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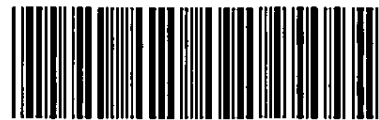
smiths

bringing technology to life

Opportunities to create value

Annual report 2009

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Smiths Group plc

Smiths is a global technology company listed on the London Stock Exchange. A world leader in the practical application of advanced technologies, Smiths Group delivers products and services for the threat and contraband detection, energy, medical devices, communications and engineered components markets worldwide. Our products and services make the world safer, healthier and more productive.

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Front cover images

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The purpose of this Report is to provide information to the members of the Company. The Annual Report contains certain forward-looking statements with respect to the operations, performance and financial condition of the Group. By their nature, these statements involve uncertainty since future events and circumstances can cause results and developments to differ materially from those anticipated. The forward-looking statements reflect knowledge and information available at the date of preparation of this Annual Report and the Company undertakes no obligation to update these forward-looking statements. Nothing in this Annual Report should be construed as a profit forecast.

Summary performance

Annual results for the year ended 31 July 2009

	Headline*				Statutory	
	2009 £m	2008 £m	Growth	Underlying†	2009 £m	2008 £m
Continuing activities						
Sales	2,665	2,321	15%	(7%)	2,665	2,321
Operating profit	418	381	10%	(13%)	429	326
Operating margin	15.7%	16.4%	–	–	16.1%	14.0%
Pre-tax profit	371	380	(2%)	(21%)	371	319
Basic EPS	72.4p	74.5p	(3%)		70.8p	63.0p
Free cash-flow	256	91				
Dividend (per share)	34.0p	34.0p			34.0p	34.0p

*In addition to statutory reporting, Smiths Group reports its continuing operations on a headline basis. Headline profit is before exceptional items, amortisation of acquired intangible assets, profit/loss on disposal of businesses and financing gains/losses. Free cash-flow is described in the Financial review.

†Organic growth at constant currency.

Continuing activities

Sales (£m)

2009	2,665
2008	2,321
2007	2,161
2006	2,180

Headline operating profit (£m)

2009	418
2008	381
2007	348
2006	345

Headline earnings per share (pence)

2009	72.4
2008	74.5
2007	47.0
2006	41.5

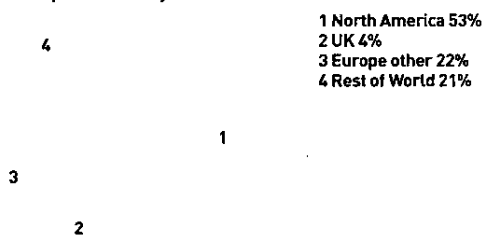
Dividend per share (pence)

2009	34.0
2008	34.0
2007	34.0
2006	31.35

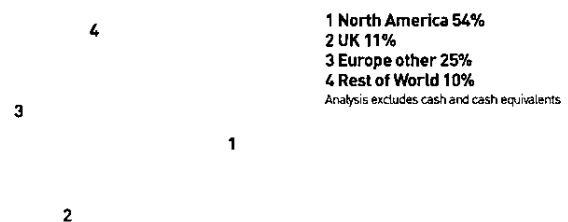
Smiths Group: a global business

Smiths has evolved substantially since its foundation. Now employing around 22,000 people in more than 50 countries, we serve a diverse range of global customers including governments and their agencies, petrochemical companies, hospitals, telecommunications companies and manufacturers in a variety of sectors around the world.

Group sales by destination



Location of assets



Smiths Group major manufacturing and service locations by division

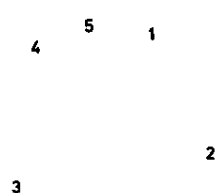
Smiths Detection
John Crane
Smiths Medical
Smiths Interconnect
Flex-Tek

Divisional sales



1 Smiths Detection 19%
2 John Crane 30%
3 Smiths Medical 31%
4 Smiths Interconnect 12%
5 Flex-Tek 8%

Divisional headline operating profit



1 Smiths Detection 14%
2 John Crane 32%
3 Smiths Medical 37%
4 Smiths Interconnect 12%
5 Flex-Tek 5%
Percentage relates to headline operating profit before corporate costs

Smiths divisions

Smiths Group has five divisions: Smiths Detection, John Crane, Smiths Medical, Smiths Interconnect and Flex-Tek. Our businesses are highly competitive, with strong technology positions, and operate in sectors with excellent opportunities for growth.

We bring technology to life.

Smiths Detection

Smiths Detection is a world-leading designer and manufacturer of sensors that detect and identify explosives, narcotics, weapons, chemical agents, biohazards and contraband.

Contribution to 2009 sales

19%

Contribution to 2009 headline operating profit*

14%

Operational priorities

- Bring new technologies to market
- Roll-out checkpoint and cargo screening systems
- Seek complementary technologies through acquisition
- Implement cost reduction initiatives
- Complete the roll-out of single ERP business system

Customers

A significant majority of sales are influenced by more than 100 governments and their agencies, including homeland security authorities, customs authorities, emergency responders and the military. These include the US Department of Defense, US Transportation Security Administration (TSA), UK Ministry of Defence, and airport operators such as BAA in the UK.

Key strengths

- Market leader with a global presence
- Strong technology positions and excellent product engineering skills
- Access to growth markets
- Investment in R&D increasing to support innovative product launches

Employees

2,400

John Crane

John Crane is a world-leading provider of products and services for the major process industries. These include the oil and gas, power generation, chemical, pharmaceutical, pulp and paper, and mining sectors.

Contribution to 2009 sales

30%

Contribution to 2009 headline operating profit*

32%

Operational priorities

- Deliver the restructuring programme and associated operational efficiencies
- Expand technology footprint through acquisitions
- Build new upstream services business that uses existing global network
- Increase original equipment sales and manufacturing capacity and extend global customer service network

Customers

John Crane serves oil & gas and power generation companies, refineries, pump and compressor manufacturers, chemical and other process industries. Its main customers include BP, Chevron, China Petroleum, ConocoPhillips, ExxonMobil, Gazprom, Qatargas, Saudi Aramco, Shell, Petrom, Total, Dresser, Elliot, Flowserve, GE Nuovo Pignone, GE Energy and Power, Andritz Hydro, Siemens and ITT.

Key strengths

- Two-thirds of revenue from aftermarket service
- Market leader in its field, blue chip customer base
- Driven by long-term demand for energy
- Good positions in key markets

Employees

6,600

Smiths Medical

Smiths Medical is a leading supplier of specialist medical devices and equipment for global markets. Our products are focused in the medication delivery, vital care and safety devices market segments.

Contribution to 2009 sales

31%

Contribution to 2009 headline operating profit*

37%

Operational priorities

- Complete ERP implementation and optimise supply chain
- Reduce business complexity through portfolio rationalisation
- Leverage global product development process and increase percentage of sales from products under three years old
- Scope to reduce costs and improve margins

Customers

Smiths Medical estimates that around three-quarters of its end customers are hospitals with the remainder comprising the alternate care market such as home care and other surgery centres. We have a direct sales presence in 20 countries with distribution arrangements in many others.

Key strengths

- Established brands with practitioner loyalty
- Global sales & marketing network
- Increasing roll-out of new products
- Focusing increased R&D investment on higher growth segments and markets

Employees
7,400

Smiths Interconnect

Smiths Interconnect designs and manufactures specialised electronic and radio frequency products that connect, protect and control critical systems for global wireless telecommunications, aerospace, defence, space, rail, medical and industrial markets.

Contribution to 2009 sales

12%

Contribution to 2009 headline operating profit*

12%

Operational priorities

- Expand globally from US base
- Leverage market knowledge and customer relationships throughout the business
- Add new technologies and territories through bolt-on acquisitions from fragmented sector
- Rationalise manufacturing and continue to move to lower cost markets

Customers

Smiths Interconnect supplies to multiple levels of the supply chain and its blue chip customers include primes and service providers, OEMs, system suppliers and sub-system manufacturers. Amongst our largest customers are Raytheon, Finmeccanica, BAE Systems, Boeing, AAI/Textron, Northrop Grumman, General Dynamics, Lockheed Martin, Ericsson, Motorola, AT&T, Verizon, Sprint Nextel, Emerson, ZTE, Huawei, GE Medical and Alstom.

Key strengths

- Technical differentiation providing barriers to entry for competition
- Strong brands recognised by customers
- Excellent military programme positions
- Positive market dynamics in wireless infrastructure and defence

Employees
3,350

Flex-Tek

Flex-Tek provides engineered components that heat and move fluids and gases for the aerospace, medical, industrial, construction and domestic markets.

Contribution to 2009 sales

8%

Contribution to 2009 headline operating profit*

5%

Operational priorities

- Expand non-construction market activities eg aerospace and medical
- Exploit growth potential in Asian industrial and appliance markets
- Develop new products to drive revenue growth and returns
- Continue the site rationalisation programme

Customers

Flex-Tek serves mainly aerospace engine and airframe manufacturers, domestic appliance manufacturers and the US construction industry. Large customers include Whirlpool, Electrolux, Trane, Carrier, Boeing, Airbus, Pratt & Whitney, GE Aerospace, and Resipronics.

Key strengths

- Strong positions in niche markets
- Lean manufacturing culture with strong cost control
- Good performance in markets other than US construction market, civil and military aircraft demand rising

Employees
2,000

*Percentage relates to headline operating profit before corporate costs

Chairman's statement

After a year of economic turmoil, it is gratifying to report that Smiths Group has emerged relatively unscathed. A combination of management initiatives, geographically diverse markets and largely defensive businesses has resulted in a resilient performance under truly challenging circumstances.

Donald Brydon
Chairman

In the 2008 statement, I deliberately sounded a note of caution when looking at the prospects for the year. However, few people could have envisaged the sheer severity of the recession which thankfully now appears to be easing. Fortunately, under the management of Philip Bowman, your company had already embarked on a 'self-help' restructuring programme that has gone a long way towards mitigating the worst effects of the downturn. Operating in markets with long-term underlying defensive traits helps. Terror threats remain real and present. Global energy demands show few signs of abating over the long term, and advances in healthcare are still needed to meet the growing needs of ageing populations. Innovations in wireless communications emerge almost daily.

However, government spending priorities, radically revised in response to the global crisis, have taken their toll on Smiths Detection in particular. It has experienced repeated contract deferrals which have put pressure on the order book. Nonetheless, we remain confident that this sector will soon return to long-term growth and that Detection will benefit from its leadership in the roll-out of the next generation of security systems.

So amid today's economic and financial uncertainties, our focus remains firmly on what is within our power to manage or influence. A corporate restructuring programme to cut costs and improve performance is on track towards its savings targets. We have reorganised into five divisions headquartered close to their markets and overseen by a streamlined corporate office in central London. A performance-driven culture permeates the entire Smiths Group and I am confident that the early positive impact of the reorganisation will rapidly accelerate when trading conditions recover.

However, we have not neglected to prepare for the eventual economic upturn. Our product offering and geographic reach have been expanded through a number of bolt-on acquisitions, half of them in Asia Pacific. Equally, innovation and R&D have been the lifeblood of Smiths for well over a century and this remains the case, particularly in Smiths Detection and Smiths Medical. We will continue to support the launch of new products which will in time drive higher margin sales growth.

The Board is also pleased with the Group's steady progress in environment, health and safety. These areas are addressed at the top of the agenda of every management meeting and business review. Our safety performance has exceeded the tougher targets we set ourselves last year. This is, in part, because we are now monitoring near misses as well as incidents and therefore can get closer to their root cause. On the environment, three-year targets were set in August 2007 to be achieved by July 2010 for greenhouse gas emissions, waste disposal and water consumption. Each of our key indicators shows improvement, currently beating our goals. Our Code of Business Ethics has been revised and strengthened and is now available in all our main operating languages. Since its launch a year ago, almost all staff have now been trained in its 12 core principles.

I would like to acknowledge the contributions made by our non-executive directors; in particular Peter Jackson, who will retire after the AGM in November. I want to thank him for his role in the success of Smiths Group over recent years. The Board has benefited from his wisdom, guidance and perspective. I am delighted to welcome a new non-executive director, Anne Quinn, who joined us on 1 August. I look forward to working with her in the coming years. The Board takes its corporate governance responsibilities very seriously and undertakes regular evaluations of its performance. To reinforce this approach, the directors have decided to offer themselves up for re-election on an annual basis with effect from the 2010 AGM, rather than triennially as is current practice.

The next 12 months will continue to make great demands on us all. The economic outlook, while less bleak than a year ago, remains extremely challenging. Pressure on sales and margins is intense. We will continue to focus on the restructuring 'self-help' initiatives that are underway, on improving our business systems to drive efficiencies and improve decision-making, and on consolidating the business through targeted acquisitions.

Overall, I believe that Philip, his team and all the staff, deserve our thanks for what they have achieved during an exceptionally tough year. Operational improvements across the divisions are firmly on track. Combined with our performance-driven culture, they will provide a solid foundation to deliver enhanced value to shareholders.

Chief Executive's statement

The past year has been marked by significant economic instability affecting most companies across the world. Although Smiths Group has not been immune from the associated challenges, we have continued to make solid progress in driving operational improvements and better cash generation. The breadth of our portfolio and its exposure to a wide range of end markets and geographies has provided both resilience in these testing times and support for sales and profit growth.

Sales +15%

£2,665m

Headline operating profit +10%

£418m

Statutory operating profit +32%

£429m

Philip Bowman
Chief Executive

Many parts of Smiths Group have benefited from the defensive nature of their end markets or have been able to respond quickly in cutting costs to preserve margins and increase cash generation. John Crane has succeeded in growing its underlying margins through cost savings despite its sales of original equipment coming under pressure during the year. At the same time, two-thirds of John Crane's sales are in aftermarket servicing which has proved more resilient. We have made further progress in improving the supply chain in Smiths Medical and in reshaping its product portfolio. Although demand for medical devices increases steadily as populations age and become more prosperous, reduced hospital capital budgets and our exit from the diabetes market curtailed Smiths Medical's hardware revenues during the year. However, sales of single-use consumable items have been more robust. Smiths Detection is driven by security risks that demand increased protection and detection capability. However, as previously announced, its order flow was significantly lower this year – particularly in the ports and borders segment – as some governments have delayed projects or airport operators have reviewed their infrastructure plans. Smiths Interconnect has benefited from continued growth in its largest end market which serves several long-term military programmes, while investment by telecom wireless infrastructure providers has slowed. Flex-Tek is exposed to more cyclical markets such as US housing and domestic appliances, but it has also made solid progress in preserving margins through cost management and pricing.

A year ago, I outlined several opportunities for Smiths Group to improve performance progressively over a three-year period and generate value for shareholders. We have made excellent progress towards these goals:

- The restructuring programme announced last year has delivered savings in the year of £17m which reflects the successful implementation of several initiatives;
- The improvement of our business systems to support better data-driven decision-making is on schedule, with ERP programmes progressing well in Smiths Detection, John Crane and Smiths Medical;
- Our investment in better operational data is enabling us to leverage our scale more effectively across the Group with a new procurement initiative which delivered £9m of savings in the year;
- We have strengthened the product portfolio and extended our geographic reach through three acquisitions;

Chief Executive's statement continued

Headline earnings per share

72.4p

Statutory earnings per share

70.8p

Dividend per share

34.0p

Group R&D investment increased by 22%

£105m

Employees around the world

21,800

- Smiths Medical is rationalising its portfolio of low-margin and loss-making products with the first 3,000 to be eliminated by the end of October 2009;
- We have also significantly increased our investment in R&D to drive future growth through new product initiatives;
- While the pension deficit increased in the year as a result of falling stock markets, we have taken positive action to reduce our liabilities by limiting our exposure to post-retirement benefit obligations; and
- Our balance sheet has been strengthened through the issue of \$675m of long-term debt while we have also substantially increased free cash-flow.

At the end of last year we launched a major restructuring programme across the Group which has delivered savings of £17m in the year. The reorganisation of the corporate HQ is now complete and, as a result, we have delivered savings of £5m. To date we have delivered overall annualised savings of £17m and have spent £28m, with £24m in the year. Together, the programmes are expected to produce annual savings of £50m when completed in 2011, slightly ahead of the £47m originally forecast. The total cost of delivering these programmes is expected to be £45m, lower than the £48m originally planned.

Our investment in better information systems to enhance data flow and speed up decision-making is starting to deliver results. ERP systems are currently being deployed in Detection, John Crane and Medical where, in the past year, we achieved successful implementations at a total of 36 sites across these divisions. As a result, we are on track to complete the on-going projects during the current financial year.

Improved data at a Group and divisional level is creating opportunities to leverage the Group's scale through Group-wide procurement initiatives. In the year, this programme delivered £9m savings from IT, utilities, freight, packaging, ceramics and injection moulding, among others. Looking ahead, there are further opportunities in these areas as well as travel, raw materials, printed circuit boards and many others. Overall, the programme is expected to deliver further savings of £11m in the current financial year and enhance margins across the business.

Over the past two years, we have made 10 acquisitions, five of which have been in Asia, and all of which have helped to build our portfolio through a combination of adding complementary technologies, supporting geographic expansion or leveraging existing infrastructure. During this year, Smiths Medical acquired a Chinese syringe pump manufacturer, Zhejiang Zheda Medical Instrument Co. Ltd, which gives us access to the fast-growing Chinese healthcare market. Smiths Interconnect purchased Shenzhen Dowin Lightning Technologies, a manufacturer of power and signal protection devices operating mainly in the wireless telecoms market. John Crane also extended the presence and capabilities of its engineered bearings offering through the acquisition in May of Orion Corporation, a leading US designer and manufacturer of hydrodynamic bearings.

We have also begun a programme to enhance profitability of the Smiths Medical portfolio by reviewing our customer base and range of stock-keeping units (SKUs). The analysis has already highlighted significant opportunities in pricing, minimum order quantities, customer management and complexity reduction. An early decision from this review was our decision in March 2009 to exit the diabetes business. At the same time, we are working through a programme to reduce the number of low margin, low volume products, which will help improve the overall profitability of the Smiths Medical portfolio over time.

Delivering operational efficiencies

In 2008, we launched a major restructuring programme to reduce costs and deliver operational efficiencies which has achieved £17m of cost savings in the year. As part of these plans, a streamlined corporate office was opened in central London saving £5m.

Our investment in research and development is a key priority as we seek to deliver new product launches and higher levels of organic revenue growth. We are focusing our investment on growth areas that will deliver superior returns. R&D investment for the Group increased by 3%, at constant currency, to £105m; or 22% at reported exchange rates. In Detection, we launched an advanced people-screener which uses patented millimetre-wave technology to reveal a far wider range of threat items than currently possible with traditional technologies. In Medical, we have extended the launch of CADD@-Solis, a leading ambulatory infusion pump, to new markets.

The pension deficit increased during the year as stock markets and asset values have fallen. The impact has been further exaggerated by the downward pressure on yields driven by government quantitative easing programmes. The timing of our interim results made us among the first of what has been many companies to break the news about the deteriorating pension position. As a result, our share price reacted particularly adversely following our interim results. However, since then we have successfully reduced the Company's exposure to these liabilities by closing the defined benefit pension plan in the US and capping our obligations for post-retirement healthcare benefits in the UK and US. Consultation is underway to close the defined benefit pension plan in the UK during the new financial year.

During the year, we have significantly improved our cash generation and strengthened the balance sheet. The maturity profile of our debt was extended through the issue of long-term debt capital: \$175m through a US private placement with a fixed nine-year maturity and via a US bond offering with two tranches of \$250m, with a fixed maturity of five and 10 years respectively. This followed a thorough review of the Group's financing strategy with the objective of extending the maturity of its debt and reducing its dependency on the banking market.

Last September, we set out ranges for sales growth and margins for each of the divisions based on what we believed the businesses could achieve over the medium term in a financial and commercial environment consistent with that of recent years. Since then, the global economy has slowed significantly and, while our businesses are comparatively well placed, it will be harder to operate within these ranges in the near term. In the current environment, the sales growth targets will be more difficult to achieve than the margin targets where we have greater control over delivering cost reductions and efficiencies. However, we remain committed to improving performance and delivering shareholder value consistent with achieving these ranges as the financial markets stabilise and world economies return to growth.

Outlook

Our priority for the coming year is to deliver the cost saving initiatives and build on the improvements in cash-flow while investing in future growth through R&D and expansion in developing markets. Whilst we have yet to see any real evidence of increased demand across our businesses, we are now better positioned to benefit from improved levels of activity when world economies return to more normal levels of growth. Meanwhile, Smiths Detection has had a positive start to the year although we are cautious about how the current economic environment may affect the timing of orders from governments, given that some of their finances remain under significant pressure. Even though John Crane sales have slowed, primarily due to lower OEM sales, margins should continue to improve through its restructuring and efficiency initiatives. Smiths Medical margins should also benefit from the restructuring and cost reduction measures implemented last year while sales will continue to be affected by the exit from diabetes. Several long-term military programmes support over a third of Smiths Interconnect sales while the wireless telecoms and other industrial sectors are likely to continue to be challenging. Flex-Tek sales will be affected by the US residential construction market while its focus on cost control will help maintain margins and make it strongly leveraged to any recovery.

Key strengths

Smiths Group implements its strategy by capitalising on its key corporate strengths, which are common across its portfolio of businesses.

Globally recognised quality brands

Our brands are recognised by customers across the world, particularly in protecting transport, borders and the military (Smiths Detection), supplying vital oil and gas seals and services (John Crane) and airway and pain management and regional anaesthesia (Smiths Medical).

Markets with historic long-term defensive qualities

We operate in markets with historic long-term underlying defensive dynamics. These include security enhancement to combat evolving terror threats, oil and gas production to meet global energy demands, products to meet the growing healthcare needs of ageing populations and continual advances in wireless communications.

Product engineering

Our core competency is leadership in innovation and advanced technology and their practical, commercial applications. These include a new generation of security scanners for airports and borders, advanced testers for mobile phone networks, portable medication delivery systems and solar-powered pumps for remote gas wells.

Small batch, low-cost manufacturing

Access to a global manufacturing and service footprint minimises costs and allows us to sustain margins over the long term. With around 22,000 staff in over 50 countries, we are pushing through a programme of site rationalisation and relocation to low-cost countries, such as Mexico (John Crane, Smiths Medical, Smiths Interconnect and Flex-Tek) and Costa Rica and Tunisia (Smiths Interconnect). We create efficiencies through a lean divisional structure and a focus on customers. We are expanding in high-growth markets such as China and India.

Low capital intensity and strong free cash-flow

Our businesses generally have low requirements for major upfront capital commitments, allowing solid investment in research and development. After working capital and net capital expenditure, our operating cash-flow is a high percentage of operating profit.

Close relationships with blue chip customers and governments

We enjoy strong relationships with our customer base, including blue chip corporates, such as Motorola, Boeing, GE and Shell, governments, such as the US and UK, and government agencies including the TSA.

Delivering operational efficiencies

We see big opportunities to improve margins through self-help and restructuring. Last year we launched a major restructuring programme to sharpen customer focus and cut costs. To date, it has delivered savings of £17m.

We are upgrading our business systems to support faster, data-driven decision-making. This is helping us leverage our scale more effectively and negotiate better terms with our suppliers.

Our global footprint enables us to rationalise operations and relocate manufacturing to low-cost countries such as China, Mexico, Costa Rica, Tunisia and India.

Investing in the business

Research and Development (R&D) is the lifeblood of new products. Successful product launches drive superior sales growth, command higher margins, and confer competitive advantage.

We are focusing our R&D investment more tightly on growth areas that will deliver greater returns. Recent successful product launches include wireless blood pressure monitors in Smiths Medical, body image scanners in Smiths Detection and mobile network testers in Smiths Interconnect.

In parallel, we are investing in expanding our geographic footprint through new and improved facilities such as the new service centres for John Crane in the Middle East and Asia.

An Indufit filtration system which has expanded the John Crane portfolio

Reshaping the portfolio

A key objective for the Group is to optimise the allocation of capital between the different businesses. We are reshaping the portfolio to drive higher returns and to expand our addressable markets. In two years we have made 10 acquisitions that have added complementary technologies, leveraged our infrastructure and extended our geographic reach.

At the same time, we have rationalised the portfolio through divestments and by reviewing profitability of stock keeping units in businesses such as Smiths Medical. This reduces complexity and removes low-margin, low-volume parts of the business to boost margins and returns in the medium term.

Generating cash

Improving cash generation through better working capital management is another primary focus. During the year, we successfully lowered inventories and reduced debtors to improve operating cash conversion from 72% to 104% and free cash-flow from £91m to £256m.

At the same time, we are optimising the Group's capital structure and securing its long-term financing. In the year we raised \$675m of long-term debt capital through a private placement and US bond offer. This extended the maturity of the Group's debt profile and reduced our dependency on the banking market.

Promoting responsibility

Every one of us in Smiths has a duty to promote a culture of responsibility and accountability.

During the year we rolled-out an enhanced Code of Business Ethics, supported by an extensive training programme across all the divisions.

The year was our safest yet, further improving on the positive trend already established in recent years.

We also made good progress towards meeting our challenging three-year environmental goals for reducing water consumption and waste generation and capping greenhouse gas emissions.

Business review: Group

Smiths is a global technology business serving the detection, medical devices mechanical seals, electronic product and engineered component markets.

Strategy

Smiths is committed to creating long-term value for shareholders by building and sustaining strong businesses in growth sectors.

The Group's objective is to create value from organic growth and from reinvestment of self-generated cash-flow. Value can also be generated by managing the portfolio of businesses and enhancing the business mix through both acquisitions and disposals.

Key performance indicators

In implementing the strategy, the Board monitors progress via a wide range of metrics. The key performance indicators are set out in the table below.

Key performance indicators

Strategy	Operational priorities	Key performance indicators	
Growing the business	- Investing in R&D to drive sales growth and margins - Increasing our exposure to growth markets and product categories	Sales (£m)	
		2009	2,665
		2008	2,321
		2007	2,161
Delivering operational efficiencies	- Expanding our margins through a programme of self-help - Delivering efficiencies by restructuring and using our scale more effectively - Focusing on low-cost manufacturing	Headline operating margin (%)	
		2009	15.7
		2008	16.4
		2007	16.1
Reshaping the portfolio	- Making bolt-on acquisitions to add complementary technologies and extend our geographic reach - Rationalisation of product portfolios to maximise profitability - Optimising the allocation of capital between our businesses	Headline return on capital employed	
		2009	16.5
		2008	15.8
		2007	14.0
Generating cash	- Improving working capital management and cash generation - Optimising the capital structure and securing the long-term financing of the Group	Free cash-flow (£m)	
		2009	256
		2008	91
		2007	101
Promoting responsibility	- Conducting our activities to achieve the highest practicable standards of safety - Minimising the impact of our activities on the environment	Recordable incident rate (per 100 employees)	
		2009	1.03
		2008	1.21
		2007	1.89
Greenhouse gas emissions 9% reduction on 2007 baseline			

Sales increased by 15% to

£2,665m

Headline operating profit increased by 10% to

£418m

Statutory operating profit increased by 32% to

£429m

Sales

Sales increased by £344m to £2,665m. Currency translation on overseas sales contributed £449m of this increase while the net impact of acquisitions and disposals increased sales by £75m. On an underlying basis, excluding the effects of currency translation and acquisitions and disposals, sales fell by £180m, or 7%. This £180m underlying decline in sales was driven by:

- Smiths Detection down £99m reflecting the variable nature of the order flow, in particular with lower sales from the ports and borders market;
- Flex-Tek down £38m driven by the recession in US residential construction and domestic appliances, offset in part by growth in sales of fuel and hydraulic hoses to aerospace customers;
- Smiths Medical down £16m as a result of lower diabetes sales following our decision to exit the business and reduced hardware sales;
- Smiths Interconnect down £17m reflecting a slowdown in sales of components and subsystems to the wireless telecoms industry partially offset by continued growth in several military programmes; and
- John Crane down £10m because of lower sales of original equipment.

Profit

Headline operating profit rose £37m to £418m. Headline operating margin decreased by 70 basis points to 15.7% (2008: 16.4%). The increase in headline operating profit comprises £77m from favourable currency translation, £20m from the net impact of acquisitions and disposals made during the year, offset by a £60m, or 13%, decrease in underlying headline operating profit. The main drivers of this £60m underlying decline are:

- John Crane up £9m reflecting the benefit of its restructuring initiatives;
- Corporate centre costs lower by £6m, offset by;
- Smiths Detection down £47m driven by lower volumes and the associated lower cost absorption;
- Smiths Interconnect down £13m as a result of lower volumes, adverse mix and restructuring costs;
- Flex-Tek down £8m reflecting lower volumes; and
- Smiths Medical down £7m reflecting lower volumes driven by diabetes and lower hardware sales as well as increased R&D costs.

Operating profit on a statutory basis, after taking account of the items excluded from the headline figures, was £429m (2008: £326m).

The net interest charge increased to £52m (2008: £41m) which reflects the higher interest costs on the newly refinanced debt. There was a reduced pensions financing gain of £5m (2008: £42m) as a result of the worsening funding position of the company's retirement benefit schemes. As a result, the headline profit before tax decreased by £9m to £371m. On an underlying basis, headline profit before tax fell by 21%.

On a statutory basis, after taking account of items excluded from the headline figure, the profit before tax was unchanged at £371m.

The Group's tax rate on headline profit for the period was 24% (2008: 24%). Headline earnings per share decreased by 3% to 72.4p (2008: 74.5p).

Cash generation

Strong cash generation this year resulted in a free cash-flow of £256m (2008: £91m). Substantially improved headline operating cash of £435m (2008: £273m) represented 104% (2008: 72%) of headline operating profit. The improvement was a result of reduced investment in working capital, particularly inventories and debtors, and lower net capital expenditure. Although net debt increased by £114m to £885m, the increase resulted from foreign exchange translation and net investment hedges.

Dividend policy

In March 2008, the Board announced its intention to rebuild dividend cover to around 2.5 times in the medium term. In line with previous guidance, the Board has recommended an unchanged final dividend of 23.5p per share, making a total dividend for the year of 34.0p per share. Looking ahead, our focus will remain on rebuilding dividend cover as we invest in organic growth and acquisitions while maintaining a prudent approach to balance sheet financing. The final dividend will be paid on 20 November to shareholders registered at the close of business on 23 October. The ex-dividend date is 21 October.

Business review: Smiths Detection

Smiths Detection is a world leading designer and manufacturer of sensors that detect and identify explosives, weapons, chemical agents, biohazards, narcotics and contraband.

Our technology helps customers in the global transportation, ports and borders, critical infrastructure, military and emergency responder markets. We have the most comprehensive range of detection technologies in the world, including X-ray, trace detection, millimetre-wave, infra-red, biological detection and diagnostics.

Employees

2,400

Stephen Phipson
President

Contribution to 2009
Group sales

19%

Contribution to 2009
Group headline
operating profit

14%

Percentage relates to headline operating profit
before corporate costs

Principal operating regions

Our eight manufacturing centres are concentrated in North America, Germany, France and the UK. We sell to over 100 markets around the world either through a sales and marketing company or a third-party distributor.

Customers

A significant majority of sales are influenced by more than 100 governments and their agencies, including homeland security authorities, customs authorities, emergency responders and the military. These include the US Department of Defense, US Transportation Security Administration (TSA), UK Ministry of Defence, and airport operators such as BAA in the UK.

Competitors

Data published by IMS Research* shows that, in the combined transportation, critical infrastructure and ports & borders sectors, Smiths Detection has a 31% market share, compared to its main competitors being L3 Security & Detection Systems (10.5%), Rapiscan Systems (9.7%), Nuctech (8.6%) and AS&E (6.4%). In the Military and Emergency responder markets, which are not included in this data, the main competitors are General Dynamics, Bruker, Environics and Canberra.

*The World Market for Explosives, Weapons & Contraband Detection Equipment 2009 Edition

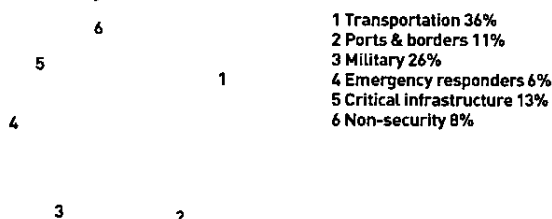
Suppliers

We are redesigning our supply chain model to maximise shared component parts and reduce costs across the division while taking into account the growing demand for local sourcing, particularly in North America. Our supplier base is being adapted accordingly while ensuring quality and delivery requirements are maintained.

Sales performance



Sales by sector: £501m



Expanding in the US

Our Edgewood, Maryland, facility almost doubled in size to 130,000 square feet in a \$3.5m expansion designed to meet the record level of orders from the Department of Defense. These include vehicle integration programmes, such as the Chemical Biological Protective Shelter and the Profiler which gathers real-time meteorological data to assist the accuracy of military operations. The plant expansion has also allowed increased production of JCAD, the advanced chemical agent detector designed to help safeguard troops by automatically detecting chemical threats and toxic industrial chemicals.

Markets and trends

Smiths Detection products serve the transportation, ports and borders, military, emergency responder and critical infrastructure markets. The business also adapts technology developed for these markets for carefully selected industrial applications in diagnostics, life sciences, food quality and safety.

Homeland security remains a priority in western countries, with 11% annual growth expected over the long term. However, government spending and airport operator investment have been affected by the current global economic downturn which has in turn caused delays to orders. As a result, recent growth rates have been lower in certain segments of the wider homeland security market. The worldwide market for Smiths Detection products and services is worth an estimated £3.5 billion.

The transportation sector, which includes airports, is the largest representing 36% of total sales. In the short term, airport investment has slowed in certain markets as passenger and air cargo traffic has declined. However, over the long term the airport security market is expected to grow in response to:

- projected long term growth in air traffic;
- new security threats; and
- customer pressure for faster throughput at checkpoints and an improved passenger experience.

The ports and borders market has been affected by the global slowdown in container traffic and delays to infrastructure investment by customers. However, over the long term, this is expected to be a growth sector driven by government objectives of enhancing security screening and protecting tax revenues. Customers require mobile and fixed units capable of detecting explosives, weapons, radioactive materials, narcotics and contraband.

The military market for UK and US technology is restricted by export controls, and these two governments comprise a major slice of the market which is characterised by tendering opportunities for large individual contracts that typically run for several years. Smiths Detection continues to develop new business by increasing systems integration activity, offering improved functionality in protective shelters and introducing new technologies through government-funded partnerships.

Within the emergency responder sector, the US accounts for more than 50% of global demand. This market is characterised by more localised purchasing decisions and stable market trends.

The critical infrastructure market is diversified with varying growth rates in the different segments. Smiths Detection focuses on three key areas: mass transit, sports and events, and government and military facilities. Smiths Detection has a growing involvement in helping protect a number of important metro systems in both the US and Europe. Demand for greater hotel security has also increased substantially in the wake of the Mumbai attacks in November 2008.

A possible future market is with biological detection and its application to veterinary diagnostics. Smiths Detection's expertise in producing rugged, portable sensor equipment has enabled the development of a field-based device which can detect a range of animal infections such as foot-and-mouth and avian flu. It could also be developed for clinical applications such as combating the spread of the H1N1 flu virus.

The markets served by Smiths Detection are influenced by specific events and the perception of threat from terrorist activity or other security issues. This perception itself has been and is likely to remain variable.

Business review: Smiths Detection continued

Performance

	2009 £m	2008 £m	Reported growth	Underlying growth
Sales	501	509	(2%)	(17%)
Headline operating profit	63	93	(32%)	(43%)
Headline operating margin	12.6%	18.3%		
Statutory operating profit	63	93		

Reported sales declined 2%, or £8m, reflecting a currency benefit of £91m offset by a decrease in underlying sales of £99m, or 17%. As previously announced, this reflects the increasingly variable nature of the order flow of this largely government contracting business. The majority of this decline is caused by the ports and borders segment which has seen repeated delays to several contract tender processes underway in different markets. In addition, the prior period benefited from a large Russian contract. Excluding ports and borders, underlying sales for Smiths Detection declined by 5%. This decline reflects lower sales primarily in transportation and non-security, offset by strong growth in the military area which has had its best ever year.

The fall in sales volumes together with the associated lower cost absorption is the principal driver of the lower margins and the 43% (£47m) decline in underlying headline operating profit. We are taking action to address the cost base and have begun a restructuring project that will rationalise our manufacturing facilities. We have announced the closure of a satellite site in Wiesbaden, the consolidation of two existing New Jersey sites into a new facility and the closure of two UK sites. We are currently assessing opportunities for further site rationalisation. We have already reorganised the business into Security & Inspection, which will focus on airports, ports and borders and critical infrastructure, and Military and Emergency Response.

Underlying sales in transportation fell by 19% which reflects good growth in the US offset by weaker sales in EMEA. US sales have benefited from the introduction of a new generation of airport checkpoint explosive detection systems which, unlike conventional systems, can capture multiple views of carry-on bags in a single sweep. The systems also include software algorithms that help the operator detect potential threat items and they can easily be upgraded to meet future threats. Airports in Europe and other markets have been slower to adopt the new technology while trials are still underway, and the current economic downturn has prompted governments and airport operators to review the timing of some projects.

The ports and borders market has seen a 59% underlying decline in sales following a strong performance in the first six months of last year which benefited from a large contract in Russia. Average contract size has grown over recent years as governments have become more co-ordinated in their approach to border security and customs revenue protection. As a result, the sales profile in this business has become more variable and the working capital requirement has also increased. Our leading-edge technology leaves us well placed to benefit from long-term growth prospects. For instance the US has mandated that 100% of arriving cargo be scanned by 2012. We continue to tender on some substantial projects in several markets. In July 2009, we won a \$10.6m order for mobile, high-energy cargo screeners. Since the year end, we have won confirmed orders for a further £20m from several different markets.

Scanner nets record drug haul

Advanced HCV cargo scanners are tested at the new Alcoa, Tennessee, facility. Smiths Detection recently won a \$10.6m order from the US Government. Their high-energy x-rays can penetrate steel as thick as 280mm (11 inches) and a range of fixed and mobile versions are used by customs authorities across the world to detect threat items, contraband and drugs. In June 2009, a Smiths Detection mobile HCV helped the French authorities uncover the biggest haul of illegal drugs ever seized on a road in France. Almost 700 kilos of cocaine, with a street value of around \$70m, was discovered hidden in a truckload of potting soil near the Spanish border.

Military sales enjoyed their strongest year on record with underlying sales up 42% through the ongoing JCAD programme. We received further orders from the US Department of Defense amounting to \$179m during the year. The lightweight JCAD is an advanced chemical point detector designed to help safeguard troops by automatically detecting, identifying and quantifying both chemical warfare agents and toxic industrial chemicals. We also won a \$19m contract from the US Army for Meteorological Measuring Set-Profiler (MMS-P) systems, taking the total programme value to over \$89m to date. The MMS-P gathers real-time meteorological data to assist the accuracy of military operations.

The implementation of a new ERP system began during 2008 and will complete by the end of calendar year 2009. This single system replaces 14 legacy business software systems and provides a common information platform to support data-driven decision-making. Sixteen sites representing 70% of sales have now gone live with the new system. Investment to date has been £24m. We anticipate that once complete the project will generate efficiencies in working capital of £11m and annual cost savings of £8m.

Research and development

Smiths Detection has maintained its leadership in the sector through a consistent commitment to product innovation developed by in-house R&D, government-funded research and through partnerships and licences. Company-funded R&D increased by 21% to £35m or 6.9% of sales (2008: 5.6% of sales). This includes £10m of capitalised projects. Smiths Detection actively seeks customer and government support for R&D which totalled £10m in the period (2008: £9m). Total R&D spend was £45m (2008: £38m) or 8.9% of sales.

The principal focus for R&D investment continues to be X-ray for a variety of applications, including baggage scanning at airports and cargo screening at ports and borders. The next generation of cargo screening equipment is able to discriminate between different materials in a single pass. Our airport checkpoint explosive detectors are currently undergoing trials for the software that would allow automatic detection of suspect liquids in carry-on baggage.

We have also launched an advanced people-screener which for the first time uses electronic, real-time imaging in a standard checkpoint layout to detect weapons or explosives concealed under layers of clothing, without physical contact. The new system, called 'eqo', is based on patented millimetre-wave technology.

Our techniques in chemical and trace detection have continued to develop and have supported the launch of several new products during the year including the High-Performance Radioisotope Identifier (HPRID) and the Multi-Mode Threat Detector (MMTD).

Diagnostics continues to be an area of focus with development of a portable biological detection system that enables veterinarians to carry out rapid on-site diagnosis of animal diseases. The same technology is now being developed for clinical applications such as the detection and identification of MRSA, *clostridium difficile* and other infectious diseases.

Outlook

Smiths Detection has had a positive start to the year although we are cautious about how the current economic environment may affect the timing of orders from governments, given that some of their finances remain under significant pressure. Longer term, we believe that the sector is set for sustained growth and Smiths Detection will benefit from its leadership position and the roll-out of innovative products. As a result, we shall continue to invest in research and development to launch new products while restructuring the business to lower costs and support margin improvement.

Business review: John Crane

John Crane is a world-leading provider of products and services for the major process industries. These include the oil and gas, power generation, chemical, pharmaceutical, pulp and paper, and mining sectors.

We help to enhance customer productivity by providing advanced technology mechanical products and performance-enhancing services backed by an exceptional global network.

Employees

6,600

Paul Cox
President

Contribution to 2009
Group sales

30%

Contribution to 2009
Group headline
operating profit

32%

Percentage relates to headline operating profit before corporate costs

Principal operating regions

John Crane is a global business with a presence in more than 50 countries.

