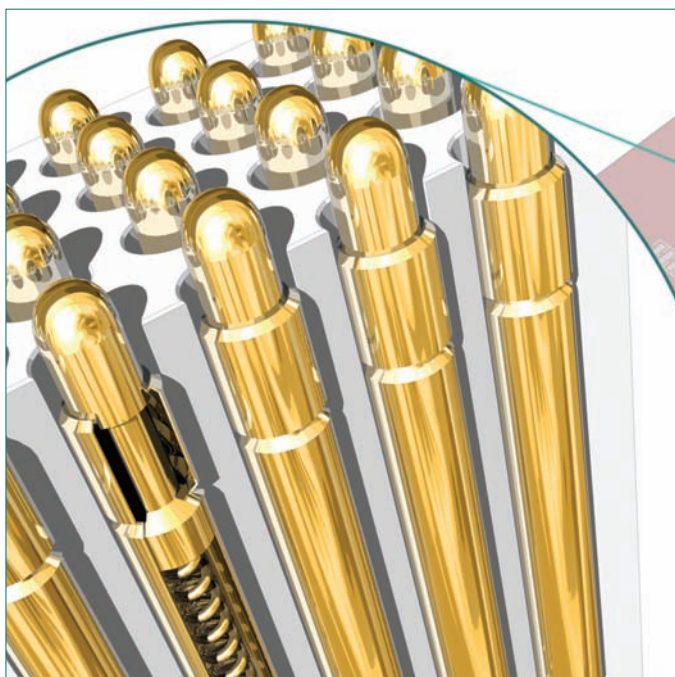
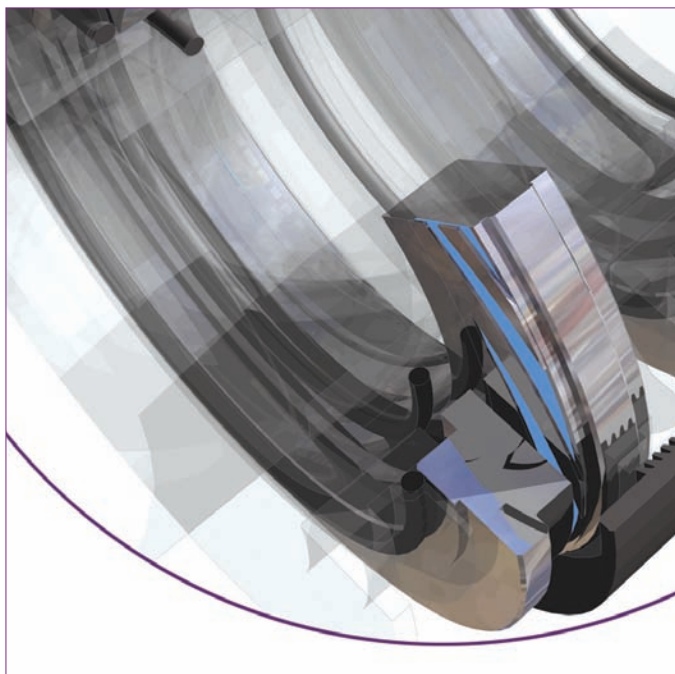
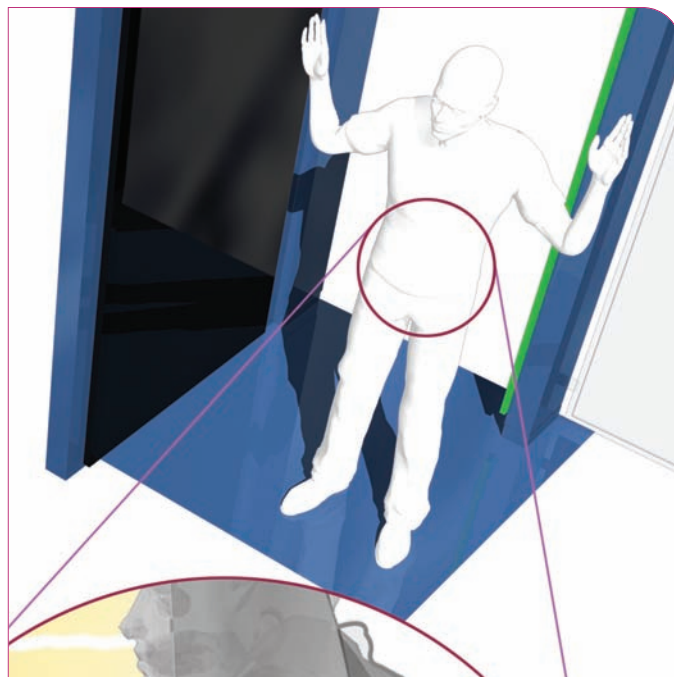


# Annual Report 2010

Opportunities to create value

**smiths**  
bringing technology to life



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The purpose of this document is to provide information to the members of the Company. This document contains certain statements that are forward-looking statements. They appear in a number of places throughout this document and include statements regarding our intentions, beliefs or current expectations and those of our officers, directors and employees concerning, amongst other things, our results of operations, financial condition, liquidity, prospects, growth, strategies and the business we operate. 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 document and unless otherwise required by applicable law the Company undertakes no obligation to update or revise these forward-looking statements. Nothing in this document should be construed as a profit forecast. The Company and its directors accept no liability to third parties in respect of this document save as would arise under English law.

Front cover: These illustrations capture five examples of the practical application of our technology to meet our customers' needs. Further details are given in the divisional reviews.

# 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 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.

## Annual results for the year ended 31 July 2010

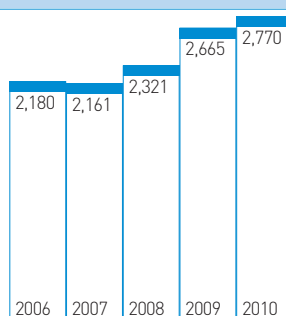
|                              | Headline*    |            | Growth | Underlying* | Statutory    |            |
|------------------------------|--------------|------------|--------|-------------|--------------|------------|
|                              | 2010<br>£m   | 2009<br>£m |        |             | 2010<br>£m   | 2009<br>£m |
| <b>Continuing activities</b> |              |            |        |             |              |            |
| Sales                        | <b>2,770</b> | 2,665      | 4%     | 0%          | <b>2,770</b> | 2,665      |
| Operating profit             | <b>492</b>   | 418        | 18%    | 14%         | <b>436</b>   | 429        |
| Operating margin             | <b>17.8%</b> | 15.7%      | –      | –           | <b>15.7%</b> | 16.1%      |
| Pre-tax profit               | <b>435</b>   | 371        | 17%    | 14%         | <b>373</b>   | 371        |
| Basic EPS                    | <b>84.6p</b> | 72.4p      | 17%    |             | <b>75.3p</b> | 70.8p      |
| Free cash-flow               | <b>331</b>   | 256        | 29%    |             |              |            |
| Dividend                     | <b>34.0p</b> | 34.0p      |        |             | <b>34.0p</b> | 34.0p      |
| Return on capital employed   | <b>16.6%</b> | 14.7%      |        |             |              |            |

\*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, costs of acquisitions and financing gains/losses from currency hedging. Free cash-flow and return on capital employed are described in the Financial review.

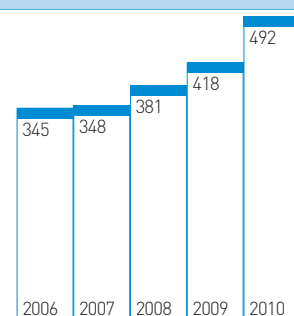
#Organic growth at constant currency.

For more financial information on our results see page 17

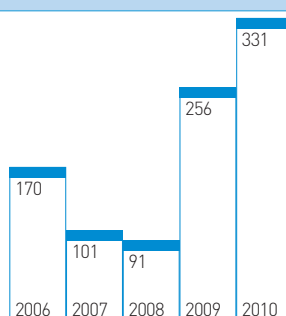
### Sales £m



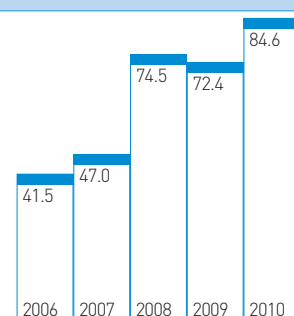
### Headline operating profit £m



### Free cash flow £m



### Headline earnings per share pence

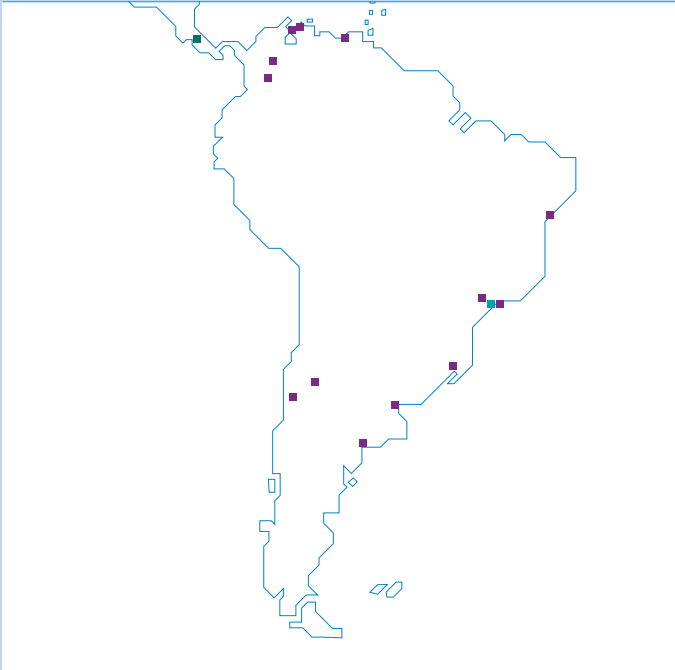
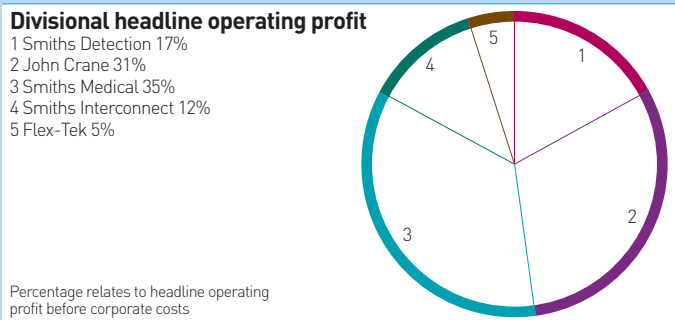
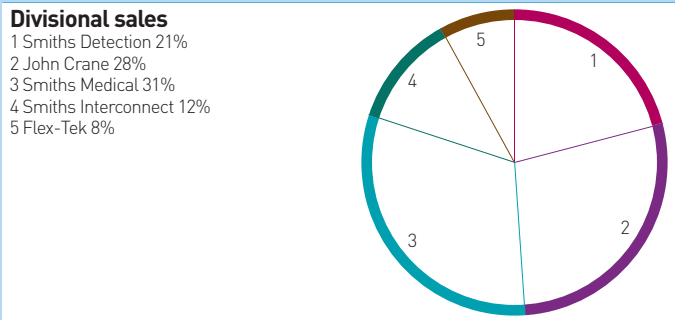
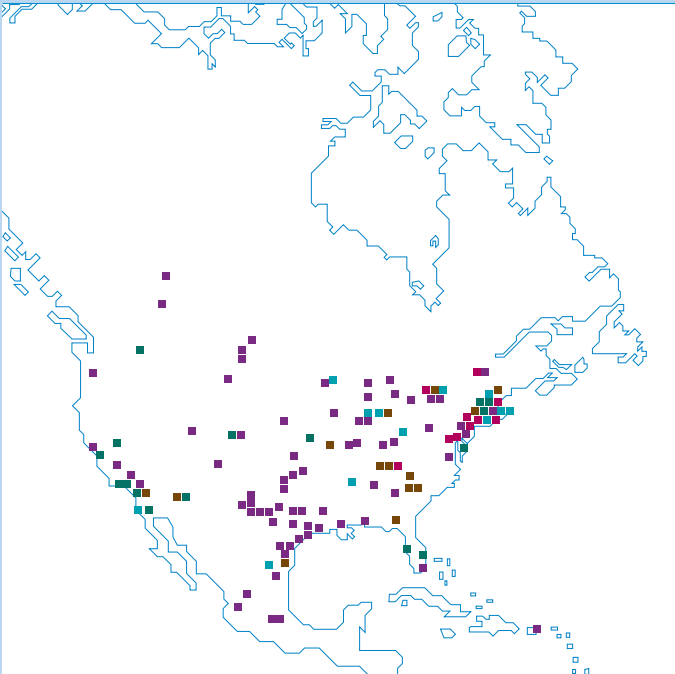


# Smiths Group: a global business

Smiths has evolved substantially since its foundation. Now employing over 23,000 people in more than 50 countries, it serves 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.

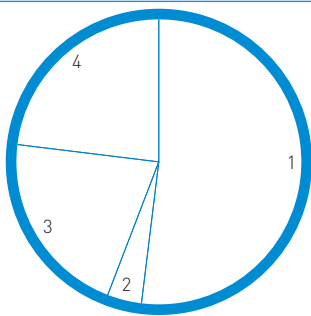
**Group manufacturing and service locations by division**

- Smiths Detection
- John Crane
- Smiths Medical
- Smiths Interconnect
- Flex-Tek



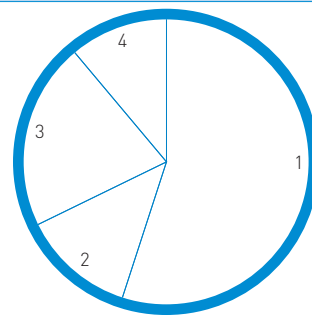
### Group sales by destination

- 1 North America 52%
- 2 United Kingdom 4%
- 3 Europe other 21%
- 4 Rest of World 23%

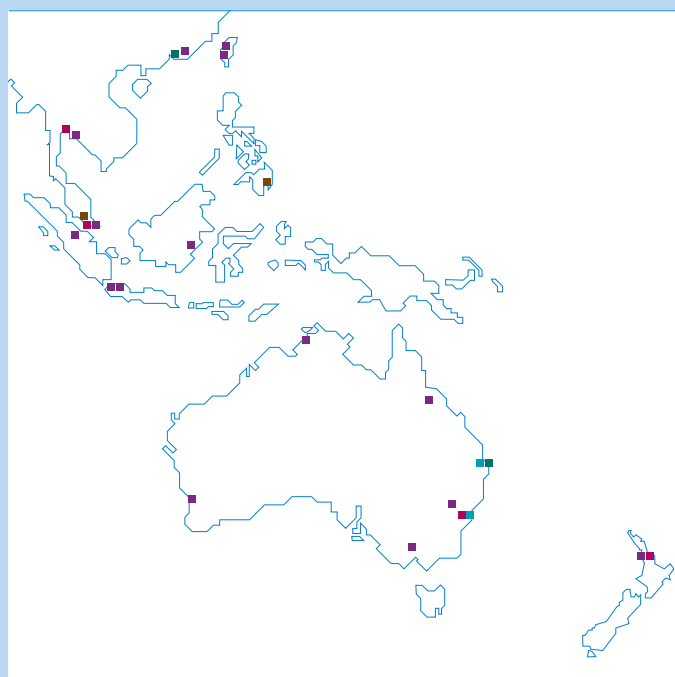
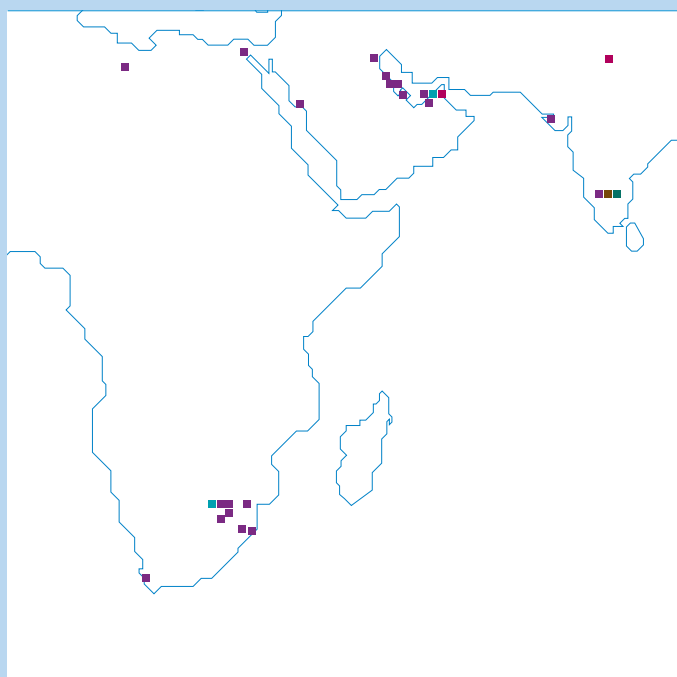
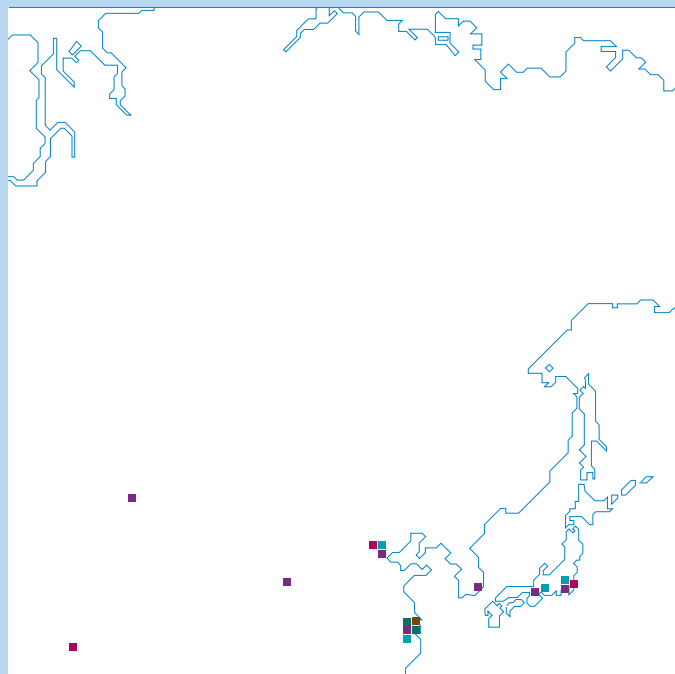
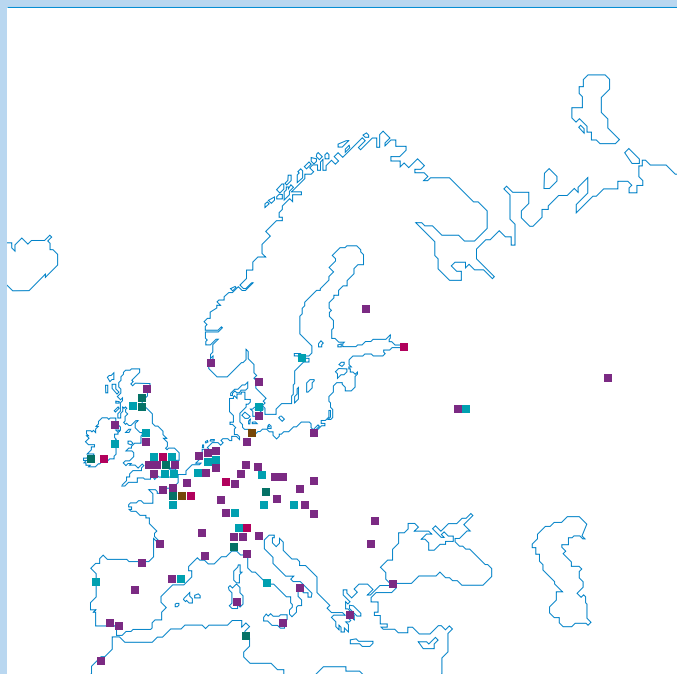


### Location of assets

- 1 North America 55%
- 2 United Kingdom 13%
- 3 Europe other 21%
- 4 Rest of World 11%



Analysis excludes cash and cash equivalents



## 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, operating 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.

|                  |       |
|------------------|-------|
| <b>Employees</b> | 2,400 |
|------------------|-------|

|                   |       |
|-------------------|-------|
| <b>2010 Sales</b> | £574m |
|-------------------|-------|

|                                              |       |
|----------------------------------------------|-------|
| <b>2010 Headline operating profit margin</b> | 15.7% |
|----------------------------------------------|-------|

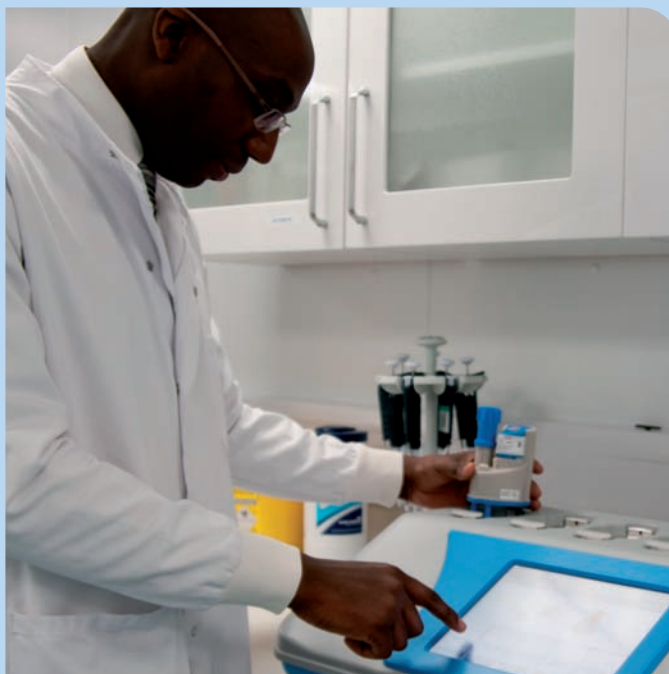
#### Key strengths

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



### John Crane

A world-leading provider of products and services for the major process industries, including the oil and gas, power generation, chemical, pharmaceutical, pulp and paper, and mining sectors.

|                  |       |
|------------------|-------|
| <b>Employees</b> | 6,700 |
|------------------|-------|

|                   |       |
|-------------------|-------|
| <b>2010 Sales</b> | £786m |
|-------------------|-------|

|                                              |       |
|----------------------------------------------|-------|
| <b>2010 Headline operating profit margin</b> | 20.7% |
|----------------------------------------------|-------|

#### Key strengths

Two-thirds of revenue from aftermarket service

Market leader in its field with a blue chip customer base

Driven by long-term demand for energy

Good positions in key markets



## Smiths Medical

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.

**Employees** 8,400

**2010 Sales** £858m

**2010 Headline operating profit margin** 21.5%

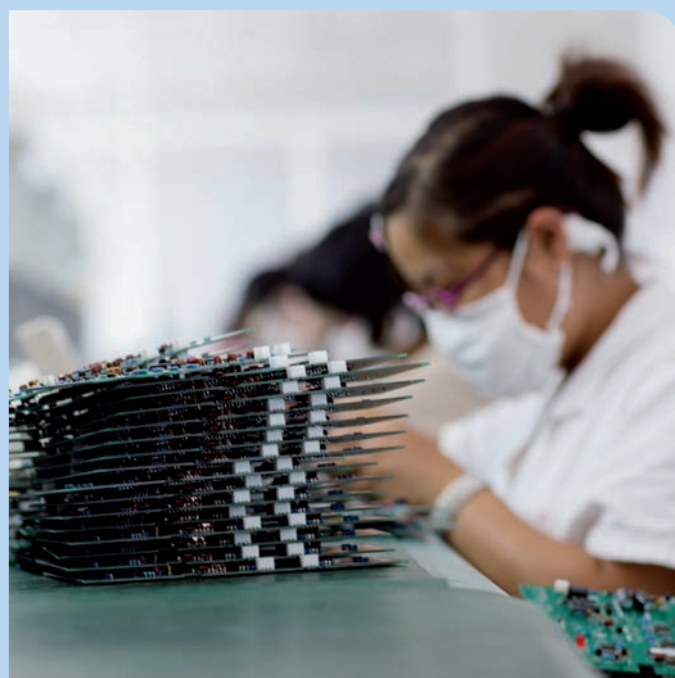
### Key strengths

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



Overview

Strategy

## Smiths Interconnect

A leader in electronic components and sub-systems that connect, protect and control critical systems for wireless telecommunications, aerospace, defence, space, test, medical, rail and industrial markets.

**Employees** 4,000

**2010 Sales** £340m

**2010 Headline operating profit margin** 18.2%

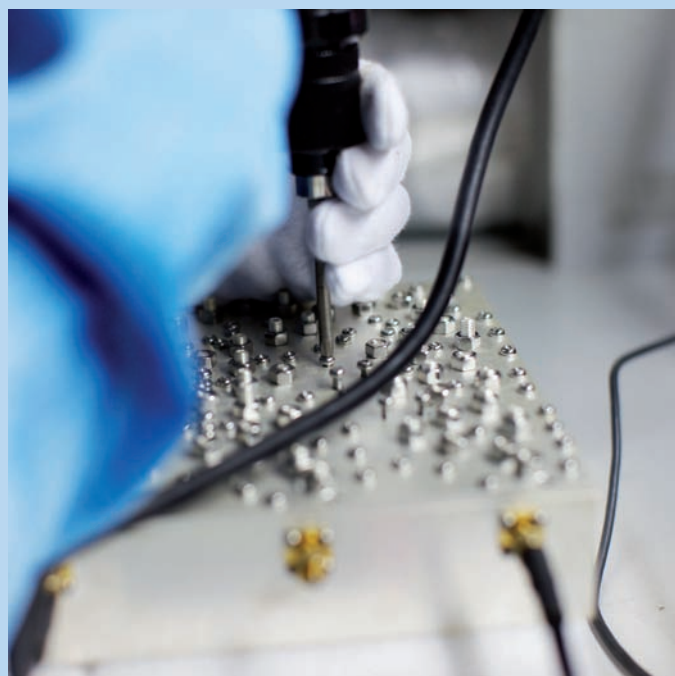
### Key strengths

Technical differentiation providing barriers to entry for competition

Strong brands recognised by customers

Excellent military programme positions

Positive market dynamics in wireless infrastructure, semiconductor test and military/aerospace



Operating and financial review

Risks and responsibility

## 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.

**Employees** 2,000

**2010 Sales** £212m

**2010 Headline operating profit margin** 11.1%

### Key strengths

Strong positions in niche markets

Lean manufacturing culture with strong cost control

Well-positioned for a recovery in US housing and domestic appliances with strong operating leverage



Governance

Accounts

## Chairman's statement

Despite another testing year, Smiths Group has again delivered a strong performance that highlights the lasting value of the restructuring programme underway across our businesses.

My caution about prospects for the global economy, expressed in the 2009 Annual Report, proved well founded as most markets have recorded only fitful progress, if any, towards sustained growth. However your Company's focus on operational improvements and better cash generation, combined with geographically diverse and largely defensive end markets, helped generate the best profit margins in a decade.

This impressive performance is the result of much hard work from all our staff worldwide, particularly assisted by a range of cost-saving initiatives such as the divisional restructuring, more efficient global procurement, and improved information services. Launched two years ago, these 'self-help' initiatives have driven profitability to new highs against a backdrop of continuing economic uncertainty. Our performance has also been aided by the underlying resilience that characterises our core markets. Terror threats, seen most dramatically in the failed bombing of an airliner over Detroit last Christmas, show few signs of diminishing; ageing populations require greater health care; global energy demand keeps growing; and wireless communications advance at a tremendous pace.

While our relentless drive on operational savings and cash generation will be maintained, we are well aware that preparedness for an eventual economic recovery cannot be neglected. A renewed focus on growing sales is underway, as seen through our greater investment in research and development, the addition of complementary technologies, and increased exposure to such fast-growing markets as China and India.

In Smiths Medical, for example, sales of products launched in the last three years are up 16%. Smiths Detection engineers are co-operating with their counterparts at Analogic, an image processing company, to develop the next generation of high-speed systems for screening checked baggage for explosives. In the potentially lucrative field of clinical diagnostics, Smiths Detection has signed an agreement with healthcare multinational, Novartis. This grants it exclusive rights to market Smiths Detection's Bio-Seeq system for clinical diagnostics and associated technology designed to deliver rapid and precise diagnosis via easy-to-use, on-site devices.

We have also continued to reshape the Group portfolio towards growth through our targeted acquisition programme. The purchase of Interconnect Devices, Inc. (IDI), a spring probe connector company, by Smiths Interconnect has added a complementary technology and is now also increasing the division's sales capabilities in China. There is also valuable scope to leverage sales in Europe where IDI currently has limited presence.

I am confident that these developments, aided by a far leaner operational structure in the businesses and a more focused corporate centre, will allow Smiths Group to leverage a disproportionate advantage when trading conditions eventually recover.



**Donald Brydon**  
Chairman

If any reminder were needed, recent events in the Gulf of Mexico illustrate the vital importance of unrelenting corporate vigilance over issues of environment, health and safety. These topics are reviewed at every management meeting and we have recorded further steady progress in exceeding the tough targets we set ourselves, as evidenced in our corporate responsibility report.

The past year has also seen some important changes to the Smiths Group Board. John Langston retired as Finance Director on 31 May after 10 years on the Board. John had held a variety of senior roles within the Group and I would like to thank him for his substantial contribution to the success of Smiths in recent years. Peter Turner joined in April from Venture Production plc and became Finance Director after a brief handover from John. Smiths will benefit both from Peter's strong finance skills and his wide knowledge and experience of multinational operations, particularly in oil and gas. On the non-executive side, Bruno Angelici joined the Board from 1 July following a highly successful 20-year career with AstraZeneca plc. Bruno brings a wealth of experience from the pharmaceutical and healthcare markets. I welcome both to the Board and look forward to working with them.

An internal Board review conducted during the year highlighted both our good practice on governance and the complementary mix of experience and expertise among our directors. The Board sees these reviews as an extremely useful measure of the collective effectiveness of the directors, as well as a means of assessing individual performance and leadership.

The economic and financial upheavals of the past two years have been testing for the Board which, like the Group, has emerged strengthened by the experience. We now look forward to the future challenges and opportunities with even greater commitment and enthusiasm. The economic outlook remains uncertain. Markets are struggling to assess how governments' withdrawal of fiscal stimulus and the imposition of tough spending cuts will impact on business prospects across the globe. Parts of Europe came close to a second banking crisis this summer; some market data indicates that any economic recovery could be muted at best; and the threat of a double-dip recession stubbornly remains.

Such a fundamental lack of business confidence could act as a brake on sales growth and we must continue to focus relentlessly on managing the areas within our control. In that way, as seen this past year, we will be best placed to generate value for our shareholders.

On behalf of the Board, I would like to thank Philip and all our staff for another year of significant achievement. These results are a fitting testament to their dedication and commitment to improving the performance of our businesses.

**Sales +4%**

**£2,770m**

**Headline operating profit +18%**

**£492m**

**Statutory operating profit +2%**

**£436m**

## Chief Executive's statement

These strong results have been achieved in a tough economic environment and demonstrate our substantial progress in delivering operational improvements and generating strong cash-flows. We have also benefited from the strength and breadth of being a diversified-industrial company, with our portfolio of leading-edge, technology-driven businesses serving a broad range of geographies and markets.

The major restructuring programme and other cost saving initiatives that began some two years ago have delivered strong margin improvement despite the difficult sales environment. While we have been effective in cutting costs, we have also continued to invest in growth opportunities such as new product development and bolt-on acquisitions.

All businesses in the Group delivered margin improvement as a result of our actions to restructure and cut costs. The Group's focus on working capital management has also delivered strong free cash-flows. Smiths Detection has achieved double-digit sales growth following difficult trading last year as it benefited from a good order flow from transportation, ports and borders and military customers. As a result, margins have rebounded rapidly with the higher volumes. Through its strong technology, Smiths Detection is well placed to take advantage of future market growth. Smiths Medical has benefited substantially from the performance improvement programme initiated over two years ago. The business has returned to growth, adjusting for the diabetes exit, and its margins are back in their target range at 21.5%. More importantly, the operational platform is now stable and provides a sound base from which to grow the business. John Crane has improved its underlying margins by 260 basis points to a record 20.7%. This was achieved through cost savings and despite the pressure on sales during the period. However, the order intake strengthened as the year progressed and second half sales were ahead by almost 4% on the prior year. Smiths Interconnect also delivered improved second half sales driven by the military and aerospace markets, while margins benefited from the restructuring programme. Flex-Tek is heavily exposed to the US housing and domestic appliances markets which, for the first time in several years, showed signs of growth during the second half. Flex-Tek increased margins through continued focus on cost reduction and site rationalisation.



**Philip Bowman**  
Chief Executive

## Investing in new product development

A key driver of future sales and margin growth is the launch of new products which command higher margins and deliver superior returns. This commitment to innovation also sustains our technology leadership in many areas. We raised company-funded investment in R&D by 5% to £93m and were successful in securing a further £13m of customer-funded investment to bring our total spend to £106m, or 3.9% of sales. We launched a range of new products in John Crane, including a specialised bearing for power generation turbines and seals designed for the supercritical CO<sub>2</sub> sealing needs of the growing carbon capture and enhanced oil recovery markets. Sales in Smiths Medical benefited from the continued success of our ambulatory smart pump, CADD®-Solis, which is now being sold in additional markets. In Smiths Detection, we continue to develop eqo, our body image scanner, with airport and regulatory trials underway to improve security and passenger experience. In the past year, Smiths Detection also entered into development partnerships with Analogic, to design the next generation of checked baggage screening equipment, and with Novartis Diagnostics to develop a range of clinical tests for bacterial and viral pathogens using the established Bio-Seq platform. Smiths Interconnect launched a new broadband antenna, KuStream™, for commercial aircraft, which is currently being installed by Row44 on the Southwest Airlines fleet to provide passengers with a variety of high data rate applications.

## A focus on performance improvement

Across the Group, the major restructuring programme has generated further savings of £24m in the period, well ahead of our original plans. To date, we have delivered savings of £41m and have spent £36m, with £8m in the year. Together, the programmes are expected to produce annual savings of £50m when completed in 2011. The total cost of these programmes is expected to be £45m.

We have also enhanced the information flow in the business through significant investment in new information systems over recent years. The implementation of ERP systems at Smiths Detection, John Crane and Smith Medical were substantially completed during the year. The better data at Group and divisional levels has highlighted opportunities to leverage the Group's scale through Group-wide procurement initiatives. In the year, this programme generated £11m savings, principally from IT, raw materials, machine parts, utilities and freight. Overall, the programme has delivered £20m of savings to date.

We have identified a further tranche of cost savings to be realised from a rationalisation of certain 'back-office' functions to reduce overheads across the Group. This will also help to drive further efficiencies and benefits from the ERP systems now they are implemented. These benefits will be achieved by using shared service centres and removing duplication across these functions within divisions. The programme is estimated to deliver £20m of annual benefits by the financial year ending July 2013, at a cost of £19m, which will be treated as an exceptional item, with £13m of costs expected in the financial year ahead.

Headline earnings per share +17%

84.6p

Statutory earnings per share +6%

75.3p

Dividend per share

34.0p

Free cash-flow up £75m

£331m

Employees around the world

23,550

# Chief Executive's statement

## continued

### Efficient balance sheet management

During the year, we improved significantly our cash generation and strengthened the balance sheet. Following the successful issue of US dollar-denominated debt last year, the maturity profile was further extended through a €300m bond issue. These notes have a seven-year maturity and were priced at a fixed coupon of 4.125%. Average debt maturity is now over six years, which gives the Group long-term certainty over its future financing.

### Investing in growth and driving returns

We continued to enhance the portfolio through a targeted acquisition programme. Over the past three years, we have made 12 acquisitions. Six of them have extended our footprint in the faster growing Asian markets. The acquisition strategy seeks to add complementary technologies, to support geographic expansion in faster growth markets and to leverage existing infrastructure such as sales and service centres. In October 2009, Smiths Interconnect acquired Channel Microwave, a California-based microwave components business, focused on the defence and homeland security markets. In April 2010, Smiths Interconnect acquired for US\$188m, Interconnect Devices, Inc., a leading connector company with an international presence, and a strong base in North America and China. The integration of both these acquisitions is substantially complete, with both performing ahead of expectations.

The Group has continued to focus on improving returns on capital by enhancing margins while operating an efficient capital base. This has delivered a significant improvement in headline return on capital employed, up 190 basis points to 16.6%.

### Targeting performance improvement

In September 2008, 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 an economic environment consistent with that of recent years. Since then we have seen a fundamental deterioration in world economies and, although it will be harder to operate within these ranges in the near term, those targets remain in place. In the current environment it will take longer to achieve them; particularly sales growth, which will be harder to deliver than improved margins – where we have greater control over driving cost reductions and operating efficiencies. Nonetheless, we have made good progress this year, with three divisions delivering margins within their target ranges, and we remain focused on driving further improvements.

### Dividend

The Board has recommended a final dividend in line with last year of 23.5p per share, making a total dividend for the year of 34.0p per share. The final dividend will be paid on 19 November to shareholders registered at the close of business on 22 October. The ex-dividend date is 20 October.

Since March 2008, the Board has pursued a policy to rebuild dividend cover to around 2.5 times over the medium term, a goal we have now almost reached. As a result, the Board intends to adopt a progressive dividend policy for future payouts while maintaining this prudent level of cover. We believe that this policy will enable us to retain sufficient cash-flow to finance our investment in the drivers of growth.

### Outlook

The economic environment remains uncertain and delivering sales growth in the short to medium term is likely to remain challenging, although the Group is well positioned to benefit from a recovery whenever that occurs. Our focus for the year ahead is to drive margin enhancement through the further cost savings due from our restructuring and site rationalisation programmes. As we have already accelerated the delivery of some of the benefits from these programmes, however, the effect on the rate of future profit growth will be more muted in the coming year. We will also seek to maintain strong cash generation which will enable us to continue investing in the long-term growth drivers of new product development, acquisitions, and expansion in faster growing developing markets.

## Group strategy

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

### Bringing technology to life

Smiths Group is a diversified technology company with a portfolio of businesses delivering highly engineered products and services to end markets with long-term underlying growth prospects. These end markets include, among others, threat detection and security to combat evolving terror threats; components and servicing for oil and gas production to meet global energy needs; the provision of medical devices for ageing populations; and components to support the continued demand for wireless communications. The defensive characteristics of many of these markets and our significant exposure to aftermarket servicing and single-use consumables also provide resilience throughout the economic cycle.

We have quality brands our customers recognise as leaders in their markets. A deep understanding of these markets, their products and services, combined with strong customer relationships, enables Smiths to apply its leading-edge technologies and deliver engineered solutions to specific client applications. Our products and services are also often critical to customer operations while our proprietary advanced technology and high service levels create barriers to entry. This supports high margins across our portfolio.

The Group is managed by a lean corporate centre which sets the strategic direction and applies rigorous capital allocation to actively manage the portfolio and drive returns. It continuously seeks opportunities to improve information flow, speed up decision-making and leverage the Group's scale. It also ensures compliance as a UK listed company and promotes a culture of responsibility and accountability.

### Strategy

Our strategy is to deliver shareholder value by:

- delivering sales growth through investment in organic growth drivers such as new product development and expansion in high growth markets;
- enhancing margins through a relentless drive for operational improvement across all our businesses;
- managing the balance sheet and operations efficiently to generate strong cash-flows;
- implementing a rigorous approach to allocating capital across the businesses through active and disciplined portfolio management;
- making acquisitions that add complementary technologies or products, extend our geographic reach, particularly in emerging markets, or leverage our existing sales footprint; and
- improving returns on capital.

As a multi-industry business, we manage the business to drive above average sales growth, improve margins, maximise cash-flows and enhance returns for our shareholders while promoting a culture of responsibility across the business. We measure our performance and the effectiveness of our strategy through several key performance indicators: see overleaf.

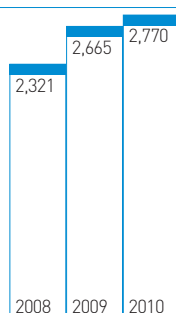
# Key performance indicators

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

## Growing the business

- Investing in R&D to drive sales growth
- Increasing our exposure to growth markets and product categories

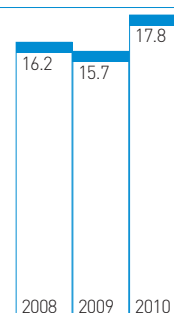
### Sales £m



## 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 %



|                     | Sales targets | 2010 results |
|---------------------|---------------|--------------|
| Smiths Detection    | 10-12%        | +13%         |
| John Crane          | 6-8%          | -5%          |
| Smiths Medical*     | 3-5%          | +2%          |
| Smiths Interconnect | 6-10%         | -3%          |
| Flex-Tek            | 0-7%          | -6%          |

Average annual organic growth over the medium term at constant currency  
– see commentary on page 10

\*Excluding diabetes

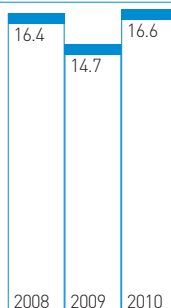
|                     | Margin targets | 2010 results |
|---------------------|----------------|--------------|
| Smiths Detection    | 17-20%         | 15.7%        |
| John Crane          | 17-22%         | 20.7%        |
| Smiths Medical      | 20-24%         | 21.5%        |
| Smiths Interconnect | 21-23%         | 18.2%        |
| Flex-Tek            | 11-16%         | 11.1%        |

Medium term targets – see commentary on page 10

## 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

## Return on capital employed

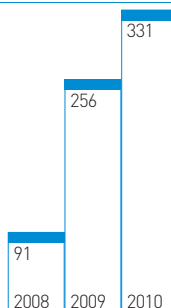


See page 49 for further details

## Generating cash

- Improving working capital management and cash generation
- Optimising the capital structure and securing the long-term financing of the Group

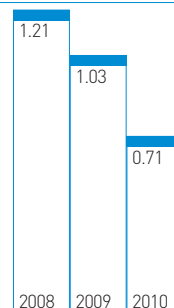
## Free cash-flow £m



## Promoting responsibility

- Living by the Smiths Code of Business Ethics
- 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



Target (August 2007 – July 2010)

2010 result

### Greenhouse gas emissions

**8% reduction**

No absolute increase over the 2007 baseline

### Total non-recycled waste

**38% reduction**

9% reduction over three years normalised against turnover

### Water consumption

**21% reduction**

9% reduction over three years normalised against turnover

# Key strengths

Implementing strategy by exploiting key corporate strengths.

## Market insight and strong customer relationships

Our businesses have a deep understanding of their markets and customers needs. We have strong relationships with a customer base that ranges from blue chip corporates to governments and related agencies such as the US Transportation Security Administration and US Department of Defense. This knowledge of our customers informs our new product development and supports our ability to provide engineered solutions to address their needs.

## Data-based decision-making

We have invested in better information systems to enhance data flow and speed up decision-making. Improved data at a Group and divisional level has created major opportunities to leverage the Group's scale through procurement initiatives. Better data on product and customer profitability has helped us remove costs, increase pricing and reshape portfolios in, for example, Smiths Medical and John Crane. Our new systems have given us insight into operational efficiencies to improve margins.

