Chief Executive Officer's Review

Delivering sustainable long-term performance

Jon Stanton
Chief Executive Officer

2017 saw the Group deliver strong growth and strategic progress by being proactive and leveraging our leadership positions in increasingly attractive markets.

This time last year I set out our new 'We are Weir' strategic framework. It gave the Group a clear future direction and articulated the distinctive competencies – People, Customers, Technology, and Performance – that will help Weir achieve our vision of being the most admired engineering business in our markets.

As 2017 progressed, 'We are Weir' gained real traction across the business with teams from all over the world contributing to a vibrant debate about how best to execute our new strategy and deliver strong returns for all our stakeholders.

That passion and shared sense of purpose is extremely important and powerful. As we look to the future, we have a good sense of where we want to go as a business and how we are going to get there. That includes agreeing new key performance indicators to be delivered over the medium term, starting in 2018. They are:

- Improved sustainable engagement and organisational effectiveness
- Increased market share
- Improved percentage of revenues from new solutions
- Sustainably higher margins through the cycle

These indicators will guide our short- to medium-term progress and will require excellent execution of our strategy, building on the good progress delivered in 2017.

Strategic progress

People

Safety is our number one priority and I am pleased to report excellent progress in the past year. The Group's total incident rate (TIR), our primary measure of safety performance, reduced from 0.66 to 0.53, a 20% improvement. This has been achieved by a clear commitment from the top of the organisation through the Chief Executive's Safety Committee and other initiatives, but more importantly by the widespread adoption of a bottom-up behavioural safety culture that focuses on reducing harm and ensuring our people have a safe start, safe finish and safe journey home. There are parts of the Group that consistently achieve zero harm, but we won't be satisfied until that is consistent across all our businesses.

In addition to improving safety, we have also re-invested in our people development programmes. This was an area where the business cut back during the downturn and it was important to rebuild in order to maintain our strong record of execution. Having leaders who can mentor and develop the potential of their teams is vital. The quality and passion of our people is a real differentiator for Weir and ensuring we have a highly skilled and fully engaged workforce is critical to our future success.

Going forward, safety will continue to be our number one priority. We have also developed a new people strategy aimed at strengthening our culture and inspiring our people to reach their potential and build a personal legacy. It includes a new approach to strategic workforce planning and reviewing the employee experience to ensure it aligns with our culture and allows us to recruit and retain a diverse and vibrant workforce.

To help ensure our performance is fully aligned to the interests of our investors we'll introduce an all-employee share ownership plan in 2019. The success of the Group depends on the efforts of all our people and it is right that we give them a real stake in our future. You can read further details of our proposed plan in our Remuneration Committee report from page 95.

Customers

Our customers are the reason we exist and thrive. Every Weir colleague should wake up each day thinking how we can do more to help our customers do better.

Traditionally, we have taken a product-led approach, but as part of the We are Weir strategic framework, we are moving to an integrated solutions mindset in which our people spend more time on site, listening to customers' operational challenges and then designing a package of solutions to help them achieve their goals.

This approach helps embed Weir even further into the operations of our customers and differentiates us more clearly from competitors. In Minerals, it helped increase orders ahead of global mining and sustaining capital spending. Oil & Gas also outperformed North American rig count growth, leveraging their key account management programme to build even closer relationships with leading oilfield services companies. Flow Control grew aftermarket orders in tough markets and reshaped its sales and marketing structure to increase its customer intimacy.

We will continue to build even closer customer relationships in the future, building on the competitive advantage provided by our comprehensive service network and seeking to continue to take early advantage of market trends. We will also work closely with customers to jointly develop new technologies that help them achieve their objectives and further embed Weir at the heart of their operations.

You can read more in our divisional operational reviews beginning on page 28.

Technology

The Group delivered revenues of £168m from new solutions in 2017, a 53% increase, as we continued to benefit from our commitment to research and development (R&D) during the downturns that affected both mining and oil and gas markets. We also made progress towards our aim of investing 2% of revenues in R&D with 2017 expenditure of £40m

A CEO 'Town Hall' meeting in Jiading, China.

