00137013

# Annual Report 2011
Smiths Group plc

smiths
bringing technology to life

Bringing technology to life

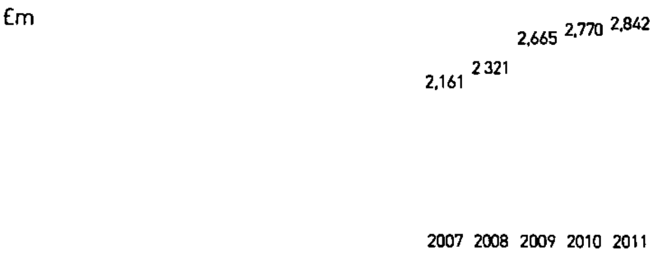
# Financial highlights

**Continuing activities**

| | 2011 £m | 2010 £m |
|---|---|---|
| Sales | **2,842** | 2,770 |
| Headline operating profit* | **517** | 492 |
| Statutory operating profit | **438** | 436 |
| Headline basic EPS* | **92.7p** | 84.6p |
| Statutory basic EPS | **77.8p** | 75.3p |
| Free cash-flow | **236** | 331 |
| Dividend | **36.25p** | 34.0p |
| Return on capital employed | **17.0%** | 16.6% |

*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

**Sales**

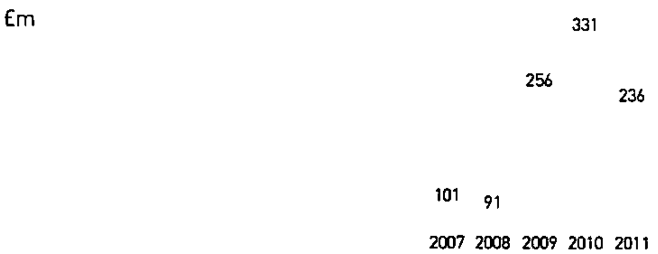



Go to ▶ pages 17, 130 and note 1 for more information

**Headline operating profit**

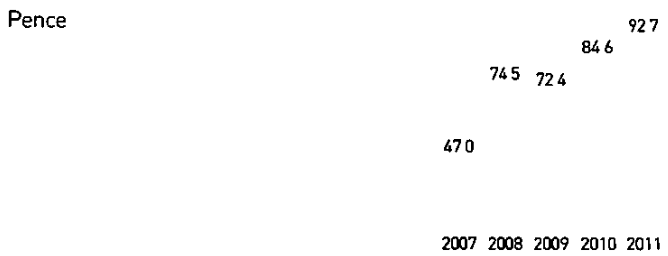

Go to ▶ pages 17, 130 and note 1 for more information

**Free cash-flow**




Go to ▶ pages 48, 130 and note 28 for more information

**Headline earnings per share**




Go to ▶ pages 48, 130 and note 9 for more information

# Contents



**Group overview**

**We explain who we are, where we operate, our business model and strategy, investment case and a summary of how we performed against our key performance indicators**



**Chairman and Chief Executive**

**Our Chairman introduces the report and the Chief Executive reviews this year's operational achievements against our strategic objectives**



**Operating and financial review**

**For each division, we review their markets and trends, the key operational developments during the year and their future outlook. We also review our financial performance**



**Risks and responsibility**

**We set out the key risks that may affect our business and strategy We also explain our approach to sustainability and our commitments for future improvement**



**Governance**

**We introduce our Board, explain our approach to corporate governance and give details of the Company's remuneration principles and policies to support shareholder value creation**



**Accounts**

**This section contains the financial statements, the auditors' report, the accounting policies and the notes to the accounts**

# About Smiths Group
## Bringing technology to life

Smiths Group is a global business, listed on the London Stock Exchange. We develop advanced technology and bring it to life to create products that meet our customers' evolving needs.

We do this through five divisions, which employ around 23,000 people in more than 50 countries.

This diversified portfolio offers a wide range of long-term growth markets with different customers, demand drivers and competitors It makes our business relatively resilient throughout the economic cycle

Our businesses also share some common characteristics These include high-quality brands, a deep understanding of customers and markets, the ability to engineer products to meet customers specific needs, and expertise in small-batch, low-cost manufacturing

We have a lean corporate centre, which sets our strategic direction and allocates capital to manage the portfolio and drive returns It also fosters a culture of responsibility and accountability wherever we work around the world

## Smiths Detection

A world-leading designer and manufacturer of sensors that detect and identify explosives, narcotics, weapons, chemical agents, biohazards, nuclear & radioactive material and contraband

| | |
|---|---|
| **Employees** | 2,500 |
| **2011 Sales** | £510m |
| **2011 Headline operating profit margin** | 12 8% |

**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 customer requirements

Go to pages 18-23 and www smithsdetection com

## John Crane

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

| | |
|---|---|
| **Employees** | 6,800 |
| **2011 Sales** | £894m |
| **2011 Headline operating profit margin** | 21 1% |

**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

Go to pages 24-29 and www johncrane com

## Smiths Medical

A leading supplier of specialist medical devices and equipment for global markets Our products are focused on the medication delivery, vital care and safety devices market segments

| | |
|---|---|
| **Employees** | 7,550 |
| **2011 Sales** | £838m |
| **2011 Headline operating profit margin** | 23 4% |

**Strengths**
- Established brands with practitioner loyalty
- Global sales & marketing network
- Single-use consumable devices represent c 80% of sales
- Focusing increased R&D investment on higher growth segments and markets

Go to pages 30-35 and www smiths-medical com

## Flex-Tek

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 |
| **2011 Sales** | £221m |
| **2011 Headline operating profit margin** | 12.5% |

**Strengths**
- Strong positions in niche markets
- Lean manufacturing culture with tight cost control
- Well-positioned for a recovery in US housing and domestic appliances with strong operating leverage

Go to pages 42-47 and www flextekgroup com

## 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 |
| **2011 Sales** | £379m |
| **2011 Headline operating profit margin** | 17 8% |

**Strengths**
- Technical differentiation providing solutions to customer needs
- Strong brands recognised by customers
- Excellent programme positions
- Positive long-term dynamics in diverse end markets including wireless infrastructure, semiconductor test and aerospace

Go to pages 36-41 and www smithsinterconnect com

# About Smiths Group
continued

### Divisional sales

1 Smiths Detection 18%
2 John Crane 31%
3 Smiths Medical 30%
4 Smiths Interconnect 13%
5 Flex-Tek 8%

Go to note 1 on page 98 for more information

### Divisional headline operating profit

1 Smiths Detection 12%
2 John Crane 35%
3 Smiths Medical 36%
4 Smiths Interconnect 12%
5 Flex-Tek 5%

Percentage relates to headline operating profit before corporate costs

Go to note 1 on page 98 for more information

### Group sales by destination

1 North America 50%
2 United Kingdom 4%
3 Europe other 22%
4 Rest of World 24%

Go to note 1 on page 101 for more information

### Location of assets

1 North America 52%
2 United Kingdom 14%
3 Europe other 22%
4 Rest of World 12%

Analysis excludes cash and cash equivalents

### Group manufacturing and service locations by division

Smiths Detection
John Crane
Smiths Medical
Smiths Interconnect
Flex-Tek

# The investment case



## Smiths Group offers a clear proposition to investors. We have a portfolio of fundamentally strong businesses, which gives us six key benefits:

1

**Strong market positions in sectors with long-term profitable growth**

Our businesses are either market leaders or are well placed in attractive niches This allows us to benefit from the long-term growth drivers in their industries Across our portfolio, these growth drivers include the

- global demand for energy
- healthcare needs of ageing populations
- threat of terrorism
- expansion of wireless communications
- aerospace demand
- US residential construction

We have sales growth targets for each division, which reflect these positive fundamentals

2

**Leading-edge technologies and service levels that command high margins**

We stay at the forefront of technology by understanding the needs of our customers and investing in research and development to meet those needs Our technological strengths give us a competitive advantage and create customer loyalty, enabling us to earn attractive margins

Our businesses often provide significant levels of aftermarket service and essential consumables This helps us retain customers and provide recurring income as well as insight into customer needs

3

**Further scope for operational improvement and margin enhancement**

Operational efficiencies will drive our margins higher Our restructuring programme has already delivered significant value, with more to come in the next two years

We have invested to improve our systems, with enterprise resource planning projects installed in Smiths Detection, Smiths Medical and John Crane Better information enables us to leverage the Group s scale and deliver further savings Portfolio profitability reviews are also improving operational efficiency

We have margin targets for each division and have made good progress towards them, with scope for further improvement

4

**Opportunity to realise value through more active portfolio management**

We also assess active portfolio management opportunities where we see the potential to create a more focused portfolio through a targeted programme of acquisitions and disposals

We invest in business acquisitions to increase our exposure to attractive and adjacent growing sectors as well as to expand our current businesses

5

**High returns on capital employed**

Our divisions generate attractive margins and tend to specialise in small-batch, low-cost manufacturing As a result, they have low capital intensity and deliver returns above our weighted average cost of capital

We have opportunities to invest for growth in our businesses to generate attractive incremental returns for our shareholders We maintain a strong discipline to ensure we make informed investment choices

6

**Strong cash generation to reinvest in top-line growth and increase dividends**

Closely managing our working capital enables us to convert most of our operating profit into cash-flow Improved business data will continue to drive cash generation

Our focus on cash ensures we have the resources needed to reinvest in our businesses through targeted acquisitions, and in organic growth drivers such as product development, and sales and marketing in growth markets At the same time, it allows us to increase dividend payments to shareholders, while maintaining an efficient balance sheet and meeting the obligations of our legacy liabilities, such as pensions and product liability litigation

# Our strategy and key performance indicators

We have a five-part strategy for creating long-term value for our shareholders.

We measure our performance against this strategy through several key performance indicators.

## Strategy

### Driving top-line growth

We drive our top-line growth in three ways First, we invest in research and development – the lifeblood of a technology business such as Smiths This supports innovation and new product development Second, we look to expand in emerging markets such as China, India and Brazil, through organic investment and acquisitions Third, we work to improve our sales and marketing effectiveness, for example through sharing tools and best practice around the world

### Enhancing margins

We intend to continue to enhance our attractive margins through further operational improvement, leveraging our scale and IT systems, and focusing on low-cost manufacturing

### Generating cash and managing the balance sheet

By emphasising working-capital management, particularly our debtors and inventories, we are able to convert a high proportion of headline operating profit into cash

We also look to optimise our capital structure and secure long-term financing Our borrowings are mainly through long-term bonds rather than bank debt We also closely match the currency of our debt with our assets and earnings

### Allocating capital to maximise returns

Smiths Group delivers high returns on capital We achieve this through disciplined capital allocation to the divisions, by enhancing our profitability and through active portfolio management, with a targeted programme of acquisitions and disposals

At the same time, we actively manage our portfolio of liabilities, such as our defined benefit pension schemes and legacy product liability issues, so that we minimise their impact on our value creation

### Promoting corporate responsibility

We promote a culture of responsibility throughout Smiths Group This requires us all to work according to our Code of Ethics Smiths is also committed to working in a way that, as far as reasonably practicable, protects the health and safety of employees and minimises any environmental effects of its activities, products and services This delivers real business benefits, while ensuring that we meet our obligations to all of our stakeholders

## Key performance indicator

### Sales £m

The absolute level of sales achieved in the year This includes the effect of portfolio changes and currency movements

Sales grew 3% this year reflecting organic growth and the benefit of recent acquisitions

| 2009 | 2010 | 2011 |
|---|---|---|
| 2 665 | 2,770 | 2,842 |

**Priorities**

We aim to accelerate our top-line growth through continued investment and have set targets for each division These are based on annual organic growth over the medium term, at constant currency

Go to note 1 on page 98 and page 130 for more information

### Headline operating margin %

Based on our headline operating profit, which excludes a number of items that do not reflect the portfolio s underlying performance

Headline operating margin improved 40 basis points reflecting volume leverage better pricing and the benefits of our cost saving initiatives

| 2009 | 2010 | 2011 |
|---|---|---|
| 15 7 | 17 8 | 18 2 |

To deliver continuous improvements in margins We have set medium-term margin targets for each division

Go to note 1 on page 98 and page 130 for more information

### Cash conversion %

This is the proportion of headline operating profit that we are able to convert to headline operating cash

Headline operating cash conversion this year was in line with guidance of 90-100% cash conversion Conversion in 2009 and 2010 benefited from reduced working capital arising from certain one-off initiatives

| 2009 | 2010 | 2011 |
|---|---|---|
| 104 | 115 | 95 |

To continue to focus on cash generation and balance sheet management, so that we have the financial strength to grow the business

Go to note 28 on page 127 and page 130 for more information

### Headline return on capital employed %

This is headline operating profit divided by monthly average capital employed, expressed as a percentage Capital employed is total equity, adjusted for goodwill recognised directly in reserves, net post-retirement benefit assets and liabilities, and net debt

Headline return on capital improved 40 basis points reflecting the improved profitability

| 2009 | 2010 | 2011 |
|---|---|---|
| 14 7 | 16 6 | 17 0 |

To continue to manage our portfolio to create maximum value for shareholders

Go to note 1 on pages 98-99 and page 130 for more information

### A range of indicators for safety and environmental impact

| | |
|---|---|
| **Recordable incident rate per 100 employees**<br>FY2013 target is to be below 0 5 per 100 employees | FY2011 result<br>0.66 |
| **Greenhouse gas emissions**<br>10% reduction FY2010 to FY2015 | FY2011 v FY2010<br>-4 5% |
| **Total non-recycled waste**<br>10% reduction FY2010 to FY2015 | FY2011 v FY2010<br>-5 2% |
| **Water consumption**<br>5% reduction FY2010 to FY2015 | FY2011 v FY2010<br>-8 4% |

We will sustain our focus on working responsibly and have set targets for each of our KPIs

Go to pages 58-60 and www smiths com/corporate_responsibility

# Our business model

Smiths Group's business model operates at two levels. The Group manages our portfolio to create value for shareholders, while the divisions manage their businesses to meet customers' needs and create value for the Group.

**The Group's role**

**The Group has a clear model for managing our portfolio. It:**

**The divisional business model**

**The business model followed by our divisions.**

### Develop deep understanding of the markets

The starting point for our businesses is to develop detailed knowledge of their markets This includes knowing the scale of the market and its growth rate, the competitors and their activities, and our potential sources of competitive advantage This helps us anticipate and respond to developments As part of this activity, we also consider what is happening in adjacent markets, the lessons we can learn from them and the potential for changes in these markets to affect our markets

### Invest in research and development

R&D is the key driver of sales growth and margins It enables us to keep at the forefront of technology and develop products that meet our customers evolving needs

We fund the majority of our R&D and we also seek funding from our customers Our spend is focused more on product development than pure research

- sets the strategic framework and culture for the Group as a whole
- ensures the divisional strategies are aligned to Group strategy
- agrees annual divisional budgets
- regularly reviews and challenges divisional performance
- approves and allocates capital for significant investments such as acquisitions, and supports their implementation, for example through monitoring, due diligence and integration
- ensures the right business systems and processes are in place across the Group, so decisions are made efficiently based on high-quality data
- reviews the Group's structure and considers opportunities to create value through portfolio management
- meets the requirements of a listed company and sets the governance and risk management framework for the Group.

**Consider acquisitions and disposals**

We buy businesses that add complementary technologies and products, that expand our geographical footprint, particularly in emerging markets, or that allow us to leverage our existing scale and infrastructure

Acquisitions must also support our sales growth and margin targets and deliver strong cash-flow Our primary focus is on returns, however, and we typically look for a 12% post-tax return on investment by the third year of ownership We also look to dispose of businesses that offer less attractive returns

**Manufacture products efficiently**

The majority of the manufacturing process is in small-batch assembly, much of which is made to meet specific customer orders This makes us capital-light and flexible Where appropriate, we have established production facilities in lower-cost countries, such as Mexico, China, India, the Czech Republic, Costa Rica and Tunisia

**Get close to customers**

Our business is centred on strong relationships and a high degree of customer intimacy Getting close to our customers enables us to anticipate their specific needs This helps us to keep our customers for the long term

**Aftermarket service and consumables**

Many of our businesses provide a high level of after-sales service We also sell significant quantities of single-use consumables These activities help us to retain customer loyalty, improve our understanding of how our products perform over their lifetime and increase our resilience throughout the economic cycle

# Securing future returns

Smiths is exposed to a range of risks in running its businesses. We regularly review these risks and ensure we have appropriate processes and policies for managing them. We also look at other measures, such as insurance, which can help to mitigate these risks.

**Managing risk**

**The diagram summarises how we manage risk**

The Board has ultimate responsibility for our risk management policies and for ensuring we have an effective system of internal control Our executive and operational management assess the risks facing our businesses and respectively create and implement our risk management policies The Audit Committee ensures appropriate oversight of risk management and is supported by our internal audit function, which tests the effectiveness of our controls and identifies areas for improvement

**Board**
Policy approval
Oversight

Implementation

Oversight

**Executive management**
Policy creation
Risk assessment

**Audit Committee**
Oversight (on behalf of the Board)

**Operational management**
Policy implementation

Identified improvements

**Internal audit**
Controls testing

**The risks to our strategy**

**The table below shows the main categories of risks we face and shows which of our strategic objectives they could affect**

| | **Strategy** | | | | |
|---|---|---|---|---|---|
| **Risk** | Driving top-line growth | Enhancing margins | Generating cash and managing the balance sheet | Allocating capital to maximise returns | Promoting corporate responsibility |
| Economic outlook | | | | | |
| Financial risks | | | | | |
| Global supply chain/ concentration of manufacturing | | | | | |
| Government customers | | | | | |
| Information technology | | | | | |
| Acquisitions and disposals | | | | | |
| Legislation and regulations | | | | | |
| Pension funding | | | | | |
| Product liability and litigation | | | | | |
| Technology and innovation | | | | | |
| Talent and succession planning | | | | | |

Although the Group faces more risks than those listed above, these are the risks that are currently of most concern to the business and have been debated at recent Board or Audit Committee meetings A full description of these risks, their potential impact and how we manage them is set out in the risk management section

Go to pages 52 to 56 for more information

# A responsible company



Acting responsibly is a fundamental part of our strategy. Our approach is based on our Code of Business Ethics, which applies to all of our businesses and employees worldwide.

**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

**Acting responsibly delivers real business benefits**
Operating within the Code enables us to meet our obligations to all of our stakeholders It also delivers real business benefits, including

- helping our people to work productively in a safe environment
- protecting our reputation and our ability to grow
- enhancing our efficiency, for example through lower energy costs, and
- reducing the risk of an incident and avoiding the associated costs

Sustainability issues also present a business opportunity for us For example, the seals sold by John Crane help our customers to reduce their environmental impact

Go to pages 57-61 and our separate corporate responsibility report www smiths com/corporate_responsibility aspx

# Chairman's statement

## Against a persistently difficult economic backdrop and significant constraints on government spending in developed economies, Smiths Group has again delivered improved performance by enhancing operational efficiencies and exploiting its broad business reach across markets and geographies.

**Donald Brydon**

**Chairman**

**Sales**

**Up to £2,842m**

+3%

Go to pages 17 and note 1 on page 98 for more information

**Headline operating profit**

**Up to £517m**

+5%

Go to pages 17, 48 and note 1 on page 98 for more information

**Statutory operating profit**

**Up to £438m**

0%

Go to pages 17, 48 and note 1 on page 98 for more information

Margins in most of the divisions continued to improve, benefiting from the excellent work of our employees and such self-help initiatives as the ongoing restructuring programmes, global procurement savings and vastly improved information systems These cost-saving moves have again helped drive profitability to new highs However, we recognise the need for more focus on sales growth if we are to capitalise on the opportunities that emerge when the global economy finally recovers on a sustainable basis

With this in mind we continue to increase investment in research and development, a prerequisite for sustained growth in an advanced technology business like ours In the divisional reports we detail significant new product developments

We are also keenly aware of the growth potential in emerging markets and continue to extend our geographic footprint outside the mature economies of North America and Europe Recent acquisitions have a significant presence in emerging markets Smiths Detection has acquired its distributors in Brazil and India to take full control of its routes to market in these fast-growing economies For example, the security equipment installed at Delhi s new international airport terminal and at the Commonwealth Games was supplied by Smiths Detection Smiths Interconnect has significantly expanded its presence in China through a number of acquisitions John Crane has invested heavily in developing its service centres in the Middle East, Asia and Latin America while Smiths Medical has expanded its sales capabilities in China and India

Although our focus on operational improvement and margin enhancement will continue, we are likely to enter a phase of continuous improvement, with the exception of Smiths Detection where there is more substantial restructuring work yet to be done At the same time, we intend to manage the portfolio more actively over the next few years through seeking appropriate acquisitions that satisfy our strategic and financial objectives and disposals that realise additional value for our shareholders For example, Smiths Interconnect will transform its power protection group through the recently announced $235m purchase of Power Holdings Inc , a leading designer and maker of a range of specialist power systems, and John Crane has agreed to acquire the business of Turbo Components and Engineering Inc to expand its bearings aftermarket services Equally important, we must carefully manage the legacy liabilities of the actuarial deficits on the defined benefit pension plans and ongoing product liability litigation

In managing any portfolio of assets, your Board is duty bound to consider whether we are the best owner of each business or if we could generate more value by divestment and redeploying the capital to drive superior returns, always subject to market conditions During the year, we received an unsolicited approach for Smiths Medical from a private equity firm The indicative valuation was £2 45 billion in cash, as a best and final offer, but subject to extensive due diligence and completion of financing After careful consideration, the Board concluded it would not be in the interests of shareholders to pursue this approach In reaching this decision, we took into account the quality and highly cash-generative nature of Smiths Medical, both standalone and in the context of the Group as a whole

In parallel with improving our business operations, our continued promotion of a culture of responsibility has been rewarded with a steady improvement in our safety record Lost time and recordable incident rates are down Similarly, we have been able to reduce greenhouse gas emissions, waste generation and water consumption, all key environmental metrics

The strict anti-bribery legislation recently passed by the UK Parliament aligns well with our robust Code of Business Ethics which has already been in place for several years It commits us all to a set of common values – integrity, honesty, fairness and transparency Details on health, safety, environment and business ethics are contained in our corporate responsibility report

A successful board requires the right interaction between the individuals at both a personal and professional level and a mixture of skills and outlooks that brings balanced judgements, relevant variety of experience and industry knowledge, and the ability to rise above day-to-day detail There needs to be respect for the stature and intellect of the board members throughout the company

At Smiths the Board is, by design, small This facilitates intense discussion with every voice fully heard Substance trumps form The Nominations Committee has worked hard to obtain the right balance as the Board has been reduced in size from 15 members to eight As a multi-industry company it has judged that the individual business presidents are best focused on their divisional responsibilities rather than on the company as a whole The Board in consequence has two executive directors – the Chief Executive and the Finance Director

Amongst our non-executive directors, we have expertise in government and defence, international manufacturing and supply chain, healthcare, oil and gas, finance and the Asian region

The engineering industry is notoriously masculine globally and this is reflected in the proportion of female executives in senior positions in the company To meet Lord Davies s aspiration for female board representation, which we support, presents a particular challenge for a small board With one out of eight members (and four nationalities – five, if Scottish is allowed) the female proportion today is 12 5% To reach 25% requires the replacement of a present director When the company next has cause to recruit to the board it will do so with Lord Davies s objective in mind consistent with the need for the specialist expertise that the company at that time requires It is not possible to set out an artificial timetable for this action

Looking ahead, there is no lack of daunting challenges to our goal of sustained sales growth and improved profitability Foremost is the unremittingly tough economic climate Grave concerns linger over the health of many major economies and much of the Western world still teeters on the edge of a financial crisis

However, we have an excellent management team and these results have again shown what Smiths Group can achieve even against tough economic headwinds On behalf of the Board, I thank Philip and all the staff for their dedication and commitment to performance improvement and creating value for shareholders

# Chief Executive's statement

Smiths Group has made good progress in a tough economic environment. These results demonstrate the significant benefits delivered by our sustained focus on operational improvement that have enhanced margins to new highs. We have delivered strong cash conversion, in line with guidance.