## New product development and product engineering

Our leadership in innovation and leading-edge technology is a core competence. We excel at product engineering and the practical commercial application of state-of-the-art technology so it is accessible and easy to use. Products include the new generation of scanners for airports and borders, advanced testers for mobile phone networks, portable medication delivery systems and solar-powered gas pumps for remote wells. Our technology leadership supports growth and high margins.

## Efficient management of the balance sheet and cash-flows

We seek to optimise our balance sheet structure to generate strong cash-flows and increase returns for shareholders. Our businesses generally have low requirements for major upfront capital commitments, allowing investment to be focused on research and development or bolt-on acquisitions. After working capital and net capital expenditure, we have an operating cash-flow that is a high percentage of operating profit.

## Managing a complex supply chain

Our strength in small-batch, low-cost manufacturing with access to a global sales and service footprint enables us to minimise costs and sustain margins over the long term. We employ more than 23,000 people in over 50 countries and have undertaken a programme of site rationalisation and relocation to low-cost countries, such as Mexico, China, India, Czech Republic, Costa Rica and Tunisia. We create efficiencies through lean divisional structures and expanding in high growth markets such as China and India.

## Active management of the portfolio to deliver superior returns

Smiths Group has reinvented itself many times in its 160-year history, from its origins in clocks and watches, through the significant growth in the automotive and aerospace sectors during the 20th century to its current portfolio of assets which tap into high-tech markets with strong underlying growth characteristics. We will continue to rebalance the portfolio to access growth markets, raise margins and increase returns. In recent years, Smiths Group has made several acquisitions to add complementary technologies, leverage our infrastructure and extend our geographic reach. We have also freed up capital to redeploy in the business to command higher margins and deliver superior returns.

# Investment case

Smiths Group has an attractive investment proposition.

## Strong blend of technology businesses that diversify risk

- Smiths Group owns a broad portfolio of businesses that diversify risk through serving a wide range of customers, markets and geographies

## Highly effective cash generation and balance sheet management

- Businesses typically have low capital intensity and strong cash generation characteristics
- Focus on reducing working capital as a percentage of sales
- We seek to optimise our balance sheet to deliver superior returns for shareholders
- Disciplined approach to capital allocation

## Exposure to markets with long-term underlying growth characteristics

- We serve several end markets – such as energy, healthcare, security and telecommunications – that typically have long-term underlying growth characteristics
- Our businesses are either the market leaders or have strong positions in selected niche markets

## Operational capabilities support delivery

- Revitalised management team with strong skills and proven track record of creating value
- Continued focus on operating efficiencies and delivering a self-help programme to improve margins
- Investment in business systems is driving data-based decision-making

## Leading-edge technologies and high service levels support high margins

- We provide the practical application of leading-edge technologies that are critical to our customers products and processes
- Our consistent investment in new product development and understanding our customer needs enables our businesses to stay at the forefront of their technologies and command high margins
- High-quality service levels supports strong customer retention

## Opportunities to generate value through portfolio management

- Smiths Group is focused on businesses that deliver long-term growth, higher margins and increased returns
- Strong track record in acquisitions which add complementary technologies and products, leverage our existing infrastructure and extend our geographic presence
- We are reshaping the portfolio through acquisitions and divestments that allocate capital to business areas that will generate value for shareholders

## Business review: Group

Smiths is a world leader in the practical application of advanced technologies, Smiths delivers products and services for the threat and contraband detection, energy, medical devices, communications and engineered components markets worldwide.

|                                               |         |
|-----------------------------------------------|---------|
| Sales increased by 4% to                      | £2,770m |
| Headline operating profit increased by 18% to | £492m   |
| Statutory operating profit increased by 2% to | £436m   |

## Sales

Sales increased by 4%, or £105m, to £2,770m. Currency translation gains on overseas sales totalled £59m and the net impact of acquisitions and disposals increased sales by £48m. On an underlying basis, excluding the effects of currency translation and acquisitions and disposals, sales fell by just £2m, despite strong growth in Smiths Detection (up £63m) caused by a rebound in orders from the ports and borders and transportation sectors. The decline in sales was a result of lower volumes across the other divisions: John Crane (down £44m); Flex-Tek (down £12m); Smiths Interconnect (down £8m); and Smiths Medical (down £1m).

The flat underlying sales performance reflects a decline in the first half of 5% followed by growth in the second half of 5%.

## Profit

Headline operating profit rose £74m to £492m. Headline operating margin increased by 210 basis points to 17.8% (2009: 15.7%). The increase in headline operating profit comprises £8m from favourable currency translation, £8m from the net impact of acquisitions and disposals made during the year, and a £58m, or 14%, increase in underlying headline operating profit. All divisions contributed to the improvement, with the main drivers being higher volumes and improved overhead recovery at Smiths Detection, up £26m; cost saving initiatives at the other divisions with Smiths Medical up £17m, John Crane up £13m, Smiths Interconnect up £1m, and Flex-Tek up £2m. Corporate centre costs were held in line with last year.

Operating profit on a statutory basis, after taking account of the items excluded from the headline figures, was £436m (2009: £429m).

The net interest charge on debt increased to £62m (2009: £52m) which reflects the higher coupon on bonds issued during the last two years as part of a programme to extend debt maturities. There was a reduced pensions financing gain of £2m (2009: £5m). As a result, headline profit before tax increased by £64m to £435m (2009: £371m). On an underlying basis, headline profit before tax grew by 14%.

On a statutory basis, after taking account of items excluded from the headline figure, the profit before tax increased £2m to £373m (2009: £371m).

The Group's tax rate on headline profit for the period was 24% (2009: 24%). Headline earnings per share increased by 17% to 84.6p (2009: 72.4p).

## Cash generation

Strong cash generation this year resulted in free cash-flow of £331m (2009: £256m). Substantially improved headline operating cash of £565m (2009: £435m) represented 115% (2009: 104%) of headline operating profit. The improvement resulted from better working capital management, particularly inventories, and lower net capital expenditure. The strong cash generation reduced net debt by £48m to £837m, despite outflows of £133m for dividends and £133m for acquisitions.

## Dividend

The Board has recommended a final dividend in line with last year of 23.5p per share, making a total dividend for the year of 34.0p per share. The final dividend will be paid on 19 November to shareholders registered at the close of business on 22 October. The ex-dividend date is 20 October.

Since March 2008, the Board has pursued a policy to rebuild dividend cover to around 2.5 times over the medium term, a goal we have now almost reached. As a result, the Board intends to adopt a progressive dividend policy for future payouts while maintaining this prudent level of cover. We believe that this policy will enable us to retain sufficient cash-flow to finance our investment in the drivers of growth.

# Business review

## continued

### Smiths Detection

Smiths Detection is a world-leading designer and manufacturer of sensors that detect and identify explosives, weapons, chemical agents, biohazards, nuclear & radioactive material, 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 trace detection, millimetre-wave, infra-red, biological detection and diagnostics.

#### Employees

2,400

#### Contribution to 2010 Group sales

21%

#### Contribution to 2010 Group headline operating profit

17%

Percentage relates to headline operating profit before corporate costs

**Stephen Phipson, CBE**  
President



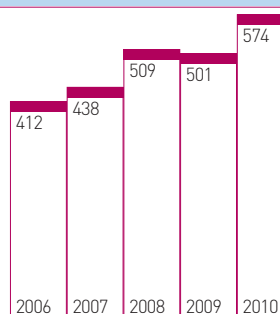
#### Principal operating regions

Our eight manufacturing centres are concentrated in North America, Germany, France, Russia and the UK. We sell to over 150 countries around the world either direct or through third-party distributors.

#### 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), and the UK Ministry of Defence.

#### Sales performance £m

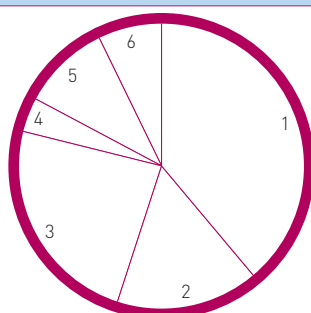


#### Competitors

Consolidated market data shows that, in the combined transportation, critical infrastructure and ports & borders sectors, Smiths Detection has a 32% market share, compared to its main competitors of: L3 Security & Detection Systems (11%), Rapiscan Systems (14%), Morpho (15%), Nuctech (12%) and AS&E (12%). In the Military and Emergency responder markets, which are not included in this data, the main competitors are General Dynamics, Bruker, FLIR and SAIC.

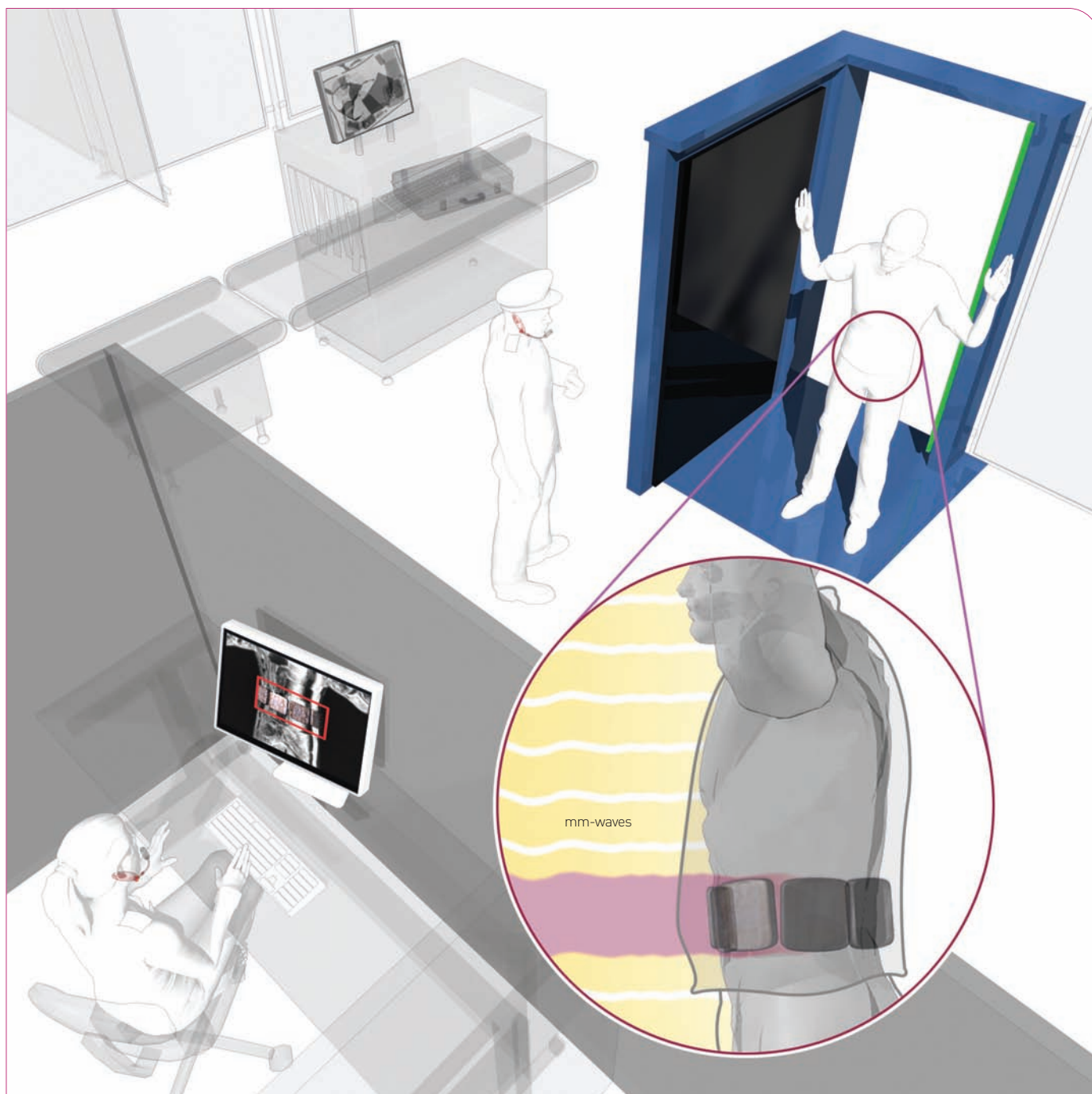
#### Sales by sector: £574m

- 1 Transportation 39%
- 2 Ports and borders 16%
- 3 Military 24%
- 4 Emergency responders 4%
- 5 Critical infrastructure 10%
- 6 Non-security 7%



#### Suppliers

We continue to redesign 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 that quality and delivery requirements are maintained.



### eqo improves privacy features

Trials towards enhancing the privacy features of Smiths Detection's revolutionary eqo body imager are at an advanced stage. eqo uses millimetre-waves to detect metal and non-metallic threats concealed under clothing. Fitting easily into a standard checkpoint layout, eqo works by bouncing harmless radio-style waves off passengers as they go through a portal and turn in front of a flat panel. The waves 'echo' back to sensors and reveal any anomalies via full-motion, real-time images. These appear on a remote screen and are currently checked by operators who alert security over an audio link if a suspected threat is detected. Software upgrades that enable eqo to alarm automatically will greatly reduce or eliminate the need for visual inspections. The new software can be easily retro-fitted in the eqo systems already operating in international airports.



# Business review

continued

## Smiths Detection

continued

### 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 applications such as diagnostics.

Homeland security remains a priority in western countries, with up to 10% annual growth expected in the near term. However, government spending and airport operator investment have been affected by the current global economic downturn, which has in turn caused some delays in projects and orders. 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 £3.3bn.

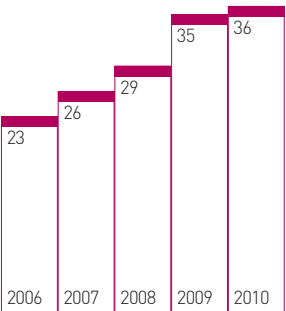
The transportation sector, which includes airports, is the largest representing 38% of total sales. Airport investment is recovering as passenger and air cargo traffic has started to grow again. Over the long term the airport security market is expected to grow in response to:

- 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 but provided strong growth recovery over the period. In the longer term, this is expected to remain 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.

### Company-funded R&D

£m



Organic sales growth  
target range

10-12%

Headline operating margin  
target range

17-20%

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### Safe from chemical and biological attack

Smiths Detection is helping the US military meet its need for collective, integrated protection from chemical and bio-threats by developing advanced, mobile shelters that provide safe work space for combat, medical and support personnel. The Chemical Biological Protective Shelter (CBPS) is a long-term government programme with a \$333m contract ceiling. To date, Smiths Detection has been awarded a \$75m tranche of the programme and is now formally testing the 400-square-foot, vehicle-based shelters after a successful development phase. Designed and built in the newly expanded Edgewood facility in Maryland, US, the CBPS should be in full production by the middle of 2011. The military's requirement for the CBPS, which eliminates the need for protective clothing in potentially contaminated areas, is estimated at around 1,200 systems.

The military market for UK and US technology is restricted by export controls. 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 major events.

Smiths Detection is actively developing adjacent markets, with the main focus on clinical diagnostics. Building on its expertise in the identification of biological agents, it has developed an instrument and sample preparation consumables and is developing a range of diagnostic tests. A collaboration and licence agreement has granted Novartis Diagnostics exclusive rights to market the instrument and associated technology, for infectious disease diagnostics.

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

## continued

### Smiths Detection

continued

#### Performance

|                            | 2010<br>£m   | 2009<br>£m | Reported<br>growth | Underlying<br>growth |
|----------------------------|--------------|------------|--------------------|----------------------|
| Sales                      | <b>574</b>   | 501        | 15%                | 13%                  |
| Headline operating profit  | <b>90</b>    | 63         | 43%                | 40%                  |
| Headline operating margin  | <b>15.7%</b> | 12.6%      |                    |                      |
| Statutory operating profit | <b>89</b>    | 63         |                    |                      |
| Return on capital employed | <b>13.3%</b> | 9.5%       |                    |                      |

Reported sales grew 15%, or £73m, reflecting an underlying increase in sales of £63m (13%) and a currency benefit of £10m. The underlying growth has come primarily from the ports and borders, transportation and military sectors, offset by a small decline in critical infrastructure and other segments. Smiths Detection has maintained its position as one of the world's largest suppliers of government-regulated CBRNE sensors and systems during the period.

The 310 basis point improvement in margins to 15.7% was driven by increased sales volumes and the associated enhancement in overhead cost recovery. We began a restructuring programme late last financial year to reduce the cost base and introduce more flexibility so we can respond more quickly to variations in order flow. This will be achieved through rationalising several manufacturing facilities. We expensed restructuring costs of around £2.2m in the year, which has generated savings in the current year of around £1.6m with further savings expected in 2011.

Underlying sales in transportation grew 19% following a strong performance in the second half. The business secured several large contracts including one for advanced X-ray systems to upgrade Canada's existing airport checkpoints; an order from the US Transportation Security Administration (TSA) to supply portable liquid detection scanners for its Bottle Liquid Scanner programme; and a contract to supply advanced X-ray and trace detection systems in the newly opened Terminal 3 in New Delhi's international airport. Many airports have been reviewing their security arrangements following the attempted terror attack on an aircraft on 25 December. This has led to increased orders for explosive trace equipment such as the Ionscan 500DT, including an \$11m order from the TSA. This portable technology is highly effective at detecting minute traces of explosives and can be easily deployed at airports. Many governments and airports are also considering installing body imaging systems and we have deployed our millimetre-wave system, eqo, as part of a number of trials. eqo uses electronic, real-time imaging in a standard checkpoint layout to detect metal and non-metallic threats concealed under clothing, without physical contact. We have also benefited from the investment in air cargo screening in the US to meet the target of 100% screening by 1 August 2010, a key requirement of the 9/11 Act. We now offer 16 different X-ray machines on the TSA's approved technology list, which meet a wide variety of applications.

Underlying sales in the ports and borders market rose 66% following a weak performance last year. The market experienced widespread contract delays during the previous financial year, as government customers reviewed their expenditure plans against a backdrop of deteriorating economies and strained finances. Several new contract wins supported strong sales growth during the period, including projects in Saudi Arabia, Russia and Japan. For example, we won an order for 13 high-energy X-ray scanners in Saudi Arabia, to inspect inbound and outbound containers and trucks for contraband, weapons, explosives and narcotics. The long-term outlook for ports and borders remains strong as governments improve their border security. Our leading-edge technology positions us well to meet this demand.

Our military business grew underlying sales by 4%, largely through the success of the Lightweight Chemical Detector (LCD) in multiple programmes including Canadian and German contracts and most notably for the Joint Chemical Agent Detector (JCAD) programme for the US Department of Defense. The LCD, an advanced chemical point detector that helps safeguard troops by automatically detecting chemical warfare agents and toxic industrial chemicals, has gained worldwide acceptance as the leading detector in its class. As expected, the sales profile flattened in the second half due to the phasing of orders. Sales of sensor instruments to the emergency responder market also continued to grow steadily, with new sales in Europe and Asia complementing the strong position in the US.

Progress was made during the period in the development of molecular diagnostics detection systems for biological identification applications. Agreement was reached with Novartis to develop these systems for application to the clinical diagnostics markets in future years.

Implementation of a new ERP system was completed on schedule at 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. Investment totalled £25m and we have delivered annualised cost savings of £7m against our target of £8m and working capital efficiencies of £20m compared with a target of £11m.

**Company-funded R&D**  
% of sales

**6.2%**

**Customer-funded R&D**  
% of sales

**1.4%**



### Another milestone in India

Against stiff competition, Smiths Detection secured the prestige contract to equip New Delhi international airport's newly opened Terminal 3 with a wide range of advanced X-ray and trace detection systems to screen passengers, hand luggage, checked baggage, and freight. The terminal, one of the biggest in the world, will help treble the airport's capacity to more than 60 million passengers a year. The contract marks another milestone in Smith Detection's expansion into India's large and fast-growing security market. Other big customers include India's major airports, the Indian Armed Forces, Presidential House, government, state and police departments, hotel chains and diplomatic missions.

### 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 via partnerships and licences. Company-funded R&D increased 3% to £36m or 6.2% of sales (2009: 6.9% of sales). This includes £11m of capitalised projects. Smiths Detection actively seeks customer and government support for R&D which totalled £8m in the period (2009: £10m). Total R&D spend was £44m (2009: £45m) or 7.6% of sales.

The main 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. In December 2009, we entered an agreement with Analogic to develop the next generation of high-speed Explosive Detection Systems (EDS) for screening checked airport baggage. The new system will incorporate the complementary expertise of each company in multi-energy X-ray technology and three-dimensional computed tomography (CT). The development cost will be absorbed within Smiths Detection's ongoing R&D spend over the next two years. The project has met all interim milestones and is progressing well.

We are also looking to enhance the privacy features of eqo by developing software upgrades that enable the system to alarm automatically on detecting any threat items beneath clothes, so greatly reducing the need for visual inspections. These upgrades could be easily installed in the eqo systems already deployed. eqo was one of the joint winners of the Equipment and Technology Award, sponsored by the UK's Aerospace, Defence and Security trade organisation.

Our global leadership in biological and chemical trace detection supported the development of several new products in the period. This included a new chemical sensor nose cone for the US Army's Raven unmanned aerial vehicle, which can provide effective standoff detection and identification to warn troops against a chemical attack. We also launched a new version of our portable bio-threat detector, SmartBio™ Sensor, which can detect the presence of airborne biological microbes and bio-toxins. Other new product launches included HazMatID 360 for rapid in-field chemical analysis of unknown solids, gels and liquids; LCD-Nexus, a rugged chemical warfare agent and toxic industrial chemical detector that can be remotely networked and controlled; and HGVI LINX™, a pioneering software system to help emergency responders evaluate data from remote HGVI units (Hand-held Gas & Vapor Identifier).

### Outlook

Smiths Detection is well placed to benefit from future growth opportunities, although government finances remain under pressure in many markets which may affect the timing and profile of orders. We expect growth to come from the transportation and ports and borders markets, while the military market is likely to soften following a period of strong growth. Longer term, we expect continued demand for leading-edge technology solutions for threat detection and identification. Smiths Detection will continue to invest in new product development to maintain market leadership, while restructuring the business to cut costs and support margin improvement.

# Business review

## continued

### 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 enhance customer productivity by providing advanced technology industrial products and performance-enhancing services backed by an exceptional global network.

#### Employees

6,700

#### Contribution to 2010 Group sales

28%

#### Contribution to 2010 Group headline operating profit

31%

Percentage relates to headline operating profit before corporate costs

#### Paul Cox President



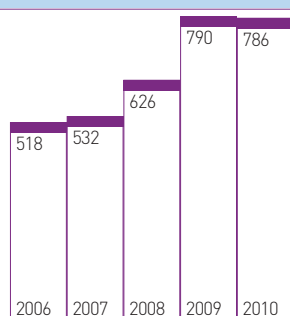
#### Principal operating regions

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 Chevron, BP, China Petroleum, Suncor/Petro Canada, ExxonMobil, Gazprom, PDVSA, Pemex, Saudi Aramco, Shell, Petrom, Sulzer, ITT Goulds, Flowserve, GE Nuovo Pignone, GE Energy and Power, Andritz Hydro, Siemens, Mitsubishi, Solar Turbines, Elliot, York, BASF, Bayer, and Dow.

#### Sales performance £m



#### Competitors

For rotating technologies, John Crane's main competitors are, Flowserve and Eagle Burgmann 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 global competitors include Weatherford and Norris.

#### Sales by sector: £786m

##### OEM: 37%

1 Original equipment manufacture 37%

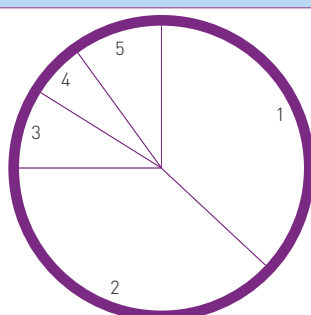
##### Aftermarket: 63%

2 Oil, gas & petrochemical 38%

3 Chemical & pharmaceutical 9%

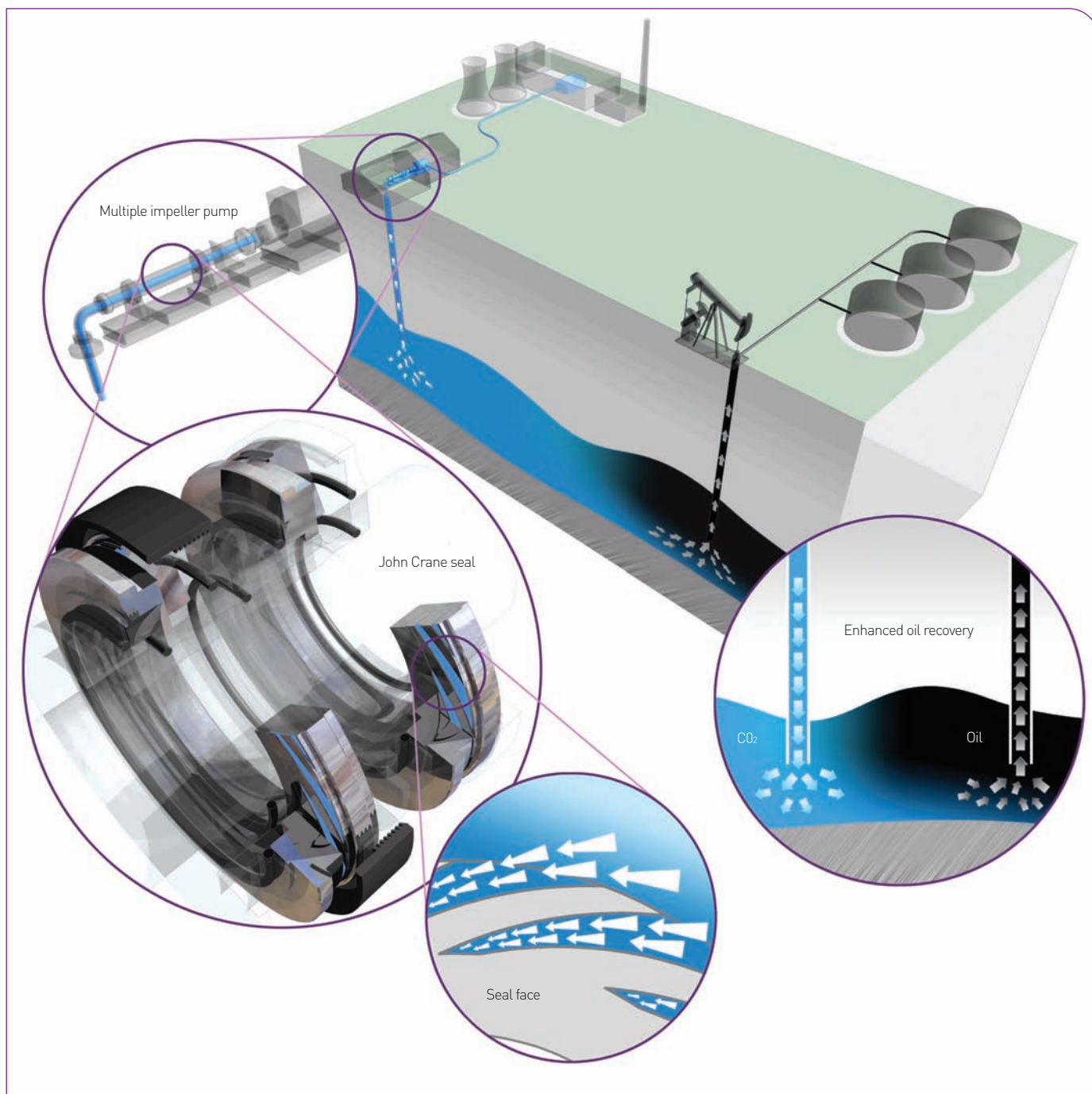
4 Distributors 6%

5 General industry 10%



#### 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, Femax, DuPont, Greene Tweed, Scot Industries and Ashland Chemical.



### Helping capture carbon

With so-called carbon capture increasingly used to cut 'greenhouse' gas emissions, John Crane has developed advanced sealing technology that enables the complex process of pumping 'captured' CO<sub>2</sub> from conventional power stations to safe storage underground. John Crane's engineers have more than 10 years experience in supercritical CO<sub>2</sub> sealing to deal with a volatile compound that can change from gas to liquid or vice versa at the slightest variation of temperature or pressure. Reliable sealing is achieved using proprietary non-contacting spiral grooves that are uniquely designed for moving CO<sub>2</sub> or other unstable 'gases' irrespective of density. The same technology applies if the CO<sub>2</sub> is being compressed or pumped into a depleted oil field for enhanced recovery of oil or natural gas.



# Business review

continued

## John Crane

continued

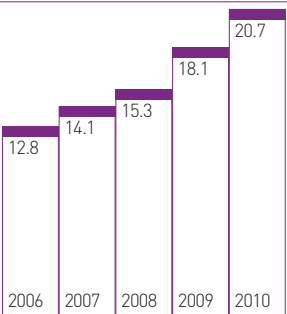
### Markets and trends

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 onshore down-hole ‘artificial lift’ 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 arise from the design and supply of products to original equipment manufacturers, while the remaining two-thirds of sales stem 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, e.g. 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 organic sales growth of around 6-8% a year over the medium term.

### Headline operating margin

%



Organic sales growth  
target range

6-8%

Headline operating margin  
target range

17-22%

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### Bearings on energy saving

John Crane is constantly finessing its range of advanced bearings to meet the evolving needs of power plant operators who face increasingly stringent performance and environmental standards. Its patented bearing technology is now used in upgraded gas and steam turbines to help boost performance while simultaneously cutting energy consumption. Sophisticated geometric profiling of internal surfaces combines with state-of-the-art lubrication systems to minimise secondary energy losses and cut overall oil consumption, even at the highest temperatures. The optimised lubrication helps reduce the bearings' energy usage by as much as 25%. Steam turbines in particular can also gain up to 25% more load capacity and wider operational safety margins through lower bearing temperatures.

The John Crane addressable market has doubled over the past three 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

## continued

### John Crane

continued

### Performance

|                            | 2010<br>£m   | 2009<br>£m | Reported<br>growth | Underlying<br>growth |
|----------------------------|--------------|------------|--------------------|----------------------|
| Sales                      | <b>786</b>   | 790        | (1)%               | (5)%                 |
| Headline operating profit  | <b>163</b>   | 143        | 14%                | 9%                   |
| Headline operating margin  | <b>20.7%</b> | 18.1%      |                    |                      |
| Statutory operating profit | <b>124</b>   | 106        |                    |                      |
| Return on capital employed | <b>22.2%</b> | 20.4%      |                    |                      |

John Crane margins improved to an all-time high of 20.7% with a 260 basis point increase against a 5% (£44m) decline in underlying sales. These margins demonstrate the cost saving benefits from the global restructuring programme, the implementation of an ERP system and procurement savings. The reduced underlying sales reflect lower orders for first-fit original equipment which offset a slight increase in aftermarket sales, driven primarily by a recovery in the oil, gas and petrochemical sectors. First half underlying sales declined by 15% but an improving order book, particularly in the aftermarket for rotating equipment (seals, bearings, and filtration), helped second half sales grow by 4% on the same period in the prior year. Reported sales fell 1% after a £19m benefit from currency translation and a £21m contribution from recent acquisitions.

Reported headline operating profit grew by 14% driven primarily by a 9%, £13m, increase in underlying profit, as well as a £4m gain from currency translation and £3m from acquisitions. The underlying improvement in profitability stems from the benefits delivered from our cost-saving initiatives. The restructuring programme launched in August 2008 to create one global John Crane division is progressing on schedule. As a result, there is tighter global co-ordination of corporate functions while sales and service operations have been kept close to customers in regional organisations. We have also gained from moving manufacturing to lower-cost countries in Eastern Europe, Asia and Mexico.

These changes are delivering improved customer service, quicker delivery, and lower costs. In the period, we spent £4m and delivered savings of £12m so that annualised savings to date now total £19m. Overall, the project is on track to deliver annual savings of £25m.

Overall aftermarket sales grew by 1% on an underlying basis. Aftermarket sales of rotating equipment increased 2% driven by the oil, gas and petrochemical, general industry and distribution sectors as spending started to recover and new distributors were added. The chemical and pharmaceutical sectors continued to decline for rotating equipment. Sales for John Crane Production Solutions, our energy services business, are all in the aftermarket and declined 10% due to lower activity levels in Romania and in US onshore gas and oil production. Going forward, John Crane Production Solutions won a major contract to upgrade and maintain Romania's oil wells by providing pump repair services and equipment for Petrom's 8000-plus wells. The contract for pump repair services began on 1 December 2009. This new contract is expected to generate annual revenues of about £14m.

First-fit original equipment sales declined by some 15% on an underlying basis as the recession prompted customers to curtail capital expenditure.

Our recent acquisitions to broaden our product offering in the areas of engineered bearings and specialist filtration have been integrated into the existing portfolio. These businesses have a greater exposure to the first-fit OEMs and are more exposed to the capital spending cycle until we fully realise aftermarket channels for these products. Progress was made within the year with several new accounts achieved for bearings and filtration. In line with our original plans, we expect to progressively build the aftermarket sales for these products over time by leveraging our existing global network of sales and service centres and our unrivalled expertise in aftermarket servicing.

Implementation of a new ERP system across Europe, Middle East, Africa and Asia completed on schedule in July 2010 and within the £24m budget. The project is expected to generate annual cost savings of £10m. To date, the project has realised £5m of savings.

Critical to continued expansion of our market-leading sales and service network, significant infrastructure enhancements were completed during this past year. The John Crane Asia Pacific headquarters were relocated to a new custom-built facility providing 'state-of-the-art' manufacturing, service and training capabilities. This centre now provides advanced design and development of seal support systems as well as regional technical support for all John Crane product lines including bearings and filtration. Service network enhancements include the opening of a new larger couplings facility in Houston, expansion of the largest North American service centre, also in Houston, and a new service centre in Auckland, New Zealand. In addition, a new service centre opened in Kwidzyn, Poland, strategically located near six major pulp and paper plants, establishing exceptional customer service response capability and a business growth opportunity.

% sales in first-fit OEM

37%

% sales in aftermarket service

63%



### Partnership approach pays off

The discovery of vast, oil fields off the Brazilian coast opens potentially lucrative opportunities for John Crane which already enjoys long-established commercial ties with Petrobras, Brazil's state-led energy company. Already the niche market leader in Brazil, John Crane has installed and maintained dry gas seals for Petrobras offshore platforms since 2003 and has just signed a \$5m exclusive repair services contract. The three-year deal is the result of a close partnership approach between the two companies which should lead to further business as the new fields come online.

### Research and development

John Crane's commitment to technical leadership through investment in product research and development is the foundation to maintaining our industry-leading position. This past year John Crane spent £10m on the development of new wet and dry gas seals, advancement of coupling and bearing technologies, control monitoring systems and expansion of test capabilities. Addressing industry demands associated with gas transmission trends including CO<sub>2</sub> capture and re-injection, gas seal development programmes are ongoing including the launch of a new high pressure gas seal design, new test rigs capable of extreme high-pressures and advanced seal face materials development. Wet seal product developments include the introduction of a new high-performance split seal line approved for use on naval ships, unique high temperature non-contacting pump gas seal technology, a high solids-capable slurry seal for mining and flue gas desulphurisation applications and advancement of diamond coatings for seal faces. In addition, significant investment has been directed to the improvement of proprietary analysis tools that further enable our product development programmes and support customer service initiatives.

### Outlook

John Crane's order rate has continued to improve. This should support sales growth in the coming year, subject to a sustained expansion in market economies and further customer investment in capital projects. Margins will benefit from the remainder of the cost saving initiatives in the coming year, although this will be offset by strategic investment in growth opportunities such as the expansion of our sales and service network and increasing our presence in growth markets. John Crane will capitalise on its market leadership in mechanical seals and continue to leverage its global sales and service network to promote the newly acquired products such as hydrodynamic bearings and specialist filtration systems whilst continuing to build the John Crane Production Solutions business.

# Business review

## continued

### 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

8,400

#### Contribution to 2010 Group sales

31%

#### Contribution to 2010 Group headline operating profit

35%

Percentage relates to headline operating profit before corporate costs

**Srini Seshadri**  
President



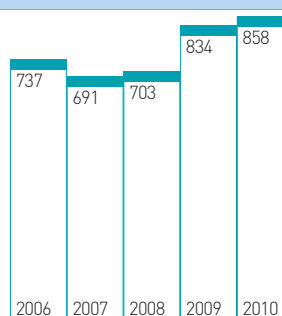
#### Principal operating regions

Manufacturing is concentrated in Mexico, the US and UK, Italy, Germany and China. We sell to over 120 markets worldwide, the US being our largest single market with around 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.

#### Sales performance £m

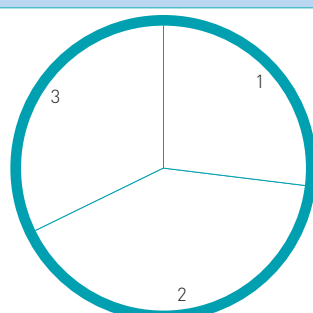


#### Competitors

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 and CareFusion, among many others. In many cases, we compete with only a small portion of their medical businesses so comparison between peers is not straightforward.

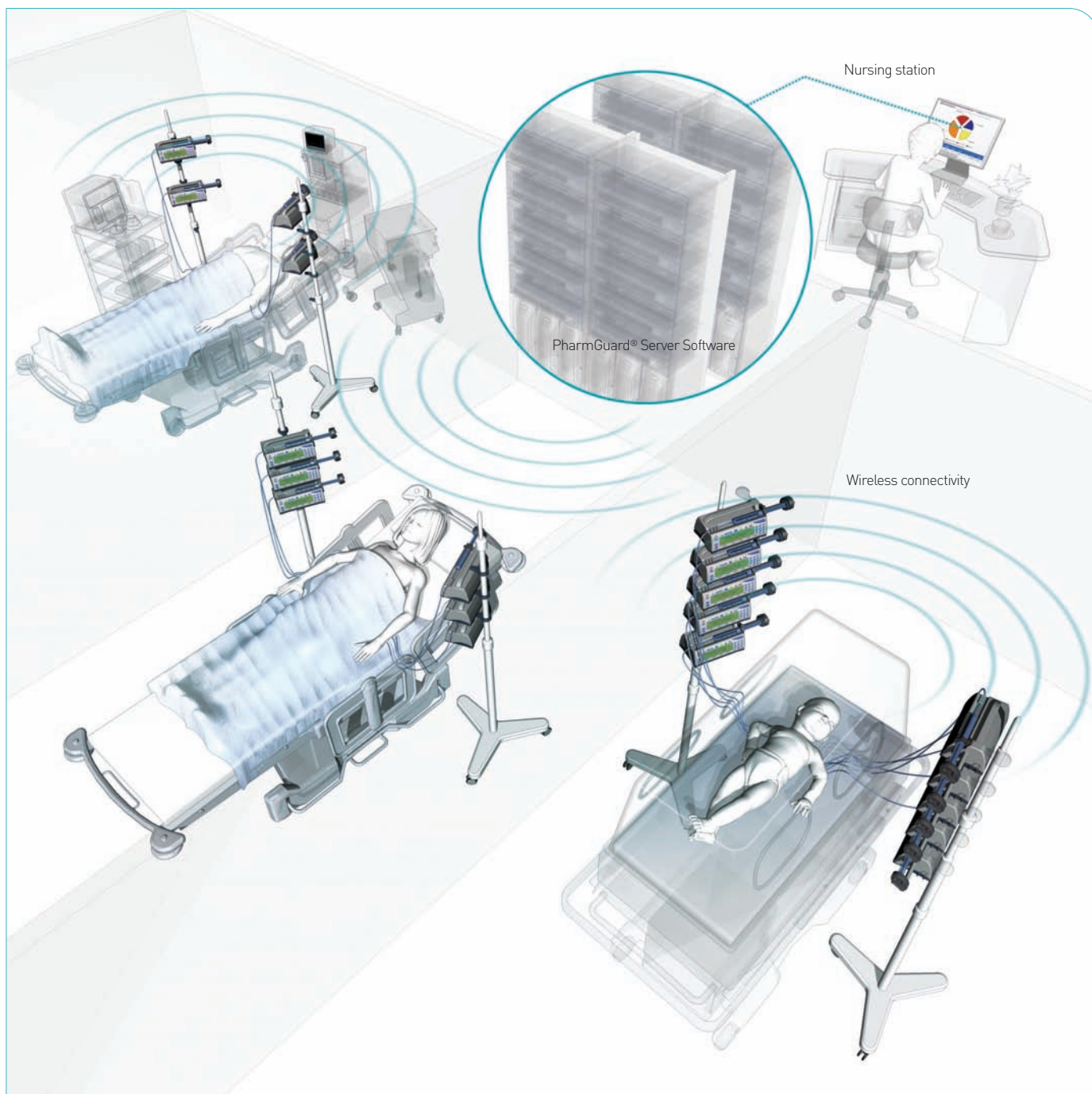
#### Sales by sector: £858m

- 1 Medication delivery 27%
- 2 Vital care 41%
- 3 Safety devices 32%



#### Suppliers

Our strategy is to engage suppliers in product innovation, value engineering and a commitment to quality. Our goal is to reduce product and supply chain costs, improve delivery performance and reduce the cost of out-of-specification or poor-quality supplies. The majority of our direct spending is on injection moulding, packaging materials and electronics. Among indirect purchases, freight, services, travel, temporary labour and capital equipment represent the majority.



### Delivering safer treatment

Smiths Medical is helping hospitals and clinicians reduce potentially dangerous medical errors through its industry-leading medication delivery systems and advanced software programmes which enhance both patient safety and healthcare practices. A combination of its Medfusion™ syringe pump and PharmGuard® Medication Safety Software is now widely used in leading children's hospitals for 'smart' infusion systems particularly in intensive care. The advanced features include extensive drug libraries that facilitate programming by drug with built-in dosage limits, precise infusion accuracy and advanced syringe recognition. Our next generation infusion systems will deliver operational efficiencies by enabling pumps to be remotely and wirelessly updated with the latest drug libraries. Moreover, quality improvements will be achieved through the collection of pump infusion data, analysis of programming errors and generation of key compliance metrics.



# Business review

continued

## Smiths Medical

continued

### 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 £4.0bn, with opportunities in target adjacent markets that would more than double the size of the addressable market. Smiths Medical has global reach in the design, production and distribution of medical device products, with sales and marketing activities in over 120 countries. Its product ranges serve three main markets – medication delivery, vital care and safety.

Looking at trends across the business, Smiths Medical is well placed in lower-risk, short residency, interventional devices, where there is continued demand. Its broad portfolio includes iconic brands in hardware and consumable products; in hospitals and alternate care settings; and in software and services.

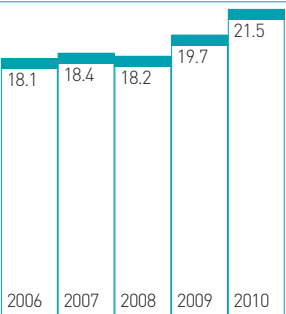
Regarding specific growth opportunities, recent legislation in the European Union directs EU member states to adopt country-level safety legislation. This represents a breakthrough in that region. When similar laws were passed in the US several years ago, Smiths Medical saw double-digit growth in sales of safety products. In addition, the division is making significant progress in the development of medication delivery systems that link to healthcare providers' networks, a global trend. Finally, the move in vital care from standalone products to integrated solutions suits Smiths Medical's broad and deep offerings.

