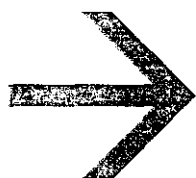


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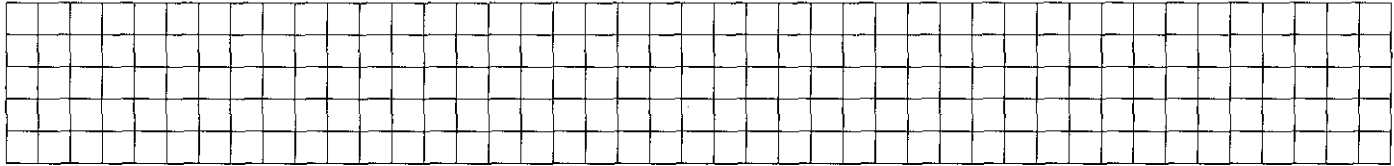
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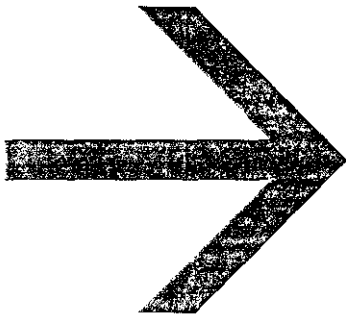
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smiths

SMITHS FOCUSES ON ENGINEERING GROWTH
THROUGH INNOVATIVE PRODUCT DEVELOPMENT,
TARGETED ACQUISITIONS AND CONTINUAL
EFFICIENCY IMPROVEMENTS.



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SUMMARY PERFORMANCE 2002

CONTINUING ACTIVITIES	2002		2001	
	Sales £m	Profit £m	Sales £m	Profit £m
Aerospace	1,346	191	1,301	209
Medical	480	97	452	93
Sealing Solutions	822	100	892	104
Industrial	422	64	487	93
Operating – continuing*	3,070	452	3,132	499
Interest – continuing		(46)		(58)
Pre-tax profit – continuing*		406		441
EPS – continuing*		52.3p		56.4p

* before goodwill amortisation and exceptionals

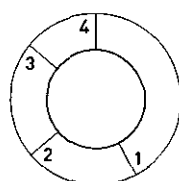
DISCONTINUED ACTIVITIES	2002		2001	
	Sales	Profit	Sales	Profit
Operating – discontinued*	153	10	1,826	152
Interest – discontinued		(11)		(58)
Pre-tax profit – discontinued*		(1)		94

* before goodwill amortisation and exceptionals

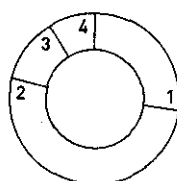
CONTINUING AND DISCONTINUED ACTIVITIES	2002		2001	
	Sales	Profit	Sales	Profit
Pre-tax*	3,223	405	4,958	535
Amortisation		(51)		(49)
Exceptionals		(68)		(598)
Pre-tax profit		286		(112)
EPS – overall		34.4p		(37.3p)

* before goodwill amortisation and exceptionals

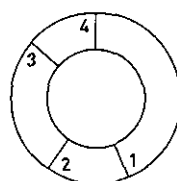
PROFIT
BY MARKET £m



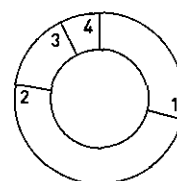
PROFIT
BY ORIGIN £m



TURNOVER
BY MARKET £m



TURNOVER
BY ORIGIN £m



1 Aerospace £191m
2 Medical £97m
3 Sealing Solutions £100m
4 Industrial £64m

1 United Kingdom £123m
2 USA £234m
3 Europe £55m
4 Other overseas £40m

1 Aerospace £1,346m
2 Medical £480m
3 Sealing Solutions £822m
4 Industrial £422m

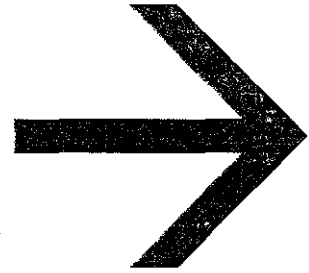
1 United Kingdom £966m
2 USA £1,629m
3 Europe £496m
4 Other overseas £253m

Note this exceeds total due to
intercompany transactions

ENGINEERING GROWTH

THIS YEAR HAS SEEN A SIGNIFICANT DECLINE IN MANY OF OUR MARKETS AND SMITHS IS NOT IMMUNE TO THESE EXTERNAL FORCES. HOWEVER, WE HAVE FOUND PROTECTION IN THE DIVERSITY OF OUR BUSINESSES AND ARE WELL POSITIONED TO GENERATE LONG-TERM, SUSTAINABLE GROWTH.

DURING 2001-2002 WE HAVE TAKEN ACTIONS TO ENSURE THAT WE CONTINUE TO ENGINEER GROWTH FOR OUR SHAREHOLDERS THROUGH PRODUCT DEVELOPMENT AND RESTRUCTURING.



While cyclical downturns have impacted a number of our businesses, this has been partly offset by rapidly expanding demand in a number of long-term growth sectors. Nowhere is this more true than AEROSPACE, where the reduction in civil aircraft production was counterbalanced by rising requirements for our military aerospace and detection products. We have established strong market positions in both military and detection and expect sales to grow strongly over the next few years. Our

MEDICAL division is focusing on the most rapid areas of growth in a long-term growth sector. Worldwide sales of medical devices are likely to increase significantly in the next few years, with some focused markets developing even faster. We are concentrating on those areas where there is greatest opportunity for additional sales and where we have the most expertise. SEALING SOLUTIONS was unable to avoid the contraction of one of its key markets – capital goods. However, management accelerated its

existing restructuring programme, so reducing cost and raising productivity. INDUSTRIAL was hurt by falling demand for its communications products. Management adjusted manufacturing capacity to meet demand.

Overall, Smiths has demonstrated resilience to recession and is positioned for long-term growth.

DRIVING LEAN INITIATIVES → WE ARE RIDING OUT THE TOUGH ECONOMIC CLIMATE BY INSTALLING EFFICIENCY INITIATIVES THROUGHOUT OUR BUSINESSES. Through lean initiatives we are reducing waste and streamlining operations. This is increasing the proportion of value-added activity across every discipline, including production, sales, marketing and administration. We are becoming both more productive and more responsive to our customers' requirements.	STRONG FINANCIAL MANAGEMENT → WE BELIEVE STRONG FINANCIAL MANAGEMENT IS THE KEY TO MAINTAINING A ROBUST BUSINESS. Notably, all of our divisions generate high levels of operating cash-flow. This gives us the flexibility we need to reduce debt or to make acquisitions. Additionally, we have a strong balance sheet. Everything the group does is characterised by a prudent financial approach.
MAXIMISING POTENTIAL → WE SEEK TO MAXIMISE THE POTENTIAL OF OUR BUSINESSES THROUGH BUILDING STRONG POSITIONS IN GROWTH MARKETS. This requires both foresight and a competitive edge. We are continually improving our product technology, product range, marketing, customer service, inventory control and cost control. Through maximising the potential of our businesses we drive organic growth.	ACQUIRING FOR GROWTH → BY ACQUIRING WE GAIN STRENGTH IN KEY AREAS, CREATING REAL VALUE FOR OUR SHAREHOLDERS. Targeted acquisitions allow us to build our businesses in growth areas. They also give us the ability to offer highly integrated systems, which secure incremental orders at good margins. This is how we progressively improve the quality of our assets.
STRATEGIC REFOCUSING → THROUGH STRATEGIC REFOCUSING WE MAINTAIN HIGH MARGINS AND INCREASE OUR FOCUS ON THOSE AREAS WITH THE GREATEST OPPORTUNITIES FOR GROWTH. Tactical refocusing enables us to identify and sell businesses that do not fit with our strategy and gives us the resources to make growth-enhancing acquisitions. This also enables us to adjust our businesses to reflect demand and to reduce cost.	TECHNOLOGICAL LEADERSHIP → WE ARE COMMITTED TO TECHNOLOGY LEADERSHIP IN OUR SPECIALIST SECTORS NOW AND IN THE FUTURE. Through investment in research and development we keep our products at the forefront of technology in their fields. Premium products attract strong sales and command the best prices. This fundamental principle is a driving force behind our ability to generate sustained organic growth and to achieve high margins.

CHAIRMAN'S STATEMENT

DIVIDEND 25.5p

IT IS A SIGN OF OUR CONFIDENCE IN SMITHS' FUTURE THAT WE FEEL ABLE TO INCREASE THE DIVIDEND.

2002 WAS A CHALLENGING YEAR FOR SMITHS. AS WELL AS THE WIDELY PUBLICISED DOWNTURN IN CIVIL AEROSPACE, DEMAND FOR MANY OTHER ENGINEERING PRODUCTS WAS REDUCED. THESE ADVERSE FACTORS WERE PARTIALLY OFFSET BY RISING DEFENCE BUDGETS, THE CONTINUING EXPANSION OF HEALTHCARE DEMAND AND THE DRIVE TO IMPROVE THE SECURITY OF TRANSPORTATION AND PUBLIC BUILDINGS, PARTICULARLY IN THE UNITED STATES. IT IS ENCOURAGING THAT, WHILE THE FACTORS THAT HURT THE BUSINESS THIS YEAR WERE LARGELY SHORT TERM, THOSE THAT WERE OF BENEFIT ARE LIKELY TO LAST FOR THE LONGER TERM.

In the group's results the most important number to focus on for 2002 is the £452m of operating profits on continuing activities, since this allows the most direct comparison when looking forward to next year and at last year. The Chief Executive reports on the performance of these continuing activities in his review.

However, I shall first comment on the consolidated results of Smiths Group plc, which includes the discontinued activities, principally the now divested John Crane-Lips marine seals business. On sales of £3,223m, including £153m from the discontinued activities, Smiths earned profits before tax, amortisation and exceptionals of £405m. After amortisation and exceptionals, the pre-tax profit was £286m, representing earnings per share of 34.4p, compared with a loss per share of 37.3p last year (largely due to merger-related exceptionals).

The Board is recommending a final dividend of 16.75p, bringing the total for the year to 25.5p, an increase of 2%, and a level of payment that is twice covered by earnings from the continuing activities before goodwill amortisation and exceptionals.

One indication of Smiths' financial good health is the current low level of debt. Very strong cash-flow and the proceeds of disposals have allowed us to reduce net debt to a comfortable level for a company of our size. Net debt is now just 2.3 times free cash-flow.

But our strength is not just financial. We have a real commitment to responsible social and environmental behaviour. We shall publish our first corporate social responsibility report in 2003. In the meantime, details of our current progress can be found later in this book. Above all, we recognise that the quality of our employees underpins our capabilities. I would like to take the opportunity to thank them for their contribution during this challenging year.

The role of non-executive directors is more topical than ever. We have a well balanced Board, with six of the 13 directors being non-executive. I can confidently say that we non-executives are diligent in the pursuit of shareholders' interests. I chair the Nominations & Remuneration Committee. As a team, the non-executives and the executives work effectively together to ensure the success of the company.

The Chief Executive outlines Smiths' prospects in his review. As he explains, the underlying strength of our businesses gives us confidence that we can sustain the long-term growth of the company.



KEITH ORRELL-JONES
CHAIRMAN

CHIEF EXECUTIVE'S OPERATING REVIEW

DURING 2002 SMITHS MADE SOLID PROGRESS IN SPITE OF EXCEPTIONALLY DIFFICULT ECONOMIC CONDITIONS. MANY OF OUR BUSINESSES CONTINUED TO EXPAND, WHILE OTHERS WERE RESILIENT IN THE FACE OF LOWER DEMAND. THROUGHOUT THE GROUP, WE TOOK ACTION TO INCREASE EFFICIENCY AND TO IMPROVE OUR FOCUS ON THE AREAS WITH GREATEST OPPORTUNITY FOR LONG-TERM GROWTH.

Big increases in the US defence budget led to higher sales of military equipment in Aerospace, our largest division. However, the beneficial effects of this were offset by the serious downturn in civil aerospace. Notably, the Medical division's sales continued to increase, benefiting from strong competitive positions in a number of high-growth markets.

The year called more than ever for our active style of management. We took decisive action to cut capacity in those areas affected by the poor business environment, at the same time establishing new manufacturing jobs in low-cost economies in Eastern Europe and Mexico. We increased efficiency in many of our activities through the introduction of lean initiatives.

The benefits of this will be in addition to the synergy gains already being achieved from the TI merger restructuring. As you will read later, the latter had a particularly positive impact on the profits of our Sealing Solutions division.

On a like-for-like basis Smiths' headcount fell by 7%.

Smiths generated £3,070m of sales from continuing activities in the year to 31 July 2002, a decline of just 2% from 2001's result. Operating profits fell by 9% to £452m and pre-tax profits by 8% to £406m, as the decline in sales was concentrated in higher-margin activities. Earnings per share reduced by 7% to 52.3p. Even in these challenging times, our margins remain first-class at 15%, broadly in line with Smiths' historically high profitability.

From a sales perspective we started to see the anticipated rewards from our merger with TI. Within Aerospace, we are now winning major contracts as a direct result of broadening the division's activities.

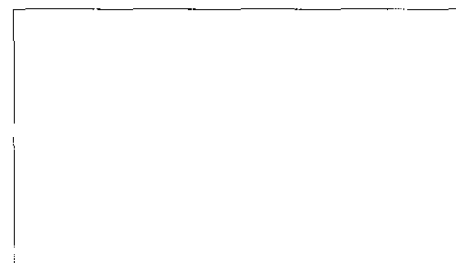
Exceptional items of £68m reflect the cost of the restructuring programme and a loss on the book value of discontinued businesses.

Our cash performance illustrated the group's underlying financial strength. While Smiths always generates a high level of cash, we significantly exceeded our target of 80% profit-to-cash conversion, with operating cash-flow (after capital expenditure) of £473m for the continuing activities. This robust cash-flow allows us to pay down debt and gives us the flexibility to make acquisitions.

As a matter of course, we continued to improve our strategic position through disposing of non-core businesses and making bolt-on acquisitions in growth areas. We sold the John Crane-Lips marine seals business and most of the former EIS engineering businesses. In total, we raised £247m from disposals. We spent £66m on small but strategic acquisitions and remain keen to buy businesses that fulfil our acquisition criteria.

Debt was reduced substantially. Disposal proceeds were responsible for some of the reduction, but operating cash-flow played the greatest part. Net debt stood at £725m at the year-end, 35% less than the debt of £1,120m at the end of 2001. All borrowings are recorded on our balance sheet. Interest costs for the year amounted to £46m.

We also increased our spending on research and development (R&D), as new technology is a driver of our growth. The year's £212m R&D spend compares with £188m in 2001. From an accounting perspective, £116m of this was treated as an expense during the year, while our customers paid for the remainder.



CONTINUING ACTIVITIES	2002 £m	Change
SALES	3,070	-2%
OPERATING PROFIT*	452	-9%
PRE-TAX PROFIT*	406	-8%
EPS*	52.3p	-7%

*before exceptionals and goodwill charges

MARGINS AND CASH

MARGINS OF 15% AND OPERATING CASH-FLOW OF £473M DEMONSTRATE THE SUBSTANCE TO THE PROFIT.

GOING FORWARD WE CAN SEE CONSIDERABLE OPPORTUNITIES, ESPECIALLY IN AEROSPACE AND MEDICAL.

In summary, while we have not been able to avoid the world's economic difficulties, we have found protection in the strength and diversity of our businesses. After a careful review, we have concluded that our greatest opportunities lie in the Aerospace and Medical divisions – which are both in sectors with attractive long-term growth prospects. As a result, we are concentrating on building these divisions both by product development and acquisition. We are also continuing to improve our Sealing Solutions and Industrial divisions.

growth as governments – particularly the US – increase the capabilities of their national security systems.

In civil aerospace, sales suffered principally because of a reduction in the number of aircraft being built. Our main customers, Boeing and Airbus, are building considerably fewer planes today than when the cycle peaked at the turn of the Millennium. Within the industry, it is generally expected that aircraft production is likely to be some 25% below recent peak rates.

AEROSPACE		
	2002 £m	2001 £m
SALES	1,346	1,301
PROFIT	191	209
EMPLOYEES: 11,400		

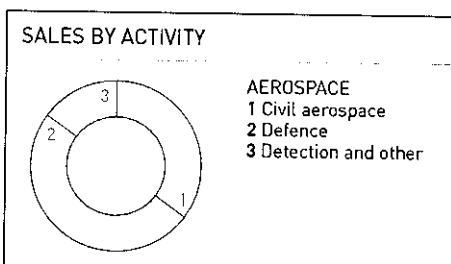
AEROSPACE

SMITHS AEROSPACE IS A FIRST TIER SUPPLIER OF INTEGRATED SYSTEMS TO AIRCRAFT PRIME MANUFACTURERS AND ENGINE BUILDERS. THE MAJORITY OF OUR SALES ARE IN LONG-TERM GROWTH AREAS.

Production facilities have been consolidated and there has been a reduction in overall employment, but we have been able to retain key skills in many areas by transferring engineers to defence programmes where there is a growing demand.

Systems integrator

As mentioned earlier in this review, a number of contracts validated our guiding strategy of enlarging the Aerospace division in order to supply integrated systems to the prime manufacturers. We are now firmly established as a systems supplier, as shown by our winning sizeable contracts for the B767 Global Tanker Transport Aircraft (GTTA) and the new A380 super jumbo.



In Aerospace there was strong demand for military systems and detection equipment. Notably, both of these sectors are on strong growth trends that should underpin sales in the years ahead. However, civil aerospace experienced a marked downturn in demand, which was exacerbated by the tragic events of September 11th, 2001.

In the case of GTTA, Boeing selected us in March to supply the hose and drogue refuelling system. This requires capabilities in aerostructures, systems/software engineering and microprocessor-based refuelling control systems. We acquired Able Corp., a US engineering company, to supply the hose systems. The GTTA programme offers the opportunity to generate more than \$1bn in sales.

3,000 PLUS

F-35s ARE PLANNED TO BE BUILT AND THE PROGRAMME WILL MAKE A MAJOR CONTRIBUTION TO THE AEROSPACE DIVISION'S GROWTH.

Sales were a little higher for the year at £1,346m, 3% ahead of 2001. Operating profit, however, fell by 9% to £191m. The comparatively weaker operating profit chiefly reflects lower sales of retrofits and spares to the civil airlines.

Sales to military aircraft programmes grew significantly as the US government stepped up defence procurement. Defence equipment now represents about half of the division's sales and we are chosen suppliers to most of the high-value military aircraft programmes of the next decade, including the Joint Strike Fighter F-35, which will be the highest volume fighter aircraft in production.

The A380 contract to supply the integrated system that operates the plane's landing gear was awarded by Airbus in April 2002. This system combines electronic and actuation components to control one of the biggest structures on the whole aircraft. Contracts so far secured on the A380 are expected to generate lifetime revenues approaching \$1bn.

Smiths Detection, which makes devices to detect explosives, narcotics and biological and chemical agents, doubled sales. Although Detection is a relatively small business, accounting for roughly 10% of divisional turnover in 2002, it achieves good margins and is the fastest growing part of Smiths. We anticipate rapid

However, the biggest business win of the year was the F-35 fighter aircraft, where we have secured business worth around \$1m per plane. Lockheed Martin, which has selected us as a supplier, won the

manufacturing programme in October 2001. More than 3,000 F-35s are planned to be built and the programme should make a major contribution to the division's long-term growth.