Customers

John Crane serves oil & gas and power generation companies, refineries, pump and compressor manufacturers, chemical and other process industries. Its main customers include BP, Chevron, China Petroleum, ConocoPhillips, ExxonMobil, Gazprom, Qatargas, Saudi Aramco, Shell, Petrom, Total, Dresser, Elliot, Flowserve, GE Nuovo Pignone, GE Energy and Power, Andritz Hydro, Siemens, ITT, Mitsubishi, Solar Turbines, Sulzer, York, BASF, Bayer, Dow, Koch Industries and LyondellBasell.

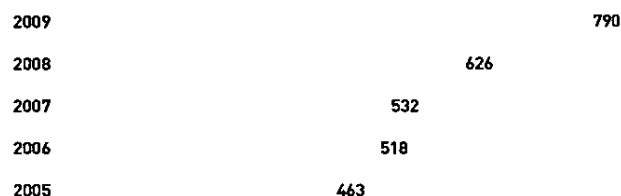
Competitors

For rotating technologies, John Crane's main competitors are, Flowserve and EagleBurgmann Industries (mechanical seals); Kingsbury and Waukesha (engineered bearings); Pall and Hydac (filtration systems); Rexnord and Emerson (couplings). For equipment in upstream energy John Crane's principal competitors include Weatherford and Norris.

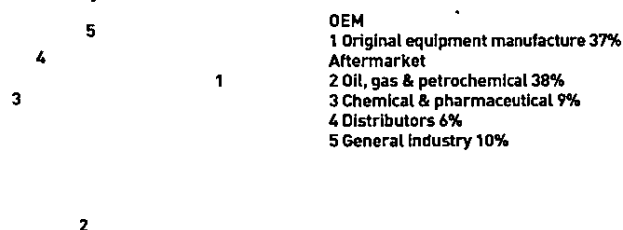
Suppliers

John Crane operates its supply chain globally, using global, regional and local partnerships to meet the required service levels. Its main suppliers are Morgan Group, Coors Tek, Schunk, ESK, Earle M. Jorgensen, Fernax, DuPont, Greene Tweed, Scot Industries and Ashland Chemical.

Sales performance



Sales by sector: £790m



Global service, local support

When a major customer in Chile had to close its gas refinery in June because of damaged compressor seals, prospects for a quick resumption of output looked bleak. Local spares were unavailable and H1N1 flu-related travel restrictions meant specialists could not be sent. However, technicians at John Crane's headquarters in Morton Grove, tapping into global experience and using advanced web-based communications, helped Chilean engineers locate the damage, repair it and rebuild the seals within days. Once installed, they worked perfectly and the plant was able to resume full production.

Markets and trends

John Crane sustains the effective operation of customers' rotating equipment and other machinery with products that include mechanical seals, seal support systems, engineered bearings, power transmission couplings and specialist filtration systems. John Crane also helps maintain and enhance oil and gas productivity through the servicing and provision of down-hole pumping hardware. All this technology is supported by a global sales and service network that provides performance-enhancing services. Using expertise developed from decades of experience, service teams in more than 50 countries maintain and support customer assets throughout their economic lifetime.

Approximately one-third of John Crane sales is the design and supply of products to original equipment manufacturers, while the remaining two-thirds of sales stems from the aftermarket servicing and support of existing installed equipment. The business serves a wide range of process industries including oil and gas, chemical, power and general industrial applications. Demand for John Crane products and services is influenced by a number of factors: the global demand for energy and an increased desire for national energy independence; more stringent regulatory requirements, eg to reduce emissions; the need to replace ageing infrastructure and deliver operational efficiencies; global demographics and long-term economic growth. The long-term drivers, such as the global demand for energy, support growth in original equipment investment in the key end markets that should enable John Crane to deliver average sales growth of around 6% a year over the medium term.

The John Crane addressable market has doubled over the past two years as a result of a targeted acquisition strategy which has added complementary product lines such as engineered bearings, specialist filters and upstream energy services to the existing portfolio of mechanical seals, couplings and seal support systems. These new product areas typically serve similar customers and offer scope for a strong aftermarket business. John Crane is a market leader in its existing product areas with a share of around 28%, while there is significant opportunity to grow its share in the newly acquired product ranges. These new products also allow John Crane to leverage its global network of sales, service and manufacturing centres more effectively. We will continue to seek further opportunities for similar acquisitions which support this growth strategy.

John Crane's global network of over 155 service centres in more than 50 countries is a key asset which allows service closer to customers' operations and provides a swift and effective aftermarket service to them. These facilities provide a range of added value services including repair, root cause analysis, alignment and condition monitoring, all designed to improve the performance of customers' rotating equipment and to reduce downtime. The geographic footprint continued to expand through opening additional manufacturing, sales and service centres in key markets – particularly in growth markets such as the Middle East and Asia Pacific.

Business review: John Crane continued

Performance

	2009 £m	2008 £8m	Reported growth	Underlying growth
Sales	790	626	26%	(1%)
Headline operating profit	143	104	38%	7%
Headline operating margin	18.1%	16.6%		
Statutory operating profit	106	47		

John Crane's reported sales rose 26% and headline operating profit increased by 38%. Sales benefited from currency translation (£109m) and from acquisitions (£65m) while underlying sales declined by 1% (£10m) reflecting a lower level of orders for original equipment (OE). Orders began to slow from January 2009, which has caused underlying sales to decline by 7% in the second half compared with a growth of 6% in the first half.

Demand for aftermarket servicing has remained robust and underlying sales remained in line with last year. Within the aftermarket, underlying sales in our largest segment, oil, gas and petrochemical, has continued to grow at 5% as it continues to benefit from the infrastructure investment made by customers over recent years; while the aftermarket for other sectors such as general industrial were down 10% and the chemical and pharmaceutical sector has fallen by 8%. Underlying original equipment sales have declined 3% year on year, reflecting lower sales to the general industrial and chemical sectors offsetting continued growth in our engineered original equipment for bespoke applications, particularly for oil, gas and petrochemical customers.

Headline operating profit benefited from currency translation (£16m) and from acquisitions (£14m), leaving an underlying growth rate of 7%. Margins improved by 150 basis points to 18.1% reflecting the benefits of the restructuring programme which launched at the end of last financial year.

The restructuring programme to create one global John Crane division by integrating the two previous regional organisations is well underway. Corporate functions such as finance, IT, human resources, legal, engineering and product line management are now co-ordinated globally. Sales and service functions have been kept close to customers in regional organisations. Certain manufacturing has been moved to countries in Eastern Europe, Asia and Mexico. These changes are facilitating improved customer focus, quicker decision-making, better delivery, lower cost and more effective communications. In the period, we spent £9m and delivered savings of £6m. Overall, the project is expected to deliver annual savings of £25m.

Implementation of a new ERP system is well underway, with 20 regions across Europe, Middle East and Africa all successfully online. This represents approximately 70% of total project completion. Roll-out is now in progress in India and Asia Pacific regions, with 11 implementations to complete before the end of the project in July 2010. Investment to date has been £22m out of a projected total of £24m. The project is expected to generate annual cost savings of £10m. Since inception the project has realised £4m of savings.

During the year, John Crane has continued to expand its industry-leading, global network of service centres. Current developments are focused on key growth markets. In the Middle East, four new facilities were opened, including a wet seal service centre in Bahrain and a service, sales, manufacturing and training facility in Damman, Saudi Arabia. In Asia Pacific, another four service centres have been opened. This year saw expanded service capability in Rayong, Thailand to serve the petrochemical and oil and gas markets; a new facility in Darwin, Australia to service the oil and gas and minerals mining markets. In China a new service centre opened in Du Shanzi servicing the North West of the country together with a state-of-the-art wet and gas seal service facility in Tianjin, China, part of the recently opened John Crane China facility.

Sealed for energy saving

John Crane has developed a new and highly reliable gas-lubricated mechanical seal that not only seals high-temperature process fluids on rotating equipment but also saves energy because it is non-contact and friction-free. The Type 2874NE seal ensures no emissions escape into the atmosphere during the pumping of hazardous fluids at temperatures of up to 425° Centigrade while the non-contacting faces maximise seal life. It has already been successfully deployed in many refineries around the world.

In the past year we continued our acquisition strategy to expand the product portfolio with complementary technologies for similar customers that can leverage the global sales and service network, and build an upstream energy services business. In May 2009 we acquired Orion Corporation, which added a leading US-based designer and manufacturer of hydrodynamic bearings for the oil and gas and industrial power markets. Orion complements and extends John Crane Bearing Technology, a business unit formed following the acquisition of Sartorius Bearing Technology in October 2007. Moreover, it adds complementary products and a manufacturing, sales and service base in North America to supplement existing European operations, and establishes John Crane as one of the leading manufacturers in the hydrodynamic bearings sector. Training and development activity for the John Crane sales force is well underway to promote and sell the product range through John Crane's extensive network. The overall integration process is continuing to progress well and John Crane Bearing Technology was successfully migrated onto the global ERP system in November 2008.

In the upstream energy sector, the John Crane Production Solutions business unit was formed this year to capitalise on the synergies of the CDI Energy Services and Fiberod acquisitions.

Expanding the range of products offered, John Crane Production Solutions launched an Automated Prime Mover (APM) product line which provides auxiliary power to well sites. The product is aimed at geographical areas which are remote from developed power grids, by providing interim power to drilling companies while they wait for power to be run to their wells. APM use will increase oil field production and also meets new carbon emissions standards. John Crane Production Solutions continues to expand international applications, with active opportunities in Indonesia, Romania, India and Mexico.

Outlook

John Crane's strength and revenue in aftermarket sectors will continue to be enhanced through additional investments in both locations and services offered. The overall order book for the aftermarket and original equipment is below that of the same period last year, primarily because of lower original equipment orders. As a result, we anticipate that overall sales will decline during the first half of the new financial year, particularly against a strong comparator period. In spite of this pressure on sales, there is scope to deliver continued margin expansion as a result of cost controls and the restructuring programme that is underway.

Business review: Smiths Medical

Smiths Medical is a leading supplier of specialist medical devices and equipment for global markets.

In medication delivery, our devices help treat cancer patients and provide relief to those in pain. Our vital care products reduce hospital-acquired infections, manage patients' airways before, during, and after surgery, maintain body temperature and assist reproduction through IVF therapy. Our safety products keep health workers safe by helping prevent needlestick injuries and reducing cross-infections.

Employees

7,400

Srini Seshadri
President

Contribution to 2009
Group sales

31%

Contribution to 2009
Group headline
operating profit

37%

Percentage relates to headline operating profit before corporate costs

Principal operating regions

Manufacturing is concentrated in Mexico, the US, the UK, Italy, Germany and China. We sell to over 100 markets worldwide, with the US being our largest single market with 50% of sales.

Customers

We estimate that around three-quarters of our end customers are hospitals, with the remainder comprising the alternate care market such as home care, clinics and other surgery centres. We have a direct sales presence in 20 countries, with distribution arrangements in many others.

Competitors

The competitive landscape for Smiths Medical is complex as we compete with different businesses across the wide range of product areas. Our competitors include Covidien, Teleflex, B Braun, Becton Dickinson, Hospira, CareFusion and Vital Signs, among many others. In many cases, we compete only with a small portion of their medical businesses so comparison between peers is not straightforward.

Suppliers

Our strategic focus is to reduce the current number of suppliers, while strengthening relationships that are key to the Division's success. The following five commodities account for around half of our direct spending: injection moulding, purchased finished goods, packaging materials, syringes/needles and electronics. Among indirect purchases, the top five account for around three quarters of our spending: freight, services, travel, temporary labour and capital equipment. We are also working with other divisions to reduce costs and leverage economies of scale.

Sales performance

2009	834
2008	703
2007	691
2006	737
2005	563

Sales by sector: £834m

3	1	1 Medication delivery 29%
		2 Vital care 40%
		3 Safety devices 31%

Pandemic preparedness

Production of Smiths Medical's EDGE™ range of safety syringes has been stepped up as the US Government prepares to combat the threatened pandemic spread of H1N1 flu this winter. The Department of Health and Human Services (HHS) has placed an order that could reach \$10m as part of its national flu preparedness efforts. The EDGE™ syringes, which maximise vaccine delivery through elimination of 'dead space' in the hypodermic chamber, can be activated single-handedly, reducing the chance of needlestick injuries to medical staff. Such medical safety devices are already the norm in the US and the European Parliament has now agreed in principle to move towards greater use of products (such as these syringes) that protect patients and health-care workers.

Markets and trends

Healthcare spending continues to increase worldwide, driven by demographics – ageing populations and increasing prosperity – particularly in Asia. The overall world market for devices and equipment of the type supplied by Smiths Medical is estimated to be worth £4.0 billion and is growing consistently. Smiths Medical has a global reach in the design, production and distribution of medical device products, with sales and marketing activities in over 100 countries. Its product ranges serve three main markets – medication delivery, vital care and safety.

Medication delivery

Smiths Medical designs and manufactures drug delivery systems that relieve acute and chronic pain (CADD and Medfusion) and chemotherapy delivery systems to treat cancer patients (CADD). The global market for medication delivery products is estimated to be worth £1.5 billion and growing at around 4-7% a year. This growth is due to the increase in treatment of chronic conditions, integrating medication delivery devices with hospital IT systems, and the move to treating patients outside hospitals. We are a leader in ambulatory infusion, with a strong position in hospital infusion particularly in the syringe pump market.

Vital care

Smiths Medical's products manage patient airways before, during and after surgery (Portex), aid patients with breathing difficulties (Portex, Pneupac), help to maintain body temperature (Level 1), monitor vital signs such as blood pressure and heart rate (BCI, Medex) and assist reproduction through IVF therapy (Wallace). The market for vital care products grows at around 2-4% annually, partly due to a steady increase in the incidence of chronic respiratory diseases and obesity. Demand is increasing for single use devices such as Portex airway management products. The market is expected to continue growing as the number of operations and intensive care beds both increase. This market is currently worth about £1.5 billion a year. We are a market leader in airway products.

Safety devices

Smiths Medical makes effective safety devices that prevent needlestick injuries and reduce cross infections. These cover a range of functions including drawing blood samples (Jelco), administering injections and vaccinations (Jelco), and delivering intravenous drugs (Deltec). The global market for safety products is estimated to be worth £1.0 billion and growing at 3-5% annually. Smiths Medical is one of the world's leading suppliers of safety needles and catheters.

Looking at trends across the business, Smiths Medical is benefiting from the move towards treatment of illnesses in their chronic, rather than acute stages. A number of airway management products and ambulatory pumps already address this trend – such as the CADD ambulatory infusion pump range and the Portex Acapella respiratory therapy system – and it is becoming a focus for our vital care products.

The advantages of using safety devices are well understood in the US, and there is now greater recognition of the contribution safety devices make towards improving the safety and productivity of healthcare employees. In other geographic markets, conversion to safety products is in its infancy, with opportunities for rapid future growth. Safety products are also being introduced into other areas of healthcare, such as dentistry.

Business review: Smiths Medical continued

Performance

	2009 £m	2008 £m	Reported growth	Underlying growth
Sales	834	703	19%	(2%)
Headline operating profit	164	140	17%	(4%)
Headline operating margin	19.7%	19.8%		
Statutory operating profit	148	119		

At reported exchange rates, Smiths Medical's sales grew 19% while headline operating profit increased by 17%. Reported sales benefited from currency translation (£139m) and acquisitions (£7m) which, if excluded, give an underlying sales decline of 2%. Sales were affected by our decision to exit the diabetes market which reduced revenue by £9m. Excluding all diabetes sales, underlying sales declined by 1% in the year. Headline operating profit benefited from currency translation (£28m) and acquisitions (£4m). Operating profit margins declined slightly; underlying profit slipped 4%. Our ongoing cost reduction efforts began to show their full effects in the second half, although we do not expect to benefit fully from these actions until the new financial year.

In the overall medical device market, the economic downturn has adversely affected hospital capital budgets, although we are now seeing a gradual improvement in some parts of the world. Excluding diabetes, hardware sales were down 5% while sales of our disposable products were flat. The outbreak of H1N1 'swine' flu, caused some hospitals to limit access so they could focus on caring for people affected by H1N1. However, Smiths Medical was unaffected because most of our products are vital for healthcare staff and some are used in the treatment of flu.

We have continued to deliver operational improvements which, in conjunction with the beginning of a hardware market recovery and stabilisation of disposable sales, has helped deliver a stronger second half. Customer backorders have been halved since last year enabling further improvements to customer service, thus boosting our customer recovery and retention efforts. Finally, we cut headcount in Smiths Medical by around 1000 throughout the year. These actions will help improve margins in the coming year.

In Medication Delivery, underlying sales declined by 4% for the year. Excluding diabetes, sales were only slightly down reflecting an improvement during the last six months from increased sales of CADD®-Solis pumps. The planned exit from the diabetes business has gone well, with the decline in sales in line with expectations. Elsewhere, deferrals of purchases of our infusion systems by some large customers have continued, most notably in Canada, although we expect those sales to recover. Sales of our next-generation ambulatory smart pump, CADD®-Solis, grew during the second half in North America and are gaining considerable traction in other English-speaking markets. The pump will be available in other languages in the new fiscal year.

Vital Care underlying sales declined by 3%, but delivered a stronger performance in the second half from our temperature management franchise. We also saw small increases in sales of our respiratory products because of the H1N1 flu outbreak. Our tracheostomy business delivered strong growth and we plan to undertake a new e-business initiative to support our custom tracheostomy products.

Safety Devices underlying sales grew by 2%, driven by a number of OEM agreements, co-branded sales, and an increase in our base business. In some markets, particularly outside the US, we continue to see competitive pressure from lower-cost safety catheters, which has slowed the growth rate of this franchise. However, we see an opportunity for safety products to be taken up more widely in the EU since the EU parliament agreed a move toward their adoption.

Expansion in fast-growing market

The acquisition of the Hangzhou-based medical instruments manufacturer ZDMI, now known as Smiths Medical Zhejiang (SMZ), has expanded Smiths Medical's presence in the vast and rapidly growing Chinese market. Sales of its range of syringe pumps and enteral feeding devices have exceeded expectations and we plan to make SMZ a low-cost R&D base for the development of hospital infusion products for China and other international markets. The first drug pumps from SMZ to include 'medication error' software, designed to prevent over-infusion of drugs, will be launched by the end of calendar 2009.

Our product portfolio review has led to a number of strategic decisions that will improve margins. On pricing, we have identified £6m in improvements in our product 'tail', and have already delivered £3m in the year across the total portfolio. We plan to eliminate 3,000 SKUs, effective 31 October, with no negative responses from customers to date. This will simplify the business and provide opportunities to sell alternative products. We are rolling out a more sophisticated account management system globally to improve customer profitability.

Efficiency improvements and cost reductions are protecting business performance during the current downturn and positioning the business for greater margin growth as conditions improve. The North American restructuring programme is now virtually complete with the three former operational units now managed under a single management team. Though primarily intended to ensure one face to the customer, we have been able simultaneously to drive business efficiencies.

Implementation of our global ERP business systems is on track for completion by March 2010 and is within budget. Virtually all of the products we sell already flow through the ERP system at some point in the supply chain. Additionally, we have rolled out a strategic global sales data warehouse. The ERP project remains on track to deliver annual savings of £15m, and is providing better transparency to key information, thus enabling more data-driven business decisions.

Business developments

Our acquisition in November 2008 of Zhejiang Zheda Medical Instrument Co. Ltd ("ZDMI"), now known as Smiths Medical Zhejiang (SMZ), has exceeded our expectations (contributing £7m in the year). We plan to make SMZ a low-cost R&D base for the development of hospital infusion products for China and other international markets.

Research and development

Our R&D spend was £29m (2008: £26m) or 3.5% of sales (2008: 3.7%). However, a more important measure is the amount of sales from products launched in the last three years, which is up 12% year-on-year. Our new, focused approach has significantly improved the efficiency of our R&D spend and has helped us execute nearly all of our planned product launches on time and within budget.

Our highest-profile new product launches have met or exceeded our expectations. This includes smartX®, the first wireless blood pressure monitoring device; Uniperc®, a tracheostomy device for people with large necks; and CADD®-Solis infusion pump and associated medication error prevention software. During the second half, we launched a new set of disposable circuits for our PneuPac ventilators; the SACETT endotracheal tube, which is designed to help prevent ventilator-associated pneumonia; and the Stimulating Plexus Needle in our peripheral nerve block line. Each of these new products fills a gap in, or extends, one of our strong product lines. Early signs from these recent launches have been positive.

Outlook

Smiths Medical will focus on its performance improvement programme through a number of initiatives. The SKU, portfolio and customer profitability reviews will reduce complexity, while cutting overheads. R&D will help drive top-line growth through new product launches. The underlying revenue momentum achieved in the second half is expected to continue but will be held back by the exit from the diabetes market. Margins should improve as we benefit from the cost initiatives taken to date.

Business review: Smiths Interconnect

Smiths Interconnect is a recognised leader in technically differentiated electronic components and sub-systems providing signal, power and microwave solutions.

We design and manufacture products that connect, protect and control critical systems for the global wireless telecommunications, aerospace, defence, space, medical, rail and industrial markets.

Our products are application-specific and incorporate innovative technologies to provide our customers with a competitive advantage.

Employees

3,350

Ralph Phillips
President

Contribution to 2009
Group sales

12%

Contribution to 2009
Group headline
operating profit

12%

Percentage relates to headline operating profit before corporate costs

Principal operating regions

Smiths Interconnect operates globally and has locations in the US, Mexico, Costa Rica, Ireland, UK, France, Germany, Italy, Tunisia, India, China and Australia.

Customers

Smiths Interconnect supplies to multiple levels of the supply chain and its blue chip customers include primes and service providers, OEMs, system suppliers and sub-system manufacturers. Amongst our largest customers are Raytheon, Finmeccanica, BAE Systems, Boeing, AAI/Textron, Northrop Grumman, General Dynamics, Lockheed Martin, Ericsson, Motorola, AT&T, Verizon, Sprint Nextel, Emerson, ZTE, Huawei, GE Medical and Alstom.

Competitors

Smiths Interconnect operates in a fragmented market with many small and medium-sized competitors in various product and technology areas. Connector competitors include Amphenol, Deutsch, Radiall, Souriau. Our high-reliability components and wireless telecoms businesses compete with, amongst others, Anaren, Spectrum Control, PowerWave, KMW, Dover and CommScope. The competitors of our microwave sub-systems companies include EMS, Herley, Cobham, Teledyne and L3. Huber & Suhner, Dehn and SL Industries offer competitive protection products.

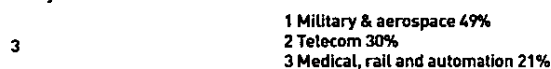
Suppliers

Smiths Interconnect maintains a strong supply base with machined parts and electronic components each representing approximately 25% of total spend. No individual supplier accounts for more than 4% of total purchased value.

Sales performance



Sales by sector: £318m



1

2

Manufacture of telecommunications products in China

With the acquisition of Allrizon and Triasx last year, Smiths Interconnect significantly increased its Chinese design and manufacturing capabilities, predominantly focusing on microwave products for the wireless telecommunications market, both domestically and globally.

Including the recent addition of the Shenzhen-based Dowin surge protection business, the number of Chinese employees in Smiths Interconnect has risen from approximately 200 in April 2008 to over 850 today, including some 67 engineers.

Although the overall wireless telecommunications market softened during the year, one notable exception was the major investment of the three major Chinese wireless operators in building out nationwide 3G networks, projects that will continue for several more years.

Markets and trends

The two largest markets for Smiths Interconnect are mil/aero (military, aerospace and space) and wireless telecommunications.

Intelligence, surveillance and reconnaissance (ISR) is a key priority for global defence spending, with improved battlespace awareness, network-centric communications systems and force protection being seen as critical success factors for future conflicts, particularly irregular warfare.

Typical military applications for Smiths Interconnect technology include unmanned aerial systems (UAS), next-generation ground vehicles, network-centric communications systems, surveillance systems and self-protection systems. Our radio frequency and rugged connectors solutions are deployed in the most extreme environments, such as enabling sensor and communications systems and keeping military personnel protected in areas of conflict.

The commercial aerospace market generally demonstrates short-term cyclical growth and long-term growth driven by increased passenger and freight demand from an expanding global economy. Smiths Interconnect provides electrical and microwave connectivity solutions for various aircraft, space vehicles and satellites.

The propensity for higher data rates and true mobility are the main drivers for growth in the field of commercial mobile telecommunications. Smiths Interconnect supplies niche microwave components used in base stations and cell sites, as well as solutions to optimise network performance and integrity, and to safeguard the high value infrastructure from the effects of lightning strikes and power surges.

Other applications for Smiths Interconnect products include medical equipment such as MRI scanners, automation equipment for the test and measurement and machine tool markets, and mass transit systems.

Technology

Smiths Interconnect comprises five focused technology areas:

- Connectors provides application-specific, high-reliability electrical interconnect solutions from highly integrated assemblies to micro-miniature connectors.
- High Reliability Components provides passive microwave products used within the building blocks that generate, transmit, receive and process high-frequency signals for communication systems.
- Microwave Sub-Systems provides microwave and millimetre-wave sub-assemblies, antennas and systems solutions for both defence and commercial applications.
- Protection provides signal and power integrity components that protect high-value electrical systems from surges caused by power surges and lightning strikes.
- Wireless Technologies provides solutions that test, filter and process high-frequency signals for communications systems.

Business review: Smiths Interconnect continued

Performance

	2009 £m	2008 £m	Reported growth	Underlying growth
Sales	318	261	22%	(5%)
Headline operating profit	56	54	3%	(20%)
Headline operating margin	17.4%	20.7%		
Statutory operating profit	51	51		

Reported sales for Smiths Interconnect increased by 22%, or £57m, driven by currency translation (£60m) and acquisitions (£15m). On an underlying basis, excluding the benefits of currency translation and acquisitions, sales fell 5% due to declines in sales of components to the wireless infrastructure market as well as the rail, industrial and automation markets in Europe. In particular, sales of our lightning and surge protection equipment declined against the same period last year which benefited from some significant short-term contracts. Sales to the military and aerospace markets have remained strong, medical sales were flat, while the industrial, rail and automation markets have become more challenging.

Headline operating profit increased by 3%. Excluding the benefit of currency translation (£12m) and acquisitions (£3m), headline profit declined by 20%, or £13m. Margins were adversely affected by one-off restructuring charges (£2m), lower volumes and an adverse mix effect on gross margins caused by lower wireless sales.

On an underlying basis, sales into military, aerospace and space applications increased 9% during the year. The growth came from a good mix of new research and development activities; projects transitioning from development to the initial production phase; and ongoing volume production projects such as our Mobile Directional Antenna Systems and connectors for the Eurofighter programme.

We achieved several new wins on intelligence, surveillance and reconnaissance (ISR) and communications programmes, including being selected to provide:

- an airborne antenna system for a high-frequency data link enabling air-to-ground transfer of battlespace information;
- a frequency and time reference module that will enable a network-centric radio system to connect different tactical ground, airborne and satellite communications terminals together providing total radio/network compatibility on-the-move and in variable terrain; and
- a direction-finding antenna system to support upgrades to shipboard Electronic Warfare systems.

Good progress was also made on securing key positions on major Satcom programmes within the US Department of Defense including a new win supporting a major UAV platform. We also continued high rate deliveries of telemetry and situational awareness systems for several major UAV programs such as the Shadow, Raven and Warrior.

In the area of Force Protection, high-volume manufacture of microwave filter components for systems which counter improvised explosive devices remained a strong contributor to sales. We further developed our business providing transient voltage protection devices against the potential effects of High Altitude Electromagnetic Pulse (HEMP) and Electromagnetic Pulse (EMP) weapons with several new programme wins. In addition, we were selected to provide an ultra-low noise frequency source for a next-generation integrated countermeasures system which will provide self-protection capabilities to US Navy aircraft.

In space, we were awarded a contract to develop millimetre-wave components for a joint NASA and JAXA (Japan) satellite used to monitor the earth's weather patterns. Sales to commercial aerospace declined in the period as production rates slowed.

Microwave filters for 'Force Protection' systems

The nature of irregular warfare has caused 'Force Protection' systems to become a high-priority and well-funded segment of defence budgets.

Through its Lorch Microwave business, Smiths Interconnect provides microwave filters that are incorporated into various systems which counter radio-controlled improvised explosive devices that have been rapidly deployed to areas of conflict.

In addition to ground-based systems, Smiths Interconnect provides components and sub-systems for force protection applications in use on a variety of fixed and rotary wing military platforms.

Wireless telecommunications sales were buoyed by the full-year effect of the acquisitions of Allrizon and Triasx, as well as Dowin, the Shenzhen-based manufacturer of power and signal protection devices which was acquired in April 2009. Excluding the impact of exchange rates and acquisitions, sales to the wireless market reduced by 21%, mainly because strong prior-year sales of lightning and surge protection solutions for the roll-out of the WiMAX broadband network in the US were not repeated this year. Furthermore, there was a general softening of demand from new infrastructure deployments.

With the notable exception of the 3G network build-outs in China, most operators cut back new network capital expenditure and focused on improving the performance of their existing networks, which is supporting demand for our network optimisation products. Sales of our portable passive intermodulation analysers grew strongly, particularly in the US, as operators recognised the benefits the instrument provides in identifying network performance issues.

Other wireless telecoms developments included gaining positions to supply resistive devices to the Chinese equipment manufacturers and increasing sales of millimetre-wave point-to-multipoint antennas.

Sales to the medical, rail and automation markets declined 12% on an underlying basis. Adverse market conditions were partially offset by new product launches and programme wins in the medical sector, although the industrial markets in Europe were particularly difficult.

Business developments

Smiths Interconnect executed numerous restructuring projects during the year, targeting cost savings and also increasing the percentage of manufacturing in low-cost economies. This included the combination of two US businesses with the majority of manufacturing transferring to our Mexico facility and the retention of a satellite engineering office. In addition, substantial reductions in work force were completed in Italy, Ireland, California and Florida, and short-time working was introduced in Germany and France. All of these projects started to pay back during the year and will help margin improvements in the coming year.

In April, Smiths Interconnect completed the purchase of Dowin, a Chinese manufacturer of power and signal protection devices, operating mainly in the wireless telecoms market and based in Shenzhen. This move complements our existing protection portfolio and provides a platform in Asia where we expect further investment in the roll-out of wireless infrastructure. This is the third acquisition in Asia made by Interconnect in the past two years.

Outlook

Short-term market conditions are expected to remain challenging for automation, rail and medical applications, as well as wireless telecommunications where demand has slowed after the initial surge of demand to support 3G infrastructure. Defence revenues are expected to continue to grow and the restructuring actions taken during the year are expected to generate some margin improvement.

In the longer term, Smiths Interconnect's continued focus on the technologies that support the future strategic direction of defence spending will deliver robust performance in the event of an overall reduction in military budgets. Furthermore, in the next two to three years wireless telecommunications operators are expected to increase significantly capital investment to deploy high-speed next-generation networks requiring specialist network optimisation capabilities such as ours to support high-data rate applications.

Business review: Flex-Tek

Flex-Tek is a global provider of engineered components that heat and move fluids and gases for the aerospace, medical, industrial, construction and domestic appliance markets.

Our flexible hosing, rigid tubing, and thermal systems are deployed on commercial and military aircraft for fuel and hydraulic applications and medical devices for patient care. They also improve the performance of domestic appliances such as clothes tumble dryers, vacuum cleaners and HVAC equipment.

Employees

2,000

Tedd Smith
President

Contribution to 2009
Group sales

8%

Contribution to 2009
Group headline
operating profit

5%

Percentage relates to headline operating profit
before corporate costs

Principal operating regions

Flex-Tek conducts most of its business in the US but also manufactures in France, Malaysia, India, China and Mexico.

Customers

We serve mainly aerospace engine and airframe manufacturers, domestic appliance manufacturers and the US construction industry. Large customers include Whirlpool, Electrolux, Trane, Carrier, Boeing, Airbus, Pratt & Whitney, GE Aerospace, and Respirationics.

Competitors

Smiths Tubular Systems Aerospace's competitors include Parker-Hannifin and Eaton as well as outsourced capacity from its key customers. Flexible Solutions competes globally with a number of smaller privately owned businesses which manufacture specialty hoses. Heat Solutions' domestic appliance and specialty heating element competitors include Emerson, Watlow and Chromalox. The construction-related products competitors comprise mainly Hitachi, Atco, Omega-Flex, Hart & Cooley and Goodman.

Suppliers

Flex-Tek sources key raw materials from world-class companies including electrical resistance wire from Sandvik, fibreglass insulation from Owens Corning, specialty plastic resins from DuPont and PolyOne, and stainless steel from Allegheny Ludlum. Each of these supply chain partners is chosen based on its ability to provide exceptional quality, service and value. No individual supplier represents more than 10% of total Flex-Tek purchased value.

Sales performance

2009	222
2008	206
2007	213
2006	240
2005	191

Sales by sector: £222m

1	1 Smiths Tubular Systems Aerospace 27%
2	2 Flexible Solutions 22%
3	3 Heat Solutions 51%

Specialty medical heater

A specialty medical heater was developed and built by Tutco-Farnam for use in Computed Tomography (CT) scanners, widely used in advanced medical diagnostics. It was designed to address the problem of variable CT image quality caused by the wide range of temperatures within the scanner. By monitoring both the external temperature of the room and those within the scanner chamber itself, the heater helps stabilise them, so allowing consistent high-quality imaging. It is one of a range of thermal systems produced by Flex-Tek for medical-related use including: patient warming, nebulisers and blood analysis.

Markets and trends

Flex-Tek designs and manufactures engineered components which heat and move fluids and gases for aerospace, consumer products and construction applications. Products include proprietary hose and tubing technology, engineered thermal systems and heating elements.

We manufacture specialised high-performance tubing for the civil and military aerospace industry and supply most major aircraft and engine manufacturers. Customers also include leading domestic appliance manufacturers and the US construction industry. In addition, Flex-Tek supports specialised original equipment manufacturers (OEMs) with a wide range of solutions for equipment used to treat sleep disorders, semi-conductor manufacture, and temperature control in extrusion and large commercial heating and ventilation.

Flex-Tek goes to market via three distinct technology areas:

Smiths Tubular Systems Aerospace

Meeting the aircraft industry's need for rigid and flexible hydraulic and fuel hose, STS Aerospace delivers high-performance airframe fluid management systems that are also deployed in the world of motorsport. Demand for these products is linked to the worldwide air transport market and military spending.

Flexible Solutions

Focusing on flexible hose assemblies for a range of domestic appliance manufacturers, Flexible Solutions makes both high- and low- pressure hose assemblies for OEMs and distributors. Applications for the flexible hose and ducting products range from gasoline vapour recovery to post-operative patient warming. Business performance generally follows macroeconomic indicators such as US GDP and capital goods expenditures.

Heat Solutions

Comprising specialised heating elements and thermal systems, HVAC ducting and gas delivery tubing, Heat Solutions' products serve customers that manufacture tumble dryers, HVAC equipment and specialised OEM customers described above. Ducting and gas delivery tubing is largely supplied to the construction industry via distributors. Demand is normally related to a mix of the strength of the US construction industry and worldwide household appliance expenditures.

Business review: Flex-Tek continued

Performance

	2009 £m	2008 £m	Reported growth	Underlying growth
Sales	222	206	8%	[15%]
Headline operating profit	22	24	(10%)	(27%)
Headline operating margin	9.9%	11.8%		
Statutory operating profit	18	24		

On a reported basis, Flex-Tek's sales rose 8%, or £16m, driven by currency translation (£51m) and the acquisition of Fast Heat (£3m), offset by a fall in underlying sales of £38m, or 15%. This decline reflects the impact of the deep recession in the US residential construction markets as well as significantly softer demand in the household appliances and industrial goods markets.

Headline operating profit declined by 10%, or £2m, stemming from an £8m fall in underlying operating profit, partly offset by a £6m benefit from currency translation. As a result, margins narrowed by 190 basis points. The underlying decline in operating profit is caused mainly by lower volumes (£15m) and offset by £4m from the cost-saving initiatives.

Softer sales of components and services to civil aviation were balanced by steady demand in commercial and military markets, resulting in flat aerospace revenues versus the prior year. The group has also benefited from production efficiency gains and, through a focus on tight cost control, has been able to improve margins.

Heat Solutions underlying sales declined by 16% mainly due to lower sales of gas piping and HVAC ducting in the US construction market. The recession in the US market has prompted a 44% fall in housing starts in the year compared with the same period last year. Sales of heating elements to appliance manufacturers were slightly down but offset by full-year sales from the acquisition of Fast Heat, resulting in flat sales compared to the previous year. Against this background, sales fell at a lower rate than the market, indicating that we have successfully gained share in a challenging trading environment. In addition, a sharper focus on low-cost manufacturing and combined product marketing programmes have helped preserve margins.

Underlying sales of flexible hose assemblies from the Flexible Solutions division were down 23% resulting from softer demand in the US floorcare and general industrial markets.

Flex-Tek's new facilities in Asia continue to expand. We are in the process of widening the range of products delivered from our Changshu, China, facility to include high-pressure tubing for aerospace and industrial applications. Our Aerospace tubing plant in Bangalore, India, should be well positioned to benefit from recent announcements by the Indian government regarding increased defence spending.

Business developments

The challenges in the housing and domestic appliance markets have prompted Flex-Tek to identify opportunities to rationalise its manufacturing portfolio and deliver efficiency improvements. The programme is part of the wider Group restructuring and is expected to deliver annualised savings of £9m. During the year, Flex-Tek has closed a factory near Glasgow, Scotland, and announced the closure of a heating element facility in Elmhurst, Illinois, which will complete by the end of the 2009 calendar year. As a result, savings to date total £4m.

Outlook

Flex-Tek faces continued uncertainty in the US residential construction, household appliance and industrial markets. It will continue to rationalise its portfolio of sites and reduce costs in order to deliver future value when these markets improve. The initiatives to date have made Flex-Tek a leaner business, which is strongly leveraged to a recovery in US housing – when that occurs. It will continue to seek growth opportunities in sectors outside residential construction and in developing markets.

FlexSure Solar Tubing

Recognising the rising demand for energy efficiency Flex-Tek has successfully adapted its manufacturing to produce freeze-protected tubing for use in solar water heating systems. FlexSure Solar Tubing, made of stainless steel, flexible and highly resilient in extreme weather, helps connect the supply and return lines between a solar thermal panel and hot water storage tank. A typical residential solar water-heating system reduces the need for conventional water heating by about two-thirds. It both cuts the cost of electricity or fossil fuel needed to heat the water and reduces the impact on the environment.

Financial review

Earnings per share

Basic headline earnings per share from continuing activities were 72.4p (2008: 74.5p), a decline of 3%. This reflects an increased headline operating profit offset by higher interest costs on the newly refinanced debt and a lower pensions financing gain as a result of the worsening funding position of the company's retirement benefit schemes.

On a statutory basis, the basic earnings per share from continuing activities were 70.8p (2008: 63.0p).

Exceptional and other items relating to continuing activities excluded from headline profits

These items had no net impact in the year compared with a charge of £61m in 2008. They comprised:

- Gains of £70m arising from the actions taken to reduce liabilities associated with the pensions and post-retirement healthcare benefits;
- £24m (2008: £4m) in respect of restructuring corporate and divisional headquarters. This is part of a programme which is expected to cost approximately £45m;
- £22m (2008: £54m) in connection with John Crane, Inc. asbestos litigation (see litigation paragraph on page 41);
- Amortisation of intangible assets acquired in business combinations of £35m (2008: £19m). The amortisation relates principally to technology and customer relationships; and
- Profit on disposal of businesses and property of £15m (2008: £27m).
- Financing losses amounted to £4m (2008: £2m). These represent the results of derivatives and other financing instruments which are not hedge accounted under IFRS.

Exceptional items in 2008 included Medex integration costs of £9m.

Cash generation

Strong cash generation this year resulted in a free cash-flow of £256m (2008: £91m). Substantially improved headline operating cash of £435m (2008: £273m) represented 104% (2008: 72%) of headline operating profit. The improvement was a result of reduced investment in working capital, particularly inventories and debtors, and lower net capital expenditure.

On a statutory basis, net cash inflow from continuing operations was £332m (2008: £198m).

Net cash expenditure on exceptional items was £32m, compared to £26m in the previous year. The Group made special pension contributions of £34m (2008: £34m). Free cash-flow from continuing operations (after interest and tax but before acquisitions, dividends and net investment hedges) was £256m (2008: £91m).

Dividends paid in the year on ordinary shares amounted to £132m, compared with £131m in 2008.

Interest and other financing costs

Interest payable on debt, net of interest earned on cash deposits, was £52m compared with £41m in 2008. Interest costs were covered 8 times covered by headline operating profits.

The Group accounts for pensions using IAS19. As required by this standard, a finance credit is recognised reflecting the expected return on pension scheme assets and a finance charge is recognised reflecting the unwinding of the discount on the future pension liability. The net financing credit was £5m in 2009 compared with a net financing credit of £42m in 2008.

Net debt

Net debt at 31 July 2009 was £885m, up from £771m in 2008. The increase in net debt was the result of exchange rate changes, which resulted in a cash outflow of £90m on net investment hedges and a £28m translation increase in currency-denominated net debt.

During the year a £90m cash outflow, which increased net debt, occurred on the rollover of short term derivative net investment hedges caused by weaker sterling. These derivative hedges swapped sterling bonds into primarily US dollar and euro liabilities to hedge the significant translation exposure on US dollar and euro assets. If the bonds had been denominated in US dollars and euro, the same increase in reported debt would have occurred – reported not as a cash outflow but as an adverse translation effect. The financing strategy launched during 2009 with the raising of \$675m of long term dollar bonds will replace these derivative investment hedges and more effectively match long term currency assets and liabilities.

Research and development

Investment in research and development (R&D) drives future performance and is a measure of the Group's commitment to the future organic growth of the business.