### Medication delivery

Smiths Medical designs and manufactures drug delivery systems that relieve acute and chronic pain (CADD), treat the most at risk critical care patients in high care units around the world (Medfusion and Graseby), and enable patients with cancer, pulmonary hypertension or Parkinson's disease to receive their treatment at home (CADD). The global market for medication delivery products is estimated to be worth £1.2bn and growing at around 3-5% a year. This growth is due to the increase in treatment of chronic conditions, the integration of 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 the syringe pump market.

### Headline operating margin

%



Organic sales growth  
target range

3-5%

Headline operating margin  
target range

20-24%

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#### Uniperc® is 'best in category'

Smiths Medical's groundbreaking Portex® UniPerc® tracheostomy kit has won a prestigious MDEA Gold Award, the highest designation given by the MDEA (Medical Design Excellence Awards) in the US. It was selected 'best in category' over several other high-tech medical solutions. UniPerc® is the first dedicated percutaneous tracheostomy option with tubes specifically designed for patients with larger necks. Its products and components have been designed to make percutaneous insertions into large necks quicker, safer and more effective than standard tubes.

#### 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. Demand continues to grow at a rapid rate globally for IVF as well. The vital care market is currently worth about £1.7bn.

#### Safety

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 £1.2bn and growing at 3-5% annually. Smiths Medical is one of the world's leading suppliers of safety needles and catheters; as such, it is well-positioned to capitalise on the recently agreed European Union directive calling for the increased use of safety products to protect healthcare workers.

# Business review

## continued

### Smiths Medical

continued

#### Performance

|                            | 2010<br>£m   | 2009<br>£m | Reported<br>growth | Underlying<br>growth |
|----------------------------|--------------|------------|--------------------|----------------------|
| Sales                      | <b>858</b>   | 834        | 3%                 | 0%                   |
| Sales (excluding diabetes) | <b>844</b>   | 801        | 6%                 | 2%                   |
| Headline operating profit  | <b>184</b>   | 164        | 12%                | 10%                  |
| Headline operating margin  | <b>21.5%</b> | 19.7%      |                    |                      |
| Statutory operating profit | <b>172</b>   | 148        |                    |                      |
| Return on capital employed | <b>15.1%</b> | 12.8%      |                    |                      |

Underlying sales were flat due to our exit from diabetes which reduced revenue by £20m; excluding diabetes, underlying sales grew 2%. At reported exchange rates, Smiths Medical sales grew 3% (£24m), which reflects gains from currency translation (£23m) and acquisitions (£2m), while headline operating profit rose 12% (£20m). Headline operating margins increased by 180 basis points to 21.5%, reflecting a strong underlying growth in profit of £17m, a currency benefit of £2m, and profit from acquisitions of £1m. Margins benefited from the various cost saving initiatives to address overheads and material costs as well as and other manufacturing efficiency measures. The portfolio profitability review, begun last year, delivered price improvements and better margins. The momentum established in the first half of the fiscal year continued, with underlying hardware sales up 2%, excluding diabetes, while sales of our disposable products grew 3%.

These results demonstrate the significant progress made through the performance improvement programme introduced two years ago to address the supply chain and operational challenges facing the business. Among many operational metrics, we have seen a marked improvement in on-time delivery and customer service, as well as reduced customer backorders.

At the same time, there has been some recovery in the hardware market and stabilisation of disposable sales. This follows a tough period last year when the economic downturn squeezed hospital budgets and prompted significant distributor destocking. We have also seen a rise in accompanying disposable sales in line with hardware sales improvements.

In medication delivery, excluding diabetes, underlying revenue grew 5% from increased sales of our next-generation CADD®-Solis ambulatory smart pumps as they are rolled out to new markets and gain ground in existing markets. Deferrals of purchases of our infusion systems by some large customers have continued, although we expect those sales to recover. Sales of CADD®-Solis pumps grew in North America and are expanding in other English-speaking markets. The European multi-language launch of CADD®-Solis pumps began in February, and early results show strong market acceptance. In addition, we recently announced a commercial collaboration with Hospira to co-promote infusion pump systems. As part of this agreement, the two companies have begun development of software for managing infusion safety medication. This is designed to enhance patient safety and simplify how clinicians work. This agreement will allow us to extend the use of our Medfusion syringe pumps with PharmGuard Medication Safety Software to more hospitals and care areas in the US and Canada.

Vital care underlying sales grew 2% mainly through a continued strong performance by our temperature management franchise, which represents a positive turnaround. We benefited from growth in our respiratory products, particularly early in the year, partly due to preparations made by various organisations for potential H1N1 flu outbreaks. Our tracheostomy business also delivered strong growth in the period. The UniPerc® tracheostomy kit for people with large necks boosted this franchise after it won a prestigious Medical Design Excellence Award, attracting increased interest in the product. Our assisted reproduction products are also growing strongly as we benefit from our leading presence in a niche market.

Underlying sales of safety devices rose 1%, driven by several large orders in support of H1N1 preparation early in the year, and a significant OEM partnership. Interest in safety products remains high in developed markets, and is growing in developing markets like India. In May 2010, the European Commission adopted a Directive, with the aim of "achieving the safest possible working environment for healthcare workers through prevention from sharps injuries". Countries across the continent are beginning to seek products that adhere to these guidelines, and Smiths Medical is in a strong position to capitalise on this trend.

We continued to manage our product portfolio aggressively to boost profitability and reduce complexity. By the end of October 2009, we had simplified our business by successfully eliminating some 3,000 SKUs; this has provided opportunities to convert customers to alternative products. In the second phase of our portfolio review, we are looking at our product line holistically. We will delete additional low-performing SKUs, as appropriate, while pursuing additional up-selling and cross-selling opportunities, and price increases. A more sophisticated global key account management system is gaining traction and helping improve customer profitability. At the same time, our previously regional organisation was restructured to create global management teams for sales and marketing and product management respectively. We have continued to optimise our manufacturing footprint to deliver an efficient supply chain.

**Company-funded R&D**  
% of sales

**3.5%**

**Sales from products launched**  
in last three years

**+16%**



### Promotion partnership

Smiths Medical has signed a two-part agreement with Hospira to co-promote their infusion pump ranges in the US and Canada and develop an enterprise management software application for the Medfusion pump that will enhance patient safety and simplify clinicians' work. The enterprise application will continue to facilitate the monitoring of hospital devices and improve medication management and safety that will complement the next generation of Smiths Medical smart infusion pumps. With complementary product lines, the co-promotion allows Smiths Medical to expand the reach of its industry-leading syringe pumps.

During the year, we closed a manufacturing facility at Waukesha, Wisconsin, and transferred the BCI and SurgiVet production lines to our St Paul, Minnesota, facility. We also rationalised two distribution centres – in Otay Mesa, California, and Cherwell, UK – merging them into existing distribution centres. The restructuring of our North American operations has produced £3m of savings to date.

Implementation of our global ERP business systems was completed at the end of February. The new systems are already providing far greater transparency of key data across the business. This is enabling faster, data-driven decision-making that will improve our quality and customer satisfaction to support revenue and margin growth.

### Research and development

We continued to increase the sales from products launched in the last three years, up 16% on last year. This metric demonstrates that we are directing our R&D investment more effectively and executing more of our product launches on time and within budget. Our R&D spend totalled £30m (2009: £29m) or 3.5% of sales (2009: 3.5%).

During the year, we extended the reach of a number of products into new markets, including CADD®-Solis and Medfusion™ pumps, the UniPerc® tracheostomy range, LockIt Plus™ catheter securement devices and SuctionPro™ 72 closed suction systems. We also completed a global launch of our new, full range of convective warming blankets, which have been well received in all of our key markets.

### Outlook

Smiths Medical's strategic imperatives for fiscal year 2011 are growth, globalisation and new products. We will continue to drive positive sales momentum, although growth will be constrained by the exit from diabetes. The potential impact of government cuts to healthcare budgets may affect the rate of growth. We will continue to push through efficiencies to support planned increases in investment in R&D and sales and marketing. We expect sustained and significant sales expansion in China, with a rapid pick-up in growth in India, as our regional direct sales strategy gains momentum. Margins will benefit from the restructuring and cost reduction initiatives and from our ability to make data-driven decisions regarding portfolio and customer profitability.

# Business review

## continued

### 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, test and industrial markets.

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

#### Employees

4,000

#### Contribution to 2010 Group sales

12%

#### Contribution to 2010 Group headline operating profit

12%

Percentage relates to headline operating profit before corporate costs

#### Ralph Phillips

President



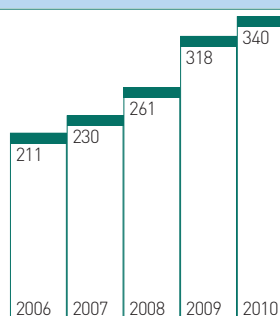
#### Principal operating regions

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, Varian, Qualcomm, NVIDIA and Alstom.

#### Sales performance £m

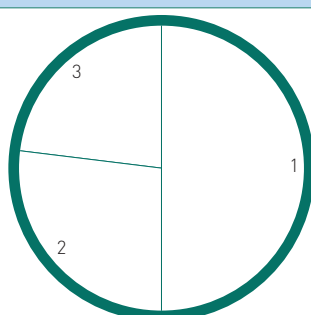


#### Competitors

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, Everett Charles, Radiall and Souriau. Our microwave components and sub-systems compete with, amongst others, Anaren, Spectrum Control, PowerWave, KMW, Dover, CommScope, EMS, Herley, Cobham, Teledyne and L3. Huber & Suhner, Dehn and SL Industries offer competitive protection products.

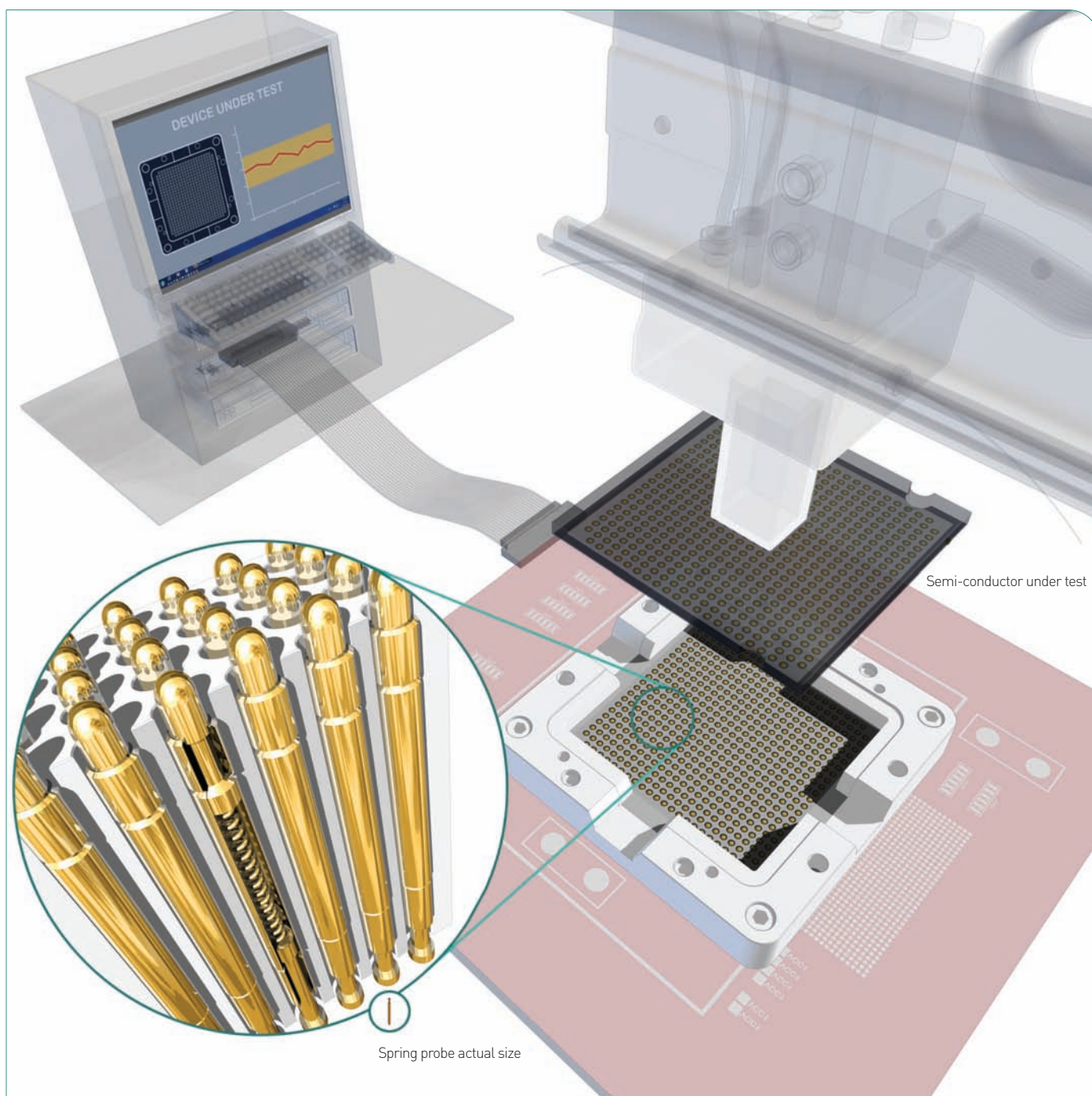
#### Sales by sector: £340m

- 1 Military & aerospace 50%
- 2 Telecom 27%
- 3 Medical, rail, automation and test 23%



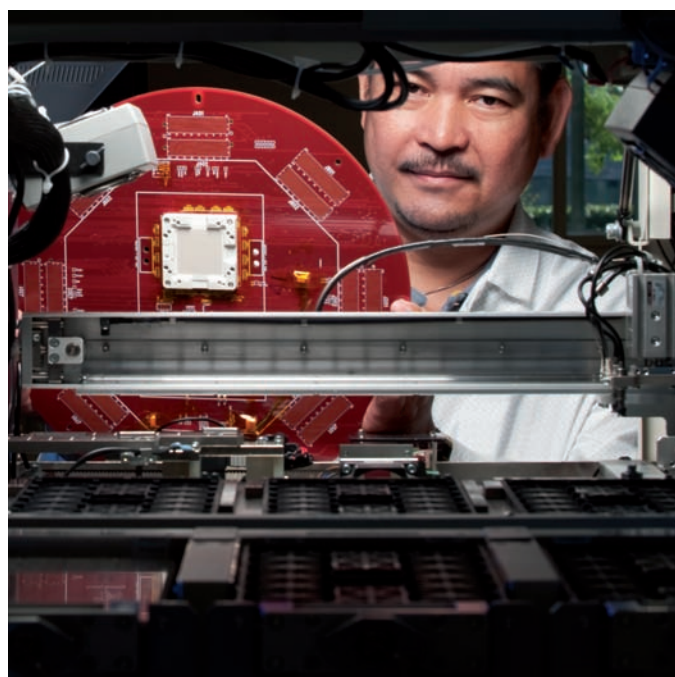
#### Suppliers

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



### IDI connects with niche market

IDI's highly engineered, application-specific connectors use a proprietary spring probe contact technology and are sold into the semi-conductor test, circuit-board testing, military, medical and homeland security markets. Within semiconductor test applications, the IDI test sockets are used to relay electrical test signals to and from the semiconductor device under test. A new growth sector is being driven by the explosive global demand for smart phones and related consumer items, such as tablets and portable media players. These devices rely on specific semiconductor sets where the chips are stacked one on another, a configuration that complicates testing as multiple contacts must be lined up on different planes. However, IDI has developed package-on-package test solutions that meet the accuracy, alignment and repeatability challenges such that three of the top five producers of these chipsets have selected IDI.



# Business review

continued

## Smiths Interconnect

continued

### Markets and trends

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

Intelligence, surveillance and reconnaissance (ISR) is a key priority for global defence spending, with improved battle space awareness, network-centric communications systems and force protection being seen as critical success factors in current and 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, radars and electronic warfare 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.

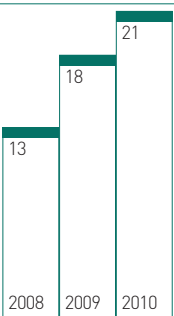
The historically cyclical commercial aerospace market is experiencing a growth phase driven by increased passenger and freight demand from a recovering global economy. Smiths Interconnect provides electrical and microwave connectivity solutions for various aircraft, space vehicles and satellites.

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.

Smiths Interconnect provides connector solutions to semiconductor test, automated test equipment and circuit-board test applications. The continued proliferation of electronic devices, high rate of technology refresh and increased functionality are key drivers for these markets.

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

Total R&D investment  
£m



Organic sales growth  
target range

6-10%

Headline operating margin  
target range

21-23%

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### Enabling the next generation

As mobile operators across the globe prepare for the imminent arrival of the 4G [4th generation] platform of wireless communications, Smiths Interconnect is developing a range of specialised filtering and test products to optimise network performance in an increasingly congested frequency spectrum. Operators will need to invest heavily in 4G networks to support the massive increase in mobile data traffic ranging from smart phones, tablets and laptops to social networking, video conferencing, and HDTV. Smiths Interconnect has already been chosen by one major US carrier to provide both network enhancing filter products and RF and power surge protection devices for the imminent build out of its 4G network.

### Technology

Smiths Interconnect comprises four technology-focused cohesive business units:

- Connectors provides application-specific, high-reliability electrical interconnect solutions from highly integrated assemblies to micro-miniature connectors and spring probe contacts.
- Microwave Defence provides microwave and millimetre-wave components, sub-assemblies, antennas and systems solutions, primarily for defence and aerospace applications.
- Microwave Telecoms provides solutions that test, filter and process high-frequency signals for wireless telecommunication networks.
- Protection provides power and signal integrity components that protect critical and high-value electrical systems from transient effects caused by power surges and lightning strikes.

# Business review

## continued

### Smiths Interconnect

continued

#### Performance

|                            | 2010<br>£m   | 2009<br>£m | Reported<br>growth | Underlying<br>growth |
|----------------------------|--------------|------------|--------------------|----------------------|
| Sales                      | <b>340</b>   | 318        | 7%                 | (3)%                 |
| Headline operating profit  | <b>62</b>    | 56         | 12%                | 3%                   |
| Headline operating margin  | <b>18.2%</b> | 17.4%      |                    |                      |
| Statutory operating profit | <b>53</b>    | 51         |                    |                      |
| Return on capital employed | <b>17.3%</b> | 18.4%      |                    |                      |

Reported sales for Smiths Interconnect grew 7%, or £22m, reflecting gains from currency translation (£5m) and acquisitions (£25m) that offset a 3% (£8m) underlying fall in sales. The lower underlying figure was primarily due to slowing investment in wireless infrastructure and weaker sales of components to the rail, industrial and automation markets in Europe. However these markets have shown some recent signs of recovery. Overall revenue was boosted by sales growth in military and aerospace markets particularly towards the end of the year, such that underlying sales rose 3% in the second half compared with a first half decline of 9%.

Headline operating profit margins improved by 80 basis points to 18.2%. Reported headline operating profit increased 12%. Excluding the £1m benefit from currency translation and £4m from acquisitions, underlying headline profit grew 3%. The improved margins were driven by a combination of initiatives taken during the year as well as the benefits of restructuring actions from last year, including headcount reductions at multiple sites and short-time working in continental Europe. Gross margins improved because of restructuring savings, cost savings from the Group-wide procurement initiative, lower labour costs as more production was transferred to low-cost economies, and efficiency improvements in targeted product lines. Fixed costs continued to be tightly controlled.

On an underlying basis, sales into military, aerospace and space applications improved by 6% for the full year with a strong second half more than offsetting the 3% decline in the first half.

A key driver was the launch of the KuStream™ advanced broadband satellite antenna system, which enables airline passengers to access high data rate applications including internet, cell-phone services, live television and movies. The KuStream™ antenna was selected by Southwest Airlines and production deliveries of the \$30m order started in the latter part of the year. The system is currently being considered by other airlines and we have also supplied initial development phase quantities for military applications.

The military market showed signs of becoming more challenging with some major programmes declining or being delayed. However our areas of focus, particularly C4ISR (command, control, communications, computers, intelligence, surveillance, and reconnaissance) and force protection applications, remained relatively robust. Our microwave and millimetre-wave businesses continued to support multiple secure military communications-on-the-move, sensor systems, and electronic warfare applications. These included completing the development phase of a significant shipboard communications programme for which the first phase of a six-year production contract is expected shortly.

Demand increased for transient voltage and RF protection for military communications systems and strategic facilities as customers' awareness of the effects of Electromagnetic Pulse (EMP) increased. Smiths Interconnect has been selected to supply various protection devices on several multi-year US military programmes, including a tactical communications system, a maritime surveillance programme, and a missile defence sensor system.

For our specialist connector business, the military market remained positive, with continued strong demand on the Eurofighter programme. Although two other significant production programmes closed, we also had several new successes. These included being selected to supply high power connectors for hybrid electric drive applications for future combat vehicles programmes and the choice of our new SnapTac series of miniature circular connectors for several future soldier programmes.

Underlying sales to the wireless telecommunications market fell 13% as network operators limited capital investment in new infrastructure; and price pressures, particularly in emerging markets, were felt throughout the supply chain. With new investment constrained, operators focused on optimising performance of existing network infrastructure, boosting sales of our portable passive intermodulation test equipment in the US as well as notching up breakthroughs in new regions including Europe, India and China. In the second half of the year, sales started improving as operators began releasing funds for network enhancements and we saw an uptick in demand for both network optimisation filter products and power and RF protection devices.

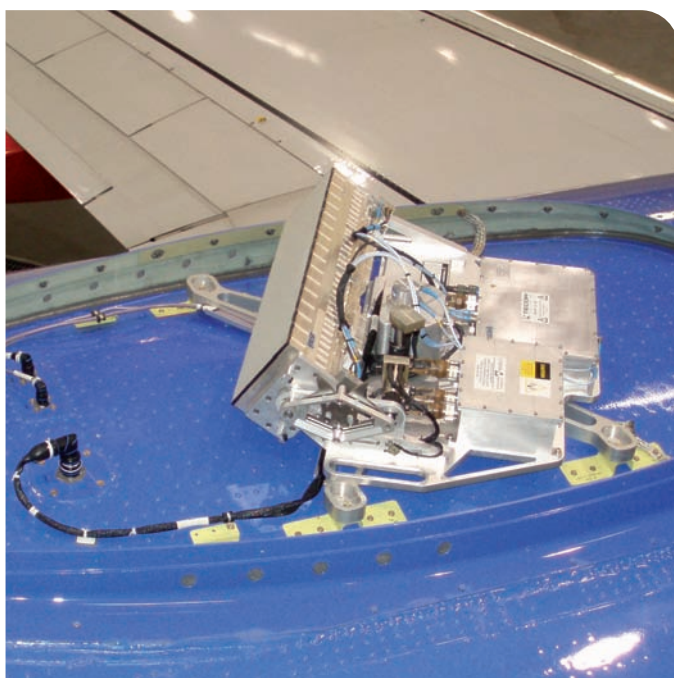
The need for faster and higher bandwidth networks to support high data rate applications, as seen in booming sales of smart phones, is driving many network operators to prepare to invest in fourth generation (4G) wireless networks. Smiths Interconnect has already been selected by one major US carrier to provide both network-enhancing filter products and RF and power surge protection devices. We also experienced continued sales growth of filters, protection products, and millimetre-wave antennas in support of enhancing backhaul systems to meet the higher data rate requirements.

**Company-funded R&D**  
% of sales

**4.8%**

**Customer-funded R&D**  
% of sales

**1.5%**



### KuStream™ builds on success

Smiths Interconnect's newly launched advanced antenna system is key to an in-flight hub that is attracting interest from more airlines hoping to provide passengers with the broadband access they enjoy at home or in the office. KuStream™ allows the Row44 In-flight Broadband Connectivity System to offer high data rate applications such as internet, cell-phone services, live television and movies. It is currently being installed in Southwest Airlines' 500-strong fleet as part of a contract announced in March 2010, valued in excess of \$30m. KuStream™ provides industry-leading performance in three vital areas: high data rates that enable applications such as internet and live TV; accuracy that ensures connectivity with satellites even at shallow trajectories; and signal sensitivity allowing maintained connection at weak signal strengths. The system is currently being evaluated by major US and European airlines. The US military is also interested in possible applications.

Sales to the medical, rail, automation and test markets declined 7% on an underlying basis although there were signs of stabilisation during the latter part of the year. In medical, we have strengthened our position supplying surge protection and connector products to leading oncology, cardiac mapping, and MRI scanner providers. We have also added new customers and broadened our product offering, most noticeably with our new contact used in implantable medical devices.

The rail market remained challenging throughout the year although there are signs of recovery with significant investment being planned for both infrastructure and rolling stock in the US, Europe and China. Safety and communication systems are high priority applications, ideally suited to Smiths Interconnect's product offerings of connectors, protection and microwave devices. Market conditions in automation only stabilised towards the end of the year, whereas in test the market rebounded strongly in the second half.

### Research and development

Total R&D spend rose 17% to £21m or 6.3% of sales (2009: £18m or 5.8% of sales). The customer-funded portion remained flat at £5m or 1.5% of sales (2009: £5m) and acquisitions contributed £1m with the underlying company-funded portion increasing to £15m or 4.8% of sales (2009: £13m or 4.2% of sales).

During the year, the proportion of non-US based engineering resources increased significantly to 30%, providing scope for new product development in emerging markets. We are also focusing R&D resources more on projects that create long term value. Specific investments included the launch of the KuStream antenna, passive intermodulation test solutions, new filtering products to support 4G networks, microwave subsystems for counter-IED systems, and next generation timing systems for military tactical communication networks.

### Business developments

Smiths Interconnect completed two acquisitions which, combined with the full year effect of the Dowin acquisition in April 2009, contributed a total of £25m of sales and £4m of headline operating profit.

In April 2010, we acquired Interconnect Devices, Inc. (IDI), a leading designer and manufacturer of highly engineered, application-specific connectors using a proprietary spring probe contact technology. It focuses on mission-critical applications for semiconductor and circuit-board testing, and connectors for military, medical, homeland security and industrial test markets. With a major plant in Suzhou, China, IDI complements and extends Smiths Interconnect's connector product portfolio and its geographic reach. The transaction allows Smiths Interconnect to leverage existing scale, particularly in Europe, and provides customers with a far wider range of solutions. Integration of IDI is essentially complete and, buoyed by the resurgent circuit-board and semiconductor test markets, the business is performing ahead of expectations. In October, we completed the acquisition of Channel Microwave, a small microwave components company that complements our Lorch and TRAK businesses.

### Outlook

The military sector is expected to become more challenging as budgetary pressures mount. However we expect continued sales growth in military and aerospace due to the increasing demand for the KuStream™ antenna, our focus on high priority areas for defence spending, our existing positions on several major US military programmes, and new programme wins. In wireless telecommunications, network operators are currently preparing for significant capital investment in higher speed next-generation technologies which will drive demand. Semiconductor and circuit-board test applications are expected to continue to grow, spurred by the increasing demand for and sophistication of electronic devices such as smart phones, tablet computers and web-enabled televisions. We expect further margin improvement from volume increases, restructuring benefits, and ongoing cost saving initiatives.

# Business review

## continued

### 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 and rigid tubing provide fluid management for fuel and hydraulic applications on commercial and military aircraft, deliver fuel gas and conditioned air in residential and commercial buildings, and provide respiratory care for medical applications. Flex-Tek heating elements and thermal systems improve the performance of medical and diagnostic equipment as well as that of domestic appliances such as clothes tumble dryers and HVAC equipment.

#### Employees

2,000

#### Contribution to 2010 Group sales

8%

#### Contribution to 2010 Group headline operating profit

5%

Percentage relates to headline operating profit before corporate costs

#### Tedd Smith President



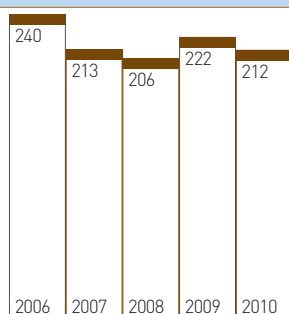
#### Principal operating regions

Flex-Tek operations are principally located in the US and Mexico with Asian operations located in India, China, Malaysia, and the Philippines, and European facilities in France and Germany.

#### Customers

We serve mainly aerospace engine and airframe manufacturers, domestic appliance manufacturers and the US construction industry. Large customers include Boeing, Airbus, Pratt & Whitney, GE Aerospace, Whirlpool, Electrolux, Trane, and Carrier. Our notable distributors in the US construction market include Ferguson and Watsco.

#### Sales performance £m

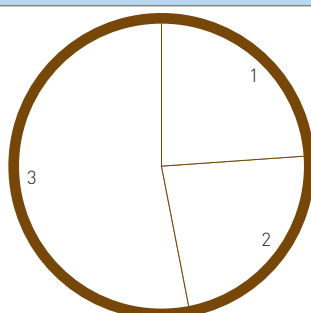


#### Competitors

Competitors for aerospace tubing include specialty segments of Parker-Hannifin and Eaton businesses as well as vertically integrated capacity from key customers. Heat Solutions competes with US suppliers such as Emerson, Watlow and Chromalox; however as our business grows in Asia we will face competition from Chinese manufacturers. Flex-Tek construction products compete with US manufacturers Hitachi, Atco, Omega-Flex, Hart & Cooley and Goodman. Flexible Solutions competes globally with small, privately owned businesses which manufacture specialty hoses.

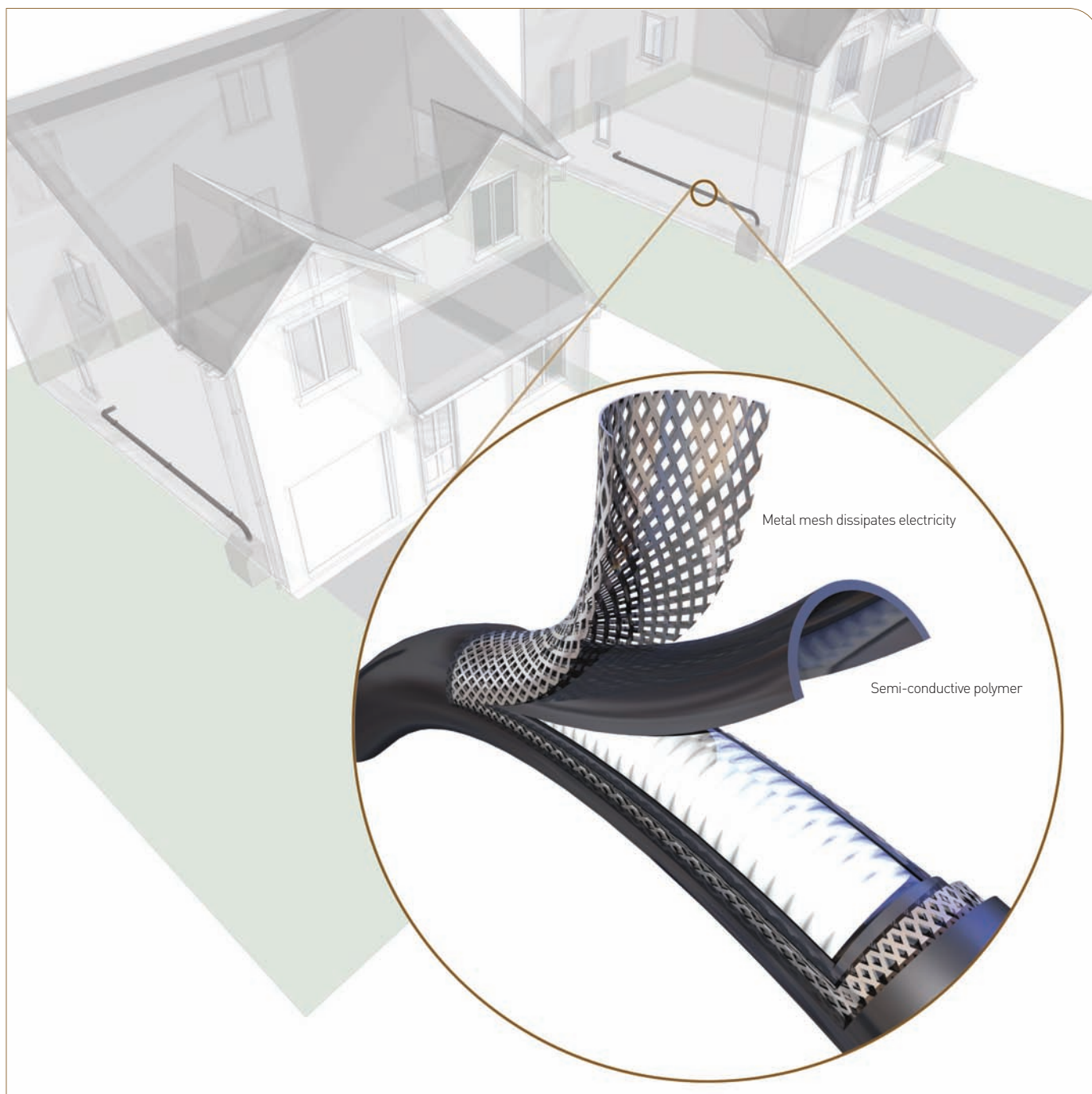
#### Sales by sector: £212m

- 1 Smiths Tubular Systems Aerospace 24%
- 2 Flexible Solutions 23%
- 3 Heat Solutions 53%



#### 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.



### Shielding homes from lightning

Flex-Tek has launched a new, multi-layered version of its flexible gas piping to minimise the risk of household damage from lightning. FlashShield™ is a greatly enhanced form of Corrugated Stainless Steel Tubing which uses a unique layer of metal mesh between jackets of semi-conductive polymer to help dissipate the heat and electricity generated by a lightning strike. Independent testing has shown it provides 10 times the protection of standard flexible gas piping. FlashShield™ also eliminates the need for additional bonding.



# Business review

continued

## Flex-Tek

continued

### Markets and trends

Flex-Tek designs and manufactures engineered components which heat and move fluids and gases for aerospace, consumer products and construction applications. The diverse nature of these applications reduces Flex-Tek reliance on any specific technology, although Flex-Tek is highly leveraged to the US economy.

### Technology

Flex-Tek comprises three technology areas:

#### Aerospace Tubular Systems

Meeting the aircraft industry's need for rigid and flexible hydraulic and fuel hose, Flex-Tek's aerospace tubing business delivers high-performance airframe fluid management systems around the globe. Our customers utilise our specialised high-performance tubing in the civil and military aerospace industry for aircraft and engine applications. Demand for these products is linked to the worldwide air transport market and military spending.

#### Heat Solutions

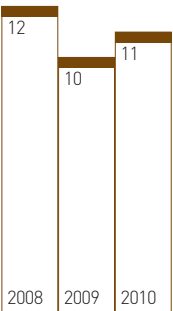
Our specialised heating elements and thermal systems serve customers that manufacture tumble dryers, HVAC equipment, medical applications, and bespoke applications. Revenue is largely dictated by household appliance demand in the US.

Flex-Tek construction related products: HVAC ducting and gas delivery tubing, are supplied to the North American construction industry via distributors. Demand is a mix of the strength of the US construction industry and replacement sales.

#### Flexible Solutions

Flexible Solutions hose assemblies can be found in a wide range of applications including: medical respiratory care, floorcare appliances, natural gas vehicles, leaf collection, and gasoline vapour recovery. The business performance generally follows macroeconomic indicators such as US GDP and capital goods expenditures.

### Headline operating profit margin %



Organic sales growth  
target range

0-7%

Headline operating margin  
target range

11-16%

Overview

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Courtesy of Chesapeake Energy

### Successful conversions

Flex-Tek has partnered with Clean Energy in the US to service the growing market for converting petrol vehicles to run on natural gas, a more environmentally friendly fuel. The converted vehicles, increasingly popular because of their low emissions, need the kind of specialised fuel hose assembly that Flex-Tek has excelled in designing over decades of supplying the aerospace and automotive industries, including Formula One. Clean Energy, the largest provider of natural gas for transportation in North America, recently won a contract to convert almost 2,000 AT&T service vans using Flex-Tek hoses. Aside from supplying fleet conversions, Flex-Tek is also developing a unique delivery hose to be used at pumps as the network of fuelling stations spreads, particularly in metropolitan areas like Los Angeles.

# Business review

## continued

### Flex-Tek

continued

### Performance

|                            | 2010<br>£m   | 2009<br>£m | Reported<br>growth | Underlying<br>growth |
|----------------------------|--------------|------------|--------------------|----------------------|
| Sales                      | <b>212</b>   | 222        | (5)%               | (6)%                 |
| Headline operating profit  | <b>24</b>    | 22         | 7%                 | 6%                   |
| Headline operating margin  | <b>11.1%</b> | 9.9%       |                    |                      |
| Statutory operating profit | <b>21</b>    | 18         |                    |                      |
| Return on capital employed | <b>18.4%</b> | 16.7%      |                    |                      |

Flex-Tek's reported sales declined 5%, or £10m, because of a £12m (6%) drop in underlying sales which was offset by £2m from currency translation. This decline primarily reflects a downturn in sales of components to the OEM aerospace market. Sales to the US residential construction and domestic appliance markets began the year with declining sales but began to show an improving trend during the second half. As a result, overall sales grew in the second half by 3% on an underlying basis driven by improving sales from the Flexible Solution and Heat Solutions groups.

Headline operating profit margins increased by 120 basis points to 11.1% as a result of the further progress in cutting costs and site rationalisation. The underlying increase in operating profit of £2m was caused by the net effect of lower volumes (£4m) offset by cost saving benefits (£6m) driven by lower costs in materials, freight and overheads as well as some improvement in targeted pricing.

Sales of components to aerospace customers began to decline at the beginning of the period with a weakness primarily in the market for regional aircraft and business jets. Although sales were down 16%, margins declined only slightly with the lower volumes being partially offset by production efficiency gains and cost cutting.

Heat Solutions underlying sales fell 3%, mainly due to declines in sales of gas piping and HVAC ducting in the US construction market during the first six months. Sales grew in the second half, reflecting an improvement in underlying housing starts which began to show some growth from November 2009. This improvement was supported by the Homebuyer Tax Credit Program, particularly as builders increased housing inventories to support demand ahead of the expiry of the tax credit at the end of April 2010. The improving trend stabilised during the summer following withdrawal of the tax credit. Sales of heating elements to appliance manufacturers were slightly down. Against this challenging trading environment, Heat Solutions sales fell at a lower rate than the market, pointing to an increase in market share. In addition, a sharper focus on low-cost manufacturing and combined product marketing programmes has helped preserve margins. We have recently launched a new product for the US construction market – FlashShield™ – which offers leading-edge lightning protection for corrugated stainless steel tubing used in residential gas piping.

Underlying sales of flexible hose assemblies from the Flexible Solutions division were flat. This reflects weak demand in the US floorcare and general industrial markets in the first half which was offset by growth in the second half. In addition, we saw success with new product introductions to the natural gas vehicle market in the US.

Flex-Tek has continued 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. In the year, we delivered a further £3m of savings which bring the cumulative annualised savings to £8m. Flex-Tek remains on plan to achieve the rationalisation of two facilities in Massachusetts.

### Sales

£212m

### Headline operating profit

£24m



### Fibre optics open new market

Flex-Tek's long expertise in designing flexible steel tubing for household gas supply has won it an unexpected new market. Instead of keeping gas in, its newly developed harsh environment conduit is designed to keep damaging hydrogen gas out of fibre optic cables. Based on Flex-Tek's corrugated, semi-rigid stainless steel tubing, the conduit hermetically seals the cable from naturally occurring hydrogen commonly found in regions rich in fossil fuels. The gas can penetrate conventional plastic pipes and, through a chemical reaction, cause darkening of the fibres and loss of signal capacity. Flex-Tek's tubing minimises the risks of potentially costly repairs and communication interruptions, an acute problem for oil and gas companies which use fibre optics for distributed temperature sensing.

### Outlook

The outlook for the US residential construction, household appliance and industrial markets is still uncertain, with a mixed flow of economic and housing data from the US. The aerospace sector is likely to remain challenging. Flex-Tek will benefit from the savings generated through site rationalisation and cost cutting programmes, which will help preserve margins. Flex-Tek is strongly leveraged to a recovery in US housing.

# Financial review

Sales +4%

£2,770m

Headline operating profit margin

17.8%

## Earnings per share

Basic headline earnings per share from continuing activities were 84.6p (2009: 72.4p), a growth of 17%. This reflects an increased headline operating profit partially offset by higher interest costs on the refinanced debt and a lower pensions financing credit.

On a statutory basis, the basic earnings per share from continuing activities were 75.3p (2009: 70.8p).

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

These items amounted to a charge of £62m compared to last year when they had no net impact. They comprised:

- Amortisation of intangible assets acquired in business combinations of £42m (2009: £35m). The amortisation relates principally to technology and customer relationships;
- A charge of £25m (2009: £22m) in connection with John Crane, Inc. asbestos litigation;
- A charge of £8m (2009: £24m) in respect of restructuring. This is part of a programme which is expected to cost approximately £45m by the end of 2011;
- Profit on disposal of businesses and property of £9m (2009: £15m);
- Gains of £4m arising from the closure of the principal UK defined benefit pension schemes. In 2009, there was a gain of £70m arising from changes to the US pension and post-retirement healthcare plans;
- Acquisition costs of £1m. These costs are now charged to profit following the implementation of IFRS3 (Revised); and
- Financing gains of £1m (2009: £4m loss). These represent exchange movements on derivatives and other financing instruments not hedge accounted under IFRS.

## Cash generation and net debt

Strong cash generation in the period resulted in a free cash-flow of £331m (2009: £256m) based on cash-flow after interest and tax but before acquisitions, financing activities and dividends. Substantially improved headline operating cash of £565m (2009: £435m) represented 115% (2009: 104%) of headline operating profit. The improvement was a result of reduced investment in working capital, particularly inventories, and lower net capital expenditure.

On a statutory basis, net cash inflow from continuing operations was £410m (2009: £332m).

Dividends paid in the year on ordinary shares amounted to £133m, compared with £132m in 2009.

Net debt at 31 July 2010 was £837m, down from £885m at 31 July 2009. The decrease in net debt reflects strong cash generation despite outflows of £133m for dividends and £133m for acquisitions.

## Interest and other financing costs

Interest payable on debt, net of interest earned on cash deposits, was £62m compared with £52m in 2009. This increase reflects the higher cost of refinancing long-term debt. Interest costs were covered 8 times 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 £2m in 2010 (2009: £5m credit).

## 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 £106m in R&D on continuing operations, equivalent to 3.9% of sales. Of that total, £93m was funded by the Company compared with £90m in 2009, an increase of 5%. We actively seek funding from customers to support R&D and this amounted to £13m (2009: £15m). Under IFRS, certain of these development costs are capitalised, and this amounted to £24m in the year (2009: £23m). 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.

## Taxation

The headline tax charge of £104m for 2010 represented an effective rate of 24% on the headline profit before taxation – unchanged from last year. On a statutory basis, the tax charge on continuing activities was £79m (2009: £95m).

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. However, our increased profitability, particularly in profits derived from the US where there are higher rates of corporation tax, will cause the headline tax rate to increase over time with a rate of between 26-27% expected in the year ending 31 July 2011.