Our relationship with Lockheed has evolved in just a few years from that of sub-contractor to business partner. We are now one of only seven members of the company's Strategic Supplier Alliance Programme. We have similar partnership agreements with Boeing and BAE Systems.

Smiths Detection

Smiths Detection experienced huge growth in demand as the US government and others came to terms with the need to increase homeland security. US government departments are making extensive use of our trace detection technology as they upgrade counter terrorism detection systems for facilities such as airports and public buildings. Our inclusion in a team to develop a complete bio-agent detection system for the US Postal Service indicates the strength of our competitive position.

We expect US spending on detection equipment to more than treble from its 2001 level by 2003 and then to remain at a high level for the rest of the decade. Over the past year, we have prepared for this market expansion, increasing our R&D spend by a multiple of four, launching seven new products and investing substantially in our business infrastructure. We have a strong product range, including a recently introduced walk-through portal system for explosive detection that is creating worldwide interest.

Outlook – Aerospace

Aerospace is well positioned for long-term growth. Actions taken to adjust our manufacturing to reflect demand will help us to weather the civil downturn. We believe the strong prospects for defence and detection, which make up 60% of divisional sales, mean the division as a whole has the prospect of a return to growth.

MEDICAL

SMITHS MEDICAL IS A LEADING SUPPLIER OF DEVICES USED DURING CRITICAL AND INTENSIVE CARE PROCEDURES AND FOR POST-OPERATIVE CARE DURING RECOVERY. WE FOCUS ON AREAS WHERE WE HAVE A COMPETITIVE EDGE AND WHERE THERE ARE EXCEPTIONAL OPPORTUNITIES.

The market for medical devices is expanding steadily as the ageing of the developed world's population creates continuously increasing demand for healthcare. We are developing strategic positions within this market, concentrating on the therapy areas where we excel and where there are the greatest opportunities for growth.

Medical delivered a 6% expansion in sales to £480m, and a 4% increase in operating profit to £97m. Margins remained high at 20%. Sales and profits would have been a little higher but for the decline of the Yen, which reduced the reported contribution from the important Japanese market.

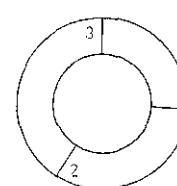
Growth was achieved throughout Medical's nine global business units. One of the fastest growing was Needle Protection, which makes devices to protect clinicians and nurses from needle-stick injuries. Needle protection is compulsory across the US under the Needlestick Safety and Prevention Act, which became effective in April 2001.

Within the Ambulatory Infusion business unit, our market-leading Deltec infusion pumps enjoyed considerable success. Our new Cozmo diabetes pump, which obtained US Food & Drug Administration approval shortly after our financial year-end, has great potential. There are one million insulin-dependent diabetics in the US who would benefit from receiving insulin from an ambulatory pump rather than injecting themselves up to six times a day. Cozmo is the first insulin pump that individualises the dose. It is attracting considerable interest from diabetes sufferers across the US.

MEDICAL

	2002 £m	2001 £m
SALES	480	452
PROFIT	97	93
EMPLOYEES: 4,800		

SALES BY ACTIVITY



MEDICAL

- 1 Infusion therapy
- 2 Respiratory and anaesthesia
- 3 Specialist care

WE ARE DEVELOPING STRATEGIC POSITIONS WITHIN THE MEDICAL DEVICES MARKET, CONCENTRATING ON THE THERAPY AREAS WHERE WE EXCEL AND WHERE THERE ARE THE GREATEST OPPORTUNITIES FOR GROWTH.

CHIEF EXECUTIVE'S OPERATING REVIEW continued

Restructuring

Medical was restructured into global business units in August 2001. The broad aim was to divide the business into therapy areas where we have competitive strength, to develop global scale and focus in these areas and to reduce manufacturing costs. Real benefits are already apparent and will be increasingly so over the next two to three years.

Most importantly, through concentrating on specific therapy areas we have naturally become far more focused on our customers' requirements. Being global, our business units are able to develop considerable synergies between geographical areas. Each business unit now has a dedicated specialist sales force. Sales should also be boosted by the establishment of a single organisation to manage third party distributors.

As part of the restructuring, some production lines have been transferred to our low-cost global assembly facility in Tijuana, Mexico. By the end of 2003, Tijuana will employ 1,000 people and will make one third of our devices for customers throughout the world.

Innovative products

Taking cost out of manufacturing is allowing us to increase our spending on product development. This should underpin our sales and margins because medical devices tend to sell best and to generate their highest margins when initially introduced. At present, we have a good new product pipeline – more than 20% of our product range has been introduced within the past three years.

We also pursue product development through acquisition. Abbott Laboratories' epidural kits and trays business was acquired in December to strengthen our market position in anaesthesia kits for pain management. We also acquired Bivona, Inc., a leading US supplier of silicone tubes used in anaesthesia and critical care, to extend our product range of airway management single-use devices.

We improved our range of needle protection devices through acquiring exclusive distribution rights to Medisys' Futura retractable safety syringe.

Two non-core businesses making urology and ostomy products were sold during the year.

Outlook – Medical

While the medical devices market continues to expand, we are concentrating product development on focused markets with exciting opportunities such as needle protection, diabetes pumps, airway management and medication delivery, especially in the oncology field. Savings from the concentration of assembly work in Mexico should improve profitability. Funds are also being released for investment in product development.

SEALING SOLUTIONS

SEALING SOLUTIONS IS A WORLD LEADER IN THE DESIGN OF HIGH-PERFORMANCE MECHANICAL AND POLYMER SEALS FOR A WIDE RANGE OF APPLICATIONS, INCLUDING OIL AND GAS, PETROCHEMICAL, PROCESSING PLANTS, MOBILE HYDRAULIC MACHINERY AND PULP AND PAPER.

For Sealing Solutions, 2002 was a year of considerable achievement in the face of weakening demand in several key markets. Strong management action achieved savings which increased margins, so creating a lasting improvement in profitability.

While sales fell 8% to £822m, operating profit declined by just 4% to £100m. Once again, cash generation was strong, with a profit-to-cash conversion ratio of 100%.

Within John Crane, the business unit that makes mechanical seals, sales held up relatively well. By contrast, Polymer Sealing Solutions' sales fell significantly, reflecting the downturn in the European market for capital goods and equipment.

The division sold a number of non-core businesses. The biggest was John Crane-Lips, the marine seals specialist, which Finland's Wärtsilä Corporation bought for £235m. John Crane-Lips is included in the discontinued line of our accounts.

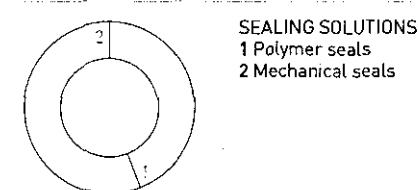
Accelerated cost cutting

The post-TI restructuring programme was brought forward and expanded during the year. At the time of the merger, we

SEALING SOLUTIONS

	2002 £m	2001 £m
SALES	822	892
PROFIT	100	104
EMPLOYEES: 12,200		

SALES BY ACTIVITY



PERFORMANCE

JOHN CRANE'S PROFITABILITY IMPROVED SIGNIFICANTLY.

anticipated achieving a £30m a year saving by 2003. As a result of actions taken in 2002, however, savings will amount to £33m.

In addition to the restructuring, a sharp fall in activity in some parts of our Polymer business unit caused us to adjust production capacity, bringing employment worldwide down to around 6,000.

We have also made considerable performance gains through better supply chain management and various lean initiatives. We have reorganised our supply chain, with significant financial benefits resulting from factors such as a reduction in inventory. Furthermore, e-business solutions continued to be introduced to allow our customers to order on-line, realising efficiency and financial gains.

Business wins

There were some notable business wins. John Crane forged a \$20m five-year alliance with Textron, the US conglomerate, to be its sole supplier of open specification sealing solutions. Additionally, we agreed to supply mechanical seals and power transmission couplings for the \$4bn Nanhai petrochemical project in south-east China, which will be one of the world's biggest petrochemical plants. Also, our polymer seals were used in the UK's prestigious Falkirk Millennium Lock.

As with our other divisions, product development is vital for Sealing Solutions. The LaserFace mechanical seal was a major step forward. This new seal reduces interface friction, so allowing compressors to pump more while minimising leakage levels.

Outlook - Sealing Solutions

During 2003, we plan to build on this year's achievements. Improvements in sales and marketing combined with the introduction of new technologies should generate higher sales. At the same time, cost reductions and other efficiency gains should feed through to profit as restructuring benefits are experienced over a full 12 months.

INDUSTRIAL

INDUSTRIAL IS FOCUSED ON TWO SPECIALISED MARKET SECTORS. INTERCONNECT SUPPLIES ELECTRONIC CONNECTORS AND COMPONENTS FOR DEFENCE, TRANSPORT, TELECOMMUNICATIONS AND OTHER INDUSTRIES, WHILE AIR MOVEMENT PRODUCTS INCLUDE DUCTING AND VENTILATION SYSTEMS.

With most exposure to the declining sectors of the world economy, the Industrial division experienced a marked drop in sales and profits. The greatest fall was in our Interconnect communications components businesses, which suffered as expansion of the mobile telecommunications infrastructure slowed. Lower demand for Interconnect products from the civil aerospace industry was offset by defence growth.

In total, sales fell by 13% to £422m and operating profits by 31% to £64m. More positively, cash conversion was strong at well over 100% of operating profits. Importantly, even at this lower level of activity the Interconnect communications businesses are making respectable profit margins. The Air Movement businesses performed well, attaining good margins on flat sales.

In reaction to the lower levels of business activity, we reduced employee numbers by 12%. The costs associated with restructuring were charged directly against profits. Within Air Movement, Vent-Axia's manufacturing operations were consolidated to improve efficiency and customer service.

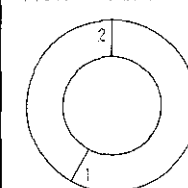
Specialised products

Strategically, the division continued moving towards its goal of becoming a supplier of highly specialised products that solve its customers' problems. In the US, our Sabritec business launched its Fibre Channel high data-rate multi-pin connector during the year. This meets the needs of an aerospace and space industry looking

INDUSTRIAL

	2002 £m	2001 £m
SALES	422	487
PROFIT	64	93
EMPLOYEES: 4,400		

SALES BY ACTIVITY



INDUSTRIAL
1 Air Movement
2 Interconnect

RESTRUCTURED

WE HAVE RESTRUCTURED THE TELECOM RELATED BUSINESS TO RETAIN GOOD PROFITABILITY DURING THE DOWNTURN.

CHIEF EXECUTIVE'S OPERATING REVIEW continued

for higher density cabling. We have already received a large number of orders. Among other applications, Fibre Channel is being installed as part of the cockpit upgrade in NASA's fleet of seven space shuttles. In another example of the success of our approach, the PolyPhaser business was contracted to supply lightning protection equipment for E911 radio equipment used by the emergency services in the US.

Within Air Movement, Vent-Axia continued to launch new products to build on its market-leading brand, including a low-energy version of its flagship 'T' series fan.

We took action during the year to focus on specialist businesses within the Industrial division where we have critical mass. In particular, we want to concentrate management time on those business areas offering the best long-term prospects for growth. To this end, we sold a number of small businesses, including Fans & Spares Group and our European flexible hose business. We are constantly looking for bolt-on acquisitions that will add to the capabilities of our chosen business areas, but we will not overpay for such acquisitions.

Outlook - Industrial

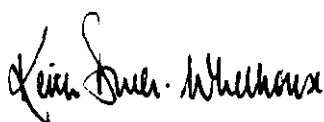
Looking forward, the actions taken this year have left us well positioned for any recovery in our markets. If demand does not deteriorate further, reduced costs should feed through to higher profits in 2003.

GROUP PROSPECTS

In the course of 2002, we have narrowed our focus on chosen growth areas and reduced costs. Smiths has performed well in difficult markets, mainly as a result of the cost savings which have limited the reduction in operating profit. The high level of cash generation demonstrates the substance to these profits.

A number of actions will benefit future performance. We have reduced debt by £1bn since the formation of Smiths Group in December 2000, and the balance sheet is strong. R&D has been substantially increased. The reshaping of the company to focus on growth opportunities continues to make good progress.

The company is not counting on an upturn in the general economic climate, although we expect specific sectors, including defence, healthcare and detection equipment, to continue to grow. With our constant focus on operational improvement, we are confident that, even under these mixed conditions, the performance of Smiths will remain robust in the period ahead.



KEITH BUTLER-WHEELHOUSE
CHIEF EXECUTIVE

FINANCIAL REVIEW

THE FINANCIAL PARAMETERS THAT GOVERN THE SUCCESS OF SMITHS REMAIN FIRMLY IN PLACE. WHILE ONGOING EPS DECLINED 7% TO 52.3P, THE FOCUS ON OVERHEAD REDUCTION AND DISPOSAL OF NON-CORE BUSINESSES MITIGATED THE PROFIT SHORTFALL AND FURTHER STRENGTHENED THE CASH-FLOW. THIS WAS A RESILIENT PERFORMANCE IN DIFFICULT TRADING CONDITIONS. CASH GENERATION WAS £395M, REDUCING NET DEBT FROM £1,120M TO £725M.

Since the merger with TI Group in December 2000, Smiths has disposed of non-core businesses, including automotive, which made up 23% of its 2001 profit.

'Discontinued activities' are shown in a separate column in the profit and loss account in order to illustrate more clearly the ongoing activities. Interest is allocated to discontinued businesses on the basis of sales consideration received. The profit before tax in the ongoing column is thus stated on a comparable basis between 2002 and 2001.

'Goodwill amortisation' and 'exceptional items' are also shown in separate columns in the profit and loss account – and are discussed below.

Ongoing profit and loss

The ongoing profit and loss account shows the impact of the difficult economic climate.

	2002 £m	2001 £m	Change
SALES	3,070	3,132	-2%
OPERATING PROFIT	452	499	-9%
PRE-TAX PROFIT	406	441	-8%
EPS	52.3p	56.4p	-7%

Activity levels varied sharply across the divisions. The civil part of Aerospace was affected, as were Industrial and Sealing Solutions. Medical and the defence and detection sectors of Aerospace moved ahead.

Operating profit declined 9%. The profit decline was sharper than the sales reduction despite significant overhead

reductions, as the sales shortfalls were concentrated in higher-margin activities.

Operating margins, although slightly lower, remained strong at 15%, with all divisions above 12%.

The impact of current-year acquisitions on the profit and loss account was small, adding £6m to operating profit.

Interest costs reduced to £46m (2001 £58m) as a result of reduced borrowings and lower interest rates.

Benefiting from a 1% lower tax rate, earnings per share declined by 7%. The dividend is twice covered by earnings.

Cash-flow

Healthy cash-flow has long been a feature of Smiths' businesses. We monitor closely the correlation between profit and cash generation in each business and expect only a small proportion of cash from profits to be absorbed into funding additional balance-sheet assets.

To this end we measure cash-flow at the operating level after capital expenditure and also at the free cash level.

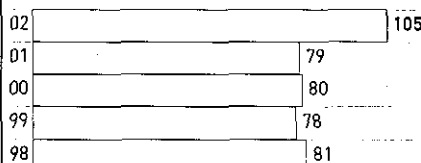
Our standard performance is to convert 80% of profit into cash after capital spend. In 2002 we achieved 105% conversion of operating profit to cash, reflecting the efforts to reduce working capital levels. The free cash-flow was £315m, 53% higher than last year and covering the dividend 2.2 times.

Operating assets expressed as a ratio are 31% of sales, with working capital accounting for 13% and fixed assets 18%.

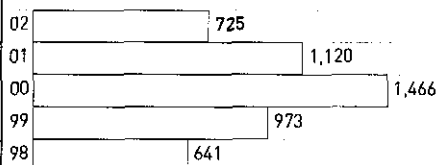
Net borrowings at year-end were £725m, down from £1,120m last year, and less than half the level of debt at the time of the merger.

The five-year record of converting operating profit to operating cash – expressed after capital spend – and the five-year trend of Smiths' net debt are shown in the next column.

OPERATING CASH % of operating profit



NET DEBT £m



FINANCIAL REVIEW continued

CASH-FLOW	2002		2001
	Continuing £m	Total £m	Total £m
OPERATING PROFIT	452	462	651
DEPRECIATION	89	92	139
WORKING CAPITAL	30	29	(89)
CASH-FLOW FROM			
OPERATING ACTIVITIES	571	583	701
CAPITAL SPEND (NET)	(98)	(100)	(188)
OPERATING CASH-FLOW			
AFTER CAPEX	473	483	513
TAX AND INTEREST		(109)	(234)
RESTRUCTURING		(59)	(74)
FREE CASH-FLOW		315	205
MERGER COSTS			(54)
DIVIDENDS		(139)	(171)
ACQUISITIONS		(66)	(198)
DISPOSALS		247	605
OTHER		38	(41)
NET CASH-FLOW		395	346

Restructuring

The merger-related restructuring programme is nearing completion and the expected savings were achieved.

Following the events of September 11th and the subsequent sharp contraction in civil aerospace, the company instigated further restructuring.

The £44m charge relates to significant overhead reduction in Aerospace (£39m) and moving further Medical production to Mexico (£5m).

Together, the merger-related restructuring and the 2002 restructuring programme eliminated £60m of overheads in 2002 and will have a full-year effect of £100m in 2003.

Exceptional charges

The exceptional charges comprise the £44m cost of the restructuring programme and the £24m loss on the book value of the discontinued businesses.

Goodwill

In accordance with UK accounting standards, the goodwill on all acquisitions is capitalised and subsequently amortised over a maximum 20-year period. The carrying value of acquisitions is formally reviewed at the first full year-end following acquisition and is also reviewed when circumstances require it.

Smiths purchased Radio Waves, Inc. in December 2000 for £17m. This business manufactures microwave antennae for the telecoms industry and has not achieved the expected trading performance. An impairment charge of £12m has been made.

Over the last several years the company has invested £120m in telecoms component businesses. With the exception of Radio Waves, each of these businesses performed well following acquisition, before falling back to a level of performance that remains encouraging in terms of profit and cash generation.

Discontinued

The disposals programme continued in 2002 with £247m raised from the sale of non-core businesses. The largest discontinued business was John Crane-Lips Marine; the other businesses mainly being part of the former EIS Group.

The 2001 operating profit of the sold businesses was £25m. The sales proceeds represent 14 times after-tax earnings.

Acquisitions

With uncertain demand in several of our sectors, we concentrated on acquiring small but strategically important bolt-on acquisitions during 2002, principally for our Medical and Aerospace businesses. The acquisition spend was £66m.

A key acquisition was Able Corp., which provided the expertise and technology to enable the Flight Refuelling systems contract for the Boeing 767 Tanker Programme to be secured.

The purchases of Bivona and a product line of anaesthesia procedures kits from Abbott Laboratories for Medical are expanding our product offerings in growing market segments.

TI Automotive investment

As part of the demerger of TI Automotive in July 2001 Smiths received £325m of preference shares in the demerged entity.