**Philip Bowman**

**Chief Executive**

**Headline earnings per share**

**Up 10%**

92.7p

Go to note 9 on page 107 for more information

**Statutory earnings per share**

**Up 3%**

77.8p

Go to note 9 on page 107 for more information

**Dividend per share**

**Up 7%**

36 25p

Go to page 16 for more information

We have delivered across all our key financial metrics sales growth, margins, cash generation and return on capital Sales benefited from organic growth in John Crane, Interconnect and Flex-Tex and recent acquisitions, partly offset by a disappointing performance from Smiths Detection and the impact of a tougher trading environment and continuing portfolio rationalisation at Smiths Medical A detailed performance improvement programme has begun in Smiths Detection and its delivery is a key priority Group margins have advanced as a result of volume leverage, better pricing and our continued focus on operational improvement and restructuring Cash conversion remains strong and return on capital employed increased 40 basis points to 17 0%

John Crane s revenues grew strongly with robust demand from its end markets, particularly the oil and gas sector, for its aftermarket services and original equipment Margins advanced as a result of the higher volumes and further savings from its various cost reduction programmes, more than offsetting some adverse mix effects from the acceleration in growth in sales of original equipment and the lower margin upstream energy services business Smiths Medical delivered further profit improvement to raise margins to 10-year highs, while also increasing investment in the future growth drivers, such as new product development and sales and marketing This has been achieved in a tough operating environment, particularly the mature markets in the US and Europe, where budget pressures have constrained capital purchases and unemployment has reduced medical procedure rates A focus on product profitability and SKU rationalisation benefited margins but adversely affected sales As previously guided, Smiths Detection experienced delays to orders across a number of sectors which caused sales declines and adversely impacted margins However, we launched a performance improvement programme to deliver cost savings and operational improvements Smiths Interconnect delivered overall sales growth despite declines in its military sales as a result of lower defence spending, this was more than offset by strong sales of specialist connector components to the medical, rail, automation and test markets, as well as growth in components and sub-systems for wireless telecoms and commercial aerospace markets The acquisition of IDI last year also benefited sales and margins Flex-Tek delivered revenue growth across the aerospace and construction markets, which in turn supported higher margins as a result of its strong operational gearing

**Free cash-flow**

**Strong cash conversion resulting in free cash-flow of.**

£236m

Go to note 28 on page 127 for more information

**Employees around the world**

**In over 50 countries**

22,900

Go to note 11 on page 112 for more information

**Investing in sales growth**
We have maintained technology leadership in many areas through a firm commitment to new product development and innovation, which in turn is a key driver of future sales and margin growth as new products typically command higher margins and deliver superior returns We raised company-funded investment in R&D by 5% to £99m and secured a further £12m of customer-funded investment to bring our total spend to £111m, or 3 9% of sales (2010 3 9%) This long-term investment is delivering results In Canada, Smiths Medical launched a new syringe pump with wireless networking, Medfusion™ 4000, as well the new CADD®-Solis VIP pump which targets the growing alternate site and homecare markets The Medfusion™ 4000 recently received FDA 510(k) clearance for sale in the US and we expect to extend both products to other markets subject to regulatory clearances In Smiths Detection, the development of a next-generation explosives detection system for screening airport checked baggage, in cooperation with Analogic Corporation, is meeting our programme milestones John Crane has continued to make progress on its portfolio of environmentally focused zero and low emission seals and on extending the high pressure capabilities of its compressor dry gas seals

To support growth opportunities in emerging markets, we established a direct sales and marketing team in India for Smiths Medical This builds on an existing distributor presence and supports further direct investment to drive accelerated growth in this rapidly growing market We also made two acquisitions during the period, buying Smiths Detection s existing distributors in India and Brazil, to create a direct sales presence in these important fast growing markets Smiths Detection is already prominent in India with its equipment operating at more than 125 sites, while in Brazil, Smiths Detection s systems are deployed throughout the vast country, from airports and ports in major cities such as Sao Paulo and Rio de Janeiro to remote border crossings in the Amazon

**Enhancing margins**
Margins have continued to benefit from the major restructuring programme that began in 2008, delivering further savings of £15m in the period To date, we have generated savings of £56m against our total planned savings of £70m when completed in 2012/13

We have also launched a performance improvement programme in Smiths Detection which is expected to deliver annualised savings of £40m by the end of financial year 2014, at a cost of £40m It is expected that £15m of these savings will be delivered in the first year This will lower the fixed cost base and make the business better able to respond to variations in demand while improving customer service

**Strong cash generation and financing**
We have achieved strong free cash-flow which has reduced net debt by £108m to £729m The Group benefits from high cash conversion and a sound balance sheet During the year, we refinanced our bank facility with a new US$800m revolving credit facility The new facility, which matures in December 2015, is currently undrawn Over the past three years, we have progressively refinanced all our facilities, giving us an average maturity of almost five years and a strong balance sheet to finance our plans

**Allocating capital to maximise returns**
The Group continues to focus on improving returns on capital across all divisions by enhancing margins while operating an efficient capital base This has increased headline return on capital employed by 40 basis points to 17 0%

Subject to suitable market conditions, we will undertake more active management of our portfolio through a combination of acquisitions that satisfy our strategic and financial objectives and disposals that realise additional value for our shareholders This will be undertaken in the context of continuing to manage the legacy issues of the actuarial deficits on the defined benefit pension plans and the ongoing historic product liability litigation against John Crane, Inc

# Chief Executive's statement
continued

There are attractive opportunities to invest in our businesses to deliver superior returns After the year end, Smiths Interconnect agreed to acquire Power Holdings Inc, a leading designer and manufacturer of specialist power distribution, conditioning and monitoring systems for $235m, subject to regulatory approvals This acquisition will transform Smiths Interconnect s existing power protection group with a complementary range of products and technologies, as well as new growth opportunities In August 2011, John Crane agreed, conditional upon regulatory approvals, to acquire the business of Turbo Components and Engineering Inc which services, repairs and builds replacement bearings and seals used in critical rotating equipment This will accelerate the development of John Cranes aftermarket services offering for bearings

**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 the immediately preceding period However, the downturn in world economies since then has made it harder to operate within these targets in the near term, particularly sales growth, which is harder to deliver than improved margins, where we have greater control over delivering cost savings and efficiencies

We are planning to review these targets during the course of the 2012 financial year, although the recent economic uncertainty and risk of a further recession has made this more challenging in the near term In the meantime, we will continue to strive to deliver improvements in sales growth and margins against our targets

**Managing our legacy liabilities**
We manage two areas of material historic liabilities actuarial deficits on our defined benefit pension plans and ongoing product liability litigation in connection with John Crane, Inc

The net funding position for the pension schemes has deteriorated in recent years as a result of increased liabilities caused by low bond yields and increased longevity, and poor asset performance in weak equity markets Over this time, the Group has taken steps to minimise this liability by closing the defined benefit schemes and capping our obligations for post-retirement health benefits In addition, the Group has agreed 10-year funding plans with the UK Trustees Steps have also been taken to improve the matching of the Schemes assets and liabilities In September 2011, the Trustee of the TI Group Pension Scheme invested approximately £147m in a bulk annuity policy as a match for specific pensioner liabilities, thereby mitigating the longevity risk in the Scheme This follows similar annuity purchases in 2008 involving assets of around £500m

The product liability litigation relates to various sealing products containing asbestos that John Crane, Inc (JCI), a US subsidiary of John Crane, ceased making in 1985 JCI resists these claims based on a safe product defence because the asbestos was encapsulated in such a manner that, based on tests conducted on its behalf, the products were safe In our accounts, we disclose details of recent claims experience and of the provisions established for these liabilities During the year, the provisioning approach for both the adverse judgments and legal defence costs was harmonised by using the same asbestos valuation experts and the same 10-year rolling period for both, compared with up to 16-years for previous estimates of legal costs We will continue to update these provisions every six months During the year, the number of claims in which JCI is a defendant continued to fall Further details are given in note 23 to the accounts

**Dividend**
Having reached our target dividend cover of around 2 5 times last year, the Board has adopted a progressive dividend policy for future payouts while maintaining this prudent level of cover This policy will enable us to retain sufficient cash-flow to meet our legacy liabilities and finance our investment in the drivers of growth

The Board has recommended a final dividend of 25 0p per share giving a total for the year of 36 25p, an increase of 7% The final dividend will be paid on 25 November to shareholders registered at the close of business on 28 October The ex-dividend date is 26 October

**Outlook**
The economic outlook remains uncertain and continued pressures on government spending, which particularly impacted Smiths Detection, Medical and Interconnect are likely to continue to constrain revenue opportunities of some of our businesses during fiscal 2012 However, we still see further potential to drive operational improvements, enhance margins and deliver strong cash conversion Outlook statements for the divisions are provided in the Business review

# 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**

Sales increased by 3%, or £72m, to £2,842m The net impact of acquisitions and disposals contributed £45m, partly offset by adverse currency translation on overseas sales of £3m On an underlying basis, excluding currency translation and acquisitions, sales grew £30m This increase was driven primarily by strong growth at John Crane (up £104m), Flex-Tek (up £12m) and Smiths Interconnect (up £9m) partly offset by underlying sales declines in Smiths Detection (£73m) and Smiths Medical (£22m)

**Profit**

Headline operating profit rose £25m to £517m Headline operating margin increased by 40 basis points to 18 2% (2010 17 8%) The growth comprises a £19m, or 4%, underlying increase in headline operating profit and £8m benefit from the net impact of acquisitions and disposals, partly offset by £2m from adverse currency translation The main drivers of this £19m underlying improvement were higher volumes and cost savings at John Crane (up £25m), manufacturing and overhead efficiencies at Smiths Medical (up £13m), and higher volumes and prices at Flex-Tek (up £5m), partly offset by lower volumes at Smiths Detection (down £24m) and adverse mix and price at Smiths Interconnect (down £1m) Corporate centre costs were down £1m on last year reflecting lower bonus payments

Operating profit on a statutory basis, after taking account of the items excluded from the headline figures was £438m (2010 £436m)

The net interest charge on debt declined to £59m (2010 £62m) which reflects reduced average levels of debt The pensions financing credit increased to £23m (2010 £2m), reflecting the improved funding level at 1 August 2010 Contribution from associates increased by £2m to £4m As a result, headline profit before tax increased by £51m to £486m (2010 £435m) On an underlying basis, headline profit before tax grew by 11%

On a statutory basis, after taking account of items excluded from the headline figure, profit before tax increased £25m to £398m (2010 £373m)

The Group s tax rate on headline profit for the period was 25% (2010 24%) Headline earnings per share increased by 10% to 92 7p (2010 84 6p)

**Cash generation**

Operating cash generation remained strong, albeit below the high levels of the previous years Headline operating cash of £489m (2010 £565m) represented 95% (2010 115%) of headline operating profit Cash conversion benefited in 2010 from reduced working capital arising from certain one-off initiatives Free cash-flow declined £95m to £236m (2010 £331m) Free cash-flow is stated after interest and tax but before acquisitions, financing activities and dividends (see note 28 to the accounts for a reconciliation of headline operating cash and free cash-flow to statutory cash-flow measures)

On a statutory basis, net cash inflow from continuing operations was £322m (2010 £410m)

Dividends paid in the year on ordinary shares amounted to £136m (2010 £133m)

Net debt at 31 July was £729m, down from £837m at 31 July 2010 The decrease in net debt reflects the strong free cash-flow and outflows of £136m for dividends and £21m for the net effect of acquisitions and disposals

**Company-funded research and development**

**Increased by 5% to**

£99m

Go to page 48 for more information

**Net debt**

**Down £108m to**

£729m

Go to note 20 on page 117 for more information

**Annual dividend**

**Increased by 7% to**

36 25p

Go to page 16 for more information

# 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** | 2,500 |
| **Contribution to 2011 Group sales** | 18% |
| **Contribution to 2011 Group headline operating profit**<br>Percentage relates to headline operating profit before corporate costs | 12% |

Go to www smithsdetection com

**Sales by sector £510m**

1 Transportation 43%
2 Ports and borders 15%
3 Military 15%
4 Emergency responders 5%
5 Critical infrastructure 17%
6 Non-security 5%

6 5 1 4 3 2

**Sales performance**

£m

| 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| 438 | 509 | 501 | 574 | 510 |

**Business features**

**Principal operations 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

**Competitors**

Smiths Detection s broad portfolio in the homeland security and defence sectors brings it into competition with a wide range of companies in individual segments Principal competitors include Morpho (air transportation), Rapiscan (air transportation, ports and borders, critical infrastructure), L3 Security & Detection Systems (air transportation, ports and borders), Nuctech (ports and borders), AS&E (ports and borders), FLIR (air transportation, defence), SAIC (air transportation, ports and borders), Chemring (military), Bruker (military, emergency responders), Thermo Fisher (military, emergency responders)

**Suppliers**

We are actively developing synergies across sites and restructuring our purchasing group to ensure that we fully leverage the size of our business These developments will be ongoing taking into account the demand for local content with some of our major customers as well as our stringent quality and delivery requirements

**Markets and trends**

Smiths Detection produces equipment for customers in the air transportation, ports and borders, critical infrastructure, military and emergency responder sectors to help them secure the safety and security of critical assets and people

At the beginning of the year, the division reorganised into global management structures in sales and programmes to deliver improved customer services across technologies and end markets

Ongoing geo-political unrest, and the terrorist and criminal threats it creates, ensures that demand for detection equipment in these markets (estimated at more than £4bn) is forecast to continue to grow at around 7% per annum in the near-term

The transportation sector is the largest sector for the division representing 43% of total sales Smiths Detection has an estimated 26% market share in the sector Rising passenger and air cargo traffic volumes, new security threats and a drive for higher throughputs will continue to support market growth In addition more stringent requirements from major regulatory bodies will increase the sophistication of security equipment

Sales in the ports and borders market comprised 15% of the divisional total in the period Rising concerns about smuggling of explosives, weapons, radiological materials and contraband together with the recovery in worldwide trade will continue to increase demand for detection equipment to address these threats

The division s sales to the military market provides equipment to protect troops and assets from a broadening range of chemical, biological, radiological, nuclear and explosive threats, whether in theatre, in transit or at bases Continuing deployments, local tensions and the need for developing nations to increase their levels of protection from these threats will continue to drive market growth Sales in the sector were 15% of total revenues

Overall demand in the highly fragmented critical infrastructure market continues to grow strongly as governments and other organisations seek to protect their assets from a wide range of threats and increasing levels of perceived risk The highly diverse nature of customers and the different forms of threat they face requires application-specific solutions to be developed Divisional sales to the critical infrastructure market were 17% of the total

Governments are increasingly seeking to ensure that emergency responders who are required to assess and mitigate potential or actual incidents are fully equipped with all necessary detection equipment to verify the nature and extent of any present threats and minimise the danger to themselves or the broader public or infrastructure Sales of equipment to emergency responders contributed 5% to total revenues

**Combating dirty bombs**

Smiths Detection has developed a handheld radioisotope identifier that helps resolve the perennial problem of distinguishing genuine radiological and nuclear threats from benign, background radiation sources The RadSeeker DL was approved for acquisition by the US Government s Domestic Nuclear Detection Office in July 2011, the only instrument of this type to gain such an endorsement

The lightweight RadSeeker puts the most powerful and accurate radiation detection capabilities literally in the palm of the hand It can be used by civil defence and first responders reacting to an emergency or by port and border personnel checking cargo containers for suspected radioactive materials

Currently, most rad-nuc detection systems either detect radiation without discriminating between sources or suffer from low identification accuracy Many natural and commercial materials, such as ceramics, metals and even some fruits, emit radioactivity that can trigger these detectors, resulting in nuisance alarms The containers then have to be opened and searched by hand RadSeeker helps solve that problem It was specifically designed to meet the Department of Homeland Security (DHS) mission requirements for a next-generation system able to detect and identify Improvised Nuclear Devices and Radiological Dispersal Devices, the latter commonly known as dirty bombs

**Smiths Detection**

**Continued**

**Bringing technology to life**

**Advanced screening for threats**

Smiths Detection s aTiX (Automatic Threat Identification X-ray) system, now deployed at airports worldwide, was the first to provide automatic explosives detection at security checkpoints Its multi-view X-ray technology and sophisticated software enable it to detect explosive threats and liquid containers inadvertently left in carry-on baggage Any potential threat item is immediately flagged up on the monitor by a red box and security staff can then zoom into the image for detailed checks to decide on clearance or manual inspection aTiX was also the first system of its kind approved to EU LEDS Standard 2 Type C, capable of analysing multiple bottled liquids in one scan These standards are among the toughest in the world, imposed by the European Union as it prepares to allow airports to ease the ban on taking liquids on board flights by 2013

**Material discrimination**

X-ray beams scan baggage from different angles in a single pass to provide high-quality colour images with multiple views Advanced software algorithms, which process the image data, calculate the atomic numbers and densities of the contents, automatically identifying materials whose chemical profiles fall within those of dangerous substances

**Smiths Detection**

**Continued**

### Performance

| | 2011 £m | 2010 £m | Reported growth | Underlying growth |
|---|---|---|---|---|
| Sales | **510** | 574 | (11)% | (13)% |
| Headline operating profit | **66** | 90 | (27)% | (27)% |
| Headline operating margin | **12.8%** | 15 7% | (290) bps | |
| Statutory operating profit | **64** | 89 | | |
| Return on capital employed | **9.8%** | 13 3% | (350) bps | |

Reported sales declined 11%, or £64m, reflecting an underlying revenue fall of £73m and an adverse currency effect of £3m, partly offset by a benefit from acquisitions of £12m The decrease in underlying sales was driven primarily by lower sales to the military market, reflecting the timing of a number of large military programmes, with smaller declines in other sectors, offsetting strong growth in the critical infrastructure segment Excluding military sales, underlying sales fell 4%, reflecting uncertainty in government budgets and regulatory delays in aviation security

Operating margins fell by 290 basis points to 12 8% as headline operating profit declined by £24m on an underlying basis The fall in sales volumes and its effect on operational gearing was the principal driver for the lower margins

As a result, there was a change in management and a performance improvement programme was initiated at the end of the year, targeting annualised savings of at least £40m by the end of the 2014 financial year The programme will cost £40m, of which £33m will be treated as an exceptional item over three years and a £7m charge against headline operating profit in 2012 financial year It is expected that this programme will deliver savings of £15m in the first year The programme will comprise a number of different workstreams A reduction in the size of the workforce has begun and discretionary spending has been severely curtailed and remains a focus as part of tighter budget control A site rationalisation programme has commenced, as the manufacturing base is realigned to match the business needs It will build on the global reorganisation that took place during the past year

Specific initiatives have also been implemented in materials sourcing and a value engineering project to reduce scrap, rework and warranty liabilities We will also leverage our investment in our global ERP system by maximising revenue and cash collection through the adoption of consistent and timely processes, as well as reduce costs

Underlying sales in transportation fell 4% as a result of various budget and regulatory delays For example, the uncertainty in the US federal budget caused procurement delays and the regulatory delays in Europe on air cargo and on the relaxation of liquids in passenger hand baggage affected order flow Major orders included a US$43 5m contract from the Transportation Security Administration (TSA) for Advanced Technology X-ray systems to be deployed at airport checkpoints across the United States We also received a C$19m order from the Canadian Air Transportation Security Authority (CATSA) to provide advanced X-ray systems for use at airport baggage checkpoints At Frankfurt International Airport we are fulfilling a requirement for around 50 aTiX systems for security checkpoints At Berlin's new Brandenburg International Airport, we delivered checked baggage screening systems and secured an exclusive supply contract for checkpoint security systems, to be delivered in the next financial year The Berlin contracts will together be worth some £19m Lufthansa Cargo added to its extensive installation of Smiths Detection systems with multiple X-ray inspection and trace detection units to support air cargo screening throughout the Americas We also secured contracts during the year from international airports in Doha, Mumbai, Munich, Yemen, Turkey and London Gatwick Technology upgrades and investment in enhanced security screening continue to fuel demand for advanced X-ray scanners for hold and carry-on baggage Governments are also assessing a multi-layered approach to aviation security that combines the deployment of detection technologies for screening passengers, baggage and cargo with other measures, such as the training of airport security staff in behavioural analysis techniques and increased cooperation between international intelligence agencies to improve the sharing of information

Underlying sales in the ports and borders market declined 17% as a result of order delays During the period we delivered an order from Japan for five high-energy cargo inspection systems The German Federal Ministry of Finance ordered three high-energy X-ray systems for mobile customs checkpoints and at the start of the new financial year a contract was placed by the Cayman Islands Customs Department for similar equipment to improve border security The market sector will continue to be influenced in the short term by global economic conditions, with government customers reviewing their expenditure plans Governments are committed to improve their border security and customs revenue protection but are being forced to adopt more cost-effective approaches, layered with different levels of technological support

Our military business saw underlying sales fall 42% as a result of a cyclical transition between mature and new programmes, as well as the return of US government military expenditure to more normal funding levels following the easing of recent conflicts Nevertheless, opportunities for military programmes in the US, Europe and Asia remain strong, with new contract wins in Canada, Sweden and Germany During the period we delivered a $30m order to the United States Department of Defense under the long-running Joint Chemical Agent Detector (JCAD) programme This latest order was for enhanced JCAD detectors which are based on Smiths Detection's LCD 3 3, an advanced, detect-to-warn device that protects troops by sampling the air for chemical warfare agents This latest contract takes the total awarded to Smiths Detection under the JCAD programme to more than $350m, with the continuing programme presenting further contract opportunities

Critical infrastructure grew 37% as a result of a number of contracts including supplying equipment for the Commonwealth Games in India, and for US Government Services including the FBI, Federal Protective Services and Federal Bureau of Prisons We see considerable opportunities in the critical infrastructure market in the immediate future and will be focusing strongly on this sector

### Research and development

Smiths Detection is continuing to invest heavily in a new product pipeline while sharpening the focus and effectiveness of the product development process We seek to meet customers needs through a consistent commitment to product innovation using in-house R&D, government-funded research, partnerships and licences

Company-funded R&D declined 1% to £35m (2010 £36m), although increased as a percentage of sales to 6 9% (2010 6 2% of sales) This includes £17m of capitalised projects Smiths Detection actively seeks customer and government support for R&D which totalled £8m in the period (2010 £8m) Total R&D spend was £43m (2010 £44m) or 8 5% of sales

In a significant product launch, Smiths Detection moved directly into the market for the detection and identification of radiological and nuclear threats The handheld RadSeeker detector was developed in collaboration with the US Domestic Nuclear Detection Office, subsequently approved its production and deployment, leading to the award of an initial delivery contract RadSeeker fulfils a number of applications, such as assisting civil defence and first responders in search operations and helping port and border personnel with cargo, container and vehicle screening

The main focus for R&D investment continues to be on X-ray for a variety of applications, including checkpoint and baggage scanning at airports and cargo screening at ports and borders Our next-generation explosives detection system project with Analogic leverages the complementary expertise of each company in multi-energy X-ray technology and three-dimensional computed tomography (CT) Prototype machines have been placed in airports for preliminary data collection

Following an evaluation of projects, it was decided to terminate the programme to develop the diagnostics instrument platform for use in a medical environment as a result of extended development times and unfavourable market conditions We will sustain assay development, including continuing to work with Novartis under the existing agreement, while determining how best to develop the relationship to support the long-term goals of both companies

We have a strong pipeline of new product launches planned during the next year These will be spread across the key product groups

### Business developments

To support growth opportunities in the Indian market, Smiths Detection acquired the detection sales, distribution and service business of Veecon IPA Gastchnik Limited This business has acted as a distributor for Smiths Detection and helped build a market-leading presence in this important market

Smiths Detection also purchased its Brazilian distributor from EBCO Systems Limited, taking direct control over product sales in one of the world s fastest-growing economies EBCO, based in Sao Paulo, had been the exclusive distributor for Smiths Detection in Brazil since 1994, with a wide customer base that included customs authorities, airports, and prisons The new company, Smiths Detection Brazil, employs about 55 people, managing a well-established sales and service network

