S&P Global
Market Intelligence

Intertek Group plc LSE:ITRK

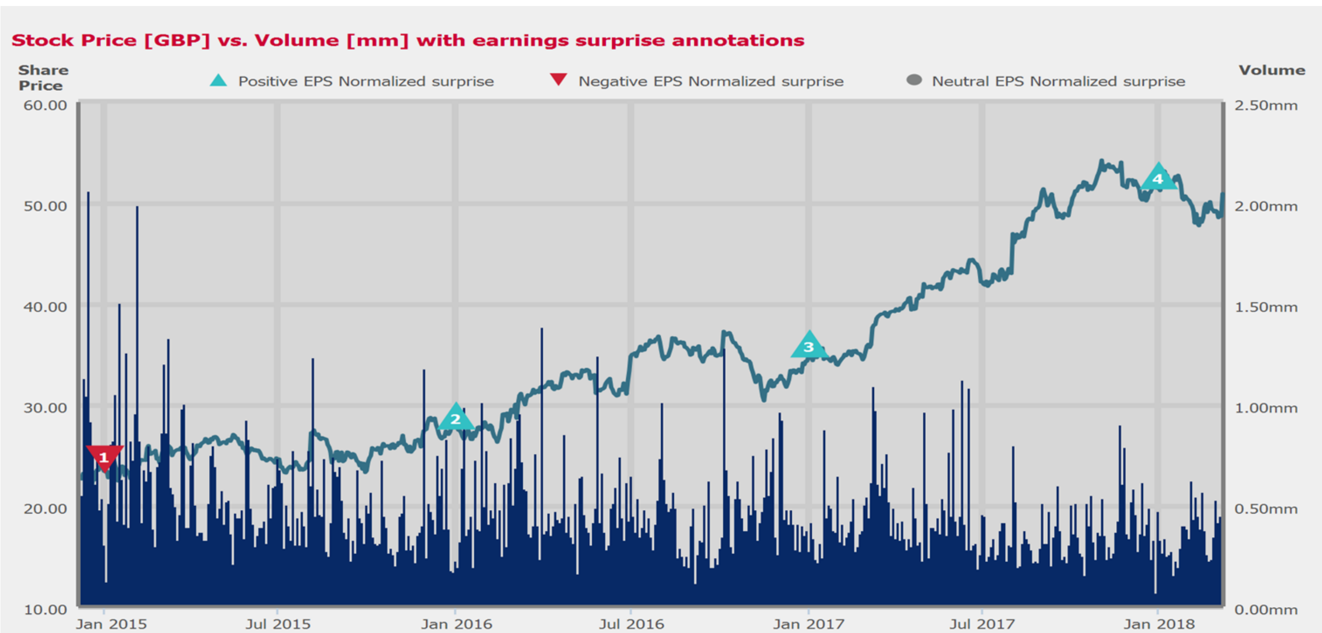
FY 2017 Earnings Call Transcripts

Tuesday, March 06, 2018 9:00 AM GMT

S&P Global Market Intelligence Estimates

	-FY 2017-			-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	1.88	1.92	▲2.13	1.97
Revenue (mm)	2771.87	2769.10	▼(0.10 %)	2804.00

Currency: GBP
Consensus as of Mar-06-2018 8:58 AM GMT



- EPS NORMALIZED -			
	CONSENSUS	ACTUAL	SURPRISE
FY 2016	1.61	1.68	1 4.35 %
FY 2017	1.88	1.92	2 2.13 %

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Call Participants

EXECUTIVES

André Pierre Joseph Lacroix
CEO & Director

Edward Leigh
Former CFO & Director

ANALYSTS

Andrew Charles Grobler
Crédit Suisse AG, Research Division

Charles Edward Stanley
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Deutsche Bank AG, Research Division

Will Kirkness
Jefferies LLC, Research Division

Presentation

André Pierre Joseph Lacroix
CEO & Director

Good morning to you all. It's 9:00. Let's try to start on time. We have some of our attendees today on the line, so I just want to make sure that everybody is on time. So good morning, and thanks for attending our results face-to-face. It's a real pleasure to see you all.

In 2017, we've seen continuous progress on revenue growth, margin management and cash generation. And I'm sure you will have noted that our profitability and cash results are ahead of expectations, which is good news for everyone. In my view, these results really demonstrate the quality of our earnings models but also the disciplined approach we take to performance management. Today, we'll start with our performance highlights, what has happened in 2017. Ed will then take you through a detailed presentation of our results. We will spend a bit of time then on strategy. I'd like to give you an update on where we are with our differentiated strategy. And then we'll finish, as you will expect, with the outlook for 2018 and what it means for each of our divisions.

So I'd like to start with the performance highlights, and I'm going to go through relatively quickly because you've seen the numbers already. Nonetheless, I think it's important to highlight the key points.

I think the first point is obviously from a revenue standpoint, GBP 2.8 billion, up year-on-year at 7.9% at actual currency and 3% at constant currency. I think our revenue performance at constant currency was driven by solid organic growth of 2.1%, and it was an acceleration on the organic growth that we saw in '16. And certainly H2 was better than H1, but nonetheless, in addition to organic growth, we saw the positive contribution from the recent acquisition that we have made. Operating profit was GBP 468 million, up 14.2% at actual currency and 10% at constant currency, really pleased about that, driven by a very strong margin performance. You all will have seen it. We've delivered a record operating margin of 16.9%, up 90 basis point at actual rate and 110 basis point at constant currency.

We've delivered a full year adjusted EPS of 191.6p, up 14.3% at actual currency and 10.4% at constant rate. We've announced a proposed final dividend of 47.8p. That will increase the full year dividend to 71.3p, an increase of 14.3% year-on-year, in line with our progressive dividend policy.

Our cash conversion has remained very strong. And our free cash flow, as you've seen, was up 7.4%.

We have delivered GDP+ organic growth in 94% of our earnings, with 4.8% organic revenue growth at constant currency in the combined product and Trade divisions. In both divisions, we benefited from broad-based organic revenue growth. Our product business grew by 5.5% at constant currency, and our Trade business by 3%. No surprise and as expected, conditions remained challenging in our resource division. We saw an organic revenue decline of 8.6%. Important to note is, during the year, we saw the rate of decline in Resources improve from minus 12.3% in H1 to minus 4.5% in H2.