The preference shares carry a fixed 15% dividend, of which 5% is payable annually in cash and the balance is deferred. No accrual has been made for this dividend.

TI Automotive Ltd's growth ambitions have been affected by the current slowdown, particularly following September 11th, and TI Automotive is in the process of restructuring its borrowings. The preference dividend will not be paid until this refinancing is completed.

Operating margins and cash generation remain a feature of the company's results.

Smiths expects to realise its full investment in the longer term from a flotation of TI Automotive Ltd or on a sale of the investment when the automotive markets regain momentum. The present and forecast levels of profitability by TI Automotive Ltd are judged sufficient to justify the carrying value of the preference shares.

Geographic spread and exchange rates

The geographic analysis of ongoing operations, which was broadly unchanged from 2001, is shown in the table.

	Sales	Profit
UK	29%	27%
US	49%	52%
CONTINENTAL EUROPE	15%	12%
REST OF WORLD	7%	9%

The key exchange rates affecting the group are the US\$ and Euro. The table opposite shows the average and year-end rates for these currencies.

THE MERGER-RELATED RESTRUCTURING PROGRAMME NEARED COMPLETION IN 2002 AND THE EXPECTED SAVINGS WERE ACHIEVED.

	US\$	Euro
AVERAGE		
2002	1.455	1.61
2001	1.45	1.63
	0%	+1%
YEAR-END		
2002	1.56	1.59
2001	1.43	1.63
	-9%	+2%

The Dollar weakened in the last two months of the year and the Euro strengthened. The small movements in average rates had little effect in 2002 on either the group's export transactions or the translation of overseas profits.

Cost of capital and return on investment

The company's weighted average cost of capital is a function of the proportion of debt and equity financing and their relative cost.

During 2002 the company's cost of capital remained at 8%. At July 2002 the average all-in cost of debt was 5% before tax relief.

The after-tax return on average shareholder investment, including goodwill, was 11% compared with 12% last year.

We maintain our long-standing objective of achieving a 15% return on investment, although this objective was set when inflation was higher and double-digit growth was a normal expectation.

Taxation

The tax charge for the year represented an effective rate of 28% on profit of ongoing businesses before taxation, goodwill amortisation and exceptional items (2001 29%). This is a reduction of 2.6 percentage points since 2000 and the lowest effective rate for the group for over 10 years. This was achieved largely from tax efficiencies arising from the merger, which also yielded several large tax refunds in the

year and reduced the net tax payments. A reconciliation of the tax charge is set out in note 9 to the accounts.

We have adopted the requirements of FRS19 – Accounting for Deferred Taxation – this year, resulting in a reduction in opening reserves of £26m to reflect the potential deferred tax liability that could arise on a future sale of certain businesses, in accordance with the standard. The effect on the reported profit for the prior period was not material.

Pensions

The company's principal pension schemes are in the UK and the US. The most recent actuarial valuations were performed as at March 2001 in the UK and July 2001 in the US. In aggregate at these dates assets exceeded liabilities by 20%.

The company calculates its pension expense under SSAP24 and amortises the surplus over the active members' estimated remaining working lives.

Companies now have the option to introduce the new FRS17 accounting standard over the next several years, or to await the prospective international harmonisation of accounting standards in 2005.

All pension and post-retirement healthcare plans have been actuarially reviewed at July 2002 under the methodology prescribed by FRS17. Note 12 discloses the funding position and pension expense on this basis.

During the month of July 2002 world stock markets fell sharply. The FRS17 valuation reflects the 31 July 'snapshot'. Expressed on the FRS17 prescribed basis, the 31 July funding ratio of the funded pension plans declined from 114% to 97%, with the UK funds in surplus and a deficit in the US.

The combined pension schemes are approximately 40% invested in equities –

a significantly lower exposure than for pension schemes generally.

Pension funding decisions are made on the advice of independent actuaries taking into account the long-term nature of the liabilities.

The pension expense (including post-retirement healthcare) for the year was £15m calculated in accordance with SSAP24.

The FRS17 basis of calculation would have given a pension expense of £23m.

Looking ahead to 2003, if FRS17 is adopted, the FRS17 charge to pretax profit based on the July 2002 equity market would increase by £30m.

Accounting for pensions has always been a complex subject, not helped by the transition to a new standard, the recently announced extension of the transition period of that new standard, and volatile markets. Cash-flow is less subject to these complexities. The net cash outflow in relation to defined benefit pension schemes in 2002 was £14m. This is expected to increase only slightly in 2003 and, if the low equity market valuations of July 2002 continue, will further increase in future years.

Treasury

Smiths adopts a centralised treasury approach to manage its financial risks, within a strong control environment. This ensures that all funding is properly recorded on the balance sheet in accordance with UK GAAP and that there is no speculation or trading in derivative financial instruments.

The objectives of the Treasury function are clearly established to deliver the liquidity requirements for the businesses in a cost-effective manner; to manage the central financing demands; to develop strong banking relationships and services; and to reasonably protect the group from the effect of foreign currency fluctuations.

Smiths has credit ratings with Standard & Poor's and Moody's of A- and A3, respectively, recognising the strong financial disciplines of the group and high resilience to the current adverse global trading conditions.

SMITHS HAS CREDIT RATINGS WITH STANDARD & POOR'S AND MOODY'S OF A- AND A3, RESPECTIVELY, RECOGNISING THE STRONG FINANCIAL DISCIPLINES OF THE GROUP.

The maturity profile of the debt is managed so that debt repayments are well spread and can be repaid from the group's free cash generation.

2002 has been a period of sustained debt repayment and the group is well positioned to utilise the banking and capital markets to finance new opportunities if required.

The group maintains a broadly even overall mix of fixed rate and floating rate funding. This has benefited us in the current period, allowing our cost of funds to fall with lower global interest rates.

Smiths has established detailed Treasury Policies, which have been approved by the Board, and compliance with these policies is annually reported to the Audit Committee. These policies are set out in detail in note 23 to the accounts, in accordance with FRS13 – Derivatives and Other Financial Instruments.

Legal issues

As confirmed in a statement issued in December 2001, John Crane, Inc. ("John Crane"), a subsidiary of the company, is one of many co-defendants in numerous law suits pending in the US in which plaintiffs are claiming damages arising from exposure to or use of products containing asbestos. The John Crane products generally referred to in these cases are ones in which the asbestos fibres were encapsulated in such a manner that, according to tests conducted on behalf of John Crane, the products were safe. John Crane ceased manufacturing products containing asbestos in 1985.

With the benefit of its 'safe product' defence and with access to insurance judged sufficient to meet all material costs of defending these claims for the foreseeable future, John Crane has resisted every case in which it has been named and intends to continue the robust defence of asbestos-related claims.

As a result of its defence policy, John Crane has been dismissed before trial from cases involving approximately 76,000 claimants over the last 23 years. John Crane is currently a defendant in cases involving approximately 150,000 claims. Despite these large numbers of claims, John Crane has had final judgments against it,

after appeals, in only 16 cases, amounting to awards of some \$13.5m, over that 23 year period. These awards, the related interest and all material defence costs, have been met in full by insurance.

The company continues to hold the view that the litigation does not represent a material contingent liability. Hence no provision relating to it has been made in these accounts.

Accounting Standards

With the exception of FRS19 (Deferred Taxation) and the increased disclosures required by FRS17 (Retirement Benefits) as set out above, there have been no Accounting Standards issued which would require changes in the group's accounting policies this year.

Financial controls

While our decentralised organisation delegates day-to-day control to local management, we have comprehensive budgetary control systems in place, with regular reporting to the Board.

The internal audit department reports to the Audit Committee and reviews all key business units over a rolling three-year cycle. Acquisitions are reviewed within 12 months of acquisition, to verify compliance with the company's procedures.

Further information on the group's internal control procedures are set out in the corporate governance section of the directors' report on pages 21 to 23.

Smiths' traditional financial values have served the company well in the difficult economic conditions of 2002.

Cash generation was a priority. Debt at the date of the merger exceeded £1,750m and has now been reduced to £725m.

ALAN THOMSON
FINANCIAL DIRECTOR

SMITHS' TRADITIONAL
VALUES HAVE SERVED
THE COMPANY WELL IN
THE DIFFICULT ECONOMIC
CONDITIONS OF 2002 WITH
PROFITS MATCHED BY
CASH GENERATION.

360°

APPRAISALS OF MANAGEMENT-LEVEL STAFF WILL HELP US PLAN THE CAREER DEVELOPMENT AND MANAGEMENT SUCCESSION THAT SAFEGUARD THE COMPANY'S FUTURE.

EVERY COMPANY IS EXPECTED TO OBSERVE HIGH STANDARDS OF CORPORATE SOCIAL RESPONSIBILITY AND SMITHS IS NO EXCEPTION.

Value-added human capital

While the introduction of lean processes and the sharing of best practices are making significant contributions to growing the businesses within Smiths, maintaining our momentum demands the retention of talented people as well as an inflow and development of highly skilled employees. Whether markets rise or fall, the constant challenge in this highly competitive global business is to secure and retain high-calibre individuals at all levels in the organisation. Our continued goal is to be the 'employer of choice' – attracting and retaining top-quartile talent throughout our operations.

Smiths has 33,000 employees worldwide in 120 major facilities, with 75% based in the UK and North America and the other 25% predominantly in the EU, Malta, Mexico, the Czech Republic and the Far East. In this large-scale, multicultural organisation, we have made excellent progress in terms of bringing consistency to the way we communicate with and reward our workforces and the way that environment, health and safety (EHS) policies are put into practice.

Career management

Having successfully completed the post-merger restructuring of the group and the combining of teams, particularly at management levels, we are now taking the opportunity to develop a 360° appraisal for all our management-level staff, inviting feedback on individuals from reporting staff as well as from senior colleagues. This will help us to identify the skills mix of our people more clearly and assist with the management succession that safeguards the company's future and the career development that attracts and motivates bright new recruits.

The development of talented employees to achieve their full potential within Smiths is essential to the company's organic growth and provides the core of continuity that is critical in a marketplace where first-rate talent is at a premium. We have programmes in place across the group to encourage and promote highly capable individuals and teams. Mentoring, for example, continues to be valuable in helping younger people from diverse backgrounds across Smiths to develop fully by benefiting from the experience of more mature managers. We also recognise the merits of mentoring at all stages in management development and have gained much from the positive outcomes of these mentoring relationships in preparing future leaders.

To help individual businesses in Smiths recruit the future talent that is our lifeblood as a high-technology company, we have increased our graduate intake programmes this year. We have also introduced a new recruitment website, www.whatsnext4u.com, which directly communicates the opportunities in Smiths for exciting, dynamic and challenging careers for graduates. In addition, all job vacancies worldwide are advertised internally on the web, thus giving employees an opportunity to manage their own careers. The next step will be to widen our reach and reduce recruitment costs by advertising vacancies externally on our website.

Ethics in action

To underline our commitment to doing business according to our core values of honesty, integrity, transparency and fairness, we are currently formulating new human rights policies. These set out our principles on managing and developing people across the group, whether or not local laws require this. The overall aim is to make clear that this is a company in which people respect each other and which demands high ethical standards

WE ARE MAKING CLEAR THAT THIS IS A COMPANY IN WHICH PEOPLE RESPECT EACH OTHER AND WHICH DEMANDS HIGH ETHICAL STANDARDS FROM EMPLOYEES AND SUPPLIERS.

40%

OF OUR 120 MAJOR
MANUFACTURING SITES ARE
NOW CERTIFIED TO ISO 14001.
OUR AMBITIOUS TARGET IS
TO HAVE ALL 120 CERTIFIED
BY THE END OF 2003.

from employees and suppliers. The basics are already common practice within Smiths – for example we have long-established procedures to protect ‘whistleblowers’ and to take firm action against harassment at work.

Other examples of fairness and openness in practice include the action we are taking ahead of UK legislation in eliminating age discrimination and in implementing equal pay audits. We are also introducing flexible working practices where they are appropriate for the business model of the individual operation. Several businesses are already offering flexible start and finish times around a core work period.

Following a successful 12-month pilot of an Employee Assistance Programme at Smiths Detection, we are using the results to design a scheme that offers wider support and links with our current work on extending occupational health programmes. In addition, we are taking the initiative in examining all aspects of business driving – working closely with the RAC to see where we can improve safety and reduce stress. While these are pressing personal concerns for employees, they are also business issues with substantial cost implications over the long run. Our aim is to develop a system for managing these issues in line with company policies.

Corporate reporting

Plans are well advanced for the publication in 2003 of the first full environmental performance report for the group. This will also encompass for the first time a report on corporate social responsibility for Smiths. Many individual businesses – both in the US and Europe – have long-established roots in their communities, where they are often a major employer. While we support good community relations practices at the corporate level, it is individual sites and employees who nurture the relationships by taking an active role.

Staff at many of our sites have long-term programmes of liaison and exchange visits with local schools to help prepare school

leavers for the transition to work. Managers have also provided an ‘industrial mentoring’ support system for pupils in their final year at school. In addition, Smiths is a strong supporter of the Year in Industry scheme that gives one-year placements to young students prior to starting their university courses.

Employee communications

This year saw the successful renegotiation of the Smiths European Forum constitution to enlarge its membership to accommodate the new group structure following the merger with TI. At this year’s meeting in Amsterdam, the Chief Executive presented the company’s results and an overview of growth plans to delegates.

Lean manufacturing was another key topic on the agenda. Lean initiatives – particularly in our manufacturing sites – are focusing our efforts on improving the efficiency and effectiveness of our work processes and procedures and on extending these principles to our customers and the supply chain. These initiatives are yielding very positive bottom-line benefits throughout the company. The Smiths Purchasing Council comprises a range of managers with purchasing responsibility who work together to consolidate areas of common spend into global deals or to buy from new sources at more competitive prices. Travel, communications and energy are all areas where costs have been reduced.

Environment, health and safety (EHS)

Smiths regards good EHS practices as an integral part of business performance. The Chief Executive continues to take overall responsibility for EHS performance through the Director, Human Resources. Smiths corporate management of EHS has largely converged during the year because of the increasing overlap in goals and the activities needed to achieve them. There is a need to take an integrated management approach across EHS issues and there are also strong similarities in management systems.

Management systems and auditing

We continue to work towards our ambitious target of having all major Smiths' manufacturing businesses certified to ISO 14001 by the end of 2003. The scale of the challenge is enormous, but all 120 of our major manufacturing sites have now begun the process and 49 sites – representing 40% – are now certified, up from 36 last year.

Our internal health and safety (H&S) audit system is a valuable tool for identifying opportunities for improvement and is rolling out worldwide, along with training to speed its implementation. Complete in the UK and now generating useful management information, it is expected to be complete in the US by the end of the year.

Communicating best practice

Effective communication is vitally important to our EHS programmes. A significant advance over the past 12 months is our Trilogy website, launched in July this year. It is a three-part communications and information management tool for sharing EHS best practice and reporting performance across the group. In parallel with this, we continue to share best practice through EHS conferences. A total of six were held during the year, with further events planned for the UK, Europe and US next year.

From across Smiths, 100 people attended the highly interactive, three-day ISO 14001 implementation courses which focused delegates' attention on outcomes and performance improvements.

Measurement and targets

By combining the best systems from across the company, we successfully upgraded our environmental metrics reporting system and extended it throughout the group. This

holds the data on our use of resources, as well as our reduction targets for greenhouse gas emissions, water and waste to landfill. We expect to sign up to MACC2 (Make A Corporate Commitment) later in 2002. This is a UK government-supported initiative to help organisations improve their resource efficiency and environmental performance (www.macc2.org.uk). We shall specify baseline performance in these areas and report annually on progress against five-year reduction targets (summarised below).

Our demonstration project on waste minimisation is ongoing, with five companies working together to minimise waste. To date, this has identified 53 waste-saving opportunities, with a total savings value estimated at £340,000. Case studies will be put on the Trilogy website to encourage the replication of these and other successes across the company.

EHS is an integral part of our lean enterprise initiative – progressing in one year from a debit of £200,000 through our investment in lean programmes to achieving an estimated cost saving of £2.8m for last year (and rising). This has come from a combination of initiatives, particularly those that have reduced our use of raw materials, energy and water.

Reporting on H&S is enhanced this year with the introduction of a broader performance index, based on audit scores, accident statistics and workers' compensation/ employer liability payments made. This is a development of the earlier system that used only audit scores. We have also introduced an internal audit/management software tool to help line managers meet their H&S responsibilities. The addition of accident statistics makes the index a useful management tool that reflects what the company is actually doing. No accident

is acceptable, but our accident figures continue to be exceptionally low in our sector.

Reporting to stakeholders

Smiths has published H&S reports annually since 1999 and later this year will reflect the convergence of EHS issues with the publication of an EHS report. This will be a precursor to the full environmental and social performance report that we have committed to publish next year. By then we will have sufficient consistent data across the group to make this meaningful.

Adding value

Two essentials drive our global HR and EHS policies. One is maintaining our technical and managerial vitality by recruiting, developing and retaining excellent people. The other is the creation of a climate that maximises their value to the company by fostering personal development, innovative thinking and the sharing of knowledge and best practice. Our transition to web-based systems is central to this and is delivering commercial value in many areas. Making the best information available throughout the company enables our widespread businesses to replicate successes in adopting lean operations and in meeting and exceeding EHS targets. Such systems also open attractive global opportunities for talented individuals, which in turn helps to build Smiths' capability in international management.

The strength of Smiths is underpinned by the quality of our people. The global management systems we are putting in place are the foundation for reinforcing this strength for the long term.

	Absolute level (2001)	Current efficiency ratio/£1,000 sales	Reduction target/ £1,000 sales	Duration
CO ₂ EMISSIONS	268,721 tonnes	87 kg CO ₂	5% kg CO ₂	2001-2006
WATER USE	1.28 million m ³	417 litres	10% litres water	2001-2006
WASTE TO LANDFILL	20,204 tonnes	6.6 kg	10% kg waste to landfill	2001-2006

BOARD OF DIRECTORS

01

02

03

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01 KEITH ORRELL-JONES CHAIRMAN **

Aged 65, British. He was appointed to the Board in December 1992, becoming non-executive Chairman in November 1998. He is non-executive Chairman of FKI plc and was formerly Group Chief Executive of Blue Circle Industries PLC.

Chairman of the Nominations & Remuneration Committee.

02 KEITH BUTLER-WHEELHOUSE CHIEF EXECUTIVE

Aged 56, British. He was appointed to the Board in August 1996 and became Chief Executive in November 1996. He was previously President and Chief Executive Officer of Saab Automobile in Sweden and prior to that had been Chairman and Chief Executive of Delta Motor Corporation in South Africa. He is a non-executive director of Delta Motor Corporation and of J Sainsbury plc.

03 ROBERT O'LEARY NON-EXECUTIVE DIRECTOR **

Aged 58, US citizen. He was appointed to the Board as a non-executive director in September 1997. He is Chairman and Chief Executive Officer of ICN Pharmaceuticals Inc. and Chairman of Ascension Health Ventures, LLC. He was formerly Chairman and Chief Executive Officer of Premier Inc. and of American Medical International. He is a member of the Boards of Directors of Thermo Electron Corporation and of Viasys Healthcare Inc.