The fundamental principles of the Group's approach to taxation remain unchanged. The Group 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 capital employed

The return on capital employed (ROCE) is the percentage that headline operating profit comprises of monthly average capital employed. Capital employed comprises total equity adjusted for goodwill recognised directly in reserves, net post-retirement benefit assets and liabilities and net debt (see note 1 to the accounts).

The ROCE was 16.6% (2009: 14.7%). The comparative ROCE has been adjusted from that reported previously to reflect a revised method of calculating capital employed.

## 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 2010 and evaluating liabilities at period-end AA corporate bond interest rates.

We have taken action to reduce the Company's liabilities in respect of retirement benefits. From 31 October 2009, the UK-defined benefit pension schemes were closed to future accrual. 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.

The retirement benefit position was:

|                              | 31 July<br>2010 | 30 January<br>2010 | 31 July<br>2009 |
|------------------------------|-----------------|--------------------|-----------------|
| Funded plans                 |                 |                    |                 |
| UK plans – funding status    | <b>98%</b>      | 98%                | 95%             |
| US plans – funding status    | <b>71%</b>      | 73%                | 72%             |
| Other plans – funding status | <b>69%</b>      | 76%                | 75%             |

|                           | 31 July<br>2010<br>£m | 30 January<br>2010<br>£m | 31 July<br>2009<br>£m |
|---------------------------|-----------------------|--------------------------|-----------------------|
| Surplus/(deficit)         |                       |                          |                       |
| Funded plans              | <b>(216)</b>          | (208)                    | (254)                 |
| Unfunded plans            | <b>(89)</b>           | (86)                     | (85)                  |
| Total surplus/(liability) | <b>(305)</b>          | (294)                    | (339)                 |

In July, we reached 10-year funding agreements with the Trustees of the two major UK pension schemes. The funding agreements are structured to provide certainty to the Trustees while maximising flexibility for the Company. Full details of the retirement benefits and funding agreements are shown in note 10 to the accounts.

## 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.

|                 | 31 July<br>2010 | 31 July<br>2009 |                        | 30 January<br>2010 |
|-----------------|-----------------|-----------------|------------------------|--------------------|
| Average rates:  |                 |                 |                        |                    |
| US dollar       | <b>1.57</b>     | 1.58            | Dollar strengthened 1% | 1.63               |
| Euro            | <b>1.14</b>     | 1.16            | Euro strengthened 2%   | 1.12               |
| Year-end rates: |                 |                 |                        |                    |
| US dollar       | <b>1.57</b>     | 1.67            | Dollar strengthened 6% | 1.60               |
| Euro            | <b>1.20</b>     | 1.17            | Euro weakened 3%       | 1.15               |

## 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 (Revised) 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 2010.

## 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 89 to 94.

## 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 89.

# 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 Board 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 July 2010 were maintained at BBB+ / Baa2 (both negative outlook) from Standard & Poor's and Moody's respectively, the same ratings as 2009. An essential element of an investment grade rating is robust cash-flow metrics. The Group's objective is to maintain a headline operating cash conversion of greater than 80% and to maintain net debt/headline EBITDA of less than two times. At 31 July 2010, these measures were 115% (2009: 104%) and 1.4 times (2009: 1.8 times) respectively.

#### 2. Debt and interest rate management

The Group's debt funding requirements are managed centrally. At 31 July 2010 net debt was £837m (2009: £885m). In 2010, the Group raised new long-term Euro capital markets financing to further its debt strategy via €300m of 4.125% senior notes due 2017. These funds were used to refinance the 7.875% sterling bonds due in 2010 and for general corporate purposes. 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 over 60% of net debt is at fixed rate of interest. At the 31 July 2010, these measures were 0% (2009: 8%); 6.0 years (2009: 5.4 years) and 92% (2009: 79%).

#### 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 2010 the facility was completely un-drawn (2009: £623m undrawn). 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 2010, this measure was £660m (2009: £595m) respectively.

The Group aims to ensure that, where surplus cash resources exist, the funds are securely placed on deposit 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 2010, 69% (2009: 83%) of group liquid resources were on deposit with the 11 global relationship banks and only £5m (2009: £5m) was held 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 the same currency liability. At 31 July 2010, 51% (2009: 51%) of total 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 67 to 71.

#### 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 major 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 184,000 claims against JCI have been dismissed before trial over the last 30 years. JCI is currently a defendant in cases involving approximately 116,000 claims. Despite these large numbers of claims, JCI has had final judgments against it in only 100 cases, and has had to pay awards amounting to approximately US \$95m over the 31-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 2010, the aggregate provision for JCI asbestos litigation, including for adverse judgments and defence costs, amounted to £176m expressed at the then current exchange rate. 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.

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.

Some of the risks to which Smiths is exposed arise from the specific nature of the businesses in which it is engaged; others are common to many international manufacturing companies.

### Risks specific to the nature of Smiths Group businesses

#### 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.

## Global political and economic conditions

Smiths operates in over 50 countries, and is affected by global economic conditions, particularly in the US. Smiths business is affected by government spending priorities, in particular in the US and UK, 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.

## 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.

## 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.

If integration is unsuccessful, or anticipated benefits are not realised, or trading by acquired businesses fall behind expectations such that the net present value of expected cash-flows from acquisitions is lower than the carrying value of the related goodwill and acquired intangible assets, it may be necessary to impair the carrying value of these assets.

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 not novated to the purchasers of these businesses.

## 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.

## 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.

## 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 51.

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.

# Risks and uncertainties

## continued

### Other risks common in international manufacturing companies

#### 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.

#### 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.

#### 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 2010 Smiths effective tax rate on headline profits was 24%, our increased profitability, particularly those derived from the US where there are higher rates of corporation tax, will cause the headline tax rate to increase over time. Changes in the tax and fiscal regulations in the countries in which the Group operates could have an adverse impact on the Group, particularly at times when public sector debt is high, as could the uncertainty surrounding the outlook for the basis of taxation of foreign profits under the UK's controlled foreign companies' regime.

#### 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.

### The 12 principles of the Code of Business Ethics:

|    |                                                                  |
|----|------------------------------------------------------------------|
| 1  | We comply with the law                                           |
| 2  | We compete fairly                                                |
| 3  | We act with integrity in all our business dealings               |
| 4  | We treat 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                                    |

# Corporate responsibility

## continued

The Smiths Code of Business Ethics ('Code') 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](http://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 and is supported by the Senior Vice President and General Counsel – Ethics & Compliance. The Council meets quarterly to determine priorities and review key issues. Council members take the lead in co-ordinating resources in their divisions or corporate functions. The Senior Vice President and General Counsel – Ethics & Compliance 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.

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 freephone numbers in approximately 40 countries where Smiths has businesses, staffed by individuals who speak the local language.

The Senior Vice President and General Counsel – Ethics and Compliance serves as an adviser and resources on all Ethics issues. He manages the responses to all inquiries and allegations assisted by the Ethics and Compliance Manager.

Compliance support to Smiths' businesses comes from legal counsel who provide advice, export control policies, education, training, guidance materials and risk assessment tools.

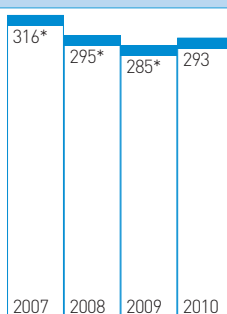
Some specific issues are managed by other functions within Smiths Group, depending on the nature of the issue and how it can most effectively be managed:

- 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.

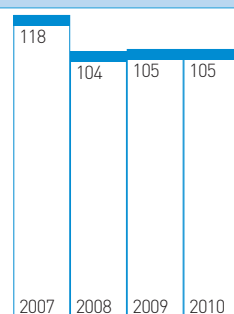
\*Total has been adjusted from the 2009 Corporate responsibility report to reflect data audits

All years normalised using FY 2010 turnover

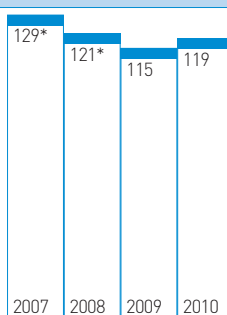
### Total energy '000 MWh



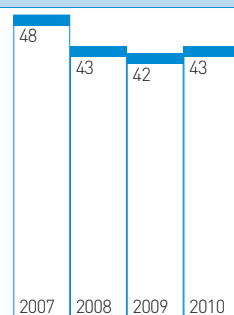
### Total energy efficiency MWh/£m turnover



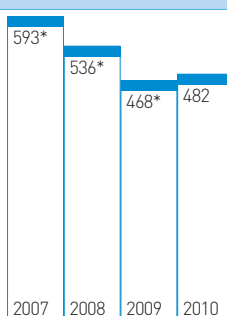
### CO<sub>2</sub> emissions '000 Tonnes



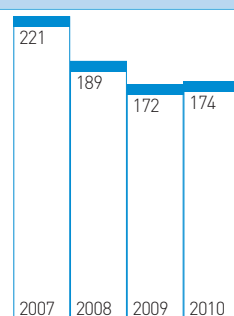
### CO<sub>2</sub> emissions Tonnes/£m turnover



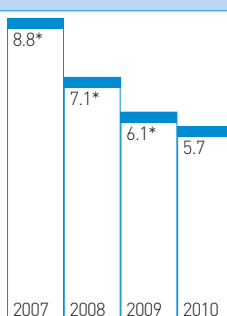
### Water use '000m<sup>3</sup>



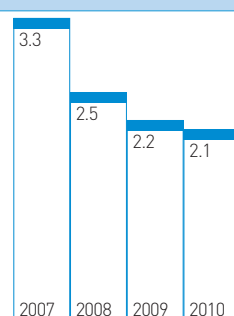
### Water consumption m³/£m turnover



### Total non-recycled waste '000 Tonnes



### Total non-recycled waste Tonnes/£m turnover



# Corporate responsibility

## continued

### 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 OHSAS 18001 by July 2010 at its manufacturing facilities with more than 50 employees. We achieved our goal with certification of 77 facilities, providing an externally verified framework for risk reduction, continual improvement, compliance assurance and management review.

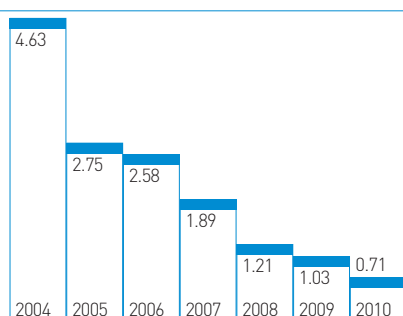
The success of OHSAS 18001, together with other targeted initiatives is measured against recordable incident rate (RIR) performance (based on the US OSHA standard). In 2007, we established a RIR goal of 1.5 recordable incidents per 100 employees per year to be achieved by mid-2010. We have significantly outperformed this goal, achieving a RIR of 0.71 in 2010, a 62% reduction over our baseline 2007 performance of 1.89 RIR. Since 2004, we have achieved a steady reduction in our RIR with 2010 being our safest on record. As part of our goal to continuously improve safety in the workplace, we have recently set challenging new three-year RIR targets.

### Performance against targets

| Target (August 2007 – July 2010)                                                                       | 2010 Result                   |
|--------------------------------------------------------------------------------------------------------|-------------------------------|
| <b>OHSAS18001 certification</b><br>Certification at all sites with more than 50 employees by July 2010 | <b>77 out of 77 certified</b> |
| <b>Recordable incident rate</b><br>Better than 1.5 per 100 employees                                   | <b>0.71</b>                   |
| <b>Lost time incident rate</b><br>No target set                                                        | <b>0.30</b>                   |

### Recordable Incident Rate

Where an employee requires medical attention beyond first aid (per 100 employees per year)



### 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.

All Smiths manufacturing facilities with more than 50 employees are required to achieve certification to the international environmental management system standard ISO 14001. New acquisitions and sites that grow above this threshold have two years to comply. Currently, we have 76 manufacturing facilities certified.

In 2007, Smiths set three-year targets to reduce water consumption by 9%, waste generation by 9% (both normalised against sales) and to cap greenhouse gas emissions at FY2007 levels (absolute). Our focus on environmental performance improvement resulted in beating our goals as shown below. However, during FY2010, we experienced an increase in energy consumption, CO2 emissions and water use. When these environmental metrics are normalised to turnover, they have lower increases than the absolute values, indicating that parts of the increases are associated with increased output. Increases were also associated with the addition of new businesses that began reporting in FY2010, and the acts of relocating and consolidating operations. Though we work to minimise environmental impacts caused during our operational changes, opportunities to reduce still exist, on which we will continue to focus. In addition, our newly acquired businesses will implement actions to reduce their environmental footprint.

We recently set new five-year improvement targets for our environmental metrics and added energy, all of which supports our efforts to reduce costs and our impact on the environment. Our new targets include 10% reductions in energy usage and greenhouse gas emissions and a 5% reduction in water usage by FY2015, all normalised to turnover.

### Performance against targets

| Target (August 2007 – July 2010)                                                             | 2010 Result          |
|----------------------------------------------------------------------------------------------|----------------------|
| <b>Greenhouse gas emissions</b><br>No absolute increase over the 2007 baseline               | <b>8% reduction</b>  |
| <b>Total non-recycled waste</b><br>9% reduction over three years normalised against turnover | <b>38% reduction</b> |
| <b>Water consumption</b><br>9% reduction over three years normalised against turnover        | <b>21% reduction</b> |

Smiths Group is committed to the efficient use of energy and natural resources and the reduction of greenhouse gases, thereby minimising our environmental impact worldwide, adding value to our business and enabling us to fulfil our corporate responsibilities. In support of this commitment, in 2010 we established a new policy to specifically address our energy and greenhouse gas impacts.

## 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 periodically 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.

Horizons is a two-year programme for employees who will be or have been recently appointed managers. 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.

### 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 together with the Royal Academy of Engineering in the UK, the Smiths Technology Education Programme is now in its fourth 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 London 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 2010 Corporate Responsibility Report at [www.smiths.com/cr10](http://www.smiths.com/cr10).

### Controls on defence sales

All sales of defence equipment are undertaken in accordance with government export and approval procedures and regulations, such as the International Traffic in Arms Regulation and the Export Administration Regulations in the USA. These laws prohibit export of certain items to specific countries. 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

Smiths continues to be awarded membership of the FTSE4Good Index which recognises companies that meet globally recognised corporate responsibility standards. Whilst we are not complacent about the ongoing work required, we were pleased to receive this external recognition of our corporate responsibility initiatives and business ethics programme.

# Board of directors



## 1 Donald Brydon, CBE

### Chairman \*\*

Aged 65. British. Donald Brydon was appointed to the Board in April 2004, becoming Chairman in September 2004. He is Chairman 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 the London Metal Exchange and 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 57. 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 Peter Turner

### Finance Director

Aged 40. British. Peter Turner was appointed an executive director of the Board in April 2010 and, after a brief handover period, become Finance Director in June 2010. He was Finance Director of Venture Production plc from 2007 until its acquisition by Centrica plc in 2009. He spent the previous 11 years at the BOC Group plc where he held a number of senior finance posts including Director of Taxation and Treasury, and Finance Director of the group's largest division. He qualified as a Chartered Accountant whilst working for PricewaterhouseCoopers.

## 4 David Challen, CBE

### Non-executive director \*\*\*

Aged 67. 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.

Senior Independent Director

## 5 Stuart Chambers

### Non-executive director \*\*\*

Aged 54. 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 September 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. He is a non-executive director of Tesco plc and of Manchester Airport Group plc.

Chairman of the Remuneration Committee.

## 6 Anne Quinn, CBE

### Non-executive director \*\*\*

Aged 59. 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.

## 7 Sir Kevin Tebbit, KCB, CMG

### Non-executive director \*\*\*

Aged 63. 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 Chairman of the Defence Advisory Group to the UKTI Defence and Security Organisation. He is also Visiting Professor at Queen Mary, University of London.

## 8 Bruno Angelici

### Non-executive Director \*\*\*

Aged 63. French. Bruno Angelici was appointed to the Board as a non-executive director in July 2010. He pursued a 20-year career with AstraZeneca plc before retiring in 2009 as Executive Vice President, International, after holding responsibility for its national operations in France and then in Japan. Prior to this he held a number of senior management roles during a decade at Baxter. He currently sits on the Supervisory Board of Wolters Kluwer, a Dutch-based information services and publishing company, and is Chairman of the Supervisory Board of Reims Management School.

## 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 2010, 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, medical, rail, test and industrial 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 11 to 59 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 2010; 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 2010 are set out in the Consolidated income statement. Sales for the year amounted to £2,770m (2009: £2,665m). The profit for the year after taxation amounted to £310.6m (2009: £270.0m).

An interim dividend of 10.5p per ordinary share of 37.5p was paid on 23 April 2010. The directors recommend for payment on 19 November 2010 a final cash dividend of 23.5p per ordinary share of 37.5p, making a total dividend of 34.0p for the financial year.

The retained profit of £310.6m was transferred to Reserves.

## Changes in the Company and its interests during the financial year

On 19 October 2009 the Company acquired the business and assets of Channel Microwave for US\$6.0m in cash.

On 17 November 2009 the Company adopted new Articles of Association.

On 6 April 2010 the Company acquired all the issued share capital of Interconnect Devices, Inc. for US\$187.9m in cash.

On 5 May 2010 the Company closed a euro-denominated bond offering totalling €300 million in Senior Notes. The Notes have a seven year maturity and were priced at a fixed coupon of 4.125%.

On 7 July 2010 the Company announced that it had agreed a 10 year funding plan with both the trustees of the Smiths Industries Pension Scheme and the trustees of the TI Group Pension Scheme.

## 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 £520,000 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; and S.J. Chambers; Ms A.C. Quinn, CBE; and Sir Kevin Tebbit, KCB, CMG, all served throughout the year. Mr P.A. Turner was appointed as an executive director on 19 April 2010 and became Finance Director on 1 June 2010. Mr B.F.J. Angelici was appointed as a non-executive director on 1 July 2010. Mr P.J. Jackson retired as a non-executive director on 17 November 2009 and Mr J. Langston retired as Finance Director on 31 May 2010.

## Reappointment of directors

Mr Angelici and Mr Turner will retire from office at the Annual General Meeting ('AGM') in accordance with Article 49(1). Mr Angelici and Mr Turner are each willing and eligible to stand for election and resolutions will be proposed at the AGM to elect them. Messrs Bowman, Brydon, Challen and Chambers; Ms Quinn; and Sir Kevin Tebbit will all retire voluntarily from office at the AGM and will seek re-election. Separate resolutions to re-elect each of them as a director of the Company will be proposed at the AGM.

## Directors' remuneration report

The Directors' remuneration report is on pages 73 to 81.

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 78 and 79. 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 80 and 81.

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 2010 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 25 September 2010 the Company had been notified, pursuant to the FSA's Disclosure & Transparency Rules, of the following notifiable voting rights in its issued share capital:

|                                              | No. of shares | Percentage of issued ordinary share capital* |
|----------------------------------------------|---------------|----------------------------------------------|
| BlackRock Investment Management (UK) Limited | 38.8m         | 9.9%                                         |
| Legal & General Group plc                    | 15.4m         | 3.9%                                         |
| Massachusetts Financial Services Company     | 19.1m         | 4.9%                                         |
| Newton Investment Management Limited         | 15.2m         | 3.9%                                         |

\*Percentage of ordinary share capital in issue on 25 September 2010.

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 78.

## Corporate governance statement

The Corporate governance statement is on pages 67 to 71 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 83.

## 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 foreign exchange risk, interest rate risk, financial credit risk and liquidity risk is outlined in note 21 of the Group accounts.

## Going concern

The group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Business Review on pages 11 to 59. The financial position of the company, its cash flows, liquidity position and borrowing facilities are described in the Financial Review on pages 48 to 50. In addition, the notes to the accounts include the company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk.

At 31 July 2010 the Group had undrawn committed borrowing facilities of £660m which are due to expire in 2012 (unless otherwise extended or reviewed). Whilst these facilities have certain financial covenants they are not expected to prevent full utilisation of the facilities if required. This, together with the maturity profile of debt, provides confidence that the Group has sufficient financial resources for the foreseeable future. As a consequence, the directors believe that the company is well placed to manage its business despite the current uncertain economic environment which increases risk and uncertainties (see pages 52 to 54).

The directors, having made appropriate enquiries, have a reasonable expectation that the company and the group have adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the annual accounts of the company and the group.

## Policy on payment of creditors

The Company's policy and practice is to pay creditors (including suppliers) promptly in accordance with agreed terms of business. The average time taken to pay an invoice was 31 days (2009: 28) for the parent Company and 36 days (2009: 31) for the Group as a whole.

## Share capital and control

As at 31 July 2010, the Company's issued share capital was £146,523,016.125 and comprised 390,728,043 ordinary shares of 37.5p each nominal value (ordinary shares). 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.

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. There are no arrangements of which the directors are aware 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 2010 the trust held 32,858 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 63 sets out the notifications received by the Company pursuant to the FSA's Disclosure & Transparency Rules, as at 25 September 2010, from persons with significant direct or indirect holdings in the Company's share capital.

# Group directors' report

## continued

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 17 November 2009. These 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 came into force on 1 October 2009 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 Article 5. 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 may cause options and awards to vest on a change in control, subject to the satisfaction of performance conditions at that time. 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 78, 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, subject to the satisfaction of performance conditions at that time.

### Purchase of shares

No shares were purchased by the Company during the financial year ended 31 July 2010.

### 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, employee and health and safety matters, including key performance indicators, is contained in the Corporate responsibility summary in the business review on pages 55 to 59. The full Corporate responsibility report is available online at [www.smiths.com/cr10](http://www.smiths.com/cr10).

### Annual General Meeting

The 2010 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 16 November 2010 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, 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 £48,883,565, which is equivalent to approximately one third of the total issued ordinary share capital of the Company as at 25 September 2010.

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 £48,883,565, which is equivalent to approximately one third of the total issued ordinary share capital of the Company as at 25 September 2010. This is in line with corporate governance guidelines.

At 25 September 2010, 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 2012 and the end of the AGM due to be held in 2011.

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 £7,332,534, equivalent to 5% of the total issued ordinary share capital of the Company as at 25 September 2010, in each case without the shares first being offered to existing shareholders in proportion to their existing holdings.

The purpose of 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 2010, the following ordinary shares in the Company were issued:

- 1,701,616 ordinary shares of 37.5p pursuant to the terms of the Company's shareholder-approved share option schemes and share plans.

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 39,106,852 ordinary shares, until the AGM in 2011 or 31 January 2012 whichever is the earlier. This represents 10% of the ordinary shares in issue as at 25 September 2010 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 25 September 2010 there were 5.4m outstanding options granted under all share option schemes operated by the Company, which, if exercised would represent 1.4% of the issued ordinary share capital of the Company. If this authority were exercised in full, that percentage would increase to 1.5%.

### 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 (as defined in the 2006 Act) and to incur political expenditure (as defined in the 2006 Act) 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.

### Notice period for extraordinary general meetings

A special resolution will be proposed at the AGM to renew the authority, granted by the shareholders at the last AGM to the Company, to call a general meeting of the Company other than an AGM with a minimum notice period of 14 clear days. Changes made to the 2006 Act by the Shareholders' Rights Regulations increased 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. Any exercise of this power by the Company will be conducted in accordance with any relevant corporate governance guidelines applicable at the time. In particular, the shorter notice period will only be used where flexibility is merited by the business of the meeting and is thought to be to the advantage of shareholders as a whole. The approval will be effective until the Company's next AGM, when it is intended that a similar resolution will be proposed.

The Company will comply with the requirement to provide appropriate facilities for all shareholders to vote by electronic means at general meetings held on less than 21 clear days' notice.

# Group directors' report

## continued

### 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.

### Proposed long-term incentive arrangements for 2010/11

In the 2008/09 Directors' Remuneration Report the Company explained its intention to consider potential long-term incentives for participants in the Value Sharing Plan (VSP) during 2010. Following a review by the Remuneration Committee, the Company believes that the broad structure of the VSP remains appropriate going forward. As a result, it is proposed that awards be made under a new VSP, to be known as the Smiths Group 2010 Value Sharing Plan, as follows:

- Annual grants vesting after three years
- Individual VSP opportunities reduced by approximately two-thirds to reflect the proposed frequency of grants and following an assessment of the market competitiveness of the fair value of the total package
- For the Group VSP, awards granted in 2010/11 to comprise an Earnings Element and a TSR Element.

Approval for this new VSP will be sought at the Annual General Meeting on 16 November 2010. Further details on the new VSP can be found in the notes accompanying the Notice of AGM.

### Electronic communications at [www.smiths.com](http://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 2010 and the Notice of AGM will be posted on the Company's website, [www.smiths.com](http://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](http://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](http://www.shareview.co.uk).

### 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](http://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 16 November 2010 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](http://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

28 September 2010

# Corporate governance statement

Throughout the period 1 August 2009 to 31 July 2010 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](http://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 (slightly amended from last year) would be used to judge its success:

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

It involves ensuring that an effective internal framework of systems and controls is put in place which clearly defines authority and accountability and that promotes success whilst permitting the management of risk to appropriate levels. It involves the exercise of judgement as to the definitions of success, the appropriateness of risk and the levels of delegation to the executive. The exercise of this judgement is the responsibility of the Board and involves consideration of processes and assumptions 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 team is required to provide such information to the Board as the Board 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 the assessment of 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.

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 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 and finding this balance between individuality and team behaviour is driving more and more Boards to have fewer and fewer executive directors. In our circumstances as a holding company for a number of businesses, the reduced Board size works effectively and an appropriate balance is struck.

Notwithstanding the tensions created by many external expectations which may be wholly or in part unrealistic, a successful Board should, ideally, be composed of a group of respected, experienced, like-minded but diverse people who coalesce around a common purpose of promoting the overall success of the Company, provide a unified vision of the definitions of success and appropriate risk, endeavour to support management (i.e. those who honestly criticise at times but encourage all the time) and who create confidence in all stakeholders in the integrity of the business.

A Board meeting 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: challenge, 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. Board 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, on 1 August 2009, Ms A.C. Quinn was appointed as an independent non-executive director of the Company; on 19 April 2010, Mr P.A. Turner was appointed as an executive director; and on 1 July 2010, Mr B.F.J. Angelici was appointed as an independent non-executive director. On 17 November 2009 Mr P.J. Jackson retired as a non-executive director and, on 31 May 2010, Mr J. Langston retired as an executive director.

As at 25 September 2010, the Board comprises Mr Brydon (Chairman), Mr Bowman (Chief Executive), Mr Turner (Finance Director) and five independent non-executive directors. Mr Challen is the senior independent director. Biographies of these directors, giving details of their experience and other main commitments, are set out on page 61. 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 or divestment of significant companies or businesses, 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 pages 55 and 56.

The Chairman meets the non-executive directors without the executive directors present at least twice 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 2010 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. For example, in September 2009, the Chairman and Ms Quinn visited several of the Company's manufacturing facilities in the US. As part of her induction process, Ms Quinn also visited a number of manufacturing sites in the UK. In January 2010 the Board visited the Smiths Medical facility in Latina, Italy and in May 2010 the Board visited the Smiths Detection facility in Wiesbaden, Germany. 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                             | 6                  | 6        | –                  | –        | 4                      | 4        | 3                    | 3        |
| P. Bowman                               | 6                  | 6        | –                  | –        | –                      | –        | –                    | –        |
| P.A. Turner (appointed 19 April 2010)   | 2                  | 2        | –                  | –        | –                      | –        | –                    | –        |
| B.F.J. Angelici (appointed 1 July 2010) | 1                  | 1        | 1                  | 0        | 1                      | 1        | 1                    | 1        |
| D.J. Challen                            | 6                  | 5        | 3                  | 3        | 4                      | 3        | 3                    | 3        |
| S.J. Chambers                           | 6                  | 5        | 3                  | 2        | 4                      | 4        | 3                    | 3        |
| Ms A.C. Quinn                           | 6                  | 6        | 3                  | 3        | 4                      | 4        | 3                    | 3        |
| K.R. Tebbit                             | 6                  | 6        | 3                  | 3        | 4                      | 4        | 3                    | 3        |
| P.J. Jackson (retired 17 November 2009) | 2                  | 2        | 1                  | 1        | 1                      | 1        | 1                    | 1        |
| J. Langston (retired 31 May 2010)       | 5                  | 5        | –                  | –        | –                      | –        | –                    | –        |

– indicates not a member of that Committee in 2009/10

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 Directors are 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

Under the Companies Act 2006 (the '2006 Act') a director must avoid a situation where he or she 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. 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 each director. The Board, led by the Chairman, used a detailed questionnaire, completed by each director, as the basis of these evaluations.

The performance evaluation of the Chairman is led by the senior independent director who obtains 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 61. 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

All directors stand for election by the shareholders at the first Annual General Meeting ('AGM') following their appointment. 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, subject now to annual re-election at each AGM, 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 three-year term, subject to annual re-election by shareholders.

## Remuneration

Information regarding the Remuneration Committee is set out on page 71 and the Directors' remuneration report is on pages 73 to 81.

## 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 82.

The 'going concern' statement required by the Code is set out in the Group directors' report on page 63.

### 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, by the Audit Committee, 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 monitoring 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.

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 information provision, 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, legal, risk management and other control issues.

# Corporate governance statement

## continued

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; 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 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 2010 AGM. 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](http://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 2009 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](http://www.smiths.com).

#### Audit Committee

The members of the Committee during the financial year were Mr Challen (Chairman of the Committee), Mr Chambers, Ms Quinn and Sir Kevin Tebbit. On 1 July 2010 Mr Angelici was appointed to the Committee. Mr Jackson left the Committee when he retired as a director of the Company on 17 November 2009.

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.

The annual review of the Committee's terms of reference was conducted in July 2010.

In the year to 31 July 2010, 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 2009/10 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 2009/10 work programme and regular reports on the key issues arising from 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; 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 and the Audit Committee concurs with that view

#### **Remuneration Committee**

Mr Chambers (Chairman of the Committee), Mr Brydon, Mr Challen, Ms Quinn and Sir Kevin Tebbit were members of the Committee throughout the financial year. On 1 July 2010 Mr Angelici was appointed to the Committee. Mr Jackson left the Committee when he retired as a director of the Company on 17 November 2009.

The Committee's responsibilities and terms of reference are described in the Directors' remuneration report on page 73. The Committee reviews its terms of reference and effectiveness annually and recommends to the Board any changes required as a result of such review. The annual review of the Committee's Terms of Reference was conducted in July 2010.

#### **Nomination Committee**

During the financial year the members of the Committee were: Mr Brydon, as Chairman of the Committee, Mr Challen, Mr Chambers, Ms Quinn and Sir Kevin Tebbit. On 1 July 2010 Mr Angelici was appointed to the Committee. Mr Jackson left the Committee when he retired as a director of the Company on 17 November 2009.

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. The annual review of the Committee's terms of reference was conducted in July 2010.

The procedures referred to above were used by the Nomination Committee in recommending the appointments of Mr Turner, as an executive director and finance director-elect on 19 April 2010, and Mr Angelici as a non-executive director on 1 July 2010.

#### **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 & Transparency Rules. The information required to be disclosed by sub-section 2.6 of Rule 7 is shown in the Group directors' report on pages 63 and 64 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, or to its successor, the UK Corporate Governance Code. The financial crisis and its consequences have made clearer than ever that boards of directors, and independent non-executive directors in particular, have a duty to scrutinise and challenge proposals made by executive management, to ensure that the balance of risk and reward has been properly considered in all significant business decisions.

At Smiths 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". The non-executive directors provide constructive challenge, and bring independence and different skills, perspectives and experience to the decision making process. When Peter Jackson retired from the Board in November last year, I was pleased to take on the role of Senior Independent Director. I aim to continue the work, championed by Peter and supported by all the non-executive directors, of providing critical yet constructive engagement with executive management on the key issues affecting the Company.

As set out in the statement from the non-executive directors in last year's Annual Report, a number of structured processes exist throughout the Company to support good governance. All the non-executive directors are members of all the principal Board Committees: Audit, Nomination and Remuneration, which gives each of them insight into a cross-section of important areas, and informs Board discussions\*. Accordingly, when Mr Angelici joined the Board on 1 July 2010, he also joined the three committees with immediate effect. Mr Angelici brings a wealth of international management experience to the Board and the committees, as well as in depth knowledge of the health care industry.

Below Board level the structures and processes described in last year's Annual Report, including the Executive Committee and the Divisional Boards remain in place and continue to work well. The non-executive directors hear directly from the General Managers of each division at least twice a year at Board Meetings and more often when a specific issue relating to a particular division is under review by the Board. Each Divisional General Manager also presents a detailed report to the Audit Committee once a year setting out the principal risks facing his division and the steps in place to manage those risks. Where the Audit Committee or Board has follow up questions, or the non-executive directors require further information of any description, this is provided promptly and time is set aside for further review and discussion at subsequent meetings if required.

A key role for the non-executive directors is the review of the strategy and portfolio management of the Company. At least once a year the Board has an extended meeting at one of the Company's manufacturing facilities. As well as receiving detailed presentations on various aspects of the business, these visits provide the non-executive directors with opportunities for more informal discussions with a cross-section of staff. The Board uses these extended meetings to take an in-depth look at the strategy for the relevant division and the rest of the Company.

The non-executive directors are regularly updated on shareholder views. Following analyst or investor meetings with executive management or the Chairman, detailed briefings are circulated to the Board, including verbatim comments and feedback from those present. The Board discusses issues raised by investors and takes soundings from the Company's external advisors on market perception of the Company and current issues. As the Senior Independent Director, I regard myself as always available to shareholders.

All the non-executive directors are aware of our responsibilities and accountability to shareholders for our part in the leadership of the Company. All the directors will be standing for annual re-election at this year's Annual General Meeting in November, as agreed by the Board in July 2009. This gives shareholders the opportunity, if they so choose, to provide feedback on our individual performance on an annual basis.

Performance evaluation is taken seriously by the non-executive directors and the Board as a whole. Whilst appraisal is an ongoing process throughout the year, a formal Board evaluation is conducted each year. This year the evaluation is based on the responses to a detailed questionnaire, with separate sections on the functioning of the Board and each of the committees and the performance of each director. At my request, as Chairman of the Audit Committee, additional detailed feedback has also been compiled on the Audit Committee, in order to collate views and shape future practice in areas such as the Committee's oversight of risk. As the Senior Independent Director, I am also responsible for the review of the Chairman's performance which utilises the responses to the questionnaire, in addition to feedback from discussion with the other directors, to help shape the Chairman's approach in the current financial year.

The independent non-executive directors are satisfied that the Company's corporate governance controls have been effective throughout the financial year ended 31 July 2010.

**David Challen**  
**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 16 November 2010 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. In doing so, the Committee takes into account pay and employment conditions elsewhere in the Company and 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, to be renamed the UK Corporate Governance Code relating to directors' remuneration throughout the financial year except as is disclosed on page 67.

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

- Annual Incentive Plan performance and payments for the financial year ended 31 July 2009
- Annual Incentive Plan structure and performance targets for the financial year ended 31 July 2010
- remuneration arrangements for the new Finance Director
- follow-on long-term incentive arrangements to the Value Sharing Plan for the financial year ending 31 July 2011
- framework of executive total remuneration
- principles to govern the Annual Incentive Plan for the financial year ending 31 July 2011
- Committee terms of reference
- structure of the directors' remuneration report for the financial year ended 31 July 2010

In 2009/10 the Committee consisted of:

Stuart Chambers (Chairman of the Committee)  
Bruno Angelici (from 1 July 2010)  
Donald Brydon  
David Challen  
Peter Jackson (until 17 November 2009)  
Anne Quinn  
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 was appointed by the Company to advise 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.

It is the Company's policy to take in to account the pay and conditions of employees throughout the Group when determining directors' remuneration. During the year, the committee received a paper from the Group HR Director and noted the pay policy applicable in the Groups main areas of operation in determining that directors' base pay should be frozen for the 2011 financial year.

### 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 2009/10, 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 2009/10 included the Smiths Group Sharesave Scheme, the Smiths Group Co-Investment Plan (CIP) and a continued interest in the Smiths Group Value Sharing Plan (VSP) granted on 28 July 2008. Other than under the CIP, no long-term incentive awards were granted to executive directors in the financial year ended 31 July 2010.

# Directors' remuneration report

## continued

### Elements of remuneration

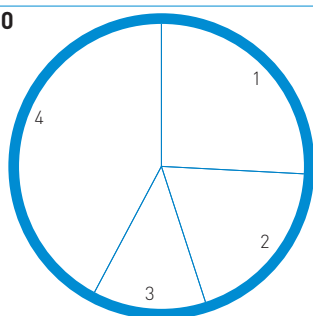
The main elements of remuneration for executive directors in 2009/10 are summarised below:

| Element: 2009/10 policy                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | Objective                                                                                                                                                                                                                                                                                 |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Base salary: frozen at 2007/08 levels (see page 74)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                | <ul style="list-style-type: none"> <li>• Reflect size and nature of the role, individual performance and experience</li> </ul>                                                                                                                                                            |
| Annual bonus: maximum opportunity of 180% of salary for the Chief Executive, 150% of salary for the former Finance Director (J Langston) and 125% for the new Finance Director (P Turner) (see page 75)                                                                                                                                                                                                                                                                                                                                                                                                            | <ul style="list-style-type: none"> <li>• Incentivise short-term operational, financial and personal performance</li> </ul>                                                                                                                                                                |
| 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 75)                                                                                                                                                                                                                                                                                                                                                                                 | <ul style="list-style-type: none"> <li>• Help align short- and long-term remuneration through compulsory deferral of 50% of net earned bonus into Smiths shares</li> <li>• Reward operating efficiency</li> <li>• Support executives in building a shareholding in the Company</li> </ul> |
| Value Sharing Plan (VSP): under the awards made in 2008/09, executives were granted conditional awards of 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. 50% of an award vests on performance over the 3-year period 1 August 2008 – 31 July 2011 and 50% vests on performance over the 4-year period 1 August 2008 – 31 July 2012. No awards were made under this plan in 2009/10 (see page 75) | <ul style="list-style-type: none"> <li>• Incentivise senior executives to drive long-term value creation for shareholders</li> <li>• Reinforce and reward delivery of strategic goals</li> </ul>                                                                                          |
| Pension (see page 76 and 78)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | <ul style="list-style-type: none"> <li>• Provide competitive retirement benefits</li> </ul>                                                                                                                                                                                               |
| Share ownership guidelines: 200% of salary for the Chief Executive and 150% of salary for the Finance Director (see page 76)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | <ul style="list-style-type: none"> <li>• Require executives to build and maintain a significant shareholding in Smiths</li> <li>• Support alignment with shareholder interests</li> </ul>                                                                                                 |

The following charts illustrate the proportions of the 2009/10 remuneration packages comprising fixed (ie base salary) and variable elements of pay, assuming target annual bonus and expected values of long-term incentives. For 2009/10, c.70% of the fair value of executive directors' total remuneration was performance related.

#### Executive Director pay mix, 2009/10 CEO

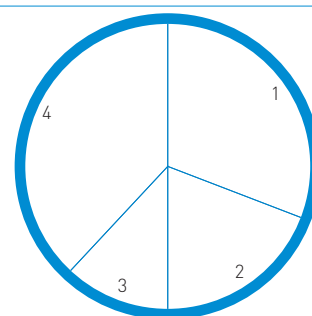
- 1 Base salary 26%
- 2 Annual bonus 19%
- 3 Co-Investment Plan (CIP) 13%
- 4 Value Sharing Plan (VSP) 42%



(based on an annualised fair value of the award granted on 28 July 2008)

#### Former Finance Director J Langston

- 1 Base salary 31%
- 2 Annual bonus 19%
- 3 Co-Investment Plan (CIP) 12%
- 4 Value Sharing Plan (VSP) 38%



Please note: Peter Turner, Mr Langston's successor, did not receive any long-term incentive awards in 2009/10. Details of the mix of his remuneration for 2010/11 will be disclosed in next year's Report

### 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 the Chief Executive, remain frozen at their 2007/08 levels for 2010/11. Executive directors' annual base salaries for 2010/11 are, therefore, at the following levels:

| Executive director                    | Salary last reviewed | 2008/09 salary | 2009/10 salary | 2010/11 salary |
|---------------------------------------|----------------------|----------------|----------------|----------------|
| P. Bowman                             | 10 December 2007     | £800,000       | £800,000       | £800,000       |
| J. Langston (retired 31 May 2010)     | 1 August 2007        | £424,000       | £424,000       | n/a            |
| P.A. Turner (appointed 19 April 2010) | 19 April 2010        | n/a            | £400,000       | £400,000       |

Benefits include a car allowance and health insurance.

Mr Turner received part year medical insurance but does not receive a car allowance.

## 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 former Finance Director (J Langston) was 150% of salary. The maximum annual bonus opportunity for the new Finance Director (P Turner) was 125% 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 2009/10 annual bonus plan and the awards receivable for performance in 2009/10.

### 2009/10 annual bonus outcome as a percentage of salary earned in 2009/10

| Executive director       | Group EPS |        | Cash conversion |        | Personal objectives |        | Total (% of salary) |        |
|--------------------------|-----------|--------|-----------------|--------|---------------------|--------|---------------------|--------|
|                          | Maximum   | Actual | Maximum         | Actual | Maximum             | Actual | Maximum             | Actual |
| P. Bowman                | 90%       | 90%    | 36%             | 36%    | 54%                 | 45.9%  | 180%                | 172%   |
| J. Langston <sup>1</sup> | 75%       | 75%    | 30%             | 30%    | 45%                 | 37%    | 150%                | 142%   |
| P.A. Turner <sup>1</sup> | 62.5%     | 62.5%  | 30%             | 30%    | 32.5%               | 32.5%  | 125%                | 125%   |

1. Annual bonus outcome as a £ amount reflects the part-year served (see emoluments table on page 77)

### Co-Investment Plan (CIP)

Since 2008/09, 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 long-term one-off incentive plans designed to reinforce Smiths strategy of focusing on shareholder value creation at the Group and divisional levels. No grants were made under the VSPs during the financial year ended 31 July 2010.

#### 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. In line with the Plan Rules approved by shareholders in July 2008, the Committee agreed that Mr Langston would retain a reduced interest in the Group VSP but the potential share entitlement under his award will be prorated for time served to the date of his retirement and will vest on the normal vesting dates subject to corporate performance.

#### – 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 (ie 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 implemented 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.

# Directors' remuneration report

## continued

### Proposed long-term incentive arrangements for 2010/11

The Remuneration Committee explained in the 2008/09 Directors' Remuneration Report its intention to consider potential long-term incentives for participants in the VSP during 2010. This was in line with the commitment to shareholders at the time of implementation of the VSP in 2008 that long-term incentive arrangements for participants in the Group or Divisional VSPs would not be reviewed until 2010.

The Committee has reviewed long term incentive arrangements and believes the broad structure of the VSP remains appropriate going forward. As a result, it is proposed that awards be made under a new VSP to be known as Smiths Group 2010 Value Sharing Plan, as follows:

- Annual grants vesting after 3 years
- Individual VSP opportunities reduced by approximately two-thirds to reflect the proposed frequency of grants and following an assessment of the market competitiveness of the fair value of the total package
- For the Group VSP, awards granted in 2010/11 to comprise an Earnings Element and a TSR Element

Approval for this new VSP will be sought at the Annual General Meeting on 16 November 2010. Further details on the VSP can be found in the Notice of AGM.

