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SMITHS INDUSTRIES

Aerospace · Medical Systems · Industrial

A **STRATEGY** THAT DELIVERS...



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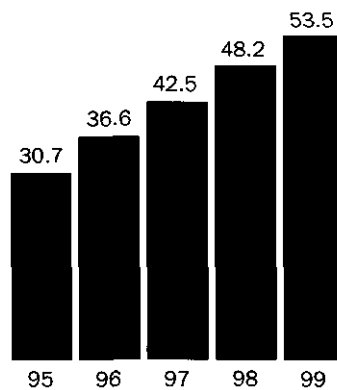


SMITHS INDUSTRIES

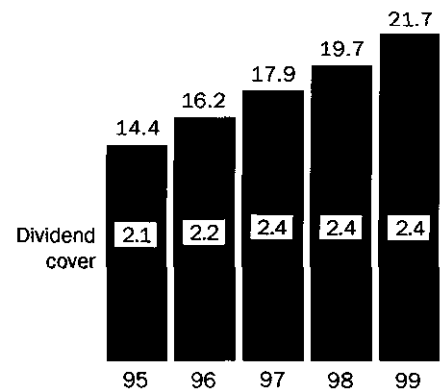
Aerospace · Medical Systems · Industrial

Smiths Industries is a focused engineering company with an approach to innovation that has brought world leadership in precisely chosen sectors of advanced aerospace electronics, medical systems, and specialised industrial products.

EPS Pence



Dividends Pence



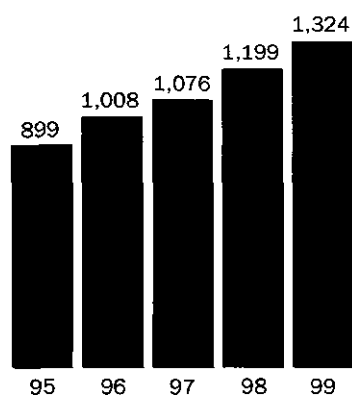
...INCREASED VALUE TO SHAREHOLDERS AND A

Over the past five years, Smiths Industries has delivered a 15% compound growth rate in earnings per share and a 11% annual increase in the dividend. In fact, dividends have now increased year-on-year for the past 29 years.

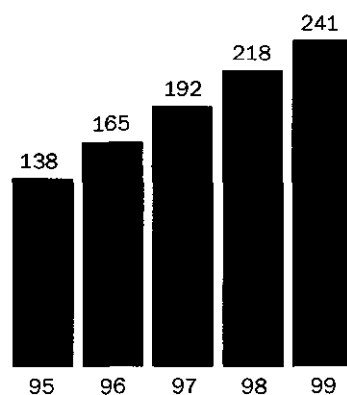
Financial highlights

	1999	1998	change
Turnover	£1,324m	£1,199m	+10%
Profit before tax and amortisation	£241m	£218m	+10%
Net borrowings	(£93m)	(£83m)	-
Earnings per share	53.5p	48.2p	+11%
Dividend for the year	21.65p	19.65p	+10%

Turnover £m



Profit before tax £m

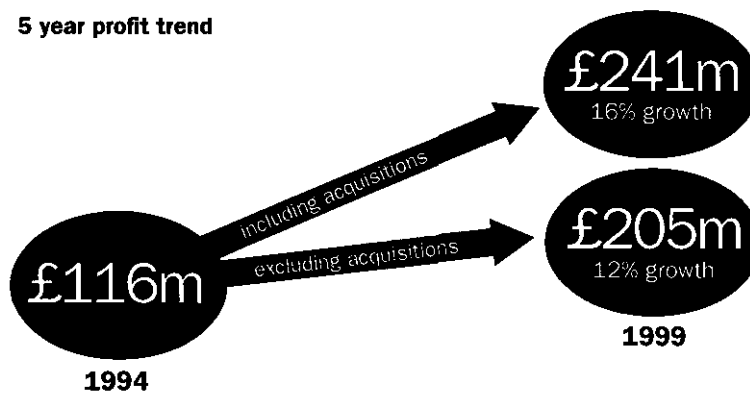


**CONSISTENTLY
STRONG FINANCIAL
PERFORMANCE BY...**

Smiths Industries has a strong track record of growth. High margins make an important contribution, and are earned through product leadership and constant productivity improvements.

In the past five years, the pre-tax profit from our established activities has shown solid growth at an annual rate of 12%. The cash generated has been used to fund acquisitions whose contributions have raised our total growth to 16% a year during this period.

5 year profit trend



**...BUILDING BUSINESSES
THROUGH ORGANIC
GROWTH AND ACQUISITION,**

We build significant relationships with top-name customers by developing highly innovative, added-value solutions for very specialised needs, often through shared R&D investment. As a result, for two-thirds of our product lines we are one of the top two suppliers in the marketplace.

With our depth of management ability and financial resources we are well positioned to take advantage of opportunities arising from further consolidation in our industry sectors.

AND DEVELOPING
**STRONG CUSTOMER
PARTNERSHIPS BY...**



Smiths Industries at a glance

Aerospace

We are a first-tier supplier of advanced avionics to the UK and US armed forces, and to all major civil and defence platform manufacturers.

Another main activity is Product Support – providing spares, repair and overhaul services for our airline and airforce customers.

Financial performance

Sales rose 14% to £529m.

Profits increased by 28% to £99m.

Margins improved by 2 points to 19%.

Profits have grown rapidly at 20% a year over five years and margins have improved from 10% to 19% over this period.

Product areas

We develop advanced, integrated avionics which have applications in both civil and defence aircraft programmes.

Our products are provided both for equipping new-build aircraft and retrofitting and supporting existing aircraft.

Medical

We are a leading supplier of devices and equipment used during critical and intensive care procedures, and for continuing care during post-operative recovery.

Manufacturing is concentrated in the UK and US, with a large proportion of UK production being exported.

Financial performance

Sales this year grew 9% to £376m.

Profits increased by 2% to £76m.

Margins reduced slightly to 20%, but this remains our most profitable business.

Strong sales growth at 13% a year over five years reflects both organic growth and acquisitions.

Product areas

Our single-use devices are mainly used for anaesthesia and respiratory care.

Another major product area is infusion therapy: a fast-growing, high-margin field. Our products are used in hospitals – including the operating theatre – and in longer-term care for patients outside the hospital environment.

Industrial

We operate in the US, UK and continental Europe, producing specialised engineering products which meet customers' requirements for high levels of systems performance.

Financial performance

Sales rose 7% to £419m.

Profits increased by 1% to £73m.

Margins eased 1 point to 17%.

Industrial has been our fastest-growing business over the past five years, with operating profit increasing at an average of 21% a year.

Product areas

Interconnect products – our electrical/electronic connectors and cable management systems – are used in hazardous and safety-critical environments, and in protecting installations against the effects of lightning strikes.

The second major product grouping is air-movement systems, comprising fans, ducting and hosing for commercial and domestic applications.

...APPLYING
**WORLD LEADING
TECHNOLOGIES IN ALL**

The marketplace

We are currently at the top of the demand curve for civil jets. However, original equipment for civil aircraft (as distinct from retrofit and spares) represents only 20% of our business. Looking ahead, the greatest opportunity will come from the defence sector, in which a large number of military platforms are now moving to volume production.

Highlights of the year

We have established our leadership in the new technology of Health and Usage Monitoring Systems.

Product Support captured over 50% of repairs carried out to our original equipment – more than twice the average of our competitors.

Growth opportunities

We will grow through our ownership of the key building-block technologies around which integrated avionics systems are developed.

Defence programmes will provide the main stimulus for organic growth.

We will continue to make acquisitions to strengthen our core capabilities.

The marketplace

The world market for medical devices is expanding at 6% a year.

The US healthcare sector is growing strongly, and we resist the constant pricing pressure by supplying premium products.

Highlights of the year

The acquisition of BCI gained us another market-leading product that extends our capabilities in vital-signs monitoring.

Intravenous therapy has become a major sector of our businesses, driven by our successful grouping of complementary products.

Growth opportunities

We are intent on gaining much better market penetration, in both our existing territories and new marketplaces. To achieve this we will leverage our US technology leadership throughout our world-wide distribution system.

We are also focusing on reducing our operating costs through continuous improvements in product development, manufacturing, distribution, and productivity.

The marketplace

Our products are generally market leaders with exclusive technologies suited to niches in growing application areas.

There is growing demand for our products from buoyant sectors such as aerospace, defence, and telecommunications.

Highlights of the year

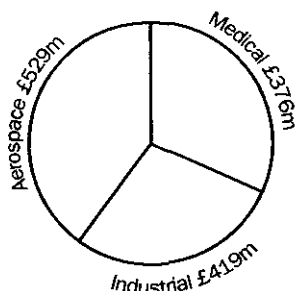
The acquisition of Transtector has strengthened our telecoms capability to expand our share of this global market.

Aerospace and defence, followed by telecoms, are now the largest application areas for our interconnect products.

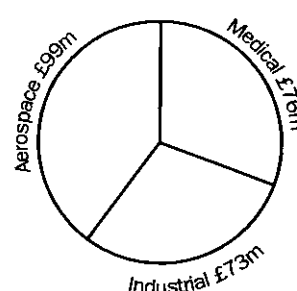
Growth opportunities

There are opportunities to gain additional sales through further integration of activities, especially where we are supplying complementary products to the same customer base.

Turnover £1,324m
by business

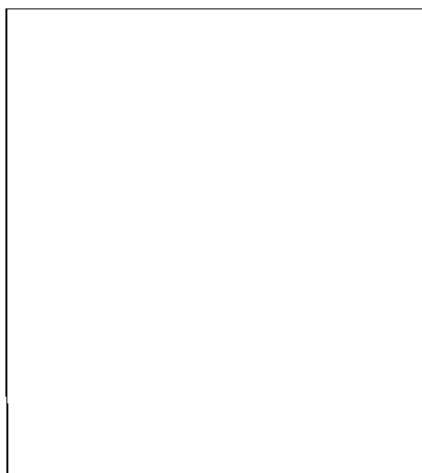


Operating profit £248m
by business



THREE HIGHLY FOCUSED BUSINESSES.

Chairman's statement



Keith Orrell-Jones, Chairman

**"...earnings
per share
have increased
by 11%..."**

The assurance of continuity is an important consideration for shareholders, and so, in my first year as Chairman, I am happy to tell you that the company has again produced results which set a new record of performance. More than anything, this is a reflection of the great strength and depth of management throughout Smiths Industries. All three divisions share this vital quality for success, although it is Aerospace which takes much of the credit for the improvement this time.

Our earnings per share increased 11% to 53.5p in 1999 (1998: 48.2p), and the Board is recommending a final dividend of 14.25p (12.9p), making a total for the year of 21.65p (19.65p), a 10% increase on the payout for the previous year. The dividend is covered 2.4 times by earnings, and shareholders will again be offered the alternative of a scrip dividend.

These results are consistent with the long-term performance of the company. The dividend has been increased by 10% or more in each of the past five years, and the average increase per annum over the past decade has been only one point less than that. In fact, 1999 marks the 29th successive year of dividend increases. With inflation at an all time low, an increase of 10% is a valuable step forward.

I am confident that Smiths Industries continues to run very smoothly. An important measure to help judge this is the 15% after-tax rate of return on total shareholder investment (including goodwill valued at £900m), which is a clear six percentage points above the company's current cost of capital.

May I take this opportunity to pay tribute to all the Company's employees, without whom none of this would have been achieved.

Turning now to The Board, it is good to be able to report that we have a strong team of executives and non-executives. During the year, Peter Hollins joined us as a non-executive director. Peter is Chief Executive of

British Energy plc, and – if you will forgive the pun – is already bringing some of that energy to our own Board. Roger Leverton has become Chairman of the Audit Committee, and I remain Chairman of the Nominations and Remuneration Committee.

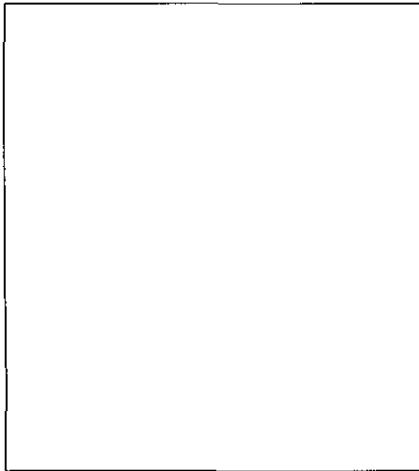
Smiths Industries is operating in markets with interesting dynamics. Aerospace, particularly in its defence sector, is in a long-term growth phase. Medical serves a healthcare sector subject to dramatic demographic trends, including a rapidly ageing population in the developed world. Industrial, on the other hand, is far closer to the economic cycle of each country where it trades.

I am no economic seer, but the American economy continues to perform well, Britain and Europe have not yet started to enjoy an industrial resurgence, and the Rest of the World remains volatile, but with some specific opportunities for us.

Altogether, I expect this environment to remain favourable for the company in the future. We are financially strong and ready for a bigger step if we judge it to be value enhancing. For the period ahead, the management is properly focused on driving the existing business forward in a way that will deliver excellent returns for shareholders, and it is this performance which I believe will continue to make Smiths Industries an attractive investment.

Keith Orrell-Jones Chairman

Chief Executive's review



Keith Butler-Wheelhouse, Chief Executive

“...operating profits have increased by 10%...”

Shareholders have come to expect Smiths Industries to deliver strong growth and above-average returns on investment. I am pleased to report that we have met these expectations for 1999, with a 10% or more improvement in the key measures of performance. Equally important to shareholders is our confidence that we can sustain this success in the years ahead. We will achieve it by holding fast to the values which define Smiths Industries and are deeply ingrained in our corporate culture.

First, I believe that we are good at what we do. Over many years' involvement in aerospace, medical and industrial sectors we have concentrated on the things we know how to do best. This know-how includes market awareness, the ability to develop innovative products and technologies, a real understanding of customers' expectations, and the skills and experience of 15,000 committed employees. The following pages show how these attributes keep us among the world's leading suppliers in our specialised sectors.

Secondly, these Accounts reveal qualities shared by few of our peers. Judge Smiths Industries not only by earnings, but also by margin on sales and cash-flow. It is these that give us the ability to fund our own growth: witness the £800m spent on acquisitions in the past decade while maintaining gearing at a very low level.

Building on this sound base, we are now focusing on profitable top-line sales growth from existing activities and on raising productivity. The gains are already evident in last year's results. By all of the measures I have described, our strategy

is to deliver enhanced value to shareholders in both the short and long-term.

Pre-tax profits for 1999 increased 10% over the previous year, rising to £241m before goodwill amortisation. A reduced tax rate accounted for the slightly higher level of earnings growth mentioned by the Chairman. Interest costs amounted to £7m, and we ended the year with net debt of £93m, only £10m up, despite spending £93m on acquisitions during the year.

Turnover and operating profits also increased by over 10% to £1,324m and £248m, with Aerospace making the greatest contribution to the improvement. Margin on sales remained strong at 19%, and all three of our activities achieved profitability close to this combined figure.

Cash-flow is one of our fundamentals, and last year operating cash-flow of £195m represented about 80% conversion of profits into cash, measured after net capital expenditure at a record £48m. After tax and interest, free cash-flow was £117m, providing ample headroom for further complementary acquisitions.

Through acquisitions we can generate a better rate of return than the cash would otherwise have earned. For example, acquisitions made in 1998 produced profits, in their first full year, well in excess of their funding costs. In 1999 we made seven acquisitions for the £93m outlay, adding valuable technologies to all three of our activities. Their combined contribution to profits during the year matched their funding costs, and we expect them to make a positive contribution in the current year.

Financial highlights	1999	1998	increase
Turnover (£m)	1,324	1,199	+10%
Pre-tax profit (£m)*	241	218	+10%
EPS (p)*	53.5	48.2	+11%
Dividend (p)	21.65	19.65	+10%
Net borrowings (£m)	(93)	(83)	
Acquisition spend (£m)	93	132	

*before goodwill amortisation

The company's existing activities contributed most of the total improvement in profits last year. Our focus on achieving additional sales – without sacrificing margins – is yielding results, as are our efforts to reduce costs and boost efficiency. Productivity, measured as sales per employee, showed a 6% gain in 1999.

Another important factor is our extensive involvement in the US, where we now have 25 manufacturing locations employing 6,300 people. By destination of sales the US is much the largest single market for Smiths Industries, at 45% of the total, which includes high-value aerospace products made in the UK for customers such as Boeing. We are benefiting from the US economy's remarkably long period of buoyancy, and are also building up our exports from the US, which reached \$176m last year.

As a result, most of our currency exposure lies in the relationship between the dollar and sterling, which has changed little since 1998. Sterling itself also remained relatively stable against the other currencies we trade in. Overall, the translation effect of differing exchange rates year-on-year was not significant.

However, as a major UK exporter (£296m sales in 1999) we have had to

adapt to the continued high level of sterling in recent years. It has been tough, for example, selling into continental European countries which are already suffering from depressed industrial investment.

Another of our fundamental values is a firm commitment to innovative technology. By solving users' most complex problems we add value to our customers' products while commanding a premium and securing margins in the high teens. Research and development is therefore the lifeblood of the company, and we have built an invaluable asset of proprietary technology covered by thousands of patents. Aerospace accounts for the largest part of the expenditure, but it is increasing in Medical as we move further into advanced monitoring and therapy systems. Expenditure on R&D last year was £127m, of which £73m was recovered from customers, mainly for US and UK government funded defence projects.

Each of our three operational areas has performed well in widely differing market conditions.

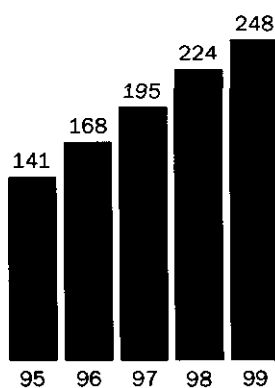
Aerospace: On sales 14% ahead at £529m, profits advanced by 28% to £99m, marking the third successive year of near 30% profit growth, with margin on sales now close to 19%. This

performance is aided by positive trends in the industry, but largely results from our success in winning business on major aircraft programmes, and our ability to respond to rising volumes while controlling overheads.

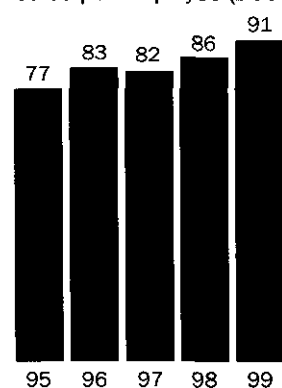
While production rates for civil jets reached an all-time high during the year, this sector of the industry has now reached the top of its present cycle. Since our deliveries of systems for new-build civil aircraft represents only 20% of Aerospace sales, this is not a serious threat. More significant is the renewed attention to defence spending in many countries, including the US. Our advanced avionics systems are securing their place on the new military aircraft programmes now moving into the production phase, and the defence sector of our business, already the most important, is set to grow rapidly.