### Outlook

Smiths Detection is focused on delivering a performance improvement programme under its new leadership This will reduce fixed costs, improve operational efficiency and customer service, its delivery is a key priority However, this is principally a government contracting business, directly affected by terror incidents, security regulations and government budgets The sales environment is likely to remain challenging in the near term Longer term, we believe the sector is set for sustained growth and Smiths Detection is well placed to benefit from its leadership position and strong technologies

### Integrating systems with FirstView-LINX

Smiths Detection's FirstView-LINX offers air freight carriers a unique security combination of X-ray and trace detection data in a single view workstation that also incorporates automatic barcoding to meet increasingly strict audit requirements for scanned cargo The unique barcode allows any package to be quickly traced for a security review, immediately generating a consolidated report including X-ray image, explosive trace results and time and date of screening Conformity of freight between origin and destination is thus assured without the need for physical checks

In addition, FirstView-LINX has an embedded Network Video Recorder (NVR) that can be activated to provide enhanced monitoring of designated screening areas Alarms from third-party physical security tools – such as access controls and fence sensors – can also be linked into this single product, reducing the cost and space associated with multiple security consoles

## John Crane

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

Delivering engineered solutions that keep process plants running, John Crane enhances customer productivity by providing advanced technology industrial products and performance-enhancing services backed by an exceptional global network

| | |
|---|---|
| **Employees** | 6,800 |
| **Contribution to 2011 Group sales** | 31% |
| **Contribution to 2011 Group headline operating profit** | 35% |

Percentage relates to headline operating profit before corporate costs

Go to www.johncrane com

**Sales by sector £894m**

**OEM: 37%**
1 Original equipment manufacture 37%
**Aftermarket. 63%**
2 Oil, gas & petrochemical 39%
3 Chemical & pharmaceutical 8%
4 Distributors 7%
5 General industry 9%

5
4
1
3
2

**Sales performance**

£m

| 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| 532 | 626 | 790 | 786 | 894 |

**Business features**

**Principal operations 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, Valero, Petrobras, ExxonMobil, Gazprom, TOTAL, Sabic, PDVSA, Pemex, Saudi Aramco, Shell, Petrom, Sulzer, ITT Goulds, Flowserve, GE Nuovo Pignone, GE Energy and Power, Andritz Hydro, Rolls Royce, Siemens, Mitsubishi, Solar Turbines, Elliot, York, BASF, Weir Group, Bayer, and Dow No customer is larger than 3% of sales

**Competitors**

For rotating equipment 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

**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, Penn United Carbide, and Ashland Chemical

**Markets and trends**

Across the process industries, John Crane provides engineered solutions that drive reliability improvements and sustain the effective operation of customers' rotating equipment and other machinery The expanded product portfolio includes mechanical seals, seal support systems, engineered bearings, power transmission couplings and specialist filtration systems John Crane also helps maintain and enhance oil and gas field site productivity through the servicing and provision of onshore down-hole artificial lift pumping hardware and systems All this technology is supported by a global sales and service network that provides performance-enhancing services utilising expertise developed from decades of technology leadership coupled with proven field experience Service teams in more than 50 countries maintain and support the operation of critical customer assets throughout their economic lifetime

Focused on aftermarket customer service, approximately two-thirds of John Crane's sales stem from the aftermarket servicing and support of existing installed equipment while the remaining one-third arise from the design and supply of products to original equipment manufacturers 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 continues to grow, being influenced by a number of factors the global demand for energy and an increased desire for national energy independence, more stringent environmental and safety regulatory requirements, the need to replace ageing infrastructure and deliver operational efficiencies, global demographics and regional economic growth The long-term market dynamics, such as the increasing global demand for energy, are driving growth in original equipment investment in key end markets These expand the processing equipment installed base which underpins an average organic sales growth of around 6-8% per year over the medium term

As a result of a targeted acquisition strategy adding complementary products that leverage John Crane's service footprint and rotating equipment expertise, we have more than doubled our addressable market over the past four years The new lines – engineered bearings, specialist filters and upstream energy services – now enhance and benefit from the market-leading position of our legacy 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 traditional product areas (mechanical seals, seal support systems and couplings) with a share of around 28% There is significant opportunity to continue 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 acquisition opportunities which support this growth strategy

John Crane's global network, present in more than 50 countries, is a key asset which allows for swift and effective aftermarket service close to customers operations These facilities provide a range of value-added 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 continues to expand through opening additional manufacturing, sales and service centres in key markets

**Aftermarket plus**

Performance Plus contracts offer John Crane's customers in the energy and process industries the guarantee that original equipment installations will benefit from the highest level of managed reliability and service A recently signed maintenance and service contract with the Milazzo oil refinery in northern Sicily is typical of how John Crane leverages long-term business relationships to expand the range and depth of its technical support Performance Plus provides lower cost of ownership through greater long-term reliability, availability, safety, and inventory optimisation The contract with Milazzo, owned by Eni and Kuwait Petroleum Italy, commits John Crane to a range of new reliability support activities These include systematic root cause analysis of seal failures, assistance with installations and start-ups, reliability assessments, and improvement recommendations Almost two-thirds of John Crane's revenue is generated by aftermarket services, underlining the success of the company's restructuring into one global business with an expanded network of dedicated service centres

**John Crane**

**Continued**

**Bringing technology to life**

**Advanced monitoring to prevent unplanned shutdowns**

John Crane is developing advanced gas seal technology that will use computerised sensors to help minimise the risk of liquid contamination, the most common cause of gas seal failure and the subsequent unplanned operational shutdown of centrifugal gas compressor trains As the turbo machinery needs of the oil and gas industry continuously evolve, gas seals are used for increasingly more demanding applications Gas reinjection, gas gathering and hydrogen recycle are particularly prone to liquid contamination of the seal Standard methods of monitoring the health of a seal are often insufficient to detect problems before the ensuing damage forces the operator to halt operations and undertake costly emergency repairs In advanced applications, where the gas control panel incorporates a gas conditioning unit, the settings can be adjusted to extend the life of the seal Or a decision can be made to plan the necessary maintenance in advance, minimising cost and operational impact

GAS COMPRESSOR

REMOTE
CONTROL
ROOM

GAS
SEAL

REFINERY SITE

**Technology brings remote monitoring**

John Crane s patented seal technology uses an array of sensors on the seal and compressor to transmit real-time data to a computer at the central control point  Sophisticated software constantly analyses the information flow and alerts the operator at the earliest sign of any potentially crippling contamination

**John Crane**

**Continued**

**Performance**

| | 2011 £m | 2010 £m | Reported growth | Underlying growth |
|---|---|---|---|---|
| Sales | **894** | 786 | 14% | 13% |
| Headline operating profit | **189** | 163 | 16% | 15% |
| Headline operating margin | **21 1%** | 20 7% | 40 bps | |
| Statutory operating profit | **143** | 124 | | |
| Return on capital employed | **25.4%** | 22 2% | 320 bps | |

John Crane grew sales by 14%, or £108m, reflecting an underlying increase in revenue of £104m (13%) against a relatively weak comparator period, as well as a currency benefit of £4m The underlying growth reflects higher orders for first-fit original equipment and increased aftermarket sales across all end markets, particularly from the oil, gas and petrochemical sectors

Reported headline operating profit grew by 16% driven by a 15%, £25m, increase in underlying profit, and a £1m gain from currency translation Margins increased to new highs of 21 1% The underlying improvement in profitability stems from increased volumes, benefits from our cost-saving initiatives and improved pricing on aftermarket sales These positive margin effects were partly offset by adverse mix as a result of faster growth in first-fit original equipment sales and from John Crane Production Solutions (JCPS), our upstream energy services business Return on capital employed improved 320 basis points to 25 4% as a result of the improved profitability

The restructuring programme launched in August 2008 to create one global John Crane division is delivering improved customer service, quicker delivery, and lower costs In the period, we spent £3m and delivered savings of £6m so that annualised savings to date now total £23m Overall, the project is on track to deliver annualised savings of £25m during the coming financial year

Overall aftermarket sales grew 13% on an underlying basis which benefited from strong demand in the oil and gas sector, particularly from JCPS Sales for JCPS advanced 68% as a result of higher activity levels in US onshore gas and oil production and the full year effect of a contract to upgrade and maintain Petrom s 9000-plus wells in Romania Aftermarket sales of rotating equipment (seals, seal support systems, couplings, bearings and filtration) increased 5% with growth across all sectors

First-fit original equipment sales rose 14% on an underlying basis as customers increased their capital expenditure in new projects We saw strong activity in the oil, gas and petrochemical sectors in the Middle East, Latin America and Asia Some of this activity has been the start-up of previously delayed projects and a number of these have experienced some competitive pricing pressure In the short term, investment in these capital projects may constrain margin improvement but will support aftermarket sales growth, as well as market share gains and margin strength longer term

We continued to invest in infrastructure enhancement to expand our market-leading sales and service network During this past year a new state of the art manufacturing and service centre was opened in Dammam, Saudi Arabia and the Middle East HQ located in Dubai is being significantly expanded to increase manufacturing, service and training capabilities In China, manufacturing of the well-known Safematic product line has been introduced in response to key pulp and paper customer requirements Expansion of manufacturing in China continued with the introduction of a new metal bellows seal line which is meeting specific needs of the local market In the US, a new Indufil capability was added in the Deer Park facility in Texas, providing users of Indufil filtration equipment in the Americas with local technical and commercial support

**Research and development**

Our investment in research and development continues to progress on several fronts environmentally focused zero and low emission seals, rotating equipment condition monitoring with responsive control, advanced materials for seals and couplings, expansion of the performance range limit for compressor dry gas seals to extreme high pressures and engineered point solutions to target specific application services Recent new product introductions include the launch of a non-contacting supercritical $CO_2$ pump seal used in enhanced oilfield recovery and a line of high-duty American Petroleum Institute (API) compliant couplings

In keeping with our commitment to leading-edge product technology development, over the past year John Crane has invested more than £1m in the expansion of test capabilities including the establishment of a dedicated bearings test facility in Gottingen Germany, and a state of the art high-duty couplings test rig in Manchester, UK

John Crane Production Solutions has also introduced to the market a high-temperature version of its fibreglass sucker rods for lifting oil from wells This advanced product design will provide a more cost-effective pumping solution for customers and open new market opportunities for JCPS previously inaccessible due to well temperature

**Business developments**

John Crane has also pursued a strategy to expand its addressable market by making targeted acquisitions that add complementary technologies and products while also leveraging its extensive network of sales and service centres In August 2011, we advanced this strategy through the agreement to acquire, subject to regulatory approvals, the business of Houston-based Turbo Components and Engineering Inc, which services, repairs and builds replacement bearings and seals used in critical rotating equipment This acquisition is complementary to our existing engineered bearings business which was formed through acquisitions in 2007 and 2009 It will accelerate our plans to develop an aftermarket services business to support our existing engineered bearings offering This acquisition also provides more technically differentiated solutions which will improve the scale and overall profitability of the bearings product line in the immediate future Further progress was made within the year to advance the penetration of our expanded product line with several new accounts achieved for bearings and filtration

**Outlook**

John Crane's order rate has continued at strong levels This visibility should support sales growth in the first half of the coming year The full year sales growth will be subject to a sustained expansion in market economies and further customer investment in capital projects Margins will benefit from the full year impact of the cost saving initiatives in the coming year However this will be offset by strategic investments in longer term growth opportunities such as the expansion of our sales and service network, targeted large projects 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 full product line while continuing to build the JCPS business

**John Crane boosts oil and gas production**

John Crane's goal of becoming the supplier of choice of artificial lift products, services and solutions for oil and gas companies is best illustrated in Romania where it is helping upgrade and maintain the country's 9,500 wells A long-term contract between JCPS (John Crane Production Solutions) and Petrom has generated revenue of around £26m this year alone The managed reliability and service programme is cutting production downtime and boosting output in what is seen as a model partnership between JCPS and an oil company to revamp both site and service locations With well reliability and production greatly enhanced, such partnerships deliver considerable savings to customers who see a reduction in costly equipment failures JCPS is also using the experience to finesse new product development, introducing high temperature fibreglass sucker rods for the first time These give oil and gas operators the tools to produce in wells too hot for traditional sucker rods, an innovation that could soon become standard

**First-fit OEM**

**Percentage of sales**

37%

**Aftermarket service**

**Percentage of sales**

63%

## Smiths Medical

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

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

| | |
|---|---|
| **Employees** | 7,550 |
| **Contribution to 2011 Group sales** | 30% |
| **Contribution to 2011 Group headline operating profit**<br>Percentage relates to headline operating profit before corporate costs | 36% |

Go to www smiths-medical com

**Sales by sector £838m**

1 Medication delivery 28%
2 Vital care 41%
3 Safety devices 31%

3 1 2

**Sales performance**

£m

| 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| 691 | 703 | 834 | 858 | 838 |

### Business features

**Principal operations regions**

We have operations in over 30 countries with manufacturing concentrated in Mexico, the US and UK, Italy, Germany and China We sell to around 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 homecare, clinics and other surgery centres We have a direct sales presence in 22 countries, with distribution arrangements in some 100 others

**Competitors**

The competitive landscape for Smiths Medical is complex as we compete with different businesses across a wide range of product areas Our competitors include Covidien Teleflex B Braun, Becton Dickinson, C R Bard, 3M (Arizant), 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 In emerging markets, we compete with both large multinational companies and smaller domestic players

**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

## Markets and trends

Budgetary restrictions have continued to constrain customers capital spend and increased price pressure in many markets Procedure growth rates have also declined in some countries driven by reduced budgets and unemployment rates These factors, coupled with the exceptional H1N1 growth in several of our markets during the previous year have caused a meaningful slowdown in market growth rates during this past fiscal year

Despite these market challenges, medical device markets will continue to be attractive, driven by ageing populations and associated disease states as well as increasing prosperity – particularly in Asia The global market for devices and equipment of the type supplied by Smiths Medical is estimated to be worth over £4bn, with opportunities in target adjacent markets that would more than double the size of the addressable market Smiths Medical has the global reach in the design, production and distribution of medical device products, with sales and marketing activities in some 120 countries, necessary to capture global opportunities

Smiths Medical product ranges serve three main markets – medication delivery, vital care and safety It is particularly 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 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 Medicals broad and deep offerings

### Medication delivery

Smiths Medical designs and manufactures drug delivery systems that relieve acute and chronic pain, treat the most at risk critical care patients in high care units around the world, and enable patients with cancer, pulmonary hypertension or Parkinson s disease to receive their treatment at home The global market for medication delivery products is estimated to be worth £1 2bn We expect continued market growth 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 Our CADD brand is a leader in ambulatory infusion, and we have a strong position in the syringe pump market with our Medfusion and Graseby products

### Vital care

Smiths Medicals 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 overall vital care market has been affected by a slowdown in procedure rate growth, but we expect future growth due to underlying drivers such as increasing chronic disease incidence rates and ageing populations Demand continues to grow at a rapid rate globally for IVF as well The vital care market is currently estimated to be around £1 7bn

### Launching Graseby 2000 in China

Smiths Medical is launching an easy-to-use, affordable syringe pump system into a range of emerging markets following the integration of a Chinese medical instruments company The purchase of Hangzhou-based Zheda Medical Instruments (ZDMI) in 2008 has already led to accelerated sales in a range of pumps, including a 2000-unit order from the Chinese military ambulance service The recent launch of the new Graseby 2000 will build on these successes Ideally suited to emerging markets, the Graseby 2000 range provides versatile and reliable syringe pumps requiring fewer technological features and at a competitive price The pump, which delivers medication at a continuous infusion rate, is designed with cost-effectiveness uppermost in mind This allows Smiths Medical to target Southeast Asia, the Indian subcontinent, the Middle East, Eastern Europe and Latin America where healthcare budgets are less robust but steadily developing

### 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 Market growth has been limited in the past year by the exceptional H1N1 sales in the prior year Looking ahead, the safety market is expected to grow as focus on safety and controlling infections continues Smiths Medical is one of the world s leading suppliers of safety needles and catheters, as such, it is well positioned to capitalise on safety trends such as the recently agreed European Union directive calling for the increased use of safety products to protect healthcare workers

## Smiths Medical

**Continued**

### Bringing technology to life

**Mobile life-saver**

With some 15,000 units in use throughout the world, Smiths Medicals mobile Pneupac ventilators have helped save many lives in a wide range of emergencies The new paraPAC™ model, launched this year, offers an enhanced platform that can be extended as required by customers in the acute, ambulance, military and mass emergency markets paraPAC™ is able to increase the oxygen mix to ease breathing, provide CPAP (Continuous Positive Airway Pressure) typically for heart attack victims needing urgent attention, or switch to full ventilation mode for the critically ill who require immediate resuscitation and hospital-standard intensive care The ruggedised design of Pneupac ventilators allows them to operate in the harshest of weathers and terrains and they are currently used by more than 20 army medical corps worldwide

**Ideal in the field**

Powered solely by compressed oxygen, paraPAC™ needs no batteries and is ideal for field deployment Paramedics use the lightweight devices for on-site treatment of cardio-pulmonary breathing problems, from relatively minor to life-critical situations

**And for hospital care**

Within hospitals, paraPAC™ enjoys the added advantage of MRI (Magnetic Resonance Imaging) compatibility because it contains no magnetising metals that could interfere with the advanced bodyscans

**Smiths Medical**

**Continued**

**Performance**

| | 2011 £m | 2010 £m | Reported growth | Underlying growth |
|---|---|---|---|---|
| Sales | **838** | 858 | (2)% | (3)% |
| Headline operating profit | **196** | 184 | 7% | 7% |
| Headline operating margin | **23 4%** | 21 5% | 190 bps | |
| Statutory operating profit | **178** | 172 | | |
| Return on capital employed | **16.9%** | 15 1% | 180 bps | |

Headline operating profit rose 7% (£12m), and headline operating margin increased 190 basis points to 23 4%, the highest achieved for more than 10 years This reflects underlying profit growth of £13m and adverse currency translation of £1m Margins benefited from our ongoing initiatives to reduce overheads and manufacturing costs, as well as our portfolio profitability review Underlying sales were down 3% Our portfolio management initiatives accounted for the majority of sales declines, including our diabetes business exit (£3m), and declines in other product lines (£9m) such as patient monitoring, kitting and interventional imaging The rest of the decline reflects the difficult trading conditions, driven by economic pressures, unemployment and a slowdown in procedure growth rates in the US and Europe At reported exchange rates, Smiths Medical sales declined 2% (£20m), including positive impact from currency translation (£2m)

We have seen strong growth in some hardware products, which has driven sales of related disposable products The performance of our other disposable lines continues to reflect the trading pressures described, especially in developed markets

We have reorganised to create a global organisation for all functions The new structure has reduced costs and enhanced communication, while integrated global processes have improved customer focus and service levels The business reorganised field sales and marketing structures in most regions during the year, investing in building key account management, sales force effectiveness and training tools Our new sales structure will promote sales effectiveness and our ability to prioritise sales opportunities by product category and market

In medication delivery, excluding diabetes, underlying revenue grew 1% from increased sales of our CADD ambulatory pumps, which grew at 5% We have seen share gains due to the superior capabilities of the CADD®-Solis smart pump and through the efforts of our dedicated sales and clinical teams Sales of CADD®-Solis HPCA pumps grew in North America and continue to expand into Europe following the introduction of a multi-language platform CADD®-Solis VIP, which is the Companys first smart multi-therapy pump targeted at the alternate site and homecare segment, was successfully launched into the Canadian market this year The launch of Medfusion™ 4000, our innovative wireless syringe pump, into the Canadian acute care market was received well Pending appropriate market regulatory clearances, we anticipate launching CADD®-Solis VIP and Medfusion™ 4000 globally The Medfusion™ 4000 recently received FDA 510(k) clearance in the US and will be launched during our 2012 fiscal year The collaboration with Hospira to co-promote infusion pump systems continued to gain some ground in the year As part of this agreement, the two companies have started the development of software for managing infusion medication, 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 declined by 3%, primarily due to a weaker flu season than the prior year, the H1N1 sales in 2010 and reduced sales in areas such as patient monitoring, interventional imaging and kitting, which have been a focus of our SKU rationalisation initiative Our temperature management business grew slightly in challenging markets where we continue to show particular strength in convective warming and temperature probes We have seen good growth in bronchial hygiene products and humidification systems driven by our Ventilator Associated Pneumonia (VAP) reduction campaigns Our tracheostomy business also grew, benefiting from our award-winning UniPerc® tracheostomy kit as well as strong Bivona silicone tracheostomy sales Our assisted reproduction products also grew strongly as we benefit from our leading presence in this niche market

Underlying sales of safety devices declined 4%, driven by a tough competitive environment, procedure trends and reduced demand versus H1N1 needs in the prior year Although our safety catheter business grew, our overall PIVC and sharps safety businesses were slightly down during for the year Vascular access was also down, reflecting difficult market conditions Interest in safety products remains high in developed markets, and is growing in developing markets like India and China We anticipate improved safety market performance given our strong product line

Emerging markets continue to be a source of growth as the quality of, and access to, healthcare improves We continue to expand our efforts and presence in emerging markets which now represent approximately 9% of sales and are growing at greater than 10% per annum, depending on the market While we have had a presence in India for many years, we recently established an operating entity which includes a direct sales and marketing team to complement our distributor business and will continue to invest in emerging market opportunities

We have continued to manage our product portfolio aggressively to boost profitability and reduce complexity We have eliminated around 4,000 SKUs in the last two years and in many cases have successfully converted customers to alternative higher margin products, which has contributed to our significantly improved profitability There are further opportunities for margin improvement through portfolio management

We have also optimised our footprint to deliver a more efficient supply chain During the year, we merged a distribution centre in Milan, Italy into our central European distribution centre in Nijmegen, Netherlands We also in-sourced the Nijmegen distribution centre operations, to reduce costs and improve performance Additional initiatives to optimise our manufacturing and distribution network are currently in progress, with a focus on migrating the footprint closer to our markets, as well as cutting costs We have aggressively pursued productivity initiatives and significantly reduced variable costs by some 4-5% in each of the last three years

**Research and development**

Investment in R&D continues to be a priority with an increase of 3% Our total R&D spend of £31m (2010 £30m) comprised 3 7% of sales (2010 3 5%) At the same time we significantly reduced the number of pipeline projects thereby increasing the investment on the highest impact products This is enabling a higher level of project execution and will increase overall R&D effectiveness

Sales from products launched in the last three years represent some 10% of sales and, with the strength of our pipeline, we expect this to improve in 2012 and beyond During the year, we launched two significant new medication delivery products into Canada the CADD®-Solis VIP ambulatory pump and Medfusion™ 4000 wireless syringe pump, generating new business and strengthening existing customer relationships In addition, we released the CT Marker in our PORT-A-CATH® and PAS PORT® POWER PAC systems, Gripper®Micro Extension, and Pneupac® paraPAC™ plus, expanding our offerings in vascular access and mobile ventilation We also continued to extend the reach of a number of existing products into new regions, broadening our offering particularly in emerging markets

**Outlook**

Developed markets are likely to remain challenging in the short term as healthcare cost controls and unemployment put pressure on price and volumes Against these trading conditions, our R&D pipeline is strong and we will seek to drive sales growth through new product introductions in 2012 and beyond, coupled with an increased emphasis on customer-facing resources and sales effectiveness Our investments in China, India and other emerging markets will also serve as a source of growth Additional opportunities exist to drive operational improvements to support continued margin expansion success We will reinvest some of these savings into sales and marketing and new product development efforts to accelerate long-term growth

**Intensive care protection**

Seriously ill patients under mechanical ventilation are particularly prone to infections, a challenge Smiths Medical has met by developing a sophisticated breathing tube that incorporates a suction line to help prevent the accumulation of dangerous secretions in the trachea For decades our Portex brand has been synonymous with advanced endotracheal tubes used to access patients lungs for ventilation in operating rooms and intensive care units SACETT™ (Suction Above the Cuff Endotracheal Tube) is designed with a Soft Seal ® inflatable cuff that provides both maximum seal security and comfort and helps the pooling and easy disposal of bacteria-laden secretions that can readily develop into pneumonia Reducing the incidence of Ventilator Associated Pneumonia (VAP) not only saves lives but also cuts healthcare costs by aiding a speedier recovery and freeing up vital hospital beds

**Company-funded R&D**

**Percentage of sales**

3.7%

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

**Percentage of sales**

10%

## 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

**Sales by sector £379m**

1 Military & aerospace 43%
2 Telecom 25%
3 Medical, rail, automation and test 32%

3

1

2

**Sales performance**

£m

| 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| 230 | 261 | 318 | 340 | 379 |

| | |
|---|---|
| **Employees** | 4,000 |
| **Contribution to 2011 Group sales** | 13% |
| **Contribution to 2011 Group headline operating profit**<br>Percentage relates to headline operating profit before corporate costs | 12% |

Go to www smithsinterconnect com

**Business features**

**Principal operations 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

**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

**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

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

Government budgets, particularly defence spending, remain under considerable pressure and, while no area is likely to be immune, it is expected that areas such as intelligence, surveillance and reconnaissance (ISR) will remain a key priority Improved battle space awareness, network-centric communications systems and force protection are also seen as critical success factors in current and future conflicts

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 currently strong, driven by increasing passenger and freight demand particularly in Asia and the Middle East 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

The range of end markets will be expanded on completion of the acquisition of Power Holdings Inc to include data centres and alternative energy

**Technology**
Smiths Interconnect comprises four technology-focused cohesive business units

- Connectors provides application-specific, high-reliability electrical interconnect solutions from highly integrated assemblies to microminiature 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

**Next generation millimetre wave applications**

As the electromagnetic spectrum becomes increasingly congested, higher frequency technologies that offer more bandwidth and greater resolution are at the forefront of a range of next-generation applications Smiths Interconnect, a leading designer and manufacturer of complex components and sub-systems used in such high frequency systems, is working with renowned research institutes in applying millimetre-wave (MMW) technology to a series of pioneering developments For example, our MMW components are used for the diagnostic monitoring of hot ionised gases in experimental fusion test reactors which are laying the groundwork for the future development of full-scale fusion power plants, a clean and intrinsically safe form of energy generation They are also used within the most modern US weather satellites and in such scientific applications as the Herschel HIFI instrument, currently searching for signs of water in outer space Water is revealed through sub-MMW fingerprints and is key to helping astronomers understand the mechanisms of star formation

Smiths Interconnect

Continued

**Bringing technology to life**

**Protecting critical systems**

Growing recognition of the threat posed by electromagnetic pulses (EMPs), whether from high-altitude nuclear detonations or solar flares, has prompted Smiths Interconnect to expand its power and signal integrity products to include protection against the potentially devastating impact on electrical, power and communications systems. A three-year test project with the US military on how to protect against EMPs resulted in Smiths Interconnect winning a $4.6m contract from the US Air Force Global Strike Command to provide its SREMP ESA (Source Region Electromagnetic Pulse Electrical Surge Arrestor) hardened technology to shield Minuteman Weapon Systems. This technology is already being applied to protect vital electrical and communications systems in a variety of other defence applications including military ground vehicles, naval vessels, aircraft and ground facilities.