04 SIR NIGEL BROOMFIELD, KCMG NON-EXECUTIVE DIRECTOR **

Aged 65, British. He was appointed to the Board in December 2000 having been a non-executive director of TI Group since 1998. He is a director of the Ditchley Foundation and a trustee of the Dresden Trust. He transferred from the Army to the Foreign Service in 1968. His last post was as British Ambassador to the Federal Republic of Germany from 1993-97.

05 JOHN FERRIE GROUP MANAGING DIRECTOR AEROSPACE

Aged 55, British. He was appointed to the Board in April 2000 and became Group Managing Director, Aerospace, in August 2000. He previously worked at Rolls-Royce plc for 35 years. He completed an Engineering Doctorate in 1998, is a Fellow of the Royal Academy of Engineering and is a member of the Board of the Engineering Council (UK).

09 LAWRENCE KINET GROUP MANAGING DIRECTOR MEDICAL

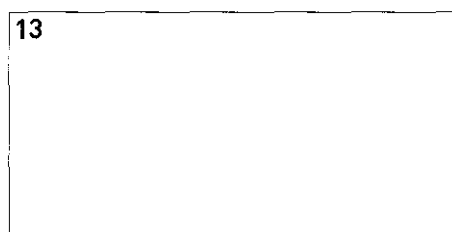
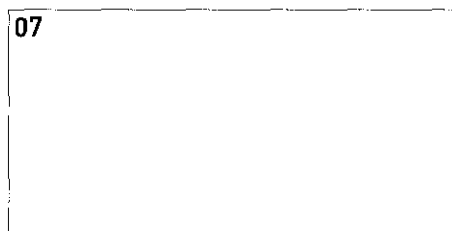
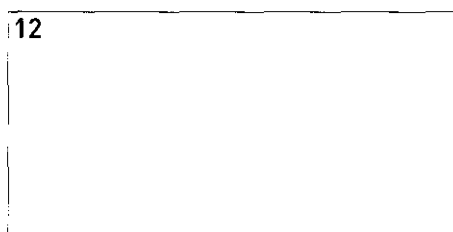
Aged 55, US citizen. He was appointed to the Board in February 2000 and became Group Managing Director, Medical, in August 2000. He was previously Chairman, President and Chief Executive Officer of Aksys Ltd and prior to that held senior appointments with Oculon Corp, Kensington Group and Baxter International Inc.

10 ALAN THOMSON FINANCIAL DIRECTOR

Aged 56, British. He was appointed to the Board as Financial Director on joining the company in April 1995. He was previously Finance Director of 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 Johnson Matthey plc.

11 JULIAN HORN-SMITH NON-EXECUTIVE DIRECTOR **

Aged 53, British. He was appointed to the Board as a non-executive director in February 2000. He is Chief Operating Officer of Vodafone Group Plc, a director of several of its European operating companies and Chairman of the Management Board of Mannesmann AG.



06 JOHN HIGNETT

NON-EXECUTIVE DIRECTOR **

Aged 68, British. He was appointed to the Board in December 2000 having been a non-executive director of TI Group since 1989 and Deputy Chairman from 1993-2000. He is Chairman of Schroder Income Growth Fund plc. He was formerly Managing Director of Lazard Brothers & Co. Ltd, Director General of the Takeover Panel and Finance Director of Glaxo Holdings plc. *Mr Hignett will retire from the Board at the 2002 AGM.*

12 JOHN LANGSTON

GROUP MANAGING DIRECTOR SEALING SOLUTIONS

Aged 52, British. He was appointed to the Board in December 2000, having been a director of TI Group since October 1998. He joined TI Group in 1993, becoming Chief Executive of Bundy Automotive in 1996 and Chief Executive of TI Specialty Polymer Products in 1998. He formerly worked for Lucas Industries.

07 DAVID LILLYCROP

GENERAL COUNSEL

Aged 46, British. He was appointed to the Board in December 2000, having been an executive director of TI Group since June 1998. He joined TI Group in 1989, becoming Group Company Secretary in 1991 and, additionally, General Counsel in 1997. A barrister, he was previously Director of Legal Affairs at Quaker Oats Ltd. He is Chairman of TI Pension Trustee Ltd.

13 EINAR LINDH

GROUP MANAGING DIRECTOR INDUSTRIAL

Aged 57, British. He was appointed to the Board, as head of Industrial 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 in 1983, becoming Managing Director of Portex Ltd in 1990. He is a non-executive director of Spirax Sarco Engineering plc.

08 SIR COLIN CHANDLER

NON-EXECUTIVE DEPUTY CHAIRMAN **

Aged 62, British. He was appointed to the Board in December 2000, having been a non-executive director of TI Group since 1992. He is Chairman of Vickers Defence Systems and was formerly Chairman of Vickers plc. Earlier he was seconded from British Aerospace to the role of Head of Defence Export Services, MoD. He was Chairman of Racal Electronics plc. He is non-executive Deputy Chairman of easyJet plc and is Pro-Chancellor of Cranfield University.

Chairman of the Audit Committee.

COMMITTEES

* AUDIT COMMITTEE

† NOMINATIONS & REMUNERATION COMMITTEE

Principal activities

The principal activities of the company and its subsidiaries are the development, manufacture, sale and support of:

- integrated aerospace systems, including electronic and actuation systems and precision components, for civil and military aircraft. Also equipment for land, naval and marine and other defence applications, including detection and protection against chemical and biological agents;
- medical devices and critical care equipment aligned to specific therapies, principally airway, pain and temperature management and infusion. Also needle protection, critical care monitoring, women's healthcare and vascular access;
- mechanical and polymer seals used in industries ranging from petrochemical processing to aerospace;
- interconnect products to connect and protect safety-critical electrical and electronic equipment, and air movement systems and components.

The main manufacturing operations are in the UK, the Americas and Continental Europe. A review of the development of the company and its subsidiaries during the 2001-2002 financial year is on pages 05 to 14.

Results and dividends

The results for the year to 31 July 2002 are set out in the consolidated profit and loss account on page 30. Sales for the year amounted to £3,223m, against £4,958m last year. The profit for the year after taxation, minority interests and goodwill amortisation amounted to £191m (2001 loss of £206m).

An interim dividend of 8.75p per ordinary share of 25p was paid on 19 April 2002. The directors recommend for payment on 15 November 2002 a final cash dividend on each ordinary share of 16.75p, making a total dividend of 25.5p for the year.

The retained profit of £49m was transferred to Reserves.

Research and development (R&D)

£212m was spent on R&D during the year, of which £116m was funded by the company and the balance by customers. Each business carries out R&D programmes to suit its own particular market and product needs. Interchange of technology and technical information between Smiths manufacturing businesses is centrally co-ordinated.

Changes in the company and its interests during the year

On 10 September 2001 EIS Group plc sold its fluid handling business, Plenty Group, comprising the assets of GSF Europe BV; Plenty Products, Inc.; Plenty India Limited; Plenty Uniquip Pty Limited and the majority of Plenty Limited, to SPX Lightnin for £11m in cash.

On 14 September 2001 Smiths Industries B.V. sold all the issued share capitals of Induplas SpA and Flexiplas S.A. and Smiths Industries Industrial Group Limited sold the EuroHose business to A.G. Petzetakis S.A. for a total of €12.55m in cash.

On 26 October 2001 TI Group Limited sold all the issued share capitals of Cambridge Vacuum Engineering Limited; Wentgate Dynaweld Limited; and Wentgate Dynaweld, Inc. to Aquasium Technologies Limited for £4.3m in cash.

On 31 October 2001 Smiths Group North America, Inc. bought all the issued share capital of Bivona, Inc. for approximately US\$35.9m in cash.

On 2 November 2001 Polymer Sealing Solutions Limited sold its Woodville Airbags business to Automotive Safety Components International for £3m in cash.

On 30 November 2001 EIS Group plc sold all the issued share capitals of Horstman Defence Systems Limited, Aeronautical & General Instruments Limited and AB Precision (Poole) Limited to Harris Watson Holdings PLC for £4.2m in cash.

On 2 December 2001 Smiths Group North America, Inc. bought all the issued share capital of Summitek Instruments, Inc. for approximately US\$10m in cash.

On 5 December 2001 EIS Group plc sold all the issued share capitals of Hick, Hargreaves and Company Limited; Hibon International SA; Wilhelm Klein GmbH; and 3H Czech and the business of Stokes Vacuum, Inc. to BOC Edwards for £12.8m in cash.

On 20 December 2001 Portex, Inc. bought the anaesthesia kit and tray business and assets of Abbott Laboratories for US\$26m in cash.

On 1 April 2002 Smiths Group North America, Inc. bought all the issued share capital of Able Corp. for US\$21.5m in cash, of which US\$4m will be paid over five years, plus earn-out provisions potentially worth up to a further US\$1.2m.

On 15 April 2002 the company sold the John Crane-Lips group of companies to Wärtsilä Corporation of Finland for £235m in cash.

On 16 April 2002 Smiths Industries B.V. sold all the issued share capital of Dan Chambers Limited to Season Controls Group plc for €0.96m in cash, payable over four years.

On 7 May 2002 Portex Limited sold its urology and ostomy businesses to Mentor Corporation for £7.3m in cash.

On 12 July 2002 Roof Units (Group) Limited sold the Fans & Spares businesses to R&S

Cartwright (Manchester) Engineers Limited for £5.75m in cash.

On 19 July 2002 EIS Group plc sold the Mixing Solutions business to a subsidiary company of American Manufacturing Company for a nominal amount.

During the year, all the external shareholders' interests in Nordex SpA and Triveni Flexibox Limited were acquired.

Post balance sheet events

There have been no post balance sheet events.

Future developments

The company will pursue its existing international activities and continue to seek business opportunities in both the UK and overseas.

Charitable and political donations

During the year the company made donations of £853,000 for charitable purposes including payments totalling £300,000 for the Portex Chair of Paediatric Anaesthesia. No political donations were made.

Directors

The names of those who were directors at the end of the financial year are listed on pages 18 and 19.

Reappointment of directors

Messrs K Orrell-Jones, L H N Kinet and R W O'Leary will retire by rotation, in accordance with Articles 73 and 74 and, being eligible, will seek reappointment at the AGM. Mr J M Hignett will retire at the AGM and will not seek re-election.

Directors' interests in contracts

Details of the executive directors' service contracts are as disclosed in the Contract Terms section of the Report of the Nominations & Remuneration Committee on page 25.

Apart from the exceptions referred to above, no director had an interest in any contract to which the company or its subsidiaries was a party during the year.

Interests in shares

As at 24 September 2002 the company had been notified, pursuant to the Companies Act 1985, of the following material or notifiable interests in its issued share capital:

	No. of shares	Issued share capital [†]
The Capital Group Companies, Inc*	61.9m	11.1%
Franklin Resources, Inc.	34.1m	6.1%
Scottish Widows Investment Partnership	16.8m	3.0%

*Includes the interests of Capital Guardian Trust Company in 10.0% of the issued share capital

[†]Percentage of share capital in issue on 24 September 2002

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 27 and 28.

Corporate governance

The company complies with the Combined Code, as defined in the Listing Rules of the UK Listing Authority, (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 as necessary to deal with urgent items.

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. Arrangements are in place for all directors to receive appropriate training, whether on their appointment or periodically, as necessary.

Mr Orrell-Jones, who is the senior non-executive director, is the Chairman and also chairs the Nominations & Remuneration Committee. Sir Colin Chandler is the Deputy Chairman and chairs the Audit Committee. No other non-executive director has been appointed as a recognised senior independent 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 Sir Colin. Mr Butler-Wheelhouse is the Chief Executive. There are six independent non-executive directors and seven 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 and on-site 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 & Remuneration Committee, which is chaired by Mr Orrell-Jones and comprises all the non-executive directors, makes recommendations to the Board on

appointments. Appointments approved by the Board are subject to confirmation by the shareholders at the next AGM.

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 & Remuneration Committee meets at least three times a year. The Chief Executive and General Counsel normally attend meetings of the Committee by invitation but do not participate in discussions of their 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 on directors' emoluments and interests is set out on pages 25 to 28.

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 relating to principles C.1 and C.2.

The Board believes that the 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 29.

The Audit Committee's terms of reference accord with the Code. The Committee comprises all the non-executive directors and meets at least three times a year with the Chief Executive, Financial Director, General Counsel, Director of Internal Audit and the auditors normally attending.

Apart from work in relation to acquisitions and disposals, all work not related to the audit for which the company might consider engaging the auditors, is put out to tender. The Board is kept fully informed of all non-audit work awarded to the auditors.

Internal control. Internal control is based on assessment of risk and a framework of control procedures to manage risks and to monitor compliance with procedures. The procedures of accountability and control, which accord with the guidance on internal control issued by the Turnbull Committee, are outlined below.

The Board accepts its responsibility for maintaining and reviewing the effectiveness of the company's internal control systems. These are designed to meet the company's particular needs and the risks to which it is exposed and, by their nature, can provide only reasonable, not absolute, assurance against material loss to the company or material misstatement in the financial accounts.

The group has an embedded process for the identification, evaluation and management of significant business risks. The process is reviewed through the Audit Committee and monitored by the Group Internal Audit Department. The four operating divisions and Corporate HQ have, during the year, identified and evaluated the key risks under three categories – strategic; operational; and information – and have ensured that effective controls and procedures are in place to manage these risks.

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.

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.

Throughout the year the Board has reviewed the effectiveness of internal control and the management of risks at its regular board meetings. In addition to financial and business reports, the Board has reviewed medium and longer-term strategic plans; capital expenditure and development programmes; management and product development programmes; reports on key operational issues; tax; treasury; risk management; insurance; legal matters; and Audit Committee reports, including internal and external auditor reports.

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 Code to the extent required by the Listing Rules of the UK Listing Authority. The results of their review are set out on page 29.

Policy on payment of creditors

The company's policy and practice are to pay creditors promptly in accordance with agreed terms of business. The average time taken to pay an invoice was 37 days for the parent company and 51 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 minimise, as far as is reasonably practicable, any detrimental effects to the environment from its operations and products. A senior

corporate staff director has responsibility for environmental, health and safety (EHS) matters; three full-time managers report to that director and co-ordinate and monitor the EHS activities of the company. A more detailed statement appears on pages 15 to 17.

Employment policies

It is the company's policy to provide equal opportunities for employment and to attend 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 acquire an interest in the company's shares and to align their interests more closely with those of the shareholders.

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, Works Councils and other consultative bodies that allow the views of personnel to be taken into account.

All matters concerning EHS 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. A more detailed statement appears on pages 15 to 17.

Authority to issue shares

At the AGM shareholders will be asked to renew the authority, given to the directors at the last AGM, to allot relevant securities 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 AGM. The authority proposed will expire on the fifth anniversary of the meeting unless otherwise renewed. The amount of relevant securities to which this authority relates (£46,536,930 nominal

DIRECTORS' REPORT continued

share capital) represents one third of the share capital in issue on 24 September 2002. The directors have no present intention of exercising this authority except for allotments of shares pursuant to the company's share-option schemes. The ordinary resolution is set out in the Notice of Annual General Meeting.

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 expire on the fifth anniversary of the meeting, unless otherwise renewed. It 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 £6,980,539 (approximately 5% of the issued share capital on 24 September 2002).

The directors intend seeking renewal of these authorities annually.

During the year ended 31 July 2002 the following ordinary shares in Smiths Group plc were issued:

- 1,113,378 shares pursuant to the terms of the company's shareholder-approved share-option schemes;
- 1,574,364 shares pursuant to the terms of Ti Group share-option schemes.

Authority to purchase shares

At the AGM the company will seek to renew the authority, granted at the last AGM to the directors, to purchase the company's shares in the market. The authority will be limited to 10% of the share capital in issue on 24 September 2002 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 five business days prior to any purchase.

The directors will exercise the authority only 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. The directors will also give careful consideration to the gearing levels of the company and its general financial position.

On 24 September 2002 options over approximately 25.9m shares were outstanding under the company's share option schemes, representing approximately 4.5% of the then issued share capital. If the authority to purchase shares being sought at the AGM were to be used in full, then the outstanding options would represent approximately 5.1% of the reduced issued share capital.

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

Auditors

Resolutions will be proposed at the AGM to reappoint PricewaterhouseCoopers as auditors and to authorise the directors to determine the auditors' remuneration.

Articles of Association

A special resolution will be proposed at the AGM to replace the company's Articles of Association. The current Articles were adopted in 1995 and, although amendments have been made, the directors propose that new Articles be adopted which will comply with current best practice and the Listing Rules of the UK Listing Authority. Proposed changes include provisions (i) to facilitate electronic voting at general meetings and electronic communications with shareholders; (ii) requiring directors to retire at intervals not exceeding three years; and (iii) to permit expressly the transfer of securities through CREST, the paperless trading system. The directors also propose to increase the limit on the aggregate fees which may be paid to non-

executive directors from the current level of £200,000 per annum, which was established in 1995, to £500,000 per annum. Further details of the principal differences between the existing Articles and the proposed new Articles are set out in the Notice of Annual General Meeting to be held on 12 November 2002.

Summary Financial Statement

The company has produced a Summary Financial Statement ('SFS') as an alternative to this Annual Report and Accounts and intends to continue to produce SFSs as well as statutory reports and accounts in future years. Shareholders will automatically be sent SFSs each year unless they elect in writing to receive the full report and accounts. Copies of the 2002 SFS may be obtained free of charge by writing to the Deputy Group Secretary, Smiths Group plc, 765 Finchley Road, London NW11 8DS (e-mail: secretary@smiths-group.com). Shareholders who wish to receive the full accounts instead of SFSs or vice versa should write to Lloyds TSB Registrars, The Causeway, Worthing, West Sussex BN99 6DA, quoting Reference 0282. The company expects the introduction of SFSs to result in significant savings in the cost of producing the accounts each year.

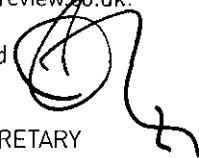
www.smiths-group.com

Electronic copies of this Report and Accounts, the Notice of Annual General Meeting and the Summary Financial Statement will be posted on the company's website, www.smiths-group.com. The company's announcements to the Stock Exchange and press releases are available on-line through the website. Shareholding details and practical help on share transfers and changes of address can be found at www.shareview.co.uk.

By Order of the Board

DAVID P LILLYCROP
DIRECTOR AND SECRETARY

27 September 2002
765 Finchley Road
London NW11 8DS



DIRECTORS' EMOLUMENTS AND INTERESTS

Report on directors' remuneration

The Nominations & Remuneration Committee of the Board referred to on page 22 determines the remuneration of executive directors, including their annual bonus targets and grants of share options. Its constitution and practice accord with the relevant provisions of the Combined Code, as defined in the Listing Rules of the UK Listing Authority (the Code).

The Committee seeks to maintain a competitive programme that 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 reviewing its remuneration policy the Committee has given full consideration to the Code and considers that there are no matters which should be submitted for approval to this year's AGM, at which the Chairman of the Committee will be present to answer questions.

The remuneration of directors is set out in tables on pages 26 to 28.

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 aerospace and engineering companies.

Bonuses are based on successful performance and are paid only on the achievement of carefully considered targets and objectives. All bonuses are capped. Under a deferred share scheme, established in 1992, executive directors 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 November 2001 five executive directors participated in the scheme in respect of their 2001 bonuses

and were granted options over shares as shown in a table on page 28.

The annual bonus and any gains under share option schemes are not pensionable.