Once in service, both civil and defence aircraft offer many further opportunities. New-generation avionics can bring greater efficiency to older civil jets and superior combat capabilities to military aircraft, in both cases extending the useful life of the airframe and representing good income for us. Equally valuable to us is product support for our end-user customers, the airlines and airforces. Here our rapid response to the operators in the competitive environment

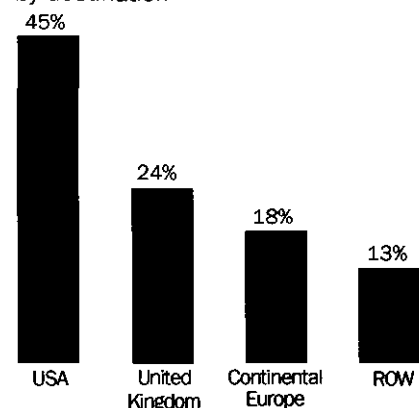
Operating profit
£m



Productivity
Sales per employee (£000's)



Geographical sales
by destination



“We have built an **invaluable asset** of proprietary technology...”

for spares, repair and overhaul has generated a profitable business.

Aerospace has climbed to the point where it now represents 40% of the sales and profits of Smiths Industries. As the company continues to grow, we expect it to hold that proportion in the near term.

Medical: On sales up 9% to £376m, profits increased 2% to £76m, causing a slight reduction in margins to 20%, still the highest of our three areas of activity. Over the past three years Medical Systems (SIMS) growth has shifted down a gear, due largely to changing purchasing practices in the US, the strength of sterling and economic conditions in the Far East. Through the actions we have taken SIMS is back on a growth path, as can be seen from last year: at the Interim we reported flat sales and profits compared with a year earlier, while in the second half, like-for-like sales improved by 5%.

New single-use and infusion therapy products launched at the end of the year will accelerate the drive for growth, and help maintain the ‘premium’ profile of the SIMS range. In another move to revitalise sales in Europe we have reorganised distribution in the main territories by taking responsibility in-house to offer the complete range from a single source in each country. Necessary de-stocking at our majority-owned Japanese distributor is working its way through, and although this affected exports from the UK, sales in Japan have been good.

SIMS makes many products in high volume, often involving labour-intensive assembly, and thus manufacturing costs are a significant element. In North America, our transfer of some processes to a ‘maquiladora’ plant across the Mexican border has helped the US operations remain price competitive.

Overall, medical devices and equipment is a good sector to be in. World demand for better healthcare is rising inexorably. Medical professionals in developing countries recognise the value of single-use practices in preventing cross infection.

In the more developed countries, ageing populations are requiring greater medical attention. SIMS is well placed to benefit from these trends.

Industrial: On sales 7% higher at £419m, profits increased slightly to £73m, with margins down one point to 17%. Industrial operations are focused in two main areas: electrical/electronic interconnection products (Interconnect) and Air Movement Systems. They trade widely throughout Europe and the US and, in general, their performance last year mirrored the economic conditions on either side of the Atlantic.

More than half of Industrial’s sales are in the US, where business was buoyant. Air-movement operations benefited from strong demand for hosing and heating elements from domestic appliance manufacturers, and for air conditioning ducting used in new buildings. We invested in additional production facilities during the year in the expectation of continued sales growth.

Interconnect’s largest customers include US aerospace and defence companies, and demand from these followed the same pattern experienced by our Aerospace operations, while the still-expanding cellular telephone industry in the US also stimulated sales of lightning protection and other products.

In the UK and continental Europe, lack of capital goods investment painted a duller picture for sales of fans, hosing and ducting. Interconnect fared better, again with defence and telecom business holding up well.

In this year of consolidation for Industrial, one primary concern has been to match production levels to lower demand in the UK and the Continent. However, Industrial is the No. 1 or No. 2 supplier in 75% of the product areas we serve, thus its performance follows general economic indicators, and if the early signs of recovery for manufacturing sectors in Europe prove accurate, we expect Industrial to regain growth quickly.

Prospects: At the start of the 20th century, Sam Smith’s company – already 50 years old – was poised for growth, and grow it did. At the start of the 21st century Smiths Industries is again ready to face new challenges. We are well placed in our key engineering sectors, while our specialised products are in high demand.

Aerospace is currently the brightest star and has exciting prospects in the defence sector; Medical is beginning to regain sales growth; while, within Industrial, the Interconnect operations are aligned with the upward momentum in aerospace and defence. We can therefore deliver growth from all three activities in the near term, and I am confident that earnings and dividend increases can be maintained in the years ahead.



Keith Butler-Wheelhouse Chief Executive

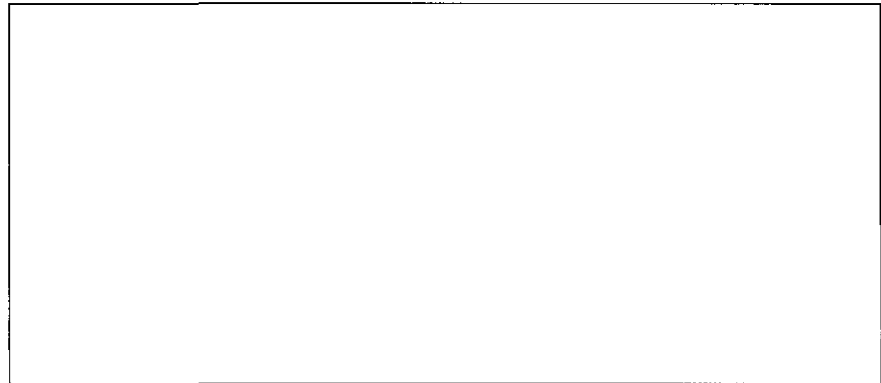
Business review

Smiths Industries Aerospace delivered yet another very strong performance last year, making the largest contribution to the company's overall improvement in 1999. Aerospace has grown rapidly for five years, and the opportunities for further growth are no less exciting. Profits have doubled in that period and the margin on sales has risen from 11% to nearly 19% last year. On sales of £529m, up 14%, Aerospace earned profits of £99m, a jump of 28%, with only a very small part of the increase coming from acquisitions. At this level, it now accounts for 40% of the company's sales and profits.

One contribution to the good performance has been a marked improvement in productivity, with

reorganisation at the start of the year yielding rapid benefits. The formation of centres of excellence for distinct product groups, which eliminated the separation between civil and defence products, has proved the right decision. We are now more responsive to customers, who have in turn rewarded us with preferred supplier status at a number of locations. During the year we opened an £18m state-of-the-art US facility in Grand Rapids, matching the one at Cheltenham, and at both locations we have gained from more productive working practices.

This product-focused organisation enables Aerospace to concentrate on a number of clearly defined technologies

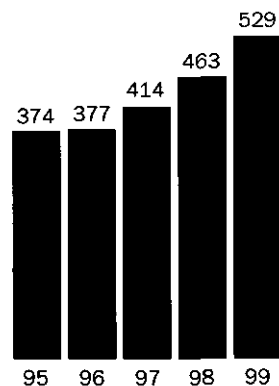


Forming valuable partnerships

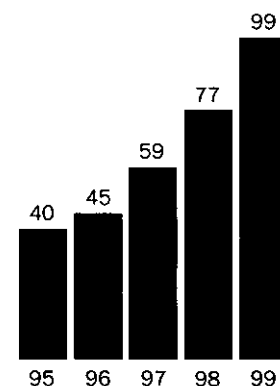
Norman Barber, Chairman, Aerospace, right, with François Lureau, Chairman and CEO, Sextant. Through our partnership with Sextant, the new

Flight Management System we jointly developed for Airbus Industrie has now been selected by eight international airlines – both for future aircraft and retrofit of existing Airbus fleets.

Aerospace turnover
£m



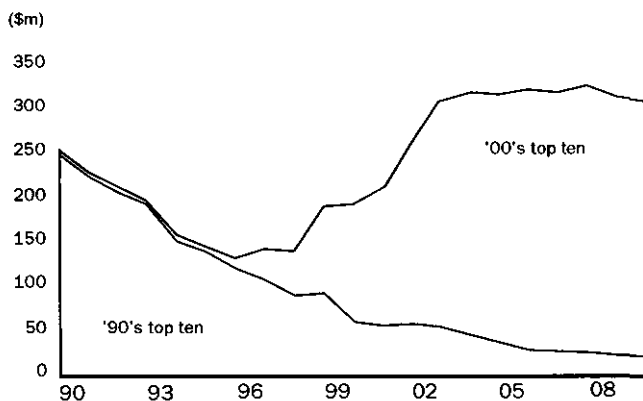
Aerospace profit
£m



The main **growth for aerospace** will be in the defence sector

Benefiting from the upswing

As suppliers of important equipment to many large-scale military aircraft now moving into the production phase, we expect combined sales for our new 'top ten' defence programmes to average \$250m a year for the coming decade, compared with \$150m a year during the 1990s.



Pushing up the standards

The Eurofighter's cockpit is being upgraded with our latest Active Matrix Liquid Crystal Display (AMLCD) technology, which provides better definition and sunlight readability than conventional units. With a number of our systems on this aircraft, we will benefit from the 620 firm orders and the continuing strong sales outlook.

Investing for future demands

We have critical systems on both Boeing and Lockheed Martin versions of the Joint Strike Fighter, a combat aircraft scheduled to enter service between 2008 and 2010 and expected to be one of the largest aircraft manufacturing programmes in the new century.

where we have built market niches with world-leading or highly competitive positions. They include systems for flight management, electrical power generation and load management, utilities control, stores management, fuel measurement, cockpit displays and health and usage monitoring (HUMS). In each case, these systems are integral to the aircraft's avionics and, once specified, are generally sole-sourced from Smiths Industries by the prime contractor for a particular programme. A further area of expertise, chemical/biological agent detection, was acquired a year ago with Graseby which – with its mainly defence department customers – has been smoothly absorbed within Aerospace.

We have strengthened our involvement in two of these areas through a series of acquisitions that extended our technology and market access. Adding to our HUMS and related capabilities, we purchased Stewart Hughes in the UK, and SPS and STSI in the US at a combined cost of £2.5m. HUMS is a rapidly growing requirement for helicopters, with self-evident safety and efficiency benefits. Together with our existing HUMS business, these additions put us well

ahead of all other competitors in a market estimated soon to be worth \$400m per annum. Just into the new financial year we completed the £9m acquisition of Environmental Technologies Group, the US counterpart to Graseby Dynamics. The two operations are highly complementary: both hold major contracts with the US Department of Defense, and were already co-operating on development and production. Dynamics has performed exceptionally well since joining Smiths Industries, and the market for chemical/biological agent detection equipment is growing even faster than first predicted.

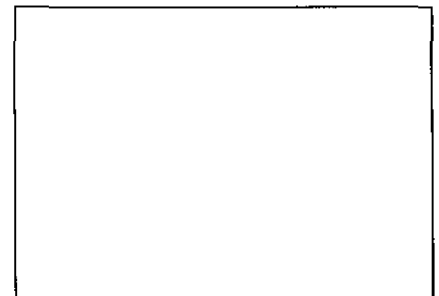
The arrival of the millennium coincides with a shift of emphasis for Smiths Industries Aerospace. In recent years much of its growth has been fuelled by demand from the civil aircraft sector: a boom in production, the need to upgrade jets in airline service and higher levels of product support as traffic has increased. Now, the defence market has become the driving force for growth. We have entered a period when an unusual number of large-scale military aircraft programmes are moving simultaneously

Building strategic links

In looking for new opportunities with companies where we have not previously been strong, we have won business with Eurocopter, one of the world's largest helicopter manufacturers. Serge Germanetti (left), helicopter avionics project manager at Eurocopter and Lee Barthold from our Malvern, Pennsylvania site discuss the on-board computers that form part of an upgrade to the Super Puma.

Outperforming the norms

Our new Integrated Standby Instrument System is being fitted to the new 100-seat Boeing 717. In gaining FAA certification – the first for this type of instrument on a large commercial aircraft – the new unit with its liquid crystal display consistently outperformed the mechanical equivalents.



from development and test into their production phase. The combination of valuable 'shipsets' per plane and sustained delivery through the decade ahead will have a beneficial effect on revenues. Programmes include the F-18 E/F Super Hornet, AH-64D Longbow Apache, Eurofighter Typhoon, Hawk and T-6A (JPATS) trainers, Nimrod and the EH-101 helicopter. We are now in the first year of a ramp-up which will see sales double on our new 'top ten' defence programmes by the middle of the decade, and this will be on top of the momentum business from the current aircraft which will remain in production for some years.

However, it is generally accepted that civil aircraft production is at the top of the cycle, and production rates will decrease from their present very high level. We are less seriously affected than some others in the industry. Boeing, and now Airbus, are important customers, and we have long-term supply agreements in place. But only 20% of Aerospace revenues are generated from original equipment for civil aircraft, within which the growing business on Airbus models will offset lower volumes elsewhere. Our own forecasts show a short-lived dip which

remains above 96/97 levels: within five years we expect production of civil jets to be rising again.

Smiths Industries is one of the most highly respected names in the world of avionics. This has been achieved by a combination of factors, one of the most important being our very firm commitment to Research and Development. We have sustained investment in R&D at high levels over many years – even when the business was less profitable – and have charged it against profits in the year it is incurred. Including customer-funded development (mostly military), expenditure has been close to 20% of sales. This commitment has kept the company among the first tier of suppliers who are directly contracted by the prime manufacturers and government defence departments. It has also given us the essential systems integrator status that enables us to submit credible proposals for the most advanced programmes. For example, we have recently been selected by both contenders for the US Joint Strike Fighter programme which will build some 3,000 aircraft. Another benefit of this reputation for technology leadership is the winning of new business

from customers with whom we have not previously made significant inroads – including Raytheon, Bombardier and Eurocopter.

There is a growing trend in the industry for the leading avionics suppliers to co-operate on opportunities where their interests coincide. We enjoy a good working relationship with Rockwell Collins on the provision of flight management systems (FMS) for certain applications. More recently we have teamed with Sextant to develop an FMS for Airbus, and this is quickly becoming the system of choice for most Airbus customers. For the Lockheed Martin JSF programme we have teamed with Hamilton Sundstrand to provide an integrated electrical power generation and management system. These are valuable co-operative efforts, but in other respects we remain competitors. Within the Naval & Marine business, our joint venture with Fugro to provide ships at sea with navigational chart updates via satellite is still in the early stages of business development.

Both military and civil aircraft now in service around the world offer wide opportunities for further business in two distinct ways. Civil jets remain

in service for typically 20 years and military aircraft (with fewer hours airborne) for twice that. The 25,000 of them fitted with our kit require continuing product support in the form of spares, repairs and overhaul. It is a competitive market, in which we re-capture more than 50% of the repairs to our own products, twice the industry average, and at good margins, thanks to our rapid turn-around times. The second area of opportunity is in the upgrade of older aircraft, retrofitting the latest avionics to enable them to match the operational performance on newer models. A front-line fighter will have its avionics upgraded at least twice in its lifetime to keep it combat-capable. A civil jet, such as the Boeing 737 Classic, can regain its commercial edge with our new generation FMS, and we are working our way through the 2,000 of them in this category. A recent example shows how valuable this installed base can be. We have secured a Direct Vendor Delivery agreement with the US Navy to provide total logistics

support for our stores management systems on their F-14s, F-18s and AV-8Bs. Over time, it will generate \$100m in revenues.

Aerospace has a bright future. Having secured continued upward momentum through recent contract awards, it is trading in an expanding world market, where the increase in defence activity will outweigh a modest slowdown in the civil sector. Tight control of costs will ensure that this will be a period of profitable growth. Even after high R&D expenditure, the business generates cash closely related to profits. In addition, we shall pursue the acquisition of businesses that complement our existing activities, strengthen our technologies and enable us to offer greater integration to customers. Smiths Industries is already world-renowned in aerospace electronics. In a consolidating industry sector, we have the market and financial status to be an active participant, but we shall act only if and when the opportunities offer benefits that are clearly evident to shareholders.

Making safety our priority

In our Grand Rapids lab, Engineering Manager Kevin Scholten runs the Flight Management Desktop Training System. By mirroring the precise airborne operation of our Flight Management System, it allows pilots to gain real experience before using it in flight.

Winning industry approval

Smiths Industries Aerospace won two top awards: one from Aviation Week & Space Technology magazine in the US for the quality of our management and one from Flight International in the UK – a joint win with Alaska Airlines for the use of our advanced Flight Management System.

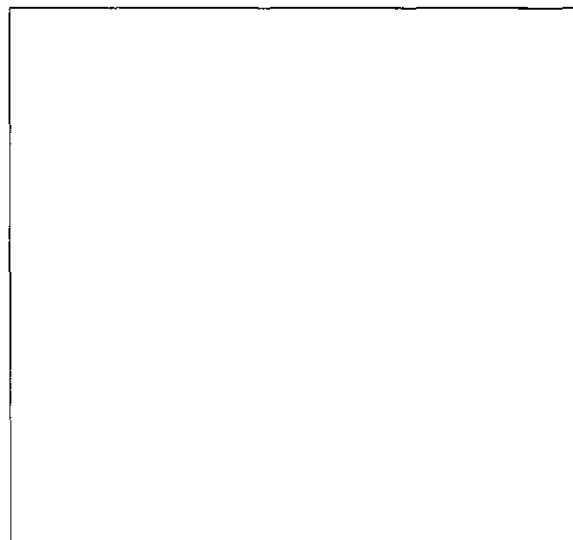
MEDICAL SYSTEMS

www.sims-medical.com

The demand for better healthcare throughout the world provides a positive business environment for Smiths Industries Medical Systems (SIMS). The market for the highly specialised devices and equipment we supply is growing at 6% per annum, underpinned by demographics. Current trends also favour the adoption of procedures that use our products: single-use devices to prevent cross infection, vital signs monitoring to warn of imminent problems, and precision delivery of drugs and fluids to patients during treatment. Such products help to promote best practice in healthcare, and are widely accepted as cost-effective by the medical profession.