Smiths invested a total of £105m in R&D on continuing operations, equivalent to 4% of sales. Of that total, £15m was funded by customers. The comparative figures for 2008 were £85m and £13m. Under IFRS, certain of these development costs are capitalised. The gross capitalisation is shown as an intangible asset. Where customers contribute to the costs of development, the contribution is included as deferred income and disclosed within trade and other payables.

Accounting policies

The accounts in this report are prepared under International Financial Reporting Standards (IFRS), as adopted by the European Union (EU). The accounting policies used in preparing these accounts are set out on pages 80 to 85.

Significant judgements, key assumptions and estimates

Applying accounting policies requires the use of certain judgements, assumptions and estimates. The most important of these are set out on page 80.

Taxation

The headline tax charge of £89m for 2009 represented an effective rate of 24% on the headline profit before taxation – unchanged from last year. The Group continues to take advantage of global manufacturing, research and development and other tax incentives, the tax-efficient use of capital and tax compliance management. On a statutory basis, the tax charge on continuing activities was £95m (2008: £75m).

The fundamental principles of the Group's approach to taxation remain unchanged as approved by the Board. It seeks to mitigate the burden of taxation in a responsible manner to enhance its competitive position on a global basis while managing its relationships with tax authorities on the basis of full disclosure, co-operation and legal compliance. A semi-annual report is reviewed by the Audit Committee to monitor compliance with these principles and tax objectives.

Return on shareholders' funds

The after-tax headline return on shareholders' funds for continuing operations, including goodwill set-off against reserves, was 16.5% (2008: 16.7%).

Retirement benefits

As required by IFRS the balance sheet reflects the net surplus or deficit in retirement benefit plans, taking assets at their market values at 31 July 2009 and evaluating liabilities at year-end AA corporate bond interest rates.

We have taken action to reduce the Company's liabilities in respect of retirement benefits. The principal US defined benefit pension plan was closed with effect from 30 April 2009, after which no further benefits have accrued. In addition, future benefits accruing under the US and UK post-retirement healthcare schemes were substantially reduced; for most members, the Company has capped its contributions at 50% of the 2009/10 premium.

Company contributions to the funded defined benefit pension plans totalled £53m (2008: £56m). Company contributions included special UK contributions of £13.1m in respect of special covenant payments (2008: £17m comprising £13m of special covenant payments and £4m arising from the sale of Smiths Aerospace). During the year, the trustees of the TI Pension Scheme invested a further £249m in annuities that are matched with specific liabilities of the fund.

The retirement benefit position was:

	31 July 2009	31 January 2009	31 July 2008
Funded plans			
UK plans – funding status	95%	94%	106%
US plans – funding status	72%	64%	89%
Other plans – funding status	75%	77%	81%
	31 July 2009	31 January 2009	31 July 2008
Surplus/(deficit)			
Funded plans	(254)	(330)	102
Unfunded plans	(85)	(134)	(113)
Total surplus/(liability)	(339)	(464)	(11)

Full details of the retirement benefits are shown in note 10.

Exchange rates

The results of overseas operations are translated into sterling at average exchange rates. The net assets are translated at year-end rates. The principal exchange rates, expressed in terms of the value of sterling, are shown in the following table.

	2009	2008	
Average rates:			
US dollar	1.58	2.00	Dollar strengthened 21%
Euro	1.16	1.35	Euro strengthened 14%
Year-end rates:			
US dollar	1.67	1.98	Dollar strengthened 16%
Euro	1.17	1.27	Euro strengthened 8%

Goodwill and intangibles

Goodwill on acquisitions has been capitalised since 1998. Until 1 August 2004 it was amortised over a maximum 20-year period. Under IFRS goodwill is no longer amortised but instead is subject to annual reviews to test for impairment.

Intangible assets arising from business combinations ('acquired intangibles') are assessed at the time of acquisition in accordance with IFRS3 and are amortised over their expected useful life. This amortisation is excluded from the measure of headline profits.

Other intangible assets comprise development costs or software which are capitalised as intangible assets as required by IFRS. Amortisation charged on these accounts is deducted from headline profits.

The goodwill balance was tested for impairment in 2009 and 2008.

Financial review continued

Treasury

The Board has approved a Treasury Risk Management policy which governs the activities of both group treasury and subsidiary companies and the financial risk profile to be maintained by the Group. A monthly report for the Executive Committee and a semi-annual report to the Audit Committee reports on compliance with the policy. The Board maintains a strong treasury control framework within which bank, financing and debt strategy, interest rate risk and currency translation exposure are reserved for group treasury while cash and currency transaction exposure management is devolved to subsidiary companies.

The Group uses financial instruments to raise financing for its global operations, to manage related interest rate and currency financial risk and to hedge transaction risk within subsidiary companies. The Group does not speculate in financial instruments. All financial instruments hedge existing business exposure and all are recognised on the balance sheet.

There are four components of the Treasury Risk policy and in each component a series of metrics measured monthly.

1. Credit quality

The Group's strategy is to maintain a solid investment grade rating to ensure access to the widest possible sources of financing and to minimise the resulting cost of debt capital. The credit ratings at the end of 2009 were maintained at BBB+ / Baa2 (both negative outlook) from Standard & Poor's and Moody's respectively, the same rating as 2008 except for the change in outlook from stable to negative. An essential element of an investment grade rating is robust cash-flow metrics. The Group's objective is to maintain an operating cash conversion of greater than 80% and to maintain net debt/headline EBITDA of less than two times. At 31 July 2009 these measures were 104% (2008: 72%) and 1.8 times (2008: 1.7 times) respectively.

2. Debt and interest rate management

The Group's debt funding requirements are managed centrally. At 31 July 2009 net debt was £885m (2008: £771m). In 2009 the Group raised \$675m in new-long term US\$ capital markets financing to further its debt strategy via \$250m 6.05% senior notes due 2014, \$175m 7.37% senior notes due 2018 and \$250m 7.2% senior notes due 2019. These funds were used to repay £70m of EIB 2010 loan finance, repay short-term bank debt and finance on-going activity of the Group. The Group's objectives are to ensure that funding from the bank market is less than 30% of net debt, the average maturity profile of all debt is at least four years and between 50% and 80% of debt is at fixed rate of interest. At the 31 July 2009, these measures were 8% (2008: 42%); 5.4 years (2008: 4.0 years) and 79% (2008: 46%), respectively.

3. Liquidity management

A committed £660m revolving bank credit facility is available to the Group until July 2012 and is provided by a quality group of 11 global relationship banks. At the 31 July 2009, £623m of the facility was un-drawn (2008: £450m). The Group's objective is to ensure that at any time un-drawn committed facilities net of overdraft financing are greater than £200m. At 31 July 2009, this measure was £595m (2008: £378m) respectively.

The Group aims to minimise levels of surplus cash across the Group and, where cash resources exist, to ensure they are securely placed on deposits with highly rated counterparties at short-notice availability. Credit exposure to every bank is defined by the Treasury Risk policy by reference to long-term rating and compliance is measured monthly. At 31 July 2009, 83% of surplus cash was on deposit with the 11 global relationship banks and only £5m was on deposit with banks rated less than A+.

4. Currency management

The Group has adopted hedge accounting for the significant majority of transaction hedging positions, thereby mitigating the impact of market value changes in the income statement. Material sales or purchases in foreign currencies are hedged at their inception by appropriate financial instruments, principally forward foreign exchange contracts and swaps. The Group's objective is to reduce medium-term volatility to cash-flow, margins and earnings.

The Group is an international business with the majority of its net assets denominated in foreign currency. It protects its balance sheet and reserves from adverse foreign exchange movements by financing its currency assets in the same currency such that, where the value of net assets is over £20m equivalent, over 50% of those assets are matched with same currency liability. In total 52% (2008: 47%) of foreign currency assets were matched by currency liabilities.

Financial controls

While the Group's decentralised organisation delegates day-to-day control to local management, Smiths has comprehensive control systems in place with regular reporting to the Board. The Group has continuous formalised business risk management processes operating at each business unit.

The internal audit department reviews all units over a rolling three-year cycle, and its findings are reported to the Audit Committee. All acquisitions are reviewed within 12 months of acquisition, to verify compliance with Group procedures.

Further information regarding the Group's procedures to maintain strict controls over all aspects of risk, including financial risk, are set out in the Corporate governance statement on pages 59 to 63.

Essential contracts

The divisional reviews describe our main customer and supplier relationships and the 'Risks and uncertainties' section outlines the risk management aspects of our contractual arrangements. Smiths Group has a wide range of suppliers and customers, and while the loss of, or disruption to, certain of these arrangements could temporarily affect the operations of an individual division, none is considered essential.

Legal issues

Smiths is committed to operating within the law in all applicable jurisdictions, and seeks to benefit from the rights and protections afforded by relevant laws. The Company aims to anticipate and meet the changing requirements of the markets it serves, as legal and regulatory reforms impact those markets.

Legal issues

Smiths faces different types of legal issues in different jurisdictions. The high level of activity in the US, for example, exposes the Company to the likelihood of various types of litigation commonplace in that country, such as 'mass tort' and 'class action' litigation, and legal challenges to the scope and validity of patents. These types of proceedings (or the threat of them) are also used to create pressure to encourage negotiated settlement of disputes.

In addition, contracting with the US Government subjects the Group to numerous stringent regulatory obligations, calling for an active programme of compliance, reporting and communication. By contrast, the Group's activities in some countries with less developed legal systems pose challenges for the protection of corporate assets such as real estate and intellectual property rights.

In order to address the challenges and exploit the opportunities arising from these and other legal issues, Smiths employs experienced lawyers both in its head office and in its divisions, and retains the services of top law firms around the world.

John Crane, Inc. litigation

John Crane, Inc. (JCI), a subsidiary of the Group, is currently one of many co-defendants in litigation in the USA relating to products previously manufactured which contained asbestos. This litigation began around 30 years ago and, typically, involves claims for a number of diseases including asbestosis, lung cancer and mesothelioma. The JCI products generally referred to in these cases consist of industrial sealing products, primarily packing and gaskets. The asbestos was encapsulated within these products in such a manner that, according to tests conducted on behalf of JCI, the products were safe. John Crane ceased manufacturing products containing asbestos in 1985.

In recent years, the litigation has focused increasingly on claims for mesothelioma, awards for which, when made, tend to be larger than those for the other diseases. Whilst the number of claims being filed against JCI and other defendants has been declining, the proportion of mesothelioma claims has increased, and JCI's ability to defend these cases is likely to have a significant impact on its annual aggregate adverse judgment and defence costs.

JCI is actively monitoring the conduct and effect of its current and expected asbestos litigation, including the efficacious presentation of its 'safe product' defence, and intends to resist all asbestos cases based on this defence. Approximately 168,000 claims against JCI have been dismissed before trial over the last 30 years. JCI is currently a defendant in cases involving approximately 129,000 claims. Despite these large numbers of claims, JCI has had final judgments against it in only 82 cases, and has had to pay awards amounting to approximately US\$82m over the 30-year period.

In connection with this litigation, JCI secured the commutation of certain liability insurance policies in financial year 2007, resulting in proceeds of £43m. While JCI has substantial excess liability insurance, the availability and exact scope of the cover are currently the subject of litigation in the United States. An adverse judgment at first instance from the Circuit Court of Cook County, Illinois is currently under appeal. Pending the outcome of that litigation, JCI has begun to meet defence costs directly.

At 31 July 2009, the aggregate provision for JCI asbestos litigation, including for adverse judgments and defence costs, amounted to £167m expressed at the then current exchange rate. Movements in exchange rates in 2009 increased the provision by £26m. In deciding upon the amount of the provision, JCI has relied on expert advice from a specialist in asbestos liability estimation. Moreover, in establishing this provision no account has been taken of any recoveries from insurers as their nature and timing are subject to pending litigation.

Risks and uncertainties

Smiths is exposed to the following principal risks. If any of these risks, or other unforeseen risks, materialise, they could have a significant adverse effect on not only our business and financial condition but also our reputation and the trading prices and liquidity of our securities. This could lead to a loss for investors of part of or, in a worst case scenario, all of their investment.

Risks and uncertainties

Smiths seeks to mitigate significant identified risks through risk management processes, appropriate Group policies and other measures (including insurance where we regard it as appropriate and economic) but there can be no assurance that such measures will be effective in any particular case.

Competition, innovation and major projects

The industries in which Smiths operates are characterised by technological innovation, intense global competition, consolidation through mergers, joint ventures and alliances and some of the Group's competitors may have greater resources than it does. Additionally, the entry of new competitors, the consolidation of competitors and changed or irrational behaviour by competitors could all have a significant adverse impact on the Group's business.

Continued development of new products and improvements to existing products are critical to the future of Smiths business and competitors may innovate in these areas more effectively. All new or improved technologies and products involve risk, including possible abortive expenditure, reputational risk and potential customer claims or onerous contracts. In addition, in some cases Smiths contracts to supply new products to customers before the design is established or proven. Further, Smiths' research and development programme may not produce successful results and its new products may not achieve market acceptance, create additional revenue or become profitable, which could materially harm its reputation and business. The same is true for investment in new facilities and other major projects.

Should there be a decrease in the funds available from the Group's operations, from customer advances (for example, if customers cancel the relevant contracts) or from government grants, Smiths may not be able to continue an adequate level of research and development activity, which would harm its ability to develop new products and, accordingly, negatively affect its future results.

Raw materials

Smiths' business is affected by the price, quality, availability and timely delivery of raw materials and purchased components. Smiths' business could be adversely impacted by factors such as the destruction of suppliers' facilities or their distribution infrastructure, a work stoppage or strike by suppliers' employees, or the failure of suppliers to provide materials of the requisite quality or by increased costs. In particular, Smiths relies on sole suppliers to provide raw materials or purchased components for some of its products. Risks include loss of such a supplier, a reduction or interruption in manufacturing, volatility in prices or an inability to secure alternative sources of raw materials or components.

Contractual arrangements and inability to supply

Smiths must service its existing contracts and win new contracts, the award of which is subject to competition and is affected by factors outside the Group's control, such as government spending decisions and administrative procedures. Risks include the failure to secure or delays in securing a consistent number of contracts or any interruption to or termination of existing contracts.

Smiths ability to execute contractual commitments depends on numerous factors, including its ability to develop necessary technologies. Failure to deliver, in a timely fashion or at all, the products and services Smiths is obliged to deliver, or any fault in contract execution due to delays or breaches by its suppliers, may lead to higher costs or penalties. In particular, some of Smiths' contracts require compliance with a variety of complex laws, regulations and standards, breaches of which could entail serious consequences for the Group. Smiths may also face difficulty enforcing contracts with customers, suppliers or other counterparties.

Also, differences between the estimated costs in Smiths' medium- and long-term contracts and actual costs may arise from a number of factors including production delays, cost overruns and other items.

Smiths Detection, Smiths Medical and Smiths Interconnect frequently need to tender for government contracts. The timing of the award of contracts and payments under such contracts may be uncertain and uneven over a given financial year. At times these divisions must bid for contracts prior to completing the necessary design, which may result in unforeseen technological difficulties and/or cost overruns.

Additionally, certain of Smiths contracts with governments include terms that allow the government body counterparty to terminate unilaterally, reduce or modify the relevant contracts.

Targeted cost savings

Smiths strategy to improve profitability through productivity and efficiency by reducing costs throughout the supply chain may not yield the anticipated cost savings, and Smiths could face unexpected increases in direct or indirect costs. Smiths ability to gain additional efficiencies may become more difficult over time, such as when synergies from the restructuring programme and acquisitions are fully realised. In addition, objectives and limitations could be imposed over the scope of savings programmes by relevant stakeholders, which may jeopardise future savings programmes.

Global political and economic conditions

Smiths operates in over 50 countries, and is affected by global economic conditions, particularly in the United States. Smiths business is affected by government spending priorities, in particular in the United States and United Kingdom, and the willingness of governments to commit substantial resources to homeland security and defence initiatives.

Current global economic and financial market conditions, including severe disruptions in the credit markets and the potential for a significant and prolonged global economic recession, have affected and may materially and adversely affect Smiths financial condition, and may also materially impact its customers, suppliers and other parties with which it does business. Adverse economic and financial market conditions may cause Smiths customers to terminate existing purchase orders or to reduce their purchases from Smiths or cause its suppliers to be unable to meet their commitments to Smiths or to make changes in the credit terms they extend it.

Smiths is also affected by the social, economic, regulatory and political conditions where it has operations, which are often unpredictable and outside its control, particularly in developing countries.

Intellectual property

If Smiths does not obtain sufficient protection for its intellectual property, or if it is unable to effectively enforce its intellectual property rights, Smiths competitiveness could be impaired.

Additionally Smiths cannot provide assurances that it will maintain its trade secrets or that Smiths would have adequate remedies to compensate it for the losses in the event of breach of agreements.

There also can be no guarantee that Smiths technology will not be found to infringe rights owned by or granted to others or that any of its currently patented products will not be the subject of intellectual property litigation or other disputes.

Acquisitions and disposals

The success of the Smiths strategy of organic growth and mergers and acquisitions depends on identifying suitable acquisition targets, obtaining the necessary authorisations and approvals and having the ability to commit the necessary financing. Even if it is successful in making an acquisition, the products and technologies that Smiths acquires may not be successful or may require significantly greater resources and investment than originally anticipated. Smiths may not be able to successfully integrate the businesses that it acquires or obtain the appropriate regulatory approvals for such acquisitions. It cannot guarantee that any anticipated benefits from an acquisition will be realised.

In recent years, Smiths has disposed of a number of businesses, including its Aerospace operations, where it has given indemnities, warranties and guarantees to counterparties. Smiths is also party to a number of contracts relating to exited businesses which it has novated to the purchasers of these businesses.

Controls and information technology

Smiths information systems, personnel and facilities are subject to security risk. Failures in security systems or processes could have significant adverse consequences, as could failures in Smiths' various corporate governance and internal controls, failures to detect fraud, theft or corruption or non-compliance with the Smiths Group Code of Business Ethics.

Additionally, Smiths is dependent on information technology systems for both internal and external communications and for the day-to-day management of its operations, with a number of key enterprise resource planning projects in the course of implementation across the Group. Any disruption to these systems, or delays or failures in the implementation of these projects, could have significant adverse consequences for the Group.

Risks and uncertainties continued

Legislative and regulatory

Smiths operates in highly regulated business sectors. Smiths Detection, Smiths Interconnect and Smiths Medical are particularly subject to regulation, with certain customers and regulatory or other enforcement bodies routinely inspecting the Group's practices, processes and premises. A compliance problem arising in one of these (or any other of Smiths) divisions could have significant adverse consequences for the Group as a whole.

Certain of Smiths products, most notably devices produced by Smiths Medical, are subject to regulatory approval processes. Should a regulator's approval process take a particularly long time, Smiths products may suffer a delay in getting to the market, which could give an advantage to a competitor with a similar product.

Due to the security functions served by their products, Smiths Detection and Smiths Interconnect are subject to numerous export controls, technology licensing and other government regulations. In addition, new regulations or certification requirements may require additional expenses or restrict Smiths' commercial flexibility and planned business strategies.

Litigation and product liability

In the ordinary course of its business, Smiths is subject to litigation such as product liability claims and lawsuits, including potential class actions, alleging that the Group's products have resulted or could result in an unsafe condition or injury. Any liability claim brought against Smiths, with or without merit, could be costly to defend and could result in an increase of the Group's insurance premiums. Some claims brought against Smiths might not be covered by its insurance policies adequately or at all. Further information regarding material litigation in which the Group is involved is set out on page 41.

In addition, manufacturing flaws, component failures or design defects could require Smiths to recall products. Many of Smiths products are used in critical applications where the consequences of a failure could be extremely serious and, in some cases, potentially catastrophic. An adverse event involving one of its products could result in reduced market acceptance and demand for all products and could harm Smiths' reputation. Smiths also may undertake voluntarily to recall products or temporarily shut down production lines based on internal safety and quality monitoring and testing data perhaps due to issues with external parties outside the Group's control.

Environmental and external

Smiths cannot provide any assurance that it has been or will be at all times in complete compliance with laws, regulations and any required permits concerning emissions into the environment, the violation of which could result in fines or other sanctions. These environmental requirements may become stricter over time and the cost of maintaining compliance with environmental laws, regulations or permits may increase.

Smiths could be held responsible for any and all liabilities and consequences arising out of past or future environmental damage, including potentially significant remedial costs. There is a risk that liabilities or remediation costs could prove greater than expected or that further contamination could be discovered with significant adverse consequences for the Group. There can be no assurance that any provisions Smiths makes for expected liabilities and remediation costs will adequately cover such liabilities or costs.

Smiths is exposed to a number of natural catastrophe risks, such as earthquakes, floods, hurricanes and other types of storm, which, like other external events, such as terrorist attacks or a disease pandemic, could have significant adverse consequences for its business.

Financial

Exchange rate fluctuations have had, and could continue to have, a material impact on Smiths operating results. The global financial crisis has led to increased volatility in exchange rates, which makes it harder to predict exchange rates and thus perform financial planning.

Smiths is exposed to two types of currency risk: transaction risk in respect of products manufactured in one currency region and sold in another currency; and translation risk in that the results of its non-UK businesses will translate into pounds sterling, the Group's reporting currency, at differing values, depending on the exchange rate.

Smiths is exposed to interest rate risk derived mainly from long-term indebtedness relating to borrowings which have been issued at floating interest rates. Cash deposits and other financial instruments expose Smiths to credit risk on the amounts due from counterparties such as suppliers, banks, insurers and customers, including governments and government agencies.

Smiths ability to refinance its borrowings in the bank or capital markets is dependent on market conditions and the proper functioning of financial markets, either of which may affect the Group's ability to refinance.

Whilst in 2009 Smiths' effective tax rate on headline profits was 24%, there can be no guarantee that this rate will be sustained.

Pension funding

As a result of benefit arrangements under the Smiths retirement plans, Smiths is subject to various funding risks, including poor performance of the investments (particularly equity investments), increased longevity of members and changes in valuation and funding assumptions. Under Smiths defined benefit plans, the Group is committed to pay a defined level of benefits to plan participants, thereby bearing the risk that the plans' assets, such as investments in equity and debt securities, will not be sufficient to cover the value of those benefits. The value of the plans' assets is affected by, among other things, developments in the equity and bond markets.

Human resources

Competition for personnel is intense and Smiths may not be successful in attracting or retaining qualified personnel, particularly engineering professionals. In addition, certain personnel may be required to receive security clearance and substantial training to work on certain programmes. The loss of key employees, Smiths inability to attract new qualified employees, adequately trained employees, or a delay in hiring key personnel could seriously harm the Group's business.

Insurance

Smiths cannot provide assurance that it will be able to obtain insurance on terms acceptable to the Group or at all since insurance varies in cost and can be difficult to obtain. Furthermore, Smiths cannot provide assurance that its insurance coverage will be sufficient to cover the loss arising from any or all of the above events. In addition, even if its coverage is sufficient, the insurance industry is subject to credit risk, particularly in the event of a catastrophe or where an insurer has substantial exposure to a specific risk.

Corporate responsibility

Our Code applies to all businesses and employees of Smiths Group worldwide. Compliance with our Code helps to sustain and enhance the good reputation of the Company and contributes to long-term value creation for shareholders.

We believe that every employee plays their part in building and strengthening the Group as a whole. We operate a non-retaliation policy: any employee who in good faith reports any act of apparent misconduct or unethical behaviour will not be victimised or treated adversely.

Smiths Code of Business Ethics ('the Code') is based on 12 principles:

- 1 We comply with the law
- 2 We compete fairly
- 3 We act with integrity in all our business dealings
- 4 We treat our suppliers, partners and customers properly
- 5 We treat our co-workers respectfully
- 6 We contribute to healthy, safe and secure workplaces
- 7 We respect the environment
- 8 We contribute to our communities
- 9 We participate in relevant public debates
- 10 We respect human rights
- 11 We have high standards of financial record-keeping and reporting
- 12 The Code applies to all of us

In 2008, Smiths introduced a revised Code of Business Ethics ('Code') that sets out 12 broad principles for how Smiths does business: these standards are based on a set of common values based around integrity, honesty, fairness and transparency. These principles cannot address all areas or all circumstances, but they provide a framework for wider policies and programmes. The Code aims to offer clear standards and guidance for the business dealings of every employee. The Code applies to all businesses and employees of Smiths Group worldwide. The Code, in 12 languages, has been provided in a printed copy format and on the Smiths intranet for each employee.

Smiths Code of Business Ethics is available to the public on the Smiths website, www.smiths.com.

In 2009, in order to communicate the revised Code and provide ethics training to individuals across the Group, a Smiths Code of Business Ethics training course was created. In collaboration with Global IT this course was launched online through a custom-built electronic training platform, the Global Learning Resource (GLR), and installed on a Smiths training portal available through the intranet. Smiths employees have been trained on the revised Code of Business Ethics through the intranet, portal or classroom-style training.

The GLR and portal is designed to support future employee training in the areas of business ethics, compliance, safety, and security.

Managing corporate responsibility

The Code Compliance Council for the Code of Business Ethics ('the Council') acts as the steering committee for the ethics programme. The Chief Ethics Officer has the responsibility to report to the Audit Committee periodically on ethics issues and suspected or actual breaches of the Code. The Council and its Chair are assisted by a dedicated, full-time Ethics and Compliance Manager for Smiths Group.

Compliance support to Smiths businesses is provided through legal counsel serving the businesses and other experts who provide advice, export control policies, education, training, guidance materials and risk assessment tools.

Responsibility for managing specific issues lies at different levels within Smiths Group, depending on the nature of the issue and how it can most effectively be managed:

- environment, health and safety (EHS) issues are the responsibility of line management and are overseen through a Group-wide EHS steering committee, a technical implementation committee and local co-ordinators;
- security, also a line management responsibility, is controlled through a Group-wide Security committee;
- employee issues are managed by line management and through the Human Resources function;
- supplier and customer programmes are managed by each business; and
- community programmes are principally managed locally, although there is also some Group-level activity.

Smiths maintains an Ethics Helpline, accessible by both phone and email, to answer queries relating to ethics issues, as well as to act as a confidential reporting line for concerns and allegations. The Helpline is available worldwide to all Smiths employees. There are toll-free phone numbers in approximately 40 countries where Smiths has businesses staffed by individuals who speak the local language. The Helpline is managed by the Chief Ethics Officer, assisted by the Ethics and Compliance Manager.

Health and safety

Smiths is committed to conducting all its activities in a manner which achieves the highest practicable standards of health and safety.

In 2007 Smiths made the commitment to achieve certification to the occupational health and safety management system standard OHSAS18001 by July 2010 at all of its manufacturing facilities with more than 50 employees.

The success of OHSAS18001, together with other targeted initiatives, is measured against the recordable incident rate (RIR) performance. In 2007, we established a RIR goal of 1.5 recordable incidents per 100 employees to be achieved by mid-2010. We have outperformed this goal early, achieving a RIR of 1.03 in 2009, a 46% reduction over our baseline 2007 performance of 1.89 RIR. Since 2004, we have achieved a steady reduction in our RIR with 2009 being our safest on record.

Performance against targets

Target (August 2007 – July 2010)	2009 result
OHSAS18001 certification Certification at all sites with more than 50 employees by July 2010	19 out of 88 certified
Recordable incident rate Better than 1.5 per 100 employees	1.03
Lost time incident rate No target set	0.51

Environment

Smiths is committed to ensuring that, as far as is reasonably practicable, any detrimental effects of its activities, products and services upon the environment are minimised. In practice, this means using performance-based environmental management systems to drive improvement throughout the business.

The environmental management system ISO14001 is required at all Smiths manufacturing sites with more than 50 employees. New acquisitions, or businesses that grow above the 50 employee threshold, are required to seek certification. Currently, 67 out of 88 manufacturing sites are certified. ISO14001 ensures that a culture of continual improvement is embedded throughout the organisation.

Three-year targets were set in August 2007 to be achieved by July 2010 for greenhouse gas emissions, waste disposal and water consumption. Each of our key indicators has shown improvement, currently beating our goal. Progress is reported below.

Performance against targets

Target (August 2007 – July 2010)	2009 result
Greenhouse gas emissions No absolute increase over the 2007 baseline	9% reduction
Total non-recycled waste 9% reduction over three years normalised against turnover	31% reduction
Water consumption 9% reduction over three years normalised against turnover	21% reduction

Corporate responsibility continued

Employees

It is the Company's policy to provide equal opportunities for employment. Smiths recruits, selects and promotes employees on the basis of their qualifications, skills, aptitude and attitude. In employment-related decisions, Smiths complies with all applicable anti-discrimination requirements in the relevant jurisdictions, including concerning matters of race, colour, national origin, gender, marital status, sexual orientation, religious belief, age, or physical or mental disability. Disabled people are given full consideration for employment and subsequent training, career development and promotion on the basis of their aptitudes and abilities.

All Smiths employees are treated with respect and dignity. Accordingly, any harassment or bullying is unacceptable. Smiths respects the right of each employee to join or not to join a trade union or other bona fide employee representative organisation. Smiths believes in good communications with employees and in promoting consultation, co-operation and teamwork on matters of mutual concern.

Smiths offers employees in the US and the UK opportunities to participate in share plans that enable employees to benefit from increases to the company's share price and to align their interests more closely with those of shareholders.

Smiths invests in employees' skills and capabilities, which in turn helps the Company and its businesses to succeed. Current priorities for Smiths are talent development, succession planning and employee engagement.

Developing talent

Smiths has a number of development programmes designed to evaluate and enhance core leadership competencies. These development programmes are designed and tailored to address a wide range of learning styles, incorporating workshops, experiential learning, mentoring, team working and project experience.

Smiths continues to be actively involved in training and developing young people, including initiatives designed to ease the transition from school or study to work. For example, Horizons is a two-year programme for newly and recently appointed graduates and those early in their career. It provides an understanding of the Group and the business world in general, and develops personal and team-working skills.

Succession management

Smiths operates a systematic succession management process for leadership roles. Our businesses identify leadership talent and development needs using common tools and a consistent language. Development plans are monitored by senior management to optimise effective succession opportunities.

Employee engagement

Smiths provides information to and communicates with employees as an important part of doing business. 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, information and consultation forums, and other consultative bodies that allow their views to be taken into account.

Young Everest study published

Smiths Medical continues to sponsor a Chair of Anaesthesia and Critical care at University College Hospital, currently held by Professor Michael Mythen. As part of the endowment, support is given to the Portex Unit of Paediatric Anaesthesia, Pain Research, Critical Care, Respiratory Medicine, Physiology and Physiotherapy located at the Institute of Child Health. In June 2009 the unit celebrated the 40th anniversary of its founding, with Smiths having sponsored the unit since 1991. The first major publication from the Smiths Medical Young Everest Study was published in April 2009 which investigated the effects of altitude and low oxygen levels on children.

Smiths Medical continues to work on developing some of the concepts derived from the studies conducted on Mount Everest. In particular work continues to find ways of delivering oxygen to patients in an efficient manner whilst maintaining an active lifestyle. This involves working with clinicians in Europe and the United States to understand and define exact requirement. It is hoped that one such product will enter active development within the next year.

Communities

Smiths contributes positively to the communities in which we operate. In addition to providing employment opportunities and playing a beneficial role in local economies, we support community involvement through charitable giving and education initiatives.

This activity is primarily managed at a divisional level. However, Smiths does offer some support to community and charitable organisations from a central budget. Consideration is given to charities and organisations that demonstrate how a donation will enhance the well-being of people through improved education, health and welfare or environment. Projects local to our operational facilities or connected to the industries in which we operate are the primary focus of Smiths support.

Education is a major recipient of our support. For example, working together with the Royal Academy of Engineering in the UK, the Smiths Technology Education Programme is now in its third year. Through the programme, school students are offered the opportunity to participate in summer school courses in engineering and technology. Those students who then go on to take an engineering or technology degree course at university are eligible to receive Smiths bursaries. Smiths also supports the Centre for the Study of Terrorism and Political Violence at St Andrews University by funding a research assistant.

Smiths divisions also deliver significant support. The Smiths Medical Chair of Anaesthesia and Critical Care at University College Hospital is an important example of long-term funding that has enhanced medical care.

In addition to donations, Smiths people devote time to local community projects around the world. For further information, please see the 2009 Corporate Responsibility Report at www.smiths.com/responsibility.

Export & Import controls

All sales of defence equipment and export-controlled products or technology are undertaken in accordance with government export and import approval procedures and regulations. These regulations include the European Union export control regulations, the United States International Traffic in Arms Regulation (ITAR) and Export Administration Regulations (EAR), and the laws of several other countries in which these sales are made or the products used. These laws restrict or prohibit export of certain items to specific countries. In addition, Smiths adheres to all relevant government guidelines designed to ensure that products are not incorporated into weapons or other equipment used for the purposes of terrorism or abuse of human rights, with internal controls to ensure compliance with these guidelines.

FTSE4Good

In 2009, Smiths was again awarded membership of the FTSE4Good Index which acknowledges companies that meet globally recognised corporate responsibility standards. Whilst we are not complacent about the ongoing work required, we were pleased to merit again this external recognition of our corporate responsibility initiatives and business ethics programme.

1 Donald Brydon, CBE Chairman **

Aged 64. British. Donald Brydon was appointed to the Board in April 2004, becoming Chairman in September 2004. He is Chairman of the London Metal Exchange and of Royal Mail Holdings plc. He had a 20-year career with Barclays Group, during which time he was Chairman and Chief Executive of BZW Investment Management, followed by 10 years with the AXA Group. He was also formerly Chairman of Amersham plc and a Director of Allied Domecq plc and Scottish Power plc. He is Chairman of the David Rattray Memorial Trust (UK).

Chairman of the Nomination Committee.

2 Philip Bowman Chief Executive

Aged 56. Australian. Philip Bowman was appointed Chief Executive in December 2007. He previously held the positions of Chief Executive at Scottish Power from early 2006 until mid 2007 and Chief Executive at Allied Domecq between 1999 and 2005. He is currently the senior independent director of Burberry Group plc. Past board appointments include British Sky Broadcasting Group plc, Scottish & Newcastle Group plc and Coles Myer Limited as well as Chairman of Liberty plc and Coral Eurobet plc. His earlier career includes five years as a director of Bass plc (now Mitchells & Butler plc and Intercontinental Hotel Group plc), where he held the roles of Chief Financial Officer and subsequently Chief Executive of Bass Taverns.

3 John Langston Finance Director

Aged 59. British. John Langston was appointed to the Board in December 2000 on the Company's merger with TI Group plc. A chartered accountant, he was appointed Finance Director in September 2006. He previously held positions as Group Managing Director of Sealing Solutions, Group Managing Director of Detection and Group Managing Director of Specialty Engineering. 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 was appointed a director of TI Group plc in October 1998. He formerly worked for Lucas Industries. He is a non-executive director at Rexam plc.

4 David Challen, CBE Non-executive director ***

Aged 66. British. David Challen was appointed to the Board in September 2004. He is Vice-Chairman of Citigroup European Investment Bank and former Chairman of J Henry Schroder & Co Ltd. He is senior independent director at Anglo American plc. He is also Deputy Chairman of the Takeover Panel.

Chairman of the Audit Committee.

5 Stuart Chambers Non-executive director ***

Aged 53. British. Stuart Chambers was appointed to the Board in November 2006. He was formerly Chief Executive of Pilkington plc and then Group Chief Executive of Nippon Sheet Glass until August 2009. Prior to joining Pilkington plc in 1996, he spent ten years at Mars Corporation, latterly as Vice President, Sales & Marketing – Mars Electronics International. A chemical engineer by training, he previously spent ten years at Shell in a variety of European roles.

Chairman of the Remuneration Committee.

6 Peter Jackson Non-executive director ***

Aged 62. British. Peter Jackson was appointed to the Board as a non-executive director in December 2003 and as senior independent director in September 2004. He was formerly Chief Executive of Associated British Foods plc and Chairman of Kingfisher plc. He is chair of the Disabilities Trust.

Senior independent director.

7 Anne Quinn, CBE Non-executive director ***

Aged 58. New Zealander. Anne Quinn was appointed to the Board as a non executive director in August 2009. She worked for BP in the UK, USA, Belgium and Colombia and held a number of positions, including Group Vice President of Gas and Natural Gas Liquids. She has also been a managing director of the energy private equity group, Riverstone LLP. She was a non executive director of BOC and is currently a non executive director of Mondi plc. She also serves on the President's Advisory Committee to the Sloan School, MIT.

8 Sir Kevin Tebbit, KCB, CMG Non-executive director ***

Aged 62. British. Sir Kevin Tebbit was appointed to the Board in June 2006. He served widely in policy, management and finance posts in the Foreign & Commonwealth Office, NATO and finally the Ministry of Defence, where he was Permanent Under-Secretary of State from July 1998 to his retirement in November 2005. He is Chairman of Finmeccanica UK and an adviser to JCB Limited. He is Chairman of the Defence Advisory Group to the UKTI Defence and Security Organisation. He is also Visiting Professor at Queen Mary, University of London and Chairman of the Lifeboat Fund.

Committees

* Audit Committee

† Remuneration Committee

Nomination Committee

Group directors' report

Principal activities

The principal activities of the Company and its subsidiaries (the Group) are and, during the year ended 31 July 2009, were the development, manufacture, sale and support of:

- advanced security equipment, including trace detection, millimetre-wave, infrared, biological detection and diagnostics, that detect and identify explosives, narcotics, weapons, chemical agents, biohazards and contraband;
- mechanical seals, seal support systems, engineered bearings, power transmission couplings, specialist filtration systems and other hardware for the oil and gas, chemical, pharmaceutical, pulp and paper and mining sectors;
- medical devices aligned to specific therapies, principally airway, pain and temperature management, infusion, needle protection, critical care monitoring and vascular access;
- specialised electronic and radio frequency products that connect, protect and control critical systems for the global wireless telecommunications, aerospace, defence, space and medical markets; and
- engineered components including ducting, hose assemblies and heating elements that move and heat fluids for the aerospace, medical, industrial, construction and domestic markets.

The main manufacturing operations are in the UK, the Americas, Continental Europe and China.

Business review / future development / research and development

The business review on pages 16 to 49 is incorporated by reference, forming part of this Directors' report. This is a review of the development and performance of the business of the Group, including the financial performance during the financial year ended 31 July 2009; key performance indicators; and the principal risks and uncertainties facing the Group. It also includes information on likely future developments and activities in the field of research and development. The cautionary statement set out on the inside front cover of this Annual Report forms part of this Annual Report and is incorporated by reference into the business review.

Results and dividends

The results for the financial year ended 31 July 2009 are set out in the Consolidated income statement. Sales for the year amounted to £2,665m (2008: £2,321m). The profit for the year after taxation amounted to £270.0m (2008: £268.8m).

An interim dividend of 10.5p per ordinary share of 37.5p was paid on 24 April 2009. The directors recommend for payment on 20 November 2009 a final cash dividend of 23.5p on each ordinary share of 37.5p, making a total dividend of 34p for the financial year.

The retained profit of £270.0m was transferred to Reserves.

Changes in the Company and its interests during the financial year

On 1 August 2008 Smiths Group disbanded its Specialty Engineering division and the Group now comprises five divisions – Smiths Detection, John Crane, Smiths Medical, Smiths Interconnect and Flex-Tek – that serve a diverse range of global customers including governments and their agencies, petrochemical companies, hospitals, telecommunications companies and manufacturers in a variety of sectors around the world.

On 1 September 2008 the Company completed the sale of land in Basingstoke for £16m in cash. A further amount may be payable, depending on the final terms of such amended planning permission as may be granted.

On 3 November 2008 the Company converted the outstanding 459,157 issued B Shares into 224,463 ordinary shares, in accordance with the rights and restrictions attached to the B Shares as set out in the Company's articles of association. The terms of the conversion were one ordinary share for every 2.04466 B Shares, fractional entitlements being disregarded. A final dividend of 8.75p per B Share was paid on the outstanding B Shares in respect of the period from and including 16 April 2008 to but excluding 3 November 2008.

On 10 November 2008 the Company acquired the issued share capital of Zhejiang Zheda Medical Instrument Co. Ltd for a cash consideration of RMB 444.3m.

On 26 January 2009 the Company's registered office was changed to 2nd Floor, Cardinal Place, 80 Victoria Street, London SW1E 5JL.

On 26 February 2009 the Company issued US\$175m of senior notes in the US private placement market with a fixed nine year maturity and a fixed coupon of 7.37%.

On 24 April 2009 the Company acquired all the issued share capital of Shenzhen Dowin Lightning Technologies for a cash consideration of RMB 197.6m.

On 14 May 2009 the Company acquired all the issued share capital of Orion Corporation for a cash consideration of US\$72.1m.

On 14 May 2009 the Company closed a dual-tranche dollar-denominated offering, totalling US\$500m in guaranteed senior notes. US\$250m was priced at a fixed coupon of 6.05% for five years and US\$250m at a fixed coupon of 7.20% for 10 years.

On 22 May 2009 the Company announced that Smiths Group International Holdings Limited had unconditionally and irrevocably guaranteed any sum payable by the Company under £150m 7.875% Bonds due 2010 and £150m 7.25% Bonds due 2016.

Post balance sheet events

There have been no disclosable post balance sheet events.

Charitable and political donations

During the financial year the Company made donations of £504,000 for charitable purposes. This comprised payments totalling £300,000 to the Institute of Child Health, in sponsorship of the Smiths Medical Professor of Anaesthesia and Critical Care and the Portex Anaesthesia, Intensive Care and Respiratory Unit, and other donations made by the Company's businesses worldwide to miscellaneous charities. No political donations were made.

Directors

Messrs P Bowman; D H Brydon, CBE; D J Challen, CBE; S J Chambers; P J Jackson; J Langston; and Sir Kevin Tebbit all served throughout the year. Ms A C Quinn, CBE was appointed as a non-executive director on 1 August 2009.