EMP
event

Clean
signal

Shielding
and
filtering

ELECTRONIC SYSTEMS

TELECOMMUNICATIONS

CRITICAL FACILITIES

MILITARY SYSTEMS AND COMMUNICATIONS

**Danger diverted**

The system works through a combination of shielding the protected electronics and shunting off excess energy through proprietary filtering and suppression technology, allowing only clean power and communications signals to pass through

**Shielding civil infrastructures**

This technology can also be used to protect non-military critical infrastructure such as government buildings, power installations, hospitals, first responder communication systems and data centres

**Smiths Interconnect**

**Continued**

### Performance

| | 2011 £m | 2010 £m | Reported growth | Underlying growth |
|---|---|---|---|---|
| Sales | **379** | 340 | 12% | 3% |
| Headline operating profit | **68** | 62 | 9% | (2)% |
| Headline operating margin | **17.8%** | 18 2% | (40) bps | |
| Statutory operating profit | **49** | 53 | | |
| Return on capital employed | **15.7%** | 17 3% | (160) bps | |

Reported sales for Smiths Interconnect grew 12%, or £39m Acquisitions contributed £33m and there was a currency translation headwind of £3m Underlying growth was 3% (£9m), primarily due to strong growth in the medical, rail, automation and test markets offsetting a decline in military and aerospace sales, particularly in the second half as the US Department of Defense budgetary cutbacks and the associated Continuing Resolution impacted demand

Reported headline operating profit increased 9%, or £6m Excluding the impact of currency translation and acquisitions, underlying headline operating profit decreased by 2% (£1m) with headline operating margin reducing by 40 basis points to 17 8% The decrease was primarily driven by the difficulty of adjusting the cost base to address the lower military sales caused by the Continuing Resolution, and slightly weaker gross margins due to sales mix and pricing pressure These were partially offset by restructuring savings, procurement initiatives and the benefit of moving of manufacturing to lower cost economies Fixed costs continued to be tightly controlled

On an underlying basis, sales into the military, aerospace and space markets fell 5% for the full year Despite a 3% increase in the first half, budget cuts at the US Department of Defense caused the market to weaken in the second half The effect of the Continuing Resolution was substantial, particularly at the components and sub-systems level in the supply chain, as funding uncertainty delayed several programmes incorporating our microwave and connector technologies

Despite these underlying conditions, our Protection technology experienced significant growth in military markets as the potential threat from an electromagnetic pulse (EMP) weapon or solar flare gains further recognition and raises demand for our transient voltage protection devices Specifically, we completed a $4 6m contract from the US Air Force Global Strike Command to supply our advanced hardened technology to protect Minuteman Weapon Systems

Demand from the military market slowed considerably for our connectors and microwave technologies In Europe, the Eurofighter programme continued to be strong but other programmes such as soldier-based electronics have been slow Similarly, upgrade programmes for counter-IED systems incorporating our microwave technology experienced delays

The SatCom, UAV (unmanned aerial vehicles) and ISR (intelligence, surveillance and reconnaissance) sectors are focus areas for our microwave business and remain more robust than other parts of the military budget During the year we were awarded several new contracts including radar components for multiple UAV programmes and a major contract for millimetre-wave instruments to be used on the next-generation US weather satellites Most notably, in December 2010, our Millitech business was awarded a $16m contract to supply the Antenna Pedestal for the US Navy Multiband Terminal (NMT) satellite communication programme which provides a powerful and reliable new capability at up to five times the current bandwidth while using smaller, lighter and more energy-efficient systems

The commercial aerospace market remained strong, with increased demand for our connector products as production rates increased at both Boeing and Airbus We also won positions on the new Chinese commercial aircraft currently in development, the Comac C919 Our KuStream broadband satellite antenna system has now been selected by three airlines, including Southwest, and is undergoing trials with several others It will be installed on over 500 aircraft enabling in-flight connectivity and applications such as live-TV, movies and internet We have also been selected to provide a military variant of the system

Underlying sales to the wireless communications market increased 3% Infrastructure spend was focused on new technology deployments within specific geographies such as LTE 4G in the US and WCDMA 3G in India, and hotspots of activity such as network improvement projects in Australasia However, growth remained constrained by network operators controlling capital expenditures and consolidation within the equipment manufacturers sector

The need for network operators to drive improved performance from existing assets resulted in significant growth in portable passive intermodulation test equipment and filter products to enhance signal performance, including sales in China and India where network quality is poor after large rapid deployments over the last five years

Wireless telecommunications demand for our RF and power protection products remained relatively flat Reductions in government budgets also adversely affected sales of our timing products used in public safety and first responder network applications However, microwave components and cable assembly sales grew as a result of new contract wins with Chinese equipment manufacturers Furthermore, increased data traffic from smart phones and tablet computers created opportunities for new products for backhaul infrastructure

Underlying sales to the medical, rail, test and automation markets remained strong in the second half and for the full year increased 20% In medical sales of high reliability connectors grew significantly, particularly during the first half, with strong demand from cardiac mapping and MRI systems, and a range of new applications Power protection product volumes increased for radiotherapy and radiosurgery systems The rail market provided modest growth as rolling stock and train control system projects started to transition from development into production and generated demand for high-speed and reliable connection systems and surge protection devices In the test market, our spring probe connector acquisition, IDI, continued to perform strongly, and two important new product ranges were developed which are expected to offset softening market conditions experienced at the end of the year The industrial market has been positive this year with particular growth in connectors for machine automation and sensor applications

**Research and development**

Total R&D spend increased 19% to £25m or 6 6% of sales (2010 £21m or 6 3% of sales) The customer-funded portion, predominantly within the Microwave Defence group, reduced by £1m to £4m or 1 1% of sales (2010 £5m) reflecting US Department of Defense budget cuts and the completion of some programmes

Investment was targeted across all technology areas and we continued to develop non-US based technical resources In Connectors, we have focused on developing smaller, higher speed and higher power products Microwave developments included improvements in our industry-leading capabilities in airborne broadband antenna systems and passive intermodulation test equipment, and new filtering products to address broader geographic markets Protection s technical advancements included high performance RF protectors with improved reflection loss and new power protection configurations for the military and rail markets More than a third of sales now come from products or technologies developed during the past three years

**Business developments**

In September 2011, Smiths Interconnect announced its intention, subject to regulatory approvals, to acquire Power Holdings Inc (PDI), a leading designer and manufacturer of specialist power distribution, conditioning and monitoring systems Based in Richmond, Virginia, PDI is the parent company for Power Distribution, Inc , Marelco Power Systems, Inc and Onyx Power, Inc It produces power distribution units, static transfer switches, remote power panels, power conditioning units, medium and low voltage transformers and patented power monitors used mainly in data centre and alternative energy applications

The acquisition of PDI transforms the existing power protection group with a new range of products and growth opportunities It strengthens Smiths Interconnect s offering of technically differentiated solutions for applications requiring ultra-reliable and precise power performance, broadening our high reliability power quality capabilities to include conditioning, protection, distribution, filtering and monitoring to ensure the optimum function of advanced electrical systems

PDI, which also has facilities in Santa Ana, California and Howell, Michigan, employs around 370 people and more than 90% of revenues come from non-government funded markets

We remain focused on cost control and further improving margin performance During the year, we consolidated our Protection activities in China into one facility and also began restructuring our European connector businesses by concentrating manufacturing into a centre of excellence in a lower cost geography We also brought together a number of our microwave wireless telecommunications businesses under a single management team which culminated with the launch of a new brand, Kaelus, providing a single face to customers and simplifying our business interactions in this fast moving sector

**Outlook**

Government-funded sectors, particularly the defence market in the US, are expected to remain challenging However, we are relatively well positioned on some long-term programmes and strategically important sectors such as communications and ISR Investment by wireless network operators in higher speed next-generation technologies will increase demand for our network optimisation products, test solutions and protection devices Market conditions in medical, rail, test and automation are expected to be mixed with the semiconductor and circuit-board test markets tightening as consumers hold back on purchases of electronic devices Margins are expected to face some pressure as volumes decline in some sectors, although this will be offset in part by restructuring benefits and operational efficiencies

**Vital connections that save lives**

Our ultra-reliable connectors are used in many vital applications, none more so than the medical sector which has generated significant revenue growth for Smiths Interconnect during the year Examples of new medical projects that are now equipped with our sophisticated miniature components include implantable contacts for a totally electrical artificial heart unit which uses our hyperboloid contact technology, a capsule endoscopy imaging system using spring contact technology from our recent acquisition, IDI, to help in internal examinations, and a tele-robotic surgical system that relies on our microminiature connectors to link the robotic arms and the control unit In all cases, Smiths Interconnect s highly engineered solutions were ideally suited to meet the specialised environmental, mechanical, electrical and reliability requirements of complex medical and surgical applications

## 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 improving the performance of domestic appliances such as clothes tumble dryers and HVAC equipment

| | |
|---|---|
| **Employees** | 2,000 |
| **Contribution to 2011 Group sales** | 8% |
| **Contribution to 2011 Group headline operating profit** <br> Percentage relates to headline operating profit before corporate costs | 5% |

Go to www flextekgroup com

**Sales by sector £221m**

1 Fluid Management 32%
2 Flexible Solutions 16%
3 Heat Solutions 27%
4 Construction 25%

4 1 3 2

**Sales performance**

£m

| 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| 213 | 206 | 222 | 212 | 221 |

**Business features**

**Principal operations regions**

Flex-Tek operations are principally located in the US and Mexico with Asian operations located in India, China, and Malaysia, 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

**Competitors**

Competitors for our Fluid Management business include specialty segments of Parker-Hannifin, Eaton, and Kongsberg, as well as vertically integrated capacity from key customers Heat Solutions noteworthy competitors in the US include Nibe, Watlow and Chromalox, and in China, Kawai and Dongfang manufacture a wide variety of electric heaters Flex-Tek s Construction products competes with US manufacturers Hitachi, Atco, Omega-Flex, Hart & Cooley and Goodman Flexible Solutions competes globally with a number of smaller privately owned businesses which manufacture specialty hoses

**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

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

**Technology**
Flex-Tek is organised under four market specific segments focusing on superior technology and service

**Fluid Management**
We are a market-leading manufacturer of specialty high-performance, flexible and rigid tubing assemblies for aerospace, industrial, and automotive applications worldwide Our specialised high-performance tubing provides reliable and efficient delivery of hydraulic fluids and jet fuel for both civil and military aircraft Automotive applications include petrol and brake fluid delivery in traditional automobiles as well as next-generation fuels for natural gas and hydrogen-powered vehicles Demand for our products is linked to both the worldwide air transport market and industrial growth

**Heat Solutions**
We are the world s largest manufacturer of open coil heating elements 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

**Construction Products**
Flex-Tek manufactures market-leading flexible gas piping and HVAC flexible ducting for the US construction market Our customers are large national wholesale distributors in North America supplying both plumbing and HVAC tradesmen Demand is a mix of the strength of the US construction industry and replacement sales

**Flexible Solutions**
Flexible Solutions hose assemblies are focused into three distinct markets medical respiratory care, floorcare appliances, and industrial ventilation The business performance generally follows macroeconomic indicators such as healthcare spending, US GDP, and capital goods expenditures

**More effective mass production**

An astonishing 220 billion paper cups are produced worldwide every year, and even the tiniest improvement in their manufacturing process can generate significant benefits both for the environment and the bottom line A standard cup comprises a special paper coated with polyethylene, an ultra-thin layer of plastic that keeps beverages cold or warm and prevents absorption or leakage of liquid Flex-Tek s advanced thermal management and heating applications helped the largest US specialty paper manufacturer eliminate the need for the drying process to be fuelled by natural gas, allowing production to continue uninterrupted during scheduled product changes The drying process now uses less total energy and operates more efficiently, contributing towards a safer and more green environment Such collaboration is part of our commitment to work closely with customers to improve their efficiency

Flex-Tek

Continued

### Bringing technology to life

### Flex-Tek expands medical range

Flex-Tek is capitalising on its expertise in flexible hosing and heat solutions to help improve the standard therapy for sleep apnoea, a debilitating condition that affects millions of people worldwide A common but little-known disorder, sleep apnoea stems from closure of the airway which interrupts regular breathing during sleep, often leaving the person gasping for air In severe cases it can increase the risk of heart disease, diabetes, and depression As part of its expansion into niche medical markets, Flex-Tek has improved the long-established therapy of Continuous Positive Airway Pressure (CPAP) by developing a light-weight, advanced temperature-controlled breathing circuit Already introduced into North America and Europe, this is one of a growing range of Flex-Tek's medical-related products, including specialised heating systems for blood diagnostic devices and CT image enhancement

**Heat control minimises condensation**

The breathing circuit greatly enhances both CPAP effectiveness and patient comfort by minimising condensation build-up through continuous heat control to align the temperature within the tube with the outside environment

**Flex-Tek**

**Continued**

**Performance**

| | 2011 £m | 2010 £m | Reported growth | Underlying growth |
|---|---|---|---|---|
| Sales | **221** | 212 | 4% | 6% |
| Headline operating profit | **28** | 24 | 18% | 19% |
| Headline operating margin | **12.5%** | 11.1% | 140 bps | |
| Statutory operating profit | **26** | 21 | | |
| Return on capital employed | **21.9%** | 18.4% | 350 bps | |

Reported sales grew 4%, or £9m, reflecting underlying sales growth of 6% that was offset by £3m of adverse currency translation. Underlying sales were boosted primarily by an increase in sales of components to the OEM aerospace market and US residential construction sector, and were partly offset by declines in sales in Flexible Solutions.

Headline operating profit margins increased by 140 basis points to 12.5% as a result of increased sales, operational gearing from prior restructuring, and price increases which helped to offset raw material inflation. The underlying increase in operating profit was £5m. Return on capital employed improved by 350 basis points driven both by profitability improvement and reductions in working capital.

As reported at the half year results, we now manage the business as four technology groups: Fluid Management, Construction Products, Heat Solutions, and Flexible Solutions.

In Fluid Management, sales of components to aerospace customers rose 16% on an underlying basis, helped by higher volumes on major airframe platforms from Airbus and Boeing. The order book for our commercial aviation OEM business remains strong and we have gained market share in our overhaul & repair service segment. In addition our sales to the US automotive market for both fuel and brake applications remains robust.

Sales to the construction market improved 10% on an underlying basis, with growth mainly coming from the first half of the year. The second half sales underlying growth rate slowed to 6% as uncertainty still clouds the US housing market. The latest US Bureau of the Census forecast is for housing starts to remain relatively flat with prior year, with no expectation of a measurable upturn in the near term. We have gained market share by bundling our ducting, flexible gas piping and HVAC heating element product lines to the US distribution market.

Heat Solutions underlying sales were in line with the prior year. In 2010, the US federal government offered rebates to consumers who traded in their old appliances for new. This programme benefited first half underlying sales, up 11%, but resulted in reduced demand in the second half, down 8%. Consumer confidence remains cautious in the US and OEM appliance manufacturers continue to project low single growth rates in the US markets.

The Flexible Solutions division sales were down 7% for the year Continued weak demand in the US for floorcare products and industrial goods was only slightly offset by higher sales for our respiratory care hoses for sleep apnoea

The final stages of Flex-Tek s restructuring programme were completed in the year as we continued to rationalise our manufacturing portfolio, refurbish facilities, and deliver productivity improvements The programme, part of the wider Group restructuring, has achieved annualised savings of £9m in line with our plans, as we delivered a further £1m of savings in the year, including the rationalisation of two facilities in the north eastern US

Flex-Tek has increased R&D spend and investment in our Asian manufacturing facilities in China and India We continue to seek new investments to grow our market share, expand our product portfolio, and target potential bolt-on acquisitions to build on the strength of the management team

**Outlook**

The momentum of the Fluid Management business should continue well into the coming year as our order book reflects a positive environment supported by a new generation of aeroplanes with better fuel efficiency and lower cost per passenger mile The US residential construction and household appliance markets are expected to remain uncertain with no significant growth projected Any upturn in these markets will generate positive earnings for the business

**Towards a cleaner environment**

Flex-Tek has built on its success in helping develop environmentally friendly vehicles by teaming up with a Korean company to provide Hyundai with a revolutionary fuel hose for its new Hydrogen Fuel Cell Concept Car Asked by Hyundai to solve the problem of transferring hydrogen fuel throughout a vehicle without standard rigid tubing, local supplier Hanil Tube turned to Flex-Tek for help The hose must offer not only similar permeation characteristics as stainless steel tubing but also superior flexibility and resistance to vibration fatigue Working closely with Hanil, our engineers developed the only hydrogen delivery hose in the industry that meets these criteria In the US, Flex-Tek has partnered with Clean Energy to supply the specialised fuel hose assembly needed for petrol vehicles converted to run on natural gas

**Sales**

**£m**

221

**Headline operating profit**

**£m**

28

# Financial review

**Sales**

**Up 3%**

£2,842m

Go to page 17 and note 1 on page 98 for more information

**Headline operating profit margin**

**Up 40 basis points**

18.2%

Go to page 17 and note 1 on page 98 for more information

**Earnings per share**
Basic headline earnings per share from continuing activities were 92.7p (2010: 84.6p), a growth of 10%. This reflects an increased headline operating profit and a higher pensions financing credit which have been partly offset by a higher tax rate.

On a statutory basis, the basic earnings per share from continuing activities were 77.8p (2010: 75.3p).

**Exceptional and other items relating to continuing activities excluded from headline profits**
These items amounted to a charge of £88m compared to a charge of £62m in 2010. They comprised:

- Amortisation and impairment of intangible assets acquired in business combinations of £50m (2010: £42m). The charge relates principally to technology and customer relationships;
- A charge of £34m (2010: £25m) in connection with John Crane, Inc. asbestos litigation;
- A charge of £16m (2010: £8m) in respect of restructuring. This is part of a programme which is expected to cost approximately £62m by the end of 2012, of which £52m has now been charged;
- Release of a diabetes-related provision of £2m (2010: nil) which was part of an exceptional cost when established;
- £10m gain in relation to changes to certain early retirement terms (2010: £4m gain arising from the closure of the principal UK defined benefit pension schemes);
- £4m profit on disposal of businesses (2010: £9m including profit on disposal of property);
- Acquisition costs of £1m (2010: £1m); and
- Financing loss of £3m (2010: £1m gain). These represent exchange movements on derivatives and other financing instruments not hedge accounted under IFRS.

**Cash generation and net debt**
Operating cash generation remained strong, albeit below the high levels of the previous years. Headline operating cash-flow of £489m (2010: £565m) represented 95% (2010: 115%) of headline operating profit. Cash conversion benefited in 2010 from reduced working capital arising from certain one-off initiatives. Free cash-flow declined £95m to £236m (2010: £331m). Free cash-flow is stated after interest and tax but before acquisitions, financing activities and dividends (see note 28 to the accounts for a reconciliation of headline operating cash-flow and free cash-flow to statutory cash-flow measures).

On a statutory basis, net cash inflow from continuing operations was £322m (2010: £410m).

Dividends paid in the year on ordinary shares amounted to £136m (2010: £133m).

Net debt at 31 July was £729m, down from £837m at 31 July 2010. The decrease in net debt reflects the strong free cash-flow and outflows of £136m for dividends and £21m for the net effect of acquisitions and disposals.

**Interest and other financing costs**
Interest payable on debt, net of interest earned on cash deposits, was £59m compared with £62m in 2010. This reduction reflects lower average levels of debt. Interest costs were covered 8.8 times by headline operating profits.

The Group accounts for pensions using IAS 19. 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 £23m (2010: £2m). With effect from 1 August 2011, we propose to report headline pre-tax profit excluding this item (see note 3 to the accounts for pro-forma 2011 figures). The headline measures are intended to report the underlying performance of the Group excluding factors which are outside management control.