### Performance Share Plan (PSP)

No awards were made under the PSP to executive directors or other participants in the VSP in 2008/09 or 2009/10 and none will be made to these executives in 2010/11.

Outstanding 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 the outstanding three-year cycle commencing in 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 options to acquire shares 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

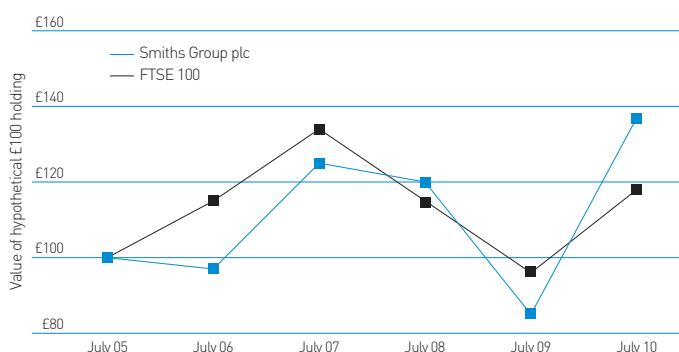
The Company follows the guidelines laid down by the Association of British Insurers. These restrict the issue of new shares under all the Company's share schemes in any 10-year period to 10% of the issued ordinary share capital and under the Company's discretionary schemes to 5% in any 10-year period. As at 31 July 2010, the headroom available under these limits was 5.27% and 1.28%, respectively (excluding the conditional share awards granted under the VSP).

### 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) as approved by the Committee to enable him to make his own pension provision. In the case of Mr Turner, the Company pays a monthly salary supplement (worth 25% of salary per annum) as approved by the Committee to enable him to make his own pension provision. Prior to his retirement, Mr Langston participated in a final salary scheme providing a pension of up to two-thirds of final pensionable salary. Details of the salary supplements, waiver and other pension provisions are set out in the tables on page 77.

### 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 £118 and £137 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:

|                                                                           | 2010<br>£000 | 2009<br>£000 |
|---------------------------------------------------------------------------|--------------|--------------|
| Fees, salaries and benefits, compensation for loss of office              | 1,920        | 1,885        |
| Performance-related bonuses                                               | 2,021        | 839          |
| Aggregate gain from exercise of share options and vesting of share awards | 398          | 866          |
| Payments in lieu of pension contribution                                  | 365          | 336          |
|                                                                           | <b>4,704</b> | <b>3,926</b> |

The emoluments of the directors are set out below:

|                                                | 2009<br>£000 | Fees/salary<br>2010<br>£000 | Compensation<br>for loss<br>of office<br>2010<br>£000 | Benefits<br>2010<br>£000 | Bonus<br>2010<br>£000 | Payments in<br>lieu of pension<br>contribution<br>2010<br>£000 | Total emoluments<br>2010<br>£000 | 2009<br>£000 |
|------------------------------------------------|--------------|-----------------------------|-------------------------------------------------------|--------------------------|-----------------------|----------------------------------------------------------------|----------------------------------|--------------|
| <b>Chairman</b>                                |              |                             |                                                       |                          |                       |                                                                |                                  |              |
| D.H. Brydon                                    | 305          | <b>305</b>                  |                                                       | <b>23</b>                |                       |                                                                | <b>328</b>                       | 328          |
| <b>Chief Executive</b>                         |              |                             |                                                       |                          |                       |                                                                |                                  |              |
| P. Bowman                                      | 800          | <b>800</b>                  |                                                       | <b>36</b>                | <b>1,375</b>          | <b>336</b>                                                     | <b>2,547</b>                     | 1,778        |
| <b>Executive director</b>                      |              |                             |                                                       |                          |                       |                                                                |                                  |              |
| P.A. Turner <sup>1</sup>                       | –            | <b>115</b>                  |                                                       |                          | <b>144</b>            | <b>29</b>                                                      | <b>288</b>                       | –            |
| J. Langston <sup>2</sup> (retired 31 May 2010) | 424          | <b>363</b>                  | –                                                     | <b>7</b>                 | <b>502</b>            | –                                                              | <b>872</b>                       | 693          |
| <b>Non-executive directors</b>                 |              |                             |                                                       |                          |                       |                                                                |                                  |              |
| D.J. Challen                                   | 69           | <b>69</b>                   |                                                       |                          |                       |                                                                | <b>69</b>                        | 69           |
| S.J. Chambers                                  | 69           | <b>69</b>                   |                                                       |                          |                       |                                                                | <b>69</b>                        | 69           |
| P.J. Jackson (retired 17 November 2009)        | 69           | <b>20</b>                   |                                                       |                          |                       |                                                                | <b>20</b>                        | 69           |
| K.R. Tebbit                                    | 54           | <b>54</b>                   |                                                       |                          |                       |                                                                | <b>54</b>                        | 54           |
| A.C. Quinn                                     | –            | <b>54</b>                   |                                                       |                          |                       |                                                                | <b>54</b>                        | –            |
| B.F.J. Angelici (appointed 1 July 2010)        | –            | <b>5</b>                    |                                                       |                          |                       |                                                                | <b>5</b>                         | –            |
|                                                | 1,790        | <b>1,854</b>                | –                                                     | <b>66</b>                | <b>2,021</b>          | <b>365</b>                                                     | <b>4,306</b>                     | 3,060        |

1. Peter Turner's total emoluments for 2010 are for a part year, covering the period from his appointment on 19 April 2010 until the end of the 2010 financial year on 31 July 2010.

2. In common with other UK employees participating in the relevant pension schemes, the salary of John Langston was reduced by £2,318 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.

# Directors' remuneration report

## continued

### Director's pension entitlements

Accrued annual pension under defined benefit schemes

|                                   | Age at<br>31 July 2010 | Accrued<br>entitlement at<br>31 July 2009<br>£000 | Transfer<br>value of<br>accrued<br>benefits at<br>31 July 2010<br>(A)<br>£000 | Transfer<br>value of<br>accrued<br>benefits at<br>31 July 2009<br>(B)<br>£000 | The amount of<br>(A – B) less<br>contributions<br>made by<br>the director<br>in 2010<br>£000 | Accrued<br>entitlement at<br>31 July 2010<br>£000 p.a. |
|-----------------------------------|------------------------|---------------------------------------------------|-------------------------------------------------------------------------------|-------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------|--------------------------------------------------------|
| J. Langston (retired 31 May 2010) | 60                     | 256                                               | 6,257                                                                         | 6,181                                                                         | 76                                                                                           | 265                                                    |

1. See Note 2 on page 77, above. The benefits provided under the relevant pension schemes were not affected by these arrangements.
2. 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.
3. An executive director's normal retirement age is 60. On death or after retirement a spouse's pension of two-thirds (before amounts taken as a Pension Commencement Lump Sum) of the director's pension is payable. All pensions in excess of the Guaranteed Minimum Pension (GMP) are guaranteed to increase 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.
4. On his retirement at 31 May 2010, Mr Langston commuted £16,000 per annum of his pension for a lump sum of £314,000. Since his retirement, Mr Langston has received pension payments of £41,600.
5. Mr Langston's defined benefits accrual ceased on 1 November 2009.

### Directors' interests in the Company's shares

|                                         | Ordinary shares<br>of 37.5p each<br>31 July 2010 | Ordinary shares<br>of 37.5p each<br>1 August 2009 |
|-----------------------------------------|--------------------------------------------------|---------------------------------------------------|
| B.F.J. Angelici (appointed 1 July 2010) | 0                                                | 0*                                                |
| D.H. Brydon                             | 8,000                                            | 8,000                                             |
| P. Bowman                               | 88,776                                           | 70,000                                            |
| D.J. Challen                            | 1,333                                            | 1,333                                             |
| S.J. Chambers                           | 1,333                                            | 1,333                                             |
| A.C. Quinn (appointed 1 August 2009)    | 1,024                                            | 0*                                                |
| K.R. Tebbit                             | 1,000                                            | 0                                                 |
| P.A. Turner (appointed 19 April 2010)   | 0                                                | 0*                                                |
| P.J. Jackson (retired 17 November 2009) | 0†                                               | 0                                                 |
| J. Langston (retired 31 May 2010)       | 279,449†                                         | 247,281                                           |

\*at date of appointment

†at date of retirement

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.

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 25 September 2010.

### 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 Turner

Mr Turner is employed under a service contract which commenced on 19 April 2010. It provides for 6 months notice given by either party for the first 6 months and thereafter a rolling one year notice period given by the Company or six months notice given by Mr Turner. In the event of termination by the Company (other than for cause), the Board is required to consider what sum should be payable as compensation to Mr Turner. In doing so, the Board shall take into account a number of specific matters, including Mr Turner's personal circumstance, the financial performance of Smiths Group, applicable corporate governance best practice, the likelihood of Mr Turner obtaining alternative employment, and various other matters relating to Mr Turner's financial loss. The amount of compensation, as so determined, will not be less than 12 months' basic salary.

## Mr Langston

Mr Langston was employed under a service contract with the Company dated 26 September 2001 until his retirement on 31 May 2010. In accordance with the provisions in this service contract, no compensation was payable to Mr Langston on his retirement. This service contract terminated on 7 November 2009 by reason of Mr Langston having reached his retirement age of 60. Mr Langston continued to provide his services to the company and to hold the office as Finance Director under a new service agreement. This terminated on 31 May 2010. No compensation was paid in respect of the termination of this agreement. The Committee has agreed that Mr Langston's rights under relevant share plans will be preserved and capable of vesting on the normal vesting dates, subject to corporate performance and time prorating. He was also entitled to the continuation of private healthcare for his and his spouse's lifetimes.

## 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 44). 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. 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 | **Expiry of current term | Date of election / last re-election |
|------------------------|---------------------|--------------------------|-------------------------------------|
| B.F.J. Angelici*       | 1 July 2010         | 2013                     | 16 November 2010                    |
| D.H. Brydon            | 19 April 2004       | 2010                     | 19 November 2007                    |
| D.J. Challen           | 21 September 2004   | 2010                     | 19 November 2007                    |
| S.J. Chambers          | 27 November 2006    | 2010                     | 19 November 2007                    |
| A.C. Quinn             | 1 August 2009       | 2012                     | 17 November 2009                    |
| K.R. Tebbit            | 14 June 2006        | 2012                     | 17 November 2009                    |

\*Mr Angelici will stand for election at the AGM on 16 November 2010 following his appointment to the Board during the year.

\*\*subject to the director's re-appointment annually at each Annual General Meeting

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 2009) to the non-executive directors for the full year 2009/10 comprised the following and will remain frozen at this level for the full year 2010/11:

| Non-executive director                   | Basic fee | Audit / Remuneration Committee chairmanship fee | Senior Independent Director fee | Total           |
|------------------------------------------|-----------|-------------------------------------------------|---------------------------------|-----------------|
| D.H. Brydon                              | £305,000  | –                                               | –                               | <b>£305,000</b> |
| B.F.J. Angelici (appointed 1 July 2010)* | £54,000   | –                                               | –                               | <b>£54,000</b>  |
| D.J. Challen                             | £54,000   | £15,000                                         | –                               | <b>£69,000</b>  |
| S.J. Chambers                            | £54,000   | £15,000                                         | –                               | <b>£69,000</b>  |
| A.C. Quinn (appointed 1 August 2009)     | £54,000   | –                                               | –                               | <b>£54,000</b>  |
| K.R. Tebbit                              | £54,000   | –                                               | –                               | <b>£54,000</b>  |
| P.J. Jackson (retired 17 November 2009)* | £54,000   | –                                               | £15,000                         | <b>£69,000</b>  |

\*Mr Angelici's fee for 2009/10 was pro-rated. Mr Jackson's fees for 2009/10 were pro-rated up to the date of his retirement from the Board.

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 77; the directors' pensions table and accompanying notes on page 78; and the directors' share options and awards table on page 80 have been audited.

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

## S.J. Chambers

28 September 2010

# Directors' remuneration report

## continued

### Directors' share option and long-term share plans

| Director and Scheme               | Options and awards held on 31 July 2010 | Options and awards held on 31 July 2009 | Performance test | Exercise price | Grant date | Option and award data |               |                         | Options exercised and awards vested 2009/10 |                         |                                  |                                            |
|-----------------------------------|-----------------------------------------|-----------------------------------------|------------------|----------------|------------|-----------------------|---------------|-------------------------|---------------------------------------------|-------------------------|----------------------------------|--------------------------------------------|
|                                   | Number                                  | Number                                  |                  |                |            | Vesting date*         | Expiry date** | Exercise / vesting date | Number                                      | Exercise/ vesting price | Market price at date of grant*** | Market price at date of exercise/ vesting† |
| P. Bowman                         |                                         |                                         |                  |                |            |                       |               |                         |                                             |                         |                                  |                                            |
| PSP                               | 75,543                                  | 75,543                                  | C                | n/a            | 11/12/07   | 11/12/10              | 11/12/10      |                         |                                             |                         |                                  |                                            |
|                                   | 37,771                                  | 37,771                                  | D                | n/a            | 11/12/07   | 11/12/10              | 11/12/10      |                         |                                             |                         |                                  |                                            |
| CIP                               | 78,199                                  | 78,199                                  | E                | n/a            | 20/10/08   | 28/09/11              | 28/09/11      |                         |                                             |                         |                                  |                                            |
|                                   | 62,919                                  | 0                                       | E                | n/a            | 15/10/09   | 26/09/12              | 26/09/12      |                         |                                             |                         |                                  |                                            |
| SAYE                              | 2,750                                   | 2,750                                   |                  | 569.0p         | 21/05/09   | 01/08/14              | 01/02/15      |                         |                                             |                         |                                  |                                            |
| J. Langston (retired 31 May 2010) |                                         |                                         |                  |                |            |                       |               |                         |                                             |                         |                                  |                                            |
| 95 ESOS                           | # 38,462                                | 38,462                                  | A                | 806.0p         | 09/04/02   | 09/04/05              | 30/11/11      |                         |                                             |                         |                                  |                                            |
|                                   | # 38,461                                | 38,461                                  | B                | 806.0p         | 09/04/02   | 09/04/05              | 30/11/11      |                         |                                             |                         |                                  |                                            |
| PSP                               | 0                                       | 44,618                                  | C                | n/a            | 29/09/06   | 25/10/09              | ♦             |                         |                                             |                         |                                  |                                            |
|                                   | 0                                       | 22,309                                  | D                | n/a            | 29/09/06   | 25/10/09              | ♦♦            | 05/11/09                | 10,485                                      | n/a                     | 896.5p                           | 920.02p                                    |
|                                   | # 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                                       | 31,881                                  | E                | n/a            | 02/02/07   | 30/09/09              |               | 14/10/09                | 31,881                                      | n/a                     | 1,068.5p                         | 944.37p                                    |
|                                   | # 22,202                                | 22,202                                  | E                | n/a            | 13/11/07   | 29/09/10              | 29/09/10      |                         |                                             |                         |                                  |                                            |
|                                   | # 22,222                                | 22,222                                  | E                | n/a            | 20/10/08   | 28/09/11              | 28/09/11      |                         |                                             |                         |                                  |                                            |
|                                   | # 24,184                                | 0                                       | E                | n/a            | 15/10/09   | 26/09/12              | 26/09/12      |                         |                                             |                         |                                  |                                            |
| SAYE                              | # 1,088                                 | 1,088                                   |                  | 868.0p         | 18/05/07   | 01/08/10              | 30/11/10      |                         |                                             |                         |                                  |                                            |

### Value Sharing Plan

| Director and Scheme                      | VSP awards held on 31 July 2010 | VSP awards held on 31 July 2009 | Award data       |                |            |               |               |              | Awards vested 2009/10 |               |                                  |                                  |
|------------------------------------------|---------------------------------|---------------------------------|------------------|----------------|------------|---------------|---------------|--------------|-----------------------|---------------|----------------------------------|----------------------------------|
|                                          | Shares per £5m surplus value    | Shares per £5m surplus value    | Performance test | Exercise price | Grant date | Vesting date* | Expiry date** | Vesting date | Number                | Vesting price | Market price at date of grant*** | Market price at date of vesting† |
| <b>P. Bowman</b>                         |                                 |                                 |                  |                |            |               |               |              |                       |               |                                  |                                  |
| VSP                                      | 417                             | 417                             | F                | n/a            | 28/07/08   | Oct 2011      | Oct 2011      |              |                       |               |                                  |                                  |
|                                          | 833                             | 833                             | G                | n/a            | 28/07/08   | Oct 2011      | Oct 2011      |              |                       |               |                                  |                                  |
|                                          | 417                             | 417                             | F                | n/a            | 28/07/08   | Oct 2012      | Oct 2012      |              |                       |               |                                  |                                  |
|                                          | 833                             | 833                             | G                | n/a            | 28/07/08   | Oct 2012      | Oct 2012      |              |                       |               |                                  |                                  |
| <b>J. Langston (retired 31 May 2010)</b> |                                 |                                 |                  |                |            |               |               |              |                       |               |                                  |                                  |
| VSP                                      | # 167                           | 167                             | F                | n/a            | 28/07/08   | Oct 2011      | Oct 2011      |              |                       |               |                                  |                                  |
|                                          | # 333                           | 333                             | G                | n/a            | 28/07/08   | Oct 2011      | Oct 2011      |              |                       |               |                                  |                                  |
|                                          | # 167                           | 167                             | F                | n/a            | 28/07/08   | Oct 2012      | Oct 2012      |              |                       |               |                                  |                                  |
|                                          | # 333                           | 333                             | G                | n/a            | 28/07/08   | Oct 2012      | Oct 2012      |              |                       |               |                                  |                                  |

#### 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 25 September 2010.

\*\*\* 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 or vesting.

# Holding at date of retirement. Mr Langston's entitlements under the VSP have been preserved but his potential entitlement to shares on vesting will be time prorated.

#### 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 2009 to 31 July 2010 were 1,186p and 720p respectively.

The mid-market closing price on 31 July 2009 was 720p and on 31 July 2010 was 1,116p.

The mid-market closing price of a Smiths share on the date of awards made to directors under the CIP in the 2009/10 financial year was 955p.

The option over 2,750 shares granted to and held by a director under the SAYE at 31 July 2010, was granted at an exercise price below the market price of a Smiths Group share on 25 September 2010 (1227p).

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 2010 are indicated in the table above by a diamond (♦), for full lapses, or a double diamond (♦♦), where part of an award vested and the balance lapsed: no other options or awards held by any director lapsed during the period 1 August 2009 to 31 July 2010.

No other Director held any options over the Company's shares during the period 1 August 2009 to 31 July 2010.

No options or awards have been granted to or exercised by directors or have lapsed during the period 1 August to 25 September 2010.

At 31 July 2010 the trustee of the Employee Share Trust held 32,858 shares (none of the directors had a direct interest in these shares at 31 July 2010). The market value of the shares held by the trustee on 31 July 2010 was £366,695 and dividends of approximately £11,500 were waived in the year in respect of the shares held by the trustee during the year.

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

#### PSP awards granted in October 2006

Smiths' TSR over the performance period in relation to 2006 PSP awards (25 October 2006 to 25 October 2009) ranked 27th in the comparator group of FTSE100 companies (excluding financial services companies), a level of performance equivalent to the 57th 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 47% of the TSR element (one-third of an award). Smiths' EPS growth over the performance period was less than 5% p.a., the threshold for vesting of the EPS element of the awards, so none of the remaining two-thirds of the award vested. Overall, 15.7% of 2006 PSP awards vested.

#### 95 ESOS awards granted up to October 2005

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 ("IFRS"), 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 and the Directors' remuneration report comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation. 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.

In accordance with the Disclosure and Transparency Rules of the UK Listing Authority, each of the directors confirms that to the best of his or her knowledge:

- the Group's financial statements have been prepared in accordance with IFRS and give a true and fair view of the Group's assets, liabilities and financial position as at 31 July 2010 and of its profit for the financial year then ended; and
- the Group directors' report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties that the Group faces.

**Peter Turner**

**Finance Director**

28 September 2010

# 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 2010 which comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated balance sheet, the consolidated statement of changes in equity, 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 Chapter 3 of Part 16 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 2010 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 matters 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 2010 and on the information in the Directors' remuneration report that is described as having been audited.

## Martin Hodgson (Senior Statutory Auditor)

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

28 September 2010

## 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 Group 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<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|------------------------------------------------------------------------------------------------|-------|----------------------------------|----------------------------------|
| <b>Continuing operations</b>                                                                   |       |                                  |                                  |
| Revenue                                                                                        | 1     | <b>2,769.6</b>                   | 2,664.6                          |
| Cost of sales                                                                                  |       | <b>(1,476.3)</b>                 | (1,447.5)                        |
| Gross profit                                                                                   |       | <b>1,293.3</b>                   | 1,217.1                          |
| Sales and distribution costs                                                                   |       | <b>(369.7)</b>                   | (370.5)                          |
| Administrative expenses                                                                        |       | <b>(491.0)</b>                   | (419.7)                          |
| Profit on disposal of businesses                                                               | 4     | <b>3.3</b>                       | 1.6                              |
| <b>Operating profit</b>                                                                        | 2     | <b>435.9</b>                     | 428.5                            |
| Comprising                                                                                     |       |                                  |                                  |
| – headline operating profit                                                                    | 3     | <b>492.4</b>                     | 417.5                            |
| – exceptional items, amortisation of acquired intangibles                                      | 3     | <b>(56.5)</b>                    | 11.0                             |
|                                                                                                |       | <b>435.9</b>                     | 428.5                            |
| Interest receivable                                                                            |       | <b>3.6</b>                       | 2.1                              |
| Interest payable                                                                               |       | <b>(65.1)</b>                    | (54.4)                           |
| Other financing losses                                                                         |       | <b>(5.4)</b>                     | (10.9)                           |
| Other finance income – retirement benefits                                                     |       | <b>2.3</b>                       | 5.1                              |
| Finance costs                                                                                  | 5     | <b>(64.6)</b>                    | (58.1)                           |
| Share of post-tax profits of associated companies                                              | 14    | <b>1.8</b>                       | 0.4                              |
| <b>Profit before taxation</b>                                                                  |       | <b>373.1</b>                     | 370.8                            |
| Comprising                                                                                     |       |                                  |                                  |
| – headline profit before taxation                                                              | 3     | <b>435.0</b>                     | 370.7                            |
| – exceptional items, amortisation of acquired intangibles and other financing gains and losses | 3     | <b>(61.9)</b>                    | 0.1                              |
|                                                                                                |       | <b>373.1</b>                     | 370.8                            |
| Taxation                                                                                       | 6     | <b>(78.9)</b>                    | (94.9)                           |
| <b>Profit after taxation – continuing operations</b>                                           |       | <b>294.2</b>                     | 275.9                            |
| Profit/(loss) – discontinued operations                                                        | 7     | <b>16.4</b>                      | (5.9)                            |
| <b>Profit for the year</b>                                                                     |       | <b>310.6</b>                     | 270.0                            |
| Attributable to                                                                                |       |                                  |                                  |
| Smiths Group shareholders                                                                      |       | <b>310.0</b>                     | 269.5                            |
| Non-controlling interests                                                                      |       | <b>0.6</b>                       | 0.5                              |
|                                                                                                |       | <b>310.6</b>                     | 270.0                            |
| <b>Earnings per share</b>                                                                      | 9     |                                  |                                  |
| Basic                                                                                          |       | <b>79.5p</b>                     | 69.3p                            |
| Basic – continuing operations                                                                  |       | <b>75.3p</b>                     | 70.8p                            |
| Diluted                                                                                        |       | <b>78.9p</b>                     | 68.6p                            |
| Diluted – continuing operations                                                                |       | <b>74.8p</b>                     | 70.1p                            |

References in the consolidated income statement, consolidated statement of comprehensive income, consolidated balance sheet, consolidated statement of changes in equity and consolidated cash-flow statement relate to notes on pages 95 to 126, which form an integral part of the consolidated accounts.

# Consolidated statement of comprehensive income

|                                                                 | Notes | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|-----------------------------------------------------------------|-------|----------------------------------|----------------------------------|
| Profit for the period                                           |       | <b>310.6</b>                     | 270.0                            |
| Exchange gains                                                  |       | <b>81.4</b>                      | 189.2                            |
| Actuarial losses on retirement benefits                         | 10    | <b>(15.2)</b>                    | (429.9)                          |
| Taxation recognised on actuarial movements                      | 6     | <b>12.2</b>                      | 94.3                             |
| Fair value gains/(losses)                                       |       |                                  |                                  |
| – on available for sale financial assets                        |       | <b>0.2</b>                       |                                  |
| – deferred in the period on cash-flow and net investment hedges |       | <b>(41.6)</b>                    | (66.6)                           |
| – reclassified to income statement                              |       | <b>(0.3)</b>                     | 8.4                              |
| <b>Total comprehensive income</b>                               |       | <b>347.3</b>                     | 65.4                             |
| Attributable to                                                 |       |                                  |                                  |
| Smiths Group shareholders                                       |       | <b>345.9</b>                     | 63.9                             |
| Non-controlling interests                                       |       | <b>1.4</b>                       | 1.5                              |
|                                                                 |       | <b>347.3</b>                     | 65.4                             |

# Consolidated balance sheet

|                                                   | Notes | 2010<br>£m       | 2009<br>£m |
|---------------------------------------------------|-------|------------------|------------|
| <b>Non-current assets</b>                         |       |                  |            |
| Intangible assets                                 | 12    | <b>1,638.6</b>   | 1,500.3    |
| Property, plant and equipment                     | 13    | <b>302.7</b>     | 318.0      |
| Investments accounted for using the equity method | 14    | <b>13.6</b>      | 11.2       |
| Financial assets – other investments              | 15    | <b>27.0</b>      | 7.8        |
| Retirement benefit assets                         | 10    | <b>80.3</b>      | 39.2       |
| Deferred tax assets                               | 6     | <b>194.2</b>     | 164.7      |
| Trade and other receivables                       | 17    | <b>33.8</b>      | 21.3       |
| Financial derivatives                             | 22    | <b>10.8</b>      | 13.9       |
|                                                   |       | <b>2,301.0</b>   | 2,076.4    |
| <b>Current assets</b>                             |       |                  |            |
| Inventories                                       | 16    | <b>390.0</b>     | 413.6      |
| Trade and other receivables                       | 17    | <b>578.9</b>     | 553.6      |
| Cash and cash equivalents                         | 18    | <b>172.9</b>     | 91.7       |
| Financial derivatives                             | 22    | <b>15.5</b>      | 40.7       |
|                                                   |       | <b>1,157.3</b>   | 1,099.6    |
| <b>Total assets</b>                               |       | <b>3,458.3</b>   | 3,176.0    |
| <b>Non-current liabilities</b>                    |       |                  |            |
| Financial liabilities                             |       |                  |            |
| – borrowings                                      | 20    | <b>(995.0)</b>   | (752.2)    |
| – financial derivatives                           | 22    | <b>(1.1)</b>     | (6.7)      |
| Provisions for liabilities and charges            | 23    | <b>(230.8)</b>   | (226.5)    |
| Retirement benefit obligations                    | 10    | <b>(385.6)</b>   | (378.2)    |
| Deferred tax liabilities                          | 6     | <b>(77.8)</b>    | (66.5)     |
| Trade and other payables                          | 19    | <b>(27.3)</b>    | (25.1)     |
|                                                   |       | <b>(1,717.6)</b> | (1,455.2)  |
| <b>Current liabilities</b>                        |       |                  |            |
| Financial liabilities                             |       |                  |            |
| – borrowings                                      | 20    | <b>(14.7)</b>    | (224.4)    |
| – financial derivatives                           | 22    | <b>(14.9)</b>    | (38.9)     |
| Provisions for liabilities and charges            | 23    | <b>(70.4)</b>    | (77.2)     |
| Trade and other payables                          | 19    | <b>(428.2)</b>   | (399.8)    |
| Current tax payable                               |       | <b>(112.7)</b>   | (117.7)    |
|                                                   |       | <b>(640.9)</b>   | (858.0)    |
| <b>Total liabilities</b>                          |       | <b>(2,358.5)</b> | (2,313.2)  |
| <b>Net assets</b>                                 |       | <b>1,099.8</b>   | 862.8      |
| <b>Shareholders' equity</b>                       |       |                  |            |
| Share capital                                     | 26    | <b>146.5</b>     | 145.9      |
| Share premium account                             |       | <b>315.3</b>     | 306.6      |
| Capital redemption reserve                        |       | <b>5.8</b>       | 5.8        |
| Revaluation reserve                               |       | <b>1.7</b>       | 1.7        |
| Merger reserve                                    |       | <b>234.8</b>     | 234.8      |
| Retained earnings                                 | 27    | <b>519.5</b>     | 251.3      |
| Hedge reserve                                     | 27    | <b>(128.8)</b>   | (87.1)     |
| Total shareholders' equity                        |       | <b>1,094.8</b>   | 859.0      |
| Non-controlling interest equity                   |       | <b>5.0</b>       | 3.8        |
| <b>Total equity</b>                               |       | <b>1,099.8</b>   | 862.8      |

The accounts on pages 84 to 126 were approved by the Board of Directors on 28 September 2010 and were signed on its behalf by:

**Philip Bowman**  
Chief Executive

**Peter Turner**  
Finance Director

# Consolidated statement of changes in equity

|                                                    | Notes | Share capital and share premium<br>£m | Other reserves<br>£m | Retained earnings<br>£m | Hedge reserve<br>£m | Equity shareholders' funds<br>£m | Non-controlling interest<br>£m | Total equity<br>£m |
|----------------------------------------------------|-------|---------------------------------------|----------------------|-------------------------|---------------------|----------------------------------|--------------------------------|--------------------|
| At 31 July 2009                                    |       | 452.5                                 | 242.3                | 251.3                   | (87.1)              | 859.0                            | 3.8                            | 862.8              |
| Profit for the year                                |       |                                       |                      | 310.0                   |                     | 310.0                            | 0.6                            | 310.6              |
| Other comprehensive income                         |       |                                       |                      |                         |                     |                                  |                                |                    |
| Exchange gains                                     |       |                                       |                      | 80.4                    | 0.2                 | 80.6                             | 0.8                            | 81.4               |
| Actuarial losses on retirement benefits net of tax |       |                                       |                      | (3.0)                   |                     | (3.0)                            |                                | (3.0)              |
| Fair value gains/(losses)                          |       |                                       |                      | 0.2                     | (41.9)              | (41.7)                           |                                | (41.7)             |
| <b>Total comprehensive income for the year</b>     |       |                                       |                      | <b>387.6</b>            | <b>(41.7)</b>       | <b>345.9</b>                     | <b>1.4</b>                     | <b>347.3</b>       |
| Transactions relating to ownership interests       |       |                                       |                      |                         |                     |                                  |                                |                    |
| Exercises of share options                         |       | 9.1                                   |                      | 0.6                     |                     | 9.7                              |                                | 9.7                |
| Taxation recognised on share-based payment         | 6     |                                       |                      | 2.4                     |                     | 2.4                              |                                | 2.4                |
| Purchase of own shares                             |       | 0.2                                   |                      | (0.2)                   |                     |                                  |                                |                    |
| Dividends                                          |       |                                       |                      |                         |                     |                                  |                                |                    |
| – equity shareholders                              | 8     |                                       |                      | (132.5)                 |                     | (132.5)                          |                                | (132.5)            |
| – non-controlling interest                         |       |                                       |                      |                         |                     |                                  | (0.2)                          | (0.2)              |
| Share-based payment                                | 30    |                                       |                      | 10.3                    |                     | 10.3                             |                                | 10.3               |
| <b>At 31 July 2010</b>                             |       | <b>461.8</b>                          | <b>242.3</b>         | <b>519.5</b>            | <b>(128.8)</b>      | <b>1,094.8</b>                   | <b>5.0</b>                     | <b>1,099.8</b>     |

|                                                    | Notes | Share capital and share premium<br>£m | Other reserves<br>£m | Retained earnings<br>£m | Hedge reserve<br>£m | Equity shareholders' funds<br>£m | Non-controlling interest<br>£m | Total equity<br>£m |
|----------------------------------------------------|-------|---------------------------------------|----------------------|-------------------------|---------------------|----------------------------------|--------------------------------|--------------------|
| At 31 July 2008                                    |       | 449.1                                 | 242.3                | 253.7                   | (29.2)              | 915.9                            | 2.3                            | 918.2              |
| Profit for the year                                |       |                                       |                      | 269.5                   |                     | 269.5                            | 0.5                            | 270.0              |
| Other comprehensive income                         |       |                                       |                      |                         |                     |                                  |                                |                    |
| Exchange gains                                     |       |                                       |                      | 187.9                   | 0.3                 | 188.2                            | 1.0                            | 189.2              |
| Actuarial losses on retirement benefits net of tax |       |                                       |                      | (335.6)                 |                     | (335.6)                          |                                | (335.6)            |
| Fair value losses                                  |       |                                       |                      |                         | (58.2)              | (58.2)                           |                                | (58.2)             |
| <b>Total comprehensive income for the year</b>     |       |                                       |                      | <b>121.8</b>            | <b>(57.9)</b>       | <b>63.9</b>                      | <b>1.5</b>                     | <b>65.4</b>        |
| Transactions relating to ownership interest        |       |                                       |                      |                         |                     |                                  |                                |                    |
| Exercises of share options                         |       | 1.5                                   |                      | 2.6                     |                     | 4.1                              |                                | 4.1                |
| Taxation recognised on share-based payment         | 6     |                                       |                      | (4.0)                   |                     | (4.0)                            |                                | (4.0)              |
| Purchase of own shares                             |       | 0.2                                   |                      | (0.2)                   |                     |                                  |                                |                    |
| Conversion of B shares                             |       | 1.7                                   |                      |                         |                     | 1.7                              |                                | 1.7                |
| Dividends paid to equity shareholders              | 8     |                                       |                      | (132.0)                 |                     | (132.0)                          |                                | (132.0)            |
| Share-based payment                                | 30    |                                       |                      | 9.4                     |                     | 9.4                              |                                | 9.4                |
| <b>At 31 July 2009</b>                             |       | <b>452.5</b>                          | <b>242.3</b>         | <b>251.3</b>            | <b>(87.1)</b>       | <b>859.0</b>                     | <b>3.8</b>                     | <b>862.8</b>       |

# Consolidated cash-flow statement

|                                                             | Notes | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|-------------------------------------------------------------|-------|----------------------------------|----------------------------------|
| <b>Net cash inflow from operating activities</b>            | 28    | <b>410.5</b>                     | 332.1                            |
| <b>Cash-flows from investing activities</b>                 |       |                                  |                                  |
| Expenditure on capitalised development                      |       | (24.3)                           | (22.5)                           |
| Expenditure on other intangible assets                      |       | (7.6)                            | (17.4)                           |
| Purchases of property, plant and equipment                  |       | (47.0)                           | (57.4)                           |
| Disposals of property, plant and equipment                  |       | 24.8                             | 19.8                             |
| Investment in financial assets                              |       | (25.3)                           | (6.6)                            |
| Acquisition of businesses                                   | 29    | (132.7)                          | (103.3)                          |
| Disposal of Aerospace                                       | 7     | 19.9                             | (1.9)                            |
| Disposals of businesses                                     |       | 1.1                              | (0.2)                            |
| <b>Net cash-flow used in investing activities</b>           |       | <b>(191.1)</b>                   | (189.5)                          |
| <b>Cash-flows from financing activities</b>                 |       |                                  |                                  |
| Proceeds from exercise of share options                     |       | 9.7                              | 4.1                              |
| Dividends paid to equity shareholders                       | 8     | (132.5)                          | (132.0)                          |
| Dividends paid to non-controlling interests                 |       | (0.2)                            |                                  |
| Cash outflow from matured derivative financial instruments  |       | (1.5)                            | (89.9)                           |
| Increase in new borrowings                                  |       | 466.8                            | 495.8                            |
| Reduction and repayment of borrowings                       |       | (408.4)                          | (357.9)                          |
| <b>Net cash-flow used in financing activities</b>           |       | <b>(66.1)</b>                    | (79.9)                           |
| <b>Net increase in cash and cash equivalents</b>            |       | <b>153.3</b>                     | 62.7                             |
| Cash and cash equivalents at beginning of year              |       | 19.7                             | (40.0)                           |
| Exchange differences                                        |       | (0.8)                            | (3.0)                            |
| <b>Cash and cash equivalents at end of year</b>             | 18    | <b>172.2</b>                     | 19.7                             |
| Cash and cash equivalents at end of year comprise           |       |                                  |                                  |
| – cash at bank and in hand                                  |       | 136.3                            | 84.0                             |
| – short-term deposits                                       |       | 36.6                             | 7.7                              |
| – bank overdrafts                                           |       | (0.7)                            | (72.0)                           |
|                                                             |       | <b>172.2</b>                     | 19.7                             |
| Included in cash and cash equivalents per the balance sheet |       | 172.9                            | 91.7                             |
| Included in overdrafts per the balance sheet                |       | (0.7)                            | (72.0)                           |
|                                                             |       | <b>172.2</b>                     | 19.7                             |

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 historical 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 year except that the Group has adopted:

- amendment to 'IAS 23: Borrowing costs' which requires borrowing costs which are directly attributable to the acquisition or construction of assets that take a substantial period of time to get ready for use or sale to be capitalised as part of the cost of that asset. This represents a change in accounting policy. However the revised standard only applies to qualifying assets for which the commencement date for capitalisation is on or after 1 August 2009, and it has not materially affected the reported position or performance.
- amendment to 'IFRS 2: Share-based payment' which clarifies that vesting conditions are service conditions and performance conditions only, and specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment. This change has had no material effect on reported performance or equity.
- 'IFRS 3: (Revised) business combinations' and 'IAS 27: (Revised) consolidated and separate financial statements', which have required changes to the recognition of goodwill, acquisition costs and contingent consideration relating to acquisitions made after 1 August 2009. Acquisition costs of £1.3m have been expensed in the current year as a result of these changes. IAS 27 (Revised) requires a different accounting treatment for non-controlling interests. This has not affected the reported financial position or performance.
- 'IAS 1: (Revised) Presentation of financial statements', which has required changes to the presentation of the primary financial statements, in particular the consolidated statement of changes in equity has been presented as a primary financial statement.
- 'IFRIC 15: Agreements for the construction of real estate' which clarifies the scope of contract accounting for real estate transactions. The same principles have been applied to contract accounting for transactions undertaken by the Group. This has not materially affected reported financial position or performance.
- amendment to 'IFRS 7: Financial instruments: Disclosures' which requires enhanced disclosures about fair value measurement and liquidity risk. The amendment requires disclosure of fair value measurements by reference to a fair value measurement hierarchy. The amendment is concerned with disclosure only and has no impact on reported financial position or performance.

## 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 £23.6m (2009: £46.9m) has been recognised in respect of contracts in progress at the year end with a total expected value of £116.2m (2009: £145.6m). A 5% increase in the proportion of the contract activity recognised in the current year would have increased operating profit by an estimated £0.4m (2009: £0.2m).

## 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 £191.4m (2009: £185.4m).

As previously reported, John Crane, Inc., a subsidiary of the Group, 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. John Crane, Inc. takes account of the advice of an expert in asbestos liability estimation in quantifying the expected costs of future adverse judgments. See note 23 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 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 £117m (2009: £111m). 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.

# Accounting policies

## continued

### Accounting policies

#### Basis of consolidation

The consolidated accounts incorporate the financial statements of Smiths Group plc ("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 comprehensive income. 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.

#### 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.

## 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 through separate disclosure. The separate reporting of exceptional items helps provide a better picture of the Company's underlying performance. Items which are included within the exceptional category include:

- profits/(losses) on disposal of businesses and costs of acquisitions;
- 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.

The cost of development projects which are expected to take a substantial period of time to complete, and commenced after 1 August 2009, includes attributable borrowing costs.

### Intangible assets acquired in business combinations

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                       | up to 12 years |
| Customer relationships           | up to 7 years  |

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

# Accounting policies

## continued

### 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%; Fixtures, fittings, tools and other equipment – 10% to 33%.

The cost of any assets which are expected to take a substantial period of time to complete whose construction began after 1 August 2009 includes attributable borrowing costs.

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.

### 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). The cost of items of inventory which take a substantial period of time to complete includes attributable borrowing costs for all items whose production began after 1 August 2009. 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 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.

## 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, available for sale financial assets 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. Available for sale financial assets are subsequently measured at fair value, with unrealised gains and losses being recognised in other comprehensive income. 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. When securities classified as available for sale are sold or impaired, the accumulated fair value adjustments previously taken to reserves are included in the income statement.

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 the hedge reserve 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 the hedge reserve are transferred from the reserve 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 the hedge reserve at that time remains in the reserve 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 other comprehensive income 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 other comprehensive income; 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.

# Accounting policies

## continued

### 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.

'IFRS 7: Financial instruments: Disclosures' requires fair value measurements to be classified according to the following hierarchy:

- level 1 – quoted prices in active markets for identical assets or liabilities;
- level 2 – valuations in which all inputs are observable either directly (ie as prices) or indirectly (ie derived from prices); and
- level 3 – valuations in which one or more inputs for the asset or liability that are not based on observable market data.

The Group uses the following methods to estimate the fair values of its financial instruments:

- cash, trade receivables and payables and floating rate borrowings – the carrying value is a good approximation of the fair value;
- government bonds – quoted market prices (level 1);
- fixed rate borrowings – quoted market prices of equivalent instruments (level 2); 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) (level 2).

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 may affect future annual reports and accounts.

- Amendment to IFRIC 14, IAS 19 – Prepayments of a minimum funding requirement
- Amendment to 'IAS 24: Related party disclosures'
- Amendment to 'IAS 32: Financial instruments: Presentation on classification of rights issues'
- 'IFRIC 19: Extinguishing financial liabilities with equity instruments'
- 'IFRS 2: Share-based payment' – Group cash-settled share-based payment transactions
- 'IFRS 9: Financial instruments'

A review of the impact of these standards and interpretations is being undertaken, and the impact of adopting them will be determined once this review has been completed. Based on the work completed to date, none of the changes are expected to have a material impact on the Group's reported position or performance.