Pensions. The company pays monthly salary supplements, as money purchase contributions, to some of the directors. For the other directors, final salary schemes provide a pension of up to two-thirds of final pensionable salary. Where Revenue limits apply, the difference between the pension payable on the cap and the target pension is, after taking into account any retained benefits from previous employment, provided by the company. Details of the money purchase contributions and the pension provisions are set out in the tables on pages 26 and 27.

Contract terms. During the year the company completed the phasing out of two-year contracts. All executive directors, including Mr L H N Kinet who, as stated in the directors' report, is to be proposed for re-election at the AGM, are now employed on terms including a one-year rolling period of notice. The terms of the one-year contracts include provision for the payment of predetermined damages in the event of termination of employment in certain circumstances.

As reported last year, two directors who joined from the Board of TI Group plc at the time of the merger in December 2000 agreed to relinquish certain rights arising under their TI service agreements. In return each of them received a special payment (identified for purposes of prior year comparison as 'TI contract payments' in the summary remuneration table on page 26) and acquired a contingent interest in certain Smiths shares (as mentioned on page 27).

Non-executive directors were paid a total of £365,000 (including £180,000 in fees) in the year to 31 July 2002. Their remuneration is determined by the Board in accordance with the articles of association. They are not eligible for bonuses or participation in share schemes and no pension contributions are made on their behalf. The non-executive directors, including those who, as stated in the directors' report, are to be proposed for re-election at the AGM, do not have service contracts.

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 27.

The executive share option scheme, approved at the AGM in 1995 and amended last year, covers approximately 350 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. Executive directors are each expected progressively to build up a shareholding with a value equal to one and a half years' salary. Options granted under the 1995 Scheme may only be exercised after three years if a performance requirement, determined by the Committee, has been met.

Under the terms of the merger with TI Group plc and the rules of the various TI Group share option schemes, holders of TI Group share options were able to exchange their options over TI Group shares for options over Smiths shares. All exchanged options remain subject to the rules of the TI Group share option scheme under which they were originally granted. Details of the exchanged options outstanding at 31 July 2002 are shown on page 53.

The Save-As-You-Earn share option scheme, which is open to all UK employees with 12 months' service, is subject to UK legislation as to the amount that 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 year to 31 July 2002, executive directors exercised share options and at 31 July 2002 held unexercised options as described in a table on page 28.

DIRECTORS' EMOLUMENTS AND INTERESTS continued

There were no changes in the options held by directors between 31 July 2002 and 24 September 2002. The Register of Directors' Interests (which is open to inspection) contains full details of directors' shareholdings and options to acquire 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 the value of shares to which certain directors may become entitled under the deferred share scheme (shown in the lower table) and also defined benefit pension arrangements, was as follows:

	2002 £000	2001 £000
Fees, salaries and benefits	3,360	2,846
Performance related bonuses	943	1,362
Gain from exercise of share options	74	32
Incremental gain/(loss) from deferred share scheme exercises	(40)	12
Money purchase pension contributions	556	429
Tf contract payments		400
	4,893	5,081

The emoluments of the directors are set out below:

	Fees/salary		Bonus	Benefits	Deferred share scheme contributions	Money purchase pension contributions	Total	
	2002 £000	2001 £000	2002 £000	2002 £000	2002 £000	2002 £000	2002 £000	2001 £000
CHAIRMAN								
K Orrell-Jones	180	172		19			199	193
CHIEF EXECUTIVE								
K O Butler-Wheelhouse	700	505	357	37	263	350	1,707	1,385
EXECUTIVE DIRECTORS								
J Ferrie	320	265	127	67	152	128	794	681
L H N Kinet	310	280	52	144		78	584	641
J Langston (appointed 4.12.00)	310	198	111	26			447	571
D P Lillycrop (appointed 4.12.00)	300	198	107	46	141		594	582
E Lindh	300	285	60	32	79		471	531
A M Thomson	360	275	129	24	113		626	567
NON-EXECUTIVE DIRECTORS								
Sir Nigel Broomfield (appointed 4.12.00)	30	20					30	20
Sir Colin Chandler (appointed 4.12.00)	65	43					65	43
J M Hignett (appointed 4.12.00)	30	19					30	19
J M Horn-Smith	30	30					30	30
R W O'Leary	30	30					30	30
	2,965	2,320	943	395	748	556	5,607	5,293

1 The deferred share scheme amounts represent shares to which certain directors may become entitled and relate to the previous year's bonus.

2 Benefits for Dr Ferrie and Mr Kinet include payments related to their relocation to the UK from the US.

Pensions

	Age at 31 July 2002	Directors' contributions during the year £000	Additional pension earned during the year (excluding any increase for inflation) £000	Accrued entitlement at 31 July 2002 £000
J Langston	52	5	17	108
D P Lillycrop	46	5	13	95
E Lindh	57	15	26	201
A M Thomson	55	14	53	118

An executive director's normal retirement age is 60. An early retirement pension, based on actual service completed, may be paid after age 50 and may be 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 Prices Index, if less; (for Messrs Langston and Lillycrop, guaranteed increases are subject to a maximum of 7% per annum). 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' interests in the company's shares

	Ordinary shares of 25p	
	31 July 2002	31 July 2001
Sir Nigel Broomfield	103	103
K O Butler-Wheelhouse	117,537	55,336
Sir Colin Chandler	8,778	8,778
J Ferrie	22,438	0
J M Hignett	67,966	67,685
J M Horn-Smith	6,682	6,682
L H N Kinet	0	0
J Langston	60,270	60,270
D P Lillycrop	65,144	68,158
E Lindh	38,189	33,584
R W O'Leary	2,642	3,315
K Orrell-Jones	3,226	3,226
A M Thomson	51,526	42,066

These interests include beneficial interests in the company's shares held in PEPs and ISAs and holdings through nominee companies. Except as reported below, none of the directors has disclosed any non-beneficial interests in the company's shares.

Mr J Langston and Mr D P Lillycrop also both have a technical interest in 756,955 ordinary shares in the company as discretionary beneficiaries under the TI Group Jersey Employee Share Trust and the TI Group Employee Share Trust. These shares may be transferred to employees who exercise options granted under the TI Group share option schemes. In addition, Mr Langston has a contingent interest in 125,000 ordinary shares and Mr Lillycrop has a contingent interest in 100,000 ordinary shares, arising from contractual arrangements related to the merger with TI Group plc.

The company has not been notified of any changes to the holdings of the directors, their families and any connected persons between 1 August and 24 September 2002.

DIRECTORS' EMOLUMENTS AND INTERESTS continued

Directors' share options

		Options held on 31 July 2002	Options held on 31 July 2001	Weighted average exercise price	Options exercised 2001-2002			Options granted 2001-2002				
Director	Scheme	Number	Number		Date exercised	Number	Exercise price	Market price*	Date of grant	Number	Exercise price	Expiry date
K O Butler-Wheelhouse	95ESOS	565,834	392,137	818.35p					9/4/02	173,697	806.00p	9/4/12
	SAYE	2,578	2,578	669.00p								
	DSS	68,563	53,248	0.10p	22/11/01	23,443	0.10p	670.00p	22/11/01	38,758	0.10p	22/10/08
J Ferrie	95ESOS	209,423	130,019	792.04p					9/4/02	79,404	806.00p	9/4/12
	SAYE	2,775	2,775	608.00p								
	DSS	22,438	0	0.10p					22/11/01	22,438	0.10p	22/10/08
L H N Kinet	95ESOS	212,664	135,741	787.21p					9/4/02	76,923	806.00p	9/4/12
	SAYE	1,593	1,593	608.00p								
J Langston	95ESOS	119,623	42,700	800.29p					9/4/02	76,923	806.00p	9/4/12
	SAYE	1,593	1,593	608.00p								
	Ti (1990) ESOS	104,030	160,104	1,021.58p	17/5/02	32,956	759.33p	860.00p				
					& 17/5/02	23,118	765.42p	860.00p				
D P Lillycrop	Ti 1999 ESOS	258,237	258,237	706.44p								
	95ESOS	117,141	42,700	800.17p					9/4/02	74,441	806.00p	9/4/12
	SAYE	1,539	0	645.00p					9/5/02	1,539	645.00p	31/1/08
	DSS	20,697	0	0.10p					22/11/01	20,697	0.10p	22/10/08
	Ti (1990) ESOS	128,378	138,215	1,021.81p	8/4/02	9,837	612.95p	806.00p				
	Ti 1999 ESOS	274,223	274,223	703.02p								
E Lindh	Ti SAYE	778	1,990	886.39p								
	84ESOS	8,851	8,851	451.00p								
	95ESOS	291,421	216,980	804.98p					9/4/02	74,441	806.00p	9/4/12
	SAYE	5,002	5,002	583.47p								
A M Thomson	DSS	44,107	35,602	0.10p	10/7/02	3,105	0.10p	813.50p	22/11/01	11,610	0.10p	22/10/08
	84ESOS	62,500	62,500	480.00p								
	95ESOS	269,098	179,768	802.94p					9/4/02	89,330	806.00p	9/4/12
	SAYE	2,775	2,775	608.00p								
	DSS	44,450	33,326	0.10p	22/11/01	5,460	0.10p	670.00p	22/11/01	16,584	0.10p	22/10/08

Key												
84ESOS	The Smiths Industries (1984) Executive Share Option Scheme			TI (1990) ESOS	The TI Group (1990) Executive Share Option Scheme							
95ESOS	The Smiths Industries 1995 Executive Share Option Scheme			TI 1999 ESOS	The TI Group 1999 Executive Share Option Scheme							
SAYE	The Smiths Industries 1982 SAYE Share Option Scheme			TI SAYE	The TI Group 1994 Savings-Related Share Option Scheme							
DSS	The Smiths Industries Senior Executive Deferred Share Scheme				*mid-market closing quotation from the London Stock Exchange Daily Official List							

Notes

The high and low market prices of the ordinary shares during the period 1 August 2001 to 31 July 2002 were 878p and 570p respectively. The mid-market price on 31 July 2001 was 772p and on 31 July 2002 was 775p.

Of the 2.64m shares under options granted to directors under the executive and savings-related share option schemes operated by the company, 2.57m shares were granted at exercise prices above the market price of a Smiths share on 24 September 2002 (605p) and 74,760 shares were at exercise prices below the market price on that date.

An option granted to Mr D P Lillycrop under the TI Group Save-As-You-Earn Share Option Scheme lapsed on 31 March 2002; no other options held by any director lapsed during the period 1 August 2001 to 31 July 2002.

No options have been granted or exercised or have lapsed during the period 1 August to 24 September 2002.

There are no performance criteria for the Smiths Industries (1984) Executive Share Option Scheme or The Smiths Industries Senior Executive Deferred Share Scheme or the TI Group Executive Share Option Schemes.

Options granted under the Smiths Industries 1995 Executive Share Option Scheme up to 2001 are subject to performance testing based on total shareholder return of the company versus the total return of the General Industrials Sector of the FTSE All Shares Index. Options granted in 2002 are subject to a performance test based on growth in the company's earnings per share exceeding the increase in the UK RPI plus a fixed percentage.

Deferred Share Scheme options were granted on 22 November 2001 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 2002 the Deferred Share Scheme held 459,014 shares for the benefit of senior executives (including the directors as disclosed above). The market value of these shares at that date was £3.56m and dividends of approximately £84,000 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 1 August 2001 to 31 July 2002.

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.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SMITHS GROUP PLC

We have audited the accounts which comprise the profit and loss account, the balance sheet, the cash-flow statement, the statement of total recognised gains and losses and the related notes, which have been prepared under the historical cost convention and the accounting policies set out in the statement of accounting policies. We have also examined the amounts disclosed relating to emoluments, share options and long-term incentives of the directors, which form part of the report on directors' remuneration.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements, United Kingdom Auditing Standards issued by the Auditing Practices Board and the Listing Rules of the Financial Services Authority.

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 1985. 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. The other information comprises only the Chairman's statement, the Chief Executive's operating review, the financial review, corporate and social responsibility review, the directors' report and the report on directors' remuneration.

We review whether the corporate governance statement reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the company's or group's corporate governance procedures or its risk and control procedures.

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 accounts give a true and fair view of the state of affairs of the company and the group at 31 July 2002 and of the profits and cash-flows of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers
PricewaterhouseCoopers
Chartered Accountants and Registered Auditors
London
27 September 2002

Notes

(a) The maintenance and integrity of the Smiths Group plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

(b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

CONSOLIDATED PROFIT AND LOSS ACCOUNT

Year ended 31 July 2002							Year ended 31 July 2001				
Note	Ordinary activities £m	Discontinued businesses £m	Goodwill amortisation and impairment £m	Exceptional items £m	Total £m		Ordinary activities £m	Discontinued businesses £m	Goodwill amortisation £m	Exceptional items £m	Total £m
Continuing operations	3,043.0				3,043.0	3,132.4					3,132.4
Acquisitions	27.1				27.1						
Discontinued businesses		153.4			153.4			1,825.8			1,825.8
TURNOVER	3,070.1	153.4			3,223.5	3,132.4		1,825.8			4,958.2
Continuing operations	446.8		(48.6)	(43.7)	354.5	499.5			(34.3)	(115.8)	349.4
Acquisitions	5.6		(1.9)		3.7						
Discontinued businesses		9.9	(0.2)		9.7			151.8	(14.4)	(17.7)	119.7
OPERATING PROFIT	452.4	9.9	(50.7)	(43.7)	367.9	499.5		151.8	(48.7)	(133.5)	469.1
Exceptional items											
– merger costs										(54.2)	(54.2)
– loss on disposal of businesses				(24.3)	(24.3)					(286.0)	(286.0)
– write-down of goodwill on anticipated future disposals										(125.0)	(125.0)
PROFIT BEFORE INTEREST AND TAX	452.4	9.9	(50.7)	(68.0)	343.6	499.5		151.8	(48.7)	(598.7)	3.9
Net interest payable	(46.4)	(11.1)			(57.5)	(58.7)	(57.5)				(116.2)
PROFIT/(LOSS) BEFORE TAXATION	406.0	(1.2)	(50.7)	(68.0)	286.1	440.8		94.3	(48.7)	(598.7)	(112.3)
Taxation	(113.7)	0.3	3.8	16.1	(93.5)	(127.9)	(28.3)		3.6	60.5	(92.1)
PROFIT/(LOSS) AFTER TAXATION	292.3	(0.9)	(46.9)	(51.9)	192.6	312.9		66.0	(45.1)	(538.2)	(204.4)
Minority interests	(1.3)				(1.3)	(1.1)	(0.5)				(1.6)
PROFIT/(LOSS) FOR THE PERIOD	291.0	(0.9)	(46.9)	(51.9)	191.3	311.8		65.5	(45.1)	(538.2)	(206.0)
Dividends	(142.2)				(142.2)	(199.5)					(199.5)
RETAINED PROFIT/(LOSS)	148.8	(0.9)	(46.9)	(51.9)	49.1	112.3		65.5	(45.1)	(538.2)	(405.5)
EARNINGS/(LOSS) PER SHARE											
Basic	52.3p	(0.2p)	(8.4p)	(9.3p)	34.4p	56.4p		11.9p	(8.2p)	(97.4p)	(37.3p)
Diluted	52.2p	(0.2p)	(8.4p)	(9.3p)	34.3p	56.2p		11.8p	(8.1p)	(97.0p)	(37.1p)

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

	2002 £m	2001 £m
Profit for the financial year attributable to shareholders	191.3	(206.0)
Exchange adjustments	(60.6)	(10.3)
Taxation recognised on exchange gains (losses):		
Current – UK	(1.2)	
Deferred – USA	4.5	(2.4)
	134.0	(218.7)
Prior year adjustment re FRS19 – Deferred Taxation	(26.0)	
	108.0	(218.7)

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 33 to 55 form part of these accounts.

BALANCE SHEETS

	Note	Consolidated		Company	
		31 July 2002 £m	31 July 2001 £m	31 July 2002 £m	31 July 2001 £m
FIXED ASSETS					
Intangible assets	14	638.3	678.3		
Tangible assets	15	563.9	620.1	42.2	47.0
Investments and advances – TI Automotive Limited preference shares	17	325.0	325.0	325.0	325.0
– other	17	11.6	12.1	1,150.5	649.7
		1,538.8	1,635.5	1,517.7	1,021.7
CURRENT ASSETS					
Stocks	18	474.5	567.6	42.7	43.9
Debtors – amounts falling due within one year	19	597.7	752.4	81.4	77.4
– amounts falling due after more than one year	19	171.0	166.2	55.6	46.1
Cash at bank and on deposit	22	109.5	117.2	125.2	65.7
		1,352.7	1,603.4	304.9	233.1
CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR	21	(913.8)	(1,181.4)	(636.8)	(484.5)
NET CURRENT ASSETS/(LIABILITIES)		438.9	422.0	(331.9)	(251.4)
TOTAL ASSETS LESS CURRENT LIABILITIES		1,977.7	2,057.5	1,185.8	770.3
Creditors: amounts falling due after more than one year	21	(765.1)	(970.2)	(537.3)	(174.4)
Provisions for liabilities and charges	25	(202.5)	(234.9)	(49.1)	(11.5)
NET ASSETS		1,010.1	852.4	599.4	584.4
CAPITAL AND RESERVES					
Called up share capital	28	139.6	138.9	139.6	138.9
Share premium account	29	163.7	146.1	163.7	146.1
Revaluation reserve	29	2.6	3.2	0.5	0.5
Merger reserve	29	234.8	234.8	180.5	180.5
Profit and loss account	29	457.5	316.7	115.1	118.4
SHAREHOLDERS' EQUITY	30	998.2	839.7	599.4	584.4
Minority equity interests		11.9	12.7		
CAPITAL EMPLOYED		1,010.1	852.4	599.4	584.4

Comparative figures for provisions for liabilities and charges and reserves have been restated on the adoption of FRS19 to include an additional deferred taxation provision of £26.0m relating to past tax benefits derived from goodwill acquired before 1 August 1998 and written off against reserves under accounting policies in force at that time.

The accounts on pages 30 to 55 were approved by the Board of directors on 27 September 2002 and were signed on its behalf by:



Keith Orrell-Jones
Chairman



Alan M Thomson
Financial Director




CASH-FLOW STATEMENT

	Note	Year ended 31 July 2002 £m	Year ended 31 July 2001 £m
RECONCILIATION OF OPERATING PROFIT TO NET CASH INFLOW FROM OPERATING ACTIVITIES			
Operating profit		367.9	469.1
Exceptional items		43.7	133.5
OPERATING PROFIT BEFORE EXCEPTIONAL ITEMS		411.6	602.6
Goodwill amortisation and impairment		50.7	48.7
Depreciation		91.5	139.3
Decrease/(increase) in stocks		18.7	[34.4]
Decrease/(increase) in debtors		38.3	[71.7]
(Decrease)/increase in creditors		(27.8)	16.5
NET CASH INFLOW FROM NORMAL OPERATING ACTIVITIES		583.0	701.0
Restructuring costs		(59.2)	[74.2]
NET CASH INFLOW FROM OPERATING ACTIVITIES		523.8	626.8

CASH-FLOW STATEMENT

NET CASH INFLOW FROM OPERATING ACTIVITIES BEFORE MERGER COSTS		523.8	626.8
Merger costs			[54.2]
NET CASH INFLOW FROM OPERATING ACTIVITIES AFTER MERGER COSTS		523.8	572.6
Returns on investments and servicing of finance	23c	(56.5)	[117.9]
Tax paid		(52.8)	[115.6]
Capital expenditure	15	(100.0)	[188.0]
		314.5	151.1
Acquisitions and disposals	26 & 27	180.9	368.6
Equity dividends paid		(139.1)	[171.3]
Management of liquid resources	22	0.1	193.6
Financing	22	(124.3)	[448.2]
INCREASE IN CASH		232.1	93.8
RECONCILIATION TO NET DEBT			
Net debt at 1 August		(1,119.8)	[1,465.7]
Increase in cash		232.1	93.8
Reduction in short-term deposits	22	(0.1)	[193.6]
Decrease in other borrowings	22	139.8	452.8
Loan note issues net of repayments	22	2.0	3.5
Term deposits acquired with acquisitions			19.0
Debt de-consolidated on disposals			19.1
Exchange variation		20.8	[48.7]
NET DEBT AT 31 JULY	22	[725.2]	[1,119.8]

Notes on pages 33 to 55 form part of these accounts.