**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.

We invested a total of £111m in R&D (2010: £107m) on continuing operations, equivalent to 3.9% of sales (2010: 3.9%). Of that total, £99m was funded by the Company compared with £93m in 2010, an increase of 5%. We actively seek funding from customers to support R&D and this amounted to £12m (2010: £13m). Under IFRS, certain development costs are capitalised, and this amounted to £31m in the period (2010: £24m). 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 £121m (2010 £104m) represented an effective rate of 25% on the headline profit before taxation (2010 24%) The tax rate has increased by 1% in the year reflecting underlying changes in the profit mix across our countries of operations and the net impact of effective compliance management including the favourable conclusion of recent tax audits On a statutory basis, the tax charge on continuing activities was £92m (2010 £79m)

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 in areas with higher tax rates will cause the headline tax rate to increase over time with a rate of between 26-28% expected in the year ending 31 July 2012

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 half yearly 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 calculated over a rolling 12-month period and 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 17 0% (2010 16 6%)

**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 2011 and evaluating liabilities at period-end AA corporate bond interest rates

The tables below disclose the net status across a number of individual plans Where any individual plan shows a surplus under IAS 19, this is disclosed on the balance sheet as a retirement benefit asset The IAS 19 surplus of any one plan is not available to fund the IAS 19 deficit of another plan

The net pension deficit has reduced to £199m at 31 July 2011 from £305m at 31 July 2010 The reduction reflects asset returns in respect of UK funded schemes and cash contributions to the schemes

The accounting basis under IAS 19 does not necessarily reflect the funding basis agreed with the Trustees and, should the schemes be wound up while they had members, they would need to buy out the benefits of all members The buyouts would cost significantly more than the present value of scheme liabilities calculated in accordance with IAS 19

The retirement benefit position was

| | **31 July 2011** | 29 January 2011 | 31 July 2010 |
|---|---|---|---|
| Funded plans | | | |
| UK plans – funding status | **101%** | 104% | 98% |
| US plans – funding status | **76%** | 78% | 71% |
| Other plans – funding status | **77%** | 70% | 69% |

| | **31 July 2011** | 29 January 2011 | 31 July 2010 |
|---|---|---|---|
| Surplus/(deficit) | | | |
| Funded plans | **(108)** | (29) | (216) |
| Unfunded plans | **(91)** | (90) | (89) |
| Total deficit | **(199)** | (119) | (305) |
| Retirement benefit assets | **141** | 151 | 80 |
| Retirement benefit liabilities | **(340)** | (270) | (385) |
| | **(199)** | (119) | (305) |

In the coming year, cash contributions to the schemes are expected to total approximately £110m (2011 £64m), including a conditional £50m to the TI Group Pension Scheme In addition, the Group will invest £24m in an escrow account as part of the 10-year funding plan agreed with the Smiths Industries Pension Scheme

**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 2011** | 31 July 2010 | | 29 January 2011 |
|---|---|---|---|---|
| Average rates | | | | |
| US dollar | **1.60** | 1 57 | Dollar weakened 2% | 1 57 |
| Euro | **1.16** | 1 14 | Euro weakened 2% | 1 18 |
| Year-end rates | | | | |
| US dollar | **1.64** | 1 57 | Dollar weakened 4% | 1 58 |
| Euro | **1.14** | 1 20 | Euro strengthened 5% | 1 16 |

**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 assets is deducted from headline profits

The goodwill balance was tested for impairment in 2010 and 2011

# Financial review
continued

**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 92-97

**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 92

**Treasury**
The Board has 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 treasury activities and compliance with the policy The Board maintains a strong treasury control framework within which approved banks, financing and debt strategy, interest rate risk and currency translation management are reserved for Group Treasury while cash and currency transaction exposure management are devolved to operating divisions Cash pools exist to manage liquid resources across divisions efficiently

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 exposures 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 is 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 2011 were BBB+ / Baa2 (stable) from Standard & Poor's and Moody's respectively The agencies removed the negative outlooks on these ratings during the financial year ended 31 July 2011 An essential element of an investment grade rating is consistent robust cash-flow metrics The Group's objective is to consistently maintain a headline operating cash conversion of greater than 80% and net debt/headline EBITDA at less than two times At 31 July 2011, these measures were 95% (2010 115%) and 1 2 times (2010 1 4 times) respectively

**2 Debt and interest rate management**
The Group's debt funding arrangements are managed centrally At 31 July 2011 net debt was £729m (2010 £837m) In December 2010, the Group completed a new US$800m five-year committed revolving credit facility with a core group of 10 global banking partners to replace the existing £660m facility which would have matured in 2012 The Group's risk management objectives are to ensure that funding from the bank market is less than 30% of net debt, the average maturity profile of gross debt is at least four years and over 60% of net debt is at fixed rates of interest At 31 July 2011, these measures were 0% (2010 0%), 4 9 years (2010 6 0 years) and 99% (2010 92%) The high fixed rate % of net debt is impacted by the levels of floating rate cash resources currently on the balance sheet Excluding cash resources, the percentage of gross debt that is at fixed rates of interest at 31 July 2011 was 74% (2010 76%)

**3 Liquidity management**
At 31 July 2011, the new $800m committed bank facility which matures in December 2015 was completely undrawn The Group's objective is to ensure that at any time undrawn committed facilities net of overdraft financing are greater than £200m At 31 July 2011, this measure was £487m (2010 £660m) At 31 July 2011, cash resources were £261m (2010 £173m)

The Group aims to ensure that surplus cash resources are securely placed on deposit with highly rated relationship bank counterparties at short-notice availability Credit exposure to every approved bank is defined by the Treasury Risk policy by reference to long-term rating and compliance is measured and reported monthly At 31 July 2011, 97% (2010 69%) of cash and resources were on deposit with the 10 global relationship banks and only £3m (2010 £5m) was invested with counterparties 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 £30m equivalent, over 50% of those assets are matched with the same currency liability At 31 July 2011, 45% (2010 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 Risk management on pages 52 to 56 and the Corporate governance statement on pages 70 to 74

**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 successfully is likely to have a significant impact on its annual aggregate adverse judgment and defence costs

JCI continues to actively monitor the conduct and effect of its current and expected asbestos litigation, including the efficacious presentation of its safe product defence, and intends to resist these asbestos cases based on this defence Approximately 202,000 claims against JCI have been dismissed before trial over the last 32 years JCI is currently a defendant in cases involving approximately 101,000 claims Despite these large numbers of claims, JCI has had final judgments against it in only 107 cases, and has had to pay awards amounting to approximately US $103m

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 2011, the aggregate provision for JCI asbestos litigation, including for adverse judgments and defence costs, amounted to £182m 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

Go to note 23 on pages 124-125 for more information

# Risk management

## Smiths is exposed to a wide range of risks in running its businesses. The Company and its divisions consider these risks on a regular basis and seek to put in place appropriate risk management processes, policies and other measures, including insurance where appropriate.

However, there can be no assurance that these measures will be effective in any particular case If any of these risks, or other unforeseen risks, materialise, they could have a significant adverse effect not only on our business and financial condition but also on 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

The Group s process for identifying, evaluating and managing significant business risks is reviewed by the Audit Committee and monitored by the Group Internal Audit Department During the year, we undertook an additional corporate risk review, to augment our divisional risk management review processes An outline of this year s review process by the Board and Audit Committee is set out in the Statement of the independent non-executive directors, on page 75 A description of the Company s internal controls and risk management processes is given in the Corporate governance statement, on page 70

Further information is provided below on our principal risks and the mitigating activities in place to address them The Group is exposed to a larger number of risks than those listed However, we have made a conscious effort to disclose those risks that have been debated at recent Board or Audit Committee meetings and are of most concern to the business at this time

**Economic outlook**

**Risk**

Smiths operates in more than 50 countries and is affected by global economic conditions, particularly in the US Our business is also 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

Current global economic and financial market conditions, and the potential for a significant and prolonged global recession, may materially and adversely affect the Company's performance and financial condition A recession may also materially affect its customers, suppliers and other parties with which it does business Adverse economic and financial market conditions may cause our customers to terminate existing orders, to reduce their purchases from Smiths, or to be unable to meet their obligations to pay outstanding amounts due to Smiths These market conditions may also cause our suppliers to be unable to meet their commitments to Smiths or to change the credit terms they extend to us

**Potential impact**

A significant and sustained economic downturn or any similar event, could have a material adverse effect on the Group s operational performance and financial condition

**Risk management**

- The Group has a diversified portfolio of businesses that mitigates against exposure to any one country or sector
- The divisions regularly monitor their order flows and other leading indicators, where available, so that they may respond quickly to a deterioration in trading conditions
- In the event of a significant economic downturn, there may be opportunities to identify and implement cost reduction opportunities to offset the impact on margins from a deterioration in sales

**Financial risks (foreign exchange, funding, tax and insurance)**

**Risk**

*Foreign exchange* Exchange rate fluctuations have had, and could continue to have, a material impact on the reported results Smiths is exposed to two types of currency risk transaction and translation

*Funding* Smiths ability to refinance its borrowings in the bank or capital markets is dependent on market conditions and the proper functioning of financial markets

*Tax* The Group s future profitability, particularly if in the US where there are higher rates of corporation tax, may cause the headline tax rate to increase over time Changes in tax and fiscal regulations and transfer pricing rules in the countries in which we operate could affect the Group, particularly at times when public sector debt is high, as could the uncertainty surrounding the basis of taxation of foreign profits under the UK s controlled foreign companies regulations

*Insurance* Smiths cannot be certain that it will be able to obtain insurance on acceptable terms or at all Furthermore, Smiths cannot be certain that its insurance will cover losses arising from events or that insurers will not dispute coverage In addition, even if our 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

**Potential impact**

*Foreign exchange* The Group s reported results will fluctuate as average exchange rates change The Group s reported net assets will fluctuate as the year-end exchange rate changes

*Funding* The Group may be unable to refinance its debt when due

*Tax* Taxation costs could rise and earnings per share could deteriorate, which could affect the Group s market valuation

*Insurance* If insurance cover is inadequate or does not pay out as expected, Smiths could be exposed to an unexpected material cash outflow, which may impact on the Group s liquidity and/or share price

**Risk management**

- *Foreign exchange* The Group's hedging strategy, whereby larger transactions are hedge accounted, mitigates the risk to profitability to some extent Net investment hedging of overseas assets of approximately 50% through borrowing in non-sterling currencies mitigates the impact of exchange rate fluctuations on net assets
- *Funding* The Group s debt maturity is staggered so that the refinancing risk is minimised As at 31 July 2011, we had an undrawn revolving credit facility of $800m
- *Tax* The Group s taxation staff coordinate tax management to mitigate possible increases in the effective tax rate Regular reporting to the Board of tax risks and exposures provides good visibility of issues
- *Insurance* Insurance risk is spread across a number of carriers to minimise individual insured risk and counterparty risk

Go to page 50 for more information

**Global supply chain/concentration of manufacturing**

**Risk**

Smiths business depends on the availability and timely delivery of raw materials and purchased components, and could be affected by a disruption to its supply chain In particular, we rely on sole suppliers to provide raw materials or components for some of our products

The Group s manufacturing facilities are exposed to a number of natural catastrophe risks, which, like other external events such as terrorist attacks or a disease pandemic, could have significant adverse consequences Smiths is also affected by the social, economic, regulatory and political conditions in the countries where it operates, which are often unpredictable and outside its control, particularly in developing countries

**Potential impact**

The concentration of manufacturing in lower cost countries, in particular in Mexico and China, increases the length of the supply chain and means that an adverse event could have more significant consequences for our ability to supply customers on time

A longer supply chain also affects transport costs, which could be exacerbated by energy cost inflation

**Risk management**

- Business continuity and disaster recovery plans are in place and tested for critical locations, to reduce the impact of an event
- Single source supplier risks are identified and, where possible, key materials or components are dual sourced to mitigate the impact of an event
- The Group regularly evaluates its key sites for a range of risk factors using externally benchmarked assessments, and takes action to improve these ratings, where appropriate
- Smiths has business interruption and property damage insurance

# Risk management
continued

### Government customers

**Risk**

We derive a significant proportion of our revenues in mature Western economies Additionally, over 40% of the Group's revenues are from governments and their agencies or are influenced by government regulation

Smiths Detection, Smiths Medical and Smiths Interconnect frequently tender for government contracts The timing of contract awards and payments under these contracts may be uncertain and uneven over a given financial year

Any significant disruption or deterioration in relationship with these governments could result in fewer contracts and lower revenues

**Potential impact**

At a time when government finances are under pressure, these headwinds may lead to slower growth across the business

A decrease in spending by key government customers could materially affect the Group s results and financial condition

Delays in awarding government contracts can affect the Group's sales, margins and cash conversion in a particular reporting period

**Risk management**

- The Group has a diversified portfolio of businesses that mitigates against exposure to any one country or sector
- Some of our government-related business has a services or consumables component, which can be more resilient during an economic downturn
- The Group has enhanced its government relations function so that it can inform policy and maintain close relationships with customers This supports the monitoring of lead indicators and helps us to position our businesses appropriately for the economic cycle

### Information technology

**Risk**

Smiths information systems, personnel and facilities are subject to security risk Smiths is dependent on information technology systems for both internal and external communications and for the day-to-day management of its operations

**Potential impact**

Any disruption to the information systems could have significant adverse consequences for the Group s operations or its ability to trade

**Risk management**

- Extensive controls and reviews are undertaken to maintain the integrity and efficiency of IT infrastructure and data
- There are also processes to deal with significant IT security incidents

### Acquisitions and disposals

**Risk**

The success of the Group's acquisition strategy depends on identifying targets, obtaining authorisations and having the necessary financing Even if an acquisition is completed, the acquired products and technologies may not be successful or may require significantly greater resources and investment than anticipated

Smiths may not be able to integrate the businesses that it acquires If integration is unsuccessful, anticipated benefits are not realised or trading by acquired businesses falls below expectations, 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 formerly owned businesses which it has not yet novated to the purchasers of these businesses

**Potential impact**

The Group's return on capital employed may fall if acquisition hurdle rates are not met

The Group s financial performance may suffer from goodwill or other acquisition-related impairment charges

Insufficient allowance for indemnities and warranties given at disposal may affect our financial position

**Risk management**

- We perform comprehensive strategic and financial reviews of all opportunities Detailed due diligence and integration work is undertaken and reviewed in accordance with Group policy
- Due diligence includes an assessment of the acquisition target s talent and competencies We also consider the integration process and management
- The Board only authorises acquisitions after completion of due diligence, and approval is subject to meeting the capital allocation and other financial hurdles set by the Board
- The Board regularly reviews post-acquisition performance and integration
- The Executive Committee and Board review the acquisition pipeline There are monthly reviews with strategy leads for each division
- On disposals, the Company seeks to minimise its exposure to indemnities and warranties and any that are provided are reviewed on a regular basis

**Compliance with legislation and regulations**

**Risk**

There is a risk that Smiths may not always be in complete compliance with laws, regulations or permits, for example concerning environmental or safety requirements

Smiths operates in highly regulated sectors Smiths Detection, Smiths Interconnect and Smiths Medical are particularly subject to regulation, with certain customers, regulators or other enforcement bodies routinely inspecting the Group's practices, processes and premises

Due to their products' security functions, Smiths Detection and Smiths Interconnect are subject to numerous export controls, technology licensing and other government regulations

In addition, new legislation, regulations or certification requirements may require additional expense, restrict commercial flexibility and business strategies or introduce additional liabilities for the company or directors There also appears to be a growing trend for legislation that could be described as protectionist', which may affect our businesses

**Potential impact**

Smiths could be held responsible for liabilities and consequences arising from past or future environmental damage, including potentially significant remedial costs There can be no assurance that any provisions for expected environmental liabilities and remediation costs will adequately cover these liabilities or costs

Should a regulator's approval process take a particularly long time, our products may be delayed in getting to market, which could lead to a loss of revenue or benefit a competitor with a similar product

Failure to comply with certain regulations may result in significant financial penalties, debarment from government contracts and/or reputational damage

**Risk management**

- Environmental, health and safety data are reported to the Quarterly Business Reviews, Executive Committee and the Board, along with actions to improve performance over time
- Smiths Medical has dedicated staff who maintain close contact with the US Food and Drug Administration and other key regulators
- All divisions have trade compliance advice and training This includes training on the Group s Code of Business Ethics and assessments to support compliance
- Divisional and Group General Counsel monitor legislative changes (assisted by Government Relations staff) and report and monitor actions as necessary This may require modifications to our supply chains and customer arrangements

**Pension funding**

**Risk**

At 31 July 2011, Smiths has legacy defined benefit pension plans, with aggregate liabilities in excess of £3bn While on an accounting basis the reported net deficit is relatively modest, changes in discount rates, inflation, asset returns or mortality assumptions could lead to a materially higher deficit For example, the cost of a buyout on a discontinued basis, and therefore using more conservative assumptions, is likely to be significantly higher than the accounting deficit

In addition, there is a risk that the plans assets, such as investments in equity and debt securities, will not be sufficient to cover the value of those benefits

**Potential impact**

The implications of a higher pension deficit include a direct impact on valuation, credit rating and potential additional funding requirements at subsequent triennial reviews Contingent payment commitments made in the 2009 triennial valuation may also be more likely to crystallise

In the event of a major disposal that generates significant cash proceeds that are returned to shareholders, the Group may be required to make additional cash payments to the schemes or provide additional security

**Risk management**

- All major schemes (US/UK) have been closed to future accrual
- Agreed funding plans are in place with the major UK schemes following the last triennial reviews The Group seeks a good working relationship with the trustees through regular update meetings
- There are plans in place to reduce the mismatch between assets classes and liabilities, as relative outperformance of the assets versus liabilities is achieved, although there is no downside protection in place should this not occur
- Pension matters are regularly reported to the Board

Go to note 10 on pages 108-111 for more information

# Risk management
continued

### Product liability and litigation

**Risk**

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

In addition, manufacturing flaws, component failures or design defects could require us to recall products Many of our products are used in critical applications where the consequences of a failure could be extremely serious and, in some cases, potentially catastrophic

Products sold to the aviation, security, healthcare, energy and consumer/domestic industries are particularly critical in nature

Furthermore, over half the Group's sales are in the US, where there is potentially increased litigation risk

**Potential impact**

Any liability claim against Smiths, with or without merit, could be costly to defend and could increase our insurance premiums Some claims might not be covered by our insurance policies, either adequately or at all

An adverse event involving one of our products could damage our reputation and reduce market acceptance and demand for all of our products

**Risk management**

- Quality assurance processes are embedded in our manufacturing locations for critical equipment, supporting compliance with industry regulations
- A global best practice programme is underway to enhance product quality processes across the Group This is sponsored by the Executive Committee and leverages the ongoing work in Smiths Medical and John Crane
- The divisions have procedures for dealing with product liability issues and potential product recalls These procedures are being informed by crisis management planning workshops and rehearsals
- The Group has insurance cover for product liability The US Safety Act provides legislative protection for certain Smiths Detection products in the US, and we support efforts to implement similar legislation in other markets
- Any litigation is managed under the supervision of the Group s General Counsel We have detailed action plans to manage actual or threatened litigation

Go to page 51 and note 23 on pages 124-125

### Technology and innovation

**Risk**

Developing new products and improving existing products is critical to our business and competitors may innovate more effectively

The emergence of a disruptive technology could have an impact on a major cash-flow contributor to the Group over time

The speed of innovation in certain markets may lead to shorter product lifecycles, increasing the need for innovation

Additionally, the entry of new competitors, the consolidation of existing competitors and changed or irrational competitor behaviour could all significantly affect the Group s business

**Potential impact**

The failure of the Group to develop its products and services, or more effective innovation by a competitor, could have a materially adverse affect on sales growth

**Risk management**

- The Group has a diversified technology portfolio in a range of sectors and geographies
- Our continued investment in R&D supports new product and service development
- The Group looks to expand the addressable markets of its key businesses by building capabilities in adjacent markets, through organic investment and targeted acquisitions

### Talent and succession planning

**Risk**

The loss of key personnel, or the failure to plan adequately for succession or develop new talent

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 or adequately trained employees, or a delay in hiring key personnel could seriously harm the Group s business

**Potential impact**

May impact the reputation of the group, or lead to a disruption in the leadership of the business

Over time, our competitive advantage is defined by the quality of our people – should we fail to attract, develop and retain key talent, in time our competitive advantage will erode, leading to weaker growth potential or returns

**Risk management**

- Each division or function holds talent and succession plan reviews at least annually These plans are reviewed by the Nomination Committee
- Remuneration packages, including variable and long-term elements of the compensation arrangements are evaluated regularly against market practice

Go to pages 60-61 for more information

# Corporate responsibility

## The Code of Business Ethics is at the heart of our approach to corporate responsibility. It sets out 12 broad principles for how we do business, based on the common values of integrity, honesty, fairness and transparency. It provides the framework for our policies, programmes and procedures for a range of corporate responsibility issues.

The Code applies to all of our businesses and employees worldwide Complying with the Code helps us to sustain and enhance our reputation and contributes to long-term value creation for shareholders

**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

Go to www smiths com/ethics aspx

Information about Code compliance is available to employees, in twelve languages in printed format and on the Smiths intranet Posters of the Code are also displayed at our sites

To communicate the Code, we provide ethics training to employees across the Group This training course is available online in English and five other languages, through a custom-built platform, the Global Learning Resource (GLR), and installed on a Smiths training portal accessible through the internet The course is also available on CD-ROM 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 our ethics programme It is supported by the Senior Vice President, 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 Council and its Chair are assisted by a dedicated, full-time ethics and compliance administrator

Smiths maintains an ethics Alertline, which answers queries and enables employees to report any concerns or allegations confidentially The Alertline is available via email, worldwide web, and toll-free phone numbers in 53 countries, and is staffed by people who speak the local language All issues are addressed promptly and referred, as required, to relevant functions so they can be properly investigated We have a non-retaliation policy, which means that any employee who in good faith reports any act of apparent misconduct or unethical behaviour will not be victimised or treated adversely

The Senior Vice President, Ethics & Compliance periodically reports to the Audit Committee on ethics issues and suspected or actual breaches of the Code He also serves as an adviser and resource on ethical issues and manages responses to all enquiries and allegations

Compliance support to Smiths businesses comes from legal counsel, who provide advice, education, training, guidance materials, export control policies 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 is also a line management responsibility and 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

# Corporate responsibility
continued

**Environment, health and safety**
Smiths is committed to working in a way that, as far as reasonably practicable, protects the health and safety of its employees and minimises any environmental effects of its activities, products and services

We strongly believe in the power of continuous improvement and use management systems to realise its benefits These systems help to improve our management of EHS issues by providing an externally verified framework for risk reduction, continual improvement, compliance assurance and management review

For several years, we have been implementing EHS management systems at manufacturing sites with 50 or more employees Since 2010, we have expanded these systems to include warehousing and service centres and sites with 20 or more employees

Sites with 50 or more employees are required to have their EHS management systems externally certified to the following standards

- OHSAS 18001 for occupational health and safety management systems, and
- ISO 14001 for environmental management systems

New acquisitions and sites that grow above these thresholds have two years to comply Of our more than 160 sites, 100 are required to implement systems and complete external certification Of these, almost 90 have so far completed certification, with the remainder planned for FY2012

**Environment**
Our environmental targets are to achieve 10% reductions in energy usage, greenhouse gas emissions and waste generation, and a 5% reduction in water usage by FY2015, all normalised to sales against a baseline of FY2010 Where necessary, we adjust our baseline metrics to account for acquisitions and disposals

We have adopted a new reporting policy for our environmental metrics, which expanded the number of sites required to report environmental performance to the Group Previously, only manufacturing sites with more than 50 employees had to report We now capture data from warehouses, service centres and offices, and have reduced the size threshold to 20 employees

We believe that these reporting changes provide us with a more comprehensive view of our environmental impact The environmental metrics for FY2010 in this report have been rebased to reflect the new reporting policy and are set out in the table below

Our environmental performance in FY2011 was very favourable compared to FY2010 We achieved significant reductions in all metrics, placing us on track to meet our FY2015 goals When analysing our changes in environmental metrics for FY2011, absolute increases are mainly associated with increased production and acquired businesses and some decreases are associated with site closures, consolidations and improved recycling

Performance against environment targets

| | Target FY2010-FY2015 | 2011 progress against FY2010 |
|---|---|---|
| **Energy** | 10% reduction over 5 years | **3.3% reduction** |
| **Greenhouse gas emissions** | 10% reduction over 5 years | **4.5% reduction** |
| **Total non-recycled waste** | 10% reduction over 5 years | **5.2% reduction** |
| **Water consumption** | 5% reduction over 5 years | **8.4% reduction** |

**Total energy**

000 MWh

| 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| 316 | 295 | 285 | 305 | 303 |

**Total energy efficiency**

MWh/£m sales

| 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| 118 | 104 | 105 | 110 | 106 |

**Total $CO_2$ emissions**

000 Tonnes

| 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| 129 | 121 | 115 | 124 | 121 |

**Total $CO_2$ emissions**

Tonnes/£m sales

| 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| 48 | 43 | 42 | 45 | 43 |

**Water use**

000m$^3$

| 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| 576 | 528 | 462 | 515 | 485 |

**Water consumption**

m$^3$/£m sales

| 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| 217 | 188 | 170 | 186 | 170 |

**Total non-recycled waste**

000 Tonnes

| 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| 8.8 | 7.1 | 6.1 | 6.2 | 6.1 |

**Total non-recycled waste**

Tonnes/£m sales

| 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| 3.3 | 2.5 | 2.2 | 2.2 | 2.1 |

2010 figures have been rebased to reflect the new reporting policy which now captures all manufacturing sites, warehouses, service centres and offices with more than 20 employees.