Acquisitions are important for us to get access to quality businesses that have strong IP, market-leading positions; and provide attractive growth and margin prospects. The acquisition we've made since 2015 have added circa GBP 250 million to our yearly revenue base.

Clearly the highlight of our performance in 2017 is the margin performance. You've seen it. We've made continuous progress in the last 3 years. And in '17, we've seen an operating margin improvement of 110 basis point at constant currency. This is very significant. We are really proud of these results. We've been able to benefit from operating leverage linked obviously to revenue growth, productivity improvement and from obviously our portfolio mix. I will give you later on in the presentations a deep dive on what we are doing at Intertek to drive margin performance. We believe that there is further scope for margin improvement in the years to come, and certainly the organization will remain focused on margin-accretive revenue growth.

Our business model is highly cash generative. That enables us to invest in future growth but also to provide attractive returns to our shareholders. In the last 2 years, we've invested GBP 219 million in M&A and CapEx. And our dividend has increased by 36%. We continue to work in a very disciplined fashion on cash generation. The working capital as percentage of revenue has reduced to 5%, an all-time low for the group, and this is really pleasing. Our free cash flow, as I said earlier, was up 7.4%. We have strengthened our balance sheet, and we've reduced our net debt by circa GBP 200 million year-on-year. And at the end of the year, our net debt-to-EBITDA ratio was 1x.

We believe in the value of accretive, disciplined allocation of capital. Our first priority, of course, is to support organic growth through capital expenditures and investment in working capital to obviously support the development of client relationships. In the medium to long term, as far as CapEx, investments in new technology, equipment, lab facility to deliver new services will be around 5% of our revenue through the long term. The second priority is to deliver sustainable returns for our shareholders with the payment of progressive dividends. And in recognition of our highly cash-generative business model, our strong financial position, our board's confidence in the attractive long-term growth prospect for the groups and our ability to fund continued growth investments in both M&A and CapEx, we are increasing our targeted dividend payout ratio to circa 50% of earnings from 2018.

The third priority is to pursue M&A activities that strengthen our portfolio in the attractive growth and margin areas of the industry. And the fourth priority is to maintain an efficient balance sheet that gives us the flexibility to invest in growth. And our guidance in terms of EBITDA, gearing ratio over the long term is between 1.5x and 2x.

I will now hand over to Ed, who will give you a detailed presentation of our financial results.

Edward Leigh
Former CFO & Director

Thank you, André. And good morning, everyone.

As André has described, we have delivered a strong earnings growth and cash generation. And I'll now take you through some of the details underlying our results.

So in summary, we delivered double-digit operating profit and EPS growth. Margin improved year-on-year at both actual and constant currency, and our cash flow performance was strong. Organic growth was 2.1% at constant currency and 6.9% at actual rates. The FX impact on total revenue was 4.9% for the year, driven by the depreciation of sterling, noting that the FX impacts turned slightly negative in the final few months as the pound strengthened. At constant rates, operating profit [progress] was up 10% to GBP 468 million, and margin was up 110 basis points. This performance, combined with the FX translation gain for the year, resulted in operating profit up 14.2% at actual rates.

Net finance costs of GBP 28.9 million were above last year. And you'll recall, in 2016, that included FX gains in our non-sterling debtors driven by the devaluation of the pound in the second half. Our tax rate was 24.5%, being down 80 bps year-on-year, reflecting a one-off benefit from the revaluation of deferred tax liabilities following the recent tax reforms in the U.S.

So overall, fully diluted EPS grew double digits to 191.6p, being up 14.3% at actual rates and 10.4% at constant.

We also delivered a strong cash performance in the year, with our focus on working capital leading to an increase in free cash flow of GBP 24 million to GBP 342 million.

I'll now take you through some high-level margin analysis.

So the group recorded a 90 bps improvement in total operating margin in [29], increasing to 16.9%. Organic improved by 90 bps at constant rates, driven by margin accretion in Products and also by the benefit of a stronger portfolio mix which contributed 30 basis points. Our disciplined focus on cost and capacity management also resulted in stable Resources margin despite a revenue decline of 8.6%. M&A

added positively to the organic margin by 20 bps with the 5 transactions carried out since the beginning of 2016. And finally and as expected, FX had a slightly negative impact on the group margin.

Now turning to the group cash flow and net debt. Our free cash flow at GBP 342 million was up strongly in the year, increasing by GBP 24 million. This was driven by the improved profitability of the group as well as our day-to-day focus on cash management. We invested GBP 137 million in both CapEx and M&A. The overall strong performance in cash flow resulted in a reduction into net debt of -- to GBP 544 million and down by 27% versus last year-end. And that's equivalent to 1x net debt-to-EBITDA ratio, which is a significant improvement to the 1.5x in the prior year. The net debt reduction year-on-year included a favorable GBP 40 million FX impact from the stronger pound on our dollar-denominated debt.

Now turning to financial guidance for 2018.

The expected net finance costs will be around GBP 25 million to GBP 27 million. And for 2018, effective tax rate is expected to be in the 25.5% to 26% range, with the impact of the recent U.S. tax reforms being broadly neutral for the group. And minority interest will be circa GBP 20 million. For your models, I've set out the number of shares for the EPS calculations. And we're currently expecting full year CapEx to be in a range of GBP 130 million to GBP 140 million.

For net debt, we expect to close the year at between GBP 400 million and GBP 450 million, although noting that this guidance is stated before any M&A completions and any material movements in FX.

And with that, I'll hand you back to André.

André Pierre Joseph Lacroix
CEO & Director

Okay, thank you, Ed, for this comprehensive review of our results.

So what I would like to do now is start with a brief strategic update and with a few comments on the quality of our earnings models because I believe this is a true differentiator for Intertek.

If you look at the highest level, what is it that Intertek does in the quality assurance industry? We provide independent quality assurance services that are critically important to our clients, and this is important to sustain the integrity of their supply chains. So in a simple expression, what we do for our clients is independent and mission critical. We offer ATIC solutions to our clients in 3 sectors of the economies: product, trade and resources. And what's also very important is we operate a capital-light business model. That's why our return on invested capital is so strong. And that capital-light business model, combined with an entrepreneurial culture, enables us to react very quickly to new growth opportunities by following the supply chain of our clients where they want to move their manufacturing footprint. And we've seen that over the years, where Intertek has moved very quickly to new geographies when our clients wanted to move their supply base there.