Reappointment of directors

Sir Kevin Tebbit and Ms Quinn will retire from office at the Annual General Meeting ('AGM') in accordance with Article 55(1). Sir Kevin and Ms Quinn are each willing and eligible to stand for re-election and resolutions will be proposed at the AGM to re-elect them.

Directors' remuneration report

The Directors' remuneration report is on pages 65 to 73.

An ordinary resolution to approve the report will be put to shareholders at the AGM.

Directors' interests in contracts

Details of the executive directors' service contracts are as disclosed in the service contracts section of the Directors' remuneration report on pages 70 to 71. Details of the interests of the executive directors in the Company's share option schemes and plans are shown in the Directors' remuneration report on pages 72 to 73.

Qualifying third party indemnity provisions (as defined by section 234 of the Companies Act 2006) have remained in force for the directors during the financial year ended 31 July 2009 and, at the date of this report, are in force for the benefit of the current directors in relation to certain losses and liabilities which they may incur (or may have incurred) to third parties in the course of their professional duties.

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 voting rights

As at 26 September 2009 the Company had been notified, pursuant to the FSA's Disclosure & Transparency Rules, of the following notifiable interests in voting rights in its issued share capital:

	No. of shares	Percentage of issued ordinary share capital*
Aviva plc	12.1m	3.1%
AXA S.A	19.4m	5.0%
Legal & General Group plc	15.6m	4.0%
Massachusetts Financial Services Company	19.1m	4.9%
Newton Investment Management Limited	15.2m	3.9%
Prudential plc (including M&G Group)	19.9m	5.1%

*Percentage of ordinary share capital in issue on 26 September 2009.

The interests of the directors, their families and any connected persons in the issued share capital of the Company are shown in the Directors' remuneration report on page 70.

Corporate governance statement

The Corporate governance statement is on pages 59 to 63 and is incorporated in this Directors' report by reference. PricewaterhouseCoopers LLP has reviewed the Company's statements as to compliance with the June 2008 issue of the Combined Code, to the extent required by the UK Listing Authority Listing Rules. The results of its review are set out in the Independent auditors' report on page 75.

Financial instruments

The financial risk management objectives and policies of the Group; the policy for hedging each major type of forecasted transaction for which hedge accounting is used; and the exposure of the Group to price risk, credit risk, liquidity risk and cash-flow risk are outlined in note 20 of the Group financial statements.

Group directors' report continued

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 Group and the Company have sufficient resources to continue in operation for the foreseeable future. The accounts are therefore prepared on a going concern basis.

Policy on payment of creditors

The Company's policy and practice is to pay creditors promptly in accordance with agreed terms of business. The average time taken to pay an invoice was 28 days (2008: 33) for the parent Company and 31 days (2008: 43) for the Group as a whole.

Share capital and control

As at 31 July 2009, the Company's authorised share capital was £200,228,879.995, divided into 533,333,333 ordinary shares of 37.5p each nominal value (ordinary shares), representing 99.9% of the total share capital, and 22,888,012 non-cumulative preference shares of 1p ('B Shares'), representing 0.1% of the total share capital. On 31 July 2009 there were 389,026,427 ordinary shares and no B Shares in issue. The ordinary shares are listed on the London Stock Exchange.

The holders of ordinary shares are entitled to receive the Company's reports and accounts; to attend and speak at General Meetings of the Company; to appoint proxies and to exercise voting rights. Following the conversion of all the outstanding B Shares into ordinary shares in November 2008, there are no rights attaching to the B share capital.

There are no restrictions on transfer or limitations on the holding of any class of shares and no requirements for prior approval of any transfers. None of the shares carries any special rights with regard to control of the Company. There are no restrictions on the voting rights attaching to the ordinary shares; the B Shares have no rights, as described in the preceding paragraph. There are no known arrangements under which financial rights are held by a person other than the holder of the shares and no known agreements or restrictions on share transfers or on voting rights.

Shares acquired through Company share schemes and plans rank *pari passu* with the shares in issue and have no special rights. The Company operates an employee benefit trust, with an independent trustee, to hold shares pending employees becoming entitled to them under the Company's share schemes and plans. On 31 July 2009 the trust held 105,932 ordinary shares in the Company. The trust waives all but 0.1p per share of each dividend entitlement on its holding and abstains from voting the shares at general meetings.

The table on page 53 sets out the notifications received by the Company pursuant to the FSA's Disclosure & Transparency Rules, as at 26 September 2009, from persons with significant direct or indirect holdings in the Company's share capital.

The rules about the appointment and replacement of directors are contained in the Company's Articles of Association. Changes to the Articles of Association must be approved by the shareholders in accordance with the legislation in force from time to time. New Articles of Association were approved by the Company in general meeting on 28 July 2008. These took effect on 1 October 2008 and were adopted primarily to take account of changes in English company law brought about by certain provisions of the Companies Act 2006 (the '2006 Act') which had already come into force or which came into force on 1 October 2008. The remaining provisions of the 2006 Act take effect on 1 October 2009. A resolution will be proposed at the AGM to adopt new Articles of Association in order to take account of the implementation of the final provisions of the 2006 Act and the implementation in the UK of the Companies (Shareholders' Rights) Regulations 2009 (the 'Shareholders' Rights Regulations') on 3 August 2009.

The powers of the directors are determined by English law and the Articles of Association of the Company in force from time to time. The directors have been authorised to issue and allot ordinary shares, pursuant to Articles 6 and 7. The directors have authority to make market purchases of ordinary shares. The powers to issue and allot shares and, subject to specified limits, to allot shares on a non pre-emptive basis, are referred to the shareholders at the AGM each year for renewal. At the AGM the shareholders are also requested to renew the power to make market purchases of ordinary shares. Any ordinary shares so purchased may be cancelled or held in treasury.

The Company has in place credit facility agreements under which a change in control would trigger prepayment clauses and has bonds in issue the terms of which would allow bondholders to exercise put options and require the Company to buy back the bonds at their principal amount plus interest if a rating downgrade occurs at the same time as a change of control takes effect. The Company's share schemes and plans contain clauses which cause options and awards to vest on a change in control. The Company is not party to any other significant agreements that would take effect, alter or terminate upon a change of control following a takeover bid.

If there is a change in control of the Company prior to 10 December 2010, the terms of Mr Bowman's service contract allow him, at any time during the three months following the change in control, to resign and treat himself as redundant. In this event, (i) Mr Bowman would be entitled to receive the sum payable on a Company-elected termination of his employment, as described on page 70, save that his bonus entitlement for the period from the start of the bonus year in which the termination falls to the end of any unserved notice period would be a minimum of 75% of base salary (less any amount already paid to him in respect of the bonus year) and (ii) all available discretions will be exercised under the Company's share schemes and in default the Company must indemnify Mr Bowman for the value of any awards that do not vest on the change in control.

No other director or employee is contractually entitled to compensation for loss of office or employment as a result of a change in control except that provisions of the Company's share schemes may cause options and awards granted to employees under such schemes to vest on a change in control.

Purchase of shares

Pursuant to the Articles of Association, the Company purchased all the 20,648,272 deferred shares of 0.00001p each that resulted from the conversion of 459,157 B Shares into 224,463 ordinary shares on 3 November 2008, for an aggregate consideration of one penny. The deferred shares were cancelled immediately after the purchase. No other shares were purchased by the Company during the financial year ended 31 July 2009.

Corporate responsibility

The Company has Group policies on environmental, health and safety matters and operates a Code of Business Ethics. The Company seeks to minimise, as far as is reasonably practicable, any detrimental effects on the environment of its operations and products. The Group HR director has responsibility for environmental, health and safety matters, which are subject to preventative, investigatory and consultative systems, overseen by the Group Environment, Health and Safety Committee, and reports regularly to the Board on these matters. Issues relevant to the Company pension schemes are likewise covered by means of structured committees, including representation from recognised trade unions.

Further information on environmental and employee health and safety matters, including key performance indicators, is contained in the Corporate responsibility summary in the business review on pages 46 to 49. The full Corporate responsibility report is available online at www.smiths.com/responsibility.

Annual General Meeting

The 2009 AGM will be held at The Thomas Lord Suite, Lord's Cricket Ground, Grace Gate, St John's Wood Road, London NW8 8QN on Tuesday 17 November 2009 at 2:30 pm.

Authority to issue shares

At the AGM shareholders will be asked to renew and extend the authority, given to the directors at the last AGM under Section 80 of the Companies Act 1985, to allot shares in the Company or grant rights to subscribe for or to convert any security into shares in the Company for the purposes of Section 551 of the 2006 Act (the 'Allotment Resolution').

The authority in the first part of the Allotment Resolution will allow the directors to allot new shares in the Company or to grant rights to subscribe for or convert any security into shares in the Company up to a nominal value of £48,637,728, which is equivalent to approximately one third of the total issued ordinary share capital of the Company as at 26 September 2009.

The authority in the second part of the Allotment Resolution will allow the directors to allot new shares or to grant rights to subscribe for or convert any security into shares in the Company only in connection with a rights issue up to a further nominal value of £48,637,728, which is equivalent to approximately one third of the total issued ordinary share capital of the Company as at 26 September 2009. This is in line with corporate governance guidelines.

As at 26 September 2009, the Company did not hold any shares in treasury.

There are no present plans to undertake a rights issue or to allot new shares other than in connection with the Company's share option schemes and plans. The directors intend to take note of relevant corporate governance guidelines on the use of such powers in the event that the authority is exercised.

If the resolution is passed the authority will expire on the earlier of 31 January 2011 and the end of the AGM due to be held in 2010.

Also at the AGM shareholders will be asked to pass a special resolution to renew the power granted to directors to disapply shareholders' pre-emption rights under certain circumstances (the 'Pre-emption Resolution').

If the directors wish to allot new shares and other equity securities or sell treasury shares for cash (other than in connection with an employee share scheme) company law requires that these shares are offered first to shareholders in proportion to their existing holdings.

The purpose of the first part of the Pre-emption Resolution is to authorise the directors to allot new shares, pursuant to the authority given by the first part of the Allotment Resolution, or to sell treasury shares for cash:

a) in connection with a pre-emptive offer; and/or

b) otherwise up to a nominal value of £7,295,659, equivalent to 5% of the total issued ordinary share capital of the Company as at 26 September 2009, in each case without the shares first being offered to existing shareholders in proportion to their existing holdings.

Group directors' report continued

The second part of the Pre-emption Resolution is to authorise the directors to allot new shares, pursuant to the authority given by the second part of the Allotment Resolution, or to sell treasury shares for cash in connection with a rights issue without the shares first being offered to existing shareholders in proportion to their existing holdings. This is in line with corporate governance guidelines.

The directors intend to adhere to the provisions in the Pre-emption Group's Statement of Principles regarding cumulative usage of authorities within a rolling three-year period where the Principles provide that usage in excess of 7.5% should not take place without prior consultation with the Investment Committees of the Association of British Insurers and the National Association of Pension Funds.

During the financial year ended 31 July 2009, the following ordinary shares in the Company were issued:

- 922,783 ordinary shares of 37.5p pursuant to the terms of the Company's shareholder-approved share option schemes and share plans; and
- 224,463 ordinary shares of 37.5p pursuant to the conversion of the B Shares.

No shares were issued in respect of the 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 ordinary shares in the market.

The effect of the resolution is to renew the authority granted to the Company to purchase its own ordinary shares, up to a maximum of 38,910,182 ordinary shares, until the AGM in 2010 or 31 January 2011 whichever is the earlier. This represents 10% of the ordinary shares in issue as at 26 September 2009 and the Company's exercise of this authority is subject to the stated upper and lower limits on the price payable, which reflect the requirements of the Listing Rules.

Pursuant to the 2006 Act (as amended), the Company can hold the shares which have been purchased as treasury shares and either resell them for cash, cancel them, either immediately or at a point in the future, or use them for the purposes of its employee share schemes. The directors believe that it is desirable for the Company to have this choice as holding the purchased shares as treasury shares would give the Company the ability to re-sell or transfer them in the future, and so provide the Company with additional flexibility in the management of its capital base. No dividends will be paid on, and no voting rights will be exercised in respect of, treasury shares. However, it is not the Company's present intention to hold shares in treasury in the event that any shares were to be purchased under this authority.

Shares will only be purchased if the directors consider such purchases to be in the best interests of shareholders generally and that they can be expected to result in an increase in earnings per share. The authority will only be used after careful consideration, taking into account market conditions prevailing at the time, other investment opportunities, appropriate gearing levels and the overall financial position of the Company. Shares held as treasury shares will not automatically be cancelled and will not be taken into account in future calculations of earnings per share (unless they are subsequently resold or transferred out of treasury).

If any shares purchased by the Company are held in treasury and used for the purposes of its employee share schemes, the Company will count those shares towards the limits on the number of new shares which may be issued under such schemes.

As at 26 September 2009 there were 7.6m outstanding options granted under all share option schemes operated by the Company, which, if exercised would represent 2.0% of the issued ordinary share capital of the Company. If this authority were exercised in full, that percentage would increase to 2.2%.

Political donations

A resolution will be proposed at the AGM to renew the authority, granted by the shareholders at the last AGM to the Company and its subsidiaries, to make donations to political organisations and to incur political expenditure.

Part 14 of the 2006 Act requires companies to obtain shareholders' authority for donations to registered political parties and other political organisations totalling more than £5,000 in any twelve month period, and for any political expenditure, subject to limited exceptions. The definition of donation in this context is very wide and extends to bodies such as those concerned with policy review, law reform and the representation of the business community. It could include special interest groups, such as those involved with the environment, which the Company and its subsidiaries might wish to support, even though these activities are not designed to support or influence support for a particular party.

It remains the policy of the Company not to make political donations or incur political expenditure as those expressions are normally understood. To avoid inadvertent infringement of the 2006 Act, the directors are seeking shareholders' authority for the Company and its UK subsidiaries to make political donations and to incur political expenditure during for the period from the date of the AGM to the conclusion of next year's AGM up to a maximum aggregate amount of £50,000.

Auditor

Resolutions will be proposed at the AGM to reappoint PricewaterhouseCoopers LLP as auditor, to hold office until the next meeting at which the accounts are laid, and to authorise the directors to determine the auditor's remuneration.

Articles of Association

A special resolution will be proposed at the AGM to adopt new Articles of Association in order to update the Company's current Articles of Association primarily to take account of changes in English company law brought about by the implementation on 1 October 2009 of the remaining parts of the 2006 Act and the implementation on 3 August 2009 of the Shareholders' Rights Regulations.

A summary of the principal differences between the existing Articles and the proposed new Articles is included in the explanatory notes set out in the Notice of AGM.

Copies of the current Articles of Association and the proposed new Articles of Association are available for inspection at the registered office of the Company and at the offices of Linklaters LLP at One Silk Street, London EC2Y 8HQ during normal business hours until the conclusion of the AGM on 17 November 2009 and, on the day of the meeting, from 2:15 pm at the place of the Meeting until the close of the Meeting.

Notice period for extraordinary general meetings

A special resolution will be proposed at the AGM to permit the minimum notice period for calling a general meeting of the Company other than an AGM to remain at 14 clear days. Changes made to the 2006 Act by the Shareholders' Rights Regulations increase the notice period required for general meetings of the Company to 21 days unless shareholders approve a shorter notice period, which cannot, however, be less than 14 clear days. AGMs will continue to be held on at least 21 clear days' notice.

Before the coming into force of the Shareholders' Rights Regulations on 3 August 2009, the Company was able to call general meetings other than an AGM on 14 clear days' notice without obtaining such shareholder approval. In order to preserve this ability, such approval is sought at the AGM. The approval will be effective until the Company's next AGM, when it is intended that a similar resolution will be proposed.

Disclosure of information to the auditor

As at the date of this report, as far as each director is aware, there is no relevant audit information of which the Company's auditor is unaware. Each director has taken all the steps he should have taken as a director in order to make himself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Electronic communications at www.smiths.com

The 2006 Act recognises the growing importance of electronic communication ('e-communication') and enables companies to provide documentation and communications to shareholders via their websites, except to those shareholders who elect to receive hard (printed paper) copies by post. E-communication allows shareholders faster access to important information about the Company; saves the Company considerable overheads, by reducing its print production costs and postage; and helps the environment by saving the energy and raw materials that would otherwise be used in producing and dispatching printed documents. At the Extraordinary General Meeting held on 11 June 2007 shareholders approved the adoption of electronic communications.

Electronic copies of the Annual Report 2009 and the Notice of AGM will be posted on the Company's website, www.smiths.com. The Company's announcements to the Stock Exchange and press releases are available online through the website. Shareholding details and practical help on share transfers and changes of address can be found at www.shareview.co.uk.

Shareholders wishing to change their election and receive documents in hard copy form can do so at any time by contacting the Company's Registrar or by logging on to www.shareview.co.uk.

Group directors' report continued

Electronic proxy voting

The Company continues to provide electronic proxy voting for this year's AGM. Shareholders who are not Crest members can appoint a proxy and vote online for or against (or consciously not vote on) the resolutions to be proposed at the AGM by visiting the website www.sharevote.co.uk. The onscreen instructions will give details on how to complete the appointment and voting process. Crest members, Crest personal members and other Crest-sponsored members should consult the Crest Manual or their sponsor or voting service provider for instructions on electronic proxy appointment and voting. The Company may treat as invalid a Crest proxy voting instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.

Paper proxy cards will be distributed with the Notice of AGM to all shareholders other than those who have elected for notification by email.

Shareholders who will not be able to attend the AGM on 17 November 2009 in person are encouraged to vote their shares by appointing a proxy and issuing voting instructions (either electronically or by completing and returning their proxy cards). Electronic and paper proxy appointments and voting instructions must be received by the Company's Registrar not later than 48 hours before the AGM in order to be valid.

Registrar

The address and contact details of Equiniti Limited, the Company's Registrar, are listed on the inside back cover of this report. Individual shareholders' access to their personal shareholder information is available online, through the www.shareview.co.uk website. Dividend payments continue to be made through Lloyds TSB Bank. The shareholder helpline telephone number is 0871 384 2943. (Note: calls to this number are charged at 8p per minute from a UK BT landline. Other telephony providers' costs may vary.)

Important information

If you are in any doubt as to what action you should take in relation to the resolutions being proposed at the AGM, you are recommended to consult your stockbroker, bank manager, solicitor, accountant or other independent professional adviser authorised under the Financial Services and Markets Act 2000. If you received this document in printed form from the Company and have recently sold or transferred all your shares in Smiths Group plc, please pass this document to the purchaser or transferee or to the agent through whom the sale or transfer was effected for transmission to the purchaser or transferee.

Recommendation

Your directors believe that all the proposals to be considered at the AGM are in the best interests of the Company and its shareholders as a whole and recommend shareholders to vote in favour of the resolutions. The directors intend to vote in favour of the resolutions in respect of their own beneficial holdings.

By Order of the Board

Sarah Cameron

Secretary

Smiths Group plc
2nd Floor, Cardinal Place
80 Victoria Street, London SW1E 5JL

29 September 2009



Company Number: 0137013

Corporate governance statement

Compliance with the Combined Code

Throughout the period 1 August 2008 to 31 July 2009 the Company has been in full compliance with the June 2008 issue of the Combined Code on Corporate Governance (the 'Code'), published by the Financial Reporting Council and available on its website www.frc.org.uk, except that the value of any fees received by executive directors in respect of external non-executive directorships is not disclosed in the Directors' remuneration report, as this is not considered relevant to the Company.

Directors

The Board

In reviewing the performance of the Board during the year, the Board determined that the following statement of its role would be used to judge its success:

'Good corporate governance is about helping to run the Company well.

It involves putting in place an effective internal framework of authority and accountability that promotes success whilst permitting the management of risk to appropriate levels. It involves the exercise of judgement as to definitions of success and of appropriateness of risk. The exercise of this judgement is the responsibility of the Board and involves consideration of processes as well as outcomes.

It also involves the creation of a sensitive interface for the views of shareholders and other stakeholders to be given appropriate consideration when reaching these judgements.

The executive is required to provide such information to the Board as it needs to enable it to exercise its judgement over these matters.

There is a very fine distinction between the approval of processes and their definition. Wherever possible it is the role of the Board to approve process rather than initiate or define it. Only exceptionally would the Board intervene to initiate or define.

The Board also sets the tone for the Company. The way in which it conducts itself, its attitude to ethical matters, its definitions of success and appropriate risk all define the atmosphere within which the executive team works.

Good corporate governance is not about adhering to codes of practice (although adherence may constitute a part of the evidence of good governance) but rather about the exercise of a mindset to do what is right. Recent changes to the law have, of course, changed some of the associated responsibilities.

One of the challenges facing any Board is the way in which the non-executive and the executive directors interact. It is clear that they each have the same legal responsibility but it is generally unrealistic to expect executive directors to speak individually on all occasions with the same freedom as the non executive directors. Equally executive directors who just "toe the executive line" in contradiction to their own views may not be effectively contributing to good governance. A well-functioning Board needs to find the right balance between hearing the collective executive view and being aware of the natural internal tensions in an executive team.

One of the consequences of both increasing the watchdog role of the Board, for example setting and examining the pay of executive directors, and this balance between individuality and team behaviour is driving more and more Boards to have fewer and fewer executive directors. We are part of this trend. In our circumstances as a holding company for a number of businesses, the reduced Board size works effectively.

In a successful Board, all the members should endeavour to form a team notwithstanding the inherent tensions created by many external expectations, some of which may be wholly or in part unrealistic. Ideally it should be composed of a group of respected, experienced, likeminded but diverse people who coalesce around a unified vision of the definitions of success and appropriate risk, endeavour to be the friends of management (ie those who honestly criticise at times but encourage all the time) and who create confidence in all stakeholders in the integrity of the business.

Board meetings should feel like a meeting at which everyone is participating to solve problems together. Above all, all participants should be able to say after a Board meeting that value has been added as a result of the meeting taking place. This added value will come in many forms: comfort, advice, clarity, imagination, support, sharing of problems, or creating strategic intent. The list is not exhaustive.

Board membership is for 365 days of the year. Responsibilities do not start and end with formal meetings. Board members, on the Company's and their own initiative, should endeavour to engage outside of meetings to bring their experience to the assistance of the executive team whenever possible.

Above all there should be a sense of value added from the engagement of the Board members in all their interaction with the Company, formal or otherwise.'

During the last financial year the membership of the Board was unchanged. On 1 August 2009 Ms A C Quinn was appointed as an independent non-executive director of the Company.

As at 26 September 2009, the Board comprises Mr Brydon (Chairman), Mr Bowman (Chief Executive), Mr Langston (Finance Director) and five independent non-executive directors. Mr Jackson is the senior independent director. Biographies of these directors, giving details of their experience and other main commitments, are set out on page 51. The wide-ranging experience and backgrounds of the non-executive directors ensure that they can debate and constructively challenge management in relation to both the development of strategy and the evaluation of performance against the goals set by the Board.

Corporate governance statement continued

The Board normally holds formal meetings at least six times a year to make and review major business decisions and monitor current trading against plans 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 significant companies, the issue of shares, significant contractual commitments, the review of the effectiveness of risk management processes and major capital expenditure. Once a year, the Board meets with a particular focus on long-term strategy and developments affecting the Company. Additional meetings are arranged as necessary to deal with urgent items.

The Board sets the Company's values and standards and has adopted a Code of Business Ethics which is referred to on page 46.

The Chairman meets the non-executive directors without the executive directors present at least three times a year. The senior independent director meets the other non-executive directors without the Chairman present at least annually.

Directors and officers of the Company and its subsidiaries have the benefit of a directors' and officers' liability insurance policy.

The following table shows the number of scheduled Board and Board Committee meetings held during the financial year ended 31 July 2009 and opposite each director's name the number of meetings they were eligible to attend and the number actually attended. However, directors attend many other meetings and make site visits during the year. The Board views directors' contributions as measured beyond meeting attendance records.

Name	Board Meetings		Audit Committee		Remuneration Committee		Nomination Committee	
	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended
D H Brydon	7	7	–	–	4	4	2	2
P Bowman	7	7	–	–	–	–	–	–
D J Challen	7	6	3	2	4	4	1	1
S J Chambers	7	6	2	2	4	4	1	1
P J Jackson	7	6	3	3	4	2	2	1
J Langston	7	7	–	–	–	–	–	–
Sir Kevin Tebbit	7	7	3	3	4	3	2	2

– indicates not a member of that Committee in 2008/09

Chairman and Chief Executive

The Board has established clearly defined roles for the Chairman and the Chief Executive. The Chairman is responsible for leadership of the Board, ensuring its effectiveness and setting its agenda. Once agreed by the Board as a whole, it is the Chief Executive's responsibility to ensure delivery of the strategic and financial objectives.

Board balance and independence

There is a balance of executive and non-executive directors such that no individual or small group can dominate the Board's decision taking. Throughout the financial year at least half the Board, excluding the Chairman, has comprised independent non-executive directors.

In deciding the chairmanship and membership of the Board Committees, the need to refresh membership of the Committees is taken into account.

All the non-executive directors are considered to be independent and Mr Brydon was considered independent at the time of his appointment as Chairman.

Appointments to the Board

The Nomination Committee has a formal, rigorous and transparent procedure for the appointment of new directors, which are made on merit and against objective criteria.

Information and professional development

The Board is provided with detailed information several days in advance on matters to be considered at its meetings and non-executive directors have ready access to the executive directors. Regular site visits are arranged and non-executive directors are encouraged to visit sites independently. During site visits, briefings are arranged and the Board is free to discuss aspects of the business with employees at all levels.

Newly-appointed directors undergo an induction programme to ensure that they have the necessary knowledge and understanding of the Company and its activities. They undertake briefing sessions on corporate governance, strategy, stakeholder issues, finance and risk management and HR strategy, as well as meetings and site visits to business locations in the UK and overseas. Each director's individual experience and background is taken into account in developing a programme tailored to his or her own requirements.

Ongoing training is provided as and when necessary. The suitability of external courses is kept under review by the Company Secretary who is charged with facilitating the induction of new directors and with assisting in the ongoing training and development of directors.

All directors have access to the advice and services of the Company Secretary and a procedure is in place for them to take independent professional advice at the Company's expense should this be required.

Conflicts of interest

The new statutory duties for directors relating to conflicts of interest, set out in the Companies Act 2006 (the '2006 Act'), came into force on 1 October 2008. Under the 2006 Act a director must avoid a situation where he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the company's interests. The requirement is very broad, and could apply, for example, if a director becomes a director of another company or a trustee of another organisation. The 2006 Act allows directors of public companies to authorise conflicts and potential conflicts where appropriate and where the articles of association contain a provision to this effect, as the Company's Articles do.

The Board has put procedures in place for directors to report any potential or actual conflicts to the other members of the Board for their authorisation where appropriate. The initial Board-wide review process was completed in September 2008, and repeated in March 2009. Each director is aware of the requirement to seek approval of the Board for any new conflict situations, as they may arise. The process of reviewing conflicts disclosed, and authorisations given, will be repeated at least annually. Any conflicts or potential conflicts considered by the Board and any authorisations given are recorded in the Board minutes and in a register of directors' conflicts which is maintained by the Company Secretary.

Performance evaluation

The Board undertakes a formal and rigorous annual evaluation of its own performance and that of its Committees and the individual directors. In 2008 this process was facilitated by Professor Goffee of the London Business School. The evaluation process formed the basis of a review by the whole Board, led by the Chairman.

The performance evaluation of the Chairman was led by the senior independent director who obtained the views of both the executive and non-executive directors.

The directorships in listed companies and other significant commitments of the Chairman and the non-executive directors are shown on page 51. It is confirmed that the Chairman and the non-executive directors have sufficient time to fulfil their commitments to the Company; that the Chairman does not hold the office of chairman of another FTSE 100 company; and that no executive director holds more than one non-executive directorship of another FTSE 100 company.

Re-election

Currently, all directors stand for election by the shareholders at the first Annual General Meeting ('AGM') following their appointment and subsequently for re-election at least every three years. With effect from 2010, the Board has resolved that all directors who are willing to continue in office will stand for re-election by the shareholders each year at the AGM. Non-executive directors are appointed for a specified term of three years and reappointment for a second three-year term is not automatic. In exceptional circumstances and only after rigorous review, a non-executive director may serve for a third term.

Remuneration

Information regarding the Remuneration Committee is set out on page 63 and the Directors' remuneration report is on pages 65 to 73.

Accountability and audit

Financial reporting

The Board is required to present a balanced and understandable assessment of the Company's position and prospects in the Annual Report and in interim and other public reports. The Board is satisfied that it has met this obligation. A summary of the directors' responsibilities for the financial statements is set out on page 74.

The 'going concern' statement required by the Code is set out in the Group directors' report on page 54.

Internal control

The Board maintains a sound system of internal control to safeguard shareholders' investment and the Company's assets. The effectiveness of the internal control system is reviewed at least annually, covering all material controls, including financial, operational and compliance controls and risk management systems, and the Board reports to shareholders that it has done so. The Financial Reporting Council's report 'Internal Control: Revised Guidance for Directors on the Combined Code (October 2005)' provides guidance.

The Company has in place internal control and risk management systems in relation to the Company's financial reporting process and the Group's process for preparation of consolidated accounts. These systems include policies and procedures that: pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; provide reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with International Financial Reporting Standards ('IFRS'); require representatives of the businesses to certify that their reported information gives a true and fair view of the state of affairs of the business and its results for the period; and review and reconcile reported data. The Audit Committee is responsible for overseeing these internal control and risk management systems.

The Company's 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 for accountability and control are outlined below.

The Company's internal control systems 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.

Corporate governance statement continued

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 Company has during the year identified and evaluated the key risks, including ethical matters, and has ensured that effective controls and procedures are in place to manage these risks.

In the highly regulated environment of the industries in which the Company operates, procedures are codified in detailed operating procedures manuals and are reinforced by training programmes. These are designed to ensure compliance not only with the regulatory requirements but also with general principles of business integrity.

A key element in any system is communication: the executive directors and senior corporate staff meet regularly with representatives from the businesses to address financial, human resource, risk management and other control issues.

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

Audit Committee and Auditor

The Audit Committee makes formal and transparent arrangements for considering how financial reporting and internal control principles are applied and for maintaining an appropriate relationship with the external auditor, PricewaterhouseCoopers LLP.

Relations with shareholders

Dialogue with shareholders

The Chief Executive, the Finance Director and the Director, Investor Relations, communicate with institutional investors through analysts' briefings and extensive investor roadshows in the UK, US and continental Europe, as well as timely Stock Exchange announcements, meetings with management and site visits. Members of the Board, and in particular non-executive directors, are kept informed of investors' views, in the main through distribution of analysts' and brokers' briefings. At least twice a year a report is made to the Board on the number and types of meetings between the Company and institutional shareholders. The Chairman and the non-executive directors are available in the event of shareholder concerns which cannot be addressed through management. On appointment, new non-executive directors are available to meet shareholders on request.

Constructive use of the Annual General Meeting

All directors normally attend the Company's AGM and shareholders are invited to ask questions during the meeting and to meet directors after the formal proceedings have ended. It is intended that there shall be a poll vote on each resolution at the 2009 AGM. Shareholders will be advised as to the provisional results of the poll vote on each resolution immediately after each poll is taken. The audited, final results of the poll votes will be released to the London Stock Exchange and published on the Company's website, www.smiths.com, as soon as is practicable after the conclusion of the AGM.

All the directors, including the Chairmen of the Audit, Nomination and Remuneration Committees, were available at the 2008 AGM to answer shareholders' questions. The notice of the AGM and related papers were sent to shareholders at least 20 working days before the meeting.

Board Committees

The full terms of reference of the following Board Committees are available upon request and on the Company's website, www.smiths.com.

Audit Committee

The members of the Committee during the financial year were Mr Challen (Chairman of the Committee), Mr Jackson and Sir Kevin Tebbit. On 20 January 2009 Mr Chambers was appointed to the Committee.

The Board has determined that the Committee members have the skills and experience necessary to contribute meaningfully to the Committee's deliberations. In addition, the Chairman of the Committee has requisite experience in accounting and financial management.

The Committee meets at least three times a year to monitor the integrity of the Company's financial statements and the effectiveness of the external audit process, corporate governance issues and, in particular, the implementation of the Company's Code of Business Ethics and the arrangements for employees to raise confidentially (and anonymously, if they so choose) concerns about possible wrongdoing in financial reporting and other matters. It is responsible for ensuring that an appropriate relationship between the Company and the external auditor is maintained, including reviewing non-audit services and fees and implementing the Company's audit partner rotation policy. The Committee has primary responsibility for making recommendations to the Board on the appointment, reappointment and removal of the external auditor.

The Committee also reviews annually the Group's systems of internal control; the processes for monitoring and evaluating the risks facing the Group; and the effectiveness of the internal audit function: it is responsible for approving the appointment and removal of the Director, Internal Audit. The Committee reviews annually its terms of reference and its effectiveness and recommends to the Board any changes required as a result of such review.

In July 2009 the annual review of the Committee's terms of reference resulted in a small number of largely clarificatory changes.

In the year to 31 July 2009, the Audit Committee discharged its responsibilities by reviewing:

- the Group's financial statements and interim results statement prior to Board approval and the external auditor's detailed reports thereon;
- the audit fee and non-audit fees payable to the Group's external auditor;
- the external auditor's effectiveness and plan for the audit of the Group's 2008/09 accounts, which included confirmations of auditor independence and the proposed audit fee, and approving the terms of engagement for the audit;
- an annual report on the Group's systems of internal control and their effectiveness, reporting to the Board on the results of the review and receiving regular updates on key risk areas of financial control;
- the risks associated with major business programmes; and
- the internal audit function's terms of reference, its 2008/09 work programme and regular reports on its work during the year.

The Committee has authority to investigate any matters within its terms of reference, to access resources, to call for information and to obtain external professional advice at the cost of the Company.

No-one other than the members of the Committee is entitled to be present at meetings. However, the Chairman; Chief Executive; Finance Director; Group Financial Controller; Director, Tax and Treasury; Director, Internal Audit; and external auditor are normally invited to attend. Others may be invited to attend by the Committee. The papers for and minutes of each Committee meeting are sent to all directors. At least once a year, there is an opportunity for the external auditor, the Director, Internal Audit and the Director of Business Ethics to discuss matters with the Committee without any executive management being present. The Director, Internal Audit, the Director of Business Ethics and the external auditor have direct access to the Chairman of the Committee outside formal Committee meetings.

The Committee reviews the nature and extent of non-audit services provided by the external auditor in order to ensure that objectivity and independence are maintained. Under the audit independence policy, approved by the Committee, certain non-audit services may not be provided by the external auditor; certain services require the approval of the Finance Director and other services require the approval of the Chairman of the Committee. Where the cost of the services is expected to exceed £100,000, the engagement will normally be subject to competitive tender. The external auditor has in place processes to ensure that its independence is maintained including safeguards to ensure that where it does provide non-audit services, its independence is not threatened. The external auditor has written to the Audit Committee confirming that, in its opinion, it is independent.

Remuneration Committee

Mr Chambers (Chairman of the Committee), Mr Brydon, Mr Challen, Mr Jackson and Sir Kevin Tebbit were members of the Committee throughout the financial year.

The Committee's responsibilities and terms of reference are described in the Directors' remuneration report on page 65.

Nomination Committee

During the financial year the members of the Committee were: Mr Brydon, as Chairman of the Committee, Mr Jackson and Sir Kevin Tebbit. On 20 January 2009 Mr Challen and Mr Chambers were appointed to the Committee.

The Committee leads the process for identifying and makes recommendations to the Board regarding candidates for appointment as directors of the Company and as Company Secretary, giving full consideration to succession planning and the leadership needs of the Group. It also makes recommendations to the Board on the composition of the Nomination Committee and the composition and chairmanship of the Audit and Remuneration Committees. It reviews regularly the structure, size and composition of the Board, including the balance of skills, knowledge and experience and the independence of the non-executive directors, and makes recommendations to the Board with regard to any changes.

The Committee meets periodically when required. No-one other than members of the Committee is entitled to be present at meetings but the Chief Executive is normally invited to attend and external advisers may be invited by the Committee to attend.

The Committee has access to such information and advice both from within the Group and externally, at the cost of the Company, as it deems necessary. This may include the appointment of external search consultants, where appropriate. The Committee reviews annually its terms of reference and effectiveness and recommends to the Board any changes required as a result of such review. In July 2009 the annual review of the Committee's terms of reference resulted in no revisions.

The procedures referred to above, including the use of an external search consultant, were used by the Nomination Committee in recommending the appointment of Ms Quinn as a non-executive director on 1 August 2009.

Disclosure & Transparency Rule 7

This statement complies with sub-sections 2.1; 2.2(1); 2.3(1); 2.5; 2.7; and 2.10 of Rule 7 of the UK Listing Authority Disclosure Rules. The information required to be disclosed by sub-section 2.6 of Rule 7 is shown in the Group directors' report on pages 54 and 55 and is incorporated in this Corporate governance statement by reference.

Statement from the independent non-executive directors

The Corporate governance statement sets out the Company's compliance with the Combined Code on Corporate Governance (the 'Code'). As that statement makes clear, the Board believes that good governance is about more than adherence to the Code. The Board is committed to ensuring that good governance systems and processes are in place and effective throughout the Group to promote sound decision-making and a culture of 'doing business the right way'.

A number of incremental changes have been made recently to support good governance and increased transparency and accountability across the Group. At Board level, it was decided in November last year, that all the non-executive directors should be members of all the principal Board Committees: Audit, Nomination and Remuneration*. Thus, all the non-executive directors can participate fully in issues such as succession planning, establishing appropriate remuneration levels and incentive schemes and managing risk. Discussions at Board meetings benefit from the insights gained by the independent non-executive directors through their participation in Board committees.

Below Board level, one of the changes put in place by the Chief Executive was to designate each of the corporate senior management team as an 'investor director' of one of the five divisions. In addition to their functional responsibility at Group level (such as Director of Human Resources or General Counsel) the investor directors participate in the monthly divisional board meetings of their respective division, and are available to the divisions' senior management teams, to discuss difficult issues, review strategy, act as a sounding board and provide counsel. As such the corporate senior management team gain more exposure and understanding of the issues facing the divisions, and the divisions each gain a trusted, but robust and independent adviser, who can provide a different perspective to the matters under review.

Although key areas are managed at an operational level in the divisions and are reported and monitored at divisional board meetings, a number of Group-wide structures exist to ensure targets and standards are met, best practice is shared and Group size is leveraged wherever practicable. In addition to the Executive Committee (comprising all the Chief Executive's direct reports), Group-wide committees or similar structures exist for a number of functional areas including environment, health and safety, security, IT, business ethics, and procurement. The objectives, findings and priorities for these critical areas are reviewed regularly at Executive Committee and Board level. As is appropriate in a globally diverse business in the 21st century, increasing use is made of share-point sites, web-based training, information platforms and other tools for remote sharing of information to ensure good communication from the Board and senior management team to the businesses and vice versa, and to facilitate cost-effective knowledge exchange between businesses.

The Board, in particular the non-executive directors, challenge themselves on a regular basis as to the value they bring to the Group and the businesses within it. In these turbulent economic times, which have seen public and shareholder confidence in a number of previously highly regarded, international companies shaken to the core, the non-executive directors are conscious more than ever of the need to contribute to good governance. This includes ensuring that the assessment of risk and reward in relation to any significant decision for the Group is based on sound, robustly tested arguments.

As part of the Board's formal annual appraisal process, the directors ask themselves a number of questions about their performance as a team and individually. The areas covered include the following:

- whether there is a constructive relationship between the non-executive directors and the executive directors

The non-executive directors in particular bring a range of skills and experience to the Board gained outside the Group. Each individual brings a different perspective, and has a part to play in contributing to Board discussions and listening to others' views. Whilst each Board member is committed to the success of the Group, there is no assumption that a matter presented by the executive directors will automatically be approved by the non-executive directors, whose independence of view is respected. The non-executive directors are satisfied that Board discussions are a free and open exchange of views and that debate and challenge are welcomed in discussions with the executive directors. Overall, the directors believe that the relationship between the non-executive directors and the executive directors is constructive, and beneficial to the Group, its shareholders and other stakeholders.

- whether the executive directors and the members of the Executive Committee work well as a team

The Board has regular contact with the members of the Executive Committee, and managers who report to members of the Executive Committee, through the frequent participation by various members of management in Board and Board Committee meetings, and other less formal discussions. For example, the Group Financial Controller, the Director, Tax and Treasury, and the Director, Internal Audit attend meetings of the Audit Committee. The non-executive directors are satisfied that the executive directors and members of senior management work well together to implement the strategy and direction set by the Board.

- whether adequate responses are provided in relation to additional information sought, or follow up questions asked, by the non-executive directors

The non-executive directors are satisfied that where additional information or clarification is requested, it is provided fully and promptly, either directly or through the executive directors or the Company Secretary. If any of the non-executive directors has a particular interest in a matter or has relevant experience, he or she is encouraged to share experience or views directly with the relevant executives responsible for implementation of the decision or project.

The independent non-executive directors are satisfied that the Company's corporate governance controls have been effective throughout the financial year ended 31 July 2009.

Peter Jackson
Senior Independent Director

**The Chairman is not a member of the Audit Committee, in accordance with the Code (C.3.1) and the Terms of Reference of the Audit Committee, but is invited to attend meetings.*

Directors' remuneration report

The directors' remuneration report is presented to shareholders by the Board. The report complies with Regulation 11 and Schedule 8 of the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008 (the Regulations). A resolution will be put to shareholders at the Annual General Meeting on 17 November 2009 inviting them to approve this report.

