in the Group Chief Executive's Review of Operations, the economy in Argentina underwent a period of high inflation during 2018. Whilst applying IAS 29 (Financial Reporting in Hyperinflationary Economies) to the Financial Statements is not required for the period ended 31st December 2018 as the impact is not material, we will continue to assess the position going forward and consider its applicability in the light of economic developments in Argentina and the materiality of their results to the Group.

GOING CONCERN

Having made appropriate enquiries, the Directors consider that the Group has adequate resources to continue in operational existence for 12 months from the date of this release and that therefore it is appropriate to adopt the going concern basis in preparing the Annual Report.

The Group has processes in place to identify, evaluate and mitigate the principal risks that could have an impact on the Group's performance. The principal risks together with a description of why they are relevant and if the significance of the risk has changed during 2018 are set out below. Details of how they link with the Group's strategy and how mitigation is managed are included in the Group's 2017 Annual Report on pages 32-33 and they will be disclosed in the 2018 Annual Report on pages 30-33.

- ***Economic and political instability***
  Economic and political instability creates risks for our locally based direct operations, including the impact of regime changes.
- ***Significant exchange rate movements***
  The Group reports its results and pays dividends in sterling. Operating and manufacturing companies trade in local currency. This risk has increased during 2018, for example in Argentina.
- ***Cybersecurity***
  A significant cybersecurity breach could result in a loss of important information and prevent the Group operating at maximum efficiency.
- ***Failure to realise acquisition objectives***
  Failure to realise acquisition objectives would impact the financial performance of the Group. At the end of 2018 this risk had decreased as a result of our robust post-acquisition integration plans for Gestra and Chromalox.
- ***Loss of manufacturing output at any Group factory***
  Loss of manufacturing output at any important plant risks serious disruption to sales operations.
- ***Breach of legal and regulatory requirements (including ABC laws)***
  The Group is subject to many different laws and regulations. Breaching these laws and regulations could have serious consequences.
- ***Loss of critical supplier***
  This risk is concerned with the impact of the loss of a critical supplier in terms of logistical difficulties and delayed deliveries. This is a new principal risk and is highlighted because of Government policy changes in Brazil and China.
- ***Health, safety and environmental risks***
  A major health and safety incident could cause total or partial closure of a manufacturing facility.

Solution specification failure, included as a principal risk in 2017, is no longer considered a principal risk but will continue to be monitored.

The possibility of a "no deal" Brexit has created economic uncertainties for business. The Group's Risk Management Committee has taken action to mitigate these uncertainties as outlined in the Risk Management section of the 2018 Annual Report on page 29. The Group has prepared for the application of tariffs for goods moving in and out of Europe as disclosed within the Governance Report in the 2018 Annual Report on page 69. However, we are also poised to take advantage of opportunities that are presented and to mitigate any adverse trading impact on the Group.

The 2018 Financial Statements were approved by the Board of Directors and authorised for issue on 6th March 2019.

2. ALTERNATIVE PERFORMANCE MEASURES

The Group reports under International Financial Reporting Standards (IFRS) and also uses alternative performance measures where the Board believe that they help to effectively monitor the performance of the Group, users of the Financial Statements might find them informative and an aid to comparison with our peers. Certain alternative performance measures also form a meaningful element of Executive Directors' annual bonuses. A definition of the alternative performance measures included in the Annual Report and a reconciliation to the closest IFRS equivalent are disclosed below.

Adjusted operating profit

Adjusted operating profit excludes items that are considered to be significant in nature and/or quantum and where treatment as an adjusted item provides stakeholders with additional useful information to assess the period-on-period trading performance of the Group and an aid to comparison with our peers. The Group excludes such items which management have defined as:

- amortisation and impairment of acquisition-related intangible assets;
- impairment of goodwill;
- costs associated with acquisitions and disposal;
- reversal of acquisition related fair value adjustments to inventory;
- changes in deferred consideration payable on acquisitions;
- profit or loss on disposal of subsidiary;
- restructuring costs;
- foreign exchange gains and losses on borrowings;
- significant profits or losses on disposal of property;
- significant plan amendments and/or legal rulings requiring a past service cost or credit for post-retirement benefit plans

A reconciliation between operating profit as reported under IFRS and adjusted operating profit is given below.