Our approach to value creation for the mid to long term is based on what we call internally the Intertek virtuous economics. We do not believe in one metric. We believe that, to drive shareholder value creation on a sustainable basis, you've got to focus on total shareholder value creation. And the way we define it at Intertek is global GDP+ organic growth plus margin accretion, plus strong cash conversion and, of course, plus disciplined capital allocation in M&A and CapEx. And we believe that, over the long term, the compounding effect of our virtuous economics year after year is what drive the consistency of our performance and, of course, the strong returns for all shareholders.

Our future growth outlook is global GDP+ organic growth in real terms. We've talked about it in the past. We expect our product divisions, which represent 75% of our earnings, to grow ahead of global GDP. Why? Our product growth drivers are truly GDP agnostic. We benefit from brand and SKU expansion; regulatory development; as well as increased focus of corporations on safety, quality and sustainability. We expect our Trade divisions, which is about 19% of our earnings, to grow at a rate broadly similar to the GDP through the cycles. And our Trade business will continue to benefit from the development of regional and global trade as well as from the increased focus of corporations on traceability. The growth prospects in our resource divisions, which represent 6% of the earnings, are linked, as you know, to the global growth drivers in the energy sector. It is obvious that investments in exploration and production for essential resources like oil and minerals will grow in the medium to long term to, of course, meet the demand of the growing population. We also expect structural growth in the renewable sector.

The main strategic objectives of our 5x5 strategy is to move the center of gravity of the group towards high-growth and high-margin sectors through to the virtuous economics model that I talked about. And to do that, we are pursuing 5 corporate goals. These have not changed since March '16. I'll go them -- through them very quickly. First, we want our employees to be fully engaged and work in a safe environment. Our second objective is to deliver superior customer service. Our third target is to deliver margin-accretive organic revenue growth based on GDP+ organic growth. Fourth, we want to drive a strong cash conversion. And fifth, we pursue an accretive, disciplined capital allocation policy.

We are seizing the exciting growth opportunities ahead with our differentiated Total Quality Assurance value proposition. We call that TQA. Globally across all of our businesses, we support the existing and emerging needs of our clients in terms of quality assurance in each area of their operations: R&D, raw materials sourcing, component suppliers, manufacturing, transportation, distribution and channel management and consumer management. We offer that superior customer service through a systemic end-to-end assurance approach based on the depth and breadth of assurance plus testing, plus inspection, plus certification solutions, importantly, delivered by our global subject matter experts in each of our operations. Our clients over the last few years have reacted very positively to our innovative quality assurance approach with our TQA value proposition. We are pleased with the progress we are making with our ATIC sales throughout the world. We've seen excellent growth in the last 2 years in the capital-light, high-margin assurance segments, which now represent as you can see 14% of the group revenue, a significant improvement compared to where the group was at the end of 2015.

I would like now to do a deep dive on our margin approach at Intertek. Last year, we did a deep dive on revenue. This year, I want to cover margin management and essentially talk about 5 important areas, starting with organization engagement.

Our 5x5 strategy is based on clear goals that are extremely well understood by our employees inside Intertek, and it's very important. It's called organization alignment. We invest considerable amount of time aligning the organizations: First, communicating the importance of putting the customer first. To give you an example, when I visit local markets, I always lead by example and take time to visit customers to talk about our TQA value proposition and get their feedback. It's important that our leaders really lead from the front and are spending their time in the markets. Personally, I spend about 50% of my time traveling around the world, supporting and coaching our operations. Nothing beats the frontline contacts to really understand where the opportunities are. We take time to recognize achievements of our people. Recognition is really important to have an engaged organizations. And I will personally host town hall in every single market visit I do. Sometimes, I will do 3 town halls if I visit 3 labs in the same market areas. And I use these to obviously communicate, connect and ask any questions that our colleagues have. We, of course, support the sharing of best practices. We invest in training and coaching. And we have a very simple, aligned incentive plan. Our yearly incentive is based on 3 metrics. 80% of the earnings opportunity is based on revenue and profit, with a higher weight towards profit to drive margin accretion, of course. And the remaining 20% is on return on capital.

The second area of focus in terms of margin management is superior customer service. Why? If you drive superior customer service on a sustainable basis, you will command a strong pricing power, which is very important. You heard me talked about it in the past. We look at good revenue growth, volume, good price and good mix but would rather have less volume but have a better price.

Our customer-centric entrepreneurial culture is really important, and it is helping us to put customer first. You probably know that we operate very decentralized operating models. For those of you who have come to our office in London, you know that we run the group with around 50 to 60 people in the center. We spend time listening to our customers. We do NPS interviews. And we do 7,000 interviews a month, which is an incredible amount of feedback we get. This is very, very timely to give us every single months the insight of our customers that we obviously use to improve our service. We use, of course, data intelligence, these NPS data, to look at our performance by site, by country and by customer. And what's important in terms of value delivery of our superior customer service, it's based on disciplined operating processes, with 0-defect quality commitment from all and obviously continuous improvement. At Intertek, we believe we can always be better.

Our growth and margin-accretive portfolio strategy is moving, as you know, the center of gravity towards higher-growth and higher-margin areas. You can see it on this slide. And just to recap: What is it we are trying to do from a portfolio standpoint? Essentially, we've got 5 priorities. First, we try to grow our global-scale businesses. They are the businesses where we've got leading market position and strong margin and obviously tremendous expertise. And these businesses are Softlines, Hardlines, Electrical & Network Assurance, Cargo/AA and GTS. The second objective from a portfolio standpoint is to focus on the businesses where we see fast growth and good margin opportunities. And these businesses are Business Assurance, Agriculture, building and products (sic) [Building Products], Transportation Technology and Food.

The third priority in our portfolio is, of course, to improve the performance of our industry service and Minerals, which has not been great over the last few years. Fourth, we continue to review the strengths of our own portfolio. We've talked about it in March '16. We operate multiple business lines in 100 geographies. And we are taking our time, with Ed and the team, to look at selected business units every single year. And this year, we have basically reviewed quite a number of these business units, which has led to the closure of 8 and the restructuring of 30. And finally, our M&A strategy is based on attractive growth and margin opportunities.

The other important part of our margin management is performance management. And we have a systemic approach across business lines, countries and sites; and this is obviously critical to sustain strong margin performance. We operate a structured performance management calendar that enable us to track progress continuously. And we measure financial and nonfinancial metrics, which gives the right level of intelligence to our team. As you know, the operational metrics are the leading indicators, and the financial metrics are the lagging indicators.