NOTES TO THE ACCOUNTS

1 ANALYSES OF TURNOVER, PROFIT AND ASSETS (ORDINARY ACTIVITIES)	Turnover		Profit		Assets	
	2002 £m	2001 £m	2002 £m	2001 £m	2002 £m	2001 £m
MARKET						
Aerospace	1,345.4	1,301.2	190.9	208.7	664.5	764.7
Sealing Solutions	822.4	891.9	99.8	104.3	397.6	487.5
Medical	479.9	452.5	97.2	93.3	383.1	365.3
Industrial	422.4	486.8	64.5	93.2	278.2	342.0
	3,070.1	3,132.4	452.4	499.5	1,723.4	1,959.5
Discontinued businesses	153.4	1,825.8	9.9	151.8		
	3,223.5	4,958.2	462.3	651.3	1,723.4	1,959.5
Goodwill amortisation and impairment			(50.7)	(48.7)		
Exceptional items			(68.0)	(598.7)		
Net interest/net borrowings			(57.5)	(116.2)	(725.2)	(1,119.8)
Profit/(loss) before tax/net assets			286.1	(112.3)	998.2	839.7
GEOGRAPHICAL ORIGIN						
United Kingdom	966.2	996.4	123.5	121.2	655.2	756.0
USA	1,628.7	1,620.9	233.6	263.6	849.1	967.7
US Dollars	\$2,369.8m	\$2,350.3m	\$339.9m	\$382.2m	\$1,324.6m	\$1,383.8m
Europe	496.1	507.4	55.4	76.5	141.0	151.2
Other overseas	253.1	239.0	39.9	38.2	78.1	84.6
Inter-company	(274.0)	(231.3)				
	3,070.1	3,132.4	452.4	499.5	1,723.4	1,959.5

Operating profit from continuing activities after exceptional items amounted to £358.2m (2001 £349.4m) after charging goodwill amortisation of £50.5m (2001 £34.3m) and exceptional items of £43.7m (2001 £115.8m).

The contribution from discontinued businesses (predominantly John Crane-Lips) comprised turnover of £153.4m (2001 £1,825.8m) and operating profits of £9.7m (2001 £119.7m) after charging goodwill amortisation of £0.2m (2001 £14.4m). The net operating assets attributable to discontinued businesses in 2001 was £115.3m.

The above segmental analyses include the following contributions from acquisitions made during the year:

MARKET		
Aerospace	3.7	0.6
Medical	21.5	4.7
Industrial	1.9	0.3
	27.1	5.6
GEOGRAPHICAL ORIGIN		
USA	27.1	5.6

Goodwill amortisation and impairment of £50.7m comprised:

	Continuing activities £m	Acquisitions £m	Discontinued businesses £m	2002 Total £m	2001 Total £m
Aerospace	14.8	0.2		15.0	13.8
Sealing Solutions	13.0		0.2	13.2	12.2
Medical	2.3	1.5		3.8	2.2
Industrial	18.5	0.2		18.7	6.4
Automotive					14.1
	48.6	1.9	0.2	50.7	48.7

The Industrial goodwill amortisation charge against continuing activities of £18.5m includes £12m relating to an impairment write-down in respect of Radio Waves, Inc., acquired in December 2000.

NOTES TO THE ACCOUNTS continued

2 ANALYSIS OF TURNOVER BY DESTINATION (ORDINARY ACTIVITIES)

	2002 £m	2001 £m
United Kingdom	520.5	496.1
USA	1,468.3	1,539.7
Europe	625.6	647.4
Japan	100.5	103.3
Other overseas	355.2	345.9
	3,070.1	3,132.4
Discontinued businesses	153.4	1,825.8
	3,223.5	4,958.2

3 COST OF SALES

Cost of sales amounted to £1,854.6m (2001 £1,807.7m) relating to ordinary activities, including £16.5m in respect of acquisitions made during the year. Total cost of sales including discontinued was £1,963.4m (2001 £3,196.0m).

4 OPERATING EXPENSES

	2002 £m	2001 £m
CONTINUING OPERATIONS		
Sales and distribution costs	343.2	335.8
Administrative expenses – before goodwill amortisation and impairment	414.9	489.4
– goodwill amortisation and impairment	48.6	34.3
	806.7	859.5
ACQUISITIONS		
Sales and distribution costs	1.0	
Administrative expenses – before goodwill amortisation	4.0	
– goodwill amortisation	1.9	
	6.9	
Total operating expenses – continuing operations	813.6	859.5
– discontinued businesses	35.1	300.1
	848.7	1,159.6

Operating expenses for discontinued businesses comprised sales and distribution costs of £9.1m (2001 £88.0m) and administrative expenses of £25.8m (2001 £212.1m) including goodwill amortisation of £0.2m (2001 £14.4m).

5 OPERATING PROFIT IS AFTER CHARGING

	2002 £m	2001 £m
Goodwill amortisation and impairment	50.7	48.7
Depreciation of fixed assets	91.5	139.3
Research and development expenditure	116.5	109.5
Operating leases – land and buildings	30.1	26.8
– other	14.5	12.9
Auditors – audit fees: parent company	0.1	0.1
other	3.7	3.3
– other fees: TI Group plc 31 December 2000 audit		3.5
other	1.3	1.3

Other fees paid to the company's auditors comprise £0.3m (2001 £nil) in respect of transaction-related services, £0.5m (2001 £0.5m) in respect of taxation services and £0.5m (2001 £0.8m) in respect of other advisory services. In addition, fees of £0.1m (2001 £0.4m) were capitalised to goodwill.

6 EXCEPTIONAL ITEMS

The company incurred operating exceptional charges in both 2002 and 2001 arising from the ongoing restructuring of its operations, the major part of which related to Aerospace. Exceptional charges in 2001 also included costs incurred following the merger with TI Group and the subsequent demerger of Automotive.

	2002 £m	2001 £m
Head office closures		43.9
Operational restructuring – continuing businesses	43.7	71.9
	43.7	115.8
Operational restructuring – Automotive		17.7
	43.7	133.5
Merger costs		54.2
Charge before tax relief	43.7	187.7
Tax relief	(13.9)	(38.1)
	29.8	149.6

The charges for head office closures in 2001 related to the closure of premises in Abingdon, Central London and New York. All three closures were completed in that year.

	John Crane-Lips £m	Other disposals £m	2002 £m	2001 £m
OTHER EXCEPTIONAL CHARGES				
(Surplus)/deficit of consideration over net assets, fees and expenses	(152.7)	27.8	(124.9)	(59.3)
Goodwill written off to reserves	145.6	3.6	149.2	470.3
(Credit)/charge before tax relief	(7.1)	31.4	24.3	411.0
Tax relief	(1.2)	(1.0)	(2.2)	(22.4)
	(8.3)	30.4	22.1	388.6

The John Crane-Lips and other disposals are detailed in note 27.

The 2001 deficit relates primarily to the disposal of Automotive. Included within the £470.3m of goodwill previously written off to reserves is £125.0m of goodwill relating to anticipated future disposals.

	2002 £m	2001 £m
7 NET INTEREST PAYABLE		
Interest receivable	5.8	13.5
Other financing gains	4.0	
Interest payable:		
Bank loans and overdrafts repayable within five years	(31.8)	(35.1)
Other loans repayable within five years	(17.2)	(69.0)
Other loans repayable in more than five years	(18.2)	(22.9)
Finance leases	(0.1)	(2.7)
	(57.5)	(116.2)

8 PROFIT ATTRIBUTABLE TO THE PARENT COMPANY

Profits for the financial year of £157.7m (2001 £23.2m) were recorded in the accounts of Smiths Group 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.

NOTES TO THE ACCOUNTS continued

9 TAXATION	2002 £m	2001 £m
TAXATION ON THE PROFIT FOR THE YEAR		
UK corporation tax at 30% (2001 30%)	62.8	95.8
Double taxation relief	(7.7)	(20.9)
	55.1	74.9
Overseas taxation	61.0	85.4
	116.1	160.3
Tax relief on exceptional items (note 6)	(16.1)	(60.5)
Current taxation	100.0	99.8
Deferred taxation	(6.5)	(7.7)
	93.5	92.1
TAX RECONCILIATION		
Profit/(loss) before taxation	286.1	(112.3)
Effective taxation at 30%	85.8	(33.7)
Effect of higher overseas rates of tax	3.9	7.4
Effect of reversal of timing differences	6.5	7.7
Tax relief on employee share schemes	(0.6)	(0.7)
Tax effect of exceptional charges	4.4	119.1
Current tax charge for the year	100.0	99.8
10 DIVIDENDS	2002 £m	2001 £m
Ordinary interim paid 8.75p per share (2001 8.75p)	48.6	48.5
Ordinary final proposed 16.75p per share (2001 16.25p)	93.6	90.4
Special dividend paid by TI Group plc in respect of the year ended 31 December 2000		60.6
	142.2	199.5
11 EARNINGS PER SHARE	2002	2001
Separate figures are given for earnings per share related to the weighted average number of shares in issue:		
Basic	556,496,716	552,770,686
Effect of dilutive share options	1,267,591	2,113,803
Diluted	557,764,307	554,884,489

12 POST-RETIREMENT BENEFITS

Smiths operates a number of pension schemes throughout the world. The principal schemes are located in the UK (the Smiths Industries Pension Scheme and the TI Group Pension Scheme) and in the USA and are of the defined benefit type, with assets held in separate trustee-administered funds.

For the principal schemes the regular pension cost is assessed using the Projected Unit method. The most recent full actuarial valuations of the two principal UK schemes were performed as at 31 March 2001 for the Smiths Industries Pension Scheme and as at 5 April 2001 for the TI Group Pension Scheme. The most recent valuations of the principal USA plans were performed at 1 August 2001.

At these dates the market value of the principal schemes' assets was £2,082m for the UK and \$485m for the USA and the aggregate funding levels were 124% and 100% respectively. The funding levels were determined by comparing the market value of each of the funds' assets with the value of benefits accrued at the valuation date.

In the UK, the actuarial valuations made allowance for future general annual salary increases of 4% and for pension increases of 2.5%. The discount rate assumed in assessing the present value of accrued future benefits was 6% for pensioner liabilities and 7% for active member liabilities. In the USA discount rates of 7.25–7.75% were used and allowance was made for salary increases of 4.5%–4.75%.

The regular pension cost is assessed at each actuarial 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.

Contributions to these schemes are made on the advice of independent qualified actuaries with the objective that the benefits be fully funded during the scheme members' working lives.

A prepayment of £155.6m (2001 £145.4m) is included in debtors in respect of the UK schemes. Other creditors includes £12.9m (2001 £4.4m) in respect of the USA plans.

The pension costs of other schemes operated by the group were assessed in accordance with local practice. The group provides a defined contributions (401K) plan for its USA employees and post-retirement healthcare benefit plans, principally in the USA. The cost of the post-retirement healthcare benefits is assessed by independent qualified actuaries and provided for in accordance with UITF6 (see note 25). The major assumptions used in the latest plan valuations are interest rates of 7.25% and a long-term rate of increase in healthcare costs of 5%.

FRS17 Retirement Benefits

The Accounting Standards Board has proposed a deferral of full mandatory adoption of Financial Reporting Standard 17 Retirement Benefits ('FRS17') following an announcement by the International Accounting Standards Board that it is to review IAS19, the present international standard for post-employment benefits. Instead the existing transitional disclosure requirements will continue.

For the purposes of the additional disclosures required by FRS17 the most recent full actuarial valuations of the principal schemes have been updated to 31 July 2002 by qualified independent actuaries. The principal assumptions used in updating the valuations are set out below. The disclosures relate to all retirement benefit plans in the UK and the USA. Plans in other territories are not material.

The principal assumptions used by the independent qualified actuaries in updating the most recent valuations of all the UK and USA schemes to 31 July for FRS17 purposes were:

	2002		2001	
	UK	USA	UK	USA
Rate of increase in salaries	3.9%	4.2%	4.0%	4.5%
Rate of increase in pensions	2.5%	n/a	2.5%	n/a
Discount rate	6.0%	7.0%	6.0%	7.25%
Inflation rate	2.4%	3.25%	2.5%	3.5%
Healthcare cost increases	5.0%	*	4.5%	**

*10% per annum reducing 1% per annum to 5% per annum in 2008

**10% per annum reducing 1% per annum to 5% per annum in 2007

NOTES TO THE ACCOUNTS continued

12 POST-RETIREMENT BENEFITS continued

The assets in the schemes and the expected rates of return as at 31 July 2002 were:

	2002				2001			
	UK schemes		USA schemes		UK schemes		USA schemes	
	Long-term rate of return	Value £m	Long-term rate of return	Value £m	Long-term rate of return	Value £m	Long-term rate of return	Value £m
Equities	8.25%	828	9.0%	158	8.0%	1,012	9.0%	160
Government bonds	4.9%	810	5.5%	39	5.2%	738	5.5%	150
Corporate bonds	6.0%	251	7.0%	55	6.0%	371	7.25%	23
Property	7.25%	116	n/a	n/a	7.0%	118	n/a	n/a
Other	4.9%	78	3.5%	10	5.0%	81	3.5%	6
Total market value		2,083		262		2,320		339
Present value of funded pension scheme liabilities		(2,075)		(355)		(1,990)		(350)
Surplus/(deficit)		8		(93)		330		(11)
Unfunded pension plans		(20)		(4)		(17)		(5)
Post-retirement healthcare		(16)		(79)		(15)		(70)
		(28)		(176)		298		(86)
Related deferred tax asset/(liability)		8		67		(89)		33
Net pension asset/(liability)		(20)		(109)		209		(53)

The net UK pension liability of £20m represents, net of related deferred tax, surpluses of £84m and deficits of £79m in funded pension plans and unfunded pension plan/post-retirement healthcare balances of £25m.

If FRS17 had been adopted in the financial statements, the group's net assets and profit and loss reserve at 31 July 2002 would be as follows:

	2002 £m	2001 £m
Net assets excluding SSAP24 assets/(liabilities)	981	863
Retirement benefit asset/(liability) - FRS17 basis	(129)	156
	852	1,019
Profit and loss reserve excluding SSAP24 assets/(liabilities)	429	328
Retirement benefit asset/(liability) - FRS17 basis	(129)	156
Profit and loss reserve	300	484

12 POST-RETIREMENT BENEFITS continued

If FRS17 had been adopted in the financial statements, the following amounts would have been recognised in the performance statements for the year to 31 July 2002:

Profit and loss account	Funded defined benefit pension schemes		Unfunded pension/post-retirement healthcare plans
	UK £m	USA £m	UK & USA £m
Amounts charged to operating profit:			
Current service cost	34	12	2
Past service cost		1	
Total operating charge	34	13	2
Amounts charged/(credited) to other finance charges:			
Expected return on pension scheme assets	(152)	(24)	
Interest on pension scheme liabilities	118	25	7
Net return	(34)	1	7
Total charged to profit and loss account		14	9
Amounts recognised in Statement of Total Recognised Gains and Losses (STRGL)			
Actual return less expected return on pension scheme assets – £m	(307)	(62)	
As % of scheme assets	(15)%	(22)%	
Experience gains/(losses) arising on the scheme liabilities – £m	54	2	(9)
As % of present value of scheme liabilities	3%	0%	(8)%
Changes in assumptions underlying the present value of the scheme liabilities	(82)	(16)	(7)
Actuarial gain/(loss) recognised in the STRGL – £m	(335)	(76)	(16)
As % of present value of scheme liabilities	(16)%	(22)%	(13)%

Movement in surplus during the year	Funded defined benefit pension schemes		Unfunded pension/post-retirement healthcare plans
	UK £m	USA £m	UK & USA £m
Surplus/(deficit) at beginning of year	330	(11)	(107)
Current service cost	(34)	(12)	(2)
Employer contributions	13	1	6
Past service costs		(1)	
Other finance income	34	(1)	(7)
Actuarial gain/(loss) recognised in STRGL	(335)	(76)	(16)
Exchange		7	7
Surplus/(deficit) at end of year	8	(93)	(119)

Comparison between SSAP24 and FRS17

FRS17 Total profit and loss account charge – including unfunded pension and post-retirement healthcare plans	23
SSAP24 Profit and loss account charge – including unfunded pension and post-retirement healthcare plans	15

Cash contributions

The company contributions to the funded defined benefit pension plans in the accounting period totalled £14m. The presently agreed rates of contribution are expected to result in overall company contributions of £16m in 2003, subject to review depending upon investment performance.

NOTES TO THE ACCOUNTS continued

13 EMPLOYEES	2002 £m	2001 £m
STAFF COSTS DURING THE YEAR		
Wages and salaries	860.8	1,213.4
Social Security	94.0	183.6
Company pension costs (including defined contribution schemes)	23.5	16.9
	978.3	1,413.9

The average number of persons employed was:	2002	2001
Aerospace	11,619	12,234
Seating Solutions	11,572	14,618
Medical	4,709	4,607
Industrial	4,607	5,328
Automotive		19,229
	32,507	56,016

Details of directors' remuneration are given on pages 25 to 28.