	2018 £m	2017 £m
Operating profit as reported under IFRS	**299.1**	**198.9**
Amortisation of acquisition-related intangible assets	25.2	18.4
Impairment of goodwill	-	3.2
Acquisition related items	(0.2)	10.3
Reversal of acquisition related fair value adjustments to inventory	-	7.2
Foreign exchange gain on borrowings	-	(2.5)
Profit on disposal of subsidiary	(47.4)	-
Profit on disposal of property	(6.5)	-
Equalising guaranteed minimum pensions for the UK post-retirement benefit plans	0.7	-
Post-retirement benefit plan in the USA being frozen to future accrual	(6.0)	-
Adjusted operating profit	**264.9**	**235.5**

The related tax effects of the above are included as adjustments in taxation as disclosed in Note 5.

Adjusted earnings per share

	2018	2017
Profit for the period attributable to equity holders as reported under IFRS (£m)	**223.1**	**157.6**
Items excluded from adjusted operating profit disclosed above (£m)	(34.2)	36.6
Tax effects on adjusted items (£m)	(5.0)	(7.7)
Tax effects of the change in the US tax rate (£m)	-	(24.4)
Adjusted profit for the period attributable to equity holders (£m)	**183.9**	**162.1**
Weighted average shares in issue (million)	73.6	73.5
Basic adjusted earnings per share	250.0p	220.5p
Diluted weighted average shares in issue (million)	73.8	73.8
Diluted adjusted earnings per share	249.1p	219.7p

Basic adjusted earnings per share is defined as adjusted profit for the period attributable to equity holders divided by the weighted average number of shares in issue. Diluted adjusted earnings per share is defined as adjusted profit for the period attributable to equity holders divided by the diluted weighted average number of shares in issue.

Basic and diluted EPS calculated on an IFRS profit basis are included in Note 6.

Adjusted cash flow

A reconciliation showing the items that bridge between net cash from operating activities as reported under IFRS to an adjusted basis is given below.

	2018 £m	2017 £m
Net cash from operating activities as reported under IFRS	**204.9**	**159.4**
Acquisition and disposal costs	0.2	10.3
Net Capital expenditure excluding acquired intangibles from acquisitions	(31.5)	(35.0)
Movement in provisions	(0.8)	(1.2)
Tax paid	61.6	61.0
Interest paid	7.7	8.1
Adjusted net cash from operating activities	**242.1**	**202.6**

Adjusted cash conversion in 2018 is 91% (2017: 86%). Cash conversion is calculated as adjusted net cash from operating activities divided by adjusted operating profit. The adjusted cash flow is included in the Financial Review on page 27.

Return on capital employed (ROCE)

This key performance indicator measures effective management of fixed assets and working capital relative to the profitability of the business. ROCE is calculated as adjusted operating profit divided by average capital employed. Average capital employed is based on capital employed at 31st December 2018 and 31st December 2017 at reported exchange rates. More information on ROCE can be found in the Capital Employed and ROCE sections of the Financial Review on page 26.

An analysis of the components is as follows:

	2018 £m	2017 £m
Property, plant and equipment	230.8	227.5
Prepayments	6.2	6.1
Inventories	160.6	145.4
Trade receivables	245.1	237.5
Other current assets	32.9	27.5
Tax recoverable	4.6	12.7
Trade, other payables and current provisions	(172.0)	(153.8)
Current tax payable	(23.7)	(23.1)
Capital employed	**484.5**	**479.8**
Average capital employed	**482.2**	**444.9**
Operating profit	299.1	198.9
Adjustments (see adjusted operating profit)	(34.2)	36.6
Adjusted operating profit	**264.9**	**235.5**
Return on capital employed	**54.9%**	**52.9%**

A reconciliation of capital employed to net assets as reported under IFRS and disclosed on the Consolidated Statement of Financial Position is given below.