We never stop looking at ways to strengthen our business. It's part of our DNA. It's part of our culture, continuous improvement with solutions that are margin accretive and our customer-facing innovations are either based on digital tools to improve our processes or technology to develop a new solution. On the digital side, for instance, our cloud-based solution Inlight is highly valued by our clients who are looking to an end-to-end visualization and tracking of their risk through the entire supply chain. In our GTS business, for instance, our workflow Astra ERP gives our clients real-time intelligence on how their certificates are progressing through the customer journey. Technology provides a central role to deliver superior customer service. For instance, one of our latest innovation is InterPret, an algorithm that use big data analytics to predict hydrocarbon composition, providing our clients with real-time information. As you would expect, we make investments in our labs with cutting-edge technology. For instance, in our Food business we've recently invested in a new equipment that detects the DNA of fish samples, believe it or not, to make sure that our retail customers know that the fishes that you're going to buy at Tesco or Sainsbury's are on spec.

Turning to operational Kaizen solutions. We've got a really good CRM system called iConnect enabling our teams to basically coordinate their local and global sales and marketing efforts. Very, very important to have this capability. In terms of enabling our performance management approach, we have put in place, as you will expect, digital tools to make it seamless and easy for employees. We operate several financial service centers, which today is given in any global enterprise. And we continue to invest. We've just recently invest in a cloud-based tool to track our carbon emission side-by-side around the world and to get real-time visibility where the operations are.

So I just touched base on a few of these innovations. In the appendix of the presentations there is a bit more detail on each of them. And we are very happy to discuss these, if you're interested.

Let's now look at what's going to happen, in our view, in 2018.

In 2018, we expect to deliver good organic revenue growth at constant currency, with a sequential progression throughout the year. We expect robust organic growth momentum in our product businesses and solid organic growth in our Trade businesses, obviously at constant currency. While we have seen a reduction of the negative growth rate in the July to December '17 period in the Resources business, we do not believe we have reached the trough yet. Trading condition in resource will remain challenging in H1, and we expect a gradual improvement in H2.

From a profitability standpoint, we expect to deliver moderate margin progression at constant currency. We will remain, of course, disciplined on cash conversion. We'll continue to invest in growth and expect our full year CapEx to be circa GBP 130 million to GBP 140 million. As you know, currencies have continued to be volatile over the last few months. And the average sterling rates in the last 3 months, as well as the spot rate, by the way, applied to the full year results for 2017 would provide a reduction of 400 bps at the revenue level and 350 bps at the earnings level.

Let's now discuss the divisions.

Starting with product. We are extremely pleased of our product business, an excellent performance with strong, margin-accretive revenue growth; 5.5% organic growth driven by broad-based revenue growth across business lines and geographies; very strong operating profits, GBP 350 million, up 13.2% at constant currency. And we've delivered a margin of 21.6%, up 140 basis points. And this is obviously the results of positive operating leverage, pricing disciplines that I've talked about and obviously productivity improvement as well as favorable product mix inside product.

Our softline business delivered robust organic growth revenue across all markets. Moving forward, we expect good organic growth in our softline business driven by increased number of SKUs and brands, supply chain expansion in new markets and increased demand in chemical testing. Our hardline business report robust organic revenue growth across our main markets of China, Hong Kong, India and Vietnam. Moving forward, we also expect robust organic growth driven by the innovation we see within our customer base as they leverage the wireless technology or IoT. We also see an increased demand for chemical testings and obviously an increased demand for inspection. We've delivered robust organic revenue growth in Electrical & Network Assurance, and moving forward, we expect that to continue. We'll benefit from electrical appliances innovations to provide better efficiencies and connectivity to consumers. And also, we expect to benefit from the increased demand for IoT services and, of course, cyber security.

Our Business Assurance business delivered double-digit organic growth in the 3 region of North America, Europe and Asia; and we expect that to continue. We'll continue to benefit from the ISO standards upgrade, increased focus of corporations on supply chain and risk management and increased consumer and government focus on ethical and sustainable supply. Our Building & Construction business delivered good organic revenue growth. And we expect that to continue, driven by the growth for greener and higher-quality commercial buildings in the U.S. as well as increased investments that we are seeing in large infrastructures.

In our Transportation Technology business we've delivered stable organic growth. And moving forward, we expect the growth to improve to good. We are seeing continuous investment from our clients in new models, new fuel-efficient engines. Obviously, you are seeing the news that we all see where cities are going to ban diesel, which means more R&D investments will go in traditional combustion engine, both hybrid and electrical engines. And this is definitely the growth areas in the industry at the moment. And in addition to that, you see an increased scrutiny on emissions. That's why we bought KJ Tech last year.

We generated good organic revenue growth in our Food business, and we expect that to continue. We are seeing obviously continuous food innovations around the world, increased focus on safety of supply chains and obviously growth in the assurance business in food. As far as chemical and pharma, we saw a solid organic growth. And we believe that, that will continue. We are seeing also growth of SKUs and increased concern obviously on product safety and traceability.

So for the full year in 2018, we expect our product-related businesses to deliver a robust organic revenue growth.

I'd just like to share some of the innovations we've launched recently in our product business. In our hardline and softline divisions, we have developed i2Q, a market-leading inspection solution for supplies inspection that provides real-time big data intelligence to our customers. And in our Transportation Technology, you might have seen the press release last -- recently. We've announced a partnership with the American Center for Mobility to provide an extensive range of ATIC services for ACM in the new 500-acre testing grounds they have built. So tremendous position for Intertek right in the center of the Detroit world of automotive, where we are working with the ACM organizations to test basically the future engines for America.

Our Trade business delivered organic revenue growth of 3% driven by broad-based revenue growth across business line and geography. We delivered an operating profit of GBP 89 million, up year-on-year by 4.1%. Our operating margin of 13.7% was slightly down on last year at constant currency.

Our cargo business reports solid organic revenue growth. And moving forward, we expect that to continue to benefit from the global and regional trend we are seeing in these markets. Our government and trade service businesses delivered robust organic growth. We won quite a lot of new contracts, you will remember from our previous conversations. And we expect that to continue moving forward. Our AgriWorld business delivered robust organic growth. And we expect to see solid organic growth in 2018, which I'm sure we will talk in the Q&A. For the full year, we expect our Trade-related businesses, which represent 19% of our earnings, to benefit from solid organic revenue growth.