(2016: £27m) representing 1.7% of sales, up from 1.5% in 2016. Our next generation frac pump, the SPM® QEM 3000, is on trial with a number of the larger oilfield services companies, positioning the Group to benefit from any capital replacement cycle as frac fleets are upgraded in the future.

The Group's Internet of Things (IoT) technology, Synertrex®, was also successfully trialled in a number of regions, allowing customers to easily monitor the performance of their equipment and giving Weir valuable data to support future innovation.

Alongside our established process of product development, the Group has developed a new technology strategy that will ensure we continue to lead the change in our markets and build on our legacy of innovative engineering. It includes increasing the digitisation of our solutions and operations, integrating advanced manufacturing into our factories, reinforcing our materials science leadership and developing ways to reduce our customers' energy and water consumption; helping underpin the sustainability of our end markets.

Performance

Operational excellence has been a traditional strength of the Group and in 2017 we took important steps to reinvigorate our Value Chain Excellence (VCE) initiatives across the business. Reviews were conducted to assess the potential of every business unit to make improvements.

More than 80 VCE projects were initiated, supported by extensive training programmes, and targeted at increasing on time delivery and reducing inventory turns. While overall working capital increased during the year as the business grew quickly, there was progress on increasing inventory turns.

In 2018, we expect that progress to accelerate as we see some of the benefits of our renewed focus on operational excellence come through. In the longer term, we aim to significantly improve working capital performance supporting the Group's ability to invest in further growth opportunities.

Capital allocation

In July, the Group acquired leading South East Asian wellhead manufacturer KOP Surface Products for an equivalent enterprise value of US$114m to support growth of our pressure control offering in the eastern hemisphere. KOP's technology complements Weir's existing Oil & Gas portfolio and will help accelerate progress in attractive Middle East and Asian markets.

2017 markets and business review

The Group's financial performance in 2017 reflects the proactive approach taken by the business to act early and invest in extending our competitive advantages. This, coupled with rapid improvement in market conditions in North American oil and gas and increased investment by miners on brownfield assets, contributed to a 20% increase in constant currency orders.

Chief Executive Officer's Review continued

Strong order growth

£2,395m

+20%

Revenues from new products

£168m

+53%

The performance of the Oil & Gas division in particular was excellent. It moved from a £9m operating loss in 2016 to an operating profit of £92m in 2017. As the oil price and North American rig count recovered through the year, the division's main manufacturing facility in Fort Worth, Texas, flexed its operations and significantly increased capacity, moving from one shift to three. As a result of previous reductions in fixed costs, the facility delivered excellent operating leverage that contributed to its overall performance.

Minerals delivered double-digit order growth as it captured opportunities in global mining markets. Alongside its integrated solutions strategy that delivered £67m in revenues, the division invested in additional sales and project engineers to support future growth, as confidence and quotation activity in mining markets increased.

As orders grew there were some limited operational issues in the division as a result of plant and supply chain reconfigurations. While these were short-term, they, alongside the additional investment and some project delays, had an impact on the division's operating margin, but it remained within its normal long-term range.

Flow Control turned a corner in the second half of the year after its first half performance was impacted by tough market conditions in power and downstream oil and gas, while the division also recorded a one-off charge of £13m resulting from legacy contract challenges in its Gabbioneta business. This resulted in the division recording a small operating loss of £3m for the full year. As 2017 progressed, there were early signs of recovery in mid and downstream oil and gas markets while nuclear activity in China and South Korea continued to progress, with the division delivering good growth in its valves aftermarket business. After a restructuring of its sales and marketing capability, the division is now clearly focused on capturing future growth opportunities.

Outlook for 2018

Customers in our main markets are expected to increase investment in 2018 with global mining expenditure expected to increase after a prolonged downturn. Investment by exploration and production companies in upstream North American markets is also expected to increase, supported by commodity prices and increased efficiencies in the industry. Power, mid and downstream oil and gas markets are showing initial indications of improvement.

To fully benefit from these trends, the Group will leverage the four distinctive competencies at the heart of our strategic framework; People, Customers, Technology and Performance.

Looking to 2018, assuming market conditions remain supportive, we expect to deliver strong constant currency revenue and profit growth and further balance sheet deleveraging.

Jon Stanton
Chief Executive Officer
28 February 2018

My Team

See biographies on page 70.