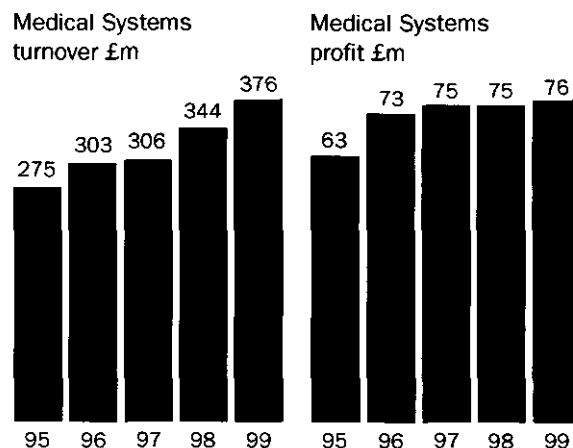
SIMS performed well last year, achieving 9% sales growth to £376m, of which one third came from the inclusion of BCI, acquired for £42m mid-way through the year. Profits at £76m were 2% ahead, and kept SIMS as the division achieving the highest margin on sales. A number of well-recognised factors restrained profit growth, including pricing pressure in the US, Asian economic problems and the strength of sterling. As a result of our actions to address these issues, SIMS had already begun to regain profitable momentum in the second half of last year.

Each of the two main, inter-related product areas has wide scope for further development by acquisition and organic growth. The first is in single-use devices for anaesthesia and critical and respiratory care. These are generally required in or close to the operating room, often during emergency or life-threatening circumstances. The sterile, plastic items made in high volumes are nevertheless premium products for which medical specialists express a strong brand preference. Our SIMS Portex operations in the UK and US work closely with hospital consultants on continuous refinement of these devices, adapting them for specific applications and, especially in the US,



George Kennedy, CBE, Chairman, Medical Systems, left, with Dr John Crowhurst, Director of Anaesthesia at Queen Charlotte's Hospital in London. Our constant discussions with medical specialists provide vital feedback for further product development.

“...wide scope for further development by **acquisition** and **organic growth**”



combining them into complete procedural kits.

Second (and most recently built-up through acquisition) is an infusion therapy and vital signs monitoring product range. These products are used during critical and intensive care. But they are equally important for use in out-patient healthcare centres, doctors' surgeries and patients' own homes where they can help maintain a stable condition or assist post-operative recovery. Among the key products are ambulatory and pole-mounted infusion pumps and syringe drivers, systems for warming blood prior to infusion and measuring body temperature during surgery, and hand-held pulse oximeters. These products too, generate recurring demand for disposable plastic items.

New products are currently being rolled out in all major territories. One example is a totally revised tracheostomy tube range, called Portex Blue Line Ultra, which builds on our market leadership. Developed jointly by Portex in the UK and US after extensive customer research, it brings innovative benefits to the user and economies of scale in production from a now unified range that meets all international regulatory requirements.

Another recent product innovation is the Deltec CADD Legacy infusion pump, which fits into an ambulatory product niche below the premium multi-functional Prizm pump launched two years ago. The lower-cost Legacy is a single-therapy unit with its application programmed during production, and is thus technically simpler. Some markets outside the US solely use the pole-mounted pumps suited to patients confined to bed, and Legacy will be useful in increasing acceptance of ambulatory pumps. While Deltec leads in the home and community care market for infusion therapy in the US, sister company Graseby has deeper experience of selling its pole-mounted pumps to hospitals throughout the world. They

Raising professional standards

We contribute to the funding of anaesthesia simulators – demonstrated here by Professor Cedric Prys-Roberts, past president of the Royal College of Anaesthetists at University Hospital,

Bristol Royal Infirmary, with Cedric Russell from SIMS Portex. The equipment enables anaesthetists to further their skills in a realistic operating theatre environment and is also an important tool for our own new product R&D.

now work closely together with an integrated marketing approach.

An earlier innovation in the single-use field has recently benefited from a surge of interest: the Needle-Pro device to prevent accidental needle-stick injuries has become a best-seller in the US. A number of States are close to introducing legislation requiring all needles used in hospitals to be fitted with a device to render them safe after use. Needle-Pro is a cost-effective solution to a serious problem.

Cost reduction measures in SIMS have been mainly in our high-volume manufacturing where small changes can yield large productivity benefits. In the highly competitive US healthcare sector, price increases are not readily achieved, so efficiency gains are vital to improving profitability. One important step has been the rapid expansion of our 'maquiladora' production facility in Tijuana, Mexico. Previously established to supply RSP in nearby Southern California, it now makes a range of items for Deltec and Portex Inc, and will be the world source for our successful Stericath device.

SIMS has made significant changes in its **routes to market**. Two years ago we took control of our hugely important Japanese distributor, and the value gained has encouraged us to follow this model elsewhere. In Europe, we have established SIMS Nordic and Benelux operations. They co-ordinate marketing, sales and distribution in those regions, and maintain closer contact with customers than was possible via independent distributors. In Germany and France, too, we have reorganised distribution channels to make them entirely responsible for all SIMS products in those countries. Meanwhile, at Japan Medico itself, majority ownership has enabled us to press on with reducing what had been an excess stock situation built up over many years. In the short term this has affected inter-company sales to Japan, but the action is prudent, and the

operation itself is doing well.

In North America, dealing with the major hospital group purchasing organisations requires a different approach. Because of the geographic scale, independent distributors are still the most effective means of delivery. However, SIMS has established a new salesforce to secure long-term contracts with these key customers, and then work with individual hospitals in the group to ensure compliance within the framework agreement.

While pursuing organic growth, we are always alert to **acquisition** opportunities. Acquisitions must meet our price/performance criteria, and fit strategically with our existing operations to bring technologies, products and market access that enhance SIMS' market presence. BCI met all the parameters: based near Milwaukee, Wisconsin, the company is a major US manufacturer of non-invasive vital signs monitoring equipment, and a leader in hand-held pulse oximeters, which measure pulse, pulse strength and oxygen levels in the blood. These units are widely used by smaller hospitals, daycare centres,

Acquiring market-leading expertise

Smiths Industries' largest acquisition this year was BCI, the market leader in economical, hand-held devices that measure oxygen in the bloodstream – a natural fit with our vital signs monitoring equipment. In BCI's Waukesha, Wisconsin site, Gail Hovey tests one of the pulse oximeter range.

Reaching out on the Internet

Our web site is increasingly important to Medical Systems as a communications channel to senior consultants, and as a source of product enquiries that we can direct to appropriate local distributors.

emergency services and in the home. Already an active exporter, BCI's horizons will be widened through access to our worldwide distribution network, and it has made an excellent start during its first six months with us.

In emerging markets for our products, higher standards of healthcare in the developing countries will be an important factor in the near-term future for SIMS. Despite severe resource limitations, hospital staff in these countries know the dangers of re-using medical devices, and the cost/benefit arguments for single-use policies are being won – aided by the rapid spread of knowledge via the Internet. SIMS has been making judicious investments to ensure that it can capitalise on these opportunities. In India, we have built a strong working relationship with a distributor who has formed a sales and marketing team for SIMS in this country with a

population of one billion. In China, we are using the existing Graseby presence to distribute a wider range of products. A dedicated sales team is now in place for South America, while in South Africa, an earlier investment in our own distribution has greatly increased penetration.

Closer to home, SIMS remains a major force in the UK medical device and equipment market, where both public and private healthcare spending is rising. The Department of Health is set on ensuring that clinical excellence and cost effectiveness will determine how healthcare is provided, and on working more closely with suppliers to the NHS. SIMS is represented on the Partnership Council of the National Institute for Clinical Excellence, the body that now guides government policy in this area. Another UK government initiative, the private/public partnership known as PFI, is helping to

Pooling international expertise

Our new Blue Line Ultra rigid tracheostomy tube is a one-piece moulding that represents both a significant advance in manufacturing and an innovative joint development by SIMS teams in the US and UK.

Strengthening our marketing

Eva Jagerstrom of Hemex demonstrates SIMS products at the Söder Hospital, Stockholm. Since acquiring Hemex, a long-time distributor of SIMS products in Sweden, we have created SIMS Nordic as a base for marketing in Scandinavia.

revitalise new hospital building and refurbishment, providing opportunities for Eschmann, our capital equipment business.

All around the world, governments see the delivery of better healthcare as a priority. Our involvement in the supply side of this equation puts **SIMS in a strong position**. We have product, brand and technology leadership in key niches, and are the No.1 or No.2 supplier in more than three-quarters of our range of products. A strong presence in the US market has proved vital for the division's success, because many of the trends in US healthcare quickly become accepted in other countries. Fleet of foot, we are confident that SIMS can keep its place at the forefront of medical technology, remain price competitive through productivity gains and be the preferred product supplier to medical professionals.

INDUSTRIAL

www.smithsind-industrial.com

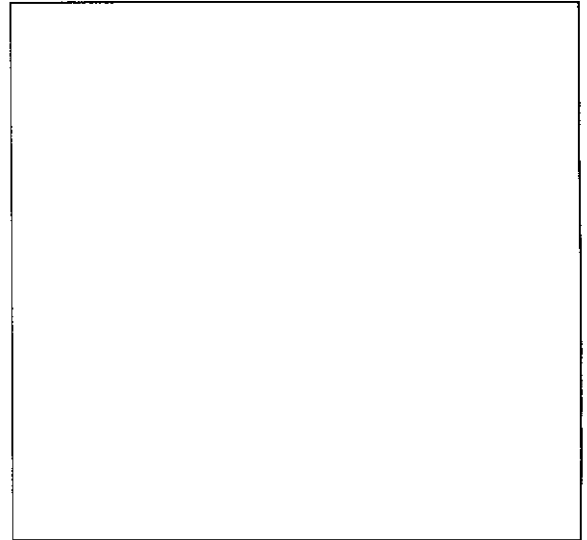
After five years of rapid growth and change, last year was a period of consolidation for Industrial, during which the rather mixed market limited overall growth. We had absorbed a dozen acquisitions over those five years, and the time was right for closer co-ordination with the existing operations. This integration continues to concentrate Industrial on its two main areas of expertise: electrical/electronic Interconnect products and Air Movement Systems.

Sales rose 7% to £419m while profits increased only slightly to £73m, reducing the margin on sales by one point to a still very healthy 17%. We spent £2.5m on acquiring two interconnect businesses, Transtector and Entraco, and they contributed eight months to these results. Profits were matched fully by cash conversion, despite higher capital expenditure on new plant and IT systems.

The trading environment for Industrial varied considerably, according to geography and business trends in its end-user markets. Operations in the United States delivered a strong performance, benefiting from buoyant demand in consumer and industrial sectors, with only the depressed US semiconductor industry holding back. Industrial generates half of its sales and profits in the US, and steady orders for Industrial products made and sold in North America continue in the current year.

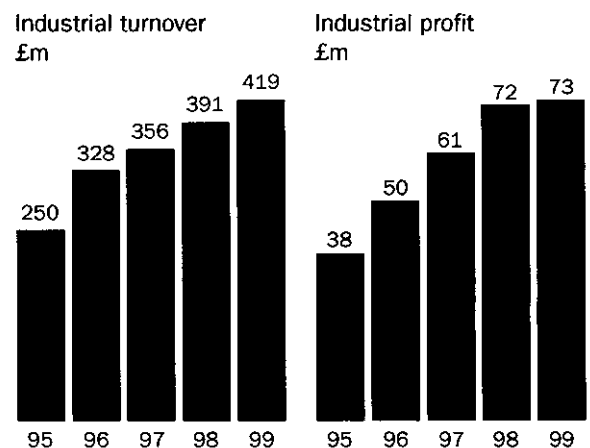
Market conditions in the UK and continental Europe were more difficult, with a dull UK manufacturing environment and reduced investment in the capital goods sector on the Continent. Levels of activity in the OEMs we supply were lower, and some orders – including those from government departments – were deferred. Since Industrial includes well-known market leaders such as Vent-Axia, we can improve our competitive position in times like these, as other suppliers suffer even more.

The consolidation now underway in Industrial is shaping two main areas.



Einar Lindh, Chairman, Industrial, at a team briefing in the Slough base of Icore, our specialist in conduits and assemblies.

“A strong performance in the US benefiting from buoyant demand...”



Making strategic acquisitions

Jim Hollis, left, of Nextel with Patrick Sanders from Transtector at a base station in Washington State. Added to the expertise of Times Microwave and Polyphaser, the acquisition of Transtector strengthens our capability in the growth area of protecting telecoms installations against power surges.

Interconnect, which now comprises close to 40% of the total, includes operations in the UK, continental Europe and the US. It makes equipment that connects and protects vital electrical and electronic circuits against hazards encountered in extreme conditions or where failure could be catastrophic. The main applications are in aerospace and defence, telecoms and IT, rail transport, process plant, medical and industrial equipment. Products include multi-pin Hypertac connectors, armoured conduit, electrical surge suppressors and filters for power and signal transmission, microwave cables, and cable management systems. The use of these products is often inter-related. All of them may be required, for example, on an aircraft or in a cellular base station, thus we are taking up opportunities to co-

Focusing on customer needs

Scarab is one of the major street-sweeper makers now adopting Flexible Ducting's new Wander-Vac hose: a lightweight, one-piece design enabling vehicle crews to change hoses on the road, reducing idle time and cost. It is now penetrating a large new-build and replacement market in the UK and abroad.

ordinate our approach to customers.

Operating in the very top slice of the worldwide connector market with premium products, Interconnect performed strongly last year, securing new business and generating increased demand from aerospace, defence and telecom customers. Echoing Smiths Industries Aerospace, Interconnect has built a substantial business with Airbus in Europe as well as with major US aerospace companies.

The larger part of Industrial is **Air Movement Systems**. It includes specialised ducting and hosing engineered for particular applications, and ventilating fans with associated air warming and cooling equipment. The products are widely used in industrial installations, in commercial premises such as hotels, restaurants and in the home. The fan units range from one-

Applying world-leading technology

Smiths Industries operations in Italy, Germany and the UK are working together to supply the highly reliable Hypertac connectors for the Eurofighter. High performance and reliability is assured by a unique interlock system.

metre-diameter fume extractors down to small dc motors to cool the disk drives in computers.

Again, these activities span the UK, continental Europe and the US, with fan operations mainly in the UK. Their individual fortunes have been decidedly mixed. Those in North America have continued to thrive, with new housing starts and consumer spending providing a good background for the ducting, hosing and heating elements we make there. Air conditioning, for example, is taken for granted in new homes in many parts of the country. Our unique six-to-one extendable hose has continued to attract orders from vacuum cleaner makers, with Hoover deciding to buy from us rather than make it.

By contrast, on this side of the Atlantic, Air Movement suffered from the cold economic climate. Its

performance – representing about one third of the total – was a major factor in preventing Industrial from continuing its profit growth last year. The fan businesses could make no progress in a very flat UK market, despite introducing interesting new products. Nevertheless, Vent-Axia – which sells premium products chosen for their specification – remains highly profitable and is well positioned to benefit from any sign of upturn. Hosing and ducting markets were slow across Europe, and among several actions, we have combined operations in Switzerland and Italy into a single unit.

Our Industrial activities have common characteristics. All the technologies are those in which we have enormous experience built up over decades. This specialised know-how in design, production and application confers a

huge competitive advantage, and is a useful barrier to entry when other companies might be tempted by our high margins. One example is our manufacture of the Hypertac connector, for which Smiths Industries first took out a licence in 1961 from its French inventor, eventually purchasing his entire business in 1995. Meanwhile we miniaturised a design with up to 400 connections in a high-density package, and added filters and lightning strike protection. This resulted in a unit chosen for the Eurofighter Typhoon, and further confirms our position at the forefront of defence technology.

All Industrial products are similarly highly engineered, offer solutions to customers' most difficult problems, and generate high added value as the best means of achieving profitable long-term growth.

Delivering brilliant innovation

Colonel Rommelfanger, US Army, and Tess Fagnant, President, Entraco, discuss the unique, swivel-action harness being retrofitted to power the BlackHawk helicopter's anti-icing heaters. Entraco's patented cable assembly lasts some 10 times longer than the existing four assemblies, and can be replaced in two hours instead of up to three days.

In the year ahead we will continue to bring a sharper focus to Industrial, and a greater concentration on the higher margin aspects. The outlook is for more of the same: good conditions in North America and in defence and telecoms, balanced against flat markets in Europe, with only the very early signs of a gradual recovery in this region.

Financial review

Operating results

1998/99 has been another year of success for Smiths Industries, with turnover and profits before tax both increasing by more than 10% to £1324m and £241m respectively. It was the fifth year in succession in which we achieved double digit growth in profits.

The main feature of our financial performance was the strong organic sales growth. Of the 10% increase in turnover in the year, more than half came from our established businesses. This represented a significant step forward from earlier years and reflects our emphasis on increasing the proportion of internally generated sales growth. Although our Aerospace business has made the biggest contribution, I am pleased to report that all three divisions recorded positive underlying growth in sales. The underlying growth in pre-tax profits was even stronger at 8% with Aerospace enjoying a third year of strong growth.

We have continued to benefit from favourable trading conditions in North America where the strength of the domestic economy has led to sustained growth and improved profitability. Elsewhere many of our units are operating in highly competitive markets, especially in the UK and the Far East. We have experienced customer destocking in some regions, reflecting tougher trading conditions and the need to manage balance sheet liquidity.

With the continuing strength of sterling, it has been difficult to increase selling prices on UK exports.

Through tight control over the operating cost base, we maintained the gross profit margin at 42%. The ratio of operating expenses to sales also remained constant despite a 10% increase in Company-funded research and development expenditure. This commitment to investing in new products and technologies will underpin our organic growth in future years.

The drive throughout the Company to improve operating productivity and boost sales growth enabled us to maintain the operating margin at 19%. Our ratio of value added per employee grew 3% in the year and over five years the positive effect has been in excess of 25%.

Within our operating activities Aerospace enjoyed continuing strength of civil markets and profits grew 28% to £99m. Margins increased by 2% due to a number of one-off contracts in our service and repair business. A strong finish to the year enabled Medical to record a 2% profit increase to £76m.

Margins dipped as strong sterling affected our efforts to raise export prices, although they were still above 20%. Industrial margins in the UK and Europe remained under pressure and there was a 1% reduction in its operating margins to a highly creditable 17.4%, with profits of £73m fully backed by cash generated.

Impact of exchange rates

Around 60% of the Company's profits are generated in foreign currencies. Exchange rates remained generally stable during the year. Overall the translation effect on profits was less than £0.5m. Our largest currency exposure is to fluctuations in the US dollar and during the year the average rate was \$1.64, similar to the previous year.

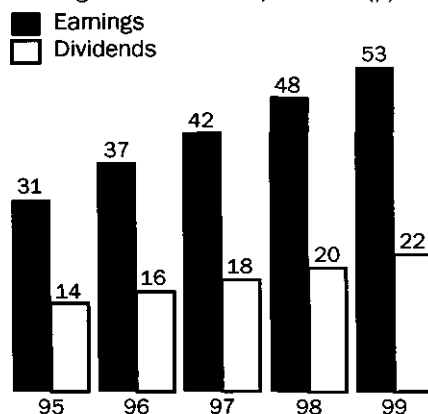
Acquisitions

We made seven acquisitions during the year for a total outlay of £93m. Aerospace acquired Stewart Hughes, Signal Processing Systems and Strategic Technology Systems Inc. at a cost of £25m. These were acquired to strengthen our position in the fast-growing market in health and usage monitoring systems. Biochem International Inc. and Hemex, our Scandinavian distributor, were acquired for Medical, at a cost of £43m. Industrial acquired Entraco Inc. and Transtector Inc. for £25m in total, including acquired debt.