A few innovation in our Trade business. Agriculture exports can be quite complex from a paperwork standpoint and very time consuming. And to ease this process, we've developed a cloud-based export documentation systems that monitors the export process and provides customers with real-time updates on their documentation which can be very cumbersome. Fuel tank inspections can be costly and risky for our customers, so to make inspection more efficient and certainly safer, we've partnered with a developer of fuel tank inspection, a company that produces robot, to make it obviously easier for our customers.

Turning to our resource division. Our resource-related business faced, as expected, continuous challenged trading conditions. And we saw an organic revenue decline of 8.6%. Operating margin at 5.7% was slightly up year-on-year at constant currency, as we continued to focus on volume, price and obviously cost control.

The revenue from CapEx Inspection Services was down on last year, driven by a low level of investment in exploration activities from our clients and price pressure. The demand for OpEx maintenance was relatively stable but in a price-competitive environment. In '17, we've seen an improvement of demand for testing activities in Minerals. In '18, as I said earlier, we expect trading conditions for resource to remain challenging in H1, and we expect a gradual improvement in H2.

A couple of innovations in our resource division. Our new PipeAware software allows our pipeline customers to access real-time information on their asset inspections throughout their entire manufacturing process. We've partnered with Unmanned Eagle Eye in the U.S. to introduce drone technology into our CapEx Inspection process.

Just like to close with a few remarks on what I consider the strengths of Intertek before we take any Q&A.

Intertek has a strong track record of shareholder value creation on sustainable basis. You can see it here in the graph. In the last 15 years, we've multiplied our revenue, EPS and cash generated from operation by circa 6x. And we've multiplied our dividend by over 13x. In 2017, we've continued to make progress on revenue, margin, cash and returns. And moving forward, we believe that our high-quality earnings models will continue to drive sustainable growth for all stakeholders. As we explained earlier, we offer a differentiated TQA value proposition that is very important for our clients, and that provides them with a superior customer service. We are uniquely positioned in terms of growth to benefit from GDP+ organic revenue growth in real terms. We have attractive structural growth drivers ahead of us, and this is really exciting. Our product division, which is 75% of the earnings, is basically driven by GDP-agnostic growth drivers; said differently, GDP+. Our Trade division, which is 19% of the group's earnings, will continue to be benefiting from global trade growth. And our resource sector, which represents 6% of the earnings, will over time benefit from the growth drivers in the energy sectors. We are very disciplined when it comes to margin and cash management. In terms of M&A, we will target attractive businesses in terms of growth and margins.

So in a nutshell, we believe that, in 2017, we made excellent progress both on performance and strategy. And we're excited about the future. We see attractive organic and inorganic growth opportunities ahead which we are ready to seize.
So we'll now pause and take any questions you have.

Question and Answer

Charles Edward Stanley
Redburn (Europe) Limited, Research Division

Edward Stanley from Redburn. Three, please. What's -- when you're looking at M&A, when you say attractive growth and margin, are there any end markets that you find most appealing? I'll ask them one by one.

André Pierre Joseph Lacroix
CEO & Director

Okay, look, in terms of -- I cannot see you. Where are you? Okay, you're there, okay. So in terms of end markets, if you look at our portfolio strategy, you've got the priorities where we see, organic, inorganic opportunities for the group. In addition to that, we will look always at new end markets that attractive. For instance, what we've done in sustainability with the acquisition in Mexico of ABC is a good example of where we can obviously invest in a new end market. And what we've done with EWA and Acumen is a strong signal and we believe that cyber security in -- is an attractive end market. So if you take portfolio plus sectors where we see attractive growth prospect, that's where we'll look at it.

Charles Edward Stanley
Redburn (Europe) Limited, Research Division

Okay. And depreciation as a percentage of sales in the Products division seems to be lower year-on-year, which has helped the margin seemingly. Can you explain why that is? And will that continue?

Edward Leigh
Former CFO & Director

I mean that's a function of, I think, the strong revenue performance we've seen coming through, so yes, I think we could expect that to continue.

Charles Edward Stanley
Redburn (Europe) Limited, Research Division

Okay. And finally, on the working capital, which is a historic low of 5% of sales. Do you foresee that continuing? And what has been the biggest driving factor behind that?

Edward Leigh
Former CFO & Director

Well, look, working capital management for us is a critical part of how we think about our business model, our operating model. And working capital at 5%, that's certainly where we are now. We continue to work on working capital initiatives across the whole range, payables, debtors et cetera. We will continue that work into the year ahead. And we're not guiding for a particular number, but that work continues.

André Pierre Joseph Lacroix
CEO & Director

I mean clearly, on working capital, the progress we've made over the last few years has certainly been ahead of our own expectations, so we are pleased where we are. We're going to continue to drive harder but don't expect the same year-on-year reduction. That's the implied message.

Josh Puddle
Joh. Berenberg, Gossler & Co. KG, Research Division

It's Josh Puddle from Berenberg. 3 questions, please. Firstly, I just wondered why margins are going down in the Trade division and if you can you comment on expectations for 2018. Secondly, the slide in your presentation on the assurance section, very broad maths. It looks like that's growing around 20%

per year. How sustainable do you think that growth rate is? And who do you see as your sort of greatest competitors in that section? And then just finally, a clarification on the Resources guidance: You say challenging H1, gradual improvement. Do you mean growth in H2, or do you mean less of a decline?