### 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 129 to 137.

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

The Group is organised into five divisions: Smiths Detection, John Crane, Smiths Medical, Smiths Interconnect and Flex-Tek. 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 components and sub-systems that connect, protect and control critical systems;
- 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 arm's length prices.

|                                                                         | Year ended 31 July 2010 |                  |                      |                           |                |              |
|-------------------------------------------------------------------------|-------------------------|------------------|----------------------|---------------------------|----------------|--------------|
|                                                                         | Smiths Detection<br>£m  | John Crane<br>£m | Smiths Medical<br>£m | Smiths Interconnect<br>£m | Flex-Tek<br>£m | Total<br>£m  |
| Revenue                                                                 | 574.1                   | 786.1            | 857.6                | 339.9                     | 211.9          | 2,769.6      |
| Divisional headline operating profit                                    | 89.9                    | 162.7            | 184.2                | 61.9                      | 23.5           | 522.2        |
| Corporate headline operating costs                                      |                         |                  |                      |                           |                | (29.8)       |
| <b>Headline operating profit</b>                                        | <b>89.9</b>             | <b>162.7</b>     | <b>184.2</b>         | <b>61.9</b>               | <b>23.5</b>    | <b>492.4</b> |
| Divisional exceptional operating items (note 4)                         | (0.3)                   | (22.3)           | 5.4                  | (0.9)                     | (2.3)          | (20.4)       |
| Corporate exceptional operating items (note 4)                          |                         |                  |                      |                           |                | 6.0          |
| Amortisation of acquired intangible assets                              | (0.4)                   | (16.2)           | (17.3)               | (8.2)                     |                | (42.1)       |
| <b>Operating profit</b>                                                 | <b>89.2</b>             | <b>124.2</b>     | <b>172.3</b>         | <b>52.8</b>               | <b>21.2</b>    | <b>435.9</b> |
| Exceptional finance costs – adjustment to discounted provision (note 4) |                         | (7.0)            |                      |                           |                | (7.0)        |
| Net finance costs – other                                               |                         |                  |                      |                           |                | (57.6)       |
| Share of post-tax profits of associate companies                        | 1.8                     |                  |                      |                           |                | 1.8          |
| <b>Profit before taxation</b>                                           |                         |                  |                      |                           |                | <b>373.1</b> |

|                                                                         | Year ended 31 July 2009 |                  |                      |                           |                |              |
|-------------------------------------------------------------------------|-------------------------|------------------|----------------------|---------------------------|----------------|--------------|
|                                                                         | Smiths Detection<br>£m  | John Crane<br>£m | Smiths Medical<br>£m | Smiths Interconnect<br>£m | Flex-Tek<br>£m | Total<br>£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)       |
| <b>Headline operating profit</b>                                        | <b>63.1</b>             | <b>142.8</b>     | <b>163.9</b>         | <b>55.5</b>               | <b>21.9</b>    | <b>417.5</b> |
| 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)       |
| <b>Operating profit</b>                                                 | <b>62.6</b>             | <b>105.7</b>     | <b>147.8</b>         | <b>51.3</b>               | <b>17.5</b>    | <b>428.5</b> |
| 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          |
| <b>Profit before taxation</b>                                           |                         |                  |                      |                           |                | <b>370.8</b> |

# Notes to the accounts

## continued

### 1 Segment information continued

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

|                                        | Year ended 31 July 2010   |                  |                         |                              |                |                            |             |
|----------------------------------------|---------------------------|------------------|-------------------------|------------------------------|----------------|----------------------------|-------------|
|                                        | Smiths<br>Detection<br>£m | John Crane<br>£m | Smiths<br>Medical<br>£m | Smiths<br>Interconnect<br>£m | Flex-Tek<br>£m | Reconciling<br>items<br>£m | Total<br>£m |
| Depreciation                           | 9.7                       | 14.9             | 27.6                    | 7.8                          | 4.8            | 0.9                        | 65.7        |
| Amortisation                           | 11.2                      | 3.0              | 10.0                    | 0.5                          | 0.2            | 42.7                       | 67.6        |
| Other non-cash items                   |                           |                  |                         |                              |                |                            |             |
| – share-based payment                  | 2.5                       | (0.2)            | 3.3                     | 0.6                          | 0.5            | 4.6                        | 11.3        |
| – goodwill and other asset impairments |                           |                  |                         |                              |                | (2.1)                      | (2.1)       |

|                                        | Year ended 31 July 2009   |                  |                         |                              |                |                            |             |
|----------------------------------------|---------------------------|------------------|-------------------------|------------------------------|----------------|----------------------------|-------------|
|                                        | Smiths<br>Detection<br>£m | John Crane<br>£m | Smiths<br>Medical<br>£m | Smiths<br>Interconnect<br>£m | Flex-Tek<br>£m | Reconciling<br>items<br>£m | Total<br>£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         |

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<br>Detection<br>£m | John Crane<br>£m | Smiths<br>Medical<br>£m | Smiths<br>Interconnect<br>£m | Flex-Tek<br>£m | Reconciling<br>items<br>£m | Total<br>£m |
|----------------------------------------------------|---------------------------|------------------|-------------------------|------------------------------|----------------|----------------------------|-------------|
| <b>Capital expenditure year ended 31 July 2010</b> | <b>21.4</b>               | <b>16.2</b>      | <b>28.1</b>             | <b>10.3</b>                  | <b>2.6</b>     | <b>0.3</b>                 | <b>78.9</b> |
| Capital expenditure year ended 31 July 2009        | 26.6                      | 19.0             | 33.7                    | 7.3                          | 4.7            | 6.0                        | 97.3        |

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

|                                                                        | 31 July 2010              |                  |                         |                              |                |                  |
|------------------------------------------------------------------------|---------------------------|------------------|-------------------------|------------------------------|----------------|------------------|
|                                                                        | Smiths<br>Detection<br>£m | John Crane<br>£m | Smiths<br>Medical<br>£m | Smiths<br>Interconnect<br>£m | Flex-Tek<br>£m | Total<br>£m      |
| Property, plant, equipment, development projects and other intangibles | 103.8                     | 101.4            | 170.1                   | 35.6                         | 25.0           | 435.9            |
| Investments in associates                                              | 13.6                      |                  |                         |                              |                | 13.6             |
| Working capital assets                                                 | 269.0                     | 288.0            | 256.6                   | 117.9                        | 65.8           | 997.3            |
| <b>Operating assets</b>                                                | <b>386.4</b>              | <b>389.4</b>     | <b>426.7</b>            | <b>153.5</b>                 | <b>90.8</b>    | <b>1,446.8</b>   |
| Derivatives, tax and retirement benefit assets                         |                           |                  |                         |                              |                | 300.8            |
| Goodwill and acquired intangibles                                      |                           |                  |                         |                              |                | 1,502.4          |
| Corporate assets                                                       |                           |                  |                         |                              |                | 35.4             |
| Cash                                                                   |                           |                  |                         |                              |                | 172.9            |
| <b>Total assets</b>                                                    |                           |                  |                         |                              |                | <b>3,458.3</b>   |
| Working capital liabilities                                            | (136.5)                   | (139.4)          | (100.5)                 | (47.9)                       | (34.2)         | (458.5)          |
| Corporate and non-headline liabilities                                 |                           |                  |                         |                              |                | (298.2)          |
| Derivatives, tax and retirement benefit liabilities                    |                           |                  |                         |                              |                | (592.1)          |
| Borrowings                                                             |                           |                  |                         |                              |                | (1,009.7)        |
| <b>Total liabilities</b>                                               |                           |                  |                         |                              |                | <b>(2,358.5)</b> |
| Average divisional capital employed                                    | 674.8                     | 733.3            | 1,219.0                 | 358.0                        | 127.4          | 3,112.5          |
| Average corporate capital employed                                     |                           |                  |                         |                              |                | (154.0)          |
| <b>Average total capital employed</b>                                  |                           |                  |                         |                              |                | <b>2,958.5</b>   |

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

Capital employed is a non-statutory measure of invested resources. It comprises statutory net assets adjusted to add goodwill recognised directly in reserves in respect of subsidiaries acquired before 1 August 1998 of £815.2m (2009: £815.2m) and eliminate post-retirement benefit assets and liabilities, net of related tax, and net debt.

## 1 Segment information continued

|                                                                        | 31 July 2009           |                  |                      |                           |                |                  |
|------------------------------------------------------------------------|------------------------|------------------|----------------------|---------------------------|----------------|------------------|
|                                                                        | Smiths Detection<br>£m | John Crane<br>£m | Smiths Medical<br>£m | Smiths Interconnect<br>£m | Flex-Tek<br>£m | Total<br>£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            |
| <b>Operating assets</b>                                                | <b>413.3</b>           | <b>367.2</b>     | <b>443.2</b>         | <b>126.3</b>              | <b>85.5</b>    | <b>1,435.5</b>   |
| Derivatives, tax and retirement benefit assets                         |                        |                  |                      |                           |                | 258.5            |
| Goodwill and acquired intangibles                                      |                        |                  |                      |                           |                | 1,373.5          |
| Corporate assets                                                       |                        |                  |                      |                           |                | 16.8             |
| Cash                                                                   |                        |                  |                      |                           |                | 91.7             |
| <b>Total assets</b>                                                    |                        |                  |                      |                           |                | <b>3,176.0</b>   |
| 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)          |
| <b>Total liabilities</b>                                               |                        |                  |                      |                           |                | <b>(2,313.2)</b> |
| Average divisional capital employed                                    | 667.0                  | 700.4            | 1,276.6              | 301.2                     | 131.3          | 3,076.5          |
| Average corporate capital employed                                     |                        |                  |                      |                           |                | (226.2)          |
| <b>Average total capital employed</b>                                  |                        |                  |                      |                           |                | <b>2,850.3</b>   |

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

Capital employed is a non-statutory measure of invested resources. It comprises statutory net assets adjusted to add goodwill recognised directly in reserves in respect of subsidiaries acquired before 1 August 1998 of £815.2m and eliminate post-retirement benefit assets and liabilities, net of related tax, and net debt.

### Analysis of revenue

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

| Smiths Detection                       | Transportation<br>£m | Ports and borders<br>£m | Military<br>£m | Emergency responders<br>£m | Critical infrastructure<br>£m | Non-security<br>£m | Total<br>£m  |
|----------------------------------------|----------------------|-------------------------|----------------|----------------------------|-------------------------------|--------------------|--------------|
| <b>Revenue year ended 31 July 2010</b> | <b>220.7</b>         | <b>90.9</b>             | <b>138.0</b>   | <b>24.7</b>                | <b>59.0</b>                   | <b>40.8</b>        | <b>574.1</b> |
| Revenue year ended 31 July 2009        | 181.9                | 53.1                    | 131.6          | 27.5                       | 67.4                          | 39.4               | 500.9        |

| John Crane                             | Original equipment manufacture |                                  |                                   | Aftermarket        |                        | Total        |
|----------------------------------------|--------------------------------|----------------------------------|-----------------------------------|--------------------|------------------------|--------------|
|                                        | £m                             | Oil, gas and petrochemical<br>£m | Chemical and pharmaceutical<br>£m | Distributors<br>£m | General industry<br>£m | £m           |
| <b>Revenue year ended 31 July 2010</b> | <b>287.5</b>                   | <b>298.6</b>                     | <b>69.4</b>                       | <b>52.0</b>        | <b>78.6</b>            | <b>786.1</b> |
| Revenue year ended 31 July 2009        | 295.6                          | 296.1                            | 71.8                              | 48.6               | 77.7                   | 789.8        |

| Smiths Medical                         | Medication delivery<br>£m | Vital care<br>£m | Safety devices<br>£m | Total<br>£m  |
|----------------------------------------|---------------------------|------------------|----------------------|--------------|
| <b>Revenue year ended 31 July 2010</b> | <b>235.0</b>              | <b>351.8</b>     | <b>270.8</b>         | <b>857.6</b> |
| Revenue year ended 31 July 2009        | 237.3                     | 335.2            | 261.0                | 833.5        |

| Smiths Interconnect                    | Telecom<br>£m | Military and Aerospace<br>£m | Rail, Medical Automation, Test<br>£m | Total<br>£m  |
|----------------------------------------|---------------|------------------------------|--------------------------------------|--------------|
| <b>Revenue year ended 31 July 2010</b> | <b>91.1</b>   | <b>170.2</b>                 | <b>78.6</b>                          | <b>339.9</b> |
| Revenue year ended 31 July 2009        | 95.9          | 154.8                        | 67.4                                 | 318.1        |

| Flex-Tek                               | Aerospace<br>£m | Flexible Solutions<br>£m | Heat Solutions<br>£m | Total<br>£m  |
|----------------------------------------|-----------------|--------------------------|----------------------|--------------|
| <b>Revenue year ended 31 July 2010</b> | <b>51.0</b>     | <b>49.4</b>              | <b>111.5</b>         | <b>211.9</b> |
| Revenue year ended 31 July 2009        | 59.7            | 49.0                     | 113.6                | 222.3        |

# Notes to the accounts

## continued

### 1 Segment information continued

#### Analysis of revenue continued

The Group's statutory revenue is analysed as follows:

|               | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|---------------|----------------------------------|----------------------------------|
| Sale of goods | <b>2,535.4</b>                   | 2,460.9                          |
| Contracts     | <b>71.8</b>                      | 67.4                             |
| Services      | <b>162.4</b>                     | 136.3                            |
|               | <b>2,769.6</b>                   | 2,664.6                          |

#### Analysis by geographical areas

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

|                          | Revenue                          |                                  | Intangible assets, property<br>plant and equipment and<br>investments accounted for<br>using the equity method |            |
|--------------------------|----------------------------------|----------------------------------|----------------------------------------------------------------------------------------------------------------|------------|
|                          | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m | 2010<br>£m                                                                                                     | 2009<br>£m |
| United Kingdom           | <b>118.4</b>                     | 115.8                            | <b>150.4</b>                                                                                                   | 143.9      |
| Germany                  | <b>149.7</b>                     | 148.4                            | <b>317.9</b>                                                                                                   | 335.7      |
| France                   | <b>97.6</b>                      | 98.2                             | <b>16.5</b>                                                                                                    | 15.1       |
| Other European           | <b>323.6</b>                     | 333.9                            | <b>89.8</b>                                                                                                    | 126.4      |
| United States of America | <b>1,274.1</b>                   | 1,287.6                          | <b>1,211.8</b>                                                                                                 | 1,056.8    |
| Canada                   | <b>142.2</b>                     | 98.9                             | <b>15.4</b>                                                                                                    | 15.5       |
| Mexico                   | <b>20.1</b>                      | 24.5                             | <b>7.5</b>                                                                                                     | 6.8        |
| Japan                    | <b>120.0</b>                     | 106.1                            | <b>20.9</b>                                                                                                    | 19.8       |
| China                    | <b>82.9</b>                      | 70.6                             | <b>73.5</b>                                                                                                    | 74.0       |
| Rest of the World        | <b>441.0</b>                     | 380.6                            | <b>51.2</b>                                                                                                    | 35.5       |
|                          | <b>2,769.6</b>                   | 2,664.6                          | <b>1,954.9</b>                                                                                                 | 1,829.5    |

### 2 Operating profit is stated after charging

|                                  | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|----------------------------------|----------------------------------|----------------------------------|
| Research and development expense | <b>69.2</b>                      | 66.7                             |
| Operating leases                 |                                  |                                  |
| – land and buildings             | <b>24.4</b>                      | 21.7                             |
| – other                          | <b>10.2</b>                      | 9.4                              |

|                                                                                                      | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|------------------------------------------------------------------------------------------------------|----------------------------------|----------------------------------|
| Audit services                                                                                       |                                  |                                  |
| Fees payable to the Company's auditors for the audit of the parent company and consolidated accounts | <b>0.5</b>                       | 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                                   | <b>3.4</b>                       | 3.4                              |
| – other services pursuant to legislation                                                             | <b>0.1</b>                       | 0.1                              |
|                                                                                                      | <b>4.0</b>                       | 4.0                              |
| Tax services                                                                                         |                                  |                                  |
| – advisory services                                                                                  | <b>0.3</b>                       | 0.2                              |
| All other services                                                                                   | <b>0.3</b>                       | 0.3                              |

Other services relate to one-off projects.

### 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<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|---------------------------------------------------------------|-------|----------------------------------|----------------------------------|
| <b>Operating profit</b>                                       |       | <b>435.9</b>                     | 428.5                            |
| Exclude                                                       |       |                                  |                                  |
| – exceptional operating items                                 | 4     | <b>14.4</b>                      | (45.6)                           |
| – amortisation of acquired intangible assets                  | 12    | <b>42.1</b>                      | 34.6                             |
| Non-headline items in operating profit                        |       | <b>56.5</b>                      | (11.0)                           |
| <b>Headline operating profit</b>                              |       | <b>492.4</b>                     | 417.5                            |
| <b>Finance costs</b>                                          |       | <b>(64.6)</b>                    | (58.1)                           |
| Exclude                                                       |       |                                  |                                  |
| – exceptional finance costs                                   | 4     | <b>7.0</b>                       | 7.1                              |
| – other financing gains and losses                            | 5     | <b>(1.6)</b>                     | 3.8                              |
| Non-headline items in finance costs                           |       | <b>5.4</b>                       | 10.9                             |
| <b>Headline finance costs</b>                                 |       | <b>(59.2)</b>                    | (47.2)                           |
| <b>Profit before taxation</b>                                 |       | <b>373.1</b>                     | 370.8                            |
| Non-headline items in operating profit                        |       | <b>56.5</b>                      | (11.0)                           |
| Non-headline items in finance costs                           |       | <b>5.4</b>                       | 10.9                             |
| <b>Headline profit before taxation</b>                        |       | <b>435.0</b>                     | 370.7                            |
| <b>Profit after taxation – continuing operations</b>          |       | <b>294.2</b>                     | 275.9                            |
| Exclude                                                       |       |                                  |                                  |
| – non-headline items in profit before taxation                |       | <b>61.9</b>                      | (0.1)                            |
| – tax on excluded items                                       | 6     | <b>(25.4)</b>                    | 6.1                              |
|                                                               |       | <b>36.5</b>                      | 6.0                              |
| <b>Headline profit after taxation – continuing operations</b> |       | <b>330.7</b>                     | 281.9                            |

# Notes to the accounts

## continued

### 4 Exceptional items

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

|                                                                          | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|--------------------------------------------------------------------------|----------------------------------|----------------------------------|
| <b>Operating items</b>                                                   |                                  |                                  |
| Restructuring of corporate headquarters and divisional reorganisation    | (8.2)                            | (23.7)                           |
| Gains on changes to post-retirement benefits                             | 3.9                              | 70.3                             |
| Profit on disposal of businesses                                         | 3.3                              | 1.6                              |
| Profit on disposal of property                                           | 5.5                              | 12.6                             |
| Costs of acquisitions                                                    | (1.3)                            |                                  |
| Litigation                                                               |                                  |                                  |
| – provision for John Crane, Inc. asbestos litigation (note 23)           | (17.6)                           | (15.2)                           |
|                                                                          | (14.4)                           | 45.6                             |
| <b>Financing items</b>                                                   |                                  |                                  |
| Exceptional finance costs – adjustment to discounted provision (note 23) | (7.0)                            | (7.1)                            |
|                                                                          | (21.4)                           | 38.5                             |

#### Year ended 31 July 2010

In the current year £8.2m has been charged in respect of the restructuring of corporate centre and divisional reorganisation. This cost has been reduced by a partial reversal of the impairment loss recognised in 2009. The total costs are expected to amount to approximately £45m.

The UK defined benefit pension schemes were closed with effect from 31 October 2009 and the curtailment gain of £3.6m arising has been reflected in the income statement. There was also a net gain of £0.3m due to the closure of a small US scheme.

The profit on disposal of businesses includes £3.8m in respect of additional consideration relating to the Group's disposal of its automotive seals manufacturing business to Cyclam Holdings LLC on 31 July 2007. This consideration was contingent on the acquirer successfully restructuring the business.

Property disposals include £5.5m arising from the grant of planning permission in respect of a property sold in the previous year.

Costs of acquisition comprise costs directly attributable to the work undertaken during the year to investigate and complete acquisitions.

The operating charge of £17.6m in respect of John Crane, Inc. asbestos litigation comprises £8.1m in respect of increased provision for adverse legal judgments, £5.2m arising from movements in the discounting due to changes in US interest rates and £4.3m in respect of legal fees in connection with litigation against insurers and defence strategy.

#### Year ended 31 July 2009

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 the year ended 31 July 2009 £23.7m was charged in respect of this restructuring, including an impairment charge of £3.1m in respect of affected properties.

The Group closed the US defined benefit pension plan with effect from 30 April 2009, and recognised a curtailment gain of £19.4m. In addition the cost of post-retirement healthcare provision in both the UK and US was reduced by requiring greater beneficiary contributions, generating a past service benefit of £50.9m.

The operating charge of £15.2m in respect of John Crane, Inc. asbestos litigation comprised £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.

## 5 Net finance costs

|                                                                  | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|------------------------------------------------------------------|----------------------------------|----------------------------------|
| <b>Interest receivable</b>                                       | <b>3.6</b>                       | 2.1                              |
| Interest payable                                                 |                                  |                                  |
| – bank loans and overdrafts                                      | <b>(7.7)</b>                     | (17.4)                           |
| – other loans                                                    | <b>(57.4)</b>                    | (37.0)                           |
| <b>Interest payable</b>                                          | <b>(65.1)</b>                    | (54.4)                           |
| Other financing gains/(losses)                                   |                                  |                                  |
| – fair value losses on hedged debt                               | <b>(2.9)</b>                     | (5.6)                            |
| – fair value gains on fair value hedge                           | <b>2.9</b>                       | 5.6                              |
| – net foreign exchange gains/(losses)                            | <b>1.6</b>                       | (3.8)                            |
| – exceptional finance costs – adjustment to discounted provision | <b>(7.0)</b>                     | (7.1)                            |
| <b>Other financing losses</b>                                    | <b>(5.4)</b>                     | (10.9)                           |
| Retirement benefits                                              |                                  |                                  |
| – return on plan assets                                          | <b>183.7</b>                     | 204.1                            |
| – interest cost                                                  | <b>(181.4)</b>                   | (199.0)                          |
| <b>Retirement benefits</b>                                       | <b>2.3</b>                       | 5.1                              |
| <b>Net finance costs</b>                                         | <b>(64.6)</b>                    | (58.1)                           |

## 6 Taxation

|                                                       | Continuing<br>Year ended<br>31 July 2010<br>£m | Continuing<br>Year ended<br>31 July 2009<br>£m | Discontinued<br>Year ended<br>31 July 2010<br>£m | Discontinued<br>Year ended<br>31 July 2009<br>£m |
|-------------------------------------------------------|------------------------------------------------|------------------------------------------------|--------------------------------------------------|--------------------------------------------------|
| The taxation charge for the year comprises            |                                                |                                                |                                                  |                                                  |
| – current taxation                                    | <b>81.1</b>                                    | 65.7                                           |                                                  |                                                  |
| – deferred taxation                                   | <b>(2.2)</b>                                   | 29.2                                           |                                                  | 0.2                                              |
| <b>Total taxation expense in the income statement</b> | <b>78.9</b>                                    | 94.9                                           |                                                  | 0.2                                              |
| Current taxation                                      |                                                |                                                |                                                  |                                                  |
| – UK corporation tax                                  | <b>81.1</b>                                    | 65.7                                           |                                                  |                                                  |
| – foreign tax                                         |                                                |                                                |                                                  |                                                  |
|                                                       | <b>81.1</b>                                    | 65.7                                           |                                                  |                                                  |

### 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% (2009: 28%). The difference is reconciled as follows:

|                                                         | Continuing<br>Year ended<br>31 July 2010<br>£m | Continuing<br>Year ended<br>31 July 2009<br>£m | Discontinued<br>Year ended<br>31 July 2010<br>£m | Discontinued<br>Year ended<br>31 July 2009<br>£m |
|---------------------------------------------------------|------------------------------------------------|------------------------------------------------|--------------------------------------------------|--------------------------------------------------|
| <b>Profit before tax</b>                                | <b>373.1</b>                                   | 370.8                                          | <b>16.4</b>                                      | (5.7)                                            |
| Notional taxation expense at UK rate of 28% (2009: 28%) | <b>104.5</b>                                   | 103.8                                          | <b>4.6</b>                                       | (1.6)                                            |
| Effect of overseas taxation                             | <b>14.7</b>                                    | 10.6                                           |                                                  |                                                  |
| Compliance benefits                                     | <b>(15.2)</b>                                  | (16.8)                                         |                                                  |                                                  |
| Local incentives                                        | <b>(16.9)</b>                                  | (8.8)                                          |                                                  |                                                  |
| Tax effect of other non-headline items                  | <b>(8.2)</b>                                   | 6.1                                            |                                                  |                                                  |
| Tax effect of Aerospace sale                            |                                                |                                                | <b>(4.6)</b>                                     | 1.8                                              |
|                                                         | <b>78.9</b>                                    | 94.9                                           |                                                  | 0.2                                              |
| Comprising                                              |                                                |                                                |                                                  |                                                  |
| – taxation on headline profit                           | <b>104.3</b>                                   | 88.8                                           |                                                  |                                                  |
| – tax on non-headline profit/(loss)                     | <b>(25.4)</b>                                  | 6.1                                            |                                                  |                                                  |
| – tax on sale of discontinued operations                |                                                |                                                |                                                  | 0.2                                              |
| <b>Total taxation expense in the income statement</b>   | <b>78.9</b>                                    | 94.9                                           |                                                  | 0.2                                              |

# Notes to the accounts

## continued

### 6 Taxation continued

|                                                  | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|--------------------------------------------------|----------------------------------|----------------------------------|
| <b>Tax on items charged/(credited) to equity</b> |                                  |                                  |
| Deferred tax charge/(credit)                     |                                  |                                  |
| – retirement benefit schemes                     | <b>(12.2)</b>                    | (94.3)                           |
| – share-based payment                            | <b>(2.4)</b>                     | 4.0                              |
|                                                  | <b>(14.6)</b>                    | (90.3)                           |

### Deferred taxation

|                                     | Excess tax<br>depreciation<br>on fixed assets<br>and goodwill<br>£m | Share-based<br>payment<br>£m | Retirement<br>benefit<br>obligations<br>£m | Capitalised<br>development<br>expenditure<br>£m | Other<br>£m  | Total<br>£m  |
|-------------------------------------|---------------------------------------------------------------------|------------------------------|--------------------------------------------|-------------------------------------------------|--------------|--------------|
| 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)       |
| Credit/(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         |
| Credit/(charge) to income statement | 22.0                                                                | 2.8                          | 0.7                                        | (3.8)                                           | (19.5)       | 2.2          |
| Credit/(charge) to equity           |                                                                     | 2.4                          | 12.2                                       |                                                 |              | 14.6         |
| Business combinations               | (3.5)                                                               |                              |                                            |                                                 |              | (3.5)        |
| Exchange adjustments                | (3.7)                                                               |                              | 3.2                                        | (1.0)                                           | 6.4          | 4.9          |
| <b>At 31 July 2010</b>              | <b>(53.6)</b>                                                       | <b>9.1</b>                   | <b>67.1</b>                                | <b>(22.4)</b>                                   | <b>116.2</b> | <b>116.4</b> |
| Deferred tax assets                 | 18.0                                                                | 9.1                          | 65.2                                       | (2.3)                                           | 104.2        | 194.2        |
| Deferred tax liabilities            | (71.6)                                                              |                              | 1.9                                        | (20.1)                                          | 12.0         | (77.8)       |
| <b>At 31 July 2010</b>              | <b>(53.6)</b>                                                       | <b>9.1</b>                   | <b>67.1</b>                                | <b>(22.4)</b>                                   | <b>116.2</b> | <b>116.4</b> |

Included in Other above is a deferred tax liability of £4.0m (2009: £4.0m) 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 £31.9m (2009: £31.3m).

The Group has not recognised deferred tax assets relating to tax losses of £92.4m (2009: £78.3m) and pensions and other long term liabilities of £194.5m (2009: £240.6m) 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

|                                | 2010<br>£m  | Expiry of<br>losses | 2009<br>£m | Expiry of<br>losses |
|--------------------------------|-------------|---------------------|------------|---------------------|
| Territory                      |             |                     |            |                     |
| – Americas                     | <b>13.9</b> | <b>2019-2025</b>    | 10.7       | 2019-2025           |
| – Asia                         | <b>2.5</b>  | <b>2014-2017</b>    |            |                     |
| <b>Total restricted losses</b> | <b>16.4</b> |                     | 10.7       |                     |
| Unrestricted losses:           |             |                     |            |                     |
| – operating losses             | <b>76.0</b> | <b>No expiry</b>    | 67.6       | No expiry           |
| <b>Total</b>                   | <b>92.4</b> |                     | 78.3       |                     |

## 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/(loss) on disposal of operation

|                                                     | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|-----------------------------------------------------|----------------------------------|----------------------------------|
| Consideration                                       | 19.9                             |                                  |
| Provisions and disposal costs                       | (3.5)                            | (5.7)                            |
| <b>Pre-tax profit/(loss) on disposal</b>            | <b>16.4</b>                      | <b>(5.7)</b>                     |
| Cash received from disposal of Aerospace operations | 19.9                             | 0.2                              |
| Disposal costs                                      |                                  | (2.1)                            |
| <b>Net cash inflow/(outflow) on disposal</b>        | <b>19.9</b>                      | <b>(1.9)</b>                     |

The further consideration of £19.9m recognised in the year was received following settlement of prior year tax filings. The loss of £3.5m in provisions and disposal costs comprises exchange gains and losses.

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

### Results from discontinued operations

|                                                         | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|---------------------------------------------------------|----------------------------------|----------------------------------|
| Profit/(loss) on disposal                               | 16.4                             | (5.7)                            |
| Attributable tax charge (note 6)                        |                                  | (0.2)                            |
| <b>Profit/(loss) for the period</b>                     | <b>16.4</b>                      | <b>(5.9)</b>                     |
| Earnings per share from discontinued operations – pence |                                  |                                  |
| Basic                                                   | 4.2p                             | (1.5p)                           |
| Diluted                                                 | 4.1p                             | (1.5p)                           |

### Cash-flows from discontinued operations

|                                                                                      | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|--------------------------------------------------------------------------------------|----------------------------------|----------------------------------|
| Profit/(loss) before taxation (including profit on disposal of Aerospace operations) | 16.4                             | (5.7)                            |
| Profit/(loss) on disposal of discontinued operations                                 | (16.4)                           | 5.7                              |
| <b>Net cash inflow from operating activities</b>                                     |                                  |                                  |

|                                                            | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|------------------------------------------------------------|----------------------------------|----------------------------------|
| Investing activities                                       | 19.9                             | (1.9)                            |
| <b>Net cash inflow/(outflow) from investing activities</b> | <b>19.9</b>                      | <b>(1.9)</b>                     |

# Notes to the accounts

## continued

### 8 Dividends

The following dividends were declared and paid in the period:

|                                                                                 | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|---------------------------------------------------------------------------------|----------------------------------|----------------------------------|
| Ordinary final dividend of 23.50p for 2009 (2008: 23.50p) paid 20 November 2009 | <b>91.6</b>                      | 91.1                             |
| Ordinary interim dividend of 10.5p for 2010 (2009: 10.5p) paid 23 April 2010    | <b>40.9</b>                      | 40.9                             |
|                                                                                 | <b>132.5</b>                     | 132.0                            |

The final dividend for the year ended 31 July 2010 of 23.5p per share was declared by the Board on 28 September 2010 and will be paid to shareholders on 19 November 2010, subject to approval by the shareholders. 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 22 October 2010.

### 9 Earnings per share

Basic earnings per share are calculated by dividing the profit for the year attributable to equity shareholders of the Parent Company by the average number of ordinary shares in issue during the year.

|                                                         | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|---------------------------------------------------------|----------------------------------|----------------------------------|
| Profit attributable to equity shareholders for the year |                                  |                                  |
| – continuing                                            | <b>293.6</b>                     | 275.4                            |
| – total                                                 | <b>310.0</b>                     | 269.5                            |
| Average number of shares in issue during the year       | <b>390,034,777</b>               | 388,786,063                      |

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 392,773,151 (2009: 392,591,613) ordinary shares, being the average number of ordinary shares in issue during the year adjusted by the dilutive effect of employee share schemes. For the year ended 31 July 2010 options over 1,729,551 (2009: 5,017,907) 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 2010 |             | Year ended 31 July 2009 |            |
|------------------------------------------------------------------|-------------------------|-------------|-------------------------|------------|
|                                                                  | £m                      | EPS<br>(p)  | £m                      | EPS<br>(p) |
| Profit attributable to equity shareholders of the Parent Company | <b>293.6</b>            | <b>75.3</b> | 275.4                   | 70.8       |
| Exclude                                                          |                         |             |                         |            |
| Non-headline items and related tax (note 3)                      | <b>36.5</b>             | <b>9.3</b>  | 6.0                     | 1.6        |
| Headline                                                         | <b>330.1</b>            | <b>84.6</b> | 281.4                   | 72.4       |
| Headline EPS – diluted (p)                                       |                         | <b>84.0</b> |                         | 71.7       |

## 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. These schemes are closed, and no further benefits are being accrued. The Group also provides defined contribution plans for its UK and US employees.

The UK defined benefit pension plans were closed with effect from 31 October 2009 and the US defined benefit pension plan was closed with effect from 30 April 2009. In 2009 future benefits accruing under the US and UK post-retirement healthcare schemes were substantially reduced.

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 2009. 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 2010. 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:

|                                              | UK   | US   | 2010<br>Other | UK   | US   | 2009<br>Other |
|----------------------------------------------|------|------|---------------|------|------|---------------|
| Rate of increase in salaries                 | n/a  | n/a  | 3.0%          | 3.8% | n/a  | 3.1%          |
| Rate of increase for active deferred members | 4.1% | n/a  | n/a           | n/a  | n/a  | n/a           |
| Rate of increase in pensions in payment      | 3.2% | n/a  | 1.4%          | 3.3% | n/a  | 1.4%          |
| Rate of increase in deferred pensions        | 3.2% | n/a  | 0.6%          | 3.3% | n/a  | 0.6%          |
| Discount rate                                | 5.4% | 5.2% | 5.2%          | 5.9% | 6.0% | 5.9%          |
| Inflation rate                               | 3.2% | n/a  | 1.8%          | 3.3% | n/a  | 1.7%          |
| Healthcare cost increases                    | 5.0% | n/a  | 3.0%          | 5.0% | n/a  | 3.0%          |

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. 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 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 2010 were:

|                                               | UK schemes                  |               | US schemes                  |                | Other countries             |               | 2010<br>Total  |
|-----------------------------------------------|-----------------------------|---------------|-----------------------------|----------------|-----------------------------|---------------|----------------|
|                                               | Long-term<br>rate of return | Value<br>£m   | Long-term<br>rate of return | Value<br>£m    | Long-term<br>rate of return | Value<br>£m   | £m             |
| Equities                                      | 8.2%                        | 1,361.2       | 8.8%                        | 222.7          | 9.4%                        | 16.1          | 1,600.0        |
| Government bonds                              | 4.2%                        | 268.9         | 3.8%                        | 91.5           | 5.8%                        | 8.1           | 368.5          |
| Corporate bonds                               | 5.4%                        | 272.7         | 5.2%                        | 58.5           | 3.7%                        | 0.9           | 332.1          |
| Insured liabilities                           | 5.4%                        | 488.0         | 5.2%                        | 2.0            |                             |               | 490.0          |
| Property                                      | 7.2%                        | 155.9         |                             |                | 3.7%                        | 0.4           | 156.3          |
| Other                                         | 4.6%                        | 69.6          | 3.0%                        | 11.9           | 4.0%                        | 14.7          | 96.2           |
| Total market value                            |                             | 2,616.3       |                             | 386.6          |                             | 40.2          | 3,043.1        |
| Present value of funded scheme liabilities    |                             | (2,658.0)     |                             | (543.4)        |                             | (57.1)        | (3,258.5)      |
| Deficit                                       |                             | (41.7)        |                             | (156.8)        |                             | (16.9)        | (215.4)        |
| Unfunded pension plans                        |                             | (37.3)        |                             | (6.1)          |                             | (22.6)        | (66.0)         |
| Post-retirement healthcare                    |                             | (8.0)         |                             | (14.4)         |                             | (0.8)         | (23.2)         |
| Present value of unfunded obligations         |                             | (45.3)        |                             | (20.5)         |                             | (23.4)        | (89.2)         |
| Unrecognised asset due to surplus restriction |                             |               |                             |                |                             | (0.7)         | (0.7)          |
| <b>Net pension liability</b>                  |                             | <b>(87.0)</b> |                             | <b>(177.3)</b> |                             | <b>(41.0)</b> | <b>(305.3)</b> |
| Post-retirement assets                        |                             | 80.3          |                             |                |                             |               | 80.3           |
| Post-retirement liabilities                   |                             | (167.3)       |                             | (177.3)        |                             | (41.0)        | (385.6)        |
| <b>Net pension liability</b>                  |                             | <b>(87.0)</b> |                             | <b>(177.3)</b> |                             | <b>(41.0)</b> | <b>(305.3)</b> |

# Notes to the accounts

## continued

### 10 Post-retirement benefits continued

|                                               | 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 |
| 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)    |
| <b>Net pension liability</b>                  |                          | (160.3)   |                          | (151.0)  |                          | (27.7)   |
| Post-retirement assets                        |                          | 39.2      |                          |          |                          |          |
| Post-retirement liabilities                   |                          | (199.5)   |                          | (151.0)  |                          | (27.7)   |
| <b>Net pension liability</b>                  |                          | (160.3)   |                          | (151.0)  |                          | (27.7)   |

Other assets in the UK and US comprise cash and current assets.

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 schemes' investment portfolios.

#### Amounts recognised in the income statement

|                                                       | Year ended 31 July 2010                |            |            |                                                   | Year ended 31 July 2009                |               |            |                                                   |
|-------------------------------------------------------|----------------------------------------|------------|------------|---------------------------------------------------|----------------------------------------|---------------|------------|---------------------------------------------------|
|                                                       | 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                                                |
| <b>Amounts (credited)/charged to operating profit</b> |                                        |            |            |                                                   |                                        |               |            |                                                   |
| Current service cost                                  | 2.8                                    | 0.3        | 1.6        | 1.4                                               | 9.4                                    | 7.4           | 1.6        | 2.5                                               |
| Past service cost                                     |                                        | 0.1        |            | 0.3                                               |                                        |               |            | (51.5)                                            |
| Curtailment (gains)/losses                            | (3.7)                                  | (0.3)      |            | 0.1                                               |                                        | (19.4)        |            |                                                   |
| <b>Total (credit)/charge</b>                          | <b>(0.9)</b>                           | <b>0.1</b> | <b>1.6</b> | <b>1.8</b>                                        | <b>9.4</b>                             | <b>(12.0)</b> | <b>1.6</b> | <b>(49.0)</b>                                     |
| <b>Amounts (credited)/charged to finance costs</b>    |                                        |            |            |                                                   |                                        |               |            |                                                   |
| Expected return on pension scheme assets              | (156.4)                                | (25.0)     | (2.3)      |                                                   | (174.0)                                | (28.3)        | (1.8)      |                                                   |
| Interest on pension scheme liabilities                | 144.8                                  | 28.8       | 3.0        | 4.8                                               | 158.8                                  | 30.0          | 2.2        | 8.0                                               |
| <b>Net return</b>                                     | <b>(11.6)</b>                          | <b>3.8</b> | <b>0.7</b> | <b>4.8</b>                                        | <b>(15.2)</b>                          | <b>1.7</b>    | <b>0.4</b> | <b>8.0</b>                                        |
| <b>Total charge/(credit) to income statement</b>      | <b>(12.5)</b>                          | <b>3.9</b> | <b>2.3</b> | <b>6.6</b>                                        | <b>(5.8)</b>                           | <b>(10.3)</b> | <b>2.0</b> | <b>(41.0)</b>                                     |

The actual return on scheme assets was a profit of £351.2m (2009: loss of £141.3m).

The 2009 past service gain of £51.5m included £41.9m related to benefit changes in the US post-retirement healthcare plans, £9.0m related to benefit changes in the UK post-retirement healthcare plans and £0.6m related to the withdrawal of a UK Christmas bonus scheme. £50.9m of this gain was recorded under exceptional operating items in the income statement.

The curtailment gains of £3.9m (2009: £19.4m) relate to the closure of the UK and US defined benefit schemes.

## 10 Post-retirement benefits continued

The operating cost is charged/(credited) as follows:

|                              | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|------------------------------|----------------------------------|----------------------------------|
| Cost of sales                | 3.4                              | 4.0                              |
| Sales and distribution costs | 2.6                              | 3.3                              |
| Administrative expenses      | 0.5                              | 13.0                             |
| Exceptional operating items  | (3.9)                            | (70.3)                           |

### Amounts recognised directly in the consolidated statement of comprehensive income

Actuarial losses of £15.2m (2009: losses of £429.9m) have been reported in the statement of comprehensive income. This includes a gain of £1.3m (2009: loss of £0.5m) in respect of unrecognised assets owing to surplus restriction. Cumulative actuarial losses from 1 August 2004 reported in the statement of comprehensive income are £558.3m (2009: cumulative losses of £543.0m).

### Changes in present value of defined benefit obligations

|                                          | Year ended 31 July 2010                |                |               |                                                   | Year ended 31 July 2009                |                |               |                                                   |
|------------------------------------------|----------------------------------------|----------------|---------------|---------------------------------------------------|----------------------------------------|----------------|---------------|---------------------------------------------------|
|                                          | Funded defined benefit pension schemes |                |               | Unfunded pension/post-retirement healthcare plans | Funded defined benefit pension schemes |                |               | Unfunded pension/post-retirement healthcare plans |
|                                          | UK<br>£m                               | US<br>£m       | Other<br>£m   | £m                                                | UK<br>£m                               | US<br>£m       | Other<br>£m   | £m                                                |
| At beginning of period                   | (2,531.8)                              | (462.6)        | (33.2)        | (84.5)                                            | (2,468.8)                              | (357.0)        | (30.7)        | (112.4)                                           |
| Reclassification of Irish pension scheme | 11.6                                   |                | (11.6)        |                                                   |                                        |                |               |                                                   |
| Current service cost                     | (2.8)                                  | (0.3)          | (1.6)         | (1.4)                                             | (9.4)                                  | (7.4)          | (1.6)         | (2.5)                                             |
| Interest on obligations                  | (144.8)                                | (28.8)         | (3.0)         | (4.8)                                             | (158.8)                                | (30.0)         | (2.2)         | (8.0)                                             |
| Employee contributions                   |                                        |                | (0.4)         |                                                   | (0.2)                                  |                | (0.1)         |                                                   |
| Past service cost                        |                                        | (0.1)          |               | (0.3)                                             |                                        |                |               | 51.5                                              |
| Actuarial (loss)/gain on liabilities     | (126.7)                                | (46.3)         | (6.4)         | (4.7)                                             | (31.7)                                 | (45.4)         | 3.5           | (10.4)                                            |
| Curtailment gain                         | 3.7                                    | 0.3            |               | (0.1)                                             |                                        | 19.4           |               |                                                   |
| Exchange adjustments                     |                                        | (29.5)         | (2.2)         | (1.2)                                             | (0.7)                                  | (64.6)         | (3.9)         | (12.1)                                            |
| Benefits paid                            | 132.8                                  | 23.9           | 1.3           | 7.8                                               | 137.8                                  | 22.4           | 1.8           | 9.4                                               |
| <b>At end of period</b>                  | <b>(2,658.0)</b>                       | <b>(543.4)</b> | <b>(57.1)</b> | <b>(89.2)</b>                                     | <b>(2,531.8)</b>                       | <b>(462.6)</b> | <b>(33.2)</b> | <b>(84.5)</b>                                     |

### Changes in present value of scheme assets

|                                          | Year ended 31 July 2010                |              |             |                                                   | Year ended 31 July 2009                |              |             |                                                   |
|------------------------------------------|----------------------------------------|--------------|-------------|---------------------------------------------------|----------------------------------------|--------------|-------------|---------------------------------------------------|
|                                          | Funded defined benefit pension schemes |              |             | Unfunded pension/post-retirement healthcare plans | Funded defined benefit pension schemes |              |             | Unfunded pension/post-retirement healthcare plans |
|                                          | UK<br>£m                               | US<br>£m     | Other<br>£m | £m                                                | UK<br>£m                               | US<br>£m     | Other<br>£m | £m                                                |
| At beginning of period                   | 2,413.7                                | 334.5        | 26.9        |                                                   | 2,618.4                                | 316.5        | 25.0        |                                                   |
| Reclassification of Irish pension scheme | (6.7)                                  |              | 6.7         |                                                   |                                        |              |             |                                                   |
| Expected return on assets                | 156.4                                  | 25.0         | 2.3         |                                                   | 174.0                                  | 28.3         | 1.8         |                                                   |
| Actuarial gain/(loss) on scheme assets   | 150.6                                  | 16.9         |             |                                                   | (279.6)                                | (61.9)       | (3.9)       |                                                   |
| Employer contributions                   | 35.1                                   | 12.7         | 3.0         | 7.8                                               | 38.0                                   | 12.6         | 2.5         | 9.4                                               |
| Employee contributions                   |                                        |              | 0.4         |                                                   | 0.2                                    |              | 0.1         |                                                   |
| Exchange adjustments                     |                                        | 21.4         | 2.2         |                                                   | 0.5                                    | 61.4         | 3.2         |                                                   |
| Benefits paid                            | (132.8)                                | (23.9)       | (1.3)       | (7.8)                                             | (137.8)                                | (22.4)       | (1.8)       | (9.4)                                             |
| <b>At end of period</b>                  | <b>2,616.3</b>                         | <b>386.6</b> | <b>40.2</b> |                                                   | <b>2,413.7</b>                         | <b>334.5</b> | <b>26.9</b> |                                                   |

# Notes to the accounts

## continued

### 10 Post-retirement benefits continued

#### Cash contributions

Company contributions to the funded defined benefit pension plans for 2010 totalled £50.8m (2009: £53.1m). Company contributions in 2010 included special covenant payments of £13.1m (2009: £13.1m).