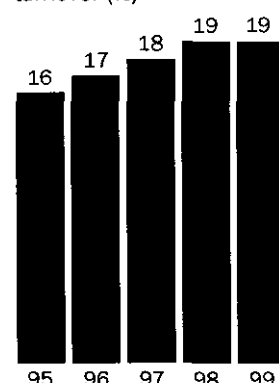
The goodwill of £94m arising from these acquisitions has been capitalised in the year. This will be amortised over the expected future life of each business, which is considered by the Directors to be a minimum of 20 years in every case. This year's charge is £3m.

In this year of transition to the new reporting conventions, we have presented our key financial indicators, such as profit before tax and earnings per share, both

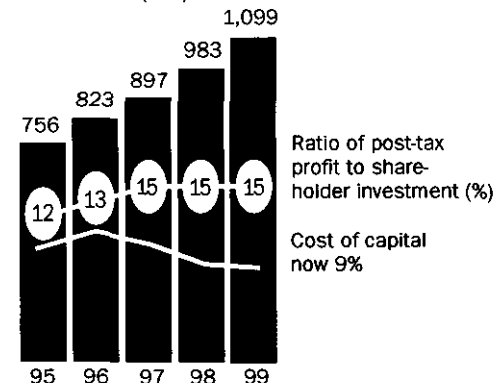
Earnings and dividends per share (p)



Operating profit to turnover (%)



Return on average investment (£m)



with and without the effect of goodwill amortisation. We intend to continue this until the investment community has fully accepted the new concept.

The overall contribution from acquisitions, after funding and integration costs and before goodwill amortisation, is neutral in the year. As the integration benefits flow we expect a positive contribution in future.

Earnings per share and dividends

The overall tax rate has dropped to 30.8% of profits before goodwill amortisation, largely as a result of the recent reduction in the UK Corporation Tax Rate. This benefit, together with a drop in minority interests, means that basic earnings per share, calculated on pre-tax profit before goodwill amortisation, have risen by 11% to 53.5p. Taken over the last five years, EPS have increased at an average annual rate of 15%. The dividend has again been increased by 10% to 21.65p, covered more than twice by profits.

Cash-flow	1999 £m	1998 £m
Operating profit	244	224
Goodwill amortisation	3	
Depreciation	36	32
Working capital increase	(40)	(16)
Cash in-flow from operating activities	243	240
Capital expenditure (net of disposals)	(48)	(37)
Operating cash-flow after capital expenditure	195	203
Tax paid	(70)	(65)
Interest paid	(8)	(6)
Free cash-flow	117	132
Dividends	(37)	(53)
Acquisitions and disposals	(94)	(132)
New shares	9	8
Other	(5)	4
Increase in borrowings	(10)	(41)

Cash-flow and borrowings

The strong focus on cash generation was maintained and produced excellent results, as shown. Operating cash-flow after capital investment amounted to

Bringing people together

Alan Thomson, Smiths Industries Finance Director, at the Paris Air Show with Alan Mulally, President of Boeing Commercial Airplane Group. Strong

links with our customers at all levels help speed the process of understanding, responding to, and anticipating their needs.

£195m which is almost 80% of operating profit. Over the past five years we have achieved an average operating profit to cash ratio of 87%. Free cash-flow after interest and taxation over the same period has been equivalent to 83% of after-tax profits.

Working capital increased by £40m, mainly due to increased debtors, following a strong sales performance in the final quarter.

This performance has been achieved despite a one-third increase in net capital spending to £48m. We made major investments in new manufacturing capacity for several businesses including an Aerospace plant in Michigan, USA and a new production facility in California for our flexible ducting company. Almost £5m was spent to ensure our

information technology facilities were Year 2000 compliant.

Non-operating cash-flow also benefited from the higher uptake of our scrip dividend alternative. This indicates the confidence that investors have in the future performance of our shares.

The overall result was that net borrowings increased by no more than £10m in the year to £93m, despite combined spend of £142m on acquisitions and capital investment projects.

Return on Investment

The return on average shareholder investment remained at 15% after tax, well ahead of our 9% cost of capital, despite earning little return from businesses acquired this year. This illustrates our ability to maximise

the return on our investments while building for the future.

Financial controls

Our decentralised organisation delegates control to local business management on a day-to-day basis. Managers are directly responsible for the procedures and controls in their own operations without reliance on others to identify weaknesses and recommend corrective actions. Our Internal Audit department carries out regular in-depth reviews to ensure that appropriate financial controls are effective throughout the Company. All key business units are reviewed over a three-year cycle. Comprehensive systems of budgetary control are in place, with approval and follow-up reporting to main Board level. Capital projects are approved according to clearly defined authority levels, progress during construction is monitored closely and the final outcome is reported back upon completion. Individual financial executives report to their own local managers but also have functional reporting lines through to the Financial Director.

Financing and Treasury

We use financial instruments to raise finance for our operations and manage financial risks. The Board agrees the objectives and policies for financial risk management, and we have formal procedures and policies in place to cover banking, foreign exchange and other treasury matters. Our policy is not to trade or speculate in financial instruments.

We finance our operations by a mixture of retained profits, equity, bank borrowings and loan notes. Funding for operating subsidiaries, apart from local overdraft facilities, is raised centrally and lent on to them on commercial terms. Since total debt levels are relatively low, borrowings are generally held under short-term floating rate facilities. Cash is remitted to the UK, subject to adverse tax issues, for redeployment and to remove further currency risk. Currency contracts are used to manage the risks arising from overseas trading.

Interest Rate Risk Management: During the year, the Company took on \$100m of additional short-term debt to finance US acquisitions. The net borrowing position of £93m at year-end represents less than 4% of the Company's market capitalisation plus net debt as at that date. The interest charge of £7m was covered more than 35 times by operating profits before goodwill amortisation. The majority of this charge arises from floating-rate borrowings, and our high interest cover protects us from undue exposure to fluctuations in interest rates.

Liquidity Risk Management: The closing borrowings will largely mature within one year. The low overall level of borrowings at year-end and our strong cash generation performance ensure that we have access to further borrowings to maintain adequate liquidity for all foreseen future business requirements. The Company also has a number of unused uncommitted facilities and overdraft lines.

Exchange Rate Risk Management:

Exposures to currency fluctuations are largely covered by the use of foreign denominated borrowings and foreign exchange contracts. Currency movements relating to secured contracts are hedged at inception by forward currency contracts. In specific cases, transactions are hedged forward for the appropriate period where there is reasonable certainty of the forecast level of orders.

Borrowings are typically denominated in local currencies to provide a natural hedge for foreign currency movements on overseas assets. Overseas profits are not hedged for translation exposure but foreign exchange effects are muted by translating profits at the average exchange rates for the year. By hedging our balance sheet we also lessen our currency exposure on translation. Further information on borrowings and other financial instruments is contained in notes 21 and 22 to the accounts.

Pensions

The Company operates a number of pension schemes, principally in the UK and the USA. During the year we merged a number of our plans to optimise efficiency of operation. The latest UK actuarial valuation was in March 1998 and the USA valuation in July 1998. At these dates assets exceeded liabilities by 25% in the UK and by 19% in the USA. This strong funding position reflected several years of good investment performance.

Our investment policy in the UK was changed in 1997 to improve alignment of assets and liabilities and to reduce exposure to a market reverse. Similar changes were made in the US in 1999.

Investment performance since the valuation dates has remained strong. The surplus is amortised in accordance with current UK accounting practice, reducing the Company's pension cost over the members' estimated remaining working lives.

Alan Thomson Financial Director

International investment in people

“We aim to be
**leaders in
management
capability,** in
our sector...”

Assuring our future

Our graduate recruitment programme underlines our commitment to employing highly qualified people to assure our technical and commercial strengths for the future. Recent recruits Hannah Farrant and Simon Pavitt are gaining experience in different areas – Simon in engineering and Hannah in management where she is taking advantage of our language programme to learn Spanish.

The drive for Smiths Industries growth depends crucially on the skills, flexibility and entrepreneurial approach of our people. By promoting best practices across the whole company – not only in training and development but also in health and safety and environmental management – we aim to be leaders in management capability in our sector. We see our investments in people as an important contributor to shareholder value.

Career development

We are energising our whole approach to developing our people – taking advantage both of the new dynamics of our business and the tremendous capability we have in-house. Recognising the paramount importance

of developing executives for international positions within the company, we have launched a new International Secondment Policy to encourage internal promotions and transfers. We have also established policies to help ensure equity for people to increase their mobility. It is significant that three of our existing managers were promoted to top positions in North American operations during the year.

We are currently working with Babson College in Boston to run our new Managing for Growth programme, which we have designed to focus on the organic growth of our business and the holistic development of entrepreneurial, commercial and management skills for individuals. Cross-functional groups

“...lifelong learning is a cornerstone of our approach to training at all levels of the company”

are given training on live projects to take business plans through to Board level, gaining tremendous experience from reaching challenging goals that have a positive effect on our business. This approach is fully endorsed by senior management.

The launch of our Graduate Trainee Programme in 1999 emphasises the crucial importance to our future of recruiting and retaining good graduates. We view this programme as a continuous development track on which graduates in different disciplines across the company will train together to foster a climate of co-operation and cross-fertilisation. They will also benefit from a new mentoring programme which will help to transfer the knowledge and skills of our best people.

Training programmes within our Career Development Portfolio also reflect the diverse and changing requirements of our business. They underline the importance of lifelong learning, which is a cornerstone of our approach to training at all levels of the company. The Management Assessment Centre has a critical role in identifying high-potential managers for our Executive Development programme. This is helping to ensure that we have the right people available for the right jobs at the right time.

Through our Business Learning Partnership with Henley Management College in the UK, where we have already developed our Inter-Company Masters in Business Administration Degree, we will start to introduce common programmes across continental Europe. Through this, we will ensure that we have consistently high standards of management programmes available for all our high-potential people in Europe.

The European Communication Forum, now in its fourth year, is of growing importance as the UK draws closer to the European Union. Delegates representing some 30 of our operations come together annually to discuss a

range of pan-European issues with senior management.

Health and safety

Through greater corporate involvement, we are moving H&S policy up the agenda across all our sites, and working towards a common health and safety approach in the workplace.

We have completed major company-wide audits to examine existing practices and identify inconsistencies, and are now finalising a global Safety Manual to provide best-practice guidelines. Hazards are similar worldwide, but local regulations vary, thus management at each site remains responsible for applying the guidelines to meet local legislative requirements.

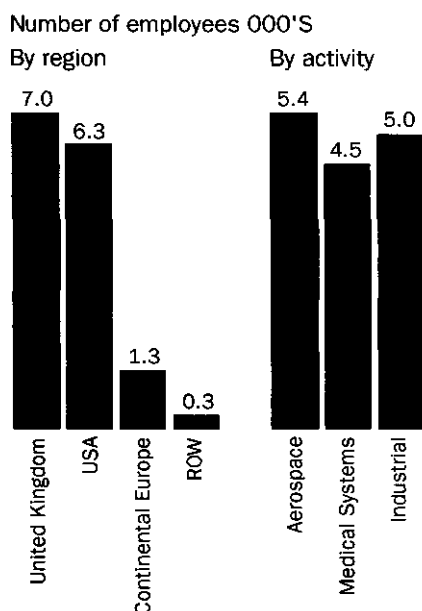
In the past 18 months we have carried out more than 80 site audits in a continuing process of evaluating H&S performance, agreeing targets, and monitoring progress. Through on-site reviews that involve management and employees, we aim to build H&S awareness into everyday working life.

We are also building a health and lifestyle management system that centres on prevention but also provides remedial measures. This is in line with UK government and Health and Safety Executive initiatives related to employee health and welfare, and will be gradually rolled out across the company.

Environment

A senior corporate staff director has responsibility to the main Board for environmental affairs, and we have also appointed a full-time Environmental Manager to drive our environmental programmes and make all our sites aware of relevant changes in legislation.

We fully recognise our duty to minimise the effects of our activities on the environment. At an Environmental Conference in June 1999, representatives from engineering, quality, and other disciplines in our UK



sites worked on preparing the launch of a systematic environmental review of our operations, products and services. We expect to complete the process in the UK in Spring 2000, when a second conference will examine the findings and develop an improvement programme. The initial experience from our UK operations will provide an important foundation of understanding for extending the review process across our European and US activities.

We pay special attention to environmental matters during due-diligence investigations related to acquisitions and divestment of property and businesses, and this may involve cleaning up contaminated sites. Smiths Industries is a founder member of Valpak, the compliance scheme for the Producer Responsibility (Packaging Waste) Regulations 1997.

“...we are moving **H&S policy** up the agenda in all our sites...”

Supporting personal development

Physics graduate Lorna Mountford joined us in 1998, and successfully completed the final stages of her PhD. Lorna is part of the development team at Icore, where her fluent German helps strengthen co-operation with counterparts in our German operations.

Board of Directors

Keith Orrell-Jones	Keith Butler-Wheelhouse	
George Kennedy CBE	Roger Leverton	Einar Lindh
Peter Hollins	Norman Barber	Alan Pink
Robert O'Leary	Alan Thomson	

Keith Orrell-Jones
Chairman †*

Aged 62, British. He was appointed to the Board in December 1992. He became non-executive Chairman in November 1998 and also chairs the company's Nominations & Remuneration Committee. He is non-executive Chairman of FKI plc and was formerly Group Chief Executive of Blue Circle Industries PLC.

Roger Leverton
Non-executive director †*

Aged 60, British. Chairman of the company's Audit Committee. He was appointed to the Board in December 1994. He is non-executive Chairman of Haden MacLellan Holdings plc, Betts Group Holdings Ltd and Renold plc and was formerly Group Chief Executive of Pilkington plc.

Peter Hollins
Non-executive director †*

Aged 51, British. He was appointed to the Board in February 1999. He is Chief Executive of British Energy plc. He was previously on the Board of European Vinyls Corporation, as the executive director responsible for the Polymers Division, and prior to that was General Manager of ICI Resins BV.

Robert O'Leary
Non-executive director †*

Aged 55, US citizen. He was appointed to the Board in September 1997. He is Chairman & Chief Executive Officer of Premier Inc. and was previously Chairman & Chief Executive Officer at American Medical International Inc. (AMI). He is a member of the Board of directors of Thermo Electron Corporation.

Keith Butler-Wheelhouse
Chief Executive

Aged 53, British. He joined the company in August 1996 as an executive director and was appointed Chief Executive in November 1996. He was previously President & Chief Executive Officer of Saab Automobile in Sweden and prior to that had been Chairman & Chief Executive of Delta Motor Corporation in South Africa. He is a non-executive director of that company and of J Sainsbury plc.

George Kennedy CBE
Chairman, Medical Systems

Aged 59, British. He joined the company in January 1973 and became Managing Director of the medical systems companies in August 1980. He was appointed to the Board in May 1983. He is non-executive Chairman of Carclo Engineering Group plc, Chairman of the Association of British Healthcare Industries (ABHI), and a member of the Department of Health's Medical Devices Agency.

Norman Barber
Chairman, Aerospace

Aged 60, British. He joined the company in April 1991 and was appointed to the Board in July 1991. He was previously Managing Director of British Aerospace (Dynamics) and British Aerospace, Military Aircraft Division. He is a non-executive director of Britax International plc and is a former President of the Society of British Aerospace Companies (SBAC).

Alan Thomson
Financial Director

Aged 53, British. He joined the company and was appointed to the Board in April 1995. He was previously Finance Director of the Rugby Group plc and prior to that had worked for Courtaulds plc, Rockwell International Corporation and Raychem Ltd. He is a non-executive director of Laporte plc.

Einar Lindh
Chairman, Industrial

Aged 54, British. Appointed to this position and to the Board in February 1996. He first joined the company in 1973, leaving in 1979 to take up an appointment at Great Universal Stores plc. He returned to Smiths Industries in 1983 as Financial Controller of Medical Systems and in 1990 he became Managing Director of the principal Medical Systems company in the UK, SIMS Portex Ltd.

Alan Pink
Non-executive director †*

Aged 61, British. He was appointed to the Board in December 1993. He was formerly an executive director of Zeneca Group plc and is a Fellow of the Institution of Chemical Engineers.

Secretary
Alan Smith

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Lloyds TSB Registrars
The Causeway
Worthing, West Sussex BN99 6DA
Tel: +44 (0) 1903 502541
www.lloydstsb-registrars.co.uk

Auditors
PricewaterhouseCoopers

Registered Office
Smiths Industries plc
765 Finchley Road
London NW11 8DS
Incorporated in England No 137013

†Audit Committee

*Nominations & Remuneration Committee

Directors' report

Principal activities

The principal activities of the Company and its subsidiaries are the development, manufacture and sale of avionics for commercial aircraft and military requirements; marine and fighting vehicle systems; single-use disposable medical products for critical care applications; medical infusion pumps; operating tables and related equipment; ducting and ventilation systems; and a varied range of products for consumer, industrial and engineering applications. The main manufacturing operations are in the UK and USA. A review of the development of the Company and its subsidiary undertakings during the 1998/99 financial year is contained in pages 10 to 21.

Results and dividends

The results for the 52 weeks ended 31 July 1999 are set out in the Consolidated Profit and Loss Account on page 40. Sales for the year amounted to £1,323.9m, against £1,198.5m last year. The profit for the year after taxation and minority interests amounted to £163.2m (1998 £148.2m).

An interim dividend of 7.4p per ordinary share of 25p was paid on 4 June 1999 (a scrip dividend share alternative was offered at a cash equivalent price of 881p per share). The directors recommend for payment on 15 December 1999 a final dividend on each ordinary share of 14.25p, making a total dividend of 21.65p for the year. A scrip dividend share alternative will be offered.

The retained profit of £95.3m was transferred to Reserves.

Research and development

£127.0m was spent on research and development during the year, of which £53.9m was funded by the Company and the balance by customers. Each business carries out research and development programmes to suit its own particular market and product needs. Interchange of technology and

technical information between businesses in the manufacturing sector is centrally co-ordinated.

Changes in Company interests during the year

On 28 August 1998 Smiths Industries Aerospace & Defense Systems, Inc. acquired the business and assets of the Signal Processing Systems division of Global Associates, Ltd. for £4.6m in cash.

On 2 November 1998 the Company acquired all the issued share capital of Stewart Hughes Limited for £10.1m in cash.

On 30 November 1998 Smiths Industries, Inc. acquired all the issued share capital of Transtector Systems, Inc. for £21.7m including acquired debt.