Water use and consumption have been revised from last year's report to reflect water monitoring corrections.

# Corporate responsibility
continued

### Health and safety

Our safety Key Performance Indicators (KPI) are our recordable incident rate (RIR) and lost time incident rate (LTIR). These are measured per 100 employees per year. A recordable incident is one where an employee requires medical attention beyond first aid. A lost-time incident is one which results in a lost work day beyond the day of the incident. All of our sites are required to report recordable and lost time incidents to the Group each month.

Since 2004, we have achieved a steady reduction in our RIR, with 2011 being our safest on record. Our goal is to reach an RIR of 0.5 by July 2013 and we made good progress in FY2011, with an RIR of 0.66, down from 0.71 in FY2010.

We have also successfully reduced our LTIR in recent years. Our LTIR has dropped from 0.86 in FY2007 to 0.29 in FY2011.

Performance against safety targets

| | FY2013 target | 2011 result |
|---|---|---|
| **Recordable incident rate** | Better than 0.5 per 100 employees | **0.66** |
| **Lost time incident rate** | No target | **0.29** |

See charts below for historic data.

Our employees recognise our commitment to health and safety. In our recent Group-wide employee engagement survey, workplace safety was the highest-scoring dimension, exceeding the study's worldwide benchmark for manufacturing industry.

Starting in FY2012, we will add a leading indicator activity metric as a KPI for safety, complementing the RIR metric. Sites with more than 50 employees will be included in the metric. Each of these sites will be required to complete a minimum number of each of the following activities, which will count towards their leading indicator activity score:

- leadership safety training
- leadership site safety tours
- employee safety accountability training
- employee safety inspection and communication events, and
- near-miss and improvement reporting.

Sites will report their scores quarterly and will be required to achieve annual targets.

### Employees

We believe in providing our employees with opportunities to develop their talent and to contribute to the business in which they work. We support them by investing in improved safety, upholding their statutory rights and creating an ethical, supportive environment where colleagues are treated fairly and with respect. Our current priorities are talent development, succession planning and employee engagement.

### Adding value

Throughout Smiths, people are taking action to achieve the best possible long-term performance for our shareholders. We invest in the skills and capabilities of our people and expect them to reflect that investment in their performance in terms of business results.

### Career progression

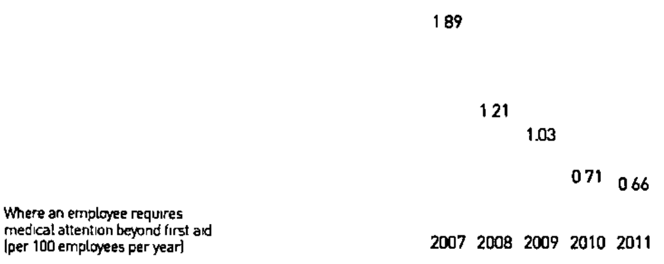
As a global technology group, we offer a variety of ways to help our people progress their career within Smiths, in line with their capabilities and performance. We identify leaders and provide them with development tools and opportunities to support their career ambitions and our business needs. We also recognise the need to balance internal development and promotion with external recruitment, where this is necessary to fulfil our commitment to add value.

### Diversity

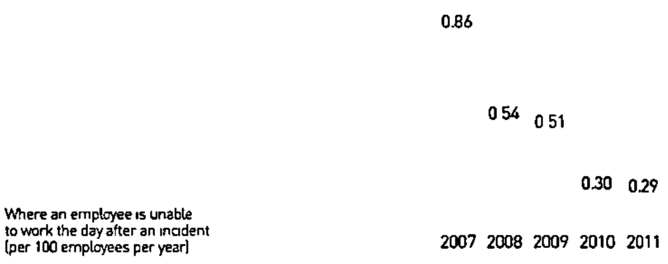
It is our policy to provide equal opportunities for employment. Smiths recruits, selects and promotes employees on the basis of their qualifications, skills, aptitude and attitude. In employment-related decisions, Smiths complies with all applicable anti-discrimination requirements in the relevant jurisdictions, 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 (including re-training, if needed, for people who have become disabled), career development and promotion on the basis of their aptitudes and abilities. We endeavour to find appropriate alternative jobs for those who are unable to continue in their existing job because of disability.

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.

**Recordable Incident Rate**




**Lost Time Incident Rate**



**Succession management**
Smiths operates a systematic succession-management process for leadership roles Our businesses identify leadership talent and development needs using a set of key competencies, common tools and a consistent language Development plans are monitored by senior management to optimise effective succession

**Developing talent**
Smiths invests in employees skills and capabilities, which in turn helps the Company and its businesses to success We have a number of development programmes to evaluate and enhance core leadership competencies These programmes are tailored to address a wide range of learning styles, incorporating workshops, experiential learning, mentoring, team working and project experience

For employees to add value, we have to ensure they are properly engaged with and committed to the business We provide training and development that represent an investment in both their future and that of the business We also offer a safe and responsible working environment that encourages mutual respect, provides opportunities for personal growth and rewards individual and team contributions that realise value for the business Smiths periodically offers employees in the US and the UK opportunities to participate in share plans that enable employees to benefit from increases in the Company s share price and to align their interests more closely with those of shareholders

**Communication**
Communication is crucial to helping employees engage with the business At business unit level, we communicate through team briefings, presentations intranets and newsletters Many businesses have well-established forums for exchanging information and best practice, as well as discussing current business issues including efficiency initiatives, training and development, and environment, health and safety issues

In European Union (EU) countries we have workplace information and consultation arrangements at our sites These link to the Smiths European Forum, through which employee representatives from across the EU meet annually to discuss transnational matters with Group executives

**Employee engagement**
In 2010, Smiths conducted a Global My Voice Employee Engagement survey for the first time We partnered with Kenexa, a leading survey provider, to ensure that responses were anonymous and to enable us to conduct the survey in local languages We achieved more than 85% participation rate Results were measured against the global norms for manufacturing industry and Divisional, local and functional results have been communicated Action plans to address the most significant issues have been drawn up using focus groups and local champions A further global survey will be conducted in Spring 2012 to measure our progress

**Acquisition integration**
Smiths Group periodically acquires new businesses and when doing so, we implement plans to integrate them into Smiths, ensuring that our business ethics, employee development, safety and environmental policies and programmes are well established

**Communities**
We contribute to the communities in which we operate In addition to providing jobs and boosting local economies, we support community involvement through charitable giving and education initiatives

We primarily manage these activities at a divisional level However, Smiths does offer some support to community and charitable organisations at Group level We consider 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 our industries are the main focus of our 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 fifth 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

**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**
The FTSE4Good Index acknowledges companies that meet globally recognised corporate responsibility standards Smiths continues to be awarded membership of the index, scoring 91 out of 100 on the FTSE4Good Environmental, Social and Governance rating While 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

Go to www smiths com/corporate_responsibility aspx

# Board of directors

**Donald Brydon, CBE**

**Chairman #†**

Aged 66 British BSc in Mathematical Science 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

Chairman of the Nomination Committee

**Philip Bowman**

**Chief Executive**

Aged 58 Australian MA in Natural Sciences 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

**Peter Turner**

**Finance Director**

Aged 41 British BA in Natural Science – Chemistry 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 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

**David Challen, CBE**

**Non-executive director *#†**

Aged 68 British BA in Mathematics, BSc in Natural Science (Physics) and MBA (Harvard) David Challen was appointed to the Board in September 2004 He is Chairman of the EMEA Governance Committee at Citi and former Chairman of J Henry Schroder & Co Ltd He is Senior Independent Director and Chairman of the Audit Committee at Anglo American plc He is also a Deputy Chairman of the Takeover Panel

Chairman of the Audit Committee

Senior Independent Director

**Stuart Chambers**

**Non-executive director *#†**

Aged 55 British Qualified chemical engineer, PhD in Business and BSc in Applied Physics Stuart Chambers was appointed to the Board in November 2006 He was Group Chief Executive of Nippon Sheet Glass until September 2009 after having been Chief Executive of Pilkington plc for several years Prior to joining Pilkington plc in 1996, he spent 10 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 Airports Group plc

Chairman of the Remuneration Committee

**Anne Quinn, CBE**

**Non-executive director *#†**

Aged 60 New Zealander BCom and MSc in Management Science 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

**Sir Kevin Tebbit, KCB, CMG**

**Non-executive director *#†**

Aged 64 British BA in History Sir Kevin Tebbit was appointed to the Board in June 2006 He served widely in policy, management and finance posts in the MoD, Foreign & Commonwealth Office and NATO before becoming Director of GCHQ and finally Permanent Secretary at the Ministry of Defence from July 1998 to November 2005 He is Chairman of Finmeccanica UK and Chairman of the Industry Advisory Group to the UKTI Defence and Security Organisation He is also Visiting Professor at Queen Mary, University of London and a member of the Advisory Board of the Imperial College Institute for Security Science and Technology

**Bruno Angelici**

**Non-executive director *#†**

Aged 64 French MBA (Kellogg School of Management) and Business and Law degrees from Reims Bruno Angelici was appointed to the Board 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 operations in France and Japan Prior to this he held a number of senior management roles during a decade at Baxter, a US-based global supplier of medical devices He currently sits on the Supervisory Board of Wolters Kluwer, a Dutch-based information services and publishing company, and on the Global Advisory Board of Takeda Pharmaceutical Company Ltd, based in Japan He is a non-executive director of Novo Nordisk A/S, a Danish healthcare company He was received into the Legion d'honneur in December 2009

**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 2011, 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 and gases 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 and model / future strategy and development / research and development**
The statements and reviews on pages 6 to 63 comprise the Group business review and are 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 2011, key performance indicators, and the principal risks and uncertainties facing the Group It also includes an explanation of the basis on which the Group generates or preserves value over the longer term and the strategy for delivering the objectives of the Group and 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 2011 are set out in the Consolidated income statement Sales for the year amounted to £2,842m (2010 £2,770m) The profit for the year after taxation amounted to £385 1m (2010 £310 6m)

An interim dividend of 11 25p per ordinary share of 37 5p was paid on 21 April 2011 The directors recommend for payment on 25 November 2011 a final cash dividend of 25 0p on each ordinary share of 37 5p, making a total dividend of 36 25p for the financial year

The retained profit of £385 1m was transferred to Reserves

**Changes in the Company and its interests during the financial year**
On 12 August 2010 the Company acquired the business and assets of Veecon IPA Gastchnik Ltd in India for cash and estimated deferred consideration of £10 5m in aggregate

On 18 March 2011 the Company sold the business and assets of Detection s Product Inspection Division business in Alcoa, TN, USA for £7 6m in cash

On 12 May 2011 the Company acquired the issued share capital of SDBR Comercio de Equipamentos de Segurança Ltda in Brazil for cash and estimated deferred consideration of £15 8m in aggregate

**Post balance sheet events**
On 18 August 2011 the Company announced an agreement to acquire the business and assets of Turbo Components & Engineering, Inc of Houston, Texas for US$20m in cash, subject to regulatory clearances

On 2 September 2011, the Company announced an agreement to acquire the issued share capital of Power Holdings, Inc of Virginia, USA for US$235m in cash, subject to post-closing adjustments and regulatory clearances

**Charitable and political donations**
During the financial year the Company made donations of £482,000 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 and its businesses worldwide The Group supports charities working in the areas of health, education and wellbeing, and the environment The Group made contributions to non-EU political organisations totalling £6,500 during the year

**Directors**
Messrs B F J Angelici, P Bowman, D H Brydon, CBE, D J Challen, CBE, S J Chambers and P A Turner, Ms A C Quinn, CBE, and Sir Kevin Tebbit, KCB, CMG all served as directors of the Company throughout the year

**Reappointment of directors**
In accordance with the UK Corporate Governance Code, all the directors will 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 Full biographical details of all the directors are set out on pages 62 and 63

**Directors' remuneration report**
The Directors remuneration report is on pages 76 to 84

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 page 81 Details of the interests of the executive directors in the Companys share option schemes and plans are shown in the Directors remuneration report on pages 83 and 84

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 2011 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 31 July 2011 the Company had been notified, pursuant to the FSAs Disclosure & Transparency Rules and the Companies Act 2006 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 | 22 5m | 5 7% |
| Legal & General Group plc | 19 7m | 5 0% |
| Lloyds Banking Group plc | 27 8m | 7 1% |
| Massachusetts Financial Services Company | see below | <5% |
| Newton Investment Management Limited | 15 2m | 3 9% |
| TIAA-CREF Investment Management LLC / Teachers Advisors, Inc | 11 9m | 3 0% |

*Percentage of ordinary share capital in issue on 31 July 2011

On 8 August 2011 Lloyds Banking Group plc notified the Company that it had notifiable voting rights over 31 7 million of the Companys shares (approximately 8 1% of the issued share capital) On 20 September 2011 BlackRock Investment Management (UK) Limited advised that it had direct and indirect interests over the voting rights of a total of 20 9 million Smiths shares (5 3% of the issued share capital) and Massachusetts Financial Services Company (MFS) advised that it held 17 9 million shares (4 6% of the issued share capital). MFS last notified the Company in March 2008 that its interests in voting rights in Smiths shares had fallen below 5% of issued share capital The Company has not been notified of any other changes to the notifiable voting rights in its shares during the period 1 August to 26 September 2011

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 81

**Corporate governance statement**
The Corporate governance statement is on pages 70 to 74 and is incorporated in this Directors report by reference PricewaterhouseCoopers LLP has reviewed the Companys statements as to compliance with the UK Corporate Governance 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 86

**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 Groups business activities, together with the factors likely to affect its future development, performance and position are set out in the Business review on pages 17 to 47 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 Companys 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 2011 the Group had available cash and short-term deposit resources of £261m and undrawn committed borrowing facilities of US$800m which are due to expire in 2015 (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 56)

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

# Group directors' report
continued

**Policy on payment of creditors**
The Companys 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 23 days (2010 31) for the parent Company and 43 days (2010 36) for the Group as a whole

**Share capital and control**
As at 31 July 2011, the Companys issued share capital was £147,131,401 125 and comprised 392,350,403 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 Companys 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 Companys share schemes and plans On 31 July 2011 the trust held 855 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 65 sets out the notifications, received by the Company pursuant to the FSAs Disclosure & Transparency Rules and the Companies Act 2006, as at 31 July 2011 and any changes thereto up to 26 September 2011, from persons with significant direct or indirect holdings in the Companys share capital

The rules about the appointment and replacement of directors are contained in the Companys 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

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 Companys share schemes and plans contain clauses which may cause options and awards to vest on a change in control, in some cases 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

If there is a change in control of the Company, the terms of Mr Bowman s service contract require that all available discretions will be exercised under the Companys 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 Companys share schemes may cause options and awards granted to employees under such schemes to vest on a change in control, in some cases 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 2011

**Corporate responsibility**
The Company has Group policies on environmental, employee and health & 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 health and safety matters, including key performance indicators, is contained in the Corporate responsibility summary on pages 57 to 61 The full Corporate responsibility report is available online at www smiths com/responsibility

**Annual General Meeting**
The 2011 AGM will be held at The Thomas Lord Suite, Lords Cricket Ground, Grace Gate, St John s Wood Road, London NW8 8QN on Tuesday 22 November 2011 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 £49,062,877, which is equivalent to approximately one third of the total issued ordinary share capital of the Company as at 26 September 2011

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 £49,062,877, which is equivalent to approximately one third of the total issued ordinary share capital of the Company as at 26 September 2011 This is in line with corporate governance guidelines

At 26 September 2011, 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 2013 and the end of the next AGM, due to be held in 2012

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 £7,359,431, equivalent to 5% of the total issued ordinary share capital of the Company as at 26 September 2011, 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 2011, the following ordinary shares in the Company were issued

- 1,622 360 ordinary shares of 37 5p pursuant to the terms of the Company s shareholder-approved share option schemes and share plans

**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 39,250,301 ordinary shares, until the next AGM (due to be held in 2012) or 31 January 2013 whichever is the earlier This represents 10% of the ordinary shares in issue as at 26 September 2011 and the Company's exercise of this authority is subject to the stated upper and lower limits on the price payable, which reflect the requirements of the Listing Rules

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

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

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

As at 26 September 2011 there were 6 9m outstanding options and awards granted under all share schemes operated by the Company, which, if vested would represent 1 7% of the issued ordinary share capital of the Company If this authority were exercised in full, that percentage would increase to 1 9% For the purpose of these calculations, it has been assumed that (i) all the extant options under the Sharesave and Executive Share Option schemes and all the conditional share awards under the Co-Investment Plan would vest in full, (ii) the number of ordinary shares that would be expected to be earned under the Value Sharing Plans (based on current projections for the satisfaction of the performance conditions) would vest and (iii) none of the extant options or awards under any of the plans would lapse prior to their applicable vesting dates The actual number of ordinary shares that will vest in respect of awards under the Co-Investment Plan and Value Sharing Plans will only be determined at their applicable vesting dates, subject to the satisfaction of the performance conditions and other requirements at those times

**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 UK 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 in the EU totalling more than £5,000 in any twelve-month period, and for any political expenditure in the EU, 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 UK subsidiaries might wish to support, even though these activities are not designed to support or influence support for a particular party

It is the policy of the Company not to make political donations or incur political expenditure in the EU, 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

**Auditors**

Resolutions will be proposed at the AGM to reappoint PricewaterhouseCoopers LLP as independent auditors, to hold office until the next meeting at which the accounts are laid, and to authorise the directors to determine the auditors 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

**Proposed long-term incentive arrangements**

Following a review by the Remuneration Committee in which the views of shareholders and institutional investor groups on uncapped, share-based, incentive arrangements were considered the Company considers that a new plan, which is a conventional long-term incentive plan (LTIP), would be an appropriate long-term incentive scheme for senior executives going forwards As a result it is proposed that awards would be made under a new LTIP as follows

- Annual grants which may vest after three years, subject to demanding performance conditions,
- Awards will be granted over fixed numbers of the Company s ordinary shares,
- Vesting conditions for 2011/12 awards will be based 50% on earnings growth, 30% on TSR vs FTSE100 and 20% on cash conversion, and
- The Remuneration Committee will explicitly reserve the right to reduce the awards to reflect the overall performance of the business

Shareholders approval for this new LTIP will be sought at the AGM on 22 November 2011 Further details on the new LTIP can be found in the notes accompanying the Notice of AGM If the new LTIP is approved at the AGM, the first awards under the LTIP will be made in November 2011 and no awards will be made in 2011/12 under the 2010 Value Sharing Plan

**Disclosure of information to the auditors**
As at the date of this report, as far as each director is aware, there is no relevant audit information of which the Companys auditors are unaware Each director has taken all the steps he or she should have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that the Companys auditors are aware of that information

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

Electronic copies of the Annual Report 2011 and the Notice of AGM will be posted on the Companys website, www smiths com The Companys announcements to the Stock Exchange and press releases are available online through the website Shareholding details and practical help on share transfers and changes of address can be found at www shareview co uk

Shareholders wishing to change their election and receive documents in hard copy form can do so at any time by contacting the Companys Registrar or by logging on to 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 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 22 November 2011 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 Companys Registrar not later than 48 hours before the AGM in order to be valid

**Registrar**
The address and contact details of Equiniti Limited, the Companys Registrar, are listed on the inside back cover of this report Individual shareholders access to their personal shareholder information is available online, through the www shareview co uk website The UK 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

S. L Cameron

27 September 2011

# Corporate governance statement

**Compliance with the UK Corporate Governance Code**
Throughout the period 1 August 2010 to 31 July 2011 the Company has been in full compliance with the UK Corporate Governance Code (the Code), published by the Financial Reporting Council and available on its website www frc org uk, except that the value of any fees received by executive directors in respect of external non-executive directorships is not disclosed in the Directors remuneration report, as this is not considered relevant to the Company

**Directors**
**The Board**
The Board determined that the following is a helpful summary of its role

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 long-term 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

As at 26 September 2011, the Board comprises Mr Brydon (Chairman), Mr Bowman (Chief Executive), Mr Turner (Finance Director) and five independent non-executive directors, Messrs Angelici, Challen and Chambers, Ms Quinn, and Sir Kevin Tebbit Mr Challen is the senior independent director Biographies of these directors, giving details of their experience and other main commitments, are set out on pages 62 and 63 The Board and its committees have the appropriate balance of skills, experience, independence and knowledge of the Company to enable them to discharge their respective duties and responsibilities effectively 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

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 page 57

The executive directors and senior management team are responsible for the Company s financial performance, the day-to-day management of the Company s businesses and implementation of the strategy and direction set by the Board

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 Board and Board Committee meetings held during the financial year ended 31 July 2011 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, as part of his induction and familiarisation process, Mr Angelici visited a large number of the Company s sites in the UK, USA and France In April 2011 the Chairman and Sir Kevin Tebbit joined the Chief Executive and members of senior management at meetings in Washington D C with Senators Congressmen and representatives of the Company s US customers In May 2011 the Board visited the John Crane facility in Lutin, in the Czech Republic The Board views directors contributions as measured beyond meeting attendance records

| | Board Meetings | | Audit Committee | | Remuneration Committee | | Nomination Committee | |
|---|---|---|---|---|---|---|---|---|
| Name | Eligible to attend | Attended | Eligible to attend | Attended | Eligible to attend | Attended | Eligible to attend | Attended |
| D H Brydon | 9 | 9 | – | – | 5 | 4 | 2 | 2 |
| P Bowman | 9 | 9 | – | – | – | – | – | – |
| PA Turner | 9 | 9 | – | – | – | – | – | – |
| B F J Angelici | 9 | 9 | 3 | 2 | 5 | 5 | 2 | 2 |
| D J Challen | 9 | 9 | 3 | 3 | 5 | 5 | 2 | 2 |
| S J Chambers | 9 | 8 | 3 | 2 | 5 | 5 | 2 | 2 |
| A C Quinn | 9 | 9 | 3 | 3 | 5 | 5 | 2 | 2 |
| K R Tebbit | 9 | 8 | 3 | 3 | 5 | 4 | 2 | 1 |

– indicates not a member of that Committee in 2010/2011

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

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

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

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

**Appointments to the Board**
The Nomination Committee has a formal, rigorous and transparent procedure for the appointment of new directors, which are made on merit and against objective criteria, having due regard for the benefits of diversity, including gender Both the Nomination Committee and the Board are satisfied that the directors are able to allocate sufficient time to their responsibilities relating to the Company The Nomination Committee and the Board have each considered the recommendations of the Davies Report on Women on Boards, as reported in the Chairman s statement on page 13

**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 Non-executive directors are provided with information and updates between meetings 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

The Chairman consults with the directors on their respective training and development requirements 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

# Corporate governance statement
continued

**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, is 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 In respect of the year ended 31 July 2011 the Board evaluation was led by Professor Rob Goffee of the London Business School, using a combination of questionnaires and individual interviews The results of the evaluation are used to inform the Board's approach going forward Professor Goffee has no other connection with the Company

The directorships in listed companies and other significant commitments of the Chairman and the non-executive directors are shown on pages 62 and 63 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 Any term for a non-executive director beyond six years is subject to a particularly rigorous review

**Remuneration**
Information regarding the Remuneration Committee is set out on page 74 and the Directors remuneration report is on pages 76 to 84