Following completion of the triennial actuarial valuation of the principal UK defined benefit schemes (SIPS and TIGPS) as at 31 March 2009 and 5 April 2009, the Group agreed 10 year funding plans which require the following contributions:

- Cash contributions to SIPS of £36m a year for 10 years.
- An initial investment of £25m in index-linked gilts which will be held in an escrow account with further ongoing monthly investments of £2m for nine years commencing in July 2011. The escrow account remains an asset of the Group (see note 15) until 2020. At that time the assets in escrow are allocated subject to the funding position of SIPS. In addition, the escrow account may revert to the Group, should there be a surplus at an intervening triennial review.
- A conditional cash contribution to the TIGPS of up to £50m is payable in May 2012, with further biannual payments of £8m thereafter. These payments may not be made, or paid only in part, subject to the funding position of the Scheme in the six months ending 5 April 2012.

In addition to the funding plans referred to above, the Group agreed to make cash contributions in respect of any future service cost based on actuarial advice. In 2011 payments to the Group's principal defined benefit schemes are expected to total approximately £65m.

#### History of schemes

|                                               | 2010<br>£m       | 2009<br>£m | 2008<br>£m | 2007<br>£m | 2006<br>£m |
|-----------------------------------------------|------------------|------------|------------|------------|------------|
| Balance sheet                                 |                  |            |            |            |            |
| Present value of defined benefit obligation   | <b>(3,347.7)</b> | (3,112.1)  | (2,968.9)  | (3,132.9)  | (3,162.6)  |
| Fair value of scheme assets                   | <b>3,043.1</b>   | 2,775.1    | 2,959.9    | 3,318.9    | 3,111.0    |
| Unrecognised asset due to surplus restriction | <b>(0.7)</b>     | (2.0)      | (1.5)      | (2.4)      | (0.5)      |
| <b>(Deficit)/surplus</b>                      | <b>(305.3)</b>   | (339.0)    | (10.5)     | 183.6      | (52.1)     |
| Post-retirement assets                        | <b>80.3</b>      | 39.2       | 174.2      | 333.7      | 183.7      |
| Post-retirement liabilities                   | <b>(385.6)</b>   | (378.2)    | (184.7)    | (150.1)    | (235.8)    |
| <b>(Deficit)/surplus</b>                      | <b>(305.3)</b>   | (339.0)    | (10.5)     | 183.6      | (52.1)     |

|                                                 | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m | Year ended<br>31 July 2008<br>£m | Period ended<br>31 July 2007<br>£m | Period ended<br>5 August 2006<br>£m |
|-------------------------------------------------|----------------------------------|----------------------------------|----------------------------------|------------------------------------|-------------------------------------|
| <b>Experience gains/(losses)</b>                |                                  |                                  |                                  |                                    |                                     |
| Experience gains/(losses) on scheme liabilities | <b>31.5</b>                      | 100.5                            | (6.4)                            | (57.6)                             | 17.6                                |
| Experience gains/(losses) on scheme assets      | <b>167.5</b>                     | (345.4)                          | (350.0)                          | 95.7                               | 76.6                                |
| Movement on restricted surplus                  | <b>1.3</b>                       | (0.5)                            | 0.9                              | (1.9)                              | (0.5)                               |

Experience gains on the liabilities in 2009 include the impact of using the latest member data for the UK triennial valuations which were in progress at 31 July 2009.

#### 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 2010 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. 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<br>for year ended<br>31 July 2011<br>£m | Increase/<br>(decrease) in<br>scheme assets<br>£m | (Increase)/<br>decrease in<br>scheme<br>liabilities<br>£m |
|--------------------------------------------------------|-----------------------------------------------------------|---------------------------------------------------|-----------------------------------------------------------|
| Rate of mortality – 1 year increase in life expectancy | (3.5)                                                     | 24.3                                              | (90.6)                                                    |
| Rate of mortality – 1 year decrease in life expectancy | 3.7                                                       | (24.8)                                            | 92.9                                                      |
| Rate of inflation – 0.25% increase                     | (3.7)                                                     | 8.5                                               | (78.8)                                                    |
| Discount rate – 0.25% increase                         | (0.8)                                                     | (11.2)                                            | 117.6                                                     |
| Expected return on scheme assets – 0.25% increase      | 5.4                                                       |                                                   |                                                           |
| Market value of scheme assets – 2.5% increase          | 4.3                                                       | 63.3                                              | (0.1)                                                     |
| Healthcare cost trends – 1% increase                   |                                                           |                                                   | (0.4)                                                     |
| Healthcare cost trends – 1% decrease                   | 0.1                                                       |                                                   | 0.4                                                       |

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 £27.1m (2009: £15.6m).

## 11 Employees

|                                                                  | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|------------------------------------------------------------------|----------------------------------|----------------------------------|
| <b>Staff costs during the period</b>                             |                                  |                                  |
| Wages and salaries                                               | 686.1                            | 660.2                            |
| Social security                                                  | 82.0                             | 79.5                             |
| Share-based payment (note 30)                                    | 11.3                             | 8.0                              |
| Pension costs (including defined contribution schemes) (note 10) | 33.8                             | 35.1                             |
|                                                                  | <b>813.2</b>                     | <b>782.8</b>                     |

The average number of persons employed was:

|                     | Year ended<br>31 July 2010 | Year ended<br>31 July 2009 |
|---------------------|----------------------------|----------------------------|
| Smiths Detection    | 2,400                      | 2,400                      |
| John Crane          | 6,700                      | 6,600                      |
| Smiths Medical      | 8,400                      | 7,400                      |
| Smiths Interconnect | 4,000                      | 3,350                      |
| Flex-Tek            | 2,000                      | 2,000                      |
| Corporate           | 50                         | 50                         |
|                     | <b>23,550</b>              | <b>21,800</b>              |

### 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 73 to 81.

|                                           | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|-------------------------------------------|----------------------------------|----------------------------------|
| <b>Key management compensation</b>        |                                  |                                  |
| Salaries and short-term employee benefits | 10.3                             | 7.2                              |
| Cost of post-retirement benefits          | 0.1                              | 0.6                              |
| Cost of share-based incentive plans       | 2.4                              | 1.0                              |

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 2010          |                           | Year ended 31 July 2009          |                           |
|------|----------------------------------|---------------------------|----------------------------------|---------------------------|
|      | Number of<br>instruments<br>'000 | Weighted<br>average price | Number of<br>instruments<br>'000 | Weighted<br>average price |
| CIP  | 315                              |                           | 340                              |                           |
| ESOS | 220                              | £8.73                     | 170                              | £8.44                     |
| PSP  | 241                              |                           | 598                              |                           |
| VSP  | 753                              |                           | 949                              |                           |
| SAYE | 5                                | £6.45                     | 8                                | £6.90                     |

The disclosure above does not include options held by individuals who retired before the year end.

### Related party transactions

The Group has a service contract with a company connected to a member of the Executive Committee. Costs of £0.2m (2009: £0.2m) were incurred in respect of this arrangement.

# Notes to the accounts

## continued

### 12 Intangible assets

|                                                 | Goodwill<br>£m | Development<br>costs<br>£m | Acquired<br>intangibles<br>(see table on<br>next page)<br>£m | Software,<br>patents and<br>intellectual<br>property<br>£m | Total<br>£m    |
|-------------------------------------------------|----------------|----------------------------|--------------------------------------------------------------|------------------------------------------------------------|----------------|
| <b>Cost</b>                                     |                |                            |                                                              |                                                            |                |
| At 1 August 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        |
| Exchange adjustments                            | 48.7           | 5.4                        | 13.8                                                         | 3.0                                                        | 70.9           |
| Business combinations                           | 64.1           |                            | 51.5                                                         |                                                            | 115.6          |
| Adjustments to prior year business combinations | 0.2            |                            |                                                              |                                                            | 0.2            |
| Additions                                       |                | 24.3                       |                                                              | 7.6                                                        | 31.9           |
| Disposals                                       |                | (0.7)                      |                                                              | (2.0)                                                      | (2.7)          |
| <b>At 31 July 2010</b>                          | <b>1,379.5</b> | <b>135.2</b>               | <b>355.5</b>                                                 | <b>124.9</b>                                               | <b>1,995.1</b> |
| <b>Amortisation</b>                             |                |                            |                                                              |                                                            |                |
| At 1 August 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           |
| Adjustments to prior year business combinations |                | 0.2                        |                                                              |                                                            | 0.2            |
| Disposals                                       |                |                            |                                                              | (1.6)                                                      | (1.6)          |
| At 31 July 2009                                 | 92.0           | 32.4                       | 91.2                                                         | 63.3                                                       | 278.9          |
| Exchange adjustments                            | 3.1            | 2.0                        | 4.2                                                          | 2.3                                                        | 11.6           |
| Charge for the year                             |                | 13.8                       | 42.1                                                         | 11.7                                                       | 67.6           |
| Disposals                                       |                |                            |                                                              | (1.6)                                                      | (1.6)          |
| <b>At 31 July 2010</b>                          | <b>95.1</b>    | <b>48.2</b>                | <b>137.5</b>                                                 | <b>75.7</b>                                                | <b>356.5</b>   |
| <b>Net book value at 31 July 2010</b>           | <b>1,284.4</b> | <b>87.0</b>                | <b>218.0</b>                                                 | <b>49.2</b>                                                | <b>1,638.6</b> |
| Net book value at 31 July 2009                  | 1,174.5        | 73.8                       | 199.0                                                        | 53.0                                                       | 1,500.3        |
| Net book value at 1 August 2008                 | 989.7          | 54.7                       | 162.2                                                        | 46.6                                                       | 1,253.2        |

## 12 Intangible assets continued

In addition to goodwill, the acquired intangible assets comprise:

|                                       | Patents, licences<br>and trademarks<br>£m | Technology<br>£m | Customer<br>relationships<br>£m | Total acquired<br>intangibles<br>£m |
|---------------------------------------|-------------------------------------------|------------------|---------------------------------|-------------------------------------|
| <b>Cost</b>                           |                                           |                  |                                 |                                     |
| At 1 August 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                               |
| Exchange adjustments                  | 4.4                                       | 5.3              | 4.1                             | 13.8                                |
| Business combinations (note 28)       |                                           | 22.8             | 28.7                            | 51.5                                |
| <b>At 31 July 2010</b>                | <b>68.7</b>                               | <b>122.5</b>     | <b>164.3</b>                    | <b>355.5</b>                        |
| <b>Amortisation</b>                   |                                           |                  |                                 |                                     |
| At 1 August 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                                |
| Exchange adjustments                  | 0.9                                       | 2.0              | 1.3                             | 4.2                                 |
| Charge for the year                   | 5.3                                       | 11.7             | 25.1                            | 42.1                                |
| <b>At 31 July 2010</b>                | <b>20.0</b>                               | <b>46.0</b>      | <b>71.5</b>                     | <b>137.5</b>                        |
| <b>Net book value at 31 July 2010</b> | <b>48.7</b>                               | <b>76.5</b>      | <b>92.8</b>                     | <b>218.0</b>                        |
| Net book value at 31 July 2009        | 50.5                                      | 62.1             | 86.4                            | 199.0                               |
| Net book value at 1 August 2008       | 44.8                                      | 57.9             | 59.5                            | 162.2                               |

### 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 |         |
|------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------|---------|------------------------|---------|
|                                          | 2010                                                                                                                                                        | 2009    | 2010                   | 2009    |
| Net book value of goodwill (£m)          | <b>398.3</b>                                                                                                                                                | 374.3   | <b>311.5</b>           | 316.0   |
| Discount rate                            | <b>8.0%</b>                                                                                                                                                 | 8.0%    | <b>8.5%</b>            | 8.0%    |
| Period covered by management projections | <b>5 years</b>                                                                                                                                              | 5 years | <b>5 years</b>         | 5 years |
| Growth rates                             | <b>2.25%</b>                                                                                                                                                | 2.25%   | <b>2.25%</b>           | 2.25%   |
| Other key assumptions                    | <ul style="list-style-type: none"> <li>– future sales prices and volumes</li> <li>– operating margins</li> <li>– cost structure and productivity</li> </ul> |         |                        |         |

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 the underlying markets 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 amounts.

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. Sensitivity analysis was also performed for these CGUs, and no reasonable changes in the key assumptions would have caused an impairment.

# Notes to the accounts

## continued

### 13 Property, plant and equipment

|                                       | Land and<br>buildings<br>£m | Plant and<br>machinery<br>£m | Fixtures,<br>fittings,<br>tools and<br>equipment<br>£m | Total<br>£m  |
|---------------------------------------|-----------------------------|------------------------------|--------------------------------------------------------|--------------|
| <b>Cost or valuation</b>              |                             |                              |                                                        |              |
| At 1 August 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        |
| Exchange adjustments                  | 8.0                         | 23.5                         | 8.3                                                    | 39.8         |
| Business combinations                 |                             | 3.4                          | 0.8                                                    | 4.2          |
| Additions                             | 6.5                         | 26.9                         | 13.6                                                   | 47.0         |
| Disposals                             | (18.8)                      | (14.8)                       | (15.6)                                                 | (49.2)       |
| <b>At 31 July 2010</b>                | <b>187.0</b>                | <b>493.6</b>                 | <b>210.0</b>                                           | <b>890.6</b> |
| <b>Depreciation</b>                   |                             |                              |                                                        |              |
| At 1 August 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        |
| Exchange adjustments                  | 3.8                         | 15.9                         | 6.2                                                    | 25.9         |
| Charge for the year                   | 7.7                         | 39.1                         | 18.9                                                   | 65.7         |
| Reversal of impairment (note 4)       | (2.1)                       |                              |                                                        | (2.1)        |
| Disposals                             | (6.4)                       | (12.7)                       | (13.3)                                                 | (32.4)       |
| <b>At 31 July 2010</b>                | <b>82.5</b>                 | <b>345.0</b>                 | <b>160.4</b>                                           | <b>587.9</b> |
| <b>Net book value at 31 July 2010</b> | <b>104.5</b>                | <b>148.6</b>                 | <b>49.6</b>                                            | <b>302.7</b> |
| Net book value at 31 July 2009        | 111.8                       | 151.9                        | 54.3                                                   | 318.0        |
| Net book value at 1 August 2008       | 110.7                       | 131.4                        | 54.2                                                   | 296.3        |

## 14 Investments accounted for using the equity method

|                                            | 2010<br>£m  | 2009<br>£m  |
|--------------------------------------------|-------------|-------------|
| <b>Investments in associated companies</b> |             |             |
| At start of period                         | 11.2        | 9.1         |
| Exchange adjustment                        | 0.7         | 1.7         |
| Share of results after tax                 | 1.8         | 0.4         |
| Dividend received                          | (0.1)       |             |
| <b>At end of period</b>                    | <b>13.6</b> | <b>11.2</b> |

The Group's share of the revenue of associates was £22.5m (2009: £19.3m). The total assets of associates are £43.1m (2009: £49.0m) and liabilities are £17.6m (2009: £16.8m). 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 35.6% (2009: 34%).

## 15 Financial assets

Available for sale financial assets include £25.2m UK government bonds. This investment forms part of the deficit funding plan agreed with the trustee of one of the principal UK pension schemes. See note 10 for additional details.

## 16 Inventories

|                               | 2010<br>£m   | 2009<br>£m   |
|-------------------------------|--------------|--------------|
| <b>Inventories comprise</b>   |              |              |
| Raw materials and consumables | 129.3        | 145.7        |
| Work in progress              | 72.4         | 95.3         |
| Finished goods                | 190.5        | 177.4        |
|                               | 392.2        | 418.4        |
| Less: payments on account     | (2.2)        | (4.8)        |
|                               | <b>390.0</b> | <b>413.6</b> |

The Group consumed £1,262.2m (2009: £1,298.4m) of inventories during the period. £19.0m (2009: £14.9m) was recognised as an expense resulting from the write-down of inventory and £5.6m (2009: £2.0m) was released to the income statement from inventory provisions charged in earlier years but no longer required.

## 17 Trade and other receivables

|                                | 2010<br>£m   | 2009<br>£m   |
|--------------------------------|--------------|--------------|
| <b>Non-current</b>             |              |              |
| Trade receivables              | 22.8         | 13.1         |
| Prepayments and accrued income | 6.0          | 2.0          |
| Other debtors                  | 5.0          | 6.2          |
|                                | 33.8         | 21.3         |
| <b>Current</b>                 |              |              |
| Trade receivables              | 535.3        | 501.0        |
| Other debtors                  | 13.1         | 13.4         |
| Prepayments and accrued income | 30.5         | 39.2         |
|                                | <b>578.9</b> | <b>553.6</b> |

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 £575.8m (2009: £533.3m).

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% (2009: 8%) of Group revenue.

# Notes to the accounts

## continued

### 17 Trade and other receivables continued

#### Ageing of trade receivables

|                                                                             | 2010<br>£m    | 2009<br>£m |
|-----------------------------------------------------------------------------|---------------|------------|
| Trade receivables which are not impaired and not yet due                    | <b>447.3</b>  | 414.9      |
| Trade receivables which are not impaired and less than three months overdue | <b>75.7</b>   | 68.9       |
| Trade receivables which are not impaired and more than three months overdue | <b>31.8</b>   | 25.0       |
| Gross value of partially and fully provided debtors                         | <b>17.9</b>   | 19.8       |
|                                                                             | <b>572.7</b>  | 528.6      |
| Provision for bad and doubtful debts                                        | <b>(14.6)</b> | (14.5)     |
| Trade receivables                                                           | <b>558.1</b>  | 514.1      |

### 18 Cash and cash equivalents

|                                                                                            | 2010<br>£m   | 2009<br>£m |
|--------------------------------------------------------------------------------------------|--------------|------------|
| Cash at bank and in hand – including impact of cash pooling gross up: £0.2m (2009: £44.0m) | <b>136.3</b> | 84.0       |
| Short-term deposits                                                                        | <b>36.6</b>  | 7.7        |
| Cash and cash equivalents                                                                  | <b>172.9</b> | 91.7       |
| Bank overdrafts                                                                            | <b>(0.7)</b> | (72.0)     |
| Net cash and cash equivalents                                                              | <b>172.2</b> | 19.7       |

Cash and cash equivalents include highly liquid investments with maturities of three months or less.

### 19 Trade and other payables

|                                          | 2010<br>£m   | 2009<br>£m |
|------------------------------------------|--------------|------------|
| <b>Non-current</b>                       |              |            |
| Other creditors                          | <b>27.3</b>  | 25.1       |
| <b>Current</b>                           |              |            |
| Trade creditors                          | <b>151.6</b> | 130.3      |
| Bills of exchange payable                | <b>0.5</b>   | 0.4        |
| Other creditors                          | <b>35.2</b>  | 40.8       |
| Other taxation and social security costs | <b>21.2</b>  | 19.1       |
| Accruals and deferred income             | <b>219.7</b> | 209.2      |
|                                          | <b>428.2</b> | 399.8      |

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.

## 20 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.

|                                                                                 | 2010<br>£m       | 2009<br>£m     |
|---------------------------------------------------------------------------------|------------------|----------------|
| <b>Cash and cash equivalents</b>                                                |                  |                |
| Net cash and deposits (note 18)                                                 | 172.9            | 91.7           |
| <b>Short-term borrowings</b>                                                    |                  |                |
| Bank overdrafts including impact of cash pooling gross up: £0.2m (2009: £44.0m) | (0.7)            | (72.0)         |
| £139m 7.875% Sterling Eurobond 2010                                             |                  | (137.7)        |
| Bank and other loans                                                            | (1.3)            | (3.7)          |
| Interest accrual                                                                | (12.7)           | (11.0)         |
|                                                                                 | (14.7)           | (224.4)        |
| <b>Long-term borrowings</b>                                                     |                  |                |
| £660m Revolving Credit Facility 2012                                            |                  | (36.9)         |
| \$250m 5.45% US\$ Private placement 2013                                        | (169.1)          | (156.5)        |
| \$250m 6.05% US\$ Guaranteed notes 2014                                         | (158.3)          | (148.5)        |
| £150m 7.25% Sterling Eurobond 2016                                              | (149.1)          | (149.0)        |
| €300m 4.125% Eurobond 2017                                                      | (247.6)          |                |
| \$175m 7.37% US\$ Private placement 2018                                        | (111.4)          | (104.7)        |
| \$250m 7.20% US\$ Guaranteed notes 2019                                         | (158.0)          | (148.3)        |
| Bank and other loans                                                            | (1.5)            | (8.3)          |
|                                                                                 | (995.0)          | (752.2)        |
| <b>Borrowings</b>                                                               | <b>(1,009.7)</b> | <b>(976.6)</b> |
| <b>Net debt</b>                                                                 | <b>(836.8)</b>   | <b>(884.9)</b> |

Borrowings are accounted for at amortised cost and are categorised as other financial liabilities. See note 21 for a maturity analysis of borrowings. The repayment dates on borrowings repayable after five years range from 2016 to 2019.

Interest of £43.2m (2009: £27.7m) 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 £0.2m at 31 July 2010 (2009: £44.0m).

### Movements in net debt

|                               | 31 July 2009<br>£m | Foreign<br>exchange<br>gains and<br>losses<br>£m | Repayments of<br>borrowings<br>and net cash<br>inflow<br>£m | Drawdown of<br>borrowings<br>and net cash<br>outflow<br>£m | Capitalisation,<br>interest<br>accruals<br>and unwind of<br>capitalised fees<br>£m | Fair value<br>movements<br>from interest<br>rate hedging<br>£m | Change in<br>maturity<br>analysis<br>£m | 31 July 2010<br>£m |
|-------------------------------|--------------------|--------------------------------------------------|-------------------------------------------------------------|------------------------------------------------------------|------------------------------------------------------------------------------------|----------------------------------------------------------------|-----------------------------------------|--------------------|
| Net cash and cash equivalents | 19.7               | (0.8)                                            | 153.3                                                       |                                                            |                                                                                    |                                                                |                                         | 172.2              |
| Other short-term borrowings   | (152.4)            | (0.5)                                            | 141.6                                                       |                                                            | (1.4)                                                                              |                                                                | (1.3)                                   | (14.0)             |
| Long-term borrowings          | (752.2)            | (40.7)                                           | 266.8                                                       | (466.8)                                                    | (0.5)                                                                              | (2.9)                                                          | 1.3                                     | (995.0)            |
| <b>Net debt</b>               | <b>(884.9)</b>     | <b>(42.0)</b>                                    | <b>561.7</b>                                                | <b>(466.8)</b>                                             | <b>(1.9)</b>                                                                       | <b>(2.9)</b>                                                   |                                         | <b>(836.8)</b>     |

The net cash inflow includes £0.3m of cash acquired with new subsidiary undertakings.

### Secured loans

Loans amounting to £2.8m (2009: £3.4m) were secured on plant and equipment with a book value of £2.6m (2009: £3.3m).

At 31 July 2009 loans amounting to £6.5m were secured by charges on freehold properties with a book value of £11.5m. These loans have been repaid, and there are no borrowings at 31 July 2010 secured on property.

# Notes to the accounts

## continued

### 21 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 17.

#### (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 the net foreign exchange exposure to known future sales and purchases is material, this 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 2010                                                       |                |            |            |             |             |
|-----------------------------------------------------------------------|----------------|------------|------------|-------------|-------------|
|                                                                       | Sterling<br>£m | US\$<br>£m | Euro<br>£m | Other<br>£m | Total<br>£m |
| <b>Financial assets and liabilities</b>                               |                |            |            |             |             |
| Financial instruments included in trade and other receivables         | 34.5           | 280.3      | 138.8      | 122.2       | 575.8       |
| Financial instruments included in trade and other payables            | (36.3)         | (143.1)    | (66.2)     | (51.1)      | (296.7)     |
| Cash and cash equivalents                                             | 30.4           | 30.6       | 19.0       | 92.9        | 172.9       |
| Borrowings not designated as net investment hedges                    | (151.6)        | (11.5)     | (2.6)      | (0.3)       | (166.0)     |
|                                                                       | (123.0)        | 156.3      | 89.0       | 163.7       | 286.0       |
| Exclude balances held in operations with the same functional currency | 124.7          | (103.9)    | (87.1)     | (159.0)     | (225.3)     |
| Exposure arising from intra-group loans                               |                | (36.0)     | 12.8       | 6.2         | (17.0)      |
| Forward foreign exchange contracts                                    | (2.6)          | 30.0       | 11.2       | (38.6)      |             |
|                                                                       | (0.9)          | 46.4       | 25.9       | (27.7)      | 43.7        |

| At 31 July 2009                                                       |                |            |            |             |             |
|-----------------------------------------------------------------------|----------------|------------|------------|-------------|-------------|
|                                                                       | Sterling<br>£m | US\$<br>£m | Euro<br>£m | Other<br>£m | Total<br>£m |
| <b>Financial assets and liabilities</b>                               |                |            |            |             |             |
| Financial instruments included in trade and other receivables         | 36.0           | 256.6      | 142.2      | 98.5        | 533.3       |
| Financial instruments included in trade and other payables            | (34.0)         | (126.1)    | (75.9)     | (37.5)      | (273.5)     |
| Cash and cash equivalents                                             | 13.3           | 16.0       | 25.3       | 37.1        | 91.7        |
| Borrowings not designated as net investment hedges                    | (306.5)        | (22.7)     | (33.4)     | (19.1)      | (381.7)     |
|                                                                       | (291.2)        | 123.8      | 58.2       | 79.0        | (30.2)      |
| Exclude balances held in operations with the same functional currency | 294.0          | (84.9)     | (52.4)     | (77.5)      | 79.2        |
| Exposure arising from intra-group loans                               |                |            | (12.0)     | 23.2        | 11.2        |
| Forward foreign exchange contracts                                    | 70.7           | (82.3)     | (2.4)      | 14.0        |             |
|                                                                       | 73.5           | (43.4)     | (8.6)      | 38.7        | 60.2        |

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<br>for the year<br>31 July 2010<br>£m | Gain/(loss)<br>recognised in<br>reserves<br>31 July 2010<br>£m | Impact on profit<br>for the year<br>31 July 2009<br>£m | Gain/(loss)<br>recognised in<br>reserves<br>31 July 2009<br>£m |
|-----------|--------------------------------------------------------|----------------------------------------------------------------|--------------------------------------------------------|----------------------------------------------------------------|
| US dollar | 1.5                                                    | (1.8)                                                          | 4.9                                                    | 5.0                                                            |
| Euro      | 1.0                                                    | 2.9                                                            | 0.2                                                    | (1.2)                                                          |
| Sterling  | 1.3                                                    | 1.8                                                            | 1.8                                                    | 5.1                                                            |

These sensitivities were calculated before adjusting for tax and exclude the effect of quasi-equity intra-group loans.

## 21 Financial risk management continued

### Cash-flow hedging

The Group uses foreign currency contracts to hedge future foreign currency sales and purchases. At 31 July 2010 contracts with a nominal value of £292.7m (2009: £310.7m) were designated as hedging instruments. In addition, the Group had outstanding foreign currency contracts with a nominal value of £152.1m (2009: £121.7m) 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 22.

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 99.6% are for periods of 12 months or less (2009: 99%).

The movements in the cash-flow hedge reserve during the period are summarised in the table below:

|                                                                                                      | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|------------------------------------------------------------------------------------------------------|----------------------------------|----------------------------------|
| Brought forward cash-flow hedge reserve at start of year                                             | 1.8                              | 1.1                              |
| Exchange adjustments                                                                                 | 0.2                              | 0.3                              |
| Gains and losses on effective cash-flow hedges recognised in equity                                  | (2.3)                            | (8.0)                            |
| Amounts removed from the hedge reserve and recognised in the following lines on the income statement |                                  |                                  |
| – revenue                                                                                            | 0.1                              | 9.6                              |
| – cost of sales                                                                                      | 0.9                              | (2.8)                            |
| – administrative expenses                                                                            | (1.3)                            | 1.6                              |
| <b>Carried forward cash-flow hedge reserve at end of year</b>                                        | <b>(0.6)</b>                     | 1.8                              |

### 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 relevant 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 2010 |            |            |             |             |
|-------------------------------------------|-----------------|------------|------------|-------------|-------------|
|                                           | Sterling<br>£m  | US\$<br>£m | Euro<br>£m | Other<br>£m | Total<br>£m |
| Loans designated as net investment hedges |                 | (587.0)    | (248.1)    |             | (835.1)     |
| Currency swap contracts                   | 206.7           | (32.4)     | (39.2)     | (135.1)     |             |
|                                           | 206.7           | (619.4)    | (287.3)    | (135.1)     | (835.1)     |

|                                           | At 31 July 2009 |            |            |             |             |
|-------------------------------------------|-----------------|------------|------------|-------------|-------------|
|                                           | Sterling<br>£m  | US\$<br>£m | Euro<br>£m | Other<br>£m | Total<br>£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 2010 swap contracts hedged the Group's exposure to Australian dollars, Canadian dollars, Japanese yen and Chinese renminbi (2009: Japanese yen and Chinese renminbi). At 31 July 2009 currency loans in other currencies hedged the Group's exposure to Canadian dollars and Australian dollars.

Of the contracts designated as net investment hedges, 56% (2009: 53%) are current and the balance matures over the next three years (2009: four years).

The gains and losses that have been deferred in the net investment hedge reserve are shown in the table below:

|                                                                    | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|--------------------------------------------------------------------|----------------------------------|----------------------------------|
| Brought forward net investment hedge reserve at start of year      | (88.9)                           | (30.3)                           |
| Amounts deferred in the period on effective net investment hedges  | (39.3)                           | (58.6)                           |
| <b>Carried forward net investment hedge reserve at end of year</b> | <b>(128.2)</b>                   | (88.9)                           |

# Notes to the accounts

## continued

### 21 Financial risk management continued

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, if the specified currencies were to strengthen 10% while all other market rates remained constant, it would have the following effect:

|           | Loss<br>recognised in<br>hedge reserve<br>31 July 2010<br>£m | Loss<br>recognised in<br>hedge reserve<br>31 July 2009<br>£m |
|-----------|--------------------------------------------------------------|--------------------------------------------------------------|
| US dollar | <b>61.8</b>                                                  | 70.8                                                         |
| Euro      | <b>26.0</b>                                                  | 10.7                                                         |

These movements would be 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.

#### (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 60% to 100% 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 2010 91.5% (2009: 73.9%) of the Group's net borrowings were at fixed interest rates, after adjusting for interest rate swaps and the impact of short maturity derivatives designated as net investment hedges.

The weighted average interest rate on borrowings and cross-currency swaps at 31 July 2010, after interest rate swaps, is 5.4% (2009: 5.8%).

#### 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<br>cash<br>equivalents<br>31 July 2010<br>£m | Borrowings<br>31 July 2010<br>£m | Fair value of<br>borrowings<br>31 July 2010<br>£m | Cash and<br>cash<br>equivalents<br>31 July 2009<br>£m | Borrowings<br>31 July 2009<br>£m | Fair value of<br>borrowings<br>31 July 2009<br>£m |
|---------------------------------------------------------------------------------------------|-------------------------------------------------------|----------------------------------|---------------------------------------------------|-------------------------------------------------------|----------------------------------|---------------------------------------------------|
| Fixed interest (adjusted for interest rate hedging)                                         |                                                       |                                  |                                                   |                                                       |                                  |                                                   |
| Less than one year                                                                          |                                                       | <b>(1.3)</b>                     | <b>(1.3)</b>                                      |                                                       | (141.4)                          | (146.8)                                           |
| Between one and five years                                                                  |                                                       | <b>(223.5)</b>                   | <b>(244.3)</b>                                    |                                                       | (152.5)                          | (156.4)                                           |
| Greater than five years                                                                     |                                                       | <b>(566.9)</b>                   | <b>(643.7)</b>                                    |                                                       | (406.4)                          | (430.6)                                           |
| Total fixed interest financial assets/(liabilities)<br>(adjusted for interest rate hedging) |                                                       | <b>(791.7)</b>                   | <b>(889.3)</b>                                    |                                                       | (700.3)                          | (733.8)                                           |
| Floating rate interest financial assets/(liabilities)                                       | <b>156.4</b>                                          | <b>(218.0)</b>                   | <b>(218.0)</b>                                    | 77.1                                                  | (276.3)                          | (268.9)                                           |
| Total interest bearing financial assets/(liabilities)                                       | <b>156.4</b>                                          | <b>(1,009.7)</b>                 | <b>(1,107.3)</b>                                  | 77.1                                                  | (976.6)                          | (1,002.7)                                         |
| Non-interest bearing assets/(liabilities) in the same category                              | <b>16.5</b>                                           |                                  |                                                   | 14.6                                                  |                                  |                                                   |
| <b>Total</b>                                                                                | <b>172.9</b>                                          | <b>(1,009.7)</b>                 | <b>(1,107.3)</b>                                  | 91.7                                                  | (976.6)                          | (1,002.7)                                         |

#### Interest rate hedging

The Group has designated US\$150.0m interest rate swaps which mature on 28 January 2013 and €120.0m interest rate swaps which mature on 5 May 2017 as fair value hedges on the US private placement and the Eurobond respectively which mature on the same dates. These positions hedge 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 22. The effect of the swaps is to convert £195.3m (2009: £149.7m) 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 2010, 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 £0.2m (2009: £2.2m) impact on the Group's profit before tax.

## 21 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 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 and derivatives, totals £199.9m at 31 July 2010 (2009: £99.5m).

|                                                                        | 2010<br>£m   | 2009<br>£m  |
|------------------------------------------------------------------------|--------------|-------------|
| Cash held in interest compensation pools with a legal right of set-off | 0.2          | 44.0        |
| Cash at banks with at least a AA- credit rating                        | 120.8        | 37.5        |
| Cash at banks with a A+ credit rating                                  | 47.3         | 12.6        |
| Cash at other banks                                                    | 4.7          | 4.0         |
| UK government bonds with a AAA credit rating (note 15)                 | 25.2         |             |
| Other investments                                                      | 1.7          | 1.4         |
|                                                                        | <b>199.9</b> | <b>99.5</b> |

At 31 July 2010 the maximum exposure with a single bank for deposits and cash is £41.6m (2009: £24.1m), whilst the maximum mark to market exposure for derivatives is £6.8m (2009: £6.4m). 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 June 2012. At the balance sheet date the Group had the following undrawn credit facilities:

|                                    | 2010<br>£m   | 2009<br>£m   |
|------------------------------------|--------------|--------------|
| Expiring within one year           |              |              |
| Expiring between one and two years | 660.0        |              |
| Expiring after two years           |              | 622.8        |
|                                    | <b>660.0</b> | <b>622.8</b> |

#### Cash deposits

As at 31 July 2010, £36.6m (2009: £7.7m) of cash and cash equivalents was on deposit with various banks of which £20.8m (2009: £5.9m) was on deposit in the UK.

#### Gross contractual cash-flows for borrowings

|                              | Borrowings<br>(Note 20)<br>31 July 2010<br>£m | Fair value<br>adjustments<br>31 July 2010<br>£m | Contractual<br>interest<br>payments<br>31 July 2010<br>£m | Total<br>contractual<br>cash-flows<br>31 July 2010<br>£m | Borrowings<br>(Note 20)<br>31 July 2009<br>£m | Fair value<br>adjustments<br>31 July 2009<br>£m | Contractual<br>interest<br>payments<br>31 July 2009<br>£m | Total<br>contractual<br>cash-flows<br>31 July 2009<br>£m |
|------------------------------|-----------------------------------------------|-------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------------|-----------------------------------------------|-------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------------|
| Less than one year           | (14.7)                                        | 1.3                                             | (47.9)                                                    | (61.3)                                                   | (224.4)                                       | (0.2)                                           | (58.4)                                                    | (283.0)                                                  |
| Between one and two years    | (1.0)                                         |                                                 | (59.2)                                                    | (60.2)                                                   | (1.6)                                         |                                                 | (47.9)                                                    | (49.5)                                                   |
| Between two and three years  | (169.6)                                       | 9.8                                             | (54.9)                                                    | (214.7)                                                  | (38.2)                                        |                                                 | (47.7)                                                    | (85.9)                                                   |
| Between three and four years | (158.3)                                       | (1.0)                                           | (50.5)                                                    | (209.8)                                                  | (157.0)                                       | 6.8                                             | (42.8)                                                    | (193.0)                                                  |
| Between four and five years  |                                               |                                                 | (40.8)                                                    | (40.8)                                                   | (149.0)                                       | (1.2)                                           | (36.7)                                                    | (186.9)                                                  |
| Greater than five years      | (666.1)                                       | (4.0)                                           | (102.0)                                                   | (772.1)                                                  | (406.4)                                       | (2.5)                                           | (101.1)                                                   | (510.0)                                                  |
| <b>Total</b>                 | <b>(1,009.7)</b>                              | <b>6.1</b>                                      | <b>(355.3)</b>                                            | <b>(1,358.9)</b>                                         | <b>(976.6)</b>                                | <b>2.9</b>                                      | <b>(334.6)</b>                                            | <b>(1,308.3)</b>                                         |

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<br>31 July 2010<br>£m | Payments<br>31 July 2010<br>£m | Net cash-flow<br>31 July 2010<br>£m | Receipts<br>31 July 2009<br>£m | Payments<br>31 July 2009<br>£m | Net cash-flow<br>31 July 2009<br>£m |
|-----------------------|--------------------------------|--------------------------------|-------------------------------------|--------------------------------|--------------------------------|-------------------------------------|
| <b>Assets</b>         |                                |                                |                                     |                                |                                |                                     |
| Less than one year    | 375.2                          | (354.0)                        | 21.2                                | 592.2                          | (545.3)                        | 46.9                                |
| Greater than one year | 78.7                           | (60.7)                         | 18.0                                | 182.7                          | (217.7)                        | (35.0)                              |
| <b>Liabilities</b>    |                                |                                |                                     |                                |                                |                                     |
| Less than one year    | 362.5                          | (377.8)                        | (15.3)                              | 460.2                          | (513.7)                        | (53.5)                              |
| Greater than one year | 30.2                           | (31.3)                         | (1.1)                               | 256.0                          | (232.7)                        | 23.3                                |
| <b>Total</b>          | <b>846.6</b>                   | <b>(823.8)</b>                 | <b>22.8</b>                         | <b>1,491.1</b>                 | <b>(1,509.4)</b>               | <b>(18.3)</b>                       |

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 22.

#### Gross contractual cash-flows for other financial liabilities

The contractual cash-flows for financial liabilities included in trade and other payables are: £284.5m (2009: £261.9m) due in less than one year, £8.2m (2009: £7.3m) due between one and five years and £4.0m (2009: £4.3m) due after more than five years.

# Notes to the accounts

## continued

### 22 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 2010                                  |                                       |             |                |              |
|--------------------------------------------------|---------------------------------------|-------------|----------------|--------------|
|                                                  | Contract or underlying nominal amount | Fair value  |                |              |
|                                                  | £m                                    | Assets £m   | Liabilities £m | Net £m       |
| Foreign exchange contracts (cash-flow hedges)    | 292.7                                 | 5.2         | (7.0)          | (1.8)        |
| Foreign exchange contracts (not hedge accounted) | 152.1                                 | 1.2         | (2.3)          | (1.1)        |
| <b>Total foreign exchange contracts</b>          | <b>444.8</b>                          | <b>6.4</b>  | <b>(9.3)</b>   | <b>(2.9)</b> |
| Currency swaps (net investment hedges)           | 206.7                                 | 4.9         | (0.8)          | 4.1          |
| Currency swaps (not hedge accounted)             | 180.7                                 | 6.7         | (5.6)          | 1.1          |
| <b>Total currency swap contracts</b>             | <b>387.4</b>                          | <b>11.6</b> | <b>(6.4)</b>   | <b>5.2</b>   |
| Interest rate swaps (fair value hedges)          | 195.3                                 | 8.3         | (0.3)          | 8.0          |
| <b>Total financial derivatives</b>               | <b>1,027.5</b>                        | <b>26.3</b> | <b>(16.0)</b>  | <b>10.3</b>  |
| Balance sheet entries                            |                                       |             |                |              |
| Non-current                                      |                                       | 10.8        | (1.1)          | 9.7          |
| Current                                          |                                       | 15.5        | (14.9)         | 0.6          |
| <b>Total financial derivatives</b>               |                                       | <b>26.3</b> | <b>(16.0)</b>  | <b>10.3</b>  |

| 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)          |            |
| <b>Total foreign exchange contracts</b>                     | <b>432.4</b>                          | <b>12.5</b> | <b>(10.1)</b>  | <b>2.4</b> |
| 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)     |
| <b>Total currency swap contracts</b>                        | <b>907.3</b>                          | <b>35.9</b> | <b>(34.3)</b>  | <b>1.6</b> |
| 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        |
| <b>Total financial derivatives</b>                          | <b>1,489.4</b>                        | <b>54.6</b> | <b>(45.6)</b>  | <b>9.0</b> |
| Balance sheet entries                                       |                                       |             |                |            |
| Non-current                                                 |                                       | 13.9        | (6.7)          | 7.2        |
| Current                                                     |                                       | 40.7        | (38.9)         | 1.8        |
| <b>Total financial derivatives</b>                          |                                       | <b>54.6</b> | <b>(45.6)</b>  | <b>9.0</b> |

#### 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.

#### 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.

#### Fair value hierarchy

All derivatives values are calculated using level 2 valuation methodologies.