On 30 November 1998 Icore International, Inc. acquired all the issued share capital of Engineering Transitions Company, Inc. for £3.3m in cash.

The Company concluded its negotiations to acquire Biochem International and, on 11 January 1999, Smiths Industries, Inc. acquired all of the issued share capital of Biochem International, Inc. for a net £42.3m in cash.

On 1 February 1999 Smiths Industries Medical Systems Nordic AB acquired all the issued share capital of Hemex Medical AB for £0.6m in cash.

On 30 April 1999 Smiths Industries Aerospace & Defense Systems, Inc. acquired all the issued share capital of Strategic Technology Systems, Inc. for £10.5m in cash.

Post balance sheet events

On 3 August 1999 Smiths Industries, Inc. acquired all the issued share capital of Environmental Technologies Group, Inc. for £9m in cash.

On 17 September 1999 the Company moved from being a part of the FTSE 100 Actuarial Index to become a member of the FTSE 250 Index.

Future developments

The Company will pursue its existing

international activities and continue to seek business opportunities in both the UK and overseas.

Interests in land

Land and buildings were professionally valued as at 31 July 1999. The value of land and buildings is estimated to exceed the book value by around £21.2m.

This valuation has not been reflected in these accounts.

Charitable and political donations

During the year the Company made donations of £754,000 for charitable purposes including payments of £345,000 for the Portex Chair of Paediatric Anaesthesia and £20,000 to the Kent Institute of Medicine and Health Science. No political donations were made.

Directors

The names of those who were directors at the end of the financial year are listed on page 29. Sir Roger Hurn and Sir Peter Thompson retired as directors at the conclusion of the Annual General Meeting held on 24 November 1998. Mr K. Orrell-Jones was appointed as Chairman with effect from 24 November 1998. Mr P.T. Hollins was appointed as a non-executive director on 9 February 1999.

Re-appointment of directors

Messrs N.V. Barber, G.M. Kennedy and E. Lindh will retire by rotation, in accordance with Articles 73 and 74, and will seek re-appointment at the Annual General Meeting. Mr P.T. Hollins will also retire at the AGM, following his appointment during the year, and seek re-appointment.

Directors' service contracts

Mr N.V. Barber's service contract may be terminated by six months notice given by either party and Mr G.M. Kennedy's contract terminates on 3 August 2000. Mr K.O. Butler-Wheelhouse, Mr E. Lindh and

Mr A.M. Thomson have service contracts with the Company which are subject to termination by two years' notice, given to expire at any time.

With the exceptions referred to above, no director had a beneficial interest in any contract to which the Company or its subsidiaries was a party during the year.

Interests in shares

As at 28 September 1999 the Company had been notified, pursuant to the Companies Act 1985, of the following material interests in its issued share capital:

	No. of shares	Per-centage of issued share capital†
Putnam Investments	12,825,378	4.08
Scottish Widows Fund and Life Assurance Society	9,429,653	3.00
Norwich Union plc	9,442,007	3.01

† percentage of share capital in issue on 28 September 1999

The Company has not acquired or disposed of any interests in its own shares.

The interests of the directors, their families and any connected persons in the issued share capital of the Company and details of their share options are shown on pages 37 and 38.

Corporate Governance

The Company complies with the Combined Code developed by the Committee on Corporate Governance and defined in the Listing Rules of the London Stock Exchange (the "Code") except that no senior independent director is recognised as required by A.2.1 of the Code.

Subject to that exception, the Company has complied with the Code throughout the accounting period covered by this Report. Reasons for non-compliance with A.2.1 are given below.

The Board of directors normally

meets formally eight times a year to make and review major business decisions and monitor current trading against budgets which it has approved. It additionally exercises control by determining matters specifically reserved to it in a formal schedule which only the Board may change: these matters include the acquisition of companies and major capital expenditure. Once a year the Board meets in conference to consider long-term strategy and industrial developments affecting the Company. Additional meetings are arranged to deal with urgent developments.

There is an agreed procedure for all directors to take independent professional advice at the Company's expense in connection with their duties. They also have access to the advice and assistance of the Company Secretary whose appointment is in accordance with the Code.

No director has been appointed as the director of a listed company for the first time during the accounting period under report. Arrangements have been made for all directors to be given appropriate training whether on their appointment, or periodically as necessary.

Mr K. Orrell-Jones, who is the senior non-executive director, has been appointed Chairman in succession to Sir Roger Hurn. Mr R. F. Leverton is the chairman of the Audit Committee. No other non-executive director has been appointed as "a recognised senior member" for the purposes of A.2.1 of the Code because matters of concern can readily be brought to the attention of either Mr Orrell-Jones or Mr Leverton who have clear areas of responsibility. Mr K. O. Butler-Wheelhouse is the Chief Executive. There are five independent non-executive directors and five executive directors on the Board.

The Board is provided with detailed information on matters to be considered at its meetings and non-executive directors have ready access

to the executive directors. Regular site visits are arranged and non-executive directors are encouraged to visit sites independently. During site visits, briefings are arranged and the Board is free to discuss aspects of the business with employees at all levels.

There is a formal procedure for appointment of all new directors. The Nominations and Remuneration Committee, which is chaired by Mr Orrell-Jones and is composed of the non-executive directors, makes recommendations to the Board on appointments. Appointments approved by the Board are subject to confirmation by the shareholders.

All directors are subject to retirement by rotation and submit themselves for re-election at intervals of no more than three years: any director who attains the age of 70 is subject to annual re-election. The initial appointment of non-executive directors is for three years: they do not participate in Company bonus, share option or pension schemes.

The Nominations and Remuneration Committee meets at least three times a year. Mr K. O. Butler-Wheelhouse attends meetings of the Committee by invitation but does not participate in discussions of his own interests. The Committee monitors the performance of the chief executive and other executive directors and has access to all information required for that purpose. The report of the Board on directors' remuneration is set out on pages 35 to 38.

The Company maintains a dialogue with institutional shareholders through regular meetings and presentations. At the AGM shareholders are encouraged to ask questions and after the meeting have access to directors and other senior executives. The Company has complied with the Code provisions related to principle C.2.

The Board believes that the present Report and Accounts present a balanced and understandable

assessment of the Company's position and prospects: the Board has complied with the Code Provisions D.1.1 to D.1.3. A statement by the Auditors appears on page 39.

The Audit Committee's terms of reference accord with the Code. The Committee consists of all the non-executive directors and meets at least three times a year with the chief executive, financial director, director of internal audit and the auditors normally attending meetings. Its chairman is Mr R. F. Leverton.

Internal Control. The Board accepts its responsibility for maintaining an effective system of internal control which supports the Company's effective and efficient operation and enables it to respond to significant business, operational, financial, compliance and other risks. Any system of internal control can provide only reasonable, not absolute, assurance against material loss to the Company or material misstatements in the financial accounts.

In the highly regulated environment of the aerospace and medical industries, procedures are codified in detailed operating procedures manuals and are reinforced by regular educational programmes. This is designed to ensure not only compliance with the regulatory requirements but also with the general principles of business integrity. Compliance with these principles throughout the Company is monitored by the Internal Audit Department referred to below.

A key element in any system is communication and a number of committees exist which enable the executive directors and senior corporate staff to address financial, human resource, risk management and other control issues. Experience is shared by subsidiaries through company-wide seminars.

The Company has an Internal Audit Department. The Director of Internal Audit, who is responsible to the Chairman of the Audit Committee, has

reported to the Audit Committee upon the Company's internal control processes.

The internal financial control system includes the following key features, which have been designed and established over a number of years to provide internal financial control appropriate to the Company's businesses:

- the approval of comprehensive budgets by the Board and the monthly monitoring of performance against budget;
- a detailed investment approval process requires Board approval of all major capital projects;
- the Audit Committee's consideration of any significant control matters;
- appointment of experienced and professional staff by recruitment and promotion.

The Audit Committee has reviewed the effectiveness of the Company's system of internal financial control. In addition to consideration of reports from the Director of Internal Audit and from the Company's external auditors, the Committee has reviewed the results of an internal self-assessment exercise which required the heads of all the business units of each operating group to report through their operating groups to the Chief Executive.

The Board is establishing procedures for reviewing the effectiveness of its internal controls as recommended by the Turnbull Report. These procedures will be in place in the course of the current financial year and will be reported on in more detail in the next Annual Report.

Going Concern. The Board's review of the accounts, budgets and forward plans, together with the internal control system, lead the directors to believe that the Company has ample resources to continue in operation for the foreseeable future. The accounts are therefore prepared on a going concern basis.

Auditors. PricewaterhouseCoopers have reviewed the Company's statements

as to compliance with the Combined Code to the extent required by the Listing Rules of the London Stock Exchange. The results of their review are set out on page 39.

Year 2000

The Company's businesses around the world have been working on their Year 2000 programmes since mid-1997. These programmes are intended to ensure that all products and critical operating systems will continue to operate through the Year 2000 transition without interruption. Products that have in-service safety implications are subject to review by the Company's safety organisation. Suppliers of goods and services are being approached to confirm their ability to trade without interruption into the next millennium. Each business has a team of senior executives that is accountable for the implementation of the Year 2000 programmes and regular progress reports are submitted to the Board. It is anticipated that the total cost of compliance with Year 2000 will be in the order of £10m with £9m already spent.

Economic and Monetary Union (EMU)

The introduction of the euro will affect the Company whether or not the UK participates in EMU. Our businesses operate in eight of the first wave countries and we expect the growing use of the euro within the UK for transactions with organisations in other European countries. The Company is taking steps to ensure that the anticipated changes will not jeopardise the continuing operation of our European businesses.

Policy on payment of creditors

The Company's policy and practice is to pay creditors promptly in accordance with agreed terms of business. The average time taken to pay an invoice

was 36 days for the parent company and 46 days for the group as a whole (calculated in compliance with the Companies Act 1985 (Directors' Report) (Statement of Payment Practice) Regulations 1997).

Environment

The Company seeks to ensure that its operations and products cause the minimum reasonably achievable detriment to the environment. Care is taken to limit discharges of environmentally harmful substances and to dispose of waste in a safe manner. The Company is a founder member of VALPAK. Contingency arrangements and plans exist to reduce the risk of and limit the effect of any accidental spillage. Where sites occupied by the Company have been found to be contaminated by past industrial practices, programmed clearance has been undertaken in co-operation with the appropriate regulatory authorities. A senior corporate staff director has responsibility for safety, health and environmental matters: two full-time managers report to that director and co-ordinate and monitor the safety, health and environmental activities of the Company.

Personnel policies

It is the Company's policy to provide equal opportunities for employment and to give the fullest consideration to employment prospects for the disabled. The Company continues to be actively involved in all aspects of the training and development of young persons, including government sponsored schemes and unit initiatives designed to ease the transition from school to work.

Share option schemes enable employees to participate financially in the affairs of the Company.

Employees are regularly provided with a wide range of information concerning the performance and prospects of the business in which they are involved by means of Employee Councils

and other similar consultative bodies which allow the views and opinions of personnel to be taken into account.

All matters concerning the environment, health and safety continue to be regulated by preventative, investigatory and consultative systems; issues relevant to the Company pension scheme are likewise covered by means of structured committees, including representation from recognised trade unions.

Authority to issue shares

At the Annual General Meeting shareholders will be asked to revise the authority, given to the directors at the Annual General Meeting in November 1998, to allot shares for the purposes of section 80 of the Companies Act 1985 so as to reflect the increase in the Company's issued share capital since the last Annual General Meeting. The authority proposed will expire on the fifth anniversary of the Meeting, unless otherwise renewed. The ordinary resolution is set out in the Notice of AGM.

Also in the Notice is the special resolution to renew the power granted to directors under section 95 of the Companies Act 1985. The new authority sought will be on substantially similar terms to those attaching to the existing authority and will permit the directors to allot equity securities for cash:

- in connection with a rights issue *pro rata* to the rights of the existing shareholders;
- pursuant to the terms of any share scheme approved by the shareholders in General Meeting; and
- for any other purpose provided that the aggregate nominal value of such allotments does not exceed £3,919,256 (approximately 5% of the issued share capital).

During the period ended 31 July 1999, a total of 1,388,087 ordinary shares were issued pursuant to the terms of

shareholder-approved share schemes and 3,447,556 shares were issued under the Scrip Dividend Share Alternative scheme.

Authority to purchase shares

At the Annual General Meeting the Company will seek to renew the authority, granted in general meeting on 24 November 1998, to make market purchases of its shares, as defined in section 163 of the Companies Act 1985. The authority will be limited to not more than 5% of the issued share capital and will be renewed annually. The maximum price that may be paid under the authority will be limited to 105% of the average of the middle market quotations of the Company's shares, as derived from the London Stock Exchange Daily Official List, for the ten business days prior to any purchase.

The directors will only exercise the authority if they are satisfied that any purchase will increase the earnings per share of the ordinary share capital in issue and will be in the interests of the shareholders.

No shares have ever been purchased or contracted for or are the subject of any option under the expiring or any prior authority.

Dividend – share alternative

A scrip dividend share alternative plan was approved at the 1997 Annual General Meeting which authorised the directors to offer a share alternative ("scrip dividend") to shareholders (i.e. the option to elect to receive new shares instead of all or part of the dividend in cash). The authority enables the directors to offer a share alternative in respect of any dividends that may be declared during a period of five years from the date of the meeting. The authority conforms to the provisions of Article 114 of the Company's Articles of Association.

The directors will only exercise the authority if it appears to them to

be in the best interests of the Company. The share alternative will not be offered to shareholders resident in territories or subject to jurisdictions where the share alternative would be illegal or where compliance with local laws or regulations would be unduly onerous.

If the final dividend for 1998/99 is approved at the AGM, a share alternative will be offered. Only shareholders eligible for the final dividend (i.e. those shareholders on the register on the dividend record date of 15 October 1999) will receive details of the share alternative and election procedures through the post. If a share alternative is offered in respect of any future dividend, shareholders at the time will be given the opportunity to elect to receive shares instead of cash. Elections to receive a share alternative may be made for a specific dividend only or for all future dividends for which a share alternative is offered, at the shareholder's discretion.

Auditor

Resolutions will be proposed at the Annual General Meeting to re-appoint PricewaterhouseCoopers as auditor and to authorise the directors to determine the auditor's remuneration.

Personal Equity Plans and Individual Savings Accounts

The Company's corporate and single company PEPs are managed by Hendersons Administrators (Helpline tel: 020 7452 1357). The Company's ISA is managed by Lloyds TSB Registrars (Helpline tel: 0870 24 24 244).

Dematerialisation of shares

On 17 March 1997 the Company's shares became tradable in uncertificated form through CREST. Shareholders who wish neither to become members of CREST nor to transfer their holdings into nominee companies may continue to hold their shares and deal in them in certificated

form. Further information on the opportunities presented by and the effects of dematerialising shares can be obtained from CRESTCo Limited, Trinity Tower, 9 Thomas Moore Street, London E1 9YN.

By Order of the Board

Alan Smith

Secretary

28 September 1999

London NW11 8DS

Statement of Directors' responsibilities

Company law requires the directors to prepare accounts for each financial year which give a true and fair view of the state of affairs of the Company and the group at the end of the year, and of the profit or loss of the group for that period. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts;
- prepare the accounts on the going concern basis unless it is inappropriate to assume that the Company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the accounts comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention of fraud and other irregularities.

Directors' emoluments and interests

Report on Directors' remuneration

The Committee of the Board referred to on page 31 determines the remuneration of executive directors including their annual bonus targets and grants of share options. Its constitution and practice accord with Section B of the Combined Code as defined in the Listing Rules of the London Stock Exchange (the Code).

The Committee seeks to maintain a competitive programme which enables the company to attract and retain the highest calibre of executive. The Committee consults with the Chief Executive, and has access to external remuneration consultants, which enables wide-ranging comparisons to be made. In framing its remuneration policy the Committee has given full consideration to Section B of the Code.

Salaries are reviewed annually. The Committee takes into account individual performance and experience, the size and nature of the job, the

relative performance of the Company, pay policy within the Company and the salary available in comparable companies. Benefits include a company car, pension, health insurance and, where appropriate, relocation expenses, generally in line with benefits available for executives in similar positions in other international aerospace and engineering companies.

Bonuses are based on successful performance and are only paid on the achievement of carefully considered targets which have been approved by the Board. All bonuses are capped. Under a deferred share scheme, established in 1992, senior executives may use their after-tax bonus to buy the Company's shares at the prevailing market price; if they retain those shares for three years they may exercise options over a matching number of shares for a nominal sum. Income tax is payable on the market value of the matching shares when the option is exercised. In October 1998 executive

directors participated in the scheme in respect of their 1998 bonus and were granted options over shares to the values listed in a table on page 38.

The remuneration of directors is set out in tables on pages 36 to 38.

The annual bonus and any gains under share option schemes are not pensionable. Company car benefits which are subject to income tax and for which a cash alternative is available are pensionable.

Pensions. Subject to Revenue limits a final salary scheme provides a pension of up to two thirds of final salary (including pensionable benefits). Where Revenue limits apply the difference between the pension payable on the cap and that payable on two thirds of final salary is, after taking into account any pension transfers, made good by the Company through a funded unapproved retirement benefit scheme. Details of pension provisions are set out in a table on page 37.

Directors' emoluments and interests continued

Contract terms. Three directors have two-year rolling contracts. The Committee considered it would be inequitable to reduce this term without compensation and, in any event, considers it to be in the best interests of the Company to maintain a degree of stability on the Board at a time when two executive directors are due to retire within the next 12 months. The Company's policy is to phase out two-year rolling contracts and new executive directors will be appointed on contracts which have an initial fixed term followed by a one-year rolling period of notice. The Committee accepts and will apply the principle of mitigation of damages on termination of a contract.

Non-executive directors were paid a total of £121,000 in fees in the year to 31 July 1999: 20% of their fees (after deduction of tax) is applied in the purchase of Company shares: they have no service contracts and are not eligible for bonuses or participation in share schemes and no pension contributions are made on their behalf.

The remuneration of the non-executive directors is determined by the Board within the limits set out in the Articles of Association.

Directors' interests in the Company's shares

The interests of directors in the issued share capital of the Company are set out in a table on page 37.

The executive share option scheme approved at the Annual General Meeting in 1995 covers approximately 250 executives. Awards are approved by the Committee. In awarding share options the Committee has regard to guidelines published by investor protection committees, the individual performance of participants and any evidence that the scheme has encouraged option holders to become shareholders. Options granted under the 1995 Scheme may only be exercised after three years if a performance requirement has been met: that requirement is that the increase in the total shareholder return of the Company, over a period of three years from the date of grant, must exceed the increase in total return achieved by the companies comprising the General Industrials Sector of the FTSE Actuaries Index over the same period.