André Pierre Joseph Lacroix
CEO & Director

Okay, I mean, on -- taking them one by one. On the Trade, basically the margin number that you've seen is essentially a function of the drop-through of the revenue we've lost in the U.S. with the storms. You will have seen it in the disclosures. We've said it's GBP 4.3 million, which basically has dropped through and impacted our margin in the second half. That's the only story behind that. As far as assurance is concerned, look, the numbers that we've presented today, and we've always said we'll give you an update on a regular basis, is a function of the double-digit organic growth we've seen in Business Assurance and also the acquisitions that we have made, so this is both organic and inorganic, all right? So the acquisition we've made in cyber security, in sustainability and obviously also with PSI have some assurance services there. As far as the competition, I think assurance is an interesting service area because, if you think about it, right, the industry has been known as TIC, testing inspection certifications. And companies today do much more TIC than they used to do, but there is still much more they could do. The assurance market is much more underdeveloped from our perspective because that's not where companies have been focused in terms of risk management over the last decade. So yes, we have competition. And we can take time to talk about some of these, but for me the -- in the assurance business the untapped opportunity is more important, i.e. what is it that corporations today don't do in terms of risk management and they should do to provide an end-to-end quality assurance to all their stakeholders? And that's the exciting part. And that's why innovation is so important. And that's where we're seeing good progress, when we talk to our clients about the fact that TIC is very important. It continues to be so and will continue to grow, but their operation is so complex that TIC at every point of the supply chain is necessary but not sufficient. They need to complement that with assurance, which is an audit of their operating procedures. So the growth remain very, very interesting. And as far as resource is concerned, look, if you look at broad base where the energy sector is, I mean, the exploration and production investments, if you take '17, [were] 50% away from the previous peak, right? So what we've seen in the oil and gas investments has been significant, and it's [160 billion] less investment. 2017, the investment in exploration and productions of our client are still reduced year-on-year. Now if you take the positive half-full glass position, yes, oil and gas companies are doing better in terms of revenue, are benefiting from the price increase of the oil, are improving their margins, but they still have a lot of work to do to repair their balance sheet. And some of them have got a lot of debt and still to catch up with dividends. So until we see growth in real investments in investment and in exploration and productions, no, we're not going to call the bottom. And I've always said that, until I see 2 or 3 quarters of stable revenue growth in Resources, I don't want to call the bottom. So we are being careful by saying that it's going to be challenging in H1 and less challenging in H2. And then it's for all of you to put numbers to these qualitative statements.

Will Kirkness
Jefferies LLC, Research Division

It's Will Kirkness from Jefferies. 2 questions, please. Firstly, could you talk about the improvement you've seen in some of your operational KPIs; and how that rate of improvement looks now, say, versus a year ago? And secondly, just a question on inflation in the U.S., particularly on wages, what you're seeing there.

André Pierre Joseph Lacroix
CEO & Director

I think, look, as far as -- let's take inflation, first. As far as inflation is concerned, look, it's early days, right, to really take a view on what's going to happen to inflation in the next 12 months. A lot of companies are careful with their own wage increases and -- but we are seeing different level of inflations around the world. And the way we manage our wages is based on the local level of inflation. So typically what we do is we tend to cover part of the wage inflation through pricing, and the rest through productivity. That's the approach we take when we have to deal with inflation in the U.S. or no matter where we are around the world. The question on operational KPIs is very, very important. Look, we measure, as you can imagine, multiple operational KPIs. And what we've tried to do is we try to make sure that every single business has got, if you want, a cockpit of leading and lagging indicators. And they try to basically sequentially improve their performance. And as you can imagine, we have 100 countries, 1,000 sites, multiple business lines, so the span of performance is quite wide. Having said that, the results we've deliver today wouldn't be possible if we have not seen improvement in many areas in terms of operational metrics. And for instance, one of the key metric that we track at local level is volume-price mix, all right? We've talked about it several times in the past because we are premium operators. And I believe in our virtuous economic value creation models. When you are premium operators, to grow revenue, you've got to do it with a strong pricing power. If you start lowering your prices, then this is the beginning of something you might not like. So volume-price mix is a huge focus area at the local level, and it's complex. Take a lab or take an operations. They will have ATIC volume price-points that are obviously different. They have sub products, but volume-price mix is a huge area of focus for us. The other area is NPS. I mean NPS has been phenomenal for us. I mean you -- some of you have met Richard Nelson and Raymond in the past. And I mean [when you spent] time with Raymond, these guys are customer centric per definition. I mean Raymond created lab tests in Hong Kong. And they believe in the value of customers. Now this is the DNA of Intertek. And it was part of the Inchcape Group that I know quite well, and the Inchcape family had the same vision. You've had to be close to your customers. Just to give you an anecdote: If you were an expat for Inchcape 20 or 30 years ago, they will send you to Kuwait or to Perth in Australia. You will not get a holiday ticket to go back here to the U.K. You have to stay for 2 or 3 years to network with your customers. So I'm giving this anecdote because I obviously heard it from Peter in Inchcape myself, but this is a true part of our culture. So where we've launched NPS, which is basically listening to our clients every single month, the reaction has been phenomenal. People love it. Why? Because it's the impartial, independent view of the clients. And this is not an organization where people believe they have maxed out. This is a very, very confident organization where we believe we can do much better. So NPS has been phenomenal in terms of operational metrics. Another example would be turnaround times. Turnaround times in our industry is very important. You only need to talk to customers. And every single day can make a huge difference; and the way our teams are focusing on turnaround times is very, very important. And talk about working capital. I mean, yes, we've made good progress, but this is by looking at obviously debtors, creditors [indiscernible]. So we have made it clear and very visible to our colleagues that we don't want to be a one-metric company. We want to make sure we drive consistency, sustainability of results. And the only way to do that is by taking a systemic approach internally as well as for our customers on all metrics. So we -- I mean what we're seeing is great, still more to come, but it's -- I mean the organization, believe it or not, we are a data company. So our people believe in the power of data, and therefore our own metrics are very important. Sorry, a long answer to a short question. I get passionate about these things, so...

Suhasini Varanasi
Goldman Sachs Group Inc., Research Division

Suhasini from Goldman Sachs. A few, if I may. One, on the -- you've seen a very nice margin pickup in 2017 led by underlying margin improvement, plus the product mix effects. How many more years of underlying margin improvement can you see in the business, especially in Products division, for example? Second one, the outlook on your individual divisions. There's a bit of a slowdown in Softlines and AgriWorld. Any comments on that? And the last one, your leverage is probably going to go to less than 1x net debt-to-EBITDA by the end of 2018. When can we expect the next material M&A?