**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 85

The going concern statement required by the Code is set out in the Group directors report on page 65

**Internal control**
The Board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its particular objectives and maintains sound risk management and internal control systems to safeguard shareholders investments 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 The Audit Committee carried out such a review during the year ended 31 July 2011 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

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 auditors reports

**Audit Committee and Auditors**
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 independent external auditors, 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, the Senior Independent Director and the other 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 2011 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, 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 2010 AGM to answer shareholders questions The notice of the AGM and related papers were sent to shareholders at least 20 working days before the meeting

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

**Audit Committee**
The members of the Committee during the financial year were Mr Challen (Chairman of the Committee), Mr Angelici, Mr Chambers, Ms Quinn and Sir Kevin Tebbit

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 auditors 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 auditors

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 2011

In the year to 31 July 2011, the Audit Committee discharged its responsibilities by reviewing

- the Group s financial statements and interim results statement prior to Board approval and the external auditors detailed reports thereon,
- the audit fee and non-audit fees payable to the Group s external auditors,
- the external auditors effectiveness and plan for the audit of the Group s 2010/11 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 2010/11 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

# Corporate governance statement
continued

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 auditors 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 auditors, 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 auditors 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 auditors 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 auditors, certain services, not exceeding £10,000 in fees, require the approval of the Finance Director and all 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 auditors have in place processes to ensure that their independence is maintained including safeguards to ensure that where they provide non-audit services, their independence is not threatened The external auditors have written to the Audit Committee confirming that, in their opinion, they are independent and the Audit Committee concurs with that view

**Remuneration Committee**
Mr Chambers (Chairman of the Committee), Mr Angelici, Mr Brydon, Mr Challen, Ms Quinn and Sir Kevin Tebbit were members of the Committee throughout the financial year

The Committee s responsibilities and terms of reference are described in the Directors remuneration report on page 76 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 2011

**Nomination Committee**
During the financial year the members of the Committee were Mr Brydon, as Chairman of the Committee, Mr Angelici, Mr Challen, Mr Chambers, Ms Quinn and Sir Kevin Tebbit

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

During the year, the Committee reviewed the Companys talent management and succession plans On 26 September 2011, the Committee agreed to amend Mr Bowman s service contract to remove the references to a retirement age, the remaining terms of the contract, including the notice periods, remained unaltered 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 2011

**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 page 66 and is incorporated in this Corporate governance statement by reference

# Statement from the independent non-executive directors



The non-executive directors of the Company, together with the executive directors and the company secretary, are committed to ensuring that the Board of the Company provides sound and effective leadership The Corporate governance statement sets out the Companys compliance with the UK Corporate Governance Code ( the Code ) The Board welcomes the clarity provided by the Code and the added emphasis on responsibility and accountability However, as the statement about the role of the Board in the Corporate governance statement makes clear, the Board believes that good governance and effective leadership are about more than adherence to the Code or to any particular guidance The members of the Board take very seriously their responsibilities to promote the success of the Company, whilst managing risk and demonstrating the high ethical standards and behaviours expected of everyone in the Company

Following an initiative I commenced last year, the Audit Committee and the Board have given additional focus this year to the approach across the Group to the identification and management of risk This has involved reviews at business, divisional and Group level, in addition to discussion at the Audit Committee and the Board, as to whether any existing processes relating to risk management within the Group could benefit from being refreshed The Board, Audit Committee and executive management teams have also examined whether any lessons could be learned from recent external events which have had significant impact on other corporates and, indeed, on governments

The steps taken to examine the risk management processes included an externally facilitated review with senior executive management to catalyse discussion of possible blue-sky risks Separately, input was also sought from the Companys external auditors An additional meeting of the Board was held to consider the Group-wide risks identified in the review by the senior management team, including their probability, likely impact and mitigating controls The Audit Committee approved a number of proposals for enhancements to the scope, programme and approach of the Internal Audit team The conclusions of the Audit Committee and the Board to refine other aspects of existing risk management processes will shape a strengthened approach to risk management and review going forward

In addition to the work on risk, each of the non-executive directors has been actively involved in the work of the other Board committees As described in the statement from the non-executive directors in last years Annual Report all the non-executive directors are members of all the principal Board Committees Audit*, Nomination and Remuneration This gives every non-executive director information about, and the opportunity to shape various important areas, and informs the Boards decision making

This year during the Boards visit to John Crane, Lutin in the Czech Republic, the Nomination Committee carried out a detailed review of talent management and succession planning across the Group, facilitated by the Groups Human Resources Director and the Groups Director of Talent Management and Reward As part of the meetings in Lutin the Board also met to consider the strategy for the John Crane division (with the Group Managing Director of John Crane and a senior member of his management team) and for the Group as a whole Following a recommendation from the Group Director of Strategy (who joined the Company in February), the Board agreed that going forward it will consider strategy for the five divisions on a rolling basis across the year, with the enhanced work on risk forming an integral part of the ongoing strategy review process Group strategy will continue to be reviewed at least once a year

Aside from the modified strategy process, the General Managers of each division already present to the Board on their businesses at least twice a year and attend additional Board meetings (often accompanied by senior members of their respective management teams) as required when a specific issue relating to a particular division is under consideration 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, and will continue to do this under the enhanced process for risk management review and reporting referred to above

The independent non-executive directors are aware of, and keep in constant view, their accountability to the Companys stakeholders in particular the providers of the Companys capital As the Senior Independent Director, I regard myself as available to shareholders at any time The non-executive directors are updated regularly on shareholders views Following analyst or investor meetings, detailed briefings are provided to the Board, including feedback from those present Analysts reports are also circulated to the non-executive directors throughout the year The Board discusses points raised by investors and seeks the views of the Companys brokers and other advisers on the market perception of the Company Towards the end of the fiscal year 2011 an independent research agency was commissioned to carry out an investor perception study for the Company The Board will consider the research agencys findings in the autumn

Shareholders can also provide feedback in relation to the individual performance of the directors at this years Annual General Meeting in November when all the directors will again be standing for re-election

As set out in the Corporate governance statement, the directors also provide structured feedback on each others performance and the effectiveness of the Board and each of the Board Committees through the annual performance evaluation process This year the evaluation has been conducted with the aid of an external, independent facilitator Professor Goffee of the London Business School Professor Goffee has worked with a large number of companies on Board evaluation and appraisal exercises, and thus brings with him expertise and a database of comparator information, which support the Board in benchmarking its own performance and understanding areas of improvement and best practice As the Senior Independent Director, I lead the annual review of the Chairmans performance on behalf of the other directors, which helps to inform the Chairmans priorities and approach going forward

The independent non-executive directors are satisfied that the Companys corporate governance controls have been effective throughout the financial year ended 31 July 2011

**David Challen**
**Senior Independent Director**

*The Chairman of the Company 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 22 November 2011 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 Companys website The Company complied with the provisions of the UK Corporate Governance Code relating to directors remuneration throughout the financial year except as is disclosed in the Corporate governance statement on page 70

The Committee met five 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 2010
- Annual Incentive Plan structure and performance targets for the financial year ended 31 July 2011
- Framework of executive total remuneration
- Principles to govern the Annual Incentive Plan for the financial year ending 31 July 2012
- Committee terms of reference
- Structure of the directors remuneration report for the financial year ended 31 July 2011

In 2010/11 the Committee consisted of

- Stuart Chambers (Chairman of the Committee)
- Bruno Angelici
- Donald Brydon
- David Challen
- Anne Quinn
- Kevin Tebbit

Each member s attendance at meetings held during the year is set out in the Corporate governance statement on page 70

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, the Committee s independent remuneration adviser, and Freshfields Bruckhaus Deringer LLP Kepler does not provide any other services to the Group 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 into 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 Group s main areas of operation in determining the remuneration of the Board, including the Executive Directors

**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 2010/11, 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 2010/11 included the Smiths Group Sharesave Scheme, the Smiths Group Co-Investment Plan (CIP), the Smiths Group 2008 Value Sharing Plan and the 2010 Smiths Group Value Sharing Plan (VSP)

**Elements of remuneration**

The main elements of remuneration for executive directors in 2010/11 are summarised below

| Element 2010/11 policy | Objective |
|---|---|
| Base salary frozen at 2007/08 levels<br>(see Base salary and benefits on page 80) | • Reflect size and nature of the role, individual performance and experience<br>• Continued salary freeze reflects Company s desire to shift remuneration towards long-term variable pay |
| Annual bonus maximum opportunity of 180% of salary for the Chief Executive and 125% for the Finance Director<br>(see Annual bonus on page 78) | • Incentivise short-term operational, financial and personal performance |
| Co-Investment Plan (CIP) mandatory investment in Smiths shares of 50% of any net bonus earned, in return for up to a 2-for-1 matching opportunity after three years, subject to average ROCE exceeding WACC+3% p a<br>(see Co-investment Plan (CIP) on page 78) | • Help align short- and long-term remuneration through compulsory deferral of 50% of net earned bonus into Smiths shares<br>• Reward operating efficiency<br>• Support executives in building a shareholding in the Company |
| 2008 Value Sharing Plan a one off plan detailed in the section below The 2010 Value Sharing Plan (VSP) following shareholder approval at the 2010 AGM for the 2010 VSP, executives were granted conditional awards of a pre-defined number of shares per £5m of surplus value created For executive directors, 30% of an award is based on TSR relative to the FTSE 100 (excluding financial services companies) and 70% on growth in internal value above a hurdle of 8 5% p a Awards vest on performance over the three year period 1 August 2010 – 31 July 2013<br>(see Value Sharing Plans (VSPs) on page 78) | • Incentivise senior executives to drive long-term value creation for shareholders<br>• Reinforce and reward delivery of strategic goals |
| Pension Allowance<br>(see Pensions on page 80) | • Enables Executive Directors to arrange their own personal pension provision |
| Share ownership guidelines 200% of salary for the Chief Executive and 150% of salary for the Finance Director<br>(see Share ownership guidelines on page 79) | • Require executives to build and maintain a significant shareholding in Smiths<br>• Support alignment with shareholder interests |

The following charts illustrate the proportions of the 2010/11 remuneration packages comprising fixed (i e base salary) and variable elements of pay, assuming target annual bonus and expected values of long-term incentives For 2010/11, c 70% of the fair value of executive directors total remuneration was performance related

**CEO pay mix, 2010/11 financial year**

1 Base salary 24%
2 Annual bonus 17%
3 Co-Investment Plan (CIP) 12%
4 2010 Value Sharing Plan (VSP) 47%


**CFO pay mix, 2010/11 financial year**

1 Base salary 30%
2 Annual bonus 15%
3 Co-Investment Plan (CIP) 10%
4 2010 Value Sharing Plan (VSP) 45%


**Base salary and benefits**

The Chief Executive s salary has been frozen since 2007/08 Salaries have 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 FTSE100 companies of similar market capitalisation, revenues and complexity to Smiths The salaries for all participants in the Value Sharing Plan, including the Chief Executive, remained frozen at their 2007/08 levels for 2010/11 The Committee has taken these matters into account and determined that the Chief Executive will receive a modest increase in annual base salary for 2011/12 as set out in the table below,

| Executive director | Salary last reviewed | 2008/09 | 2009/10 | 2010/11 | 2011/12 |
|---|---|---|---|---|---|
| P Bowman | 12 July 2011 | £800,000 | £800,000 | £800,000 | 820,000 |
| PA Turner | 19 April 2010 (on appointment) | n/a | £400,000 | £400,000 | 400,000 |

Benefits for Mr Bowman include a car allowance and health insurance

Mr Turner receives health insurance but does not receive a car allowance

### Annual bonus

Executive directors are 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 is 180% of salary and for the Finance Director is 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 2010/11 annual bonus plan and the awards receivable for performance in 2010/11

**2010/11 annual bonus outcome as a percentage of salary earned in 2010/11**

| | Group EPS | | Cash conversion | | Personal objectives | | Total (% of salary) | |
|---|---|---|---|---|---|---|---|---|
| Executive director | Maximum | Actual | Maximum | Actual | Maximum | Actual | Maximum | Actual |
| P Bowman | 90% | 44 4% | 36% | 25 2% | 54% | 45 3% | 180% | 114 9% |
| PA Turner | 62 5% | 30 8% | 30% | 21% | 32 5% | 29 6% | 125% | 81 4% |

No changes are proposed to the annual bonus plan for 2011/12

### Co-Investment Plan (CIP)

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 The Committee reviews these targets prior to the start of each award cycle to ensure they remain appropriately stretching

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 Companys average ROCE over the performance period exceeding the Companys WACC over the same period by an average margin of at least 1% p a

### Value Sharing Plans (VSPs)

Details of Group and divisional VSPs are set out in this section The 2008 VSPs are one-off plans approved by shareholders in 2008, and the 2010 VSPs, which are intended to operate annually, were approved by shareholders at the 2010 AGM The VSPs are long-term incentive plans that were designed to reinforce Smiths strategy of focusing on shareholder value creation at the Group and divisional levels

2008 Group VSP

Awards made under the Group VSP reward selected senior executives (including the CEO) 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

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

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) multiplied by 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

No retesting of either performance condition is permitted

In line with the commitment made to shareholders at the time, no subsequent grants were made under the 2008 VSPs during the financial years ended 31 July 2009 and 31 July 2010 In 2010, the Committee reviewed the Group s long-term incentive arrangements The Committee felt that the broad structure of the VSP remained appropriate going forward, and shareholders approved a new VSP at the 2010 AGM Under this 2010 VSP, grants will be made annually (with the opportunity 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) and will vest after three years

2010 Group VSP

Messrs Bowman and Turner are participants in the 2010 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 a three-year performance period

On 17 December 2010 Mr Bowman was granted an award under which he will be entitled to receive 800 Smiths Group shares for each £5m of surplus value created On the same date, Mr Turner was granted an award under which he will be entitled to receive 320 Smiths Group shares for each £5m of surplus value created

*– TSR Element*

30% of the award will depend on the three year growth in Smiths market capitalisation plus net equity cash-flows to shareholders (i e dividends plus share buybacks less share issues) over and above the median total shareholder return of the FTSE 100 companies (excluding financial services companies)

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

*– Earnings Element*

The remaining 70% of the award will be determined by the three year growth in adjusted Profit Before Tax (PBT) (from a baseline PBT of £432 7m in 2009/10) multiplied by a fixed multiple of 10 1 (representing the ratio of Smiths market capitalisation at the start of the performance period to the baseline PBT) plus net equity cash-flows to shareholders over and above a cost of equity hurdle return of 8 5% a year The Committee determined this hurdle rate of return to be sufficiently challenging whilst taking into account the substantial fall in the risk free rate over the two years since the grant of the 2008 VSP, and its impact on the Group s cost of equity

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 continues to provide 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

**2010 Divisional VSPs**

In addition to the 2010 Group VSP, the Committee also implemented revised divisional plans for each of the five divisions (Smiths Detection, Smiths Medical, John Crane, Smiths Interconnect and Flex-Tek) These plans continue to be along the same lines as the Group VSP, helping focus the most senior divisional executives on maximising the value of their divisions and returning surplus cash to the Group

**Leaving and change-of-control provisions**

The treatment of awards on leaving or a change of control is the same for both the 2008 and 2010 VSPs For bad leavers , awards lapse In the event of ill health, permanent disability or death, awards would be pro-rated for time and the performance period would run its normal course (except on death where the performance period would be curtailed) For other leavers, the treatment of awards remains subject to Committee discretion

In the event of a change of control, performance would be measured over the period from grant to change of control As the plan is based on increasing value over time faster than a benchmark, the curtailing of the performance period naturally reduces the value of the plan and in such circumstances there is no need for additional time pro-rating

The Committee retains discretion to vary these approaches if it deems it appropriate to do so

**2011 Long-Term Incentive Plan**

The Remuneration Committee reviews the Company s executive long-term incentive arrangements annually in order to reflect developments in best practice and in light of the Group s objectives and priorities The 2008 VSPs involved a one-off award granted in July 2008, maturing in two tranches following announcement of results for the 2010/11 and 2011/12 financial years The 2010 VSP was intended to operate annually, with awards vesting after three years The initial awards under the 2010 VSP were made in December 2010

Although the resolution for the adoption of the 2010 VSPs was strongly supported by shareholders at the 2010 AGM, (88% of shares voted supported the Resolution) we have since received feedback from shareholders and from the ABI expressing concern about share plans along the lines of the VSP, particularly in relation to the uncapped nature of the awards under the plan and especially in circumstances where the company intends to operate such plans on an annual basis rather than in exceptional circumstances As a consequence the Remuneration Committee has decided, after careful consideration to seek the approval of shareholders for the implementation of a new LTIP, which is a conventional share plan under which an award over a fixed number of shares will vest if a demanding performance condition is met The Committee is satisfied that the proposed LTIP is closely aligned with market practice If the LTIP is approved by shareholders at the AGM, the first LTIP awards will be made in November 2011

The main features of the proposed scheme would be

- Annual grants vesting after three years
- Vesting conditions for 2011/12 awards based 50% on earnings growth, 30% on TSR vs FTSE100 (excluding financial services) and 20% on cash conversion

Further details on the proposed scheme can be found in the Notice of AGM

**2004 Performance Share Plan (PSP)**

No awards have been made under the PSP to executive directors or other participants in the VSP since 2007/08 and none will be made to these executives in 2011/12 Following the end of the performance period of the 2007 PSP cycle in December 2010, no directors hold outstanding awards under the PSP

**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**

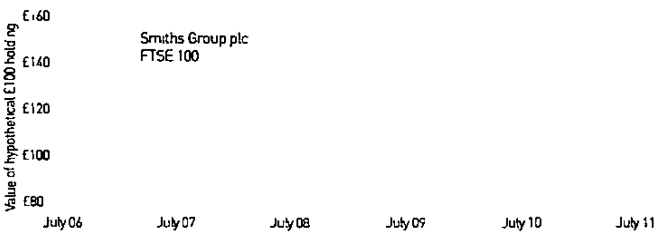
It is the Committee s policy that executive directors should, over time, acquire a shareholding with a value equal to at least one and a half years gross salary (two years gross salary for the Chief Executive) and retain at least 50% of any net vested share awards (after sales to meet tax liabilities) 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 2011, the headroom available under these limits was 5 4% and 1 5%, respectively (excluding the conditional share awards granted under the 2008 and 2010 VSPs)

#### 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 Details of the salary supplements are set out in the tables under Remuneration on page 80

#### 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 £121 and £153 respectively

#### Total shareholder return




#### 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 pension allowances, was as follows

| | 2011 £000 | 2010 £000 |
|---|---|---|
| Fees, salaries and benefits | **1,868** | 1,920 |
| Performance-related bonuses | **1,444** | 2,021 |
| Aggregate gain from exercise of share options and vesting of share awards | **1,123** | 398 |
| Payments in lieu of pension contribution | **436** | 365 |
| | **4,871** | 4,704 |

The emoluments of the directors are set out below

| | Fees/salary | | Benefits | Bonus | Payments in lieu of pension contribution | Other[3] | Total emoluments | |
|---|---|---|---|---|---|---|---|---|
| | 2010 £000 | 2011 £000 | 2011 £000 | 2011 £000 | 2011 £000 | 2011 £000 | 2011 £000 | 2010 £000 |
| **Chairman** | | | | | | | | |
| D H Brydon | 305 | **305** | **23** | | | | **328** | 328 |
| **Chief Executive** | | | | | | | | |
| P Bowman | 800 | **800** | **39** | **919** | **336** | **200** | **2,294** | 2,547 |
| **Executive director** | | | | | | | | |
| PA Turner[1] | 115 | **400** | **1** | **325** | **100** | | **826** | 288 |
| **Non-executive directors** | | | | | | | | |
| D J Challen | 69 | **69** | | | | | **69** | 69 |
| S J Chambers | 69 | **69** | | | | | **69** | 69 |
| K R Tebbit | 54 | **54** | | | | | **54** | 54 |
| A C Quinn | 54 | **54** | | | | | **54** | 54 |
| B F J Angelici[2] | 5 | **54** | | | | | **54** | 5 |
| Directors who resigned in 2009/10 (in aggregate) | 383 | | | | | | | 892 |
| Total | 1,854 | **1,805** | **63** | **1,244** | **436** | **200** | **3,748** | 4,306 |

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 Bruno Angelici s total emoluments for 2010 are for a part year, covering the period from his appointment on 1 July 2010 until the end of the 2010 financial year on 31 July 2010

3 In the 2004 Performance Share Plan 67% of the award was linked to growth in adjusted EPS The calculation of adjusted EPS growth included changes in the pension interest credit (PIC), a large line item which reflects changes in market interest rates on (largely historical) pension liabilities, and is not considered by the Board to be a proportionate reflection of current management performance The 2007 PSP scheme vested in 2010 The 2007 base figure for the pension interest credit was £34 million but fell to £2 million in 2010 It is now common practice to exclude PIC from adjusted EPS growth calculations for LTIPs and, whilst at Smiths its impact has been broadly neutral over the life of the scheme for the majority of participants, its inclusion appeared to the Committee to have been inequitable for five participants who held awards granted in 2007 but did not receive grants prior to 2007 To address this inequity the Remuneration Committee approved ex gratia payments for these participants For the Chief Executive this resulted in a lower number of shares vesting with a difference in value of £280,000 In recognition of this inequity the Remuneration Committee approved part payments for these participants For the Chief Executive this figure was £200,000 Going forward, pension interest credit is excluded from the calculation of adjusted EPS in both the base period and the performance period for the Value Sharing Plans

**Director's pension entitlements**
No director accrues annual pension under a defined benefit arrangement

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

| | **Ordinary shares of 37 5p each 31 July 2011** | Ordinary shares of 37 5p each 31 July 2010 |
|---|---|---|
| B F J Angelici | **2,000** | 0 |
| D H Brydon | **8,000** | 8 000 |
| P Bowman | **160,069** | 88,776 |
| D J Challen | **1,333** | 1,333 |
| S J Chambers | **1,333** | 1,333 |
| A C Quinn | **1,024** | 1,024 |
| K R Tebbit | **1,000** | 1,000 |
| PA Turner | **5,888** | 0 |

These interests include beneficial interests of the directors and their families in the Companys shares held in trusts and holdings through nominee companies None of the directors has disclosed any non-beneficial interests in the Companys 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 26 September 2011

**Service contracts**
The Companys 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 was for an indefinite term expressed to end automatically on his anticipated normal retirement date (age 60) On 26th September 2011 the Nominations Committee agreed to amend this contract to remove the reference to normal retirement age As before it 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 with the Company dated 23 March 2010 and effective from 19 April 2010 It provides for 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 Turners 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 Turners financial loss The amount of compensation, as so determined, will not be less than 12 months basic salary

# Directors' remuneration report
continued

**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 (AGM) following appointment and then stand for re-election at every third AGM (or such earlier AGM as the Board may determine) thereafter (under Article 49). 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 | 2013 | 16 November 2010 |
| D J Challen | 21 September 2004 | 2013 | 16 November 2010 |
| S J Chambers | 27 November 2006 | 2013 | 16 November 2010 |
| A C Quinn | 1 August 2009 | 2012 | 16 November 2010 |
| K R Tebbit | 14 June 2006 | 2012 | 16 November 2010 |

*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 to the non-executive directors were last increased with effect from 1 August 2009 and for the full year 2010/11 comprised the following:

| Non-executive director | Basic fee | Committee chairmanship fee | Total |
|---|---|---|---|
| D H Brydon | £305,000 | – | **£305,000** |
| B F J Angelici | £54,000 | – | **£54,000** |
| D J Challen* | £54,000 | £15,000 | **£69,000** |
| S J Chambers | £54,000 | £15,000 | **£69,000** |
| A C Quinn | £54,000 | – | **£54,000** |
| K R Tebbit | £54,000 | – | **£54,000** |

*The fee payable to the Senior Independent Director is not paid to Mr Challen in addition to that paid for his chairmanship of the Audit Committee

The fees payable to the non-executive directors will remain frozen at this level for the full year 2011/12.