The *Save-As-You-Earn* scheme which is open to all UK employees with 12 months' service is subject to UK legislation as to the amount which can

be saved. Participants save a fixed sum per month for three or five years and may use the sum generated by their savings contracts to exercise the options which are usually granted at a 20% discount to the market price.

In the 52 weeks to 31 July 1999, executive directors exercised share options and at 31 July 1999 held unexercised options as described in a table on page 38.

There were no changes in the options held by directors between 31 July 1999 and 28 September 1999. The Register of Directors' Interests (which is open to inspection) contains full details of directors' shareholdings and options to subscribe for shares in the Company.

Subject to the overriding requirements of the Company, the Committee is prepared to allow executive directors to accept external appointments where it considers that such appointments will contribute to the directors' breadth of knowledge and experience. Directors are permitted to retain fees associated with such appointments.

Remuneration

The total remuneration of directors, excluding defined benefit pension arrangements, is as follows:

	1999 £000	1998 £000
Fees, including Chairman's additional remuneration	188	123
Salaries and benefits	1,545	1,783
Performance related bonuses	562	832
Gain from exercise of share options	392	1,925
Money purchase pension contributions	215	193
	2,902	4,856

The emoluments of the directors are set out below:

	Fees		Salary		Bonus		Benefits		Deferred share scheme contributions		Money purchase pension contributions		Total	
	1999 £000	1998 £000	1999 £000	1998 £000	1999 £000	1998 £000	1999 £000	1998 £000	1999 £000	1998 £000	1999 £000	1998 £000	1999 £000	1998 £000
Chairman														
Sir Roger Hurn (retired 24.11.98.)			39	405		203	13	26					52	634
K Orrell-Jones (from 24.11.98.)	84												84	
Chief Executive														
K O Butler-Wheelhouse			430	385	172	193	17	21	115	80	215	193	949	872
Executive Directors														
N V Barber			260	235	104	118	22	21		50			386	424
G M Kennedy			245	235	98	118	17	22	70	25			430	400
E Lindh			245	200	98	100	17	16	66	36			426	352
A M Thomson			225	200	90	100	15	17	60	41			390	358
Non-Executive Directors														
P Hollins (appointed 9.2.99.)	13												13	
R F Leverton	25	25											25	25
R W O'Leary	25	23											25	23
K Orrell-Jones (to 24.11.98.)	8	25											8	25
A I H Pink	25	25											25	25
Sir Peter Thompson (retired 24.11.98.)	8	25											8	25
	188	123	1,444	1,660	562	832	101	123	311	232	215	193	2,821	3,163

The deferred share scheme amounts relate to the previous year's bonus.

The payments to Mr K Orrell-Jones comprise £25,000 director's fees and £67,000 special remuneration as Chairman.

The pension benefits earned by the executive directors were:

	Age at 31 July 1999	Directors' contributions during the year £000	Additional pension earned during the year (excluding any increase for inflation) £000	Accrued entitlement at 31 July 1999 £000
N V Barber	60	13	20	166
G M Kennedy	58	12	9	167
E Lindh	54	12	22	108
A M Thomson	52	11	16	81

An executive director's normal retirement age is 60. An early retirement pension, based on actual service completed, may be paid after age 50, subject to a reduction on account of early payment. On death a spouse's pension of two-thirds of the director's pension (or for death-in-service his prospective pension at age 60) is payable. All pensions in excess of the Guaranteed Minimum Pension (GMP) are guaranteed to increase at the rate of 5% per annum compound or the annual increase in the Retail Price Index, if less. There has, however, been a long-standing practice of granting additional discretionary increases on pensions in excess of the GMP to bring them into line with price inflation.

Directors' beneficial interests in the Company's shares:

	Ordinary shares of 25p			Ordinary shares of 25p	
	31 July 1999	1 August 1998		31 July 1999	1 August 1998
N V Barber	116,497	120,877	R W O'Leary	2,882	2,370
K O Butler-Wheelhouse	23,888	9,502	K Orrell-Jones	2,782	2,311
P Hollins	162	0*	A I H Pink	1,724	1,311
G M Kennedy	73,672	52,890	A M Thomson	21,957	12,340
R F Leverton	2,355	1,911			
E Lindh	15,946	15,678			

*Indicates share interest at appointment on 9 February 1999.

The Company has not been notified of any changes to the beneficial holdings of the directors, their families and any connected persons between 31 July 1999 and 28 September 1999.

Directors' emoluments and interests continued

Directors' share options:

	Scheme	Options held on		Weighted average	Options exercised			Options granted				
		31 July 1999	1 August 1998		Exercise price	Date exercised	Number	Exercise price	Market price†	Date of grant	Number	Exercise price
K O Butler-Wheelhouse	B	274,301	151,583	830.86p					21/10/98	122,718	765.00p	21/10/2008
	C	2,578	2,578	669.00p								
	D	23,443	9,429	0.10p					17/11/98	14,014	0.10p	17/10/2005
N V Barber	B	29,659	63,623	823.00p	21/4/99	33,964	632.00p	992.00p				
	C	2,729	2,729	632.00p								
	D	11,837	19,476	0.10p	21/4/99	7,639	0.10p	992.00p				
G M Kennedy	B	54,501	86,061	875.70p	31/3/99	31,560	632.00p	918.00p				
	C	3,312	6,941	430.20p	14/7/99	3,629	248.00p	847.00p				
	D	18,424	16,931	0.10p	7/12/98	7,052	0.10p	855.50p	17/11/98	8,545	0.10p	17/10/2005
E Lindh	A	16,851	16,851	451.00p								
	B	78,045	43,030	812.44p					21/10/98	35,015	765.00p	21/10/2008
	C	3,409	3,409	572.00p								
	D	23,140	15,140	0.10p					17/11/98	8,000	0.10p	17/10/2005
A M Thomson	A	62,500	62,500	480.00p								
	B	97,130	65,148	788.13p					21/10/98	31,982	765.00p	21/10/2008
	C	3,015	3,015	572.00p								
	D	17,581	12,245	0.10p	7/12/98	1,936	0.10p	855.50p	17/11/98	7,272	0.10p	17/10/2005

Key:

- A. The Smiths Industries (1984) Executive Share Option Scheme
- B. The Smiths Industries 1995 Executive Share Option Scheme
- C. The Smiths Industries 1982 SAYE Share Option Scheme
- D. The Smiths Industries Senior Executive Deferred Share Scheme

† Mid-market quotation from the London Stock Exchange Daily Official List or actual sale price if shares sold on date of acquisition.

Notes:

The high and low market prices of the ordinary shares during the period 2 August 1998 to 31 July 1999 were 1074p and 624p, respectively. The market price on 1 August 1998 was 711p and on 31 July 1999 was 869p.

All options held on 31 July 1999 were granted at exercise prices less than the market price on that date, except for options granted under the Smiths Industries 1995 Executive Share Option Scheme on 17 October 1997 (exercise price 934p per share).

No options lapsed during the period 2 August 1998 to 31 July 1999. No options have been granted or exercised or have lapsed between 31 July 1999 and 28 September 1999.

There are no performance criteria for The Smiths Industries (1984) Executive Share Option Scheme or The Smiths Industries Senior Executive Deferred Share Scheme apart from market price. The Smiths Industries 1995 Executive Share Option Scheme is subject to a performance criterion based on total shareholder return of the Company versus the total return of the General Industrials Sector of the FTSE Actuaries Index.

Deferred Share Scheme options were granted on 17 November 1998 at an exercise price of 0.1p per share and match shares purchased in the market by the grantee on that day. At 31 July 1999, the deferred share scheme held 206,585 shares for the benefit of senior executives (including the directors as disclosed above). The market value of these shares at that date was £1.8m and dividends of approximately £43,728 were waived in the year in respect of the shares.

Special provisions permit early exercise of options in the event of retirement; redundancy; death; etc.

No other director held any options over the Company's shares during the period 2 August 1998 to 31 July 1999.

Full details of the directors' shareholdings and options are contained in the Register of Directors' Interests in Shares (which is open to inspection).

Auditors' report

To the members of Smiths Industries plc

We have audited the financial statements on pages 40 to 56 which have been prepared under the historical cost convention (as modified by the revaluation of certain fixed assets) and the accounting policies set out on page 56.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the Annual Report, including as described on page 35 the financial statements. Our responsibilities, as independent auditors, are established by statute, the Auditing Practices Board, the Listing Rules of the London Stock Exchange and our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act. We also report to you *if, in our opinion, the directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by*

law or the Listing Rules regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the Annual Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

We review whether the statement on page 31 reflects the Company's compliance with those provisions of the Combined Code specified for our review by the London Stock Exchange, and we report if it does not. We are not required to form an opinion on the effectiveness of the Company's or group's corporate governance procedures or its internal controls.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies

are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the group at 31 July 1999 and of the profit and cash-flows of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.



PricewaterhouseCoopers
Chartered Accountants and
Registered Auditors
London
28 September 1999

Consolidated profit and loss account

	Note	Ordinary activities before goodwill amortisation £m	Goodwill amortisation £m	52 weeks ended 31 July 1999 £m	52 weeks ended 1 August 1998 £m
Turnover					
Continuing operations		1,290.4		1,290.4	1,198.5
Acquisitions		33.5		33.5	
	1 & 2	1,323.9		1,323.9	1,198.5
Cost of sales	3	(762.8)		(762.8)	(695.8)
Gross profit		561.1		561.1	502.7
Operating expenses	4	(313.6)	(3.0)	(316.6)	(278.5)
Operating profit					
Continuing operations	5	243.7		243.7	224.2
Acquisitions		3.8	(3.0)	0.8	
Profit on ordinary activities before interest		247.5	(3.0)	244.5	224.2
Net interest	6	(7.0)		(7.0)	(6.1)
Profit on ordinary activities before taxation		240.5	(3.0)	237.5	218.1
Tax on profit	8	(74.0)		(74.0)	(68.5)
Profit on ordinary activities after taxation		166.5	(3.0)	163.5	149.6
Minority interests		(0.3)		(0.3)	(1.4)
Profit for the financial year		166.2	(3.0)	163.2	148.2
Dividends	9	(67.9)		(67.9)	(60.8)
Retained profit for the year		98.3	(3.0)	95.3	87.4
Earnings per share	10				
Basic		53.5p	(1.0p)	52.5p	48.2p
Fully-diluted		53.0p	(1.0p)	52.0p	47.8p

Statement of total recognised gains and losses

	1999 £m	1998 £m
Profit for the financial year attributable to shareholders	163.2	148.2
Exchange adjustments	4.4	(1.5)
	167.6	146.7

There is no material difference between the profit on ordinary activities or retained profit for the year stated above, and their historical cost equivalents.

Notes on pages 43 to 55 form part of these accounts.


Balance sheets

	Note	Consolidated		Company	
		31 July 1999 £m	1 August 1998 £m	31 July 1999 £m	1 August 1998 £m
Fixed assets					
Intangible assets	13	91.5			
Tangible assets	14	231.5	211.2	48.3	46.2
Investments and advances	16	0.2	4.2	582.3	481.8
		323.2	215.4	630.6	528.0
Current assets					
Stocks	17	203.9	187.0	37.4	33.6
Debtors	18	351.3	310.8	104.0	102.4
Cash at bank and on deposit		93.4	96.9	47.6	62.5
		648.6	594.7	189.0	198.5
Creditors: amounts falling due within one year	20	(446.1)	(408.9)	(216.8)	(171.7)
Net current assets/(liabilities)		202.5	185.8	(27.8)	26.8
Total assets less current liabilities		525.7	401.2	602.8	554.8
Creditors: amounts falling due after more than one year	20	(99.2)	(99.4)	(26.3)	(13.3)
Provisions for liabilities and charges	24	(68.0)	(75.4)	(16.5)	(20.1)
Net assets		358.5	226.4	560.0	521.4
Capital and reserves					
Called up share capital	26	78.4	77.2	78.4	77.2
Share premium account	27	91.1	57.2	91.1	57.2
Revaluation reserve	27	3.3	3.3	0.6	0.6
Other reserves	27			180.5	182.1
Profit and loss account	27	179.5	84.0	209.4	204.3
Shareholders' equity	28	352.3	221.7	560.0	521.4
Minority equity interests		6.2	4.7		
Capital employed		358.5	226.4	560.0	521.4

The accounts on pages 40 to 56 were approved by the Board of directors on 28 September 1999 and were signed on its behalf by:



Keith Orrell-Jones



Alan M Thomson




Cash-flow statement

	Note	52 weeks ended 31 July 1999 £m	52 weeks ended 1 August 1998 £m
Net cash inflow from operating activities (see below)		243.4	240.5
Returns on investments and servicing of finance:			
Interest received		7.5	4.6
Interest paid		(15.6)	(10.7)
Net cash outflow from returns on investments and servicing of finance		(8.1)	(6.1)
Tax paid		(70.4)	(65.4)
Capital expenditure:			
Purchase of fixed assets		(50.4)	(42.1)
Sale of fixed assets		2.0	5.2
Net cash outflow for capital expenditure		(48.4)	(36.9)
Acquisitions and disposals:			
Purchase of businesses	25	(98.1)	(152.3)
Bank overdrafts assumed			(1.9)
Disposal of businesses	25	(0.6)	36.7
Net cash outflow for acquisitions and disposals		(98.7)	(117.5)
Equity dividends paid		(37.0)	(52.5)
Net cash outflow before financing		(19.2)	(37.9)
Management of liquid resources:			
Reduction in short-term deposits		6.2	40.6
Financing:			
Increase in term borrowings		53.5	13.8
Loan note redemptions		(19.0)	(5.9)
Share issues		9.1	7.6
Increase in cash		30.6	18.2
Reconciliation to net debt			
Net cash inflow		30.6	18.2
Reduction in short-term deposits		(6.2)	(40.6)
Increase in term borrowings		(53.5)	(13.8)
Loan notes redeemed, less issued		19.0	1.8
Term debt of acquisitions assumed	25	(3.0)	(10.1)
Term deposits of acquisitions assumed	25	8.0	
Exchange variation		(5.5)	3.7
Increase in net debt		(10.6)	(40.8)
Net debt at 2 August 1998		(82.8)	(42.0)
Net debt at 31 July 1999	21	(93.4)	(82.8)
Reconciliation of operating profit to net cash inflow from operating activities			
Operating profit		244.5	224.2
Goodwill amortisation		3.0	
Depreciation		35.6	32.2
Increase in stocks		(2.6)	(11.7)
Increase in debtors		(28.1)	(13.4)
(Decrease)/increase in creditors		(9.0)	9.2
		243.4	240.5

Notes on pages 43 to 55 form part of these accounts.

Notes to the accounts

1 Analyses of turnover, profit and assets	Turnover		Profit		Assets	
	1999 £m	1998 £m	1999 £m	1998 £m	1999 £m	1998 £m
Market						
Aerospace	528.5	463.0	98.5	77.0	103.1	63.5
Medical Systems	376.2	344.4	76.0	74.7	198.4	130.9
Industrial	419.2	391.1	73.0	72.5	144.2	110.1
	1,323.9	1,198.5	247.5	224.2	445.7	304.5
Goodwill amortisation						
Aerospace			(1.0)			
Medical Systems			(1.1)			
Industrial			(0.9)			
			244.5	224.2	445.7	304.5
Net interest/net borrowings			(7.0)	(6.1)	(93.4)	(82.8)
Profit before tax/net assets			237.5	218.1	352.3	221.7
Geographical origin						
United Kingdom	603.6	556.3	101.9	102.6	123.1	108.2
USA	612.2	535.5	124.3	100.8	248.7	140.1
<i>US dollars</i>	<i>\$1,004.0m</i>	<i>\$883.5m</i>	<i>\$203.9m</i>	<i>\$166.3m</i>	<i>\$402.9m</i>	<i>\$229.8m</i>
Europe	135.0	124.4	14.3	13.1	36.9	27.8
Other overseas	76.5	71.6	7.0	7.7	37.0	28.4
Inter-company	(103.4)	(89.3)				
	1,323.9	1,198.5	247.5	224.2	445.7	304.5
Goodwill amortisation						
United Kingdom			(0.4)			
USA			(2.6)			
			244.5	224.2	445.7	304.5
The above segmental analyses include the following contributions from acquisitions made during the year:						
Market						
Aerospace	11.7		(0.9)			
Medical Systems	12.7		2.9			
Industrial	9.1		1.8			
	33.5		3.8			
Goodwill amortisation						
Aerospace			(1.0)			
Medical Systems			(1.1)			
Industrial			(0.9)			
			0.8			
Geographical origin						
United Kingdom	2.5		(0.3)			
USA	29.8		4.0			
Europe	1.2		0.1			
	33.5		3.8			
Goodwill amortisation						
United Kingdom			(0.4)			
USA			(2.6)			
			0.8			
2 Analysis of turnover by destination					1999 £m	1998 £m
United Kingdom					313.2	288.6
USA					598.7	533.7
Europe					237.6	210.9
Japan					66.9	63.8
Other overseas					107.5	101.5
					1,323.9	1,198.5

Notes to the accounts continued

3 Cost of sales

Cost of sales of £762.8m includes £17.7m in respect of acquisitions made during the year.

	1999 £m	1998 £m
4 Operating expenses		
Continuing operations:		
Distribution costs	141.0	114.2
Administrative expenses	160.6	142.2
	301.6	256.4
Acquisitions:		
Distribution costs	6.5	9.6
Administrative expenses	5.5	12.5
Goodwill amortisation	3.0	
	15.0	22.1
Total operating expenses	316.6	278.5

	1999 £m	1998 £m
5 Operating profit is after charging		
Goodwill amortisation	3.0	
Depreciation of fixed assets	35.6	32.2
Research and development expenditure	53.9	48.8
Operating leases – Land and buildings	9.0	5.9
– Others	4.0	2.6
Auditors – Audit fees: Parent company	0.1	0.1
Other	1.2	1.1
– Other fees: Acquisitions and disposals	0.5	1.3
Other	0.2	0.2
Restructuring and redundancy costs	0.4	14.2
Year 2000 related expenditure	1.7	1.3

Other fees totalling £0.7m paid to the auditors include £0.5m charged to goodwill. Of the £0.7m, £0.1m (1998 £1.2m) was incurred in respect of the UK.

	1999 £m	1998 £m
6 Net interest		
Receivable	7.5	4.1
Payable:		
Bank loans and overdrafts repayable within 5 years	(8.5)	(3.6)
Other loans repayable within 5 years	(6.0)	(6.5)
Other loans repayable in more than 5 years		(0.1)
	(7.0)	(6.1)

7 Profit attributable to the parent company

Profits for the financial year of £74.7m (1998 £29.0m) were recorded in the accounts of Smiths Industries plc. The directors have taken advantage of the exemption afforded by s230 of the Companies Act 1985 not to present a separate profit and loss account for the parent company.