## 23 Provisions for liabilities and charges

|                                          | At<br>31 July 2009<br>£m | Exchange<br>adjustments<br>£m | Provisions<br>charged<br>£m | Provisions<br>released<br>£m | Unwind of<br>provision<br>discount<br>£m | Utilisation<br>£m | At<br>31 July 2010<br>£m |
|------------------------------------------|--------------------------|-------------------------------|-----------------------------|------------------------------|------------------------------------------|-------------------|--------------------------|
| Warranty provision and product liability | 44.4                     | 1.0                           | 14.8                        | (6.6)                        |                                          | (16.1)            | <b>37.5</b>              |
| Reorganisation                           | 15.7                     | 0.9                           | 5.4                         | (0.8)                        |                                          | (9.8)             | <b>11.4</b>              |
| Property                                 | 3.5                      |                               | 1.9                         | (0.1)                        |                                          | (0.6)             | <b>4.7</b>               |
| Disposal                                 | 54.7                     | 3.1                           |                             | (1.4)                        |                                          | (0.2)             | <b>56.2</b>              |
| Litigation                               | 185.4                    | 11.0                          | 21.4                        | (3.9)                        | 7.0                                      | (29.5)            | <b>191.4</b>             |
|                                          | 303.7                    | 16.0                          | 43.5                        | (12.8)                       | 7.0                                      | (56.2)            | <b>301.2</b>             |

Analysed as:

|                         | 2010<br>£m   | 2009<br>£m |
|-------------------------|--------------|------------|
| Current liabilities     | <b>70.4</b>  | 77.2       |
| Non-current liabilities | <b>230.8</b> | 226.5      |
|                         | <b>301.2</b> | 303.7      |

### 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 £5.4m has been charged in the current year.

Reorganisation provisions include £2.8m (2009: £4.8m) 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.

Most of the balance is expected to be utilised within the next five years.

### 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 184,000 claims against JCI have been dismissed before trial over the last 31 years. JCI is currently a defendant in cases involving approximately 116,000 claims. Despite the large number of claims brought against JCI, it has had final judgments against it, after appeals, in only 100 cases over the period, and has had to pay awards amounting to approximately US\$95m. 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.

# Notes to the accounts

## continued

### 23 Provisions for liabilities and charges continued

#### Litigation continued

##### John Crane, Inc. continued

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 17 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:

|                               | 2010<br>£m    | 2009<br>£m |
|-------------------------------|---------------|------------|
| Gross provision               | <b>214.5</b>  | 213.3      |
| Discount                      | <b>(38.8)</b> | (46.7)     |
| Discounted pre-tax provision  | <b>175.7</b>  | 166.6      |
| Deferred tax                  | <b>(47.4)</b> | (45.0)     |
| Discounted post-tax provision | <b>128.3</b>  | 121.6      |

#### Other litigation

The Group has on occasion been required to take legal action to protect its intellectual property and other rights against infringement. It has also had to defend itself against proceedings brought by other parties, including product liability and insurance subrogation claims. Provision is made for any expected costs and liabilities in relation to these proceedings where appropriate, though there can be no guarantee that such provisions (which may be subject to potentially material revision from time to time) will accurately predict the actual costs and liabilities that may be incurred.

Apart from that relating to JCI, none of the other provisions is discounted.

### 24 Operating lease commitments – minimum lease payments

The minimum uncancellable lease payments which the Group is committed to make are:

|                                                     | 2010                        |             | 2009                        |             |
|-----------------------------------------------------|-----------------------------|-------------|-----------------------------|-------------|
|                                                     | Land and<br>buildings<br>£m | Other<br>£m | Land and<br>buildings<br>£m | Other<br>£m |
| Payments due                                        |                             |             |                             |             |
| – not later than one year                           | <b>27.3</b>                 | <b>9.0</b>  | 25.0                        | 9.1         |
| – later than one year and not later than five years | <b>63.7</b>                 | <b>10.7</b> | 57.8                        | 9.4         |
| – later than five years                             | <b>27.7</b>                 | <b>0.1</b>  | 27.0                        | 0.1         |
|                                                     | <b>118.7</b>                | <b>19.8</b> | 109.8                       | 18.6        |

## 25 Contingent liabilities and commitments

### John Crane, Inc.

As stated in note 23, 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

In the ordinary course of its business, the Group is subject to litigation such as product liability claims, employee disputes and other kinds of lawsuits, and faces different types of legal issues in different jurisdictions. The high level of activity in the US, for example, exposes the Group 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. Any claim brought against the Group (with or without merit), could be costly to defend. These matters are inherently difficult to quantify. In appropriate cases a provision is recognised based on best estimates and management judgment but there can be no guarantee that these provisions (which may be subject to potentially material revision from time to time) will result in an accurate prediction of the actual costs and liabilities that may be incurred. There are also contingent liabilities in respect of litigation for which no provisions are made.

At 31 July 2010, contingent liabilities, comprising bonds and guarantees arising in the normal course of business, amounted to £143.5m (2009: £202.1m), including pension commitments of £40.6m (2009: £116.1m). At 31 July 2009 the Parent Company had two letters of credit to support the Group's pension plans, one for £100.0m and one for £50.0m, which were both partially utilised. Following the agreement of ten year funding plans with the Trustees of its two major UK pension schemes the first letter of credit has been cancelled, leaving only the £50.0m facility.

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.

## 26 Share capital

|                                            | Number of shares   | Issued capital<br>£m | Consideration<br>£m |
|--------------------------------------------|--------------------|----------------------|---------------------|
| <b>Ordinary shares of 37.5p each</b>       |                    |                      |                     |
| At 31 July 2009                            | 389,026,427        | 145.9                |                     |
| Exercise of share options                  | 1,701,616          | 0.6                  | 9.1                 |
| <b>Total share capital at 31 July 2010</b> | <b>390,728,043</b> | <b>146.5</b>         |                     |

At 31 July 2010 all of the issued share capital was in free issue. All issued shares are fully paid.

## 27 Reserves

Retained earnings include the value of Smiths Group plc shares held by the Smiths Industries Employee Benefit Trust. In the year the Company issued 558,754 (2009: 682,922) shares to the Trust. At 31 July 2010 the Trust held 32,858 (2009: 105,932) ordinary shares with a market value of £0.4m (2009: £0.8m).

The capital redemption reserve, revaluation reserve and merger reserve arose from: share repurchases; revaluations of property, plant and equipment; and merger accounting for business combinations before the adoption of IFRS, respectively.

### Capital management

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 19% (2009: 26%).

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 2010 the Group had a credit rating of BBB+/Baa2 – negative outlook (2009: BBB+/Baa2 – negative outlook) with Standard & Poor's and Moody's respectively.

### Hedge reserve

|                                                  | 2010<br>£m     | 2009<br>£m    |
|--------------------------------------------------|----------------|---------------|
| The hedge reserve on the balance sheet comprises |                |               |
| – cash-flow hedge reserve                        | (0.6)          | 1.8           |
| – net investment hedge reserve                   | (128.2)        | (88.9)        |
|                                                  | <b>(128.8)</b> | <b>(87.1)</b> |

See transactional currency exposure risk management disclosures in note 21 for additional details of cash-flow hedges and translational currency exposure risk management disclosure also in note 21 for additional details of net investment hedges.

# Notes to the accounts

## continued

### 28 Cash-flow from operating activities

|                                                     | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|-----------------------------------------------------|----------------------------------|----------------------------------|
| Operating profit – continuing                       | 435.9                            | 428.5                            |
| Operating profit – discontinued                     |                                  |                                  |
|                                                     | 435.9                            | 428.5                            |
| Amortisation of intangible assets                   | 67.6                             | 55.2                             |
| Impairment of intangible assets                     |                                  | 0.2                              |
| Profit on disposal of property, plant and equipment | (3.1)                            | (11.3)                           |
| Profit on disposal of business                      | (3.3)                            | (1.6)                            |
| Depreciation of property, plant and equipment       | 65.7                             | 62.2                             |
| Impairment of property, plant and equipment         | (2.1)                            | 3.8                              |
| Share-based payment expense                         | 10.3                             | 9.4                              |
| Retirement benefits                                 | (56.1)                           | (112.5)                          |
| Decrease in inventories                             | 46.1                             | 22.1                             |
| (Increase)/decrease in trade and other receivables  | (16.5)                           | 94.0                             |
| Increase/(decrease) in trade and other payables     | 27.0                             | (79.9)                           |
| Decrease in provisions                              | (21.8)                           | (24.9)                           |
| Cash generated from operations                      | 549.7                            | 445.2                            |
| Interest                                            | (52.8)                           | (39.1)                           |
| Tax paid                                            | (86.4)                           | (74.0)                           |
| <b>Net cash inflow from operating activities</b>    | <b>410.5</b>                     | <b>332.1</b>                     |

### 29 Acquisitions

During the period ended 31 July 2010, the Group acquired Channel Microwave (October 2009) and Interconnect Devices, Inc. ("IDI") (April 2010) on behalf of Smiths Interconnect.

IDI designs and produces highly engineered, application specific connectors using a proprietary spring probe contact technology. It focuses on mission critical applications for semiconductor and circuit-board testing, and high reliability connectors for military, medical, homeland security and industrial markets. The IDI acquisition expands the Smiths Interconnect product range and provides a significant Chinese base for the Connectors technology group.

From the date of acquisition to 31 July 2010, the acquisitions contributed £20.3m to revenue, £2.8m to headline profit before taxation and £(0.9)m to profit before taxation. If Smiths had acquired the businesses at the beginning of the financial period, the acquisitions would have contributed £52.1m to revenue and £7.2m to headline profit before tax.

The intangible assets recognised comprise £22.8m in respect of technology and £28.7m in respect of customer relationships and orders. Goodwill represents the value of synergies arising from the acquisitions and future growth opportunities. The goodwill recognised is not expected to be deductible for tax purposes. 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 2011. 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 increased by £0.2m.

|                                                                  | Interconnect Devices, Inc. |                                 |                                 | Other acquisitions |                                 |                                 | Total        |
|------------------------------------------------------------------|----------------------------|---------------------------------|---------------------------------|--------------------|---------------------------------|---------------------------------|--------------|
|                                                                  | Book value<br>£m           | Fair value<br>adjustments<br>£m | Provisional<br>fair value<br>£m | Book value<br>£m   | Fair value<br>adjustments<br>£m | Provisional<br>fair value<br>£m | £m           |
| <b>Non-current assets</b>                                        |                            |                                 |                                 |                    |                                 |                                 |              |
| – intangible assets                                              | 38.1                       | 11.9                            | 50.0                            |                    | 1.5                             | 1.5                             | 51.5         |
| – property, plant and equipment                                  | 4.2                        | (0.1)                           | 4.1                             | 0.1                |                                 | 0.1                             | 4.2          |
| – other assets                                                   | 0.8                        | (0.8)                           |                                 |                    |                                 |                                 |              |
| <b>Current assets</b>                                            |                            |                                 |                                 |                    |                                 |                                 |              |
| – cash and cash equivalents                                      | 0.3                        |                                 | 0.3                             |                    |                                 |                                 | 0.3          |
| – other current assets                                           | 12.4                       | 0.2                             | 12.6                            | 1.0                | (0.2)                           | 0.8                             | 13.4         |
| <b>Non-current liabilities</b>                                   |                            |                                 |                                 |                    |                                 |                                 |              |
| – other liabilities                                              | (0.1)                      | (3.5)                           | (3.6)                           |                    |                                 |                                 | (3.6)        |
| <b>Current liabilities</b>                                       |                            |                                 |                                 |                    |                                 |                                 |              |
| – other current liabilities                                      | (3.1)                      |                                 | (3.1)                           | (0.2)              |                                 | (0.2)                           | (3.3)        |
| <b>Net assets acquired</b>                                       | <b>52.6</b>                | <b>7.7</b>                      | <b>60.3</b>                     | <b>0.9</b>         | <b>1.3</b>                      | <b>2.2</b>                      | <b>62.5</b>  |
| Goodwill on current year acquisitions                            |                            |                                 | 62.6                            |                    |                                 | 1.5                             | 64.1         |
| Goodwill adjustments on prior year acquisitions                  |                            |                                 |                                 |                    |                                 |                                 | 0.2          |
| <b>Total consideration</b>                                       |                            |                                 | <b>122.9</b>                    |                    |                                 | <b>3.7</b>                      | <b>126.8</b> |
| Cash paid during the period – current year acquisitions          |                            |                                 |                                 |                    |                                 |                                 | 126.6        |
| Adjustments to deferred consideration on prior year acquisitions |                            |                                 |                                 |                    |                                 |                                 | 0.2          |
| <b>Total consideration</b>                                       |                            |                                 |                                 |                    |                                 |                                 | <b>126.8</b> |

### 30 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) were granted annually. The awards are 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, and the final award under the PSP will be released in December 2010.

#### Value Sharing Plan (VSP)

The VSP is a 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.

#### 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 have been 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.

|                                     | CIP        | PSP and VSP  | Other share schemes | Total        | Weighted average price for option plans £ |
|-------------------------------------|------------|--------------|---------------------|--------------|-------------------------------------------|
| Ordinary shares under option ('000) |            |              |                     |              |                                           |
| 1 August 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                                     |
| Granted                             | 412        |              | 248                 | 660          | £3.32                                     |
| Update of estimates                 |            | (241)        |                     | (241)        | £0.00                                     |
| Exercised                           | (430)      | (130)        | (1,643)             | (2,203)      | £6.18                                     |
| Lapsed                              | (95)       | (1,198)      | (1,193)             | (2,486)      | £5.53                                     |
| <b>31 July 2010</b>                 | <b>877</b> | <b>1,770</b> | <b>6,432</b>        | <b>9,079</b> | <b>£6.15</b>                              |

Options were exercised on an irregular basis during the period. The average closing share price over the financial year was 1,000.61p (2009: 832.08p). There has been no change to the effective option price of any of the outstanding options during the period.

# Notes to the accounts

## continued

### 30 Employee share schemes continued

| Range of exercise prices | Total shares<br>under option<br>(‘000) | Weighted<br>average<br>remaining<br>contractual life<br>(months) | Options<br>exercisable at<br>31 July 2010<br>(‘000) | Options<br>exercisable at<br>31 July 2009<br>(‘000) | Exercisable<br>weighted<br>average<br>exercise price<br>for options<br>exercisable at<br>31 July 2010 |
|--------------------------|----------------------------------------|------------------------------------------------------------------|-----------------------------------------------------|-----------------------------------------------------|-------------------------------------------------------------------------------------------------------|
| £0.00 – £2.00            | 2,647                                  | 14                                                               |                                                     | 1                                                   | <b>£0.00</b>                                                                                          |
| £2.01 – £6.00            | 602                                    | 50                                                               | <b>2</b>                                            | 5                                                   | <b>£5.69</b>                                                                                          |
| £6.01 – £10.00           | 4,433                                  | 52                                                               | <b>1,667</b>                                        | 2,879                                               | <b>£8.19</b>                                                                                          |
| £10.01 – £14.00          | 1,397                                  | 88                                                               | <b>51</b>                                           | 116                                                 | <b>£10.97</b>                                                                                         |

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 2010 and 2009 are volatility of 30% (2009: 23%) and dividend yield of 3.75% (2009: 3.75%). Assumptions on expected volatility and expected option term have been made on the basis of historical data, for the period corresponding with the vesting period of the option. These generated a weighted average fair value for CIP of £18.89 (2009: £6.96) and VSP/PSP of £11.21 (2009: £11.01).

Included within staff costs is an expense arising from share-based payment transactions of £11.3m (2009: £8.0m), of which £10.3m (2009: £9.4m) relates to equity-settled share-based payment.

At 31 July 2010 the creditor relating to cash-settled schemes is £0.9m (2009: £0.2m).

# Group financial record 2006-2010

|                                                                                                | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m | Period ended<br>31 July 2008<br>£m | Period ended<br>31 July 2007<br>£m | Period ended<br>5 August 2006<br>£m |
|------------------------------------------------------------------------------------------------|----------------------------------|----------------------------------|------------------------------------|------------------------------------|-------------------------------------|
| Revenue                                                                                        | <b>2,769.6</b>                   | 2,664.6                          | 2,321.2                            | 2,160.9                            | 2,180.3                             |
| <b>Headline operating profit</b>                                                               | <b>492.4</b>                     | 417.5                            | 380.6                              | 347.6                              | 344.8                               |
| Amortisation of acquired intangible assets                                                     | <b>(42.1)</b>                    | (34.6)                           | (19.2)                             | (14.8)                             | (13.0)                              |
| Exceptional items (including profit on sale/impairment of financial asset)                     | <b>(14.4)</b>                    | 45.6                             | (35.4)                             | (74.2)                             | (337.8)                             |
| Financing losses                                                                               |                                  |                                  | (0.3)                              | (1.5)                              | (1.8)                               |
| <b>Operating profit/(loss)</b>                                                                 | <b>435.9</b>                     | 428.5                            | 325.7                              | 257.1                              | (7.8)                               |
| Net finance costs                                                                              | <b>(64.6)</b>                    | (58.1)                           | (5.4)                              | (0.6)                              | (28.4)                              |
| Share of post-tax profits/(losses) of associated companies                                     | <b>1.8</b>                       | 0.4                              | (1.0)                              | (0.5)                              | (1.1)                               |
| <b>Profit/(loss) before taxation</b>                                                           | <b>373.1</b>                     | 370.8                            | 319.3                              | 256.0                              | (37.3)                              |
| Taxation                                                                                       | <b>(78.9)</b>                    | (94.9)                           | (75.0)                             | (53.1)                             | (65.4)                              |
| <b>Profit/(loss) after taxation – continuing operations</b>                                    | <b>294.2</b>                     | 275.9                            | 244.3                              | 202.9                              | (102.7)                             |
| <b>Profit/(loss) after taxation – discontinued operations</b>                                  | <b>16.4</b>                      | (5.9)                            | 24.5                               | 1,525.2                            | 126.9                               |
| <b>Shareholders' equity</b>                                                                    | <b>1,094.8</b>                   | 859.0                            | 915.9                              | 903.3                              | 1,362.9                             |
| Represented by                                                                                 |                                  |                                  |                                    |                                    |                                     |
| – intangible assets                                                                            | <b>1,638.6</b>                   | 1,500.3                          | 1,253.2                            | 1,021.3                            | 1,530.6                             |
| – property, plant & equipment and investments                                                  | <b>343.3</b>                     | 337.0                            | 309.0                              | 273.6                              | 512.6                               |
| – net current assets/provisions/retirement benefit liabilities                                 | <b>(50.3)</b>                    | (93.4)                           | 124.3                              | 198.3                              | 246.4                               |
| Net borrowings                                                                                 | <b>(836.8)</b>                   | (884.9)                          | (770.6)                            | (589.9)                            | (926.7)                             |
| <b>Funds employed</b>                                                                          | <b>1,094.8</b>                   | 859.0                            | 915.9                              | 903.3                              | 1,362.9                             |
| <b>Ratios</b>                                                                                  |                                  |                                  |                                    |                                    |                                     |
| Operating profit before amortisation of acquired intangible assets: turnover (%)               | <b>17.8</b>                      | 15.7                             | 16.4                               | 16.1                               | 14.8                                |
| Effective tax rate before amortisation of acquired intangible assets and exceptional items (%) | <b>24.0</b>                      | 24.0                             | 24.0                               | 25.1                               | 25.6                                |
| Return on shareholders' funds (%)                                                              | <b>18.4</b>                      | 16.5                             | 16.7                               | 14.9                               | 13.6                                |
| <b>Cash-flow</b>                                                                               |                                  |                                  |                                    |                                    |                                     |
| Cash-flow from normal operating activities                                                     | <b>542.5</b>                     | 422.5                            | 280.5                              | 265.9                              | 437.6                               |
| Less capital expenditure (net)                                                                 | <b>22.3</b>                      | 12.5                             | (8.0)                              | (6.7)                              | (18.0)                              |
| Operating cash after capital expenditure                                                       | <b>564.8</b>                     | 435.0                            | 272.5                              | 259.2                              | 419.6                               |
| Free cash-flow (before acquisitions and dividends, after capital expenditure)                  | <b>331.3</b>                     | 256.1                            | 90.6                               | 100.7                              | 170.4                               |
| Free cash-flow per share (p)                                                                   | <b>84.9</b>                      | 65.9                             | 23.4                               | 18.3                               | 30.1                                |
| <b>Earnings per share</b>                                                                      |                                  |                                  |                                    |                                    |                                     |
| Earnings per share before amortisation of acquired intangible assets and exceptional items (p) | <b>84.6</b>                      | 72.4                             | 74.5                               | 47.0                               | 41.5                                |
| <b>Dividends</b>                                                                               |                                  |                                  |                                    |                                    |                                     |
| Pence per share                                                                                | <b>34.0</b>                      | 34.0                             | 34.0                               | 34.0                               | 31.3                                |
| Headline dividend cover                                                                        | <b>2.5</b>                       | 2.1                              | 2.2                                | 1.4                                | 1.3                                 |
| <b>Number of employees (000s)</b>                                                              |                                  |                                  |                                    |                                    |                                     |
| United Kingdom                                                                                 | <b>2.0</b>                       | 2.0                              | 2.2                                | 2.8                                | 7.3                                 |
| Overseas                                                                                       | <b>21.6</b>                      | 19.8                             | 20.6                               | 18.6                               | 24.5                                |
|                                                                                                | <b>23.6</b>                      | 21.8                             | 22.8                               | 21.4                               | 31.8                                |

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.

# 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 2010 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 Chapter 3 of Part 16 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 2010;
- 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 Group 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 2010.

## Martin Hodgson (Senior Statutory Auditor)

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

28 September 2010

## 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 2010<br>£m | 31 July 2009<br>£m |
|----------------------------------------------------------|-------|--------------------|--------------------|
| <b>Fixed assets</b>                                      |       |                    |                    |
| Tangible assets                                          | 2     | 4.6                | 12.1               |
| Investments and advances                                 | 3     | 3,234.9            | 3,341.8            |
| Available for sale financial assets                      | 4     | 25.2               |                    |
|                                                          |       | <b>3,264.7</b>     | 3,353.9            |
| <b>Current assets</b>                                    |       |                    |                    |
| Debtors                                                  |       |                    |                    |
| – amounts falling due within one year                    | 5     | 115.0              | 74.9               |
| – amounts falling due after more than one year           | 5     | 27.5               | 35.9               |
| Cash at bank and on deposit                              |       | 20.2               | 9.2                |
| Financial derivatives                                    |       |                    |                    |
| – amounts falling due within one year                    |       | 9.1                | 28.3               |
| – amounts falling due after more than one year           |       | 10.7               | 13.8               |
|                                                          |       | <b>182.5</b>       | 162.1              |
| Creditors: amounts falling due within one year           | 6     | (113.4)            | (243.2)            |
| <b>Net current (liabilities)/assets</b>                  |       | <b>69.1</b>        | (81.1)             |
| <b>Total assets less current liabilities</b>             |       | <b>3,333.8</b>     | 3,272.8            |
| Creditors: amounts falling due after more than one year  | 6     | (984.2)            | (737.2)            |
| Provisions for liabilities and charges                   | 7     | (4.3)              | (7.5)              |
| Financial derivatives                                    |       | (1.0)              | (6.5)              |
| <b>Net assets excluding pension assets/(liabilities)</b> |       | <b>2,344.3</b>     | 2,521.6            |
| Retirement benefit liabilities                           | 8     | (164.3)            | (187.7)            |
| <b>Net assets including pension assets/(liabilities)</b> |       | <b>2,180.0</b>     | 2,333.9            |
| <b>Capital and reserves</b>                              |       |                    |                    |
| Called up share capital                                  | 9     | 146.5              | 145.9              |
| Share premium account                                    | 10    | 315.3              | 306.6              |
| Capital redemption reserve                               | 10    | 5.8                | 5.8                |
| Other reserves                                           | 10    | 180.5              | 180.5              |
| Profit and loss account                                  | 10    | 1,531.9            | 1,695.1            |
| <b>Shareholders' equity</b>                              |       | <b>2,180.0</b>     | 2,333.9            |

The accounts on pages 129 to 137 were approved by the Board of Directors on 28 September 2010 and were signed on its behalf by:

**Philip Bowman**  
Chief Executive

**Peter Turner**  
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%; Fixtures, fittings, 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 89 to 94 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

The Company 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 AA 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 total recognised gains and losses. 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 Company pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. Contributions are expensed as incurred.

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

## 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.

## 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 (2009: £0.1m).

## 2 Property, plant and equipment

|                                       | Land and buildings<br>£m | Plant and machinery<br>£m | Fixtures, fittings, tools and equipment<br>£m | Total<br>£m |
|---------------------------------------|--------------------------|---------------------------|-----------------------------------------------|-------------|
| <b>Cost or valuation</b>              |                          |                           |                                               |             |
| At 31 July 2009                       | 9.2                      | 6.7                       | 0.5                                           | 16.4        |
| Additions                             |                          | 0.4                       |                                               | 0.4         |
| Disposals                             | (9.2)                    |                           |                                               | (9.2)       |
| <b>At 31 July 2010</b>                |                          | <b>7.1</b>                | <b>0.5</b>                                    | <b>7.6</b>  |
| <b>Depreciation</b>                   |                          |                           |                                               |             |
| At 31 July 2009                       | 2.6                      | 1.4                       | 0.3                                           | 4.3         |
| Charge for the period                 | 0.1                      | 1.2                       | 0.1                                           | 1.4         |
| Reversal of impairment                | (2.1)                    |                           |                                               | (2.1)       |
| Disposals                             | (0.6)                    |                           |                                               | (0.6)       |
| <b>At 31 July 2010</b>                |                          | <b>2.6</b>                | <b>0.4</b>                                    | <b>3.0</b>  |
| <b>Net book value at 31 July 2010</b> |                          | <b>4.5</b>                | <b>0.1</b>                                    | <b>4.6</b>  |
| Net book value at 31 July 2009        | 6.6                      | 5.3                       | 0.2                                           | 12.1        |

The land and buildings are freehold properties.

## 3 Investments and advances

|                                       | Shares at cost<br>£m | Due from subsidiaries<br>£m | Due to subsidiaries<br>£m | Total<br>£m    |
|---------------------------------------|----------------------|-----------------------------|---------------------------|----------------|
| <b>Cost or valuation</b>              |                      |                             |                           |                |
| At 31 July 2009                       | 2,360.9              | 1,864.0                     | (863.1)                   | 3,361.8        |
| Exchange adjustments                  |                      | 20.7                        |                           | 20.7           |
| Additions                             |                      | 1,184.5                     | (347.2)                   | 837.3          |
| Contribution through share options    | 5.7                  |                             |                           | 5.7            |
| Disposals                             |                      | (1,025.0)                   | 57.3                      | (967.7)        |
| <b>At 31 July 2010</b>                | <b>2,366.6</b>       | <b>2,044.2</b>              | <b>(1,153.0)</b>          | <b>3,257.8</b> |
| <b>Provision for impairment</b>       |                      |                             |                           |                |
| At 31 July 2009                       | 20.0                 |                             |                           | 20.0           |
| Impairment charge for the period      | 2.0                  | 0.9                         |                           | 2.9            |
| <b>At 31 July 2010</b>                | <b>22.0</b>          | <b>0.9</b>                  |                           | <b>22.9</b>    |
| <b>Net book value at 31 July 2010</b> | <b>2,344.6</b>       | <b>2,043.3</b>              | <b>(1,153.0)</b>          | <b>3,234.9</b> |
| Net book value at 31 July 2009        | 2,340.9              | 1,864.0                     | (863.1)                   | 3,341.8        |

The impairment charge for the period relates to investments in semi-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:

Smiths Group International Holdings Limited  
 Smiths Detection Group Limited  
 John Crane Group Limited  
 Smiths Medical Group Limited  
 Smiths Interconnect Group Limited

### 3 Investments and advances continued

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.  
John Crane, Inc.  
Titeflex Corporation  
Flexible Technologies, Inc.  
Tutco, Inc.  
Hypertronics Corporation  
Sabritec, Inc.  
Transtector Systems, Inc.  
Interconnect Devices, Inc.  
JC Production Solutions, 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 Available for sale financial assets

Available for sale financial assets comprise UK government bonds. This investment forms part of the deficit funding plan agreed with the trustee of one of the principal UK pension schemes. See note 8 for additional details.

### 5 Debtors

|                                                 | 31 July 2010<br>£m | 31 July 2009<br>£m |
|-------------------------------------------------|--------------------|--------------------|
| <b>Amounts falling due within one year</b>      |                    |                    |
| Amounts owed by subsidiaries                    | 96.2               | 72.1               |
| Other debtors                                   | 7.8                | 1.9                |
| Corporation tax                                 | 10.2               | 0.7                |
| Prepayments and accrued income                  | 0.8                | 0.2                |
|                                                 | 115.0              | 74.9               |
| <b>Amounts falling after more than one year</b> |                    |                    |
| Deferred taxation                               | 27.5               | 35.9               |
|                                                 | 142.5              | 110.8              |

### 6 Creditors

|                                                     | 31 July 2010<br>£m | 31 July 2009<br>£m |
|-----------------------------------------------------|--------------------|--------------------|
| <b>Amounts falling due within one year</b>          |                    |                    |
| Overdrafts                                          |                    | 9.4                |
| Term loans                                          |                    | 137.7              |
| Amounts owed to subsidiaries                        | 76.0               | 43.6               |
| Other creditors                                     | 27.2               | 42.2               |
| Other taxation and social security costs            | 1.2                | 0.6                |
| Accruals and deferred income                        | 9.0                | 9.7                |
|                                                     | 113.4              | 243.2              |
| <b>Amounts falling due after more than one year</b> |                    |                    |
| Term loans                                          | 984.2              | 737.2              |
|                                                     | 984.2              | 737.2              |

The maturity profile and coupons for the term loans are disclosed in note 20 of the Group accounts.

# Notes to the Company accounts

## continued

### 7 Provisions for liabilities and charges

|           | At<br>31 July 2009<br>£m | Provisions<br>released<br>£m | Utilisation<br>£m | At<br>31 July 2010<br>£m |
|-----------|--------------------------|------------------------------|-------------------|--------------------------|
| Disposals | 7.5                      | (3.2)                        |                   | <b>4.3</b>               |
|           | 7.5                      | (3.2)                        |                   | <b>4.3</b>               |

The closing disposal provision relates to warranties and other obligations in respect of a past disposal and is expected to be utilised within the next five years.

### 8 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.

The UK defined benefit pension schemes were closed with effect from 31 October 2009.

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 2009. This has been rolled forward to 31 July 2010.

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 2010 | 31 July 2009 |
|----------------------------------------------|--------------|--------------|
| Rate of increase in salaries                 | <b>n/a</b>   | 3.8%         |
| Rate of increase for active deferred members | <b>4.1%</b>  | n/a          |
| Rate of increase in pensions in payment      | <b>3.2%</b>  | 3.3%         |
| Rate of increase in deferred pensions        | <b>3.2%</b>  | 3.3%         |
| Discount rate                                | <b>5.4%</b>  | 5.9%         |
| Inflation rate                               | <b>3.2%</b>  | 3.3%         |
| Healthcare cost increases                    | <b>5.0%</b>  | 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.

The assets in the scheme and the expected rates of return as at 31 July 2010 were:

|                                                    | 31 July 2010                |                  | 31 July 2009                |             |
|----------------------------------------------------|-----------------------------|------------------|-----------------------------|-------------|
|                                                    | Long-term<br>rate of return | Value<br>£m      | Long-term<br>rate of return | Value<br>£m |
| Equities                                           | <b>8.2%</b>                 | <b>783.3</b>     | 8.2%                        | 589.8       |
| Government bonds                                   | <b>4.2%</b>                 | <b>22.2</b>      | 4.5%                        | 46.0        |
| Corporate bonds                                    | <b>5.4%</b>                 | <b>272.5</b>     | 5.9%                        | 266.9       |
| Property                                           | <b>7.2%</b>                 | <b>155.5</b>     | 7.2%                        | 137.3       |
| Other                                              | <b>4.6%</b>                 | <b>92.1</b>      | 5.0%                        | 148.9       |
| Total market value                                 |                             | <b>1,325.6</b>   |                             | 1,188.9     |
| Present value of funded pension scheme liabilities |                             | <b>(1,444.6)</b> |                             | (1,340.4)   |
| Deficit                                            |                             | <b>(119.0)</b>   |                             | (151.5)     |
| Unfunded pension plans                             |                             | <b>(37.3)</b>    |                             | (36.0)      |
| Post-retirement healthcare                         |                             | <b>(8.0)</b>     |                             | (6.2)       |
|                                                    |                             | <b>(164.3)</b>   |                             | (193.7)     |
| Related deferred tax asset                         |                             |                  |                             | 6.0         |
| <b>Net pension liability</b>                       |                             | <b>(164.3)</b>   |                             | (187.7)     |

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.

## 8 Post-retirement benefits continued

### History of experience gains and losses

|                                                                     | 31 July 2010<br>£m | 31 July 2009<br>£m | 31 July 2008<br>£m | 31 July 2007<br>£m | 5 August 2006<br>£m |
|---------------------------------------------------------------------|--------------------|--------------------|--------------------|--------------------|---------------------|
| Fair value of scheme assets                                         | <b>1,325.6</b>     | 1,188.9            | 1,311.0            | 1,527.5            | 1,380.4             |
| Present value of pension and post retirement healthcare obligations | <b>(1,489.9)</b>   | (1,382.6)          | (1,383.0)          | (1,492.8)          | (1,464.1)           |
| Net pension liability                                               | <b>(164.3)</b>     | (193.7)            | (72.0)             | 34.7               | (83.7)              |
| Actual return less expected return on pension scheme assets         | <b>84.2</b>        | (180.9)            | (183.9)            | 52.6               | 23.5                |
| As a percentage of scheme assets                                    | <b>6%</b>          | (15%)              | (14%)              | 3%                 | 2%                  |
| Experience gains and losses arising on the scheme liabilities       | <b>7.1</b>         | 98.4               | (4.5)              | (36.7)             | 1.6                 |
| As a percentage of present value scheme liabilities                 | <b>0%</b>          | 7%                 | 0%                 | (2%)               | 0%                  |

### Changes in present value of defined benefit obligations

|                                      | 31 July 2010<br>£m | 31 July 2009<br>£m |
|--------------------------------------|--------------------|--------------------|
| At beginning of the period           | <b>(1,382.6)</b>   | (1,383.0)          |
| Current service cost                 | <b>(1.7)</b>       | (6.2)              |
| Past service cost                    | <b>(0.3)</b>       | 9.6                |
| Interest on obligations              | <b>(79.8)</b>      | (89.2)             |
| Actuarial (loss)/gain on liabilities | <b>(90.5)</b>      | 14.5               |
| Benefits paid                        | <b>65.0</b>        | 71.7               |
| <b>At end of the period</b>          | <b>(1,489.9)</b>   | (1,382.6)          |

### Changes in present value of scheme assets

|                                 | 31 July 2010<br>£m | 31 July 2009<br>£m |
|---------------------------------|--------------------|--------------------|
| At beginning of the period      | <b>1,188.9</b>     | 1,311.0            |
| Expected return on assets       | <b>80.7</b>        | 91.7               |
| Contributions by employer       | <b>36.8</b>        | 38.8               |
| Actuarial gain/(loss) on assets | <b>84.2</b>        | (180.9)            |
| Benefits paid                   | <b>(65.0)</b>      | (71.7)             |
| <b>At end of the period</b>     | <b>1,325.6</b>     | 1,188.9            |

### Cash contributions

Following completion of the triennial actuarial valuation of the defined benefit scheme as at 31 March 2009, the Group agreed a 10 year funding plan which requires the following contributions:

- Cash contributions of £36m a year for 10 years; and
- An initial investment of £25m in index-linked gilts which will be held in an escrow account with further ongoing monthly investments of £2m for nine years commencing in July 2011. The escrow account remains an asset of the Group (see note 4) until 2020. At that time the assets in escrow are allocated subject to the funding position of the scheme. In addition, the escrow account may revert to the Group, should there be a surplus at an intervening triennial review.

In addition to the deficit funding, the Group continues to make cash contributions in respect of current service cost based on actuarial advice. Cash payments in 2011 are expected to be £36m.

### A one percentage point change in assumed healthcare cost trend rates would have the following effects:

|                                                           | One percentage<br>point increase<br>£m | One percentage<br>point decrease<br>£m |
|-----------------------------------------------------------|----------------------------------------|----------------------------------------|
| Effect on the aggregate of service cost and interest cost | 0.1                                    | (0.1)                                  |
| Effect on defined benefit obligations                     |                                        |                                        |

# Notes to the Company accounts

## continued

### 9 Share capital

|                                            | Number of shares   | Issued capital<br>£m | Consideration<br>£m |
|--------------------------------------------|--------------------|----------------------|---------------------|
| <b>Ordinary shares of 37.5p each</b>       |                    |                      |                     |
| At 31 July 2009                            | 389,026,427        | 145.9                |                     |
| Exercise of share options                  | 1,701,616          | 0.6                  | 9.1                 |
| <b>Total share capital at 31 July 2010</b> | <b>390,728,043</b> | <b>146.5</b>         |                     |

At 31 July 2010 all of the issued share capital was in free issue. All issued shares are fully paid.

|                                                              | 31 July 2010     | 31 July 2009 |
|--------------------------------------------------------------|------------------|--------------|
| Number of ordinary shares issuable under outstanding options | <b>5,785,689</b> | 7,813,294    |

|                                                  | Year issued | Number of shares | Subscription prices | Dates normally exercisable |
|--------------------------------------------------|-------------|------------------|---------------------|----------------------------|
| Smiths Sharesave Scheme                          | 2003        | 20,493           | 554.00p             | 2006/2010                  |
|                                                  | 2004        | 26,874           | 525.00p             | 2007/2011                  |
|                                                  | 2005        | 75,058           | 704.00p             | 2008/2012                  |
|                                                  | 2006        | 62,912           | 798.00p             | 2009/2013                  |
|                                                  | 2007        | 108,470          | 868.00p             | 2010/2014                  |
|                                                  | 2008        | 152,588          | 724.00p             | 2011/2015                  |
|                                                  | 2009        | 554,252          | 569.00p             | 2012/2016                  |
|                                                  | 2010        | 121,136          | 894.00p             | 2013/2017                  |
| Smiths Industries Executive Share Option Schemes | 2001        | 56,136           | 790.00p             | 2004/2011                  |
|                                                  | 2002        | 796,452          | 806.00p             | 2005/2012                  |
|                                                  | 2002        | 77,000           | 654.00p             | 2005/2012                  |
|                                                  | 2003        | 119,116          | 669.00p             | 2006/2013                  |
|                                                  | 2004        | 422,411          | 774.00p             | 2007/2014                  |
|                                                  | 2005        | 595,000          | 901.00p             | 2008/2015                  |
|                                                  | 2006        | 1,215,000        | 896.50p             | 2009/2016                  |
|                                                  | 2007        | 1,244,000        | 1,097.00p           | 2010/2017                  |
|                                                  | 2008        | 12,500           | 835.50p             | 2011/2018                  |
|                                                  | 2009        | 126,291          | 871.00p             | 2012/2019                  |

### 10 Share premium account and reserves

|                                                                  | Share premium<br>£m | Capital redemption<br>reserve<br>£m | Other reserves<br>£m | Profit and loss account<br>£m |
|------------------------------------------------------------------|---------------------|-------------------------------------|----------------------|-------------------------------|
| At 31 July 2009                                                  | 306.6               | 5.8                                 | 180.5                | 1,695.1                       |
| Exercise of share options                                        | 8.7                 |                                     |                      | 0.6                           |
| Purchase of own shares                                           |                     |                                     |                      | (0.2)                         |
| Loss for the period                                              |                     |                                     |                      | (35.3)                        |
| Dividends paid to equity shareholders                            |                     |                                     |                      | (132.5)                       |
| Actuarial loss on retirement benefits                            |                     |                                     |                      | (6.3)                         |
| Fair value gains/(losses) on available for sale financial assets |                     |                                     |                      | 0.2                           |
| Share-based payment                                              |                     |                                     |                      | 10.3                          |
| <b>At 31 July 2010</b>                                           | <b>315.3</b>        | <b>5.8</b>                          | <b>180.5</b>         | <b>1,531.9</b>                |

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 (2009: £0.2m) and £0.6m (2009: £2.6m) was received as a result of the issue of shares. At 31 July 2010 the Trust held 32,858 (2009: 105,932) ordinary shares with a market value of £0.4m (2009: £0.8m).

The Company's profit and loss reserve of £1,531.9m includes £895.7m (2009: £895.7m) not available for distribution as dividend.

During the year, the Company received £9.1m (2009: £1.5m) on the issue of shares in respect of the exercise of options awarded under various share option schemes.

Other reserves arose from the cancellation of the share premium arising from an equity-funded acquisition in the year ended 30 July 1988.

## 11 Deferred tax

|                                            | Year ended<br>31 July 2010<br>£m | Year ended<br>31 July 2009<br>£m |
|--------------------------------------------|----------------------------------|----------------------------------|
| <b>Deferred taxation</b>                   |                                  |                                  |
| At beginning of period                     | <b>41.9</b>                      | 25.5                             |
| (Charge)/credit to profit and loss account | <b>(14.4)</b>                    | 16.4                             |
| <b>At end of period</b>                    | <b>27.5</b>                      | 41.9                             |
| Analysed as follows                        |                                  |                                  |
| Excess tax depreciation on fixed assets    | <b>1.0</b>                       | 1.5                              |
| Retirement benefit obligations             |                                  | 6.0                              |
| Share-based payment                        | <b>2.8</b>                       | 2.3                              |
| Losses carried forward                     | <b>23.1</b>                      | 31.5                             |
| Short-term timing differences              | <b>0.6</b>                       | 0.6                              |
|                                            | <b>27.5</b>                      | 41.9                             |

## 12 Contingent liabilities

The Company has provided guarantees and arranged letter of credit facilities to support the Group's pension plans. The current amount outstanding under letters of credit is £40.6m (2009: £116.1m).

The Company has guaranteed the £660m revolving credit facility available to a subsidiary.

## 13 Post balance sheet event

The directors propose a final dividend of 23.5p per share (totalling approximately £91.8m) for the year ended 31 July 2010. The dividend will be submitted for formal approval at the Annual General Meeting to be held on 16 November 2010.

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 2011. During the year ended 31 July 2010, a final dividend of 23.5p per share (totalling £91.6m) was paid in respect of the dividend declared for the period ended 31 July 2009.

# Financial calendar

|                                                 | 2010         |
|-------------------------------------------------|--------------|
| Preliminary announcement of results for 2009/10 | 29 September |
| Ordinary shares final dividend ex-dividend date | 20 October   |
| Ordinary shares final dividend record date      | 22 October   |
| Annual General Meeting                          | 16 November  |
| Ordinary shares final dividend payment date     | 19 November  |

|                                                   | 2011                       |
|---------------------------------------------------|----------------------------|
| 2010/11 interim results announced                 | 23 March (provisional)     |
| Ordinary shares interim dividend ex-dividend date | 30 March (provisional)     |
| Ordinary shares interim dividend record date      | 1 April (provisional)      |
| Ordinary shares interim dividend payment date     | 21 April (provisional)     |
| Smiths Group financial year end                   | 31 July                    |
| Preliminary announcement of results for 2010/11   | 28 September (provisional) |
| Ordinary shares final dividend ex-dividend date   | 26 October (provisional)   |
| Ordinary shares final dividend record date        | 28 October (provisional)   |
| Annual General Meeting                            | 22 November (provisional)  |
| Ordinary shares final dividend payment date       | 25 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 2010 Annual General Meeting will be held at The Thomas Lord Suite, Lord's Cricket Ground, Grace Gate, St John's Wood, London, NW8 8QN on Tuesday 16 November 2010 at 2:30pm.

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**smiths**

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