Remuneration policy and arrangements

The Remuneration Committee

Responsibilities of the Committee include making recommendations to the Board on the Group's executive remuneration policy and determining, on behalf of the Board, specific remuneration packages for the executive directors and Chairman. The Committee operates within agreed terms of reference which are available for inspection on the Company's website. The Company complied with the provisions of the Combined Code 2008 on Corporate Governance relating to directors' remuneration throughout the financial year except as is disclosed on page 59.

The Committee met four times in the past year to consider and agree, amongst other things:

- Annual Incentive Plan performance and payments for fiscal 2008
- Annual Incentive Plan structure and performance targets for fiscal 2009
- participants in the approved long-term incentive plans
- potential impact of the global recession on the Group's long-term incentive plans
- framework of executive total remuneration
- principles to govern the Annual Incentive Plan for fiscal 2010
- Committee terms of reference
- structure of the directors' remuneration report for fiscal 2009

In 2008/09 the Committee consisted of:

Stuart Chambers (Chairman of the Committee)
 Donald Brydon
 David Challen
 Peter Jackson
 Sir Kevin Tebbit

Mr Brydon is absent when his own remuneration as Chairman of the Company is under consideration. The Chief Executive attends meetings of the Committee by invitation; he is absent when his own remuneration is under consideration.

During the year, the Committee received material assistance and advice from the Chief Executive and the HR Director (who is also Secretary to the Committee). The Committee and the Company also received advice from Kepler Associates and Freshfields Bruckhaus Deringer LLP. Freshfields Bruckhaus Deringer LLP, who were appointed by the Company, also advised the Group on various legal matters during the year.

Remuneration policy

The Committee applies a remuneration policy which has at its core the following objectives:

- to align the interests of executives with those of shareholders
- to focus on top-line growth, margin improvement and capital discipline
- to link a significant proportion of remuneration to financial and individual performance, both in the short-term and long-term
- to provide strong linkage between remuneration and performance
- to ensure total remuneration is market-competitive and helps attract and retain executives of the highest calibre.

Remuneration arrangements

The remuneration of senior executives balances fixed, variable, short-term and long-term remuneration, and is reviewed each year on a total remuneration basis to ensure that executives continue to be appropriately incentivised to achieve the Group's objectives.

For 2008/09, executive directors' remuneration comprised basic salary, benefits in kind, annual bonus and pension benefits. In addition, executive directors and senior executives participate in share-based incentive schemes, which in 2008/09 included the Smiths Group Sharesave Scheme, the Smiths Group Value Sharing Plan (VSP) and the Smiths Group Co-Investment Plan (CIP).

Directors' remuneration report continued

Elements of remuneration

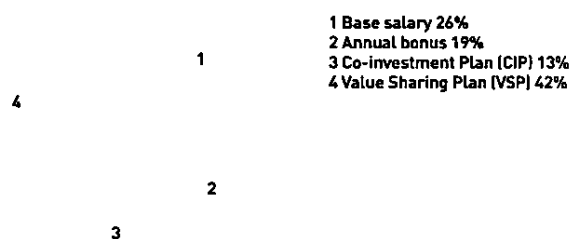
The main elements of remuneration for executive directors in 2008/09 are summarised below:

Element: 2008/09 policy	Objective
Base salary: frozen in 2008/09 for at least 2 years (see page 66)	• Reflect size and nature of the role, individual performance and experience
Annual bonus: maximum opportunity of 180% of salary for the Chief Executive and 150% of salary for the Finance Director (see page 67)	• Incentivise short-term operational, financial and personal performance
Co-Investment Plan (CIP): mandatory investment in Smiths shares of 50% of any net bonus earned, in return for up to a 2-for-1 matching opportunity after three years, subject to average ROCE exceeding WACC+3% p.a. (see page 67)	• Help align short- and long-term remuneration through compulsory deferral of 50% of net earned bonus into Smiths shares • Reward operating efficiency • Support executives in building a shareholding in the Company
Value Sharing Plan (VSP): one-off incentive under which executives receive a pre-defined number of shares per £5m of 'surplus value created'. For executive directors, 1/3rd of an award is based on TSR relative to the FTSE 100 (excluding financial services companies) and 2/3rds on growth in internal value above the cost of equity (see page 67)	• Incentivise senior executives to drive long-term value creation for shareholders • Reinforce and reward delivery of strategic goals
Pension (see page 68 and 70)	• Provide competitive retirement benefits
Share ownership guidelines: 200% of salary for the Chief Executive and 150% of salary for the Finance Director (see page 70)	• Require executives to build and maintain a significant shareholding in Smiths • Support alignment with shareholder interests

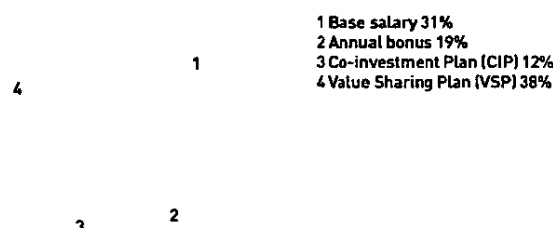
The following charts illustrate the proportions of the 2008/09 remuneration packages comprising fixed (ie base salary) and variable elements of pay, assuming target annual bonus and expected values of long term incentives. For 2008/09, c.70% of the fair value of executive directors' total remuneration was performance related.

Executive Director pay mix, 2008/09

Chief Executive Officer



Finance Director



Base salary and benefits

Executive directors' salaries have typically been reviewed annually, taking into account the size and nature of the role, individual performance and experience, the relative performance of the Company, remuneration policy within the Company and salaries at comparator companies. Salaries are benchmarked against comparable roles at other FTSE 100 companies of similar market capitalisation, revenues and complexity to Smiths. The salaries for all participants in the Value Sharing Plan, including executive directors, have been frozen at their 2007/08 levels until 1 August 2010. Executive directors' base salaries for 2009/10 are, therefore, unchanged from 2008/09 at the following levels:

Executive director	Salary last reviewed	2008/09 salary	2009/10 salary
P Bowman	10 December 2007	£800,000	£800,000
J Langston	1 August 2007	£424,000	£424,000

Benefits include a fully expensed company car, or an allowance in lieu thereof, and health insurance.

Annual bonus

Executive directors were eligible to participate in an annual bonus plan based on a combination of corporate financial goals (Group EPS and cash conversion) and individual performance. The maximum annual bonus opportunity for the Chief Executive was 180% of salary and for the Finance Director was 150% of salary. Of any bonus earned, 50% is compulsorily deferred into Smiths shares under the rules of the CIP. The table below summarises the structure of the 2008/09 annual bonus plan and the awards receivable for performance in 2008/09.

2008/09 annual bonus outcome as a percentage of salary

Executive director	Group EPS		Cash conversion		Personal objectives		Total (% of salary)	
	Maximum	Actual	Maximum	Actual	Maximum	Actual	Maximum	Actual
P Bowman	95%	0%	25%	20.5%	60%	55.2%	180%	75.7%
J Langston	80%	0%	20%	16.4%	50%	38.5%	150%	54.9%

Co-Investment Plan (CIP)

For 2008/09 and future years, executive directors and selected senior executives are required to invest 50% of any net bonus earned in Smiths shares. Invested amounts are eligible for a 2-for-1 matching share award after three years (based on the pre-tax amount of deferred bonus in question), subject to continued employment in the Group and the Company's average return on capital employed (ROCE) over the performance period exceeding the Company's weighted average cost of capital (WACC), which the Committee regards as appropriately reflecting the operating efficiency of the Company.

Matching share awards vest in full if ROCE exceeds WACC by an average margin of at least 3% a year; a 1-for-1 matching share award vests if ROCE is between WACC+1% and WACC+3% p.a. Dividends accrue on matching shares that vest.

For 2007/08 and earlier years, executive directors and selected senior executives were able to invest up to 100% of any net bonus earned (or if greater, 25% of salary) in Smiths shares. Invested amounts were eligible for a 1-for-1 matching share award after three years (based on the pre-tax amount of salary or deferred bonus in question) subject to continued employment in the Group and the Company's average ROCE over the performance period exceeding the Company's WACC over the same period by an average margin of at least 1% p.a.

Value Sharing Plans (VSPs)

The Group and divisional VSPs are one-off, long-term incentive plans designed to reinforce Smiths strategy of focusing on shareholder value creation at the Group and divisional levels.

Group VSP

Messrs Bowman and Langston are participants in the Group VSP, which rewards executive directors and selected senior executives with a pre-determined number of shares for every £5m of value created above a hurdle over the three-year and four-year performance periods from 1 August 2008 (or until a vesting event, if earlier). On 28 July 2008 Mr Bowman was granted an award under which he will be entitled to receive 1,250 Smiths Group shares for each £5m of surplus value created in respect of each performance period. On the same date Mr Langston was granted an award under which he will be entitled to receive 500 Smiths Group shares for each £5m of surplus value created in respect of each performance period.

– TSR Element

One-third of the award will depend on the growth, over each performance period, in Smiths market capitalisation plus net equity cash-flows to shareholders (i.e. dividends plus share buybacks less share issues) over and above the median total shareholder return of the FTSE 100 companies (excluding financial services companies).

Participants will only be entitled to a vesting of shares under the TSR Element if the Committee is satisfied that this is justified by the underlying financial performance of the Company over the performance period.

– Earnings Element

The remaining two-thirds of each award will be determined by the growth, over each performance period, in adjusted Profit Before Tax (PBT) (from a baseline PBT of £338.6m in 2007/08) times a fixed multiple of 12.0 plus net equity cash-flows to shareholders over and above a cost of equity hurdle return of 9.5% a year.

The Committee may reduce the payout of the Earnings Element if an acquisition results in a material reduction in return on invested capital.

No retesting of either performance condition is permitted.

Performance measure selection

The Remuneration Committee believes that the combination of relative TSR and PBT provides the best balance between internal line-of-sight and shareholder alignment, between absolute and relative performance and between internal and external perspectives. PBT is considered the best internal measure of Smiths financial performance as it is highly visible internally and regularly monitored and reported. Relative TSR provides strong alignment with shareholders and the FTSE 100 index (excluding financial services companies) continues to be considered a relevant and robust indicator of the relative value created by Smiths management for its shareholders.

Divisional VSPs

In addition to the Group VSP, the Committee has introduced divisional plans for each of the five divisions (Smiths Detection, Smiths Medical, John Crane, Smiths Interconnect, and Flex-Tek). The plans are along the same lines as the Group VSP to help focus the most senior divisional executives on maximising the value of their divisions and returning surplus cash to the Group.

The Shareholder Circular issued in July 2008 which dealt, amongst other things, with the proposed establishment of the VSP stated that the Remuneration Committee would not consider further long term incentives for participants in the Group or Divisional VSPs until 2010. The Committee intends in 2010 to consider potential long-term incentives for participants in the VSP. Any proposals for such long-term incentives will be the subject of shareholder consultation and the required approvals at the appropriate time.

Directors' remuneration report continued

Performance Share Plan (PSP)

No awards under the PSP have been made to Executive Directors or other participants in the VSP in 2008/09 and none will be made to these executives in 2009/10.

Awards vest after three years, subject to performance conditions. One-third of an award is subject to the Company's TSR performance relative to other FTSE 100 companies (excluding financial companies and investment trusts). For full vesting, the Company's TSR must be at or above the 75th percentile over the three-year performance period. Of the award, 25% will vest if the Company's TSR is at median. Awards will vest on a straight-line pro rata basis between median and 75th percentile.

The remaining two-thirds of the award will be subject to earnings per share (EPS) growth targets (measured before exceptional items). For each of the outstanding three-year cycles commencing in 2006/07 and 2007/08, full vesting will occur if the compound annual growth in EPS is equivalent to 12% a year. If the compound annual growth in EPS is equivalent to 5% a year, 25% vesting will occur with vesting on a straight-line basis between 5% and 12%. There will be no retesting of the TSR and EPS performance measures.

Sharesave Scheme

The Smiths Group Sharesave Scheme, which is open to all UK employees with at least 12 months' service, is subject to UK legislation as to the maximum amount that can be saved. Participants save a fixed sum of up to £250 a 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.

Share ownership guidelines

It is the Committee's policy that executive directors should, over time, acquire a shareholding with a value equal to at least one and a half years' gross salary (two years' gross salary for the Chief Executive) and retain at least 50% of any net vested share awards (after sales to meet tax liabilities) until those values are achieved.

Share scheme dilution limits

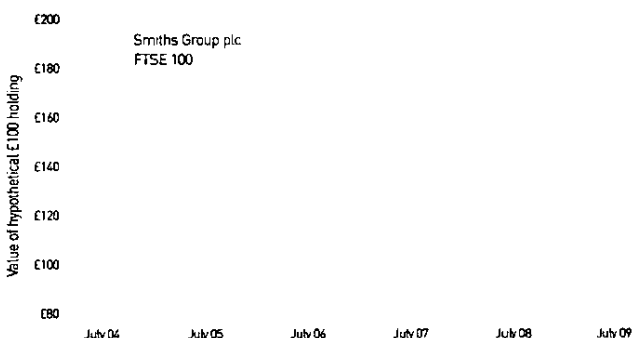
The Company follows the guidelines laid down by the Association of British Insurers. These restrict the issue of new shares under all the Company's share schemes in any 10-year period to 10% of the issued ordinary share capital and under the Company's discretionary schemes to 5% in any 10-year period. As at 31 July 2009, the headroom available under these limits was 4.1% and 0.5%, respectively (excluding the conditional share awards granted under the VSP on 28 July 2008 and subsequently).

Pension

The Company operates pension arrangements for executive directors. In the case of Mr Bowman, the Company pays a monthly salary supplement (worth 42% of salary per annum) approved by the Committee to enable him to make his own pension provision. In the case of Mr Langston, a final salary scheme provides a pension of up to two-thirds of final pensionable salary. The Company continues to apply an earnings cap, on a basis similar to the pre-2006 statutory limit, to determine the proportion of overall pension payable by the regulated pension scheme, with the balance of pension provided by the Company. This arrangement substantially represents a continuation of pre-2006 practice and involves no additional cost for the Company. In appropriate cases, the Company permits the waiver of salary and pension supplement entitlements where the arrangement does not involve additional cost for the Company. Where such waivers are made, incentives and pension entitlements continue to be calculated by reference to salaries prior to these reductions. Details of the salary supplements, waiver and other pension provisions are set out in the tables on page 70.

Five-year historical TSR performance

The following graph shows the Company's total shareholder return (TSR) performance over the past five years compared to the FTSE 100 Index. The FTSE 100 Index, of which the Company has been a member throughout the period, has been selected to reflect the TSR performance of other leading UK-listed companies. The values of hypothetical £100 investments in the FTSE 100 Index and Smiths Group plc shares (after adjustment for the Return of Cash in June 2007) were £123 and £114 respectively.



Remuneration

The total remuneration of directors, excluding the value of shares to which certain directors may become entitled under the Value Sharing Plan, Performance Share Plan and Co-Investment Plan and also defined benefit pension arrangements, was as follows:

	2009 £000	2008 £000
Fees, salaries and benefits, compensation for loss of office	1,885	4,098
Performance-related bonuses	839	1,232
Aggregate gain from exercise of share options and vesting of share awards	866	2,026
Incremental gain from deferred share scheme exercises	0	109
Payments in lieu of pension contribution	336	362
	3,926	7,827

The emoluments of the directors are set out below:

	Fees/salary		Compensation for loss of office	Benefits	Bonus	Payments in lieu of pension contribution	Total emoluments	
	2008 £000	2009 £000	2009 £000	2009 £000	2009 £000	2009 £000	2009 £000	2008 £000
Chairman								
D H Brydon	295	305		23			328	317
Chief Executive								
P Bowman ¹	516	800		36	606	336	1,778	1,355
Executive director								
J Langston ²	424	424		36	233		693	808
Non-executive directors								
D J Challen	67	69					69	67
S J Chambers	62	69					69	62
P J Jackson	67	69					69	67
Sir Kevin Tebbit	52	54					54	52
Directors who resigned in 2007/08 (in aggregate)	683							2,970
	2,166	1,790		95	839	336	3,060	5,698

1. Philip Bowman's total emoluments for 2008 are for a part year, covering the period from his appointment on 10 December 2007 until the end of the 2008 financial year on 31 July 2008.

2. In common with other UK employees participating in the relevant pension schemes, the salary of John Langston was reduced by £8,970 and the Company paid the same amount directly to his pension scheme during the year. The salaries shown in the table above for Mr Langston are the amounts he would have been paid if he had not given up these salary entitlements.

David Lillycrop resigned from the Board on 3 June 2008 and remained in service as an employee on his existing terms and conditions until 30 November 2008. Full details of Mr Lillycrop's termination arrangements were set out in last year's directors' remuneration report. In respect of the period 1 August 2008 to 30 November 2008, Mr Lillycrop received salary and benefits to the value of £151,829 as an employee.

Directors' remuneration report continued

Director's pension entitlements

Accrued annual pension under defined benefit schemes

	Age at 31 July 2009	Accrued entitlement at 31 July 2008 £000	Additional pension earned during the year (excluding any increase for inflation) £000	Transfer value of accrued benefits at 31 July 2009 (A) £000	Transfer value of accrued benefits at 31 July 2008 (B) £000	The amount of [A - B] less contributions made by the director in 2009 £000	Accrued entitlement at 31 July 2009 £000 p.a.
J Langston	59	241	3	6,181	5,670	502	256

1. Mr Langston'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 lesser of (i) 7% per annum compound and (ii) the annual increase in the Retail Prices Index. 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.

2. See Note 2 on page 69 above. The benefits provided under the relevant pension schemes were not affected by these arrangements.

3. Transfer values of the accrued benefits have been calculated on the basis of actuarial advice in accordance with pensions regulations, and represent the amount that the pension scheme would pay to another pension provider if the member elects to transfer all of his benefits out of the scheme. The transfer values do not represent sums payable or due to the director and therefore cannot be added meaningfully to annual remuneration.

Directors' interests in the Company's shares

	Ordinary shares of 37.5p each 31 July 2009	Ordinary shares of 37.5p each 1 August 2008
D H Brydon	8,000	8,000
P Bowman	70,000	20,000
D J Challen	1,333	1,333
S J Chambers	1,333	1,333
P J Jackson	0	0
J Langston	247,281	175,650
Sir Kevin Tebbit	0	0

These interests include beneficial interests of the directors and their families in the Company's shares held in trusts and holdings through nominee companies. None of the directors has disclosed any non-beneficial interests in the Company's shares.

Ms A C Quinn had no interests in the Company's shares on 1 August 2009, the date of her appointment as a director of the Company. The Company has not been notified of any changes to the holdings of the current directors, their families and any connected persons between 1 August and 26 September 2009.

Service contracts

The Company's policy is that executive directors are normally employed on terms which include a one-year rolling period of notice and provision for the payment of a predetermined sum in the event of termination of employment in certain circumstances (but excluding circumstances where the Company is entitled to dismiss without compensation).

Mr Bowman

Mr Bowman is employed under a service contract with the Company dated 15 November 2007 and effective from 10 December 2007. The service contract is for an indefinite term expressed to end automatically on his anticipated normal retirement date (age 60), but may be terminated by 12 months' notice given by the Company or six months' notice given by Mr Bowman. The Company may elect to terminate the contract by making a payment in lieu of notice equal to 150% of Mr Bowman's basic salary, this being a genuine pre-estimate of Mr Bowman's entitlement in respect of the unserved notice period, to cover:

1. salary;
2. annual pension contribution by the Company (42% of base salary);
3. the annual cost to the Company of providing all other benefits to which Mr Bowman is entitled under his contract, but excluding bonus.

In this event, the contract provides that Mr Bowman's bonus entitlement for the financial year in which termination occurs and for the unserved notice period will be the subject of a separate, good faith discussion between Mr Bowman and the Chairman; the contract also specifies that Mr Bowman would in this case be treated as a 'good leaver' for the purposes of relevant share plans. In certain constructive dismissal events, Mr Bowman is entitled to resign and be treated in the manner set out above.

Mr Langston

As stated in last year's report, Mr Langston is employed under a service contract with the Company dated 26 September 2001. The service contract is for an indefinite term expressed to end automatically on the anticipated normal retirement date (age 60), but may be terminated by 12 months' notice given by the Company or six months' notice given by Mr Langston. The Company may at its discretion elect to terminate the contract by making a payment in lieu of notice on the following terms:

1. the salary receivable during the notice period;
2. an amount equal to 50% of the maximum bonus potential receivable under the executive bonus scheme for the then current bonus year;
3. the annual cost to the Company of providing all other benefits to which Mr Langston is entitled under his contract, which has been pre-agreed as 10% of basic salary; and
4. an amount equal to the cost of securing one year's pensionable service in the appropriate pension scheme(s). In addition, the Company has given its irrevocable consent to early payment of Mr Langston's pension (from age 50) and without actuarial reduction from age 55.

External appointments

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 director's breadth of knowledge and experience. Directors are permitted to retain fees associated with such appointments.

Chairman and non-executive directors

The Chairman and the non-executive directors serve the Company under letters of appointment and do not have contracts of service or contracts for services. Except where appointed at a general meeting, directors stand for election by shareholders at the first Annual General Meeting following appointment and stand for re-election every three years thereafter (under Article 55). Either party can terminate on one month's written notice and no compensation is payable in the event of an appointment being terminated early. The dates of their original appointment were as follows:

Non-executive director	Date of appointment	Date of election / last re-election	Expiry of current term
D H Brydon	19 April 2004	19 November 2007	2010
D J Challen	21 September 2004	19 November 2007	2010
S J Chambers	27 November 2006	19 November 2007	2010
P J Jackson	1 December 2003	19 November 2007	2010
Sir Kevin Tebbit	14 June 2006	17 November 2006	2009

The Board of Directors, excluding Remuneration Committee members, is responsible for recommending the remuneration of the non-executive directors with the exception of the Chairman, whose remuneration is determined by the Remuneration Committee. The fees payable (with effect from 1 August 2008) to the non-executive directors for the full year 2008/09 comprised the following and will be frozen at this level for the full year 2009/10:

Non-executive director	Basic fee	Audit / Remuneration Committee chairmanship fee	Senior Independent Director fee	Total
D H Brydon	£305,000	–	–	£305,000
D J Challen	£54,000	£15,000	–	£69,000
S J Chambers	£54,000	£15,000	–	£69,000
P J Jackson	£54,000	–	£15,000	£69,000
Sir Kevin Tebbit	£54,000	–	–	£54,000

The Chairman and the non-executive directors are not eligible for bonuses or participation in share schemes and no pension contributions are made on their behalf.

Auditable part

The directors' remuneration tables and accompanying notes on page 69; the directors' pensions table and accompanying notes on page 70; and the directors' share options and awards table on pages 72 and 73 have been audited.

The Directors' remuneration report has been approved by the Board and signed on its behalf by:

S J Chambers

29 September 2009

X 

Directors' remuneration report continued

Directors' share option and long-term share plans

Director and Scheme	Options and awards held on 31 July 2009	Options and awards held on 31 July 2008	Performance test	Exercise price	Grant date	Option and award data			Options exercised and awards vested 2008/09			
	Number	Number				Vesting date*	Expiry date**	Exercise / vesting date	Number	Exercise price	Market price at date of grant***	Market price at date of exercise†
P Bowman												
PSP	75,543	75,543	C	n/a	11/12/07	13/11/10	13/11/10					
	37,771	37,771	D	n/a	11/12/07	13/11/10	13/11/10					
CIP	78,199	0	E	n/a	20/10/08	28/09/11	28/09/11					
SAYE	2,750	0		569.00p	21/05/09	01/08/14	01/02/15					
J Langston												
95 ESOS	38,462	38,462	A	806.00p	09/04/02	09/04/05	09/04/12					
	38,461	38,461	B	806.00p	09/04/02	09/04/05	09/04/12					
PSP	0	38,269	C	n/a	07/10/05	20/10/08		27/10/08	38,269	n/a	937.00p	720.11p
	0	19,135	D	n/a	07/10/05	20/10/08		27/10/08	7,271	n/a	937.00p	720.11p
							#	27/10/08	11,864	<i>lapsed</i>		
	44,618	44,618	C	n/a	29/09/06	25/10/09	25/10/09					
	22,039	22,039	D	n/a	29/09/06	25/10/09	25/10/09					
	38,243	38,243	C	n/a	13/11/07	13/11/10	13/11/10					
	19,121	19,121	D	n/a	13/11/07	13/11/10	13/11/10					
CIP	0	51,680	E	n/a	25/10/05	24/09/08		24/09/08	51,680	n/a	886.50p	1,040.25p
	31,881	31,881	E	n/a	02/02/07	30/09/09	30/09/09					
	22,202	22,202	E	n/a	13/11/07	29/09/10	29/09/10					
	22,222	0	E	n/a	20/10/08	28/09/11	28/09/11					
SAYE	1,088	1,088		868.00p	18/05/07	01/08/10	01/02/11					

Value Sharing Plan

VSP awards held on 31 July 2009													VSP awards held on 31 July 2008													Award data													Awards vested 2008/09																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																	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Key

95 ESOS	Smiths Industries 1995 Executive Share Option Scheme
PSP	Smiths Group Performance Share Plan
CIP	Smiths Group Co-Investment Plan
SAYE	Smiths Group Sharesave Scheme
VSP	Smiths Group Value Sharing Plan
*	Subject to the relevant performance test being passed, if applicable.
**	The expiry dates shown above apply in normal circumstances. No expiry date is shown if the option or award was exercised, vested, or lapsed prior to 26 September 2009.
***	Market price of a Smiths share at date of grant (if different from exercise price). The exercise price of an option under the SAYE is set at 20% less than the mid-market closing price of a Smiths share on the business day preceding the day on which employees are invited to participate in the grant.
†	Actual sale price on date of exercise
#	Denotes a conditional award that partially lapsed

Performance tests

- A EPS growth versus UK RPI Index + 3% p.a.
 - B EPS growth versus UK RPI Index + 4% p.a.
 - C PSP Earnings Per Share growth test
 - D PSP Total Shareholder Return rank test
 - E CIP Return on Capital Employed test
 - F Surplus Shareholder Value – VSP TSR test
 - G Surplus Internal Value – VSP PBT test
- There are no performance criteria for the SAYE

Notes

The high and low market prices of the ordinary shares during the period 1 August 2008 to 31 July 2009 were 1,156p and 663p respectively.

The mid-market closing price on 31 July 2008 was 1,047p and on 31 July 2009 was 720p.

The mid-market closing price of a Smiths share on the date of awards made to directors under the CIP in the 2008/09 financial year was 777.5p.

Of the 80,761 shares over which options had been granted under the 95 ESOS and SAYE to, and were held by, directors at 31 July 2009, 79,673 were granted at exercise prices below the market price of a Smiths Group share on 26 September 2009 (829p).

None of the options or awards listed above was subject to any payment on grant.

Options and awards which lapsed or partially lapsed during the financial year ended 31 July 2009 are indicated in the table above by a hash mark (#): no other options or awards held by any director lapsed during the period 1 August 2008 to 31 July 2009.

No other Director held any options over the Company's shares during the period 1 August 2008 to 31 July 2009.

No options or awards have been granted to or exercised by directors or have lapsed during the period 1 August to 26 September 2009.

Executive directors received their final grants of options under the 95 ESOS in October 2003. From 2004 to 2007, senior executives, including executive directors, received awards under the PSP.

PSP awards granted in October 2005

Smiths' TSR over the performance period in relation to 2005 PSP awards (20 October 2005 to 20 October 2008) ranked 32nd in the comparator group of FTSE 100 companies (excluding financial services companies), a level of performance equivalent to the 54th percentile. Based on the vesting schedule on which 25% of an award vests at median (and 100% vests for upper quartile performance), this performance warrants the vesting of 38% of the TSR element (one-third of an award). Smiths' EPS growth over the performance period was 12.2% p.a., warranting the full vesting of the remaining two-thirds of the award. Overall, 79% of 2005 PSP awards vested.

The performance tests for options granted under the 95 ESOS up to and including October 2005 have all been passed with the sole exception of the grant on 9 April 2002, which failed its initial test and two annual retests. No further retests of the April 2002 grant will be undertaken. The April 2002 grant can now only be exercised in the event of a change in control of the Company or by certain good leavers.

Statement of directors' responsibilities

Company law requires the directors to prepare accounts for each financial year. Under company law the directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for that period. In preparing these accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether the consolidated accounts comply with International Financial Reporting Standards, and the Parent Company accounts comply with applicable UK Accounting Standards, subject to any material departures disclosed and explained in the accounts;
- prepare the accounts on the going concern basis unless it is inappropriate to presume that the Group and the Company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group and the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and the Company and enable them to ensure that the accounts comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent auditors' report to the members of Smiths Group plc

We have audited the group financial statements of Smiths Group plc for the year ended 31 July 2009 which comprise the consolidated income statement, the consolidated statement of recognised income and expense, the consolidated balance sheet, the consolidated cash-flow statement, the Accounting policies and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Respective responsibilities of directors and auditors

As explained more fully in the Statement of directors' responsibilities, the directors are responsible for the preparation of the group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Sections 495 and 496 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion the group financial statements:

- give a true and fair view of the state of the group's affairs as at 31 July 2009 and of its profit and cash-flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Group directors' report for the financial year for which the group financial statements are prepared is consistent with the group financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the directors' statement in relation to going concern; and
- the part of the Corporate governance statement relating to the company's compliance with the nine provisions of the June 2008 Combined Code specified for our review.

Other matter

We have reported separately on the parent company financial statements of Smiths Group plc for the year ended 31 July 2009 and on the information in the Directors' remuneration report that is described as having been audited.

Stuart Watson (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London

29 September 2009

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 income statement

	Notes	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Continuing operations			
Revenue	1	2,664.6	2,321.2
Cost of sales		(1,447.5)	(1,265.5)
Gross profit		1,217.1	1,055.7
Sales and distribution costs		(370.5)	(311.8)
Administrative expenses		(419.7)	(445.4)
Profit on disposal of businesses	4	1.6	27.2
Operating profit	2	428.5	325.7
Comprising			
– headline operating profit	3	417.5	380.6
– exceptional items, amortisation of acquired intangibles and other financing gains and losses	3	11.0	(54.9)
		428.5	325.7
Interest receivable		2.1	2.2
Interest payable		(54.4)	(43.2)
Other financing (losses)/gains		(10.9)	(6.1)
Other finance income – retirement benefits		5.1	41.7
Finance costs	5	(58.1)	(5.4)
Share of post-tax profits/(losses) of associated companies	14	0.4	(1.0)
Profit before taxation		370.8	319.3
Comprising			
– headline profit before taxation	3	370.7	380.3
– exceptional items, amortisation of acquired intangibles and other financing gains and losses	3	0.1	(61.0)
		370.8	319.3
Taxation	6	(94.9)	(75.0)
Profit after taxation – continuing operations		275.9	244.3
(Loss)/profit after taxation – discontinued operations	7	(5.9)	24.5
Profit for the period		270.0	268.8
Attributable to:			
Smiths Group shareholders		269.5	268.5
Minority interests		0.5	0.3
		270.0	268.8
Earnings per share	9		
Basic		69.3p	69.3p
Basic – continuing operations		70.8p	63.0p
Diluted		68.6p	68.5p
Diluted – continuing operations		70.1p	62.3p

References in the consolidated income statement, consolidated statement of recognised income and expense, consolidated balance sheet and consolidated cash-flow statement relate to notes on pages 86 to 118, which form an integral part of the consolidated accounts.

Consolidated statement of recognised income and expense

	Notes	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Exchange gain		189.2	89.5
Fair value gain on acquisition of former associate			0.4
Taxation recognised on share-based payment			
– current	6		5.2
– deferred	6	(4.0)	(3.8)
Actuarial losses on retirement benefits	10	(429.9)	(254.5)
Taxation recognised on actuarial losses – deferred	6	94.3	75.5
Fair value (losses)/gains:			
– on cash-flow hedges	20	0.4	(0.5)
– on net investment hedges	20	(58.6)	(47.5)
Net expense recognised directly in equity		(208.6)	(135.7)
Profit for the period		270.0	268.8
Total recognised income and expense	26	61.4	133.1
Attributable to:			
Smiths Group shareholders		59.9	132.8
Minority interests		1.5	0.3
		61.4	133.1

Consolidated balance sheet

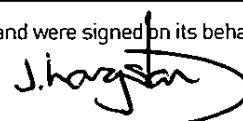
	Notes	2009 £m	2008 £m
Non-current assets			
Intangible assets	12	1,500.3	1,253.2
Property, plant and equipment	13	318.0	296.3
Investments accounted for using the equity method	14	11.2	9.1
Financial assets – other investments		7.8	3.6
Retirement benefit assets	10	39.2	174.2
Deferred tax assets	6	164.7	96.2
Trade and other receivables	16	21.3	14.6
Financial derivatives	21	13.9	1.4
		2,076.4	1,848.6
Current assets			
Inventories	15	413.6	380.3
Trade and other receivables	16	553.6	565.4
Cash and cash equivalents	17	91.7	132.5
Financial derivatives	21	40.7	6.5
		1,099.6	1,084.7
Total assets		3,176.0	2,933.3
Non-current liabilities			
Financial liabilities:			
– borrowings	19	(752.2)	(720.7)
– financial derivatives	21	(6.7)	(0.1)
Provisions for liabilities and charges	22	(226.5)	(200.6)
Retirement benefit obligations	10	(378.2)	(184.7)
Deferred tax liabilities	6	(66.5)	(64.3)
Trade and other payables	18	(25.1)	(27.5)
		(1,455.2)	(1,197.9)
Current liabilities			
Financial liabilities:			
– borrowings	19	(224.4)	(182.4)
– financial derivatives	21	(38.9)	(21.5)
Provisions for liabilities and charges	22	(77.2)	(70.0)
Trade and other payables	18	(399.8)	(420.7)
Current tax payable		(117.7)	(122.6)
		(858.0)	(817.2)
Total liabilities		(2,313.2)	(2,015.1)
Net assets		862.8	918.2
Shareholders' equity			
Share capital	25	145.9	145.5
Share premium account	26	306.6	303.6
Capital redemption reserve	26	5.8	5.8
Revaluation reserve	26	1.7	1.7
Merger reserve	26	234.8	234.8
Retained earnings	26	251.3	253.7
Hedge reserve	26	(87.1)	(29.2)
Total shareholders' equity		859.0	915.9
Minority interest equity		3.8	2.3
Total equity		862.8	918.2

The accounts on pages 76 to 118 were approved by the Board of Directors on 29 September 2009 and were signed on its behalf by:

Philip Bowman
Chief Executive



John Langston
Finance Director



Consolidated cash-flow statement

	Notes	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Net cash inflow from operating activities	27	332.1	198.1
Cash-flows from investing activities			
Expenditure on capitalised development		(22.5)	(19.8)
Expenditure on other intangible assets		(17.4)	(16.1)
Purchases of property, plant and equipment		(57.4)	(64.2)
Disposals of property, plant and equipment		19.8	2.7
Investment in financial assets		(6.6)	(3.4)
Proceeds from sale of financial assets			1.1
Acquisition of businesses	28	(103.3)	(149.7)
Disposal of Aerospace	7	(1.9)	(6.3)
Disposals of businesses		(0.2)	43.2
Net cash-flow used in investing activities		(189.5)	(212.5)
Cash-flows from financing activities			
Proceeds from exercise of share options	26	4.1	21.0
Purchase of own shares			(20.7)
Dividends paid to equity shareholders	8	(132.0)	(131.4)
Cash paid to shareholders under B share scheme			(16.4)
Cash outflow from matured derivative financial instruments		(89.9)	
Increase in new borrowings		495.8	135.9
Reduction and repayment of borrowings		(357.9)	(11.0)
Net cash-flow used in financing activities		(79.9)	(22.6)
Net increase/(decrease) in cash and cash equivalents		62.7	(37.0)
Cash and cash equivalents at beginning of period		(40.0)	3.1
Exchange differences		(3.0)	(6.1)
Cash and cash equivalents at end of period	17	19.7	(40.0)
Cash and cash equivalents at end of period comprise:			
– cash at bank and in hand		84.0	122.5
– short-term deposits		7.7	10.0
– bank overdrafts		(72.0)	(172.5)
		19.7	(40.0)
Included in cash and cash equivalents per the balance sheet	17	91.7	132.5
Included in overdrafts per the balance sheet	17	(72.0)	(172.5)
	17	19.7	(40.0)

The consolidated cash-flow statement includes cash-flows relating to discontinued operations. See note 7 for details of these cash-flows.

Accounting policies

Basis of preparation

The accounts have been prepared in accordance with the Companies Act 2006 applicable to companies reporting under International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee (IFRIC) interpretations, as adopted by the European Union in response to the IAS regulation (EC 1606/2002), under the historic cost convention modified to include revaluation of certain financial instruments, share options and pension assets and liabilities, held at fair value as described below.

The accounting policies adopted are consistent with those of the previous financial period except that the Group has adopted:

- 'IFRS 8: Operating segments', which has required changes to the segment information disclosures in note 1.
- 'IFRIC 14: The limit on a defined benefit asset, minimum funding requirements and their interaction' which provides guidance on recognising pension scheme surpluses as assets. Adopting this standard did not affect the assets recognised at 31 July 2008 in respect of pension schemes.

Significant judgements, key assumptions and estimates

The preparation of the accounts in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the accounts and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from these estimates. The key estimates and assumptions used in these consolidated financial statements are set out below.

Revenue recognition

The timing of revenue recognition on long-term funded contracts depends on the assessed stage of completion of contract activity at the balance sheet date. This assessment requires the expected total contract revenues and costs to be estimated based on the current progress of the contract.

Revenue of £46.9m (2008: £63.3m) has been recognised in respect of contracts in progress at the year end with a total expected value of £145.6m (2008: £197.5m). A 5% increase in the proportion of the contract activity recognised in the current year would have increased operating profit by an estimated £0.2m (2008: £0.6m).

Impairment

Goodwill is tested at least annually for impairment in accordance with the accounting policy for goodwill set out below. The recoverable amounts of cash generating units are determined based on value in use calculations. These calculations require the use of estimates including projected future cash-flows and other future events. See note 12 for details of the critical assumptions made and disclosures on the sensitivity of the impairment testing to these key assumptions.

Provisions for liabilities and charges

The consolidated financial statements include a provision for litigation of £185.4m (2008: £163.7m).

As previously reported, John Crane, Inc., a subsidiary of the Company, is currently one of many co-defendants in litigation relating to products previously manufactured which contained asbestos. Provision has been made for the future defence costs which the Group is expected to incur and the expected costs of future adverse judgments against John Crane, Inc. However, because of the significant uncertainty associated with the future level of asbestos claims and of the costs arising out of the related litigation, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred and, as a result, the provision may be subject to potentially material revisions from time to time if new information becomes available as a result of future events. See note 22 for details.

Retirement benefits

The consolidated financial statements include costs in relation to, and provision for, retirement benefit obligations. The costs and the present value of any related pension assets and liabilities depend on such factors as life expectancy of the members, the salary progression of current employees, the returns that plan assets generate and the discount rate used to calculate the present value of the liabilities. The Group uses previous experience and impartial actuarial advice to select the values of critical estimates. The estimates, and the effect of variances in key estimates, are disclosed in note 10.

Taxation

The Group has recognised deferred tax assets relating to UK losses of £111m (2008: £94m). The recognition of assets pertaining to these losses involves judgement by management as to the likelihood of realisation of these deferred tax assets and this is based on a number of factors, which seek to assess the expectation that the benefit of deferred tax assets will be realised, including appropriate taxable temporary timing differences and it has been concluded that there are sufficient taxable profits in future periods to support recognition.

Further detail on the Group's deferred taxation position is included in note 6.

The accounts have been prepared in accordance with the accounting policies, as described below.

Basis of consolidation

The consolidated accounts incorporate the financial statements of the Company and its subsidiary undertakings, together with the Group's share of the results of its associates.

Subsidiaries are all entities over which the Company has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which this power is transferred to the Company to the date that control ceases.

Associates are entities over which the Group has significant influence but does not control, generally accompanied by a share of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method.

Foreign currencies

The Company's presentational currency is sterling. The results and financial position of all subsidiaries and associates that have a functional currency different from sterling are translated into sterling as follows:

- assets and liabilities are translated at the rate of exchange at the date of that balance sheet;
- income and expenses are translated at average exchange rates for the period; and
- all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity. When a foreign operation is sold, the cumulative amount of such exchange differences is recognised in the income statement as part of the gain or loss on sale.

Exchange differences arising on transactions are recognised in the income statement. Those arising on trading are taken to operating profit; those arising on borrowings are classified as finance income or cost.

Revenue

Revenue from the sale of goods is recognised when the risks and rewards of ownership have been transferred to the customer, which is usually when title passes.

Revenue from services is recognised in accounting periods in which the services are rendered, by reference to completion of the specific transaction, assessed on the basis of the actual service provided as a proportion of the total services to be provided.

Revenue is measured at the fair value of the consideration received, net of trade discounts and sales taxes.

Long-term funded contracts

Where the outcome of a contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date. The Group uses the 'percentage of completion method' to determine the appropriate amount to recognise in a given period. The assessment of the stage of completion is dependent on the nature of the contract, but will generally be based on the estimated proportion of the total contract costs which have been incurred to date. If a contract is expected to be loss-making, a provision is recognised for the entire loss.

Employee benefits

Pension obligations and post-retirement benefits

The Group has both defined benefit and defined contribution plans.

For defined benefit plans the liability for each scheme recognised in the balance sheet is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised in full in the period in which they occur, outside of the income statement and are presented in the statement of recognised income and expense. Past service costs are recognised immediately in the income statement, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs are amortised on a straight-line basis over the vesting period.

For defined contribution plans, the Group pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. Contributions are expensed as incurred.

The Group also has certain post-retirement healthcare schemes which are accounted for on a similar basis to the defined benefit plans.