	2018 £m	2017 £m
Capital employed	**484.5**	**479.8**
Goodwill and other intangible assets	645.2	631.3
Post-retirement benefits	(85.1)	(85.6)
Net deferred tax	(35.5)	(36.9)
Non-current provisions and long-term payables	(6.4)	(5.5)
Net debt	(235.8)	(373.6)
Net assets as reported under IFRS	**766.9**	**609.5**

Net debt to earnings before interest, tax, depreciation and amortisation (EBITDA)

To assess the size of the net debt balance relative to the size of the earnings for the Group we analyse net debt as a proportion of earnings before interest, tax, depreciation and amortisation (EBITDA). The net debt to EBITDA ratio is calculated as follows:

	2018 £m	2017 £m
Adjusted operating profit	**264.9**	**235.5**
Depreciation and amortisation of PPE, software and development	32.9	32.6
Earnings before interest, tax, depreciation and amortisation	**297.8**	**268.1**
Net debt	235.8	373.6
Net debt to EBITDA	**0.8**	**1.4**

The components of net debt are disclosed in Note 8.

Organic measures

As we are a multi-national Group of companies, who trade in a large number of foreign currencies and regularly acquire and sometimes dispose of companies, we also refer to organic performance measures throughout the News Release. These strip out the effects of the movement of foreign currency exchange rates and of acquisitions and disposals. The Board believe that this allows users of the accounts to gain a further understanding of how the Group has performed.

Exchange translation movements are assessed by re-translating prior period reported values to current period exchange rates. Exchange transaction impacts on operating profit are assessed on the basis of transactions being at constant currency between years.

Any acquisitions and disposals that occurred in either the current period or prior period are excluded from the results of both the prior and current period at current period exchange rates.

A reconciliation of the movement in revenue and adjusted operating profit compared to the prior period is given below.

	2017 Base £m	2017 M&A £m	2017 Actual £m	Exchange £m	Organic £m	Acquisitions and disposal £m	2018 £m	Organic	Reported
Revenue	872.1	126.6	998.7	(21.4)	62.8	113.2	1,153.3	+7%	+15%
Adjusted operating profit	214.1	21.4	235.5	(9.7)	25.5	13.6	264.9	+12%	+12%
Adjusted operating margin			23.6%				23.0%	+120bps	-60bps

The reconciliation for each segment is included in the Group Chief Executive's Review of Operations.

3. SEGMENTAL REPORTING

Analysis by location of operation

2018

	Gross revenue £m	Inter-segment revenue £m	Revenue £m	Total operating profit £m	Adjusted operating profit £m	Adjusted operating margin %
Europe, Middle East & Africa	390.8	46.4	344.4	111.5	69.3	20.1%
Asia Pacific	238.2	5.5	232.7	69.9	63.9	27.5%
Americas	164.1	7.7	156.4	41.1	36.9	23.6%
Steam Specialties	793.1	59.6	733.5	222.5	170.1	23.2%
Chromalox	154.6	-	154.6	12.1	22.8	14.7%
Watson-Marlow	265.2	-	265.2	77.5	84.8	32.0%
Corporate expenses				(13.0)	(12.8)	
	1,212.9	59.6	1,153.3	299.1	264.9	23.0%
Intra Group	(59.6)	(59.6)				
Total	**1,153.3**	**-**	**1,153.3**	**299.1**	**264.9**	23.0%
Net finance expense				(10.3)	(10.3)	
Share of profit of Associate				-	-	
Profit before tax				**288.8**	**254.6**	

2017

	Gross revenue £m	Inter-segment revenue £m	Revenue £m	Total operating profit £m	Adjusted operating profit £m	Adjusted operating margin %
Europe, Middle East & Africa	348.9	43.6	305.3	58.7	66.1	21.7%
Asia Pacific	223.1	5.1	218.0	56.3	56.9	26.1%
Americas	159.4	7.3	152.1	26.0	31.6	20.8%
Steam Specialties	731.4	56.0	675.4	141.0	154.6	22.9%
Chromalox	75.1	-	75.1	4.0	13.8	18.4%
Watson-Marlow	248.2	-	248.2	74.8	80.3	32.4%
Corporate expenses				(20.9)	(13.2)	
	1,054.7	56.0	998.7	198.9	235.5	23.6%
Intra Group	(56.0)	(56.0)				
Total	**998.7**	**-**	**998.7**	**198.9**	**235.5**	23.6%
Net finance expense				(6.4)	(6.4)	
Share of profit of Associates				-	-	
Profit before tax				**192.5**	**229.1**	

Net revenue generated by Group companies based in the USA is £288.8m (2017: £222.6m), in China is £118.5m (2017: £103.1m) in the UK is £103.7m (2017: £95.3m), in Germany is £118.0m and the rest of the world is £524.3m (2017: £577.7m).