André Pierre Joseph Lacroix
CEO & Director

I think, let's just start with the last one. Look, we have a great business, more in terms of cash generation. We are very disciplined. We are very interested in M&A. We are interested in the right M&A, and we will always remain disciplined. We'd rather not do a deal than do a deal that is too expensive, we cannot execute and it's going to destroy shareholder value. So as you can imagine, we get all the leads in the market, but we remain very selective. And there is nothing more I can say. And on the question about Softlines and Agri outlook, you've spotted the differences in terms of objectives, so well done. So basically there are several points. One is on Softlines, and you might have heard it. It's in the press, what we've seen. We have seen an increased focus of the Chinese government on environmental audits in their factory, basically, network. And that is, if you want, slowing down a bit the softline industry in China. I'm not tremendously worried about it because the SKUs and the product will still have to be produced somewhere, but there is a bit of slowdown and disruption there because, frankly speaking, a lot of small factories do not operate with the acceptable environmental audits for the Chinese government. What's interesting for us is it creates opportunity from an assurance standpoint because we can obviously help there. As far as Agri is concerned, I think the Agri business had had tremendous 2 years in '15 and '16s. The first half of '17 was very strong, but what we saw in the second half, we saw a slowdown which is driven by several things. One is, in the second half of '16 and the first half of '17, we had highly unusually crops in Australia and the U.S., which are 2 important markets for us, and therefore we had significant year-on-year increase. And obviously, this year's crop isn't as good as it was. And the other thing too is we've seen a bit of demand being brought forward, believe it or not, in our fish operations in Peru and Chile. So they are the kind of things we have to also factor in, in our forecasts. And last but not least, there is a change of tariffs in Argentina, which is disturbing a bit of the supply chain. So we are a bit more careful on Agri given the strong high-base effect we had in the past and the short-term trends. As far as the margin improvement is concerned, look, we have done obviously extremely well this year. Don't expect that kind of bps improvement every single year. For me, every bp is positive. So we will continue to make sure that every single operation is focused on every bp. Every bp is a win. If you can do 2, 3, even better. And obviously, what we did is phenomenal. So we'll remain focused, and we'll see. Yes?

Ed Steele
Citigroup Inc, Research Division

Ed Steele from Citi. Just a couple of questions about the product margin, please. First of all, are you able to give us a bit of color about which of the segments within Products did particularly well in the year, please? The second question, you talked quite a few times about price discipline et cetera. I imagine you've done quite a lot of benchmarking of your pricing against peers. Are you able to give us a flavor for how you see it; and how it's changed over the last 12, 18 months maybe, please?

André Pierre Joseph Lacroix
CEO & Director

Yes. Look, I think the -- it's very difficult. As you know, there is no -- we'll take the second question, first. There is no data in the industry about pricing. In a B2B business it's very difficult to know where pricing is, so the only thing I can say is that we are very focused in making sure that, if there are certain bids where our competitors are too aggressive, i.e. they're all priced too much, we'll rather walk away unless we believe this is a major strategic commercial decisions. We need to stay with these clients. We're going to find a way to make it up, and this is important for us. And as you know, I don't like to talk about what my competition does, but clearly the margin performance, which I think has not escaped you, is slightly different than the rest. And pricing is part of what we do, not the only thing we do. As far as product is concerned, what I would say is, and you know it from the past disclosures, the highest-margin part of product is Softlines and Hardlines. And it's still the case, and these guys have done extremely well in 2017. So [inside wins] in Products, Softlines, Hardlines was very good in terms of margin. Business Assurance was very, very good. And the other business that was very, very good is electrical, okay? Thank you. Yes?

Thomas Richard Sykes
Deutsche Bank AG, Research Division

Tom Sykes. Just a few. So firstly, just on the cash flow. Although you gave a net debt range, there's FX in that and your increased dividend. Are you expecting to increase your free cash flow in 2018, when you look at the increasing CapEx, and then the working capital? Just on the margin benefit: You've put in some of those cost savings in there. And you've got cost savings presumably organically and from the acquisitions that you've made, so I was just wondering what the sort of future -- what the carryover from things you've done over the last 12, 18 months is into 2018 as part of the margin outlook and what incremental cost savings there may be in the same way as you've outlined them there. And then just there's a sort of quite a baffling array of innovations and technology bullet points in your presentation. So just when you look at that, do -- you've presumably viewed technology as growth and margin accretive, as opposed to something that's going to be a headwind to you, but is that actually any faster from an innovation point of view than we've always had in the industry? And is it just something that everybody is making quite a big deal about at the moment but it's not actually any faster but it's part of the ongoing DNA of the business, please?

André Pierre Joseph Lacroix
CEO & Director

Okay, do you want to take one?

Edward Leigh
Former CFO & Director

I'll take the cash flow one, yes, sure.

André Pierre Joseph Lacroix
CEO & Director

Yes.

Edward Leigh
Former CFO & Director

So I mean, yes, we're looking at how we're going to continually improve our free cash flow. And we've guided to the net debt, which is what we've -- the specific numbers we gave, as you know. So guidance to the GBP 400 million to GBP 450 million. That's down about -- the midpoint of that is down GBP 120 million or so year-on-year in terms of net debt. So I mean, yes, we're looking at improvements in free cash flow. And we can [give the] kind of construct later on. So yes...

Thomas Richard Sykes
Deutsche Bank AG, Research Division

And on the CapEx of GBP 130 million to GBP 140 million [indiscernible] intangibles versus tangibles within that is given the technologies, the intangibles going up.

Edward Leigh
Former CFO & Director

Yes, we don't give that level of disclosure, yes.

Thomas Richard Sykes
Deutsche Bank AG, Research Division

All right.

André Pierre Joseph Lacroix
CEO & Director

So as far as the other question you have on the impacts of some of the cost initiatives on margin. Clearly, if you look at -- the level of restructuring we did in '16 was greater than what we did in '17. Therefore, the sequential effect was what it was in '17, partly due to the other thing that I talk about this morning. As far as some of the restructuring that we have done this year -- or last year, you will see it was H1 skewed. So you had also some improvement in H2. So yes, there is a bit, but I wouldn't expect too much from it because it's really baked in into our '17 numbers. I think the -- on technology and, I will say, the concept of innovation, the reason why I've decided to shares what we do on innovation is because we do innovation to basically provide a superior value proposition to our clients and/or improve our internal productivity and efficiencies. And look, the company is very decentralized, very innovative. That's why we have this huge breadth and depth of solutions. There is no question that innovation moving forward is very important. And as we obviously see a slightly better organic growth, I think I would personally like to spend slightly more time on innovation. And innovation, for me, is not only one idea. It's to basically making sure that everyone inside Intertek understands they have the license to develop innovation. And internally, I talk about 2 type of innovation. There is 0 to one, i.e. [a lab in one zone] created something new that they can sell to their client and then can scale it up. And the other part of innovation, which is where I spend my time and with our team, is what can we scale from 1 to 100. So a good example is Inlight, which is a truly innovative industry-leading product that we offer to our clients to basically track and mitigate the risk to their supply chains. We created -- and we talked about it in the past. We created that product for PepsiCo, and PepsiCo saw something that the others had not seen. And now we are basically scaling it up to other clients around the world, what I talk about today, our InterPret, which is an incredible algorithm that we have had in the North Sea for many, many years in Aberdeen operations. Provide our clients with real-time information in terms of predictive analysis and hydrocarbon issues. And we've talked to a lot of our oil and gas clients, and they're all very excited because as well nobody has that. So my role in the company is to make sure that innovation, provided it's margin accretive, i.e. you add value to your clients. And you can have a good pricing point because that's the way to get pricing innovation, and obviously you can drive efficiencies. And it's good, but it's also identifying the one that you can take from 1 to 100 because a lot of companies are very good at innovation. They do a lot of bits and pieces of communication here, but the real plus of innovation is to scale it up when you have a business like ours. So yes, we want to spend more time on innovation.