Accounting policies continued

Employee benefits continued

Share-based compensation

The Group operates a number of equity-settled and cash-settled share-based compensation plans.

The fair value of the shares or share options granted is recognised as an expense over the vesting period to reflect the value of the employee services received.

The fair value of options granted, excluding the impact of any non-market vesting conditions, is calculated using established option pricing models, principally binomial models. The probability of meeting non-market vesting conditions, which include profitability targets, is used to estimate the number of share options which are likely to vest.

For cash-settled share-based payment a liability is recognised based on the fair value of the payment earned by the balance sheet date. For equity-settled share-based payment the corresponding credit is recognised directly in reserves.

In accordance with the transitional provisions of 'IFRS 2: Share-based payment', no charge has been recognised for grants of equity instruments made before 7 November 2002.

Exceptional items

Items which are material either because of their size or their nature, and which are non-recurring, are presented within their relevant consolidated income statement category, but highlighted separately on the face of the income statement. The separate reporting of exceptional items helps provide a better picture of the Company's underlying performance. Items which may be included within the exceptional category include:

- profits/(losses) on disposal of businesses;
- spend on the integration of significant acquisitions and other major restructuring programmes;
- significant goodwill or other asset impairments;
- income and expenditure relating to John Crane, Inc. asbestos litigation; and
- other particularly significant or unusual items.

Exceptional items are excluded from the headline profit measures used by the Group. The basis of calculation of these measures is explained in note 3.

Discontinued operations

A discontinued operation is a component of the Group's business that represents a separate major line of business or geographical area of operations that has been disposed of, has been abandoned or meets the criteria to be classified as held for sale.

Discontinued operations are presented on the income statement as a separate line and are shown net of tax.

Assets and businesses held for sale

Assets and businesses classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell. Impairment losses on initial classification as held for sale and gains or losses on subsequent re-measurements are included in the income statement. No depreciation is charged on assets and businesses classified as held for sale.

Assets and businesses are classified as held for sale if their carrying amount will be recovered or settled principally through a sale transaction rather than through continuing use. The asset or business must be available for immediate sale and the sale must be highly probable within one year.

Intangible assets

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the identifiable net assets of the acquired subsidiary at the date of acquisition.

Goodwill arising from acquisitions of subsidiaries after 1 August 1998 is included in intangible assets, tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold. Goodwill arising from acquisitions of subsidiaries before 1 August 1998 was set against reserves in the year of acquisition.

Goodwill is tested for impairment at least annually. Any impairment is recognised immediately in the income statement. Subsequent reversals of impairment losses for goodwill are not recognised.

Research and development

Expenditure on research and development is charged to the income statement in the year in which it is incurred with the exception of:

- amounts recoverable from third parties; and
- expenditure incurred in respect of the development of major new products where the outcome of those projects is assessed as being reasonably certain as regards viability and technical feasibility. Such expenditure is capitalised and amortised straight line over the estimated period of sale for each product, commencing in the year that sales of the product are first made.

Intangible assets continued**Other intangible assets**

The identifiable net assets acquired as a result of a business combination may include intangible assets other than goodwill. Any such intangible assets are amortised straight line over their expected future lives.

The estimated useful lives are as follows:

Patents, licences and trademarks	up to 20 years
Technology	7 to 12 years
Customer relationships	up to 7 years

The assets' useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Property, plant and equipment

Property, plant and equipment is stated at historical cost less accumulated depreciation and any recognised impairment losses.

Land is not depreciated. Depreciation is provided on other assets estimated to write off the depreciable amount of relevant assets by equal annual instalments over their estimated 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%.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

No borrowing costs are capitalised as part of property, plant and equipment.

Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in, first-out (FIFO) method. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). It excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

Trade and other receivables

Trade receivables are initially recognised at fair value and subsequently measured at amortised cost, less any appropriate provision for estimated irrecoverable amounts. A provision is established for irrecoverable amounts when there is objective evidence that amounts due under the original payment terms will not be collected.

Cash and cash equivalents

Cash and cash equivalents include cash at bank and in hand and highly liquid interest-bearing securities with maturities of three months or less.

In the cash-flow statement cash and cash equivalents are shown net of bank overdrafts, which are included as current borrowings in liabilities on the balance sheet.

Provisions

Provisions for warranties and product liability, disposal indemnities, restructuring costs, vacant leasehold property and legal claims are recognised when: the Company has a legal or constructive obligation as a result of a past event; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Provisions are discounted where the time value of money is material.

Where there are a number of similar obligations, for example where a warranty provision has been given, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Taxation

The charge for taxation is based on profits for the year and takes into account taxation deferred because of temporary differences between the treatment of certain items for taxation and accounting purposes.

Deferred tax is provided in full using the balance sheet liability method. A deferred tax asset is recognised where it is probable that future taxable income will be sufficient to utilise the available relief. Tax is charged or credited to the income statement except when it relates to items charged or credited directly to equity, in which case the tax is also dealt with in equity.

Deferred tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary differences is controlled by the Company and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax liabilities and assets are not discounted.

Accounting policies continued

Financial assets

The classification of financial assets depends on the purpose for which the assets were acquired. Management determines the classification of an asset at initial recognition and re-evaluates the designation at each reporting date. Financial assets are classified as: loans and receivables or financial assets where changes in fair value are charged (or credited) to the income statement.

Financial assets are initially recognised at transaction price when the Group becomes party to contractual obligations. The transaction price used includes transaction costs unless the asset is being fair valued through the income statement.

The subsequent measurement of financial assets depends on their classification. Loans and receivables are measured at amortised cost using the effective interest rate method. Financial assets where changes in fair value are charged (or credited) to the income statement are subsequently measured at fair value. Realised and unrealised gains and losses arising from changes in the fair value of the 'financial assets at fair value through the income statement' category are included in the income statement in the period in which they arise.

Financial assets are derecognised when the right to receive cash-flows from the assets has expired, or has been transferred, and the Company has transferred substantially all of the risks and rewards of ownership.

Financial assets are classified as current if they are expected to be realised within 12 months of the balance sheet date.

Financial liabilities

Borrowings are initially recognised at the fair value of the proceeds, net of related transaction costs. These transaction costs, and any discount or premium on issue, are subsequently amortised under the effective interest rate method through the income statement as interest over the life of the loan, and added to the liability disclosed in the balance sheet. Related accrued interest is included in the borrowings figure.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least one year after the balance sheet date.

Derivative financial instruments and hedging activities

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. The method of recognising any resulting gain or loss depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged.

Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in the income statement.

Fair value hedge

Changes in the fair values of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair values of the hedged assets or liabilities that are attributable to the hedged risk.

Cash-flow hedge

The effective portions of changes in the fair values of derivatives that are designated and qualify as cash-flow hedges are recognised in equity. The gain or loss relating to any ineffective portion is recognised immediately in the income statement.

Amounts accumulated in equity are recycled in the income statement in the periods when the hedged items will affect profit or loss (for instance when the forecast sale that is hedged takes place). If a forecast transaction that is hedged results in the recognition of a non-financial asset (for example, inventory) or a liability, the gains and losses previously deferred in equity are transferred from equity reserves and included in the initial measurement of the cost of the asset or liability.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

Net investment hedge

Hedges of net investments in foreign operations are accounted for similarly to cash-flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in equity; the gain or loss relating to any ineffective portion is recognised immediately in the income statement.

When a foreign operation is disposed of gains and losses accumulated in equity related to that operation are included in the income statement.

Embedded derivatives

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not carried at their fair value. Unrealised gains and losses on these embedded derivatives are recognised in the income statement.

Fair value of financial assets and liabilities

The fair values of financial assets and financial liabilities are the amounts at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

The following methods are used to estimate the fair values of the financial instruments:

- cash, trade receivables and payables and floating rate borrowings – the carrying value is a good approximation of the fair value;
- fixed rate borrowings – quoted market prices of equivalent instruments; and
- forward exchange contracts, currency swaps, interest rate instruments and embedded derivatives – net present value of the future cash-flows, calculated using market data at the balance sheet date (principally exchange rates and yield curves).

Borrowings are carried on the balance sheet at amortised cost adjusted for fair value interest rate hedging. The fair value of fixed rate borrowings is only used for supplementary disclosures.

Financial guarantees

Financial guarantees are initially recognised at the fair value of the consideration received.

At each subsequent balance sheet date an estimate is made of the payments which will be required under the guarantee in accordance with 'IAS 37: Provisions, contingent liabilities and contingent assets'. The guarantee is then valued at the higher of its initial value less revenue recognised to date and the best estimate of the total payments which will be required under the contract.

Any gains or losses on the contract are recognised in the income statement.

Dividends

Dividends are recognised as a liability in the period in which they are authorised. The interim dividend is recognised when it is paid and the final dividend is recognised when it has been approved by shareholders at the Annual General Meeting.

Recent accounting developments

The following standards and interpretations have been issued by the IASB and are likely to affect future annual reports and accounts.

An amendment to 'IAS 23: Borrowing costs' was issued in March 2007 and will be implemented by the Group from 1 August 2009. This eliminates the option, currently used by the Group, of expensing all borrowing costs when they are incurred. As retrospective adoption is not required, there will be no changes to the information previously reported when this standard is adopted. The impact of the new policy on future reported performance is expected to be limited.

An amendment to 'IFRS 2: Share-based payment' was issued in January 2008 and will be implemented by the Group from 1 August 2009. This provides a definition of vesting conditions and specifies the accounting treatment for non-vesting conditions. It is not expected to have a material effect on the share-based payment charge recognised in the Group accounts because only a small proportion of awards under employee share schemes is affected by failures to comply with non-vesting conditions.

'IFRS 3: (Revised) business combinations' and 'IAS 27: (Revised) consolidated and separate financial statements' were issued in January 2008 and will be implemented by the Group from 1 August 2009. Implementing IFRS 3 (revised) will significantly change the recognition of goodwill, acquisition costs and contingent consideration relating to acquisitions. However it only applies to acquisitions made after it has been adopted. IAS 27 (revised) requires different accounting treatment for minority interest but it is not expected to affect the Group's financial results or position materially.

'IAS 1: (Revised) Presentation of financial statements' was issued in January 2008 and will be implemented by the Group from 1 August 2009. This requires the reconciliation of movements in equity to be presented as a primary financial statement and increased disclosures when there is a restatement of comparatives.

'IFRIC 15: Agreements for the construction of real estate' was issued on 3 July 2008 and will be implemented by the Group from 1 August 2009. The Group is not involved in the construction or sale of residential real estate. However a review of contract accounting has been undertaken to establish whether or not the same principles apply to any transactions undertaken by the Group. The impact of adopting this interpretation is not expected to be material.

Parent company

The accounts of the parent company, Smiths Group plc, have been prepared in accordance with UK GAAP. The Company accounts are presented in separate financial statements on pages 121 to 130.

The principal subsidiaries of the parent company are listed in the above accounts.

The ultimate parent company of the Group is Smiths Group plc, a company incorporated in England, and listed on the London Stock Exchange.

Notes to the accounts

1 Segment information

Analysis by operating segment

From 1 August 2008 the Group has been organised into five divisions: Smiths Detection, John Crane, Smiths Medical, Smiths Interconnect and Flex-Tek. Prior period disclosures have been amended to conform to the new structure. The 'Other' division comprises the Marine Systems business which was sold on 8 November 2007 and the Specialty Engineering divisional office which was disbanded on 31 July 2008.

These divisions design and manufacture the following products:

- Smiths Detection – sensors that detect and identify explosives, narcotics, weapons, chemical agents, biohazards and contraband;
- John Crane – mechanical seals, seal support systems, engineered bearings, power transmission couplings and specialist filtration systems;
- Smiths Medical – medication delivery systems, vital care products and safety devices that prevent needlestick injuries and reduce cross infection;
- Smiths Interconnect – specialised electronic and radio frequency products;
- Flex-Tek – engineered components that heat and move fluids and gases, flexible hosing and rigid tubing.

The position and performance of each division is reported monthly to the Board of Directors. This information is prepared using the same accounting policies as the consolidated financial information except that the Group uses headline operating profit to monitor divisional results and operating assets to monitor divisional position. See note 3 for an explanation of which items are excluded from headline measures.

Intersegment sales and transfers are charged at arms length prices.

	Year ended 31 July 2009					
	Smiths Detection £m	John Crane £m	Smiths Medical £m	Smiths Interconnect £m	Flex-Tek £m	Other £m
Revenue	500.9	789.8	833.5	318.1	222.3	2,664.6
Divisional headline operating profit	63.1	142.8	163.9	55.5	21.9	447.2
Corporate headline operating costs						(29.7)
Headline operating profit	63.1	142.8	163.9	55.5	21.9	417.5
Divisional exceptional operating items (note 4)		(23.8)	0.5		(4.4)	(27.7)
Corporate exceptional operating items (note 4)						73.3
Amortisation of acquired intangible assets	(0.5)	(13.3)	(16.6)	(4.2)		(34.6)
Operating profit	62.6	105.7	147.8	51.3	17.5	428.5
Exceptional finance costs – adjustment to discounted provision (note 4)		(7.1)				(7.1)
Net finance costs – other						(51.0)
Share of post-tax profits of associate companies	0.4					0.4
Profit before taxation						370.8

	Year ended 31 July 2008					
	Smiths Detection £m	John Crane £m	Smiths Medical £m	Smiths Interconnect £m	Flex-Tek £m	Other £m
Revenue	509.3	625.8	703.4	260.6	206.1	16.0
Divisional headline operating profit	93.3	103.8	139.6	54.0	24.3	0.8
Corporate headline operating costs						(35.2)
Headline operating profit	93.3	103.8	139.6	54.0	24.3	0.8
Divisional exceptional operating items (note 4)	0.1	(51.0)	(9.4)	(1.3)	(0.1)	28.3
Corporate exceptional operating items (note 4)						(2.0)
Amortisation of acquired intangible assets	(0.4)	(5.5)	(11.3)	(2.0)		(19.2)
Financing losses			(0.4)		0.1	(0.3)
Operating profit	93.0	47.3	118.5	50.7	24.3	29.1
Exceptional finance costs – adjustment to discounted provision (note 4)		(4.7)				(4.7)
Net finance costs – other						(0.7)
Share of post-tax (losses)/profits of associate companies	(1.4)	0.4				(1.0)
Profit before taxation						319.3

1 Segment information continued

Divisional headline operating profit is stated after charging/(crediting) the following items:

Year ended 31 July 2009							
	Smiths Detection £m	John Crane £m	Smiths Medical £m	Smiths Interconnect £m	Flex-Tek £m	Other £m	Total £m
Depreciation	8.8	12.8	28.7	6.5	4.5	0.9	62.2
Amortisation	7.6	2.9	8.8	0.7	0.1	35.1	55.2
Other non-cash items							
– share-based payment	0.6	2.5	0.7	0.1	0.1	4.0	8.0
– goodwill and other asset impairments			0.6			3.4	4.0

Year ended 31 July 2008							
	Smiths Detection £m	John Crane £m	Smiths Medical £m	Smiths Interconnect £m	Flex-Tek £m	Other £m	Total £m
Depreciation	7.6	9.6	26.3	4.5	4.2	1.0	53.2
Amortisation	4.0	1.5	5.4	0.5	0.1	19.5	31.0
Other non-cash items							
– share-based payment	1.2	1.6	2.0	0.8	0.4	6.9	12.9
– goodwill and other asset impairments			0.3				0.3

The reconciling items are central costs, amortisation of acquired intangible assets and charges which qualify as exceptional.

The capital expenditure for each division is:

	Smiths Detection £m	John Crane £m	Smiths Medical £m	Smiths Interconnect £m	Flex-Tek £m	Other £m	Total £m
Capital expenditure year ended 31 July 2009	26.6	19.0	33.7	7.3	4.7	6.0	97.3
Capital expenditure year ended 31 July 2008	32.0	21.5	37.3	5.6	2.4	1.3	100.1

The operating assets and liabilities of the five divisions are set out below:

31 July 2009						
	Smiths Detection £m	John Crane £m	Smiths Medical £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Property, plant, equipment, development projects and other intangibles	101.9	101.0	180.9	30.0	26.6	440.4
Investments in associates	11.2					11.2
Working capital assets	300.2	266.2	262.3	96.3	58.9	983.9
Operating assets	413.3	367.2	443.2	126.3	85.5	1,435.5
Derivatives, tax and retirement benefit assets						258.5
Goodwill and acquired intangibles						1,373.5
Corporate assets						16.8
Cash						91.7
Total assets						3,176.0
Working capital liabilities	(141.5)	(115.7)	(100.0)	(47.2)	(25.8)	(430.2)
Corporate and non-headline liabilities						(298.4)
Derivatives, tax and retirement benefit liabilities						(608.0)
Borrowings						(976.6)
Total liabilities						(2,313.2)

Non-headline liabilities comprise provisions and accruals relating to exceptional items, acquisitions and disposals.

Notes to the accounts continued

1 Segment information continued

	31 July 2008					
	Smiths Detection £m	John Crane £m	Smiths Medical £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Property, plant, equipment, development projects and other intangibles	85.3	82.8	158.7	24.9	24.7	376.4
Investments in associates	9.1					9.1
Working capital assets	292.5	249.3	261.2	85.7	63.3	952.0
Operating assets	386.9	332.1	419.9	110.6	88.0	1,337.5
Derivatives, tax and retirement benefit assets						278.3
Goodwill and acquired intangibles						1,151.9
Corporate assets						33.1
Cash						132.5
Total assets						2,933.3
Working capital liabilities	(145.3)	(118.8)	(90.5)	(46.5)	(29.2)	(430.3)
Corporate and non-headline liabilities						(288.5)
Derivatives, tax and retirement benefit liabilities						(393.2)
Borrowings						(903.1)
Total liabilities						(2,015.1)

Non-headline liabilities comprise provisions and accruals relating to exceptional items, acquisitions and disposals.

Analysis of revenue

The Group's statutory revenue is analysed as follows:

	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Sale of goods	2,460.9	2,077.8
Contracts	67.4	132.1
Services	136.3	111.3
	2,664.6	2,321.2

The revenue for the main product and service lines for each division is:

Smiths Detection	Transportation £m	Ports and borders £m	Military £m	Emergency responders £m	Critical infrastructure £m	Non-security £m	Total £m
Revenue year ended 31 July 2009	181.9	53.1	131.6	27.5	67.4	39.4	500.9
Revenue year ended 31 July 2008	190.9	114.9	76.1	24.0	57.9	45.5	509.3

John Crane	Original equipment manufacture £m				Aftermarket £m		Total £m
		Oil, gas and petrochemical £m	Chemical and pharmaceutical £m	Distributors £m	General industry £m		
Revenue year ended 31 July 2009	295.6	296.1	71.8	48.6	77.7		789.8
Revenue year ended 31 July 2008	224.1	219.4	66.3	39.9	76.1		625.8

Smiths Medical	Medication delivery £m	Vital care £m	Safety devices £m	Total £m
Revenue year ended 31 July 2009	237.3	335.2	261.0	833.5
Revenue year ended 31 July 2008	202.8	287.3	213.3	703.4

Smiths Interconnect	Telecom £m	Military and Aerospace £m	Rail, Medical and Automation £m	Total £m
Revenue year ended 31 July 2009	95.9	154.8	67.4	318.1
Revenue year ended 31 July 2008	80.6	116.4	63.6	260.6

Flex-Tek	Aerospace £m	Flexible Solutions £m	Heat Solutions £m	Total £m
Revenue year ended 31 July 2009	59.7	49.0	113.6	222.3
Revenue year ended 31 July 2008	49.0	52.5	104.6	206.1

1 Segment information continued**Analysis by geographical areas**

The Group's revenue by destination and non-current operating assets by location are shown below:

	Revenue		Intangible assets, property plant and equipment and investments accounted for using the equity method	
	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m	2009 £m	2008 £m
United Kingdom	115.8	148.3	143.9	146.9
Germany	148.4	140.0	335.7	311.6
France	98.2	89.1	15.1	12.5
Other European	333.9	357.2	126.4	123.2
United States of America	1,287.6	1,003.2	1,056.8	875.2
Canada	98.9	83.2	15.5	14.9
Mexico	24.5	21.1	6.8	7.1
Japan	106.1	73.8	19.8	14.6
China	70.6	59.1	74.0	19.1
Rest of the World	380.6	346.2	35.5	33.5
	2,664.6	2,321.2	1,829.5	1,558.6

2 Operating profit is stated after charging

	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Research and development expense	66.7	52.7
Operating leases		
– land and buildings	21.7	20.2
– other	9.4	7.9

	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Audit services		
Fees payable to the Company's auditors for the audit of the parent company and consolidated accounts	0.5	0.5
Fees payable to the Company's auditors and its associates for other services:		
– the audit of the Company's subsidiaries, pursuant to legislation	3.4	3.5
– other services pursuant to legislation	0.1	
	4.0	4.0
Tax services		
– compliance services		0.1
– advisory services	0.2	0.1
Services in relation to corporate acquisition and disposal transactions		
– due diligence		0.1
All other services	0.3	0.2

Other services relate to one-off projects.

Notes to the accounts continued

3 Headline profit measures

The Company seeks to present a measure of underlying performance which is not impacted by exceptional items or items considered non-operational in nature. This measure of profit is described as 'headline' and is used by management to measure and monitor performance.

The following items have been excluded from the headline measure:

- exceptional items, including income and expenditure relating to John Crane, Inc. asbestos litigation;
- amortisation of intangible assets acquired in a business combination – the amortisation charge is a non-cash item, and the directors believe that it should be added back to give a clearer picture of underlying performance; and
- other financing gains and losses, which represent the potentially volatile gains and losses on derivatives and other financial instruments which do not fall to be hedge accounted under IAS 39.

The excluded items are referred to as 'non-headline' items.

	Notes	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Operating profit		428.5	325.7
Exclude:			
– exceptional operating items	4	(45.6)	35.4
– amortisation of acquired intangible assets	12	34.6	19.2
– other financing gains and losses			0.3
Non-headline items in operating profit		(11.0)	54.9
Headline operating profit		417.5	380.6
Finance costs		(58.1)	[5.4]
Exclude:			
– exceptional finance costs	4	7.1	4.7
– other financing gains and losses	5	3.8	1.4
Non-headline items in finance costs		10.9	6.1
Headline finance costs		(47.2)	0.7
Profit before taxation		370.8	319.3
Non-headline items in operating profit		(11.0)	54.9
Non-headline items in finance costs		10.9	6.1
Headline profit before taxation		370.7	380.3
Profit after taxation – continuing operations		275.9	244.3
Exclude:			
– non-headline items in profit before taxation		(0.1)	61.0
– tax on excluded items	6	6.1	[16.3]
		6.0	44.7
Headline profit after taxation – continuing operations		281.9	289.0

4 Exceptional items

An analysis of the amounts presented as exceptional items in these financial statements is given below:

	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Operating items		
Restructuring of corporate headquarters and divisional reorganisation	(23.7)	(4.5)
Gains on changes to post-retirement benefits	70.3	
Integration of acquisitions		(9.1)
Profit on disposal of businesses	1.6	27.2
Profit on disposal of property	12.6	
Litigation:		
– provision for John Crane, Inc. asbestos litigation (note 22)	(15.2)	(49.0)
	45.6	(35.4)
Financing items		
Exceptional finance costs – adjustment to discounted provision (note 22)	(7.1)	(4.7)
	38.5	(40.1)

Year ended 31 July 2009

In the current year £23.7m has been charged in respect of the restructuring of corporate centre and divisional reorganisation including an impairment charge of £3.1m in respect of affected properties. The total costs are expected to amount to approximately £45m over the period to 2010.

The Group has closed the US defined benefit pension plan. With effect from 30 April 2009, no further benefits will accrue under this plan and a curtailment gain of £19.4m has arisen. In addition the cost of post-retirement healthcare provision in both the UK and US has been reduced by requiring greater beneficiary contributions. As a result a past service benefit of £50.9m has arisen.

The operating charge of £15.2m in respect of John Crane, Inc. asbestos litigation comprises £10.6m in respect of increased provision for adverse legal judgments, £2.5m arising from movements in the discounting due to changes in US interest rates and £2.1m in respect of legal fees in connection with litigation against insurers.

Year ended 31 July 2008

On 3 June 2008 the Company announced a number of changes to its corporate centre and divisional organisation. The total cost of this restructuring, including redundancy, relocation and consolidation of manufacturing, was considered exceptional by virtue of its size.

In addition, restructuring costs in connection with the integration of Medex amounting to £9.1m were incurred in the period.

The operating charge of £49.0m in respect of John Crane, Inc. asbestos litigation comprised a £40.0m provision for the expected costs of future asbestos judgments, £5.2m in respect of adverse legal judgments (net of insurer contributions previously lodged as collateral) and £3.8m arising from movements in the discounting due to changes in US interest rates (see note 22).

Notes to the accounts continued

5 Net finance costs

	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Interest receivable	2.1	2.2
Interest payable		
– bank loans and overdrafts	(17.4)	(19.6)
– other loans	(37.0)	(23.6)
Interest payable	(54.4)	(43.2)
Other financing (losses)/gains		
– fair value losses on hedged debt	(5.6)	(4.0)
– fair value gains on fair value hedge	5.6	4.0
– net foreign exchange losses	(3.8)	(1.4)
– exceptional finance costs – adjustment to discounted provision	(7.1)	(4.7)
Other financing losses	(10.9)	(6.1)
Retirement benefits		
– return on plan assets	204.1	217.3
– interest cost	(199.0)	(175.6)
Retirement benefits	5.1	41.7
Net finance costs	(58.1)	(5.4)

6 Taxation

	Continuing Year ended 31 July 2009 £m	Continuing Year ended 31 July 2008 £m	Discontinued Year ended 31 July 2009 £m	Discontinued Year ended 31 July 2008 £m
The taxation charge for the year comprises				
– current taxation	65.7	67.0		
– deferred taxation	29.2	8.0	0.2	2.3
Total taxation expense in the income statement	94.9	75.0	0.2	2.3
Current taxation				
– UK corporation tax				
– foreign tax	65.7	67.0		
– discontinued tax				
	65.7	67.0		

Reconciliation of the total tax charge

The tax expense on the profit for the period is different from the standard rate of corporation tax in the UK of 28% (2008: 29.3%). The difference is reconciled as follows:

	Continuing Year ended 31 July 2009 £m	Continuing Year ended 31 July 2008 £m	Discontinued Year ended 31 July 2009 £m	Discontinued Year ended 31 July 2008 £m
Profit before tax	370.8	319.3	(5.7)	26.8
Notional taxation expense at UK rate of 28% (2008: 29.3%)	103.8	93.7	(1.6)	7.9
Effect of overseas taxation	10.6	8.2		
Compliance benefits	(16.8)	(12.4)		
Local incentives	(8.8)	(16.1)		
Tax effect of other non-headline items	6.1	1.6		
Tax effect of Aerospace sale			1.8	(5.6)
	94.9	75.0	0.2	2.3
Comprising				
– taxation on headline profit	88.8	91.3		
– tax on non-headline profit/(loss)	6.1	(16.3)		
– tax on sale of discontinued operations			0.2	2.3
Total taxation expense in the income statement	94.9	75.0	0.2	2.3

6 Taxation continued

	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Tax on items charged/(credited) to equity		
Current tax credit		
– share-based payment		(5.2)
		(5.2)
Deferred tax (credit)/charge		
– retirement benefit schemes	(94.3)	(75.5)
– share-based payment	4.0	3.8
	(90.3)	(76.9)

Deferred taxation

	Excess tax depreciation on fixed assets and goodwill £m	Share-based payment £m	Retirement benefit obligations £m	Capitalised development expenditure £m	Other £m	Total £m
At 31 July 2007	(72.1)	15.7	(55.2)	(10.2)	97.8	(24.0)
Credit/(charge) to income statement	9.7	0.3	(31.3)	(1.6)	12.6	(10.3)
Charge to equity		(3.8)	75.5			71.7
Other					6.0	6.0
Disposals					(12.8)	(12.8)
Exchange adjustments	(1.9)		0.5	(0.2)	2.9	1.3
At 31 July 2008	(64.3)	12.2	(10.5)	(12.0)	106.5	31.9
Deferred tax assets	(2.6)	0.3	19.7	(4.6)	83.4	96.2
Deferred tax liabilities	(61.7)	11.9	(30.2)	(7.4)	23.1	(64.3)
At 31 July 2008	(64.3)	12.2	(10.5)	(12.0)	106.5	31.9
Credit/(charge) to income statement	8.0	(4.3)	(35.8)	(4.0)	6.7	(29.4)
Charge to equity		(4.0)	94.3			90.3
Other	(4.1)					(4.1)
Exchange adjustments	(8.0)		3.0	(1.6)	16.1	9.5
At 31 July 2009	(68.4)	3.9	51.0	(17.6)	129.3	98.2
Deferred tax assets	(4.9)	3.9	50.6	(8.9)	124.0	164.7
Deferred tax liabilities	(63.5)		0.4	(8.7)	5.3	(66.5)
At 31 July 2009	(68.4)	3.9	51.0	(17.6)	129.3	98.2

Included in Other above is a deferred tax liability of £4.0m (2008: £9.3m) relating to unremitted overseas earnings. No additional tax liabilities have been recognised because the Group is in a position to control the timing of other temporary differences and it is probable that such differences will not reverse in the future. Other deferred tax also includes the tax benefits of losses carried forward amounting to £31.3m (2008: £26.7m).

The Group has not recognised deferred tax assets relating to tax losses of £78.3m (2008: £102.2m), due to uncertainty as to their recoverability. The expiry date of operating losses carried forward is dependent upon the law of the various territories in which the losses arise. A summary of expiry dates for losses in respect of which restrictions apply is set out below.

Restricted losses

	2009 £m	Expiry of losses	2008 £m	Expiry of losses
Territory				
– Americas	10.7	2019-2025	10.7	2019-2025
Total restricted losses	10.7		10.7	
Unrestricted losses:				
– operating losses	67.6	No expiry	91.5	No expiry
Total	78.3		102.2	

Notes to the accounts continued

7 Discontinued operations

On 5 May 2007, the Group sold its Aerospace operations to General Electric Company. The Aerospace operations sold comprised the previously reported Aerospace business segment and a US microwave company. The disposal group was treated as a discontinued operation in the 2007 Annual Report and Accounts.

Profit on disposal of operation

	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Total consideration		6.1
Provisions and disposal costs	(5.7)	17.1
Provision for settlement loss		3.6
Pre-tax (loss)/profit on disposal	(5.7)	26.8
Cash received from disposal of Aerospace operations	0.2	3.0
Disposal costs	(2.1)	(9.3)
Net cash outflow on disposal	(1.9)	(6.3)

Provisions and disposal costs includes exchange gains and losses on disposal provisions.

The £6.1m consideration recognised in the year ended 31 July 2008 arose from the finalisation of the working capital adjustment. The provisions and disposal costs movement for the year ended 31 July 2008 included £4.3m other finance income relating to retirement benefits and £12.7m relating to the reassessment of the carrying value of other assets and liabilities

Financial information for the Aerospace operations after Group eliminations is presented below.

Results from discontinued operations

	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
(Loss)/profit on disposal	(5.7)	26.8
Attributable tax charge (note 6)	(0.2)	(2.3)
(Loss)/profit for the period	(5.9)	24.5

Earnings per share from discontinued operations – pence

Basic	(1.5p)	6.3p
Diluted	(1.5p)	6.2p

Cash-flows from discontinued operations

	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Profit before taxation (including profit on disposal of Aerospace operations)	(5.7)	26.8
Profit on disposal of discontinued operations	5.7	(26.8)
Net cash inflow from operating activities		
Investing activities	(1.9)	(6.3)
	(1.9)	(6.3)

8 Dividends

The following dividends were declared and paid in the period:

	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Ordinary final dividend of 23.50p for 2008 (2007: 23.50p) paid 21 November 2008	91.1	90.8
Ordinary interim dividend of 10.5p for 2009 (2008: 10.5p) paid 24 April 2009	40.9	40.6
	132.0	131.4

The final dividend for the year ended 31 July 2009 of 23.5p per share was declared by the Board on 29 September 2009 and will be paid to shareholders on 20 November 2009. This dividend has not been included as a liability in these accounts and is payable to all shareholders on the register of Members at close of business on 23 October 2009.

9 Earnings per share

Basic earnings per share are calculated by dividing the profit for the period attributable to equity shareholders of the Parent Company by the average number of ordinary shares in issue during the year.

	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Profit attributable to equity shareholders for the year		
– continuing	275.4	244.0
– total	269.5	268.5
Average number of shares in issue during the year	388,786,063	387,446,186

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 392,591,613 (2008: 391,851,712) ordinary shares, being the average number of ordinary shares in issue during the period adjusted by the dilutive effect of employee share schemes. For the year ended 31 July 2009 options over 5,017,907 (2008: 1,376,331) shares were excluded from this calculation because their effect was anti-dilutive for continuing operations.

A reconciliation of basic and headline earnings per share – continuing is as follows:

	Year ended 31 July 2009		Year ended 31 July 2008	
	£m	EPS (p)	£m	EPS (p)
Profit attributable to equity shareholders of the Parent Company	275.4	70.8	244.0	63.0
Exclude:				
Non-headline items and related tax (note 3)	6.0	1.6	44.7	11.5
Headline	281.4	72.4	288.7	74.5
Headline EPS – diluted (p)		71.7		73.7

Notes to the accounts continued

10 Post-retirement benefits

Smiths operates a number of defined benefit plans throughout the world. The principal schemes are in the United Kingdom and in the United States and assets are held in separate trustee-administered funds. The Group also provides a defined contribution (401K) plan for its US employees. The US defined benefit pension plan was closed with effect from 30 April 2009, from which date no further benefits have accrued. In addition, future benefits accruing under the US and UK post-retirement healthcare schemes were substantially reduced; for most members the company will contribute 50% of the 2009 premium and the member will pay the remainder of the premium.

Pension costs are assessed in accordance with the advice of independent, professionally-qualified actuaries. The most recent actuarial valuations of the two principal UK schemes were performed using the Projected Unit Method as at 31 March 2006. The most recent valuations of the six principal US pension and post-retirement healthcare plans were performed at 1 January 2008. These valuations have been updated by independent qualified actuaries in order to assess the liabilities of the schemes as at 31 July 2009. Scheme assets are stated at their market values. Contributions to the schemes are made on the advice of the actuaries with the objective that the benefits be fully funded during the scheme members' average working lives.

The principal assumptions used in updating the valuations are set out below:

	2009			2008		
	UK	US	Other	UK	US	Other
Rate of increase in salaries	3.8%	n/a	3.1%	4.1%	3.8%	3.7%
Rate of increase in pensions in payment	3.3%	n/a	1.4%	3.6%	n/a	1.4%
Rate of increase in deferred pensions	3.3%	n/a	0.6%	3.5%	n/a	0.7%
Discount rate	5.9%	6.0%	5.9%	6.6%	6.8%	6.0%
Inflation rate	3.3%	n/a	1.7%	3.6%	3.3%	2.5%
Healthcare cost increases	5.0%	n/a	3.0%	5.0%	*	3.8%

*8% p.a. reducing 0.5% p.a. to 5% in 2014

The assumptions used are estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily occur in practice. For countries outside the UK and USA these are disclosed as a weighted average.

The mortality assumptions used in the principal UK schemes are based on the new SAPS All Birth year tables with relevant scaling factors based on recent actual mortality experience of members within each. They allow for future improvements in life expectancy in line with 80% and 60% of the long cohort for males and females respectively with an annual 1% underpin. The mortality assumptions used in the principal US schemes are based on the most recent mortality study table produced for retired pensioners in the US (RP 2000 table). The table selected allows for future mortality improvements and applies an adjustment for job classification (blue collar versus white collar). The assumptions give the following:

Expected further years of life	UK		US	
	Male	Female	Male	Female
Member who retires next year at age 65	22	24	19	21
Member, currently 45, when they retire in 20 years time	24	25	19	21

The assets in the scheme and the expected rates of return as at 31 July 2009 were:

	2009					
	UK schemes		US schemes		Other countries	
	Long-term rate of return	Value £m	Long-term rate of return	Value £m	Long-term rate of return	Value £m
						£m
Equities	8.2%	1,113.1	8.8%	198.6	9.3%	7.8
Government bonds	4.5%	242.5	4.3%	68.5	4.6%	3.5
Corporate bonds	5.9%	267.1	6.0%	44.2	7.7%	2.5
Insured liabilities	5.9%	490.1	6.0%	1.8	n/a	
Property	7.2%	137.8	n/a		2.9%	0.2
Other	5.0%	163.1	3.0%	21.4	5.0%	12.9
Total market value		2,413.7		334.5		26.9
Present value of funded scheme liabilities		(2,531.8)		(462.6)		(33.2)
Deficit		(118.1)		(128.1)		(6.3)
Unfunded pension plans		(36.0)		(4.9)		(18.7)
Post-retirement healthcare		(6.2)		(18.0)		(0.7)
Present value of unfunded obligations		(42.2)		(22.9)		(19.4)
Unrecognised asset due to surplus restriction						(2.0)
Net pension liability		(160.3)		(151.0)		(27.7)
Post-retirement assets		39.2				
Post-retirement liabilities		(199.5)		(151.0)		(27.7)
Net pension liability		(160.3)		(151.0)		(27.7)

10 Post-retirement benefits continued

	2008					
	UK schemes		US schemes		Other countries	
	Long-term rate of return	Value £m	Long-term rate of return	Value £m	Long-term rate of return	Value £m
Equities	8.2%	1,165.8	8.8%	187.5	8.8%	7.1
Government bonds	4.8%	445.1	5.3%	83.8	6.6%	4.9
Corporate bonds	6.6%	258.4	6.8%	25.8	7.1%	1.8
Insured liabilities	6.6%	271.4	6.8%	1.5	n/a	
Property	7.2%	188.7	n/a		3.2%	0.2
Other	5.8%	289.0	6.0%	17.9	5.0%	11.0
Total market value		2,618.4		316.5		25.0
Present value of funded scheme liabilities		(2,468.8)		(357.0)		(30.7)
Surplus/(deficit)		149.6		(40.5)		(5.7)
Unfunded pension plans		(34.3)		(3.7)		(16.4)
Post-retirement healthcare		(15.2)		(42.0)		(0.8)
Present value of unfunded obligations		(49.5)		(45.7)		(17.2)
Unrecognised asset due to surplus restriction						(1.5)
Net pension asset/(liability)		100.1		(86.2)		(24.4)
Post-retirement assets		174.2				
Post-retirement liabilities		(74.1)		(86.2)		(24.4)
Net pension asset/(liability)		100.1		(86.2)		(24.4)

Other assets in the UK and US comprise cash and current assets.

During 2009 the Trustees of the TI Pension Scheme invested £249.3m (2008: £250.0m) in annuities which are matched with specific liabilities of the scheme.

The scheme assets do not include any of the Group's own financial instruments, nor any property occupied by, nor other assets used by, the Group. The expected rates of return on individual categories of scheme assets are determined by reference to relevant industries. The overall rate of return is calculated by weighting the individual rates in accordance with the anticipated balance in the scheme's investment portfolios.

Amounts recognised in the income statement – continuing and discontinued operations

	Year ended 31 July 2009				Year ended 31 July 2008			
	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans
	UK £m	US £m	Other £m		UK £m	US £m	Other £m	
Current service cost	9.4	7.4	1.6	2.5	11.3	7.6	1.3	2.4
Past service (gain)/cost				(51.5)		1.0	0.1	
Settlement losses					20.7			
Curtailment gains		(19.4)			(1.1)			
Total charge/(credit)	9.4	(12.0)	1.6	(49.0)	30.9	8.6	1.4	2.4
Expected return on pension scheme assets	(174.0)	(28.3)	(1.8)		(199.5)	(24.5)	(1.5)	
Interest on pension scheme liabilities	158.8	30.0	2.2	8.0	148.3	23.0	1.5	6.7
Net return	(15.2)	1.7	0.4	8.0	(51.2)	(1.5)		6.7
Total (credited)/charged to income statement	(5.8)	(10.3)	2.0	(41.0)	(20.3)	7.1	1.4	9.1

The actual return on scheme assets was a loss of £141.3m (2008: loss of £124.5m).

The past service gain of £51.5m includes £41.9m relating to benefit changes in the US post-retirement healthcare plans, £9.0m relating to benefit changes in the UK post-retirement healthcare plans and £0.6m relating to the withdrawal of a UK Christmas bonus scheme. £50.9m of this gain is recorded under exceptional operating items in the income statement.

The curtailment gain of £19.4m relates to the closure of the US defined benefit scheme.

Notes to the accounts continued

10 Post-retirement benefits continued

The operating cost is charged as follows:

	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Cost of sales	4.0	6.6
Sales and distribution costs	3.3	5.0
Administrative expenses	13.0	12.1
Discontinued operations		20.7
Exceptional operating items	(70.3)	
Profit on disposal of business/curtailment gain		(1.1)

In 2008 the pension settlement relating to the active Aerospace employees was completed, resulting in a £20.7m settlement charge to discontinued operations.

Amounts recognised directly in the consolidated statement of recognised income and expense

Actuarial losses of £429.9m (2008: losses of £254.5m) have been reported in the statement of recognised income and expense. This includes a loss of £0.5m (2008: gain of £0.9m) in respect of unrecognised assets owing to surplus restriction. Cumulative actuarial losses from 1 August 2004 reported in the statement of recognised income and expense are £543.0m (2008: cumulative losses of £113.1m).