The total operating profit for each period includes certain items as analysed below:

2018

	Amortisation of acquisition-related intangible assets	Profit on disposal of subsidiary and property	Acquisition related items	Equalising GMP for the UK pension plans	USA pension plan frozen to future accrual	Total
	£m	£m	£m	£m	£m	£m
Europe, Middle East & Africa	(4.4)	47.4	(0.1)	(0.7)	-	42.2
Asia Pacific	(0.5)	6.5	-	-	-	6.0
Americas	(1.8)	-	-	-	6.0	4.2
Steam Specialties	(6.7)	53.9	(0.1)	(0.7)	6.0	52.4
Chromalox	(10.7)	-	-	-	-	(10.7)
Watson-Marlow	(7.8)	-	0.5	-	-	(7.3)
Corporate expenses	-	-	(0.2)	-	-	(0.2)
Total	**(25.2)**	**53.9**	**0.2**	**(0.7)**	**6.0**	**34.2**

2017

	Amortisation of acquisition-related intangible assets	Impairment of goodwill	Acquisition costs	Reversal of acquisition related fair value adjustments to inventory	Foreign exchange gain on borrowings	Total
	£m	£m	£m	£m	£m	£m
Europe, Middle East & Africa	(3.6)	-	-	(3.8)	-	(7.4)
Asia Pacific	(0.6)	-	-	-	-	(0.6)
Americas	(2.3)	(3.2)	(0.1)	-	-	(5.6)
Steam Specialties	(6.5)	(3.2)	(0.1)	(3.8)	-	(13.6)
Chromalox	(6.4)	-	-	(3.4)	-	(9.8)
Watson-Marlow	(5.5)	-	-	-	-	(5.5)
Corporate expenses	-	-	(10.2)	-	2.5	(7.7)
Total	**(18.4)**	**(3.2)**	**(10.3)**	**(7.2)**	**2.5**	**(36.6)**

Net financing income and expense

	2018	2017
	£m	£m
Europe, Middle East & Africa	(1.1)	(1.0)
Asia Pacific	-	0.1
Americas	(0.8)	(0.8)
Steam Specialties	(1.9)	(1.7)
Chromalox	-	-
Watson-Marlow	(0.1)	(0.1)
Corporate	(8.3)	(4.6)
Total net financing expense	**(10.3)**	**(6.4)**

Net assets

	2018		2017	
	Assets	**Liabilities**	**Assets**	**Liabilities**
	£m	**£m**	**£m**	**£m**
Europe, Middle East & Africa	407.6	(115.0)	400.6	(112.4)
Asia Pacific	162.2	(41.6)	162.6	(36.9)
Americas	113.8	(39.3)	112.2	(41.6)
Chromalox	409.3	(28.9)	386.7	(23.3)
Watson-Marlow	227.9	(38.7)	213.1	(30.6)
	1,320.8	(263.5)	1,275.2	(244.8)
Liabilities	(263.5)		(244.8)	
Net deferred tax	(35.5)		(36.9)	
Net current tax payable	(19.1)		(10.4)	
Net debt	(235.8)		(373.6)	
Net assets	**766.9**		**609.5**	

Non-current assets in the UK were £157.1m (2017: £154.3m), in the USA were £393.5m (2017: £376.1m) and in Germany were £169.4m (2017: £173.0m).

Capital additions, depreciation, amortisation and impairment

	2018		2017	
	Capital additions	**Depreciation, amortisation and impairment**	**Capital additions**	**Depreciation, amortisation and impairment**
	£m	**£m**	**£m**	**£m**
Europe, Middle East & Africa	18.5	17.1	81.9	16.7
Asia Pacific	4.9	7.1	8.2	7.9
Americas	4.5	5.9	4.2	9.8
Steam Specialties	27.9	30.1	94.3	34.4
Chromalox	6.0	13.6	183.3	8.2
Watson-Marlow	18.6	14.4	7.9	11.6
Group total	**52.5**	**58.1**	**285.5**	**54.2**

Capital additions include property, plant and equipment of £33.5m (2017: £56.3m), of which £0.2m (2017: £26.6m) was from acquisitions in the period, and other intangible assets of £19.0m (2017: £229.2m) of which £9.1m (2017: £218.7m) relates to acquired intangibles from acquisitions in the period. Capital additions split between the UK and rest of the world are UK £20.1m (2017: £16.6m) and rest of the world £32.4m (2017: £268.9m).