14 INTANGIBLE FIXED ASSETS	£m
GOODWILL	
COST	
At 1 August 2001	738.6
Acquired during the year	48.8
Adjustments to prior year acquisitions	(0.7)
Disposals	(5.2)
Exchange adjustments	(38.4)
At 31 July 2002	743.1
AMORTISATION	
At 1 August 2001	60.3
Charge for the year (including impairment £12m)	50.7
Disposals	(0.7)
Exchange adjustments	(5.5)
At 31 July 2002	104.8
NET BOOK VALUE AT 31 JULY 2002	638.3
Net book value at 1 August 2001	678.3

15 TANGIBLE FIXED ASSETS	Land and buildings £m	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
CONSOLIDATED				
COST OR VALUATION				
At 1 August 2001	331.2	739.0	445.0	1,515.2
Exchange adjustments	(15.9)	(32.2)	(16.3)	(64.4)
Additions	11.7	49.3	48.5	109.5
Acquisitions	1.2	2.6	1.2	5.0
Disposals	(3.8)	(25.7)	(34.1)	(63.6)
Business disposals	(28.6)	(71.4)	(13.3)	(113.3)
At 31 July 2002	295.8	661.6	431.0	1,388.4
DEPRECIATION				
At 1 August 2001	99.5	475.4	320.2	895.1
Exchange adjustments	(3.7)	(19.6)	(12.9)	(36.2)
Charge for the year	7.9	42.6	41.0	91.5
Acquisitions	0.3	0.6	0.6	1.5
Disposals	(2.2)	(22.2)	(29.5)	(53.9)
Business disposals	(14.1)	(49.7)	(9.7)	(73.5)
At 31 July 2002	87.7	427.1	309.7	824.5
NET BOOK VALUE				
AT 31 JULY 2002	208.1	234.5	121.3	563.9
At 1 August 2001	231.7	263.6	124.8	620.1
COMPANY				
COST OR VALUATION				
At 1 August 2001	30.3	16.5	74.0	120.8
Additions	0.6	1.0	5.6	7.2
Transfers	(3.7)		(0.1)	(3.8)
Disposals	(0.3)	(1.0)	(3.1)	(4.4)
At 31 July 2002	26.9	16.5	76.4	119.8
DEPRECIATION				
At 1 August 2001	3.5	12.4	57.9	73.8
Transfers	(0.5)			(0.5)
Charge for the year	0.5	0.9	6.9	8.3
Disposals	(0.1)	(1.0)	(2.9)	(4.0)
At 31 July 2002	3.4	12.3	61.9	77.6
NET BOOK VALUE				
AT 31 JULY 2002	23.5	4.2	14.5	42.2
At 1 August 2001	26.8	4.1	16.1	47.0

The net book value of assets under finance leases included in plant and machinery is £1.2m (2001 £2.0m).

NOTES TO THE ACCOUNTS continued

15 TANGIBLE FIXED ASSETS continued	Consolidated		Company	
	2002 £m	2001 £m	2002 £m	2001 £m
LAND AND BUILDINGS				
Cost	289.4	324.1	26.4	29.8
Valuation 1974	6.4	7.1	0.5	0.5
	295.8	331.2	26.9	30.3
Freehold	269.9	305.4	26.7	30.1
Long leasehold	6.8	9.3	0.2	0.2
Short leasehold	19.1	16.5		
	295.8	331.2	26.9	30.3

If land and buildings had not been revalued they would have been included at the following amounts:

	Consolidated		Company	
	2002 £m	2001 £m	2002 £m	2001 £m
Cost	292.4	327.4	26.4	29.8
Aggregate depreciation	86.9	98.7	3.4	3.5

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, but the directors do not intend to adopt a policy of annual revaluations in the future. A quinquennial external revaluation of the company's properties was carried out as at 31 July 1999 which disclosed a surplus of £19.5m over 31 July 2002 book values.

CAPITAL EXPENDITURE - CASH-FLOW

Purchase of tangible fixed assets	110.2	226.4		
Less: proceeds of disposals	(10.2)	(38.4)		
	100.0	188.0		

16 CAPITAL COMMITMENTS

ESTIMATED COMMITMENTS NOT INCLUDED IN THE ACCOUNTS

	2002 £m	2001 £m
Company	1.6	1.5
Subsidiaries	11.8	15.3
	13.4	16.8

	Consolidated		Company	
	2002 £m	2001 £m	2002 £m	2001 £m
17 INVESTMENTS AND ADVANCES				
AT COST LESS AMOUNTS WRITTEN OFF				
Subsidiary companies			1,150.5	649.7
Unlisted investments				
TI Automotive Limited preference shares	325.0	325.0	325.0	325.0
Other trade investments	3.6	3.7		
Own shares	8.0	8.4		
	336.6	337.1	1,475.5	974.7
INVESTMENTS IN SUBSIDIARIES				
Shares at cost			825.3	823.5
Due from subsidiaries			1,194.6	337.0
			2,019.9	1,160.5
Due to subsidiaries			(869.4)	(510.8)
			1,150.5	649.7

TI Automotive Limited preference shares arose from the demerger of the former Automotive Systems division from the group, and are held at cost. They carry a fixed cumulative preference dividend at the rate of 15% per annum. One third of the dividend is payable on 25 July each year, subject to certain financial conditions having been met. The preference shares are redeemable, together with unpaid dividends, following full repayment of the outstanding liabilities of TI Automotive Limited under its bank facilities. TI Automotive is undergoing a financial restructuring where it plans to issue new bonds to repay part of its bank debt. Payment of the preference dividend on 25 July 2002 has been deferred until, and provided that, this refinancing has successfully taken place. Any dividend received will be accounted for on a cash basis, and no dividend accrual has been recognised as at 31 July 2002.

The company also holds 19.99% of the issued ordinary share capital of TI Automotive Limited. The shares confer 19.99% of the voting rights attaching to ordinary shares, and additionally confer the right to appoint the Chairman and to benefit from compulsory transfer provisions which oblige the other shareholders to sell their shares to a purchaser making an offer accepted by Smiths subject to certain conditions. The ordinary shares are recorded at nil value in these accounts.

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

ENGLAND	USA
Smiths Aerospace Limited*	Smiths Group North America, Inc.*
Aerostructures Hamble Limited	Smiths Aerospace, Inc.
Graseby Medical Limited	Smiths Detection – Warren, Inc.
Portex Limited*	Tri Industries, Inc.
Smiths Industries Industrial Group Limited*	John Crane, Inc.
Smiths Detection – Watford Ltd	Portex, Inc.
	Deltec, Inc.
EUROPE	BCI, Inc.
Smiths Medical Deutschland GmbH	Level 1, Inc.
Hypertac SA (France)	Flexible Technologies, Inc.
Hypertac GmbH (Germany)	Tutco, Inc.
	Hypertronics Corporation
	PolyPhaser Corporation
JAPAN	Sabritec, Inc.
Japan Medico Co. Limited (62%)	Transtector Systems, Inc.

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 or common stock. All subsidiaries operate in their country of incorporation.

NOTES TO THE ACCOUNTS continued

	Consolidated		Company	
	2002 £m	2001 £m	2002 £m	2001 £m
18 STOCKS				
STOCKS COMPRISE				
Raw materials and consumables	133.4	154.3	2.5	2.4
Work in progress	149.2	199.7	32.2	35.8
Finished goods	216.9	235.0	16.8	12.8
	499.5	589.0	51.5	51.0
Less: payments on account	(25.0)	(21.4)	(8.8)	(7.1)
	474.5	567.6	42.7	43.9

	Consolidated		Company	
	2002 £m	2001 £m	2002 £m	2001 £m
19 DEBTORS				
AMOUNTS FALLING DUE WITHIN ONE YEAR				
Trade debtors	486.5	641.6	46.4	48.5
Amounts recoverable on contracts	52.9	61.3	8.7	7.2
Amounts owed by subsidiaries			5.7	12.0
Other debtors	28.3	18.6	13.4	5.4
Prepayments and accrued income	30.0	30.9	7.2	4.3
	597.7	752.4	81.4	77.4
AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR				
Other debtors	15.4	20.8		
Deferred taxation (note 20)				1.2
Pensions prepayment (note 12)	155.6	145.4	55.6	44.9
	768.7	918.6	137.0	123.5

	Consolidated		Company	
	2002 £m	2001 £m	2002 £m	2001 £m
20 DEFERRED TAXATION				
DEFERRED TAXATION				
Accelerated tax depreciation on fixed assets and goodwill	(63.7)	(44.8)	(12.9)	(10.6)
Post-retirement benefits	34.6	28.3	5.2	
Pension prepayment	(33.3)	(39.5)	(16.7)	(13.5)
Short-term and other timing differences	56.2	28.3	8.5	25.3
Net deferred tax (liability)/asset	(6.2)	(27.7)	(15.9)	1.2
MOVEMENTS DURING THE YEAR				
At 1 August (as restated)	(27.7)	(18.0)	1.2	(7.6)
Exchange adjustments	(5.1)	3.2		
Acquisitions	3.5			
Disposals		(18.2)		
Charge for the year	6.5	7.7	(20.1)	1.5
Recognised on exchange gains and losses	4.5	(2.4)		
Other	12.1		3.0	7.3
AT 31 JULY	(6.2)	(27.7)	(15.9)	1.2

The company has adopted FRS19 – Deferred Taxation. As a result, an adjustment of £26.0m has been made to deferred tax with a corresponding adjustment to opening reserves to reflect the deferral of tax relating to certain goodwill acquired before 1 August 1998, and written off to reserves under accounting policies in force at that time. The effect on the reported profits of the prior period is not material.

	Consolidated		Company	
	2002 £m	2001 £m	2002 £m	2001 £m
21 CREDITORS				
AMOUNTS FALLING DUE WITHIN ONE YEAR				
Bank loans and overdrafts	45.2	37.8	350.9	228.0
Finance leases	1.5	1.5		
Short-term loans	117.0	303.3		2.0
Total short-term indebtedness (note 22)	163.7	342.6	350.9	230.0
Trade creditors	196.0	285.1	17.8	21.6
Bills of exchange payable	3.3	3.4		
Amounts owed to subsidiaries			4.2	2.1
Other creditors	39.4	51.0	3.8	6.0
Proposed dividend	93.6	90.4	93.6	90.4
Corporate taxation	119.0	60.4	77.3	54.0
Other taxation and social security costs	31.6	23.3	11.1	
Accruals and deferred income	267.2	325.2	78.1	80.4
	913.8	1,181.4	636.8	484.5
AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR				
Term loans (note 22)	670.8	892.5	497.8	161.5
Finance leases	0.2	1.9		
Total long-term indebtedness	671.0	894.4	497.8	161.5
Other creditors	94.1	75.8	39.5	12.9
	765.1	970.2	537.3	174.4

22 BORROWINGS AND NET DEBT

The company funding requirements are largely driven by acquisition activity and met by centrally arranged debt finance. This is lent through to the relevant subsidiary on inter-company loans at commercial arm's length terms. Smiths' strong cash generation in the businesses is tax-efficiently remitted to the UK to repay central borrowings. Local working capital needs and capital expenditure requirements are typically funded by local bank facilities, which are not guaranteed by the parent company.

The company seeks to manage its borrowings and business risks to maintain its current credit ratings. Borrowings for periods more than 364 days require Board approval. The company seeks to maintain a spread of maturity profiles on its debt and no more than 30% of the company's net debt will be held on borrowings due within one year, without firm plans for refinancing or repayment. The analysis of net debt, after taking into account interest rate swaps, is as follows:

As at 31 July 2002	Fixed borrowings				Total 2002 £m
	Weighted average		Amount £m	Floating borrowings £m	
	Interest rate	Years fixed			
CURRENCIES					
Sterling	7.19%	13	161.9	167.0	328.9
US Dollar	8.27%	1	43.6	196.8	240.4
Euro	4.45%	2	136.8	77.0	213.8
Japanese Yen	2.30%	1	8.0	32.4	40.4
Other	10.07%	1	0.7	10.5	11.2
			351.0	483.7	834.7
Cash and deposits					(109.5)
NET DEBT					725.2
MATURITY					
On demand/under one year			46.7	117.0	163.7
One to two years			17.3	165.7	183.0
Two to five years			139.0	52.5	191.5
Over five years			148.0	148.5	296.5
			351.0	483.7	834.7

NOTES TO THE ACCOUNTS continued

22 BORROWINGS AND NET DEBT continued

As at 31 July 2001	Fixed borrowings				
	Weighted average		Amount £m	Floating borrowings £m	Total 2001 £m
	Interest rate	Years fixed			
CURRENCIES					
Sterling	7.03%	7	347.5	272.8	620.3
US Dollar	8.70%	2	59.4	269.9	329.3
Euro	5.51%	1	123.9	76.7	200.6
Japanese Yen	2.30%	3	21.3	11.3	32.6
Other			30.9	23.3	54.2
			583.0	654.0	1,237.0
Cash and deposits					(117.2)
NET DEBT					1,119.8
MATURITY					
On demand/under one year			31.9	310.7	342.6
One to two years			37.7	52.9	90.6
Two to five years			364.7	142.1	506.8
Over five years			148.7	148.3	297.0
			583.0	654.0	1,237.0

Borrowing facilities

Debt has continued to be reduced by operating cash generation and proceeds from the disposal programme with net debt decreasing from £1.12bn to £0.73bn.

The current net debt level of £0.73bn represents 2.3 times free cash-flow, and EBITDA interest cover is more than 9.6 times – comfortably within the current credit rating parameter. The maturity profile of our bonds is well spread, maturing in 2005, 2010 and 2016.

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 mainly on EURIBOR.

The borrowings of all non-UK operations are in local currencies to provide a structural hedge against foreign currency movements on the overseas assets.

The company has two private placement debts. The first with an outstanding principal of \$100m (2001 \$100m) 8.34% Senior Notes was repaid in full on 5 August 2002. The other has an outstanding principal of \$40m (2001 \$60m) 8.853% Senior Notes maturing in October 2003. Both debts are placed by Smiths Group North America, Inc. with major USA institutional investors and are guaranteed by Smiths Group plc.

The medium-term borrowings include our syndicated bank facility of £500m that runs until 2004 together with an unsecured nominal €300m 6.375% bond maturing in 2005 which is largely swapped to floating interest rates.

The long-term borrowings (greater than five years) of £297m (2001 £297m) relate to Smiths Group plc unsecured nominal £150m 7.875% bonds maturing in 2010 which are swapped to floating interest rates and to unsecured nominal £150m 7.25% bonds maturing in 2016 which remain fixed rate.

To ensure better than adequate liquidity committed unused credit facilities of at least £100m are maintained at all times. At the year-end the company had the following unused committed borrowing facilities:

	2002 £m	2001 £m
Expiring within one year	65.0	35.0
Expiring between one and two years	337.0	
Expiring after two years		440.9
	402.0	475.9

The company also has a number of uncommitted facilities and overdraft lines provided by its core relationship banking group.

22 BORROWINGS AND NET DEBT continued

ANALYSIS OF CHANGES IN NET DEBT	Borrowings			Net debt £m
	Cash and deposits £m	Under one year £m	Over one year £m	
As at 1 August 2001	117.2	(342.6)	(894.4)	(1,119.8)
Net cash inflow	(1.4)	226.0	7.5	232.1
Other movements in cash/borrowings	(0.1)	(61.6)	203.4	141.7
Exchange variation	(6.2)	14.5	12.5	20.8
AS AT 31 JULY 2002	109.5	(163.7)	(671.0)	(725.2)

FINANCING	2002 £m	2001 £m
Reduction in term borrowings	(141.8)	(456.3)
Share issues	17.5	8.1
Total financing	(124.3)	(448.2)

Management of liquid resources defined as short-term deposits shown in the cash-flow statement comprises a reduction of £0.1m in deposits.

23 FINANCIAL INSTRUMENTS

a) Fair values of financial assets and liabilities

The company uses financial instruments to raise finance for its operations and manage the related financial risks. Acceptable derivative instruments for hedging are forward currency contracts, currency and interest rate swaps and options, spot and forward rate agreements, collars, caps, floors, cylinders and similar bank products. Counterparties for hedging are limited to our relationship banks with credit ratings of A- or better to avoid unnecessary credit risk. Short-term debtors and creditors have been excluded from all the following disclosures, other than the currency risk disclosures. The company's policy forbids trading or speculation in financial instruments. Where the underlying transaction being hedged disappears or is cancelled or does not arise, the related financial instrument must also be cancelled or otherwise negated as soon as possible.

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 prices 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.

	2002 Book value £m	2002 Fair value £m	2001 Book value £m	2001 Fair value £m
Cash	109.5	109.5	117.2	117.2
Borrowings – short-term	(163.7)	(163.7)	(342.6)	(342.6)
– long-term	(671.0)	(715.3)	(894.4)	(938.3)
Net debt – book value/fair value	(725.2)	(769.5)	(1,119.8)	(1,163.7)
Derivative financial instruments – interest rate swaps	0.4	12.7		9.8
– currency rate swaps	8.8	8.7		0.1
– forward currency contracts		5.5		(17.5)
Preference shares (note 17)	325.0	325.0	325.0	325.0
Net financial liabilities – book value/fair value	(391.0)	(417.6)	(794.8)	(846.3)

The company's policy is to hedge all material contractually committed future sales using forward exchange contracts and currency options. The transactions to which the forward currency contracts relate are mainly expected to occur in 2003 and 2004. Currency rate swaps protect the group from transaction exposure in line with its policy as set out in note 23(e) and interest rate swaps are used to ensure that the group's debt is broadly evenly split between fixed and floating rate funds.

NOTES TO THE ACCOUNTS continued

23 FINANCIAL INSTRUMENTS continued

b) Hedges	Unrecognised gains £m	Unrecognised (losses) £m	Deferred total net gains £m	Total 2002 £m
Net gains/(losses) on hedges at 1 August 2001	21.7	(29.3)	9.1	1.5
Net gains/losses arising in previous years included in 2002 income	(6.0)	15.4	(2.9)	6.5
Net gains/(losses) not included in 2002 income arising before 1 August 2001	15.7	(13.9)	6.2	8.0
Change in market value of hedges not recognised in year	2.4	8.3		10.7
Gains and losses arising in 2002 that were not recognised in that year	10.0	(4.8)		5.2
AT 31 JULY 2002	28.1	(10.4)	6.2	23.9
Of which:				
Expected to be included in 2003 income	9.1	(5.8)	1.4	4.7
Expected to be included in 2004 income or later	19.0	(4.6)	4.8	19.2

	Unrecognised gains £m	Unrecognised (losses) £m	Deferred total net gains £m	Total 2001 £m
Net gains/(losses) on hedges at 1 August 2000	14.8	(33.6)	9.4	(9.4)
Net gains/losses arising in previous years included in 2001 income	(5.6)	11.0	(0.3)	5.1
Net gains/(losses) not included in 2001 income arising before 1 August 2000	9.2	(22.6)	9.1	(4.3)
Gains and losses arising in 2001 that were not recognised in that year	12.5	(6.7)		5.8
At 31 July 2001	21.7	(29.3)	9.1	1.5
Of which:				
Expected to be included in 2002 income	10.1	(14.6)	2.9	(1.6)
Expected to be included in 2003 income or later	11.6	(14.7)	6.2	3.1

The unrecognised gains on hedges at 31 July 2002 largely relate to forward currency contracts which have appreciated as a result of the weakening of the US Dollar. However, 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.

c) Interest management

The net interest cash-flow is analysed below:

	2002 £m	2001 £m
Interest received	5.8	11.1
Financing gains	1.0	2.5
Interest paid	(63.3)	(131.5)
Net interest	(56.5)	(117.9)

d) Financial assets	Preference shares (note 17)		Bank balances and cash		Short-term deposits	
	2002 £m	2001 £m	2002 £m	2001 £m	2002 £m	2001 £m
Sterling	325.0	325.0	12.9	11.8	20.7	12.9
US Dollar			8.1	5.0	2.0	2.8
Canadian Dollar			28.9	25.9	0.2	
Euro			10.7	14.9	1.2	0.8
Yen			7.3	8.7		7.3
Other			14.4	23.6	3.1	3.5
	325.0	325.0	82.3	89.9	27.2	27.3
Weighted average interest rate on interest bearing balances			2.18%	3.65%	4.15%	3.14%

The company strives to minimise the level of surplus cash balances but where these arise, tight controls apply to ensure that they are securely placed with highly rated counterparties and are available for redeployment around the group at short notice.