	1999 £m	1998 £m
8 Taxation		
Taxation on the profit for the year:		
UK corporation tax at 30.67% (1998 – 31%)	37.1	35.0
Double taxation relief	(3.2)	(0.4)
Deferred taxation	2.8	0.5
Overseas taxation	37.3	33.4
	74.0	68.5

9 Dividends	1999 £m	1998 £m
Ordinary interim paid 7.4p per share (1998 6.75p)	23.1	20.8
Ordinary final proposed 14.25p per share (1998 12.9p)	44.8	40.0
	67.9	60.8

As stated in note 27, scrip dividends amounting to £26.0m were taken up from the 1997/8 final and 1998/9 interim dividends.

10 Earnings per share	1999	1998
Separate figures are given for earnings per share related to the weighted average number of shares in issue:		
Basic	310,932,199	307,320,126
Effect of dilutive share options	2,558,478	2,826,778
Fully-diluted	313,490,677	310,146,904

11 Post-retirement benefits

Smiths Industries operates a number of pension schemes throughout the world. The major schemes are located in the UK and USA and are of the defined benefit type, with assets held in separate trustee-administered funds.

Contributions to these schemes are made on the advice of independent qualified actuaries, using in the UK the Projected Unit method and in the USA the Entry Age Normal method. The aim is for the benefits to be fully funded during the scheme members' working lives.

In both countries the regular pension cost is assessed using the Projected Unit method. The latest actuarial assessments were as at 31 March 1998 for the UK and 31 July 1998 for the USA for the major schemes.

At these dates the market value of the defined benefit schemes' assets was £729m for the UK and \$273m for the USA. The aggregate funding levels of the principal schemes were 125% for the UK and 119% for the USA. The funding levels were determined by comparing the market value of the funds' assets with the value of benefits accrued to date. Allowance is made for future annual salary increases at approximately 5% and, for the UK schemes, for pension increases of approximately 3%. The future investment return assumed in assessing the present value of future benefits was 6% p.a. for UK pensioner liabilities and 7% p.a. for UK active member liabilities and 7% p.a. for the USA. The investment return assumptions were derived from prevailing yields on government stocks.

The regular pension cost is assessed at each actuarial valuation and applied until the next valuation. The variation from regular pension cost, which recognises the excess of assets over liabilities of the pension schemes, is spread over the average remaining working life of relevant employees, generally between 10 and 15 years.

A prepayment of £35.7m is included in debtors, this being the excess of the amount funded over the accumulated pension cost.

The pension costs of other countries' schemes were assessed in accordance with local practice. The Company operates a defined contribution (401K) plan for its USA employees, and provides post-retirement healthcare benefit plans, principally at Grand Rapids in the USA.

The cost of the post-retirement healthcare benefits is assessed by independent qualified actuaries and is fully accrued (see note 24). The major assumptions used are interest rate 7.25% p.a. and medical cost inflation 7% p.a., ultimately reducing to 5% p.a.

12 Employees	1999 £m	1998 £m
Staff costs during the year:		
Wages and salaries	334.8	306.6
Social Security	32.3	29.8
Company pension costs	4.9	3.7
	372.0	340.1
The average number of persons employed was:		
Aerospace	5,248	5,055
Medical Systems	4,332	4,095
Industrial	4,888	4,723
	14,468	13,873

Details of directors' remuneration are given on pages 36 to 38.

Notes to the accounts continued

13 Intangible fixed assets	1999 £m
Goodwill:	
Acquired during the year	94.5
Amortisation charged to operating profit	(3.0)
Net book value at 31 July 1999	91.5

14 Tangible fixed assets	Land and buildings	Plant and machinery	Fixtures, fittings, tools and equipment	Total
	£m	£m	£m	£m
Consolidated				
Cost or valuation				
At 2 August 1998	128.5	166.5	203.0	498.0
Exchange adjustments	1.9	1.0	1.2	4.1
Additions	7.3	15.0	28.1	50.4
Acquisitions	2.9	3.7	2.7	9.3
Disposals	(0.5)	(7.0)	(11.0)	(18.5)
At 31 July 1999	140.1	179.2	224.0	543.3
Depreciation				
At 2 August 1998	28.6	115.3	142.9	286.8
Exchange adjustments	0.4	0.7	0.8	1.9
Charge for the year	3.6	11.6	20.4	35.6
Acquisitions	0.5	2.5	2.0	5.0
Eliminated on disposals	(0.3)	(6.6)	(10.6)	(17.5)
At 31 July 1999	32.8	123.5	155.5	311.8
Net book value				
At 31 July 1999	107.3	55.7	68.5	231.5
At 2 August 1998	99.9	51.2	60.1	211.2
Company				
Cost or valuation				
At 2 August 1998	29.3	7.7	64.0	101.0
Additions	1.0	1.0	6.8	8.8
Transfers		6.4	0.4	6.8
Disposals	(0.1)	(0.4)	(2.7)	(3.2)
At 31 July 1999	30.2	14.7	68.5	113.4
Depreciation				
At 2 August 1998	2.3	5.5	47.0	54.8
Transfers		5.2	0.3	5.5
Charge for the year	0.4	0.7	6.2	7.3
Eliminated on disposals		(0.3)	(2.2)	(2.5)
At 31 July 1999	2.7	11.1	51.3	65.1
Net book value				
At 31 July 1999	27.5	3.6	17.2	48.3
At 2 August 1998	27.0	2.2	17.0	46.2

14 Tangible fixed assets continued	Consolidated		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
Land and buildings				
Cost	132.8	121.2	29.6	28.7
Valuation 1974	7.3	7.3	0.6	0.6
	140.1	128.5	30.2	29.3
Freehold	126.9	119.1	30.0	29.3
Long leasehold (in excess of 50 years unexpired)	4.4	4.2	0.2	
Short leasehold	8.8	5.2		
	140.1	128.5	30.2	29.3
If land and buildings had not been revalued they would have been included at the following amounts:				
Cost	136.1	124.5	29.6	28.7
Aggregate depreciation	32.0	27.9	2.7	2.3

The Company's properties were revalued on the basis of open market valuation in 1974, and that valuation was incorporated into the financial statements. These values have been retained under the transitional provisions of FRS15, and the directors do not intend to adopt a policy of annual revaluations in the future. A quinquennial external revaluation of the Company's properties as at 31 July 1999 has produced a surplus of £21.2m over book value, as noted in the Directors' Report on page 30.

15 Capital commitments	1999 £m	1998 £m
Estimated commitments not included in the accounts:		
Company	2.1	3.5
Subsidiaries	4.3	4.3
	6.4	7.8

16 Investments and advances	Consolidated		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
At cost less amounts written off:				
Subsidiary companies			582.3	481.8
Assets held for resale		4.0		
Unlisted investments	0.2	0.2		
	0.2	4.2	582.3	481.8
Investments in subsidiaries:				
Shares at cost			553.1	589.0
Due from subsidiaries			200.4	73.3
			753.5	662.3
Due to subsidiaries			(171.2)	(180.5)
			582.3	481.8

The Company's principal subsidiaries and their countries of incorporation are:

England

Smiths Industries Aerospace & Defence Systems Limited*
Graseby Dynamics Limited
SIMS Portex Limited*
SIMS Graseby Limited
Eschmann Bros & Walsh Limited*
Smiths Industries Industrial Group Limited*
Air Movement (Holdings) Limited*

Europe

SIMS Deltec Graseby Vertriebs GmbH (Germany)
FRB Connectron SA (France)
Interconnectron GmbH (Germany)
Flexiplas SA (Spain)

USA

Smiths Industries, Inc.*
Smiths Industries Aerospace & Defense Systems, Inc.
SIMS Portex, Inc.
SIMS Deltec, Inc.
SIMS BCI, Inc.
SIMS Level 1, Inc.
Flexible Technologies, Inc.
Tutco, Inc.
Hypertronics Corporation
Icore International, Inc.
PolyPhaser Corporation
Transtector Systems, Inc.

Japan

Japan Medico Co. Limited (62%)

All subsidiaries marked * are 100% owned by the Company direct. The others are 100% owned through intermediate holding companies, with the exception of Japan Medico, which is 62% owned by the Company. Shareholdings are of ordinary shares, ordinary stock units or common stock. All subsidiaries operate in their country of incorporation.

Notes to the accounts continued

17 Stocks	Consolidated		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
Stocks comprise:				
Raw materials and consumables	66.2	61.4	3.2	1.9
Work in progress	67.5	61.0	31.4	25.2
Finished goods	83.5	71.5	12.8	9.9
	217.2	193.9	47.4	37.0
Less: Payments on account	(13.3)	(6.9)	(10.0)	(3.4)
	203.9	187.0	37.4	33.6

18 Debtors	Consolidated		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
Amounts falling due within one year:				
Trade debtors	247.2	223.7	51.1	51.0
Amounts recoverable on contracts	29.6	13.5	6.9	4.0
Amounts owed by subsidiaries			2.8	5.3
Other debtors	5.4	6.2	1.6	1.4
Prepayments and accrued income	14.6	12.7	5.9	5.6
	296.8	256.1	68.3	67.3
Amounts falling due after more than one year:				
Other debtors	5.4	4.9		
Deferred taxation (note 19)	13.4	13.1		3.6
Pensions prepayment	35.7	36.7	35.7	31.5
	351.3	310.8	104.0	102.4

The comparative figures for 1998 have been restated to include deferred taxation transferred from Provisions for Liabilities and Charges.

19 Deferred taxation	Consolidated				Company	
	Full provision basis		Provided		1999	1998
	1999 £m	1998 £m	1999 £m	1998 £m	1999 £m	1998 £m
Deferred taxation:						
Accelerated capital allowances	(10.1)	(9.9)	(10.1)	(9.9)	(5.4)	(5.4)
Advance corporation tax		10.0		10.0		10.0
Post-retirement benefits	9.3	9.6	9.3	9.6		
Short-term and other timing differences	25.3	12.3	14.2	3.4	1.1	(1.0)
Deferred tax asset/(liability)	24.5	22.0	13.4	13.1	(4.3)	3.6
			£m	£m	£m	£m
Movements during the year:						
At 2 August 1998			13.1	14.7	3.6	4.3
Exchange adjustments			(1.0)	0.1		
Acquisitions			3.7	0.7		
Charge for the year			(2.8)	(0.5)	(1.2)	1.1
Other			0.4	(1.9)	(6.7)	(1.8)
At 31 July 1999			13.4	13.1	(4.3)	3.6

No provision has been made for potential taxation which could arise on the remittance to the United Kingdom of retained overseas earnings, as no remittances are envisaged in the foreseeable future which could give rise to a material liability. There are no material unprovided deferred tax liabilities of the Company.

20 Creditors	Consolidated		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
Amounts falling due within one year:				
Bank loans and overdrafts	112.1	82.6	61.9	0.9
Floating rate loan notes	4.6	23.2	4.6	23.2
Other loan notes	3.6	3.3		
	120.3	109.1	66.5	24.1
Trade creditors	86.2	77.5	20.0	16.3
Bills of exchange payable	1.3	1.7		
Amounts owed to subsidiaries			4.6	1.9
Other creditors	16.2	19.8	3.5	10.5
Proposed dividend	44.8	40.0	44.8	40.0
Corporate taxation	36.1	32.6	20.1	20.3
Other taxation and social security costs	9.2	9.7	0.7	2.7
Accruals and deferred income	132.0	118.5	56.6	55.9
	446.1	408.9	216.8	171.7
Amounts falling due after more than one year:				
8.34% Senior Notes 2002	61.7	61.0		
Floating rate loan notes	4.6	4.8	4.6	4.8
Other loan notes	0.2	0.7		
Bank loans		4.1		
Deferred taxation (note 19)			4.3	
	66.5	70.6	8.9	4.8
Other creditors	32.7	28.8	17.4	8.5
	99.2	99.4	26.3	13.3

21 Borrowings and net debt

Short-term debtors and creditors have been excluded from all the following disclosures, other than the currency risk disclosures.

	Fixed borrowings			Floating borrowings £m	Total 1999 £m	Total 1998 £m
	Weighted average		Amount £m			
	Interest rate	Years fixed				
Currencies:						
Sterling	9.20%	1	3.8	9.2	13.0	32.9
US Dollar	8.34%	3	15.4	117.2	132.6	93.0
EMU participants				7.5	7.5	9.9
Japanese Yen				33.3	33.3	42.3
Other				0.4	0.4	1.6
			19.2	167.6	186.8	179.7
Cash and deposits					93.4	96.9
Net debt					93.4	82.8
Maturity:						
On demand/under one year			3.6	116.7	120.3	109.1
One to two years			0.2	2.1	2.3	5.3
Two to five years			15.4	48.8	64.2	64.6
Over five years						0.7
			19.2	167.6	186.8	179.7

Notes to the accounts continued

21 Borrowings and net debt continued

The floating-rate borrowings are related to LIBOR in the UK, to LIBOR and bank funding rates in the USA, and to LIBOR and bank base rates in Japan. Borrowings in continental Europe are based on the banks' overdraft rates.

The borrowings of all non-UK operations are in local currencies.

The medium-term borrowings are principally an issue of US\$100m Senior Notes maturing in 2002. Interest rate swaps cause the effective interest rate to be 6.2% variable on US\$75m, and 8.34% fixed on the remainder.

Cash and deposits comprise sterling and foreign currency deposits placed principally on the London money markets at call, 7-day and monthly rates on fixed interest bases. The Sterling deposits of £63m were yielding a weighted average interest rate of 5.1% and the foreign currency deposits (including US dollars totalling £3m) 3.5% as at 31 July 1999.

Reconciliation of movement in net debt	Borrowings			Net debt £m
	Cash and deposits £m	Under one year £m	Over one year £m	
As at 2 August 1998	96.9	(109.1)	(70.6)	(82.8)
Net cash (outflow)/inflow	(5.4)	36.0		30.6
Deposits/(debt) acquired with subsidiaries	8.0	(3.0)		5.0
Other movements in cash/borrowings	(6.2)	(39.3)	4.8	(40.7)
Exchange variation	0.1	(4.9)	(0.7)	(5.5)
As at 31 July 1999	93.4	(120.3)	(66.5)	(93.4)

Borrowing facilities

The Company has no committed borrowing facilities at 31 July 1999, although as noted in the Financial Review, the Company has a number of uncommitted facilities and overdraft lines.

22 Financial instruments

Fair values of financial assets and liabilities

Set out below is a year-end comparison of the book value and current fair value of the Company's financial instruments by category. Fair values of interest rate swaps, currency swap and forward currency contracts are based on the market price of comparable instruments at the balance sheet date. Where market prices are not available, the fair value has been calculated by discounting cash-flows at prevailing interest and exchange rates.

	1999 Book value £m	1999 Fair value £m	1998 Book value £m	1998 Fair value £m
Cash	93.4	93.4	96.9	96.9
Borrowings: hedge against Yen income	(15.4)	(17.7)	(23.2)	(21.7)
other short-term	(104.9)	(104.9)	(85.9)	(85.9)
long-term element	(66.5)	(69.5)	(70.6)	(74.7)
Net debt – book value/fair value	(93.4)	(98.7)	(82.8)	(85.4)
Derivative financial instruments:				
Interest rate swaps		2.0		2.9
Currency swaps	(3.6)	(4.5)		
Forward currency contracts		(0.5)		
Net financial liabilities – book value/fair value	(97.0)	(101.7)	(82.8)	(82.5)

As described in the Financial Review, the Company's policy is to hedge all material contractually committed future sales using forward exchange contracts and currency options.

Sales under a supply contract to our subsidiary Japan Medico continue to be covered by borrowing against the contract in Yen. The proceeds are converted to Sterling such that the income from supplies to Japan Medico for the year to 31 July 2000 is fully hedged.

A currency swap was entered into by the Company during the year to hedge the foreign currency exposure arising on intercompany finance. The premium received on the contract is being treated as deferred income and released evenly over the life of the contract.

The transactions to which the forward currency contracts relate are mainly expected to occur in 2000 and 2001.

22 Financial instruments continued

Currency exposures

The extent to which the Company has monetary assets and liabilities in currencies other than in their local currency has been examined.

Taking into account the effect of forward contracts and other derivative instruments, the Company had no material financial exposure to foreign exchange gains or losses on monetary assets and monetary liabilities denominated in foreign currencies at 31 July 1999.

Gains and losses arising on net investments overseas and the financial instruments used to hedge the currency exposures are recognised in the statement of total recognised gains and losses.

Hedges

As explained in the operating and financial review, the Company's policy is to hedge against exposure to movements in interest rates and exchange rates.

The table below shows the extent to which the Company has unrecognised gains and losses in respect of hedges at the beginning and end of the year.

	£m
Net gains/(losses) on hedges at 2 August 1998	0.3
Net gains/(losses) arising in previous years included in 1999 income	
Net gains/(losses) not included in 1999 income arising before 1 August 1999	0.3
Losses arising in 1999	(5.0)
Losses on hedges at 31 July 1999	(4.7)
Of which:	
Losses expected to be included in 2000 income	(0.5)
Losses expected to be included in 2001 income or later	(4.2)

All the gains and losses on the hedging transactions are expected to be matched by losses and gains on the hedged transactions or positions.

There are no material gains or losses on hedging instruments within the consolidated balance sheet.

23 Operating lease commitments

At 31 July 1999 the Company had annual commitments under non-cancellable operating leases as follows:

	Land & Buildings £m	Others £m
Expiring in less than one year	1.2	0.4
Expiring between one and five years	5.8	1.0
Expiring after five years	5.0	
	12.0	1.4

Notes to the accounts continued

24 Provisions for liabilities and charges	Profit and loss account						At 31.7.99 £m
	At 2.8.98 £m	Exchange adjustments £m	Provisions £m	Releases £m	Acquisitions £m	Utilisation £m	
Consolidated							
Post-retirement healthcare	27.2	0.3	1.1			(2.1)	26.5
Service guarantees & product liability	14.9	0.1	7.2	(1.2)	0.5	(7.5)	14.0
Reorganisation	17.5		4.5	(4.1)		(8.6)	9.3
Property	12.4	0.1	1.1	(1.0)	2.3	(2.2)	12.7
Litigation	3.4	0.1	1.6		0.9	(0.5)	5.5
	75.4	0.6	15.5	(6.3)	3.7	(20.9)	68.0
Company							
Post-retirement healthcare	2.8						2.8
Service guarantees & product liability	5.8		2.9	(0.4)	0.1	(3.9)	4.5
Reorganisation	6.5		0.2			(2.8)	3.9
Property	3.8		0.3	(0.3)		(0.1)	3.7
Litigation	1.2		0.8			(0.4)	1.6
	20.1		4.2	(0.7)	0.1	(7.2)	16.5

Post-retirement healthcare

The Company has contractual commitments to provide private healthcare after retirement to a significant number of employees, mostly in the USA. The annual charge against profits and the amount of the provision carried forward are based on actuarial assessments of the Company's discounted future obligations.