4. NET FINANCING INCOME AND EXPENSE

	2018 £m	2017 £m
Financial expenses:		
Bank and other borrowing interest payable	(9.4)	(5.6)
Interest on pension scheme liabilities	(2.0)	(2.5)
	(11.4)	(8.1)
Financial income:		
Bank interest receivable	1.1	1.7
Net financing expense	**(10.3)**	**(6.4)**
Net pension scheme financial expense	(2.0)	(2.5)
Net bank interest	(8.3)	(3.9)
Net financing expense	**(10.3)**	**(6.4)**

5. TAXATION

	2018			2017		
	Adjusted	Adj't £m	Total £m	Adjusted	Adj't £m	Total
Analysis of charge in period	£m			£m		£m
UK corporation tax:						
Current tax on income for the period	7.6	-	7.6	5.6	-	5.6
Adjustments in respect of prior periods	0.4	-	0.4	(0.7)	-	(0.7)
	8.0	-	8.0	4.9	-	4.9
Foreign tax:						
Current tax on income for the period	58.5	0.3	58.8	59.7	-	59.7
Adjustments in respect of prior periods	0.9	-	0.9	0.5	-	0.5
	59.4	0.3	59.7	60.2	-	60.2
Total current tax charge	67.4	0.3	67.7	65.1	-	65.1
Deferred tax – UK	0.1	-	0.1	0.1	-	0.1
Deferred tax – Foreign	2.9	(5.3)	(2.4)	1.5	(32.1)	(30.6)
Tax on profit on ordinary activities	**70.4**	**(5.0)**	**65.4**	**66.7**	**(32.1)**	**34.6**

The Group's tax charge in future years is likely to be affected by the proportion of profits arising and the effective tax rates in the various territories in which the Group operates.

The Group's tax charge includes a credit of £5.0m in relation to certain items excluded from adjusted operating profit. The tax impacts of these items are:

- post-retirement benefit plan in the USA being frozen to future accrual (£1.4m tax charge)
- equalising guaranteed minimum pensions (GMP) for the UK post-retirement benefit plans (£0.1m tax credit)
- profit on disposal of subsidiary (£0.3m tax charge)
- amortisation of acquisition-related intangible assets (£6.6m tax credit)

Excluding these adjustments the tax on profit and the effective tax rate are £70.4m and 27.6% respectively.

A reduction in the US federal tax rate from 35% to 21%, effective from 1st January 2018, was enacted as part of the US Tax Cuts and Jobs Act on 22nd December 2017. As a result the US deferred tax assets and liabilities at 31st December 2017 were calculated based on the future blended federal and state tax rate, with a federal tax element of 21%. This resulted in a deferred tax credit to the consolidated income statement of £24.4m; this was included within the overall credit of £32.1m in 2017.

6. EARNINGS PER SHARE

	2018	2017
Profit attributable to equity shareholders (£m)	223.1	157.6
Weighted average shares in issue (million)	73.6	73.5
Dilution (million)	0.2	0.3
Diluted weighted average shares in issue (million)	73.8	73.8
Basic earnings per share	303.1p	214.4p
Diluted earnings per share	302.0p	213.6p

Basic and diluted earnings per share calculated on an adjusted profit basis are included in Note 2. The dilution is in respect of unexercised share options and the Performance Share Plan.