Changes in present value of defined benefit obligations

	Year ended 31 July 2009				Year ended 31 July 2008			
	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans
	UK £m	US £m	Other £m	£m	UK £m	US £m	Other £m	£m
At beginning of period	(2,468.8)	(357.0)	(30.7)	(112.4)	(2,637.6)	(355.0)	(26.6)	(113.7)
Transfers in of territories outside UK and USA								(0.1)
Liabilities assumed on acquisitions							(0.1)	(1.3)
Liabilities transferred on disposal								0.3
Current service cost	(9.4)	(7.4)	(1.6)	(2.5)	(11.3)	(7.6)	(1.3)	(2.4)
Interest on obligations	(158.8)	(30.0)	(2.2)	(8.0)	(148.3)	(23.0)	(1.5)	(6.7)
Employee contributions	(0.2)		(0.1)		(0.2)		(0.2)	
Past service cost				51.5		(1.0)	(0.1)	
Actuarial gain/(loss) on liabilities	(31.7)	(45.4)	3.5	(10.4)	66.7	20.3	0.9	6.7
Curtailed gain		19.4			1.1			
Liabilities extinguished on settlements					131.3			
Exchange adjustments	(0.7)	(64.6)	(3.9)	(12.1)	(1.3)	(9.7)	(2.7)	(3.8)
Benefits paid	137.8	22.4	1.8	9.4	130.8	19.0	0.9	8.6
At end of period	(2,531.8)	(462.6)	(33.2)	(84.5)	(2,468.8)	(357.0)	(30.7)	(112.4)

Changes in present value of scheme assets

	Year ended 31 July 2009				Year ended 31 July 2008			
	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans
	UK £m	US £m	Other £m	£m	UK £m	US £m	Other £m	£m
At beginning of period	2,618.4	316.5	25.0		2,969.1	327.6	22.2	
Transfers in of territories outside UK and USA								
Expected return on assets	174.0	28.3	1.8		199.5	24.5	1.5	
Actuarial (losses)/gains on scheme assets	(279.6)	(61.9)	(3.9)		(312.1)	(35.4)	(2.5)	
Employer contributions	38.0	12.6	2.5	9.4	43.5	10.0	2.6	8.6
Employee contributions	0.2		0.1		0.2		0.2	
Assets distributed on settlements					(152.0)			
Exchange adjustments	0.5	61.4	3.2		1.0	8.8	1.9	
Benefits paid	(137.8)	(22.4)	(1.8)	(9.4)	(130.8)	(19.0)	(0.9)	(8.6)
At end of period	2,413.7	334.5	26.9		2,618.4	316.5	25.0	

10 Post-retirement benefits continued**Cash contributions**

Company contributions to the funded defined benefit pension plans for 2009 totalled £53.1m (2008: £56.1m). Company contributions in 2009 included special covenant payments of £13.1m (2008: £13.1m). In 2008 there was a further special payment of £4.0m arising from the sale of Aerospace. Agreed cash payments in 2010 are £50.6m. Discussions are in progress with the UK pension trustees in respect of additional contributions.

History of schemes

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Balance sheet					
Present value of defined benefit obligation	(3,112.1)	(2,968.9)	(3,132.9)	(3,162.6)	(3,127.4)
Fair value of scheme assets	2,775.1	2,959.9	3,318.9	3,111.0	2,890.8
Unrecognised asset due to surplus restriction	(2.0)	(1.5)	(2.4)	(0.5)	
(Deficit)/surplus	(339.0)	(10.5)	183.6	(52.1)	(236.6)
Post-retirement assets	39.2	174.2	333.7	183.7	134.6
Post-retirement liabilities	(378.2)	(184.7)	(150.1)	(235.8)	(371.2)
(Deficit)/surplus	(339.0)	(10.5)	183.6	(52.1)	(236.6)

	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m	Period ended 5 August 2006 £m	Year ended 31 July 2005 £m
Experience gains/(losses)					
Experience gains/(losses) on scheme liabilities	100.5	(6.4)	(57.6)	17.6	0.5
Experience (losses)/gains on scheme assets	(345.4)	(350.0)	95.7	76.6	242.9
Movement on restricted surplus	(0.5)	0.9	(1.9)	(0.5)	

Experience gains in 2009 include the impact of using the latest member data for the UK triennial valuations which are in progress.

Sensitivity

Valuation of post-retirement schemes involves judgements about uncertain future events. Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 July 2009 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions such as salary increases. While each of these sensitivities holds all other assumptions constant, in practice such assumptions rarely change in isolation and the impacts may offset to some extent.

	Profit before tax for year ended 31 July 2010 £m	Increase/ (decrease) in scheme assets £m	(Increase/ decrease in scheme liabilities £m)
Rate of mortality – 1 year increase in life expectancy	(3.7)	23.3	(87.9)
Rate of mortality – 1 year decrease in life expectancy	4.1	(23.9)	90.1
Rate of inflation – 0.25% increase	(3.8)	7.0	(66.8)
Discount rate – 0.25% increase	(0.1)	(11.1)	104.1
Expected return on scheme assets – 0.25% increase	5.8		
Market value of scheme assets – 2.5% increase	4.0	56.9	(0.1)
Healthcare cost trends – 1% increase			(0.4)
Healthcare cost trends – 1% decrease			0.3

The effect on profit before tax reflects the impact of current service cost, interest cost and expected return on assets.

Defined contribution plans

The Group operates a number of defined contribution plans. The total expense recognised in the income statement in respect of these plans was £15.6m (2008: £13.7m).

Notes to the accounts continued

11 Employees

	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Staff costs during the period		
Wages and salaries	660.2	545.8
Social security	79.5	67.3
Share-based payment (note 29)	8.0	12.9
Pension costs (including defined contribution schemes) (note 10)	35.1	36.4
	782.8	662.4

The average number of persons employed was:

	Year ended 31 July 2009	Year ended 31 July 2008
Smiths Detection	2,400	2,350
John Crane	6,600	6,350
Smiths Medical	7,400	8,400
Smiths Interconnect	3,350	3,100
Flex-Tek	2,000	2,300
Corporate	50	100
	21,800	22,600

The employee numbers have been reported in accordance with the new divisional structure which was put in place from 1 August 2008. The comparatives have been amended to conform to the new structure.

Key management

The key management of the Group comprises Smiths Group plc Board directors and Executive Committee members. Their aggregate compensation is shown below. Details of directors' remuneration are contained in the report of the Remuneration Committee on pages 65 to 73.

	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Key management compensation		
Salaries and short-term employee benefits	6.2	7.6
Cost of post-retirement benefits	0.6	1.0
Cost of share-based incentive plans	1.0	5.6

No member of key management had any material interest during the period in a contract of significance (other than a service contract or a qualifying third party indemnity provision) with the Company or any of its subsidiaries. Options and awards held at the end of the period by key management in respect of the Company's share-based incentive plans were:

	Year ended 31 July 2009		Year ended 31 July 2008	
	Number of instruments '000	Weighted average price	Number of instruments '000	Weighted average price
CIP	340		306	
ESOS	170	£8.44	177	£8.06
PSP	598		795	
VSP	949			
SAYE	8	£6.90	9	£8.32

The disclosure above does not include options held by individuals who retired before the year end.

Related party transactions

The Group has entered into a service contract with a company connected to a member of the Executive Committee. Costs of £0.2m were incurred in respect of this arrangement.

12 Intangible assets

	Goodwill £m	Development costs £m	Acquired intangibles (see table on next page) £m	Software, patents and intellectual property £m	Total £m
Cost					
At 1 August 2007	921.3	51.2	131.3	76.3	1,180.1
Exchange adjustments	65.4	2.5	5.7	3.3	76.9
Business combinations	87.0		74.5	0.7	162.2
Adjustments to prior year business combinations	(1.7)		1.3	(1.3)	(1.7)
Additions		19.8		16.1	35.9
Disposals	(0.2)			(0.8)	(1.0)
At 31 July 2008	1,071.8	73.5	212.8	94.3	1,452.4
Exchange adjustments	145.1	10.2	32.4	6.2	193.9
Business combinations	50.3		45.0		95.3
Adjustments to prior year business combinations	(0.7)				(0.7)
Additions		22.5		17.4	39.9
Disposals				(1.6)	(1.6)
At 31 July 2009	1,266.5	106.2	290.2	116.3	1,779.2
Amortisation					
At 1 August 2007	77.0	12.5	29.1	40.2	158.8
Exchange adjustments	5.3	0.7	1.8	2.5	10.3
Adjustments to prior year business combinations			0.5	(0.5)	
Charge for the year		5.6	19.2	6.2	31.0
Disposals	(0.2)			(0.7)	(0.9)
At 31 July 2008	82.1	18.8	50.6	47.7	199.2
Exchange adjustments	9.9	2.6	6.0	7.4	25.9
Charge for the year		10.8	34.6	9.8	55.2
Impairment		0.2			0.2
Disposals				(1.6)	(1.6)
At 31 July 2009	92.0	32.4	91.2	63.3	278.9
Net book value at 31 July 2009	1,174.5	73.8	199.0	53.0	1,500.3
Net book value at 31 July 2008	989.7	54.7	162.2	46.6	1,253.2
Net book value at 1 August 2007	844.3	38.7	102.2	36.1	1,021.3

Notes to the accounts continued

12 Intangible assets continued

In addition to goodwill, the acquired intangible assets comprise:

	Patents, licences and trademarks £m	Technology £m	Customer relationships £m	Total acquired intangibles £m
Cost				
At 1 August 2007	40.2	55.1	36.0	131.3
Exchange adjustments	1.1	1.9	2.7	5.7
Business combinations (note 28)	12.0	18.8	43.7	74.5
Adjustments to prior year business combinations		1.3		1.3
At 31 July 2008	53.3	77.1	82.4	212.8
Exchange adjustments	9.1	13.5	9.8	32.4
Business combinations (note 28)	1.9	3.8	39.3	45.0
At 31 July 2009	64.3	94.4	131.5	290.2
Amortisation				
At 1 August 2007	5.6	11.9	11.6	29.1
Exchange adjustments	0.2	0.7	0.9	1.8
Adjustments to prior year business combinations		0.5		0.5
Charge for the year	2.7	6.1	10.4	19.2
At 31 July 2008	8.5	19.2	22.9	50.6
Exchange adjustments	0.4	2.5	3.1	6.0
Charge for the year	4.9	10.6	19.1	34.6
At 31 July 2009	13.8	32.3	45.1	91.2
Net book value at 31 July 2009	50.5	62.1	86.4	199.0
Net book value at 31 July 2008	44.8	57.9	59.5	162.2
Net book value at 1 August 2007	34.6	43.2	24.4	102.2

Significant cash generating units

Goodwill is not amortised but is tested for impairment at least annually. Value in use calculations are used to determine the recoverable amount of goodwill held within each cash generating unit (CGU). Value in use is calculated as the net present value of the projected risk-adjusted post-tax cash-flows of the CGU, applying a discount rate based on the Group's post-tax weighted average cost of capital adjusted where appropriate for risks specific to the CGU. This approximates to applying a pre-tax discount rate to pre-tax cash-flows. These forecast cash-flows are based on approved budgets and represent a best estimate of future performance.

The assumptions used in the discounted cash-flow forecasts incorporate past performance, historical growth rates and margins achievable in our key markets. The assumptions used in the impairment testing of significant CGUs are as follows:

	Smiths Medical Critical Care		Smiths Detection Civil	
	2009	2008	2009	2008
Net book value of goodwill (£m)	374.3	291.5	316.0	288.8
Discount rate	8%	8%	8%	8%
Growth rates	2.25%	2.25%	2.25%	2.25%
Other key assumptions	– future sales prices and volumes – operating margins – cost structure and productivity			

The first five years of the cash-flow forecasts are based on our annual planning and strategic planning processes. The growth rates used to estimate future performance beyond this period do not exceed the long-term average growth rates for similar projects and do not reflect long-term planning assumptions used by the Group for investment planning.

Sales projections are made with reference to specific customer relationships and product lines.

Sensitivity analysis performed around the base case assumptions has indicated that no reasonable changes in key assumptions would cause the carrying amount of the Smiths Medical Critical Care and Smiths Detection Civil CGUs to exceed their respective recoverable amount.

The balance of the goodwill represents smaller individual amounts which have been allocated to specific operating companies and smaller CGUs. These amounts are tested for impairment at this level.

13 Property, plant and equipment

	Land and buildings £m	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
Cost or valuation				
At 1 August 2007	155.5	342.9	159.5	657.9
Exchange adjustments	8.4	18.1	10.8	37.3
Reclassification	1.0	(1.8)	0.8	
Business combinations	2.8	2.9	2.2	7.9
Additions	9.9	31.2	23.1	64.2
Disposals	(4.8)	(10.1)	(7.2)	(22.1)
Adjustments to acquisitions and disposals in prior years	(1.4)	6.7		5.3
At 31 July 2008	171.4	389.9	189.2	750.5
Exchange adjustments	18.2	48.4	20.5	87.1
Reclassification	1.3	5.3	(6.6)	
Business combinations	0.5	8.3	0.2	9.0
Additions	9.4	30.1	17.9	57.4
Disposals	(9.5)	(27.4)	(18.3)	(55.2)
At 31 July 2009	191.3	454.6	202.9	848.8
Depreciation				
At 1 August 2007	63.1	219.2	114.7	397.0
Exchange adjustments	2.6	12.1	7.7	22.4
Reclassification	0.8	(1.1)	0.3	
Charge for the year	5.4	28.9	18.9	53.2
Impairment charge	0.3			0.3
Disposals	(3.7)	(7.3)	(6.6)	(17.6)
Adjustments to acquisitions and disposals in prior years	(7.8)	6.7		(1.1)
At 31 July 2008	60.7	258.5	135.0	454.2
Exchange adjustments	10.0	29.9	14.7	54.6
Reclassification	0.7	4.6	(5.3)	
Charge for the year	7.2	34.9	20.1	62.2
Impairment charge	3.1	0.7		3.8
Disposals	(2.2)	(25.9)	(15.9)	(44.0)
At 31 July 2009	79.5	302.7	148.6	530.8
Net book value at 31 July 2009	111.8	151.9	54.3	318.0
Net book value at 31 July 2008	110.7	131.4	54.2	296.3
Net book value at 1 August 2007	92.4	123.7	44.8	260.9

Notes to the accounts continued

14 Investments accounted for using the equity method

	2009 £m	2008 £m
Investments in associated companies		
At start of period	9.1	12.0
Exchange adjustment	1.7	2.3
Share of results after tax	0.4	(1.0)
Dilution of interest		(0.9)
Acquisition of a controlling interest		(3.3)
At end of period	11.2	9.1

The Group acquired a controlling interest in an associate on 21 December 2007, and it has been consolidated as a subsidiary since that date.

The Group's share of the revenue of associates was £19.3m (2008: £17.6m). The total assets of associates are £49.0m (2008: £44.9m) and liabilities are £16.8m (2008: £14.1m). These figures principally represent the performance, assets and liabilities of Cross Match Technologies, Inc., incorporated in the United States. The share of these assets and liabilities attributable to Smiths Group is 34% (2008: 34%).

In 2008 the interest in Cross Match Technologies, Inc. was diluted as a result of warrants and options being exercised in the period.

15 Inventories

	2009 £m	2008 £m
Inventories comprise		
Raw materials and consumables	145.7	149.7
Work in progress	95.3	68.0
Finished goods	177.4	173.5
	418.4	391.2
Less: payments on account	(4.8)	(10.9)
	413.6	380.3

The Group consumed £1,990.5m (2008: £1,776.4m) of inventories during the period. £14.9m (2008: £11.8m) was recognised as an expense resulting from the write-down of inventory and £2.0m (2008: £1.5m) was released to the income statement from inventory provisions charged in earlier years but no longer required.

16 Trade and other receivables

	2009 £m	2008 £m
Non-current		
Trade receivables	13.1	8.8
Prepayments and accrued income	2.0	1.6
Other debtors	6.2	4.2
	21.3	14.6
Current		
Trade receivables	501.0	509.1
Other debtors	13.4	19.8
Prepayments and accrued income	39.2	36.5
	553.6	565.4

Trade receivables do not carry interest. Management considers that the carrying value of trade and other receivables approximates the fair value. Trade and other receivables, including prepayments, accrued income and other debtors qualifying as financial instruments are classified as 'loans and receivables'. The maximum credit exposure arising from these financial assets is £533.3m (2008: £536.7m).

Trade receivables are disclosed net of a provision for bad and doubtful debts. The provision for bad and doubtful debts is based on specific risk assessment and reference to past default experience.

Credit risk is managed separately for each customer and, where appropriate, a credit limit is set for the customer based on previous experience of the customer and third party credit ratings. The Group has no significant concentration of credit risk, with exposure spread over a large number of customers. The largest single customer is the US Federal Government representing less than 8% (2008: 7%) of group revenue.

16 Trade and other receivables continued
Ageing of trade receivables

	2009 £m	2008 £m
Trade receivables which are not impaired and not yet due	414.9	412.4
Trade receivables which are not impaired and less than three months overdue	68.9	79.2
Trade receivables which are not impaired and more than three months overdue	25.0	22.6
Gross value of partially and fully provided debtors	19.8	14.9
	528.6	529.1
Provision for bad and doubtful debts	(14.5)	(11.2)
Trade receivables	514.1	517.9

17 Cash and cash equivalents

	2009 £m	2008 £m
Cash at bank and in hand – including impact of cash pooling gross up: £44.0m (2008: £100.6m)	84.0	122.5
Short-term deposits	7.7	10.0
Cash and cash equivalents	91.7	132.5
Bank overdrafts	(72.0)	(172.5)
Net cash and cash equivalents	19.7	(40.0)

Cash and cash equivalents include highly liquid investments with maturities of three months or less.

18 Trade and other payables

	2009 £m	2008 £m
Non-current		
Other creditors	25.1	27.5
Current		
Trade creditors	130.3	156.7
Bills of exchange payable	0.4	1.1
Other creditors	40.8	51.0
Other taxation and social security costs	19.1	23.1
Accruals and deferred income	209.2	188.8
	399.8	420.7

Trade and other payables, including accrued expenses and other creditors qualifying as financial instruments, are accounted for at amortised cost and are categorised as other financial liabilities.

Notes to the accounts continued

19 Borrowings and net debt

This note sets out the calculation of net debt, an important measure in explaining our financing position. The net debt figure includes accrued interest and the fair value adjustments relating to hedge accounting.

	2009 £m	2008 £m
Cash and cash equivalents		
Net cash and deposits [note 17]	91.7	132.5
Short-term borrowings		
Bank overdrafts including impact of cash pooling gross up: £44.0m (2008: £100.6m)	(72.0)	(172.5)
£139m 7.875% Sterling Eurobond 2010	(137.7)	
Bank and other loans	(3.7)	(3.8)
B shares		(1.7)
Interest accrual	(11.0)	(4.4)
	(224.4)	(182.4)
Long-term borrowings		
£150m 7.875% Sterling Eurobond 2010		(149.6)
£70m EIB Sterling R. & D. Loan 2010		(70.0)
£660m Revolving Credit Facility 2012	(36.9)	(210.2)
\$250m 5.45% US\$ Private Placement 2013	(156.5)	(127.4)
\$250m 6.05% US\$ Guaranteed notes 2014	(148.5)	
£150m 7.25% Sterling Eurobond 2016	(149.0)	(148.8)
\$175m 7.37% US\$ Private placement 2018	(104.7)	
\$250m 7.20% US\$ Guaranteed notes 2019	(148.3)	
Bank and other loans	(8.3)	(14.7)
	(752.2)	(720.7)
Borrowings	(976.6)	(903.1)
Net debt	(884.9)	(770.6)

Borrowings are accounted for at amortised cost and are categorised as other financial liabilities. See note 20 for a maturity analysis of borrowings. The repayment dates on borrowings repayable after five years range from 2014 to 2022.

Interest of £27.7m (2008: £22.5m) was charged to the consolidated income statement in this period in respect of public bonds.

Cash and overdraft balances in interest compensation cash pooling systems are reported gross on the balance sheet. This gross up increased cash and overdrafts by £44.0m at 31 July 2009 (2008: £100.6m).

Movements in net debt

	31 July 2008 £m	Foreign exchange gains and losses £m	Repayments of borrowings and net cash inflow £m	Drawdown of borrowings and net cash outflow £m	Capitalisation, interest accruals and unwind of capitalised fees £m	Fair value movements from interest rate hedging £m	Change in maturity analysis £m	31 July 2009 £m
Net cash and cash equivalents	(40.0)	(3.0)	62.7					19.7
Other short-term borrowings	(9.9)	(0.2)	12.7		(5.1)		(149.9)	(152.4)
Long-term borrowings	(720.7)	(24.9)	345.2	(495.8)	(0.3)	(5.6)	149.9	(752.2)
Net debt	(770.6)	(28.1)	420.6	(495.8)	(5.4)	(5.6)		(884.9)

The net cash inflow includes £7.7m of cash acquired with new subsidiary undertakings.

Secured loans

Loans amounting to £6.5m (2008: £13.2m) were secured by charges on freehold properties with a book value of £11.5m (2008: £11.0m) and loans amounting to £3.4m (2008: £3.1m) were secured on plant and equipment with a book value of £3.3m (2008: £2.8m).

20 Financial risk management

The Group's international operations and debt financing expose it to financial risks which include the effects of changes in foreign exchange rates, changes in debt market prices, interest rates, credit risks and liquidity risks.

Treasury and risk management policies are set by the Board. The policy sets out specific guidelines to manage foreign exchange risk, interest rate risk, credit risk and the use of financial instruments to manage risk. The instruments and techniques used to manage exposures include foreign currency derivatives, debt and other interest rate derivatives. The central treasury function monitors financial risks and compliance with risk management policies. The management of operational credit risk is discussed in note 16.

(a) Foreign exchange risk

Transactional currency exposure

The Group is exposed to foreign currency risks arising from sales or purchases by businesses in currencies other than their functional currency. It is Group policy that, when such a sale or purchase is certain or highly probable, the net foreign exchange exposure is hedged using forward foreign exchange contracts. The net exposure is calculated by adjusting the expected cash-flow for payments or receipts in the same currency linked to the sale or purchase. This policy minimises the risk that the profits generated from the transaction will be affected by foreign exchange movements which occur after the price has been determined.

Hedge accounting documentation and effectiveness testing are only undertaken if it is cost effective.

The following table shows the currency of financial instruments. It excludes loans and derivatives designated as net investment hedges.

At 31 July 2009				
	Sterling £m	US\$ £m	Euro £m	Other £m
Financial assets and liabilities				
Financial instruments included in trade and other receivables	36.0	256.6	142.2	98.5
Financial instruments included in trade and other payables	(34.0)	(126.1)	(75.9)	(37.5)
Cash and cash equivalents	13.3	16.0	25.3	37.1
Borrowings not designated as net investment hedges	(306.5)	(22.7)	(33.4)	(19.1)
	(291.2)	123.8	58.2	79.0
Exclude balances held in operations with the same functional currency	294.0	(84.9)	(52.4)	(77.5)
Exposure arising from intra-group loans			(12.0)	23.2
Forward foreign exchange contracts	70.7	(82.3)	(2.4)	14.0
	73.5	(43.4)	(8.6)	38.7
				60.2
At 31 July 2008				
	Sterling £m	US\$ £m	Euro £m	Other £m
Financial assets and liabilities				
Financial instruments included in trade and other receivables	40.6	237.4	162.2	96.5
Financial instruments included in trade and other payables	(49.9)	(121.4)	(86.9)	(40.1)
Cash and cash equivalents	32.7	16.5	48.0	35.3
Borrowings not designated as net investment hedges	(412.1)	(163.2)	(13.8)	(103.8)
	(388.7)	(30.7)	109.5	(12.1)
Exclude balances held in operations with the same functional currency	389.3	56.4	(35.6)	(62.0)
Exposure arising from intra-group loans		(15.5)		(11.2)
Forward foreign exchange contracts	48.9	(50.0)	(1.9)	3.0
	49.5	(39.8)	72.0	(82.3)
				(0.6)

Financial instruments included in trade and other receivables comprise trade receivables, accrued income and other debtors which qualify as financial instruments. Similarly, financial instruments included in trade and other payables comprise trade payables, accrued expenses and other creditors which qualify as financial instruments.

Based on the assets and liabilities held at the year end, if the specified currencies were to strengthen 10% while all other market rates remained constant, the change in the fair value of financial instruments not designated as net investment hedges would have the following effect:

	Impact on profit for the year 31 July 2009 £m	Gain/(loss) recognised in reserves 31 July 2009 £m	Impact on profit for the year 31 July 2008 £m	Gain/(loss) recognised in reserves 31 July 2008 £m
US dollar	4.9	5.0	(0.1)	(3.3)
Euro	0.2	(1.2)	4.8	(1.0)
Sterling	1.8	5.1	2.1	2.8

These sensitivities were calculated before adjusting for tax and exclude the effect of quasi-equity intra-group loans.

Notes to the accounts continued

20 Financial risk management continued

Cash-flow hedging

The Group uses foreign currency contracts to hedge future foreign currency sales and purchases. At 31 July 2009 contracts with a nominal value of £310.7m (2008: £222.2m) were designated as hedging instruments. In addition, the Group had outstanding foreign currency contracts with a nominal value of £121.7m (2008: £130.1m) which were being used to manage transactional foreign exchange exposures, but were not accounted for as cash-flow hedges. The fair value of the contracts is disclosed in note 21.

The majority of hedged transactions will be recognised in the income statement in the same period that the cash-flows are expected to occur, with the only differences arising as a result of normal commercial credit terms on sales and purchases. Of the foreign exchange contracts designated as hedging instruments 99% are for periods of 12 months or less (2008: 99%).

The movements in the cash-flow hedge reserve during the period are summarised in the table below:

	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Brought forward cash-flow hedge reserve at start of period	1.1	1.4
Exchange adjustments	0.3	0.2
Gains and losses on effective cash-flow hedges recognised in equity	(8.0)	(1.0)
Amounts removed from the hedge reserve and recognised in the following lines on the income statement:		
– revenue	9.6	0.2
– cost of sales	(2.8)	0.3
– administrative expenses	1.6	
Carried forward cash-flow hedge reserve at end of period	1.8	1.1

Translational currency exposure

The Group has significant investments in overseas operations, particularly in the United States and Europe. As a result, the sterling value of the Group's balance sheet can be significantly affected by movements in exchange rates. The Group seeks to mitigate the effect of these translational currency exposures by matching the net investment in overseas operations with borrowings denominated in their functional currencies, except where significant adverse interest differentials or other factors would render the cost of such hedging activity uneconomic. This is achieved by borrowing primarily in the local currency or in some cases indirectly through the use of forward foreign exchange contracts and cross currency swaps.

Net investment hedges

The table below sets out the currency of loans and swap contracts designated as net investment hedges:

	At 31 July 2009				
	Sterling £m	US\$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges		(551.3)		(36.9)	(588.2)
Cross-currency swap contracts		59.9	(59.9)		
Currency swap contracts	380.8	(92.6)	(207.4)	(80.8)	
	380.8	(584.0)	(267.3)	(117.7)	(588.2)

	At 31 July 2008				
	Sterling £m	US\$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges		(139.6)	(70.6)		(210.2)
Currency swap contracts	371.4	(150.6)	(163.0)	(57.8)	
	371.4	(290.2)	(233.6)	(57.8)	(210.2)

Currency loans in other currencies hedge the Group's exposure to Canadian dollars and Australian dollars and the swap contracts hedge the Group's exposure to Japanese yen and Chinese renminbi.

Of the contracts designated as net investment hedges, 53% are current and the balance matures over the next four years. The contracts maturing within one year include £150m of contracts maturing on the same day as the 2010 Sterling Eurobond.

20 Financial risk management continued

The gains and losses that have been deferred in the net investment hedge reserve are shown in the table below:

	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Brought forward net investment hedge reserve at start of period	(30.3)	17.2
Amounts deferred in the period on effective net investment hedges	(58.6)	(47.5)
Carried forward net investment hedge reserve at end of period	(88.9)	(30.3)

The fair values of these net investment hedges are subject to exchange rate movements. Based on the hedging instruments in place at the year end, a 10% increase in the value of the US dollar while all other market rates remained constant would lead to a fair value loss of £70.8m (2008: £14.9m) and a 10% increase in the value of the euro while all other market rates remained constant would lead to a fair value loss of £10.7m (2008: £17.4m). These movements would be recognised in equity and fully offset by an opposite movement on the retranslation of the net assets of the overseas subsidiaries. These sensitivities were calculated before adjusting for tax.

During the year the Group de-designated currency swaps which had previously been used to hedge translational currency exposures, and entered into offsetting currency swaps to eliminate any future exchange exposure arising from these contracts. At the balance sheet date, contracts with a nominal value of £436.7m were outstanding. However the net currency profile of these contracts, translating both legs of the contract at the balance sheet rates, is:

	At 31 July 2009				
	Sterling £m	US\$ £m	Euro £m	Other £m	Total £m
Currency swap contracts	(28.6)				(28.6)

(b) Interest rate risk

The Group operates an interest rate policy designed to optimise interest cost and reduce volatility in reported earnings. The Group's current policy is to require interest rates to be fixed for 50% to 80% of the level of net debt. This is achieved primarily through fixed rate borrowings, and also through the use of interest rate swaps. At 31 July 2009 79% (2008: 46%) of the Group's net borrowings were at fixed interest rates, after adjusting for interest rate swaps.

The weighted average interest rate on borrowings and cross-currency swaps at 31 July 2009, after interest rate swaps, is 5.8% (2008: 4.6%).

Interest rate profile of financial assets and liabilities and the fair value of borrowings

The following table shows the interest rate risk exposure of cash and borrowings. The other financial assets and liabilities do not earn or bear interest and for all financial instruments except for borrowings the carrying value is not materially different from their fair value.

	Cash and cash equivalents 31 July 2009 £m	Borrowings 31 July 2009 £m	Fair value of borrowings 31 July 2009 £m	Cash and cash equivalents 31 July 2008 £m	Borrowings 31 July 2008 £m	Fair value of borrowings 31 July 2008 £m
Fixed interest (adjusted for interest rate hedging):						
Less than one year		(141.4)	(146.8)		(3.8)	(4.0)
Between one and five years		(152.5)	(156.4)		(203.5)	(207.1)
Greater than five years		(406.4)	(430.6)		(160.1)	(166.2)
Total fixed interest financial assets/(liabilities) (adjusted for interest rate hedging)		(700.3)	(733.8)		(367.4)	(377.3)
Floating rate interest financial assets/(liabilities)	77.1	(276.3)	(268.9)	122.1	(535.7)	(535.7)
Total interest bearing financial assets/(liabilities)	77.1	(976.6)	(1,002.7)	122.1	(903.1)	(913.0)
Non-interest bearing assets/(liabilities) in the same category	14.6			10.4		
Total	91.7	(976.6)	(1,002.7)	132.5	(903.1)	(913.0)

Interest rate hedging

The Group has designated US\$150m interest rate swaps and US\$100m cross-currency interest rate swaps which mature on 28 January 2013 as fair value hedges on the US private placement which matures on the same date. This hedges the risk of variability in the fair value of borrowings arising from fluctuations in base rates. The fair values of the hedging instruments are disclosed in note 21. The effect of the swaps is to convert £149.7m (2008: £75.7m) debt from fixed rate to floating rate.

Sensitivity of interest charges to interest rate movements

The Group has exposure to sterling, US dollar and euro interest rates. However the Group does not have a significant exposure to interest rate movements for any individual currency. Based on the composition of net debt and foreign exchange rates at 31 July 2009, and taking into consideration all fixed rate borrowings and interest rate swaps in place, a one percentage point (100 basis points) change in average floating interest rates for all three currencies would have a £2.2m (2008: £4.3m) impact on the Group's profit before tax.

Notes to the accounts continued

20 Financial risk management continued

(c) Financial credit risk

The Group is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, but does not currently expect any counterparties to fail to meet their obligations. Credit risk is mitigated by the Board approved policy of only selecting counterparties with a strong investment grade long-term credit rating for cash deposits, normally at least AA- or equivalent, and assigning financial limits to individual counterparties. In the normal course of business, the Group operates notional cash pooling systems, where a legal right of set-off applies.

The maximum credit risk exposure in the event of other parties failing to perform their obligations under financial assets, excluding trade and other receivables, totals £99.5m at 31 July 2009 (2008: £132.5m). This includes cash of £44.0m (2008: £100.6m) held in interest compensation pools where Smiths has a legal right of set-off. Of the £99.5m, 84% is with banks with at least a AA- credit rating.

At 31 July 2009 the maximum exposure with a single bank for deposits and cash is £24.1m (2008: £12.4m), whilst the maximum mark to market exposure for derivatives is £6.4m (2008: £1.5m). These exposures were with the same bank, which has a AA credit rating.

(d) Liquidity risk

Borrowing facilities

The Board policy specifies the maintenance of unused committed credit facilities of at least £200m at all times to ensure it has sufficient available funds for operations and planned development. The principal £660m revolving credit facility matures in 2012. At the balance sheet date the Group had the following undrawn credit facilities:

	2009 £m	2008 £m
Expiring within one year		
Expiring between one and two years		
Expiring after two years	622.8	449.8
	622.8	449.8

Cash deposits

As at 31 July 2009, £7.7m (2008: £10.0m) of cash and cash equivalents was on deposit with various banks and in money market funds of which £5.9m (2008: £7.2m) was on deposit in the UK.

Gross contractual cash-flows for borrowings

	Borrowings (Note 19) 31 July 2009 £m	Fair value adjustments 31 July 2009 £m	Contractual interest payments 31 July 2009 £m	Total contractual cash-flows 31 July 2009 £m	Borrowings (Note 19) 31 July 2008 £m	Fair value adjustments 31 July 2008 £m	Contractual interest payments 31 July 2008 £m	Total contractual cash-flows 31 July 2008 £m
Less than one year	(224.4)	(0.2)	(58.4)	(283.0)	(182.4)		(42.3)	(224.7)
Between one and two years	(1.6)		(47.9)	(49.5)	(150.9)	(0.4)	(41.5)	(192.8)
Between two and three years	(38.2)		(47.7)	(85.9)	(71.3)		(26.4)	(97.7)
Between three and four years	(157.0)	6.8	(42.8)	(193.0)	(210.7)	(0.5)	(25.0)	(236.2)
Between four and five years	(149.0)	(1.2)	(36.7)	(186.9)	(127.7)	1.2	(14.6)	(141.1)
Greater than five years	(406.4)	(2.5)	(101.1)	(510.0)	(160.1)	(1.2)	(34.4)	(195.7)
Total	(976.6)	2.9	(334.6)	(1,308.3)	(903.1)	(0.9)	(184.2)	(1,088.2)

The figures presented in the borrowings column include the non-cash adjustments which are highlighted in the adjacent column. The contractual interest reported for borrowings is before the effect of interest rate swaps.

Gross contractual cash-flows for derivative financial instruments

	Receipts 31 July 2009 £m	Payments 31 July 2009 £m	Net cash-flow 31 July 2009 £m	Receipts 31 July 2008 £m	Payments 31 July 2008 £m	Net cash-flow 31 July 2008 £m
Assets						
Less than one year		592.2	(545.3)	256.4	(247.7)	8.7
Greater than one year		182.7	(217.7)	63.9	(60.1)	3.8
Liabilities						
Less than one year	460.2	(513.7)	(53.5)	379.8	(400.6)	(20.8)
Greater than one year	256.0	(232.7)	23.3	28.1	(28.4)	(0.3)
Total	1,491.1	(1,509.4)	(18.3)	728.2	(736.8)	(8.6)

This table presents the undiscounted future contractual cash-flows for all derivative financial instruments. For this disclosure, cash-flows in foreign currencies are translated using the spot rates at the balance sheet date. The fair values of these financial instruments are presented in note 21.

Gross contractual cash-flows for other financial liabilities

The contractual cash-flows for financial liabilities included in trade and other payables are: £261.9m (2008: £285.8m) due in less than one year, £7.3m (2008: £10.9m) due between one and five years and £4.3m (2008: £1.6m) due after more than five years.

21 Financial derivatives

The tables below set out the nominal amount and fair value of derivative contracts held by the Group, identifying the derivative contracts which qualify for hedge accounting treatment:

At 31 July 2009				
	Contract or underlying nominal amount	Fair value		
	£m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	310.7	10.2	(7.8)	2.4
Foreign exchange contracts (not hedge accounted)	121.7	2.3	(2.3)	
Total foreign exchange contracts	432.4	12.5	(10.1)	2.4
Currency swaps (net investment hedges)	470.6	32.6	(2.4)	30.2
Currency swaps (not hedge accounted)	436.7	3.3	(31.9)	(28.6)
Total currency swap contracts	907.3	35.9	(34.3)	1.6
Cross-currency swaps (net investment and fair value hedges)	59.9		(1.2)	(1.2)
Interest rate swaps (fair value hedges)	89.8	6.2		6.2
Total financial derivatives	1,489.4	54.6	(45.6)	9.0
Balance sheet entries:				
Non-current		13.9	(6.7)	7.2
Current		40.7	(38.9)	1.8
Total financial derivatives		54.6	(45.6)	9.0

At 31 July 2008				
	Contract or underlying nominal amount	Fair value		
	£m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	222.2	3.8	(2.9)	0.9
Foreign exchange contracts (not hedge accounted)	130.1	1.4	(0.7)	0.7
Total foreign exchange contracts	352.3	5.2	(3.6)	1.6
Cross-currency swaps (net investment hedges)	371.4	1.5	(18.0)	(16.5)
Interest rate swaps (fair value hedges)	75.7	1.2		1.2
Total financial derivatives	799.4	7.9	(21.6)	(13.7)
Balance sheet entries:				
Non-current		1.4	(0.1)	1.3
Current		6.5	(21.5)	(15.0)
Total financial derivatives		7.9	(21.6)	(13.7)

Currency swaps not hedge accounted

These contracts comprise derivatives which were previously part of the net investment hedging programme and matching contracts to eliminate this exposure. There is no further net exposure arising from these contracts. See net investment hedges section in note 20 for details.

Accounting for other derivative contracts

Any foreign exchange contracts which are not formally designated as hedges and tested are classified as 'held for trading' and not hedge accounted.

Notes to the accounts continued

22 Provisions for liabilities and charges

	At 31 July 2008 £m	Exchange adjustments £m	Provisions charged £m	Provisions released £m	Unwind of provision discount £m	Utilisation £m	At 31 July 2009 £m
Warranty provision and product liability	46.2	4.5	24.2	(7.8)		(22.7)	44.4
Reorganisation	9.8	1.0	16.9	(1.0)		(11.0)	15.7
Property	3.5	0.1	1.0	(0.6)		(0.5)	3.5
Disposal	47.4	8.0		(0.3)		(0.4)	54.7
Litigation	163.7	29.0	23.7	(10.5)	7.1	(27.6)	185.4
	270.6	42.6	65.8	(20.2)	7.1	(62.2)	303.7

Analysed as:

	2009 £m	2008 £m
Current liabilities	77.2	70.0
Non-current liabilities	226.5	200.6
	303.7	270.6

Warranty provision and product liability

Warranties over the Group'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

On 3 June 2008 the Company announced a number of changes to its corporate centre and divisional headquarters. The total cost of this restructuring, including redundancy, relocation and consolidation of manufacturing, is expected to amount to approximately £45m over the period to 2010, of which £16.9m has been charged in the current year.

Reorganisation provisions include £4.8m (2008: £4.7m) costs relating to restructuring supply arrangements following the automotive seals disposal. These costs are expected to be spread over the next six years.

Disposal

The disposal provision relates to warranties and other obligations in respect of the disposal of the Marine Systems and Aerospace businesses.

The terms of the disposal of the Aerospace operations included certain obligations for which provision was made in 2007, including £24.3m in respect of costs of transferring aerospace active pensioners. In 2008 the pensioners were transferred, utilising £20.7m of this provision, and the balance of £3.6m was released to the income statement.

Most of the balance is expected to be utilised within the next five years.

22 Provisions for liabilities and charges continued**Litigation**

John Crane, Inc.

John Crane, Inc. ("JCI") is one of many co-defendants in numerous lawsuits pending in the United States in which plaintiffs are claiming damages arising from alleged exposure to, or use of, products previously manufactured which contained asbestos. Until 2006, the awards, the related interest and all material defence costs were met directly by insurers. In 2007, JCI secured the commutation of certain insurance policies in respect of product liability. While JCI has excess liability insurance, the availability of such insurance and scope of the cover are currently the subject of litigation in the United States. An adverse judgment at first instance from the Circuit Court of Cook County, Illinois is currently under appeal. Pending the outcome of that litigation, JCI has begun to meet defence costs directly. Provision is made in respect of the expected costs of defending known and predicted future claims and of adverse judgments in relation thereto, to the extent that such costs can be reliably estimated. No account has been taken of recoveries from insurers as their nature and timing are not yet sufficiently certain to permit recognition as an asset for these purposes.

The JCI products generally referred to in these cases consist of industrial sealing product, primarily packing and gaskets. The asbestos was encapsulated within these products in such a manner that causes JCI to believe, based on tests conducted on its behalf, that the products were safe. JCI ceased manufacturing products containing asbestos in 1985.

JCI is actively monitoring the conduct and effect of its current and expected asbestos litigation, including the most efficacious presentation of its 'safe product' defence, and intends to continue to resist all asbestos claims based upon this defence. Approximately 168,000 claims against JCI have been dismissed before trial over the last 30 years. JCI is currently a defendant in cases involving approximately 129,000 claims. Despite the large number of claims brought against JCI, it has had final judgments against it, after appeals, in only 82 cases over the period, and has had to pay awards amounting to approximately US\$82m. JCI has also incurred significant additional defence costs and, whilst the number of claims being filed against JCI and other defendants has been declining, the proportion of mesothelioma claims has increased, and JCI's ability to defend these cases is likely to have a significant impact on its annual aggregate adverse judgment and defence costs.