Team priorities

The Group Executive was strengthened in 2017 with the appointment of Geetha Dabir as Chief Technology Officer and Rosemary McGinness as Chief People Officer. Our medium-term key performance indicators are shown below:

People

Improved sustainable engagement score and increased organisational effectiveness

Customers

Increased market share

Technology

Improved percentage of revenues from new solutions

Performance

Sustainably higher margins through cycle

Chief Executive Officer's Q&A

Building a stronger legacy

Jon Stanton
Chief Executive Officer

Q What are your reflections on your first full year as Weir CEO?

The main highlight for me was the adoption of the We are Weir strategy. I've spoken to hundreds of our people in the past year and there has been great enthusiasm from across our global operations. This is a Group with a strong culture, great optimism and a clear view of the role we all have to play in building a stronger legacy for future generations.

Another highlight is the decisiveness we showed in responding to the rapid improvement in our core markets. We were aggressive during the downturn and we were determined to be equally proactive in the upturn. I think we've done that well, particularly in Oil & Gas, where the recovery was steepest. We did that while at the same time making good strategic progress that will deliver value over the long term.

In terms of improvements, I think we still have work to do to optimise our operations. 2017 was about identifying opportunities and the years ahead will be about seizing those opportunities to become more efficient and better serve our customers.

Q How has the Group's strategy developed in the past year?

We've made good progress in defining our technology strategy during the year. The appointment of our new Chief Technology Officer, Geetha Dabir, whose career has been spent in Silicon Valley, has brought a new perspective and focus to the business, as we increasingly digitise our offering. We're also developing a new people strategy led by our new Chief People Officer, Rosemary McGinness, to ensure we promote a high-performance culture and have the capabilities we will need to succeed in the years ahead. We'll do more work to refine that strategy throughout 2018. We are also further integrating sustainability throughout the business and we'll establish baselines in the next year in terms of our own performance, in addition to helping our customers operate more sustainably.

Q The Group operates in cyclical markets, how sustainable are current conditions?

Industry expectations are also for a multi-year upturn in the mining capital cycle supported by anticipated demand for commodities like copper as the world invests more in infrastructure and the move towards electric vehicles.

In oil and gas we've clearly seen a structural change with shale oil and gas becoming very competitive and maturing into a dependable source of global energy supply. North America and the Middle East are the most attractive oil and gas markets in the world and they also happen to be where most of our activity in this industry takes place. So I think we are in the right places, with good market positions.

Finally, conditions in mid and downstream oil and gas and power – both served by Flow Control – are showing some green shoots of recovery after a prolonged downturn.

Overall, our markets are increasingly attractive and we are well positioned to take advantage of those improved conditions.

Q What are the other main trends you see impacting the Group in the future?

As a truly global business that serves natural resources and energy customers, there are many issues we look at. Firstly, the health of the global economy, which improved in 2017 as growth picked up in advanced and emerging economies, driving demand for commodities.

Secondly, tackling climate change is clearly a priority and we are investigating how we can help customers reduce their energy and water usage as well as reducing our own environmental impact. And thirdly, technology is changing rapidly, with 'big data' and advanced manufacturing increasingly important in the markets we serve.

That is why we have a new technology strategy to take advantage of these changes. There are many more issues I could highlight, but uniting them all is the importance of being proactive and agile as a business so that we can respond to changes quickly and capture opportunities wherever they are.

Q And how does this impact your view on allocating capital?

We have some really strong market positions and we are focused on using those as a platform to grow in what are increasingly attractive markets.

Take comminution (crushing, grinding and screening), where we increased capability with the acquisition of Trio Engineered Products in 2014. This allowed us to offer our mining customers a wider portfolio of products while also giving us access to sand and aggregates markets.

Since the acquisition, the Minerals division has applied its materials science knowledge to develop new crusher technologies and leveraged its comprehensive service network to globalise the Trio brand in both mining and sand, and aggregates, markets. To give a sense of the progress, in 2017, comminution revenues for original equipment increased by a third.

So where there are opportunities to accelerate our strategy through disciplined mergers and acquisition activity, we'll take them.

> "This is a Group with a strong culture, great optimism and a clear view of the role we all have to play in building a stronger legacy for future generations."