7. DIVIDENDS

	2018 £m	2017 £m
Amounts paid in the year:		
Final dividend for the year ended 31st December 2017 of 62.0p (2016: 53.5p) per share	45.7	39.3
Interim dividend for the year ended 31st December 2018 of 29.0p (2017: 25.5p) per share	21.3	18.8
Total dividends paid	**67.0**	**58.1**
Amounts arising in respect of the year:		
Interim dividend for the year ended 31st December 2018 of 29.0p (2017: 25.5p) per share	21.3	18.8
Proposed final dividend for the year ended 31st December 2018 of 71.0p (2017: 62.0p) per share	52.3	45.6
Total dividends arising	**73.6**	**64.4**

8. ANALYSIS OF CHANGES IN NET DEBT, INCLUDING CHANGES IN LIABILITIES ARISING FROM FINANCING ACTIVITIES

	At 1st Jan 2018 £m	Cash flow £m	Acquired debt £m	Exchange movement £m	At 31st Dec 2018 £m
Current portion of long term borrowings	(49.3)				(41.5)
Non-current portion of long term borrowings	(455.9)				(365.3)
Short term borrowing	(20.0)				(15.7)
Total borrowings	**(525.2)**				**(422.5)**
Comprising:					
Borrowings	(524.9)	111.5	-	(8.8)	(422.2)
Finance leases	(0.3)	-	-	-	(0.3)
	(525.2)	111.5	-	(8.8)	(422.5)
Cash at bank	152.1	39.8	(0.3)	(4.5)	187.1
Bank overdrafts	(0.5)	0.1	-	-	(0.4)
Net cash and cash equivalents	**151.6**	**39.9**	**(0.3)**	**(4.5)**	**186.7**
Net (debt)	**(373.6)**	**151.4**	**(0.3)**	**(13.3)**	**(235.8)**

The cash flow for borrowings includes repayments of US$89.2m on the US$200.0m term loan.

9. PURCHASE OF BUSINESSES

In January 2018, we acquired 100% of the share capital of a small German pre-revenue company within the Watson-Marlow Fluid Technology business. The acquisition method of accounting has been used. Total consideration of a cash-free, debt-free basis at the acquisition date was expected to be £8.4m (€9.5m). This includes £0.3m to repay a bank overdraft and £0.2m which was deemed to be contingent remuneration rather than consideration under IFRS 3. £2.7m of the total £8.4m was paid on the acquisition date, with a further £5.7m deferred. The deferred payment is dependent on satisfactory compliance with agreed conditions. Separately identified intangibles are recorded as part of the provisional fair value adjustment. The fair value of net assets on acquisition under IFRS 3 were £5.9m consisting of:

- Acquired intangibles, valued at £7.8m, relating to manufacturing designs, core technology and non-compete undertakings;
- A deferred tax liability of £1.8m recognised on the acquired intangibles;
- Property, plant and equipment of £0.2m; and
- A bank overdraft of £0.3m.

Goodwill of £2.0m was recognised and is not expected to be tax deductible. Total consideration under IFRS 3 is therefore £7.9m. In the 12 months ending 31st December 2018 the acquisition generated £nil of revenue and a loss of £1.3m. Had the acquisition been made on the 1st January 2018 the revenue and loss would have been the same.

During the period the deferred consideration we expect to pay was reassessed resulting in a reduction of £0.6m to £5.1m.

During the period the fair value of the assets acquired as part of the acquisition of Chromalox Inc. and associated businesses on 3rd July 2017 were finalised. The outcome was an increase to goodwill of £2.2m.

During the period the Group acquired several distributors creating acquired intangibles of £1.3m.

10. DISPOSAL OF SUBSIDIARY

The profit on disposal of subsidiary wholly relates to the disposal of 100% of HygroMatik GmbH on 30th November 2018.

	2018 £m
Property, plant and equipment	1.3
Inventories	1.7
Trade and other receivables	1.6
Cash and cash equivalents	0.5
Trade and other payables	(4.4)
Post-retirement benefit	(0.1)
Net assets disposed	**0.6**
Consideration received satisfied in cash	49.7
Cash disposed of	(0.5)
Transaction expenses	(2.0)
Net proceeds from disposal of subsidiary	47.2
Currency translation differences transferred from translation reserve	0.3
Cash disposed of	0.5
Net assets disposed of	(0.6)
Profit on disposal of subsidiary	**47.4**

Net proceeds from disposal of subsidiary	47.2
Amount received to settle outstanding intercompany loan	4.3
Cash inflow per Consolidated Statement of Cash Flows	**51.5**

The sale of HygroMatik did not meet the definition of a discontinued operation given in IFRS 5 (Non-Current Assets Held for Sale and Discontinued Operations) and, therefore, no disclosures in relation to discontinued operations have been made.