The assumptions made in assessing the appropriate level of provision include:

- The periods over which the expenditure can be reliably estimated. Projections used range between 10 and 18 years.
- The future trend of legal costs, allowing for 3% cost inflation.
- The rate of future claims filed.
- The rate of successful resolution of claims.
- The average amount of judgments awarded.

The provision is based on past history and allows for decreasing costs based on published tables of asbestos incidence projections. However, because of the significant uncertainty associated with the future level of asbestos claims and of the costs arising out of related litigation, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred and, as a result, the provision may be subject to potentially material revision from time to time if new information becomes available as a result of future events.

The provision in respect of JCI is a discounted pre-tax provision using discount rates, being the risk-free rate on US debt instruments for the appropriate period. The deferred tax asset related to this provision is shown within the deferred tax balance (note 6). Set out below is the gross, discounted and post-tax information relating to this provision:

	2009 £m	2008 £m
Gross provision	213.3	185.9
Discount	(46.7)	(47.0)
Discounted pre-tax provision	166.6	138.9
Deferred tax	(45.0)	(37.5)
Discounted post-tax provision	121.6	101.4

Other litigation

The Group has on occasion been required to take legal action to protect its intellectual property and other rights against infringement, and similarly to 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 £10.5m (2008: £2.2m) were released relating to litigation settled at less than the expected cost. Most of the balance is expected to be utilised within the next five years.

Apart from that relating to JCI, none of the other provisions is discounted.

Notes to the accounts continued

23 Operating lease commitments – minimum lease payments

The minimum uncancellable lease payments which the Group is committed to make are:

	2009		2008	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Payments due				
– not later than one year	25.0	9.1	20.5	7.8
– later than one year and not later than five years	57.8	9.4	47.0	8.1
– later than five years	27.0	0.1	20.3	0.1
	109.8	18.6	87.8	16.0

24 Contingent liabilities and commitments

John Crane, Inc.

As stated in note 22, John Crane, Inc. ("JCI") is involved in numerous law suits pending in the United States in which plaintiffs are claiming damages arising from exposure to, or use of, products containing asbestos. The JCI 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 JCI, the products were safe. JCI ceased manufacturing products containing asbestos in 1985.

Provision has been made for the cost of adverse judgments expected to occur. The Group anticipates that asbestos litigation will continue beyond the period covered by this provision; however, because of the uncertainty surrounding the outcome of litigation beyond this period, the cost of adverse judgments cannot be reliably estimated.

Other contingent liabilities and commitments

At 31 July 2009, contingent liabilities, comprising bonds and guarantees arising in the normal course of business, amounted to £86.0m (2008: £75m).

The Group is currently co-operating with the relevant authorities in investigating certain business conduct issues. Based on the work completed to date, these are not expected to give rise to any material financial exposure.

The Parent Company has arranged two letters of credit to support the Group's pension plans, one for £100.0m and one for £50.0m. At 31 July 2009, total usage of the two facilities was £116.1m (2008: £124.9m).

25 Share capital

	Number of shares	Issued capital £m	Consideration £m
Ordinary shares			
At 31 July 2008	387,879,181	145.5	
Exercise of share options	922,783	0.3	1.5
Conversion of B shares	224,463	0.1	1.7
At 31 July 2009	389,026,427	145.9	
B shares			
At 31 July 2008	459,157		
Converted	[459,157]		
At 31 July 2009			
Share capital classified as equity at 31 July 2009	389,026,427	145.9	
Share capital classified as debt at 31 July 2009			
Total share capital at 31 July 2009	389,026,427	145.9	

On 17 April 2008 4,467,437 B shares were purchased and cancelled. On 3 November 2008 the 459,157 remaining B shares were converted into 224,463 ordinary shares.

The authorised capital at 31 July 2009 consisted of:

- 533,333,333 (2008: 533,333,333) ordinary shares of 37.5p each; and
- 600,000,000 (2008: 600,000,000) non-cumulative B shares of 1p each.

At 31 July 2009 all of the issued share capital was in free issue. All issued shares are fully paid.

26 Reconciliation of movements in equity

	Share capital £m	Share premium account £m	Other reserves £m	Hedge reserve £m	Retained earnings £m	Equity shareholders' funds £m	Minority interest £m	Total equity £m
At 1 August 2007	144.6	289.0	242.2	18.6	208.9	903.3		903.3
Exercises of share options	0.9	14.6			5.5	21.0		21.0
Purchase of own shares					(20.7)	(20.7)		(20.7)
Redemption of B shares			0.1		(0.1)			
Acquisition							2.0	2.0
Total recognised income and expenses for the period				(47.8)	180.6	132.8	0.3	133.1
Dividends paid to equity shareholders					(131.4)	(131.4)		(131.4)
Dilution of interest in associated company					(0.9)	(0.9)		(0.9)
Share-based payment					11.8	11.8		11.8
At 31 July 2008	145.5	303.6	242.3	(29.2)	253.7	915.9	2.3	918.2
Exercises of share options	0.1	1.4			2.6	4.1		4.1
Purchase of own shares	0.2				(0.2)			
Conversion of B shares	0.1	1.6				1.7		1.7
Total recognised income and expenses for the period				(57.9)	117.8	59.9	1.5	61.4
Dividends paid to equity shareholders					(132.0)	(132.0)		(132.0)
Share-based payment					9.4	9.4		9.4
At 31 July 2009	145.9	306.6	242.3	(87.1)	251.3	859.0	3.8	862.8

Other reserves comprise a capital redemption reserve of £5.8m (2008: £5.8m), a revaluation reserve of £1.7m (2008: £1.7m) and a merger reserve of £234.8m (2008: £234.8m).

Retained earnings includes the value of Smiths Group plc shares held by the Smiths Industries Employee Benefit Trust. In the year the Company issued 682,922 shares to the Trust. In 2008, the Trust paid £20.7m to acquire shares in the market. At 31 July 2009 the Trust held 105,932 (2008: 1,095,965) ordinary shares with a market value of £0.8m (2008: £11.5m).

Capital management

Capital comprises shareholders' equity adjusted for goodwill recognised directly in reserves. For the period ended 31 July 2009 the average Group capital was £1,705.7m (2008: £1,728.1m).

The capital structure is based on the directors' judgement of the balance required to maintain flexibility while achieving an efficient cost of capital. The Group has a target gearing, calculated on a market value basis, of approximately 20%. At the balance sheet date the Group had gearing of 26% (2008: 18%).

As part of this process the Group maintains its target of a solid investment grade credit rating by monitoring the factors utilised by ratings agencies and evaluating the impact of potential distributions and future funding requirements. At 31 July 2009 the Group had a credit rating of BBB+/Baa2 – negative outlook (2008: BBB+/Baa2 – stable outlook) with Standard & Poor's and Moody's respectively.

Hedge reserve

	2009 £m	2008 £m
The hedge reserve on the balance sheet comprises:		
Cash-flow hedge reserve	1.8	1.1
Net investment hedge reserve	(88.9)	(30.3)
	(87.1)	(29.2)

See transactional currency exposure risk management disclosures in note 20 for additional details of cash-flow hedges and translational currency exposure risk management disclosure also in note 20 for additional details of net investment hedges.

Notes to the accounts continued

27 Cash-flow from operating activities

	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Profit before taxation – continuing and discontinued	365.1	346.1
Net interest payable	52.3	41.0
Financing losses/(gains)		
– charged to administrative expenses		0.3
– charged to financing	10.9	6.1
Share of post-tax (profit)/loss from associate	(0.4)	1.0
Other finance income – retirement benefits	(5.1)	(41.7)
Profit on disposal of discontinued operation	5.7	(26.8)
	428.5	326.0
Amortisation of intangible assets	55.2	31.0
Impairment of intangible assets	0.2	
Profit on disposal of property, plant and equipment	(11.3)	(0.3)
(Profit)/loss on disposal of business	(1.6)	(27.2)
Depreciation of property, plant and equipment	62.2	53.2
Impairment of property, plant and equipment	3.8	0.3
Share-based payment expense	9.4	12.9
Retirement benefits	(112.5)	(37.0)
Decrease/(increase) in inventories	22.1	(21.4)
Decrease/(increase) in trade and other receivables	94.0	(10.0)
Decrease in trade and other payables	(79.9)	(56.9)
(Decrease)/increase in provisions	(24.9)	49.9
Cash generated from operations	445.2	320.5
Interest	(39.1)	(48.6)
Tax paid	(74.0)	(73.8)
Net cash inflow from operating activities	332.1	198.1

28 Acquisitions

During the period ended 31 July 2009, the Group acquired Zhejiang Zheda Medical Instrument Co. Ltd (10 November 2008) on behalf of Smiths Medical, Shenzhen Dowin Lightning Technologies Co., Ltd (24 April 2009) on behalf of Smiths Interconnect and Orion Corporation (13 May 2009) on behalf of John Crane.

From the date of acquisition to 31 July 2009, the acquisitions contributed £16.3m to revenue, £4.8m to headline profit before taxation and £0.6m to profit before taxation. If Smiths had acquired the businesses at the beginning of the financial period, the acquisitions would have contributed £54.3m to revenue and £13.5m to headline profit before tax.

The fair value adjustments in respect of intangible assets are due to the recognition of £36.5m in respect of customer relationships and orders, £2.7m in respect of non-compete agreements, £5.8m in respect of technology and intellectual property. Goodwill represents the value of synergies arising from the acquisitions and future growth opportunities which can be generated through existing sales networks. The adjustments to current assets and liabilities relate to valuation adjustments and are provisional, based on management's best estimates.

The values set out below are provisional pending finalisation of the fair values attributable, and will be finalised in the year ending 31 July 2010. Goodwill and other net assets in respect of prior year acquisitions, as previously reported, have been adjusted as a result of finalising their attributable fair values and changes in the estimated value of contingent considerations. Accordingly, goodwill has decreased by £0.7m.

28 Acquisitions continued

	Book value £m	Fair value adjustments £m	Provisional fair value £m
Non-current assets			
– intangible assets		45.0	45.0
– property, plant and equipment	9.0		9.0
Current assets			
– cash and cash equivalents	7.7		7.7
– other current assets	20.2	1.0	21.2
Non-current liabilities			
– other liabilities		(5.5)	(5.5)
Current liabilities			
– other current liabilities	(15.2)	(0.3)	(15.5)
Net assets acquired	21.7	40.2	61.9
Goodwill on current year acquisitions			50.3
Goodwill adjustments on prior year acquisitions			(0.7)
Total consideration			111.5
Cash paid during the period – current year acquisitions			94.5
Direct costs relating to current year acquisitions			1.9
Deferred consideration accrued on current year acquisitions			15.8
Adjustments to deferred consideration on prior year acquisitions			(0.7)
Total consideration			111.5

29 Employee share schemes

The Group operates share schemes and plans for the benefit of employees. The nature of the principal schemes and plans, including general conditions, is set out below:

Smiths Group Performance Share Plan (PSP)

The PSP was introduced in 2004 and replaced the 95 ESOS for executive directors and senior executives. Conditional awards of up to 1.5 times salary (and exceptionally three times salary) are granted annually. The awards will be released following the third anniversary of the date of grant to the extent the PSP's performance tests have been met. One-third of the award is subject to a total shareholder return ('TSR') target relative to other FTSE 100 companies (excluding financial companies and investment trusts). For full vesting, the company's TSR must be at or above the 75th percentile over the three year performance period. 25% of the award will vest if the company's TSR is at median. Awards will vest on a straight-line pro-rata basis between median and 75th percentile. The remaining two-thirds of the award is subject to an earnings per share ('EPS') growth target (measured before exceptional items). Full vesting will occur if the compound annual growth in EPS is equivalent to 12% per annum. 25% vesting will occur if the compound annual growth in EPS is equivalent to 5% per annum, with vesting on a straight-line basis between 5% and 12%. The PSP has been replaced by the VSP (see below).

Value Sharing Plan (VSP)

The VSP is a one-off long-term incentive plan approved by the shareholders in July 2008 rewarding executives for value creation at Group and Divisional levels over three-year and four-year periods commencing with the financial year 2008/09. Corporate participants will be rewarded under the VSP for value creation at a Group level, whereas the executives with divisional responsibilities will be rewarded for value creation within the division for which they are responsible. For the Group scheme, one-third of the award will depend on the growth in Smiths' TSR over and above the median for the companies comprising the FTSE 100 (excluding financial services companies) and the remaining two-thirds of each award will be determined by the growth in internal value in excess of 9.5% a year. The growth in internal value is calculated as follows: adjusted profit before tax ('PBT') times the ratio of PBT to market capitalisation determined at the date of grant plus net equity cash-flows to shareholders. The divisional awards will depend on meeting an internal value growth target set for the division in which the participant works.

The participants in the VSP will not be eligible for awards under the Performance Share Plan in 2008/09 or 2009/10.

Notes to the accounts continued

29 Employee share schemes continued

Smiths Group Co-Investment Plan (CIP)

Under the CIP, as introduced in October 2005, the executive directors and senior executives are able, if invited, to use their after tax bonus or 25% of their basic salary after tax, whichever is the greater, to invest in the Company's shares at the prevailing market price. At the end of a three year period, if the executive is still in office and provided the performance test is passed, matching shares will be awarded in respect of any invested shares retained for that period. The number of matching shares to be awarded is determined by the Remuneration Committee at the end of the year in which the bonus is earned by reference to annual bonus, and other corporate financial criteria. The maximum award will not exceed the value, before tax, of the bonus or salary invested in shares by the executive. Vesting of matching shares will occur and the matching shares will be released at the end of the three year period if the Group's Return on Capital Employed ('RoCE') over the Performance Period exceeds the Group's weighted average cost of capital ('WACC') over the Performance Period by an average margin of at least 1% per annum.

In July 2008 the CIP was amended. From 2009 participants will be required to invest 50% of their post tax bonus in purchased shares. The performance conditions have been expanded to include an enhanced performance condition of RoCE exceeding WACC by an average margin of 3% per annum. If the enhanced performance condition is met, two matching shares will be issued for every purchased share.

	DSS and CIP	PSP and VSP	Other share schemes	Total	Weighted average price for option plans £
Ordinary shares under option ('000)					
1 August 2007	1,406	2,932	13,378	17,716	£5.98
Granted	245	743	2,477	3,465	£7.32
Exercised	(235)	(645)	(3,614)	(4,494)	£5.67
Lapsed	(9)	(369)	(2,093)	(2,471)	£7.32
31 July 2008	1,407	2,661	10,148	14,216	£6.23
Granted	305	1,604	647	2,556	£1.45
Exercised	(675)	(683)	(584)	(1,942)	£2.18
Lapsed	(47)	(243)	(1,191)	(1,481)	£6.75
31 July 2009	990	3,339	9,020	13,349	£5.83

Options were exercised on an irregular basis during the period. The average closing share price over the financial year was 832.08p (2008: 1,014.32p). There has been no change to the effective option price of any of the outstanding options during the period.

Range of exercise prices	Total shares under option ('000)	Weighted average remaining contractual life (months)	Options exercisable at 31 July 2009 ('000)	Options exercisable at 31 July 2008 ('000)	Exercisable weighted average exercise price for options exercisable at 31 July 2009
£0.00 – £2.00	4,329	18	1	19	
£2.01 – £6.00	761	46	5	2	£5.40
£6.01 – £10.00	6,516	58	2,879	2,322	£8.20
£10.01 – £14.00	1,743	96	116	129	£11.02

For the purposes of valuing options to arrive at the share-based payment charge, the Binomial option pricing model has been used for most schemes and the Monte Carlo method is used for schemes with total shareholder return performance targets. The key assumptions used in the models for 2009 and 2008 are volatility of 23% (2008: 21%) and dividend yield of 3.75% (2008: 3.75%). Assumptions on expected volatility and expected option term have been made on the basis of historical data, wherever available, for the period corresponding with the vesting period of the option. Best estimates have been used where historical data is not available in this respect. These generated a weighted average fair value for CIP of £6.96 (2008: £9.46) and VSP/PSP of £11.01 (2008: £8.02).

Included within staff costs is an expense arising from share-based payment transactions of £8.0m (2008: £12.9m), of which £9.4m (2008: £11.8m) relates to equity-settled share-based payment.

At 31 July 2009 the creditor relating to cash-settled schemes is £0.2m (2008: £1.5m).

Group financial record 2005-2009

	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m	Period ended 5 August 2006 £m	Year ended 31 July 2005 £m
Revenue	2,664.6	2,321.2	2,160.9	2,180.3	3,005.4
Headline operating profit	417.5	380.6	347.6	344.8	415.7
Amortisation of acquired intangible assets	(34.6)	(19.2)	(14.8)	(13.0)	(5.7)
Exceptional items (including profit on sale/impairment of financial asset)	45.6	(35.4)	(74.2)	(337.8)	(28.0)
Financing losses		(0.3)	(1.5)	(1.8)	
Operating profit/(loss)	428.5	325.7	257.1	(7.8)	382.0
Net finance costs	(58.1)	(5.4)	(0.6)	(28.4)	(16.1)
Share of post-tax losses of associated companies	0.4	(1.0)	(0.5)	(1.1)	
Profit/(loss) before taxation	370.8	319.3	256.0	(37.3)	365.9
Taxation	(94.9)	(75.0)	(53.1)	(65.4)	(94.1)
Profit/(loss) after taxation – continuing operations	275.9	244.3	202.9	(102.7)	271.8
Profit after taxation – discontinued operations	(5.9)	24.5	1,525.2	126.9	
Shareholders' equity	859.0	915.9	903.3	1,362.9	1,483.8
Represented by					
– intangible assets	1,500.3	1,253.2	1,021.3	1,530.6	1,481.7
– property, plant & equipment and investments	337.0	309.0	273.6	512.6	831.3
– net current assets/provisions/retirement benefit liabilities	(93.4)	124.3	198.3	246.4	101.6
Net borrowings	(884.9)	(770.6)	(589.9)	(926.7)	(930.8)
Funds employed	859.0	915.9	903.3	1,362.9	1,483.8
Ratios					
Operating profit before amortisation of acquired intangible assets: turnover (%)	15.7	16.4	16.1	14.8	13.8
Effective tax rate before amortisation of acquired intangible assets and exceptional items (%)	24.0	24.0	25.1	25.6	26.4
Return on shareholders' funds (%)	16.5	16.7	14.9	13.6	11.2
Cash-flow					
Cash-flow from normal operating activities	422.5	280.5	265.9	437.6	277.6
Less capital expenditure (net)	12.5	(8.0)	(6.7)	(18.0)	(18.9)
Operating cash after capital expenditure	435.0	272.5	259.2	419.6	258.7
Free cash-flow (before acquisitions and dividends, after capital expenditure)	256.1	90.6	100.7	170.4	147.0
Free cash-flow per share (p)	65.9	23.4	18.3	30.1	26.1
Earnings per share before amortisation of acquired intangible assets and exceptional items (p)	72.4	74.5	47.0	41.5	52.8
Dividends					
Pence per share	34.0	34.0	34.0	31.3	29.0
Times covered before amortisation of acquired intangible assets and exceptional items	2.4	2.2	1.7	2.1	1.8
Number of employees (000s)					
United Kingdom	2.0	2.2	2.8	7.3	7.2
Overseas	19.8	20.6	18.6	24.5	23.4
	21.8	22.8	21.4	31.8	30.6

The return on shareholders' funds for the period ended 31 July 2007 has been calculated using the closing net assets adjusted for movements in goodwill set-off against reserves relating to continuing operations, in order to adjust for the Aerospace disposal.

The income statement for the period ended 5 August 2006 has been restated for discontinued operations; however information on shareholders' equity, ratios, cash-flow, dividends and employee numbers is presented for the entire Group.

Results for the year ended 31 July 2005 have not been restated for discontinued operations.

Independent auditors' report to the members of Smiths Group plc

We have audited the parent company financial statements of Smiths Group plc for the year ended 31 July 2009 which comprise the Company balance sheet, the Accounting policies and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Respective responsibilities of directors and auditors

As explained more fully in the Statement of directors' responsibilities, the directors are responsible for the preparation of the parent company financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the parent company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Sections 495 to 497 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion the parent company financial statements:

- give a true and fair view of the state of the company's affairs as at 31 July 2009;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' Report for the financial year for which the parent company financial statements are prepared is consistent with the parent company financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements and the part of the Directors' remuneration report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Other matter

We have reported separately on the group financial statements of Smiths Group plc for the year ended 31 July 2009.

Stuart Watson (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London

29 September 2009

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.

Company balance sheet

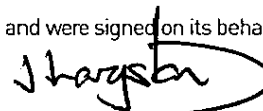
	Notes	31 July 2009 £m	31 July 2008 £m
Fixed assets			
Tangible assets	2	12.1	16.7
Investments and advances	3	3,341.8	3,216.1
		3,353.9	3,232.8
Current assets			
Debtors			
– amounts falling due within one year	4	74.9	52.2
– amounts falling due after more than one year	4	35.9	5.2
Cash at bank and on deposit		9.2	1.3
Financial derivatives			
– amounts falling due within one year		28.3	1.6
– amounts falling due after more than one year		13.8	1.1
		162.1	61.4
Creditors: amounts falling due within one year	5	(243.2)	(95.2)
Net current (liabilities)/assets		(81.1)	(33.8)
Total assets less current liabilities		3,272.8	3,199.0
Creditors: amounts falling due after more than one year	5	(737.2)	(509.0)
Provisions for liabilities and charges	6	(7.5)	(8.3)
Financial derivatives		(6.5)	(18.0)
Net assets excluding pension assets/(liabilities)		2,521.6	2,663.7
Retirement benefit liabilities	7	(187.7)	(51.7)
Net assets including pension assets/(liabilities)		2,333.9	2,612.0
Capital and reserves			
Called up share capital	8	145.9	145.5
Share premium account	9	306.6	303.6
Capital redemption reserve	9	5.8	5.8
Merger reserve	9	180.5	180.5
Profit and loss account	9	1,695.1	1,976.6
Shareholders' equity		2,333.9	2,612.0

The accounts on pages 121 to 130 were approved by the Board of Directors on 29 September 2009 and were signed on its behalf by:

Philip Bowman
Chief Executive



John Langston
Finance Director



Accounting policies

Basis of preparation

The accounts have been prepared in accordance with the Companies Act 2006 and all applicable accounting standards in the United Kingdom (UK GAAP).

These accounts have been prepared on a going concern basis and under the historical cost convention modified to include revaluation of certain financial instruments, share options and pension assets and liabilities held at fair value.

As permitted by Section 408(3) of the Companies Act 2006, the Company's entity profit and loss account and statement of total recognised gains and losses have not been presented. As permitted by Section 408 (2) information about the Company's employee numbers and costs is not presented.

The Company has taken advantage of the exemption in 'FRS 8: Related Party Disclosures' not to disclose transactions with other wholly owned members of the Smiths Group.

Foreign currencies

Foreign currency transactions are recorded at the exchange rate ruling on the date of transaction. Foreign exchange gains and losses resulting from the settlement of such transactions, and from the retranslation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies, are recognised in the profit and loss account.

Operating leases

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

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.

Tangible 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 asset investments

The Company's investments in shares in group companies are stated at cost less provision for impairment. Any impairment is charged to the profit and loss account as it arises.

Financial instruments

The policies disclosed in the Group accounting policies on pages 80 to 85 for recognition, measurement and presentation of financial instruments are applied in the Company accounts.

Where there are no differences between the disclosures required for the Group and the Company in respect of a class of financial instruments, an appropriate cross-reference is made to the Group accounts.

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 Company's taxable profits and its results as disclosed in the accounts, arising from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the accounts.

Deferred tax is not recognised on any fixed assets that have been revalued unless there is a binding agreement to sell the asset.

Provisions

Provisions for disposal indemnities, restructuring costs, vacant leasehold property and legal claims are recognised when: the Company has a legal or constructive obligation as a result of a past event; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Provisions are discounted where the time value of money is material.

Post-retirement benefits

For defined benefit schemes, the cost of benefits accruing during the year in respect of current and past service is charged against operating profit. The expected return on the schemes' assets and the increase in the present value of the schemes' liabilities arising from the passage of time are included in other finance income. Actuarial gains and losses are recognised in the statement of total recognised gains and losses. The balance sheet includes the surplus/deficit in schemes taking assets at their year-end market values and liabilities at their actuarially calculated values discounted at year-end AA corporate bond interest rates.

The Company has adopted the amendment to FRS 17 issued in December 2006.

Share-based payment

The Company operates a number of equity-settled and cash-settled share-based compensation plans.

The fair value of the shares or share options granted is recognised over the vesting period to reflect the value of the employee services received. The charge relating to grants to employees of the Company is recognised as an expense in the profit and loss account and the charge for grants to employees of other group companies is recognised as an investment in the relevant subsidiary.

The fair value of options granted, excluding the impact of any non-market vesting conditions, is calculated using established option pricing models, principally Binomial models. The probability of meeting non-market vesting conditions, which include profitability targets, is used to estimate the number of share options which are likely to vest.

For cash-settled share-based payment a liability is recognised based on the fair value of the payment earned by the balance sheet date. For equity-settled share-based payment the corresponding credit is recognised directly in reserves.

In accordance with the transitional provisions of 'FRS 20: Share-based Payment', no charge has been recognised for grants of equity instruments made before 7 November 2002.

Dividends

Dividends are recognised as a liability in the period in which they are authorised. The interim dividend is recognised when it is paid and the final dividend is recognised when it has been approved by shareholders at the Annual General Meeting.

Notes to the Company accounts

1 Audit fee

The audit fee for the parent company was £0.1m (2008: £0.1m).

2 Property, plant and equipment

	Land and buildings £m	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
Cost or valuation				
At 31 July 2008	16.1	1.2	3.9	21.2
Additions	0.4	5.5	0.1	6.0
Disposals	(7.3)		(3.5)	(10.8)
At 31 July 2009	9.2	6.7	0.5	16.4
Depreciation				
At 31 July 2008	1.1	0.5	2.9	4.5
Charge for the period	0.1	0.7	0.4	1.2
Disposals	(0.7)		(3.0)	(3.7)
Impairment	2.1	0.2		2.3
At 31 July 2009	2.6	1.4	0.3	4.3
Net book value at 31 July 2009	6.6	5.3	0.2	12.1
Net book value at 31 July 2008	15.0	0.7	1.0	16.7

	31 July 2009 £m	31 July 2008 £m
Land and buildings – cost		
Freehold	9.2	15.9
Long leasehold		0.2
	9.2	16.1

An impairment charge of £2.1m has been recognised in respect of properties affected by the restructuring of the corporate centre and divisional headquarters.

3 Investments and advances

	Shares at cost £m	Due from subsidiaries £m	Due to subsidiaries £m	Total £m
Cost or valuation				
At 31 July 2008	2,393.3	1,470.3	(640.9)	3,222.7
Exchange adjustments		60.5		60.5
Additions		3,232.7	(753.4)	2,479.3
Contribution through share options	5.0			5.0
Disposals	(37.4)	(2,899.5)	531.2	(2,405.7)
At 31 July 2009	2,360.9	1,864.0	(863.1)	3,361.8
Provision for impairment				
At 31 July 2008	6.6			6.6
Impairment charge for the period	13.4			13.4
At 31 July 2009	20.0			20.0
Net book value at 31 July 2009	2,340.9	1,864.0	(863.1)	3,341.8
Net book value at 31 July 2008	2,386.7	1,470.3	(640.9)	3,216.1

The impairment charge for the period relates to investments in dormant subsidiaries, and arises from the rationalisation of the Group's holding company structure.

The Company's subsidiaries are largely held according to business lines by the following holding companies, which are incorporated in England unless otherwise stated:

Smiths Group International Holdings Limited
 Smiths Detection Group Limited
 John Crane Group Limited
 Smiths Medical Group Limited
 Smiths Interconnect Group Limited

The principal subsidiaries and their countries of incorporation are:

England

Smiths Detection – Watford Ltd
 Smiths Medical International Limited
 John Crane UK Limited

Europe

Smiths Heimann SAS (France)
 Smiths Heimann GmbH (Germany)
 Smiths Medical France SA (France)
 Smiths Medical Deutschland GmbH (Germany)
 Hypertac SA (France)
 Hypertac GmbH (Germany)
 John Crane Italia SpA (Italy)

Other

Smiths Detection (Asia-Pacific) Pte Ltd (Singapore)
 Smiths Medical Japan Limited (Japan)
 John Crane Middle East FZE (UAE)

United States

Smiths Detection, Inc.
 Smiths Medical ASD, Inc.
 Smiths Medical PM, Inc.
 John Crane, Inc.
 Titeflex Corporation
 Flexible Technologies, Inc.
 Tutco, Inc.
 Hypertronics Corporation
 Sabritec, Inc.
 Transtector Systems, Inc.

Of the companies above Smiths Group International Holdings Limited is 100% owned directly by the Company. The others are 100% owned through intermediate holding companies. Shareholdings are of ordinary shares or common stock. All subsidiaries operate in their country of incorporation.

4 Debtors

	31 July 2009 £m	31 July 2008 £m
Amounts falling due within one year		
Amounts owed by subsidiaries	72.1	45.4
Other debtors	1.9	5.3
Corporation tax	0.7	
Prepayments and accrued income	0.2	1.5
	74.9	52.2
Amounts falling after more than one year		
Deferred taxation	35.9	5.2
	110.8	57.4

Notes to the Company accounts continued

5 Creditors

	31 July 2009 £m	31 July 2008 £m
Amounts falling due within one year		
Overdrafts	9.4	38.7
Term loans	137.7	
B shares (note 8)		1.7
Amounts owed to subsidiaries	43.6	32.4
Other creditors	42.2	6.6
Other taxation and social security costs	0.6	1.5
Accruals and deferred income	9.7	14.3
	243.2	95.2
Amounts falling due after more than one year		
Term loans	737.2	508.6
Other creditors		0.4
	737.2	509.0

6 Provisions for liabilities and charges

	At 31 July 2008 £m	Provisions released £m	Utilisation £m	At 31 July 2009 £m
Disposals	8.3	(0.4)	(0.4)	7.5
	8.3	(0.4)	(0.4)	7.5

In 2009 £0.4m was paid in respect of the Marine Systems disposal, and a further £0.4m provided in respect of this obligation was released, leaving a balance of £3.5m relating to this transaction. The closing disposal provision is expected to be utilised within the next five years.

7 Post-retirement benefits

The Company operates three defined benefit plans in the UK. The largest of them is a funded scheme with assets held in a separate trustee-administered fund. The Company is the sole employer in that scheme and, accordingly, accounts for it as a defined benefit pension plan, in accordance with FRS 17.

Pension costs are assessed in accordance with the advice of independent, professionally qualified actuaries. The most recent actuarial valuation of the funded scheme was performed using the Projected Unit Method as at 31 March 2006. This has been rolled forward to 31 July 2009.

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

The principal assumptions used in updating the valuations are set out below:

	31 July 2009	31 July 2008
Rate of increase in salaries	3.8%	4.1%
Rate of increase in pensions in payment	3.3%	3.5%
Rate of increase in deferred pensions	3.3%	3.6%
Discount rate	5.9%	6.6%
Inflation rate	3.3%	3.6%
Healthcare cost increases	5.0%	5.0%

The assumptions used are estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily occur in practice.

The mortality assumptions used in the principal UK schemes are based on the recent actual mortality experience of members within each scheme. The assumptions are based on the new SAPS All Birth tables with relevant scaling factors based on the experience of the schemes. The assumption also allows for future improvements in life expectancy in line with 80%/60% of the long cohort for males/females respectively and an annual 1% underpin. The assumptions are that a member who retires next year at age 65 will live on average for a further 22 years after retirement if they are male and for a further 24 years after retirement if they are female. For a member who is currently 45, when they retire in 20 years' time they are assumed to live on average for a further 24 years after retirement if they are male and for a further 25 years after retirement if they are female.

7 Post-retirement benefits continued

The assets in the scheme and the expected rates of return as at 31 July 2009 were:

	31 July 2009		31 July 2008	
	Long-term rate of return	Value £m	Long-term rate of return	Value £m
Equities	8.2%	589.8	8.2%	620.2
Government bonds	4.5%	46.0	4.8%	30.9
Corporate bonds	5.9%	266.9	6.6%	242.7
Property	7.2%	137.3	7.2%	188.1
Other	5.0%	148.9	5.8%	229.1
Total market value		1,188.9		1,311.0
Present value of funded pension scheme liabilities		(1,340.4)		(1,333.5)
(Deficit)/surplus		(151.5)		(22.5)
Unfunded pension plans		(36.0)		(34.3)
Post-retirement healthcare		(6.2)		(15.2)
		(193.7)		(72.0)
Related deferred tax asset/(liability)		6.0		20.3
Net pension (liability)/ asset		(187.7)		(51.7)

The scheme assets do not include any of the Group's own financial instruments, nor any property occupied by, nor other assets used by, the Group. The expected rates of return on individual categories of scheme assets are determined by reference to relevant industries. The overall rate of return is calculated by weighting the individual rates in accordance with the anticipated balance in the scheme's investment portfolios.

History of experience gains and losses

	31 July 2009 £m	31 July 2008 £m	31 July 2007 £m	5 August 2006 £m	31 July 2005 £m
Actual return less expected return on pension scheme assets	(180.9)	(183.9)	52.6	23.5	
As a percentage of scheme assets	(15%)	(14%)	3%	2%	
Experience gains and losses arising on the scheme liabilities	98.4	(4.5)	(36.7)	1.6	1.9
As a percentage of present value scheme liabilities	7%	0%	(2%)	0%	5%

Changes in present value of defined benefit obligations

	31 July 2009 £m	31 July 2008 £m
At beginning of the period	(1,383.0)	(1,492.8)
Current service cost	(6.2)	(7.6)
Past service cost	9.6	
Interest on obligations	(89.2)	(83.9)
Actuarial gain/(loss) on liabilities	14.5	36.0
Curtailment gain		1.1
Liabilities extinguished on settlements		97.2
Benefits paid	71.7	67.0
At end of the period	(1,382.6)	(1,383.0)

Changes in present value of scheme assets

	31 July 2009 £m	31 July 2008 £m
At beginning of the period	1,311.0	1,527.5
Expected return on assets	91.7	109.1
Contributions by employer	38.8	40.1
Assets distributed on settlements		(114.8)
Actuarial (loss)/gain on assets	(180.9)	(183.9)
Benefits paid	(71.7)	(67.0)
At end of the period	1,188.9	1,311.0

Notes to the Company accounts continued

7 Post-retirement benefits continued

Cash contributions

Cash payments in 2010 are expected to be £34.1m. Discussions are in progress with the pension trustees in respect of additional contributions.

A one percentage point change in assumed healthcare cost trend rates would have the following effects:

	One percentage point increase £m	One percentage point decrease £m
Effect on the aggregate of service cost and interest cost		
Effect on defined benefit obligations	0.1	(0.1)

8 Share capital

	Number of shares	Issued capital £m	Consideration £m
Ordinary shares			
At 31 July 2008	387,879,181	145.5	
Exercise of share options	922,783	0.3	1.5
Conversion of B shares	224,463	0.1	1.7
At 31 July 2009	389,026,427	145.9	
B shares			
At 31 July 2008	459,157		
Converted	(459,157)		
At 31 July 2009			
Share capital classified as equity at 31 July 2009	389,026,427	145.9	
Share capital classified as debt at 31 July 2009			
Total share capital at 31 July 2009	389,026,427	145.9	

On 17 April 2008 4,467,437 B shares were purchased and cancelled. On 3 November 2008 the 459,157 remaining B shares were converted into 224,463 ordinary shares.

The authorised capital at 31 July 2009 consisted of:

- 533,333,333 (2008: 533,333,333) ordinary shares of 37.5p each; and
- 600,000,000 (2008: 600,000,000) non-cumulative B shares of 1p each.

At 31 July 2009 all of the issued share capital was in free issue. All issued shares are fully paid.

8 Share capital continued

	31 July 2009		31 July 2008	
Number of ordinary shares issuable under outstanding options	7,813,294		8,777,181	
	Year issued	Number of shares	Subscription prices	Dates normally exercisable
Smiths Sharesave Scheme	2002	9,795	645.00p	2005/2009
	2003	23,824	554.00p	2006/2010
	2004	104,901	525.00p	2007/2011
	2005	85,693	704.00p	2008/2012
	2006	194,230	798.00p	2009/2013
	2007	123,128	868.00p	2010/2014
	2008	196,725	724.00p	2011/2015
	2009	631,827	569.00p	2012/2016
Smiths Industries Executive Share Option Schemes	1999	52,832	858.50p	2002/2009
	2000	56,100	750.00p	2003/2010
	2001	73,066	790.00p	2004/2011
	2002	966,172	806.00p	2005/2012
	2002	95,000	654.00p	2005/2012
	2003	160,100	669.00p	2006/2013
	2004	838,350	774.00p	2007/2014
	2005	928,000	901.00p	2008/2015
	2006	1,674,677	896.50p	2009/2016
	2007	1,488,250	1,097.00p	2010/2017
	2008	12,500	835.50p	2011/2018
TI Group Executive Share Option Schemes	1999	82,140	1,103.92p	2002/2009
	2000	2,459	661.23p	2003/2010
	2000	13,525	626.16p	2003/2010

Notes to the Company accounts continued

9 Share premium account and reserves

	Share premium £m	Capital redemption reserve £m	Merger reserve £m	Profit and loss account £m
At 31 July 2008	303.6	5.8	180.5	1,976.6
Exercise of share options	1.4			2.6
Purchase of own shares				[0.2]
Conversion of B shares	1.6			
Profit for the period				5.1
Dividends paid to equity shareholders				(132.0)
Actuarial loss on retirement benefits				(166.4)
Deferred tax credit related thereto				
Share-based payment				9.4
At 31 July 2009	306.6	5.8	180.5	1,695.1

The retained earnings include the purchase of Smiths Group plc shares by the Smiths Industries Employee Benefit Trust, and the issue of these shares upon the exercise of share options. The consideration paid was £0.2m (2008: £20.7m) and £2.6m (2008: £5.5m) was received as a result of the issue of shares. At 31 July 2009 the Trust held 105,932 (2008: 1,095,965) ordinary shares with a market value of £0.8m (2008: £11.5m).

The Company's profit and loss reserve of £1,695.1m includes £895.7m (2008: £895.7m) not available for distribution as dividend.

During the year, the Company received £1.5m (2008: £15.5m) on the issue of shares in respect of the exercise of options awarded under various share option schemes.

10 Contingent liabilities

The Company has arranged letter of credit facilities to support the Group's pension plans. The current amount outstanding is £116.1m (2008: £124.9m).

The Company has guaranteed the £660m revolving credit facility used by a subsidiary.

Other contingent liabilities of the Company are not expected to give rise to a material loss.

11 Post balance sheet event

The directors propose a final dividend of 23.5p per share (totalling approximately £91.4m) for the year ended 31 July 2009. The dividend will be submitted for formal approval at the Annual General Meeting to be held on 17 November 2009.

In accordance with FRS 21, these financial statements do not reflect this dividend payable, which will be accounted for in shareholders' equity as an appropriation of retained earnings in the year ending 31 July 2010. During the year ended 31 July 2009, a final dividend of 23.5p per share (totalling £91.1m) was paid in respect of the dividend declared for the period ended 31 July 2008.

12 Deferred tax

	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Deferred taxation		
At beginning of period	25.5	5.3
(Charge)/credit to profit and loss account	16.4	(21.3)
(Charge)/credit to equity		41.5
At end of period	41.9	25.5
Analysed as follows:		
Excess tax depreciation on fixed assets	1.5	
Retirement benefit obligations	6.0	20.3
Share-based payment	2.3	4.6
Losses carried forward	31.5	
Short-term timing differences	0.6	0.6
	41.9	25.5

Financial calendar

2009	
Preliminary announcement of results for 2008/09	30 September
Ordinary shares final dividend ex-dividend date	21 October
Ordinary shares final dividend record date	23 October
Annual General Meeting	17 November
Ordinary shares final dividend payment date	20 November
2010	
2009/10 interim results announced	24 March (provisional)
Ordinary shares interim dividend ex-dividend date	31 March (provisional)
Ordinary shares interim dividend record date	2 April (provisional)
Ordinary shares interim dividend payment date	23 April (provisional)
Smiths Group financial year end	31 July
Preliminary announcement of results for 2009/10	29 September (provisional)
Ordinary shares final dividend ex-dividend date	20 October (provisional)
Ordinary shares final dividend record date	22 October (provisional)
Annual General Meeting	16 November (provisional)
Ordinary shares final dividend payment date	19 November (provisional)

The market value of an ordinary share of the Company on 31 March 1982 for the purposes of capital gains tax was 136.875p (taking into account the sub-division of 50p shares into 25p shares on 14 January 1985 and the subdivision and consolidation of 25p shares into 37.5p shares on 18 June 2007).

The 2009 Annual General Meeting will be held at The Thomas Lord Suite, Lord's Cricket Ground, Grace Gate, St John's Wood Road, London NW8 8QN on Tuesday 17 November 2009 at 2.30 pm.

Registered Office

Smiths Group plc
2nd Floor
Cardinal Place
80 Victoria Street
London SW1E 5JL, UK

T +44 (0)20 7808 5500
F +44 (0)20 7808 5544
www.smiths.com

Incorporated in England No.
137013

Registrars

Equiniti Limited (formerly known
as Lloyds TSB Registrars)
Aspect House
Spencer Road
Lancing
West Sussex BN99 6DA, UK

T 0871 384 2943 (United Kingdom)
T +44 (0)121 415 7047
Textel 0870 384 2255
www.shareview.co.uk
www.equiniti.com

Auditor

PricewaterhouseCoopers LLP

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Smiths Group plc
Cardinal Place
80 Victoria Street
London SW1E 5JL, UK
T +44 (0)20 7808 5500
F +44 (0)20 7808 5544
www.smiths.com