Andrew Charles Grobler
Crédit Suisse AG, Research Division

It's Andy Grobler from Crédit Suisse. Just one, on M&A. You've talked a little bit about it earlier, but after a fairly quiet year in 2017, at least relatively, can you just talk through why you didn't find more? Is it because prices have gone up or the cultural fit wasn't there? And how do you expect that to develop over the course of 2018, '19? And I suppose, as a -- on a similar point, if you have another couple of years like 2017, what do you start doing with the excess cash? How do you think about that process?

André Pierre Joseph Lacroix
CEO & Director

Look, I think, as you know, we have an M&A team here in London but also M&A colleagues around the world. The deal flow, right, has not changed. I think our team have been as busy as in '16, in '17, or in '15, but as you know, M&A, you've got lots, lots of situations, right? Sometimes, you have someone who's got too high of a price in terms of expectations, so this is the very quick conversations. But we have lots of transactions where we spend a lot of time on and we basically find out through the process that, well, this business has got an entry point issue. The marketing brochure was great, but then when we come to the last 4 months EBITDA or revenue growth, it looks very different. And we said, okay, well, maybe it just doesn't justify the price. And we don't want to buy a business that requires a turnaround if it's not something that we really want to. I mean you have situations where you find something in a DD that is not right from a control standpoint and a compliance standpoint. And then sometimes you come into situations where the price is right. The DD is right. The entry point is right, but you feel that the management will not fit with our culture. And when you bring a company inside Intertek, we need to make sure there is the cultural fit. And then sometimes you've got situations where the vendor, the seller is not as ready as they thought they would be in terms of carving out their businesses. So you've got multiple situations. So from our own time, Ed and I, and Julia, our Head of M&A, I mean the amount of hours we spend on M&A is not different than it was in '15, '16s. The [strike rate] is slightly different, which is I will say a good testament of our disciplined approach. I wouldn't say that there is price inflation out there because some of the transaction that we've done, KJ Tech, ABC, the recent deal we've done on kappa, are very reasonable in terms of pricing. Obviously, if you've got a tremendous asset that is worth, then you will be able to pay more, but I -- price inflation is not the issue. I think the issue is making sure that, every time you buy something, you create shareholder value. At the end of the day, organic growth in terms of revenue growth has got to be the priority. Acquisition is here to complement organic revenue growth and to buy a business that adds up to your top line 12 months down the road. This is an organic business, and you want to make sure that it contributes to growth and doesn't destroy shareholder value. Look, the question you've asked, what if, I think it would be a good problem to have, and we'll deal with it at the right time. Today, we've given a very strong signal that we believe in the quality of our cash generation. And we are increasing our dividend payout ratio to 50%, which is a significant commitment to our shareholders. And we'll see what we will do if we end up with too much cash one day. Any other question? Yes.

Ted Nyhan
JP Morgan Chase & Co, Research Division

Ted Nyhan, JPMorgan. 2 questions for me, if I can. And firstly, and apologies if you've already commented on this, but in November, December, I calculated you had 2.8% organic growth. Can you comment how you're trading versus that now, how you're [trading] versus that at the moment or in the first 2 months? And secondly, what is your outlook for the Resources margin and, I suppose, in 2018? But beyond that, when revenues start to recover, should we expect operating leverage there given how well you've protected that margin?

André Pierre Joseph Lacroix
CEO & Director

Yes, thanks. We -- I mean, today, we are talking about '17 and the full year guidance. We typically don't give short-term data. So the next update will be when we do our first 4 months in May, okay? As far as Resources is concerned, I think this is a very, very good point. I mean there is no question that given the fact that with the margin that we've delivered, we are almost half from the peak we had at the time when the industry was high. There is some, obviously, margin accretion opportunity in the resource sector when the industry rebounds. The question is when are we going to start seeing the volume increase. And as you've heard this morning, until I see it, I don't want to call it. I've worked in many industries, and calling a bottom out of a downturn is very difficult. And I don't want to do that. It will be very arrogant from our side. So I think we'll have to watch it. We'll do everything we can to drive revenue performance at a good price. And when we see the bottom, we'll call it, but I will wait a couple of quarters, maybe 3. As far as margin accretion moving forward, I think what's going to happen -- and the size of the downturn in this industry, I will say, is significant, right? The investment have reduced 50% from peak to trough. The oil and gas companies still are rebuilding their margins, so -- and during these periods, we've seen both volume and price decrease. And the reason why we have to be careful is what you're going to see. You're going to see volume picks up first, and then price. And it's only when you get both volume and price that we're going to be in the new normal situations and we can expect margin improvement. So personally I'm always of the view never waste a good crisis. When you have experienced such a downturn, you have, if you've done a good job, become more productive, more efficient. I think, over time, we should be able to see some margin uplift, but we'll take it step by step. But clearly, if you take the numbers at face value over the medium to long term, we are at about 50% of our peak profit, so there is significant scope here. The question is how we time it, how we face it. The good news, it's only 6% of our earnings, so I think we have the luxury of time to just take it a step at a time and not do anything crazy. Any other question? Let me ask our colleagues or guests on the phone. Do you have any question, if you are listening in?

Operator

[Operator Instructions] We don't have any questions coming through yet.

André Pierre Joseph Lacroix
CEO & Director

Okay, okay, it doesn't look like we have question now. It's a busy day. It's 10:00. Thank you for coming to our face-to-face session today. Really appreciate it. And obviously, Ed and Josh will be there, if you have any questions.
Thank you very much.