The Group did not divest any businesses during 2017.

11. EVENTS AFTER THE BALANCE SHEET DATE

On 18th February 2019 we announced that we had entered into exclusive negotiations with a view to acquiring 100% of the share capital of Thermocoax Developpement (Thermocoax), based in France, for a cash-free, debt-free consideration of €158 million (£139 million).

Thermocoax is a leading designer and manufacturer of highly engineered electrical thermal solutions for critical applications in high added value industries.

We anticipate that Thermocoax will become part of our Chromalox business and will significantly enhance our electrical process heating business, especially in Europe. Thermocoax enables us to address critical high value applications where product cost is a secondary concern to reliability and performance and allows for cross-selling opportunities for both businesses, strengthening Thermocoax's presence in North America and Chromalox's presence in Europe.

In the year ended 31st December 2018, Thermocoax recorded revenues of €49.8m (£43.9m), EBITDA of €12.9m (£11.4m) and EBIT of €12.1m (£10.7m). In 2018, 54% of the company's revenues were in EMEA with 32% in the Americas and 14% in Asia Pacific. At 31st December 2018, Thermocoax's gross assets were €94.6m (£83.0m).

The purchase will be financed from existing cash and debt facilities and is expected to be accretive to Group earnings in 2019.

Upon completion of the exclusive negotiations, the transaction will require certain regulatory approvals in France, Germany and the USA. These regulatory approvals are expected to be satisfied during the second quarter of 2019.

12. RESPONSIBILITY STATEMENT OF THE DIRECTORS ON THE ANNUAL REPORT

The Responsibility Statement below has been prepared in connection with the Company's full Annual Report for the year ending 31st December 2018. Certain parts thereof are not included within this announcement.

We confirm to the best of our knowledge:

- the Financial Statements, prepared in accordance with IFRS as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit and loss of the company and the undertakings included in the consolidation taken as a whole;
- the Strategic Report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties they face; and
- the Annual Report and Financial Statements, taken as a whole, are fair, balanced and understandable and provide the information necessary to assess the Company's performance, business model and strategy.

This Responsibility Statement was approved by the Board of Directors on 6th March 2019 and is signed on its behalf by:

N.J. Anderson, Group Chief Executive K.J. Boyd, Chief Financial Officer

13. CAUTIONARY STATEMENT

All statements other than statements of historical fact included in this document, including, without limitation, those regarding the financial condition, results, operations and businesses of Spirax-Sarco Engineering plc and its strategy, plans and objectives and the markets and economies in which it operates, are forward-looking statements. These forward-looking statements which reflect management's assumptions made on the basis of information available to it at this time, involve known and unknown risks, uncertainties and other important factors which could cause the actual results, performance or achievements of Spirax-Sarco Engineering plc or the markets and economies in which we operate to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. Spirax-Sarco Engineering plc and its Directors accept no liability to third parties in respect of this report save as would arise under English law. Accordingly, any liability to a person who has demonstrated reliance on any untrue or misleading statement or omission shall be determined in accordance with schedule 10A of the Financial Services and Markets Act 2000. It should be noted that schedule 10A contains limits on the liability of the Directors of Spirax-Sarco Engineering plc so that their liability is solely to Spirax-Sarco Engineering plc.

14. EXCHANGE RATE IMPACTS

Whilst not an IFRS disclosure or part of the audited accounts, set out below is an additional disclosure that highlights the movements in a selection of average exchange rates between 2017 and 2018.

Average exchange rates to sterling have been as follows:

	Average 2018	Average 2017	Change %	Closing 2018	Closing 2017	Change %
Bank of England sterling index	78.3	77.6	-1%	76.6	78.0	+2%
US Dollar	1.33	1.30	-2%	1.27	1.35	+6%
Euro	1.13	1.15	+2%	1.11	1.13	+2%
Renminbi	8.82	8.75	-1%	8.74	8.81	+1%
Won	1,461	1,464	+0%	1,421	1,448	+2%
Real	4.85	4.16	-17%	4.94	4.49	-10%
Argentine Peso	37.44	21.68	-73%	47.96	25.47	-88%

RNS filter: Inside information prior to release

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