The bank balances and cash comprise £60.7m in respect of short-term balances earning interest, £17.0m in respect of balances which are non-interest earning and £4.6m held as compensating credits against Yen term loans. Short-term deposits are invested for periods with maturity under one year.

23 FINANCIAL INSTRUMENTS continued

e) Currency exposures

Transactions

All material cross-border trading contracts or forecast commitments are hedged at inception by appropriate derivative financial instruments, with the company's core banks as counterparties. The company takes competitive quotes on all major foreign exchange contracts through its central foreign exchange programme. For smaller deals, the company has centralised the entire group's foreign exchange dealings through an e-based foreign exchange trading system operated by a major bank.

The analysis below shows the net monetary assets and liabilities of the group companies that are not denominated in their functional currency and therefore give rise to exchange gains and losses in the profit and loss account. The amounts shown in the table take into account the effect of hedging instruments used to manage these exposures.

Functional currency of group companies	2002 Net foreign currency monetary assets/(liabilities)			
	Sterling £m	US Dollar £m	Euro £m	Other £m
Sterling		11.2	3.0	1.3
US Dollar	[0.1]		1.4	0.8
Euro	0.2	1.1		[0.4]
Other	0.7	8.6	[0.3]	1.4
AS AT 31 JULY 2002	0.8	20.9	4.1	3.1

There were no material financial exposures to foreign exchange gains or losses on monetary assets and monetary liabilities denominated in foreign currencies at 31 July 2001.

Translation

The company protects its reserves from foreign currency fluctuations by ensuring that at least 75% of the total net overseas operational assets are offset, either by borrowings in the respective currency or by currency swaps. The company does not hedge the translation of its overseas profits, although does mitigate currency effects through foreign interest costs and by applying average exchange rates for the year.

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.

24 OPERATING LEASE COMMITMENTS

At 31 July 2002 the company had annual commitments under non-cancellable operating leases as follows:

	Land and buildings £m	Others £m
Expiring in less than one year	4.2	4.8
Expiring between one and five years	11.1	9.5
Expiring after five years	15.2	0.1
	30.5	14.4

NOTES TO THE ACCOUNTS continued

25 PROVISIONS FOR LIABILITIES AND CHARGES	At 1.8.01 £m	Exchange adjustments £m	Profit and loss account		Acquisitions £m	Utilisation £m	Disposals £m	At 31.7.02 £m
			Provisions £m	Releases £m				
CONSOLIDATED								
Post-retirement healthcare	91.4	(6.5)	6.2			(4.9)		86.2
Service guarantees and product liability	32.8	(1.1)	16.9		0.2	(14.1)		34.7
Reorganisation	43.2	(0.6)	34.6			(40.1)		37.1
Property	21.2	(0.3)	11.4	(6.7)		(5.6)		20.0
Litigation	8.9	(0.1)	12.3	(1.6)		(1.2)		18.3
	197.5	(8.6)	81.4	(8.3)	0.2	(65.9)		196.3
Discontinued businesses	9.7					(0.1)	(9.6)	
	207.2	(8.6)	81.4	(8.3)	0.2	(66.0)	(9.6)	196.3
DEFERRED TAXATION (note 20)	27.7							6.2
Total provisions for liabilities and charges	234.9							202.5
COMPANY								
Post-retirement healthcare	2.8		1.0		10.2	(1.0)		13.0
Service guarantees and product liability	6.7		4.6			(4.3)		7.0
Reorganisation	0.2		10.1		0.8	(4.3)		6.8
Property	1.8		3.3		5.0	(4.0)		6.1
Litigation			0.3					0.3
	11.5		19.3		16.0	(13.6)		33.2
Deferred taxation (note 20)								15.9
	11.5							49.1

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 Sealing Solutions, have been undergoing a phased restructuring programme. Full provision is made for reorganisation approved and committed by the end of each financial year. This year's balance relates mainly to Aerospace. This restructuring should be completed by July 2003.

Property

As stated in the accounting policies on page 55, where a property is vacant, or sub-let under terms such that rental income is insufficient to meet all outgoings, the company provides for the expected 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. Provisions totalling £6.7m were released following a reassessment of certain future obligations.

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 expected fees and associated costs, based on professional advice as to the likely duration of each case. Provisions totalling £1.6m were released relating to litigation settled at less than the expected cost.

26 ACQUISITIONS

During the year under review the company acquired the businesses set out below. The fair values are provisional, and will be finalised in the 2003 accounts.

Businesses acquired	Dates of acquisition	Consideration (including assumed borrowings, net of cash deposits) £m	Goodwill £m	Net assets £m
Bivona	31.10.01	24.3	18.4	5.9
Abbott anaesthesia kit business	20.12.01	20.9	15.9	5.0
Summitek	2.12.01	6.8	4.9	1.9
Able	1.4.02	12.6	9.6	3.0
		64.6	48.8	15.8

Further performance-related consideration of up to £6.4m may become payable in relation to Able.

Assets acquired	Book value £m	Revaluation £m	Consistency of accounting policy £m	Fair value £m
Fixed assets	4.2	[0.7]		3.5
Stocks	9.2		[1.0]	8.2
Debtors	4.8		[0.1]	4.7
Creditors	[3.6]		[0.4]	[4.0]
Provisions			[0.2]	[0.2]
Taxation	[0.1]	3.6	0.1	3.6
Net assets acquired	14.5	2.9	[1.6]	15.8
Goodwill				48.8
Consideration – satisfied by cash				64.6
Deferred consideration on prior year acquisitions				1.9
Total acquisition spend				66.5

The acquired businesses at date of acquisition had cash deposits of £1.3m.

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

Stock and work in progress – reduction of book value to net realisable value where lower than cost, or subject to write-down where stock levels exceed anticipated future requirements.

Taxation – the revaluation of the tax asset arises from FRS19 which requires deferred tax on the purchase of goodwill to be recognised.

Fair values on acquisitions made in 2001 have now been finalised.

Goodwill arising on acquisitions made in 2002 is being amortised over its estimated useful economic life of 20 years.

NOTES TO THE ACCOUNTS continued

27 DISPOSALS

The principal disposal during the year was John Crane-Lips which was sold in April 2002. The table below shows the details of the transaction.

JOHN CRANE-LIPS	£m
PROCEEDS RECEIVED	234.8
NET ASSETS AT DATE OF SALE	
Tangible fixed assets	19.7
Associates	1.7
Stocks	26.9
Debtors	62.1
Creditors	(68.2)
Provisions	(4.0)
Net cash	23.0
Tangible net assets	61.2
Capitalised goodwill	4.3
	65.5
COSTS AND RETAINED LIABILITIES	
Transaction costs	7.9
Provisions for retained liabilities	8.7
	16.6
SURPLUS OF PROCEEDS OVER NET ASSETS, COSTS AND EXPENSES	152.7
Goodwill previously written off to reserves	(145.6)
PROFIT ON SALE	7.1

The total consideration was £234.8m. This included payment for cash balances of £23m. The consideration net of deconsolidated cash was £211.8m. The transaction costs included £3.9m costs to cancel financial instruments previously taken out in connection with the acquisition of the Lips business.

JOHN CRANE-LIPS AND OTHER DISPOSALS – PROFIT/(LOSS) ON DISPOSAL	John Crane-Lips £m	Other £m	Total £m
Proceeds less costs and retained liabilities	218.2	42.6	260.8
Net assets	65.5	70.4	135.9
Profit/(loss) on sale	152.7	(27.8)	124.9
Goodwill previously written off to reserves	(145.6)	(3.6)	(149.2)
Profit/(loss) on sale	7.1	(31.4)	(24.3)

The principal other disposal was the Vacuum and Filtration business previously acquired as part of the acquisition of EIS Group plc. The net assets of this business were £40.6m. The disposals contributed £12m to cash-flow from operating activities.

In 2001, an exceptional item of £125m was charged through the profit and loss account relating to goodwill previously written off to reserves in respect of disposals. £86m of this relates to the other disposals in 2002.

28 CALLED UP SHARE CAPITAL	Shares	Issued capital £m	Consideration £m
At 1 August 2001	555,644,327	138.9	
Exercise of share options	2,687,742	0.7	17.5
AT 31 JULY 2002	558,332,069	139.6	17.5

28 CALLED UP SHARE CAPITAL continued

The authorised capital at 31 July 2001 and 2002 consisted of 800,000,000 shares of 25p each.

At 31 July 2002 the following options had been granted and were still outstanding:

	Date issued	Number of shares	Subscription prices	Dates normally exercisable
SAYE	1995	24,634	384.0p	2000-2002
	1996	219,633	572.0p	2001-2003
	1997	203,032	632.0p	2000-2004
	1998	574,051	669.0p	2001-2005
	1999	470,995	721.0p	2002-2006
	2000	1,034,414	612.0p	2003-2007
	2001	1,752,086	608.0p	2004-2008
	2002	1,356,274	645.0p	2005-2009
EXECUTIVE	1993	17,671	347.0p	1996-2003
	1993	11,606	395.0p	1996-2003
	1994	69,160	451.0p	1997-2004
	1995	62,500	480.0p	1998-2005
	1995	158,835	632.0p	1998-2005
	1996	383,545	823.0p	1999-2006
	1997	531,919	934.0p	2000-2007
	1998	951,742	765.0p	2001-2008
	1999	1,016,661	858.5p	2002-2009
	2000	1,233,639	750.0p	2003-2010
	2000	55,424	765.0p	2003-2010
	2000	190,934	809.0p	2003-2010
	2001	1,748,603	790.0p	2004-2011
	2002	4,051,999	806.0p	2005-2012
SAYE (EX-TI GROUP PLC)	1995	24,804	689.19p	2002
	1996	25,518	853.86p	2001-2003
	1997	94,167	886.39p	2002-2004
	1998	326,105	719.68p	2001-2005
	1999	241,739	805.07p	2002-2006
	2000	712,950	587.54p	2003-2007
EXECUTIVE (EX-TI GROUP PLC)	1992	2,459	539.76p	2001-2002
	1993	48,204	612.95p	2001-2003
	1993	4,426	716.63p	2001-2003
	1994	86,073	846.74p	2001-2004
	1994	241,015	759.33p	2001-2004
	1995	66,893	765.42p	2001-2005
	1995	70,827	875.21p	2001-2005
	1996	185,921	1,058.18p	2001-2006
	1996	131,058	1,121.20p	2001-2006
	1997	454,977	1,097.82p	2001-2007
	1997	794,612	1,219.80p	2001-2007
	1998	762,142	1,026.66p	2001-2008
	1998	448,071	849.79p	2001-2008
	1999	643,620	943.31p	2002-2009
	1999	1,515,955	907.23p	2002-2009
	1999	543,984	1,103.92p	2002-2009
	2000	1,382,398	661.23p	2003-2010
	2000	1,022,952	626.16p	2003-2010
	2000	73,044	672.92p	2003-2010

NOTES TO THE ACCOUNTS continued

	Share premium account £m	Revaluation reserve £m	Merger reserve £m	Profit and loss account £m
29 SHARE PREMIUM ACCOUNT AND RESERVES				
CONSOLIDATED				
At 1 August 2001	146.1	3.2	234.8	342.7
Prior period adjustment – FRS19 Deferred Taxation				(26.0)
At 1 August 2001 (as restated)	146.1	3.2	234.8	316.7
Premium on allotments	17.6			(0.8)
Retained profit				49.1
Write-back of goodwill on disposals				149.2
Revaluation surplus realised on property disposals		(0.6)		0.6
Exchange rate changes (including tax on recognised gains)				(57.3)
AT 31 JULY 2002	163.7	2.6	234.8	457.5
COMPANY				
At 1 August 2001	146.1	0.5	180.5	118.4
Premium on allotments	17.6			(0.4)
Exchange rate changes				(18.4)
Retained profit				15.5
AT 31 JULY 2002	163.7	0.5	180.5	115.1

The retained profit of the company represents a profit for the year of £157.7m less dividends payable of £142.2m.

During the year the company received £18.3m on the issue of shares in respect of the exercise of options awarded under various share option schemes. Employees paid £17.5m for the issue of these shares and the balance of £0.8m 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.

Goodwill relating to acquisitions made before 1 August 1998 and written off to reserves amounted to £1,604.1m (2001 £1,753.3m).

	2002 £m	2001 £m
30 MOVEMENTS IN SHAREHOLDERS' EQUITY		
Profit/(loss) for the year	191.3	(206.0)
Dividends	(142.2)	(199.5)
Exchange variations	49.1	(405.5)
Taxation recognised on exchange gains (losses):	(60.6)	(10.3)
Current – UK	(1.2)	
Deferred – USA	4.5	(2.4)
Share issues	17.5	26.2
Write-back of goodwill on disposals	149.2	470.3
Net increase in shareholders' equity	158.5	78.3
Shareholders' equity:		
At 1 August 2001	865.7	787.4
Prior period adjustment – FRS19 Deferred Taxation	(26.0)	(26.0)
Shareholders' equity at 1 August 2001 (as restated)	839.7	761.4
AT 31 JULY 2002	998.2	839.7

	2002 £m	2001 £m
31 CONTINGENT LIABILITIES		
The parent company has guaranteed the 8.34% Senior Notes 2002 and the 8.853% Senior Notes 2003 privately placed by a subsidiary. The \$100m of 8.34% Senior Notes 2002 were repaid in August 2002	89.7	69.9

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. FRS19 – Deferred Taxation has been adopted during the year to 31 July 2002.

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. Goodwill impairment on prospective disposals is recognised through the profit and loss account.

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, premia and related costs of issue 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 retranslation 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

Deferred tax is recognised in respect of timing differences that have originated but not reversed as at the balance sheet date. Timing differences are differences between the group's taxable profits and its results as disclosed in the financial statements, arising from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

Deferred tax is recognised in respect of the retained earnings of overseas subsidiaries and associates only to the extent that, at the balance sheet date, dividends have been declared or an obligation is present to distribute past earnings. Deferred tax is not recognised on any fixed assets that have been revalued unless there is a binding agreement to sell the asset.

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.

FIVE YEAR REVIEW

	2002 £m	2001 £m	2000 £m	1999 £m	1998 £m
TURNOVER – CONTINUING OPERATIONS	3,070.1	3,132.4	2,740.2	2,470.4	2,126.4
– DISCONTINUED OPERATIONS	153.4	1,825.8	1,912.7	1,300.9	1,010.7
	3,223.5	4,958.2	4,652.9	3,771.3	3,137.1
OPERATING PROFIT – CONTINUING OPERATIONS	452.4	499.5	437.0	391.9	358.9
– DISCONTINUED OPERATIONS	9.9	151.8	185.8	139.3	110.9
	462.3	651.3	622.8	531.2	469.8
GOODWILL AMORTISATION	(50.7)	[48.7]	[35.5]	[5.9]	
OPERATING PROFIT (AFTER GOODWILL AMORTISATION)	411.6	602.6	587.3	525.3	469.8
NET INTEREST	(57.5)	[116.2]	[80.7]	[46.7]	[22.6]
PROFIT BEFORE EXCEPTIONAL ITEMS	354.1	486.4	506.6	478.6	447.2
EXCEPTIONAL ITEMS	(68.0)	[598.7]	[22.6]	[15.0]	3.7
PROFIT BEFORE TAXATION	286.1	[112.3]	484.0	463.6	450.9
PROFIT AFTER TAXATION	192.6	[204.4]	325.7	316.8	305.7
MINORITY INTERESTS	(1.3)	[1.6]	[1.7]	[1.1]	[2.3]
SHAREHOLDERS' EQUITY	998.2	839.7	787.4	605.7	275.8
Represented by:					
Intangible fixed assets	638.3	678.3	851.4	380.5	0.0
Tangible fixed assets and investments	900.5	957.2	1,018.8	907.8	723.0
Net current assets	184.6	324.0	382.9	290.8	193.8
Net debt	(725.2)	[1,119.8]	[1,465.7]	[973.4]	[641.0]
Funds employed	998.2	839.7	787.4	605.7	275.8
Goodwill charged directly to reserves	1,604.1	1,753.3	2,223.6	2,223.6	2,222.3
SHAREHOLDER INVESTMENT	2,602.3	2,593.0	3,011.0	2,829.3	2,498.1
RATIOS					
Operating profit before goodwill amortisation: turnover (%)	14.3	13.1	13.4	14.1	15.0
Taxation before goodwill amortisation and exceptional items (%)	28.0	29.2	30.6	30.9	31.2
After tax return on average shareholder investment (%)	11.1	12.5	12.9	12.6	13.1
CASH-FLOW					
Cash-flow from operating activities	583.0	701.0	666.6	551.3	484.9
Less capital expenditure (net)	(100.0)	[188.0]	[168.2]	[135.1]	[102.2]
Operating cash after capital expenditure	483.0	513.0	498.4	416.2	382.7
Free cash-flow (before acquisitions and dividends, after capital expenditure)	314.5	205.3	336.5	223.7	215.7
FREE CASH-FLOW PER SHARE (P)	56.5	37.1	61.7	41.8	40.9
EARNINGS PER SHARE BEFORE GOODWILL AMORTISATION AND EXCEPTIONAL ITEMS (P)	52.1	68.3	68.6	62.7	58.4
DIVIDENDS					
Pence per share	25.5	25.0	23.80	21.65	19.65
Times covered before goodwill amortisation	2.0	2.7	2.5	2.4	2.4
NUMBER OF EMPLOYEES (000'S)					
UK	10.7	13.5	15.1	15.4	15.6
Overseas	22.3	24.2	45.7	37.4	32.3
	33.0	37.7	60.8	52.8	47.9

FINANCIAL CALENDAR

2002

Preliminary announcement of results for 2001-2002

SEPTEMBER

25

Ordinary shares final dividend ex-dividend date

OCTOBER

16

Ordinary shares final dividend record date

18

AGM

NOVEMBER

12

Ordinary shares final dividend payment date

15

2003

2002-2003 interim results announced

MARCH

12 provisional

Ordinary shares interim dividend ex-dividend date

19 provisional

Ordinary shares interim dividend record date

21 provisional

Ordinary shares interim dividend payment date

APRIL

17 provisional

Smiths Group plc financial year-end

JULY

31

Preliminary announcement of results for 2002-2003

SEPTEMBER

24 provisional

Ordinary shares final dividend ex-dividend date

OCTOBER

15 provisional

Ordinary shares final dividend record date

17 provisional

AGM

NOVEMBER

11 provisional

Ordinary shares final dividend payment date

14 provisional

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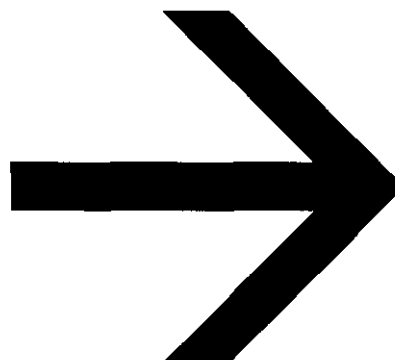
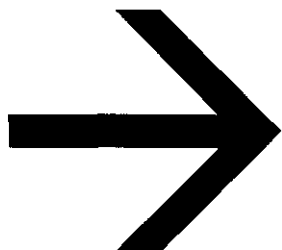
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