Service guarantees and product liability

Service guarantees and warranties over the Company's products typically cover periods of between one and three years. Provision is made for the likely cost of after-sales support based on the recent past experience of individual businesses.

Reorganisation

Significant parts of the Company's operations, especially in Aerospace and Industrial, have been undergoing a phased restructuring programme over the past three years. Full provision is made for schemes approved and committed by the end of each financial year. This year's balance relates mainly to the Aerospace sites at Cheltenham and in the USA, together with a number of Industrial businesses in the UK and Europe.

Property

As stated in the Accounting Policies on page 56, where a property is vacant, or sub-let under terms such that the rental income is insufficient to meet all outgoings, the Company provides for the anticipated future shortfall up to termination of the lease. Provision is also made for the cost of reinstatement work on leased properties where there is an obligation under the lease, and the costs can be reasonably estimated. Where evidence of contamination is found on property in the Company's occupation, provision is made for estimated remedial costs pending action on the affected site.

Litigation

The Company has on occasion been required to take legal action to protect its patents and other business intellectual property rights against infringement, and to similarly defend itself against proceedings brought by other parties. Provision is made for the anticipated fees and associated costs, based on professional advice as to the likely duration of each case.

Company provisions

The Parent Company's opening balances have been restated to recognise certain provisions previously included in creditors, but which more properly fall within the definition of provisions under FRS12.

25 Acquisitions

During the year the Company acquired the business of Signal Processing Systems (SPS) and the issued share capitals of Stewart Hughes Ltd. and Strategic Technology Systems, Inc. (STSI) for Aerospace, Biochem International, Inc. (BCI) and Hemex Medical AB for Medical Systems, and Transtector Systems, Inc. and Engineered Transitions Company, Inc. (Entraco) for Industrial. Details of the consideration paid, book values of retained assets at the dates of acquisition, and adjustments to reflect the Company's assessments of fair values are set out below. These fair values are provisional pending completion of detailed reviews, and will be finalised in subsequent financial statements.

	Dates of acquisition	Consideration £m	Bank deposits and borrowings assumed £m	Goodwill £m	Net assets £m
SPS	28.8.98	4.6		11.0	(6.4)
Stewart Hughes	2.11.98	10.1		9.6	0.5
STSI	30.4.99	10.5		8.9	1.6
BCI	11.1.99	50.3	8.0	37.8	4.5
Hemex	1.2.99	0.6		0.4	0.2
Transtector	30.11.98	18.7	(3.0)	21.7	
Entraco	30.11.98	3.3		5.1	(1.8)
		98.1	5.0	94.5	(1.4)
Prior year adjustments:	Specac			0.7	
	Disposals	0.6		0.6	
		0.6		1.3	

	Book value £m	Revaluation £m	Consistency of accounting policy £m	Fair value £m
Fixed assets	8.9	(1.8)	(2.5)	4.6
Stock	11.0	(3.2)	(0.2)	7.6
Debtors	12.0	(0.9)		11.1
Creditors	(11.9)	(11.9)		(23.8)
Provisions	(0.1)	(0.6)	(3.0)	(3.7)
Taxation	1.7	1.1		2.8
Borrowings assumed	(3.0)			(3.0)
Term deposits acquired	8.0			8.0
Net assets acquired	26.6	(17.3)	(5.7)	3.6
Goodwill				94.5
Consideration				98.1
Satisfied by cash				98.1

Ongoing reviews of the businesses acquired during the year have identified the following principal revaluation and accounting policy adjustments:

Fixed assets – the write-down of obsolete plant and machinery and the write-off of intangible assets in line with Company policy.

Stock and work in progress – reduction of book value to net realisable value where lower than cost.

Creditors – the write-off of development costs inappropriately capitalised; the full recognition of losses on loss-making contracts and adjustments for employee bonus/holiday pay and other costs under-accrued.

Provisions – reinstatement of service guarantee reserves, void property costs and ongoing litigation fees in line with Company policy.

Taxation – recognition of a US deferred tax asset.

Specac, which was acquired as part of Graseby PLC in 1997/8, and held for resale at the end of that year, has now been absorbed into Industrial. Goodwill written off against reserves at the time has been increased by £0.7m as a result, together with a further £0.6m arising from an adjustment to the consideration received from Thermo Environmental Instruments Inc. and Thermo Sentron Inc. for the sale of the Graseby product monitoring and environmental businesses.

In accordance with the provisions of FRS10 – Goodwill and Intangible Assets, the Company amortises goodwill arising on acquisitions after 1 August 1998 on a straight-line basis over a period of up to 20 years. The charge for the year was £3.0m. Goodwill relating to acquisitions up to 1 August 1998 was charged to reserves.

Notes to the accounts continued

26 Called up share capital	Shares	Issued capital £m
At 2 August 1998	308,704,905	77.2
Exercise of share options	1,388,087	0.3
Issues of scrip dividend shares	3,447,556	0.9
At 31 July 1999	313,540,548	78.4

The authorised capital at 31 July 1999 consisted of 400,000,000 shares of 25p each.
At 31 July 1999 the following options had been granted and were still outstanding:

	Date issued	Number of shares	Subscription prices	Dates normally exercisable
SAYE	1992	119,387	248p	1997/1999
	1993	199,249	278p	1998/2000
	1994	641,890	392p	1999/2001
	1995	960,388	384p	2000/2002
	1996	918,443	572p	2001/2003
	1997	1,410,625	632p	2000/2004
	1998	1,096,401	669p	2001/2005
	1999	945,512	721p	2002/2006
Executive	1991	8,736	250p	1994/2001
	1993	42,229	347p	1996/2003
	1993	79,394	395p	1996/2003
	1994	268,034	451p	1997/2004
	1995	62,500	480p	1998/2005
	1995	329,929	632p	1998/2005
	1996	609,312	823p	1999/2006
	1997	698,604	934p	2000/2007
	1998	1,207,566	765p	2001/2008

27 Share premium account and reserves	Share premium account £m	Revaluation reserve £m	Other reserves £m	Profit and loss account £m	Goodwill reserve £m
Consolidated:					
At 2 August 1998	57.2	3.3	199.8	694.5	(810.3)
Adjustment to 1998 goodwill					(1.3)
Goodwill set off against other reserves			(199.8)	(611.8)	811.6
Premium on allotments	33.9			(2.9)	
Retained profit				95.3	
Exchange rate changes				4.4	
At 31 July 1999	91.1	3.3		179.5	
Company:					
At 2 August 1998	57.2	0.6	182.1	204.3	
Premium on allotments	33.9			(2.2)	
Elimination of dormant subsidiaries			(1.6)		
Retained profit				6.8	
Exchange rate changes				0.5	
At 31 July 1999	91.1	0.6	180.5	209.4	

The retained profit of the Company represents a profit for the year of £74.7m, less dividends payable of £67.9m.

During the year the Company received £9.1m on the issue of shares in respect of the exercise of options awarded under various share option schemes. Employees paid £6.2m for the issue of these shares and the balance of £2.9m comprised contributions to the qualifying employee share ownership trust (QUEST) from undertakings within the Company. The trust has been included within the Company and consolidated financial statements.

3,447,556 shares at market values totalling £26.0m were taken up by shareholders as a scrip alternative to cash dividends.

28 Movements in shareholders' equity	1999	1998
	£m	£m
Profit for the year	163.2	148.2
Dividends	(67.9)	(60.8)
	95.3	87.4
Exchange variations	4.4	(1.5)
Share issues	32.2	11.8
Goodwill on acquisitions	(1.3)	(116.4)
Net increase - 1998 decrease - in shareholders' funds	130.6	(18.7)
Shareholders' funds:		
At 2 August 1998	221.7	240.4
At 31 July 1999	352.3	221.7

29 Contingent liabilities	1999	1998
	£m	£m
The Company has guaranteed the 8.34% Senior Notes 2002 privately placed by a subsidiary	61.7	61.0

Accounting policies

Accounting convention

The accounts have been prepared in accordance with the Companies Act 1985, as amended and with all applicable financial reporting and accounting standards under the historical cost convention modified to include the revaluation of certain properties, and now encompassing:-

FRS10 – Goodwill and Intangible Assets

FRS11 – Impairment of Fixed Assets and Goodwill

FRS12 – Provisions, Contingent Liabilities and Contingent Assets

FRS13 – Derivatives and Other Financial Instruments: Disclosure

FRS14 – Earnings per Share

FRS15 – Tangible Fixed Assets

Company profit and loss account

In accordance with the concession granted under section 230(3) of the Companies Act 1985 the profit and loss account of Smiths Industries plc has not been separately presented in these accounts.

Basis of consolidation

The consolidated financial statements include those of the parent company and its subsidiary undertakings.

The results of subsidiaries acquired during the year are consolidated from the date of acquisition.

Up to 1 August 1998, goodwill arising on consolidation, representing the difference between the cost of acquisition of a subsidiary undertaking and the fair value of its net assets at the date of acquisition, was charged to reserves in the year of acquisition.

Following the implementation of FRS10 – Goodwill and Intangible Assets, goodwill arising from acquisitions after 1 August 1998 is capitalised at cost, and amortised on a straight-line basis over an estimated useful economic life of up to 20 years.

Turnover

Turnover represents the invoiced amount of goods sold and services provided during the year, after the deduction of trade discounts and sales related taxes,

and the value of work undertaken during the year on long-term contracts.

Research and development

Expenditure, other than that recoverable from third parties, is written off in the year in which it is incurred.

Fixed assets

Depreciation is provided at rates estimated to write off the relevant assets by equal annual amounts over their expected useful lives. In general, the rates used are: Freehold and long leasehold buildings – 2%, Short leasehold property – over the period of the lease, Plant, machinery etc. – 10% to 20%, Motor vehicles – 25%, Tools and other equipment – 10% to 33%.

Fixed assets held under finance leases are capitalised and depreciated in accordance with the Company's depreciation policy. The capital element of future lease payments is included in creditors.

Payments made under operating leases are charged to the profit and loss account as incurred over the term of the lease.

Freehold properties

These financial statements include certain properties at 1974 valuation, less depreciation on the enhanced values calculated in accordance with the policy set out above. The directors have decided to invoke the transitional provisions of FRS15 – Tangible Fixed Assets, and do not intend to revalue these properties every year.

Leased properties

Where a leasehold property is vacant, or sub-let under terms such that the rental income is insufficient to meet all outgoings, provision is made for the anticipated future shortfall up to termination of the lease.

Stocks

Stocks and work in progress are valued at cost, including related production overheads, reduced to estimated net realisable value where appropriate. Profit is taken on long-term contracts by reference to the work completed. Provision for losses is made as soon as they are recognised.

Financial instruments

Financial assets are recognised in the balance sheet at the lower of cost and net realisable value. Discounts and premium are charged or credited to the profit and loss account over the life of the asset or liability to which they relate.

The Company uses derivative financial instruments to hedge its exposure to fluctuations in interest rates and foreign exchange rates.

Receipts and payments on interest rate instruments are recognised on an accruals basis over the life of the instrument.

Foreign currency assets and liabilities covered by forward contracts are translated at the contract rates of exchange. Other assets and liabilities in foreign currencies are translated at closing rates.

Foreign currencies

The profit and loss accounts of overseas subsidiaries are translated into sterling at average rates of exchange for the year.

Exchange adjustments arising from the re-translation of opening net assets in overseas subsidiaries and their results for the year at closing rates, and the translation of foreign currency borrowings to match overseas investments, are taken to the statement of total recognised gains and losses. All other exchange gains and losses are taken to the profit and loss account.

Taxation

Tax deferred or accelerated by the effect of timing differences is accounted for to the extent that it is considered probable that a liability or asset will crystallise in the foreseeable future. The only exception to this is in respect of deferred tax assets relating to provisions for post-retirement benefits which are recognised in full.

Post-retirement benefits

The cost of providing pensions and post-retirement healthcare for employees is charged in the profit and loss account over the working life of the employees taking into account the recommendation of qualified actuaries. Any funding surpluses or deficits that arise are amortised over the average working life of employees.

Statement of value added

	1999 £m		1998 £m	
Turnover	1,323.9		1,198.5	
Deduct:				
Purchased materials and services	668.7		589.2	
Value added	655.2		609.3	
		%		%
Utilised as follows:				
Wages, pension contributions and employee benefits	372.0	56.8	340.1	55.8
Restructuring and redundancy costs	0.4	0.1	14.2	2.3
Taxation	74.0	11.3	68.5	11.2
Net interest	7.0	1.0	6.1	1.0
Dividends	67.9	10.4	60.8	10.0
Goodwill amortisation	3.0	0.5		
Depreciation	35.6	5.4	32.2	5.3
Retained profit	95.3	14.5	87.4	14.4
Value added	655.2	100.0	609.3	100.0

Five year review

	1999 £m	1998 £m	1997 £m	1996 £m	1995 £m
Turnover	1,323.9	1,198.5	1,076.2	1,008.4	899.3
Operating profit (before goodwill amortisation)	247.5	224.2	194.6	168.1	140.9
Goodwill amortisation	(3.0)				
Operating profit (after goodwill amortisation)	244.5	224.2	194.6	168.1	140.9
Net interest	(7.0)	(6.1)	(2.5)	(2.7)	(2.4)
Profit before exceptional items	237.5	218.1	192.1	165.4	138.5
Exceptional items			(0.5)	5.0	(0.5)
Profit before taxation	237.5	218.1	191.6	170.4	138.0
Profit after taxation	163.5	149.6	132.6	117.8	93.9
Minority interests	(0.3)	(1.4)	(0.9)		
Shareholders' equity	352.3	221.7	240.4	211.8	225.5
Represented by:					
Intangible fixed assets	91.5				
Tangible fixed assets	231.7	215.4	198.8	190.6	171.3
Net current assets	122.5	89.1	83.6	49.5	53.4
Net debt	(93.4)	(82.8)	(42.0)	(28.3)	0.8
Funds employed	352.3	221.7	240.4	211.8	225.5
Goodwill charged against reserves	814.6	810.3	693.9	648.2	559.3
Shareholder investment	1,166.9	1,032.0	934.3	860.0	784.8
Ratios					
Operating profit before goodwill amortisation: turnover (%)	18.7	18.7	18.1	16.7	15.7
Taxation before goodwill amortisation and exceptional items (%)	30.8	31.4	32.0	33.0	33.5
After-tax return on average shareholder investment (%)	15.1	15.1	14.6	13.5	12.2
Cash-flow					
Cash-flow from operating activities	243.4	240.5	203.9	183.2	168.8
Less capital expenditure (net)	(48.4)	(36.9)	(42.9)	(32.0)	(24.5)
Operating cash after capital expenditure	195.0	203.6	161.0	151.2	144.3
Free cash-flow (before acquisitions and dividends, after capital expenditure)	116.5	132.1	98.1	98.7	103.4
Free cash-flow per share (p)	37.5	43.0	32.2	32.6	34.5
Earnings per share before exceptional items (p)	52.5	48.2	42.5	36.6	30.7
Dividends					
Pence per share	21.65	19.65	17.85	16.20	14.40
Times covered	2.4	2.4	2.4	2.2	2.1
Number of employees (000's)					
UK	7.0	6.9	6.4	6.5	6.1
Overseas	7.9	7.2	6.9	6.3	6.2
	14.9	14.1	13.3	12.8	12.3

Analysis of ordinary shareholders

16 September 1999

Class of Shareholder	No. of Holders	No. of Shares	% of total Listed Shares
Insurance Companies	25	11,082,409	3.53
Pension Funds	13	2,095,580	0.67
Banks	31	55,938	0.02
Nominees	10,456	278,451,127	88.67
Limited Companies and other Corporate Bodies	2,539	6,717,773	2.14
Individuals	9,678	15,601,877	4.97
Total	22,742	314,004,704	100.00

Financial calendar

1999

October

- 11 Ordinary shares final dividend ex-div date
15 Ordinary shares final dividend record date

November

- 16 Annual General Meeting
24 Scrip dividend share alternative election closing date†

December

- 15 Ordinary shares final dividend payment date
Scrip dividend share alternative allotment date‡

2000

March

- 15 1999/2000 interim results announced
27 Ordinary shares interim dividend ex-div date
31 Ordinary shares interim dividend record date

April

- 26 Scrip dividend share alternative election closing date‡
provisional

May

- 17 Ordinary shares interim dividend payment date
Scrip dividend share alternative allotment date‡
provisional

July

- 31 Smiths Industries financial year end

†subject to the approval of the final dividend at the AGM on 16 November 1999 and other conditions.

‡subject to the directors' decision to declare an interim dividend and offer a share alternative.

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The senior management of Smiths Industries

	Aerospace	Medical Systems	Industrial
Chairman	Norman Barber Chairman	George Kennedy Chairman	Einar Lindh Chairman
Chief Executive	Ron Albrecht Director & Group Controller	Donald Broad Director & Group Controller	Brian Knight Director & Group Controller
Keith Butler-Wheelhouse	Doug Clark President, Sensors & Components	David Buyher President, SIMS NA	Roger Ellis Director, Business Development
Executive Directors	Phil Collins Director, Technology	Malcolm Carlisle Director, Regulatory Affairs & Legal Adviser	Martin Jones Director, Technology & Innovation
Norman Barber Chairman, Aerospace	George Donovan VP Government Liaison, USA	Tom Curry Director, Manufacturing & Supply	Peter Norris Managing Director, Vent-Axia
George Kennedy CBE Chairman, Medical Systems	Ian Donovan Aerospace Group Director	Martin Jamieson Managing Director, SIMS Portex Ltd	Stephen Phipson Managing Director, Hypertac Interconnect
Einar Lindh Chairman, Industrial	Robert Ehr President, Information Management Systems	Carol Kennedy Filer Director, Product Innovation & Publicity	Tedd Smith President, Flex-Tek US
Alan Thomson Financial Director	Michael Jones Group Director, Operational Support	Greg Markham Director, Strategic Marketing	David Spencer Managing Director, Icore International
Corporate Staff	John Legg Managing Director, Product Support	Hitoshi Mikami President, Japan Medico Co Ltd	
David Flowerday Director, Strategy	David Sheppard Managing Director, Naval & Marine		
David Jeffcoat Financial Controller	Graham Thornton Director, Marketing & Business Development		
Peter Mason Director, Corporate Finance	Nick Wilton Managing Director, Display & Control Systems		
Anne Minto Director, Human Resources			
Russell Plumley Director, Public Affairs			
Alan Smith (Associate Director) Secretary & Solicitor			
Robin Taunt Director, Business Development			
Michael Walls Director, Internal Audit			