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

**Auditable part**
The directors' remuneration tables and accompanying notes on pages 80 and 81, the directors' pensions allowances and accompanying notes on page 80, and the directors' share options and awards table on page 83 have been audited.

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

**S.J. Chambers**
27 September 2011

Stuart Chambers

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

| Director and Plans | Options and awards held on 31 July 2011 Number | Options and awards held on 31 July 2010 Number | Option and award data: Performance test | Exercise price | Grant date | Vesting date* | Expiry date** | Awards vested 2010/11: Exercise/vesting date | Number | Exercise price | Market price at date of grant*** | Market price at date of exercise# |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **P. Bowman** | | | | | | | | | | | | |
| PSP | 0 | 75,543 | A | n/a | 11/12/07 | 13/12/10 | | 13/12/10 | 51,747 | n/a | 1066 00p | 1254 95p |
| | | | | | | | | ## the balance of the award over 23,796 shares lapsed | | | | |
| | 0 | 37,771 | B | n/a | 11/12/07 | 13/12/10 | | 13/12/10 | 37,771 | n/a | 1066 00p | 1254 95p |
| CIP | 78,199 | 78,199 | C | n/a | 20/10/08 | Oct 2011 | Oct 2011 | | | | | |
| | 62,919 | 62,919 | C | n/a | 15/10/09 | Oct 2012 | Oct 2012 | | | | | |
| | 112,169 | 0 | C | n/a | 05/10/10 | Oct 2013 | Oct 2013 | | | | | |
| SAYE | 2,750 | 2,750 | - | 569 00p | 21/05/09 | 01/08/14 | 01/02/15 | | | | | |
| **P.A. Turner** | | | | | | | | | | | | |
| CIP | 11,764 | 0 | C | n/a | 05/10/10 | Oct 2013 | Oct 2013 | | | | | |

## Value sharing plans

| Director and Plans | VSP awards held on 31 July 2011 Shares per £5m surplus value | VSP awards held on 31 July 2010 Shares per £5m surplus value | Award data: Performance test | Exercise price | Grant date | Vesting date* | Expiry date | Awards vested 2010/11: Exercise/vesting date | Number | Exercise price | Market price at date of grant** | Market price at date of exercise# |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **P Bowman** | | | | | | | | | | | | |
| VSP 2008 | 417 | 417 | D | n/a | 28/07/08 | Oct 2011 | Oct 2011 | | | | | |
| | 833 | 833 | E | n/a | 28/07/08 | Oct 2011 | Oct 2011 | | | | | |
| | 417 | 417 | D | n/a | 28/07/08 | Oct 2012 | Oct 2012 | | | | | |
| | 833 | 833 | E | n/a | 28/07/08 | Oct 2012 | Oct 2012 | | | | | |
| VSP 2010 | | | | | | | | | | | | |
| | 240 | 0 | F | n/a | 17/12/10 | Oct 2013 | Oct 2013 | | | | | |
| | 560 | 0 | G | n/a | 17/12/10 | Oct 2013 | Oct 2013 | | | | | |
| **P.A. Turner** | | | | | | | | | | | | |
| VSP 2010 | 96 | 0 | F | n/a | 17/12/10 | Oct 2013 | Oct 2013 | | | | | |
| | 224 | 0 | G | n/a | 17/12/10 | Oct 2013 | Oct 2013 | | | | | |

**Key**

| | |
|---|---|
| PSP | The Smiths Group Performance Share Plan |
| CIP | The Smiths Group Co-Investment Plan |
| SAYE | The Smiths Group Sharesave Scheme |
| VSP 2008 | The Smiths Group Value Sharing Plan |
| VSP 2010 | The Smiths Group 2010 Value Sharing Plan |
| * | The vesting dates shown above in respect of awards made under VSP 2008 VSP 2010 and CIP are subject to the relevant performance test being passed |
| ** | The expiry dates shown above apply in normal circumstances No expiry date is shown if the option or award was exercised or vested or lapsed prior to 26 September 2011 |
| *** | 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 option or vesting of award |

# Directors' remuneration report
continued

**Performance tests**

A PSP Earnings Per Share (EPS) growth test

B PSP Total Shareholder Return (TSR) rank test

C CIP Return on Capital Employed (ROCE) test

D Surplus Shareholder Value - VSP 2008 TSR Test

E Surplus Internal Value - VSP 2008 PBT Test

F Surplus Shareholder Value - VSP 2010 TSR Test

G Surplus Internal Value - VSP 2010 PBT Test

– There are no performance criteria for SAYE

**Notes**

The high and low market prices of the ordinary shares during the period 1 August 2010 to 31 July 2011 were 1450p and 1087p respectively

The mid-market closing price on 31 July 2010 was 1116p and on 31 July 2011 was 1135p

The mid-market closing prices of a Smiths share on the dates of awards made to directors in the 2010/11 financial year was 1240p (for the CIP Awards) and 1235p (for the VSP 2010 Awards)

The option over 2 750 shares granted to and held by directors under SAYE at 31 July 2011 was granted at an exercise price below the market price of a Smiths Group share on 26 September 2011 (922p)

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 2011 are indicated in the tables above by a double hash mark (##) no other options or awards held by any director lapsed during the period 1 August 2010 to 31 July 2011

No other Director held any options over the Company s shares during the period 1 August 2010 to 31 July 2011

No options or awards have been granted to or exercised by directors or have lapsed during the period 1 August to 26 September 2011

At 31 July 2011 the trustee of the Employee Share Trust held 855 shares (none of the directors had an interest in these shares at 31 July 2011) The market value of the shares held by the trustee on 31 July 2011 was £9 704 and dividends of approximately £296 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 2007

Smiths TSR over the performance period for the 2007 PSP awards (24 October 2007 to 24 October 2010) ranked 16th in the comparator group of FTSE 100 companies (excluding financial services companies), a level of performance equivalent to the 78th percentile Based on the vesting schedule under which 25% of the TSR element of the award (being one third of the total award) would vest at median and 100% of the element would vest at 75% or above, the TSR element of the 2007 awards vested in full Smiths EPS growth over the performance period was 9 1% p a Based on the vesting schedule under which 25% of the EPS element of an award (being two-thirds of the total award) would vest if EPS growth was 5% p a and 100% of the element would vest if EPS growth was 12% p a , 68 5% of the EPS element of the 2007 awards vested and 31 5% lapsed Overall, 79% of the 2007 PSP Awards vested

## CIP awards granted in 2007

Smiths ROCE over the performance period for the 2007 CIP awards (1 August 2007 to 31 July 2010) exceeded the Company s weighted average costs of capital (WACC) over the period by more than 1% p a Accordingly the 2007 CIP Awards vested in full

# 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 (who are listed in the Group directors report) 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 2011 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

**Philip Bowman**
**Chief Executive**
27 September 2011

**Peter Turner**
**Finance Director**

# 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 2011 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 and express an opinion on 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 In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report

**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 2011 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,
- the part of the Corporate governance statement relating to the Company s compliance with the nine provisions of the UK Corporate Governance Code specified for our review, and
- certain elements of the report to shareholders by the Board on directors remuneration

**Other matter**
We have reported separately on the Parent Company financial statements of Smiths Group plc for the year ended 31 July 2011 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

27 September 2011

**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 31 July 2011 £m | Year ended 31 July 2010 £m |
|---|---|---|---|
| **Continuing operations** | | | |
| Revenue | 1 | **2,842.0** | 2,769 6 |
| Cost of sales | | **(1,534 0)** | (1,476 3) |
| Gross profit | | **1,308 0** | 1,293 3 |
| Sales and distribution costs | | **(384.3)** | (369 7) |
| Administrative expenses | | **(490.1)** | (491 0) |
| Profit on disposal of businesses | 4 | **4.4** | 3 3 |
| **Operating profit** | 2 | **438.0** | 435 9 |
| Comprising | | | |
| – headline operating profit | 3 | **516.9** | 492 4 |
| – exceptional items, amortisation of acquired intangibles | 3 | **(78.9)** | (56 5) |
| | | **438 0** | 435 9 |
| Interest receivable | | **1.8** | 3 6 |
| Interest payable | | **(60 3)** | (65 1) |
| Other financing losses | | **(9 2)** | (5 4) |
| Other finance income – retirement benefits | | **23.3** | 2 3 |
| Finance costs | 5 | **(44 4)** | (64 6) |
| Share of post-tax profits of associated companies | 14 | **4.3** | 1 8 |
| **Profit before taxation** | | **397.9** | 373 1 |
| Comprising | | | |
| – headline profit before taxation | 3 | **486.0** | 435 0 |
| – exceptional items, amortisation of acquired intangibles and other financing gains and losses | 3 | **(88.1)** | (61 9) |
| | | **397.9** | 373 1 |
| Taxation | 6 | **(91.8)** | (78 9) |
| **Profit after taxation – continuing operations** | | **306.1** | 294 2 |
| Profit – discontinued operations | 7 | **79.0** | 16 4 |
| **Profit for the year** | | **385.1** | 310 6 |
| Attributable to | | | |
| Smiths Group shareholders | | **383.8** | 310 0 |
| Non-controlling interests | | **1.3** | 0 6 |
| | | **385.1** | 310 6 |
| **Earnings per share** | 9 | | |
| Basic | | **98.0p** | 79 5p |
| Basic – continuing operations | | **77 8p** | 75 3p |
| Diluted | | **97.1p** | 78 9p |
| Diluted – continuing operations | | **77.1p** | 74 8p |

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 98 to 129, which form an integral part of the consolidated accounts

# Consolidated statement of comprehensive income

| | Notes | **Year ended 31 July 2011 £m** | Year ended 31 July 2010 £m |
|---|---|---|---|
| Profit for the period | | **385.1** | 310.6 |
| Exchange (losses)/gains | | **(9.3)** | 81.4 |
| Actuarial losses on retirement benefits | 10 | **(0.2)** | (15.2) |
| Taxation recognised on actuarial movements | 6 | **10.9** | 12.2 |
| Fair value gains/(losses) | | | |
| – on available for sale financial assets | | **4.1** | 0.2 |
| – deferred in the period on cash-flow and net investment hedges | | **8.3** | (41.6) |
| – reclassified to income statement | | **(0.2)** | (0.3) |
| **Total other comprehensive income** | | **13.6** | 36.7 |
| **Total comprehensive income** | | **398.7** | 347.3 |
| Attributable to | | | |
| Smiths Group shareholders | | **397.0** | 345.9 |
| Non-controlling interests | | **1.7** | 1.4 |
| | | **398.7** | 347.3 |

# Consolidated balance sheet



| | Notes | 31 July 2011 £m | 31 July 2010 £m |
|---|---|---|---|
| **Non-current assets** | | | |
| Intangible assets | 12 | **1,610.2** | 1,638 6 |
| Property, plant and equipment | 13 | **282.8** | 302 7 |
| Investments accounted for using the equity method | 14 | **18 5** | 13 6 |
| Financial assets – other investments | 15 | **31.6** | 27 0 |
| Retirement benefit assets | 10 | **140.6** | 80 3 |
| Deferred tax assets | 6 | **174.8** | 194 2 |
| Trade and other receivables | 17 | **33.6** | 33 8 |
| Financial derivatives | 22 | **6.4** | 10 8 |
| | | **2,298.5** | 2,301 0 |
| **Current assets** | | | |
| Inventories | 16 | **432.5** | 390 0 |
| Current tax receivable | | **16 4** | |
| Trade and other receivables | 17 | **612 8** | 578 9 |
| Cash and cash equivalents | 18 | **261.1** | 172 9 |
| Financial derivatives | 22 | **5.7** | 15 5 |
| | | **1,328.5** | 1,157 3 |
| **Total assets** | | **3,627.0** | 3,458 3 |
| **Non-current liabilities** | | | |
| Financial liabilities | | | |
| – borrowings | 20 | **(978.4)** | (995 0) |
| – financial derivatives | 22 | **(1.5)** | (1 1) |
| Provisions for liabilities and charges | 23 | **(174.1)** | (230 8) |
| Retirement benefit obligations | 10 | **(339 6)** | (385 6) |
| Deferred tax liabilities | 6 | **(77 6)** | (77 8) |
| Trade and other payables | 19 | **(45.1)** | (27 3) |
| | | **(1,616.3)** | (1,717 6) |
| **Current liabilities** | | | |
| Financial liabilities | | | |
| – borrowings | 20 | **(11.7)** | (14 7) |
| – financial derivatives | 22 | **(8.9)** | (14 9) |
| Provisions for liabilities and charges | 23 | **(74 7)** | (70 4) |
| Trade and other payables | 19 | **(454.2)** | (428 2) |
| Current tax payable | | **(81.3)** | (112 7) |
| | | **(630.8)** | (640 9) |
| **Total liabilities** | | **(2,247.1)** | (2,358 5) |
| **Net assets** | | **1,379 9** | 1,099 8 |
| **Shareholders' equity** | | | |
| Share capital | 24 | **147 1** | 146 5 |
| Share premium account | | **329.1** | 315 3 |
| Capital redemption reserve | | **5.8** | 5 8 |
| Revaluation reserve | | **1.7** | 1 7 |
| Merger reserve | | **234.8** | 234 8 |
| Retained earnings | 25 | **775 6** | 519 5 |
| Hedge reserve | 25 | **(120 6)** | (128 8) |
| Total shareholders equity | | **1,373.5** | 1,094 8 |
| Non-controlling interest equity | | **6 4** | 5 0 |
| **Total equity** | | **1,379.9** | 1,099 8 |

The accounts on pages 87 to 129 were approved by the Board of Directors on 27 September 2011 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 £m | Other reserves £m | Retained earnings £m | Hedge reserve £m | Equity shareholders funds £m | Non-controlling interest £m | Total equity £m |
|---|---|---|---|---|---|---|---|---|
| At 31 July 2010 | | 461 8 | 242 3 | 519 5 | (128 8) | 1,094 8 | 5 0 | 1,099 8 |
| Profit for the year | | | | 383 8 | | 383 8 | 1 3 | 385 1 |
| Other comprehensive income | | | | | | | | |
| Exchange (losses)/gains | | | | (9 8) | 0 1 | (9 7) | 0 4 | (9 3) |
| Actuarial losses on retirement benefits and related tax | | | | 10 7 | | 10 7 | | 10 7 |
| Fair value gains/(losses) | | | | 4 1 | 8 1 | 12 2 | | 12 2 |
| **Total comprehensive income for the year** | | | | 388 8 | 8 2 | 397 0 | 1 7 | 398 7 |
| Transactions relating to ownership interests | | | | | | | | |
| Exercises of share options | 24 | 14 4 | | | | 14 4 | | 14 4 |
| Taxation recognised on share options | 6 | | | (1 8) | | (1 8) | | (1 8) |
| Purchase of own shares | 25 | | | (8 6) | | (8 6) | | (8 6) |
| Dividends | | | | | | | | |
| – equity shareholders | 8 | | | (136 1) | | (136 1) | | (136 1) |
| – non-controlling interest | | | | | | | (0 3) | (0 3) |
| Share-based payment | 30 | | | 13 8 | | 13 8 | | 13 8 |
| **At 31 July 2011** | | **476.2** | **242.3** | **775.6** | **(120.6)** | **1,373.5** | **6 4** | **1,379.9** |

| | Notes | Share capital and share premium £m | Other reserves £m | Retained earnings £m | Hedge reserve £m | Equity shareholders funds £m | Non-controlling interest £m | Total equity £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) |
| **Total comprehensive income for the year** | | | | 387 6 | (41 7) | 345 9 | 1 4 | 347 3 |
| Transactions relating to ownership interest | | | | | | | | |
| Exercises of share options | | 9 1 | | 0 6 | | 9 7 | | 9 7 |
| Taxation recognised on share options | 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 |
| **At 31 July 2010** | | **461 8** | **242.3** | **519.5** | **(128.8)** | **1,094.8** | **5 0** | **1,099.8** |

# Consolidated cash-flow statement



| | Notes | Year ended 31 July 2011 £m | Year ended 31 July 2010 £m |
|---|---|---|---|
| **Net cash inflow from operating activities** | 28 | **321.7** | 410 5 |
| **Cash-flows from investing activities** | | | |
| Expenditure on capitalised development | | **(30.6)** | (24 3) |
| Expenditure on other intangible assets | | **(10.2)** | (7 6) |
| Purchases of property, plant and equipment | | **(49.3)** | (47 0) |
| Disposals of property, plant and equipment | | **4 5** | 24 8 |
| Investment in financial assets | | **(0.3)** | (25 3) |
| Acquisition of businesses | | **(18.5)** | (132 7) |
| Disposal of Aerospace | 7 | **(6 2)** | 19 9 |
| Disposals of businesses | | **3 9** | 1 1 |
| **Net cash-flow used in investing activities** | | **(106.7)** | (191 1) |
| **Cash-flows from financing activities** | | | |
| Proceeds from exercise of share options | 24 | **14 4** | 9 7 |
| Purchase of own shares | | **(8 6)** | |
| Dividends paid to equity shareholders | 8 | **(136.1)** | (132 5) |
| Dividends paid to non-controlling interests | | **(0.3)** | (0 2) |
| Cash inflow/(outflow) from matured derivative financial instruments | | **1 0** | (1 5) |
| Increase in new borrowings | | **1 6** | 466 8 |
| Reduction and repayment of borrowings | | **(1.2)** | (408 4) |
| **Net cash-flow used in financing activities** | | **(129.2)** | (66 1) |
| **Net increase in cash and cash equivalents** | | **85.8** | 153 3 |
| Cash and cash equivalents at beginning of year | | **172.2** | 19 7 |
| Exchange differences | | **2.7** | (0 8) |
| **Cash and cash equivalents at end of year** | 18 | **260.7** | 172 2 |
| Cash and cash equivalents at end of year comprise | | | |
| – cash at bank and in hand | | **232.0** | 136 3 |
| – short-term deposits | | **29 1** | 36 6 |
| – bank overdrafts | | **(0 4)** | (0 7) |
| | | **260 7** | 172 2 |
| Included in cash and cash equivalents per the balance sheet | | **261 1** | 172 9 |
| Included in overdrafts per the balance sheet | | **(0.4)** | (0 7) |
| | | **260 7** | 172 2 |

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 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

These changes have not materially affected 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 £27 9m (2010 £23 6m) has been recognised in respect of contracts in progress at the year end with a total expected value of £129.3m (2010 £116 2m) A 5% increase in the proportion of the contract activity recognised in the current year would have increased operating profit by an estimated £1 1m (2010 £0 4m)

**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 £196 1m (2010 £191 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 In the current period the method used to calculate the expected costs of defending claims has been conformed to the approach used to calculate the expected cost of adverse judgments following the appointment of Bates White LLC to value both elements of John Crane, Inc s exposure See note 23 for details

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

**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

At 31 July 2011 there is a retirement benefit asset of £140 6m (2010 £80 3m) which arises from the rights of the employers to recover the surplus at the end of the life of the scheme If the pension schemes were wound up while they still had members, the schemes would need to buy out the benefits of all members The buy outs would cost significantly more than the present value of the scheme liabilities calculated in accordance with IAS 19 Employee benefits

**Taxation**
The Group has recognised deferred tax assets of £26 0m (2010 £31 9m) relating to losses and £50 6m (2010 £47 4m) relating to the John Crane, Inc litigation provision The recognition of assets pertaining to these items 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 these 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

### 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 Companys 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 is measured at the fair value of the consideration received, net of trade discounts and sales taxes Revenue is discounted only where the impact of discounting is material

Sale of goods
Revenue from the sale of goods is recognised when the risks and rewards of ownership have been transferred to the customer, the amount of revenue can be measured reliably and recovery of the consideration is probable For established products with simple installation requirements revenue is recognised when the product is delivered to the customer in accordance with the agreed delivery terms For products which are technically innovative, highly customised or require complex installation, revenue is recognised when the customer has completed its acceptance procedures

Services
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 Depending on the nature of the contract, revenue will be recognised on the basis of the proportion of the contract term completed, the proportion of the contract costs incurred or the specific services provided to date

Construction contracts
Contracts for the construction of substantial assets are accounted for as construction contracts if the customer specifies major structural elements of the design, including the ability to amend the design during the construction process These projects normally involve installing customised systems with site specific integration requirements

Where the outcome of a construction 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

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

# **Accounting policies**
continued

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

**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

Software, patents and intellectual property
The estimated useful lives are as follows

| | |
|---|---|
| Software | up to 7 years |
| Patents and intellectual property | shorter of the economic life and the period the right is legally enforceable |

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

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

Land is not depreciated Depreciation is provided on other assets estimated to write off the depreciable amount of relevant assets by equal annual instalments over their estimated useful lives In general, the rates used are Freehold and long leasehold buildings – 2%, Short leasehold property – over the period of the lease, Plant, machinery, etc – 10% to 20%, 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

**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

# Accounting policies
continued

**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

**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

**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 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 IFRS 7 Financial instruments Disclosures on derecognition
- IFRS 9 Financial instruments
- IFRS 10 Consolidated financial statements
- IAS 27 (Revised 2011) Separate financial statements
- IFRS 11 Joint arrangements
- IAS 28 (Revised 2011) Associates and joint ventures
- IFRS 12 Disclosure of interests in other entities
- IFRS 13 Fair value measurement
- IAS 19 Employee benefits (revised 2011)

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, the changes are not expected to have a material impact on the Group s reported position or performance, except for the implementation of IAS 19 Employee benefits (revised 2011) This standard which is expected to be implemented in the year ending 31 July 2014, subject to EU approval, may then result in the recognition of a financing charge in respect of retirement benefits For the year ended 31 July 2011, calculating the finance charge in accordance with the new requirements would have increased finance costs by £39 2m Under the current accounting policies the Group recognises actuarial gains and losses directly in Other comprehensive income, as required by the new standard

**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 132 to 140

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 2011 |
|---|---|---|---|---|---|---|
| | Smiths Detection £m | John Crane £m | Smiths Medical £m | Smiths Interconnect £m | Flex-Tek £m | Total £m |
| Revenue | **509.9** | **893.9** | **838 4** | **379.0** | **220.8** | **2,842 0** |
| Divisional headline operating profit | **65 5** | **188.7** | **196 2** | **67 6** | **27 6** | **545.6** |
| Corporate headline operating costs | | | | | | **(28 7)** |
| **Headline operating profit** | **65 5** | **188.7** | **196 2** | **67.6** | **27 6** | **516.9** |
| Divisional exceptional operating items (note 4) | **(0.3)** | **(30.9)** | **(1.6)** | **(1.4)** | **(1.8)** | **(36.0)** |
| Corporate exceptional operating items (note 4) | | | | | | **6.6** |
| Amortisation of acquired intangible assets | **(1.2)** | **(14.5)** | **(16.6)** | **(17.2)** | | **(49.5)** |
| **Operating profit** | **64.0** | **143.3** | **178 0** | **49.0** | **25.8** | **438 0** |
| Exceptional finance costs – adjustment to discounted provision (note 4) | | **(6.1)** | | | | **(6.1)** |
| Net finance costs – other | | | | | | **(38.3)** |
| Share of post-tax profits of associate companies | **4.3** | | | | | **4.3** |
| **Profit before taxation** | | | | | | **397.9** |

| | | | | | | Year ended 31 July 2010 |
|---|---|---|---|---|---|---|
| | Smiths Detection £m | John Crane £m | Smiths Medical £m | Smiths Interconnect £m | Flex-Tek £m | Total £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) |
| **Headline operating profit** | 89 9 | 162 7 | 184 2 | 61 9 | 23 5 | 492 4 |
| 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) |
| **Operating profit** | 89 2 | 124 2 | 172 3 | 52 8 | 21 2 | 435 9 |
| 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 |
| **Profit before taxation** | | | | | | 373 1 |

## 1 Segment information continued

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

| | Smiths Detection £m | John Crane £m | Smiths Medical £m | Smiths Interconnect £m | Flex-Tek £m | Reconciling items £m | Total £m |
|---|---|---|---|---|---|---|---|
| | | | | | | | **Year ended 31 July 2011** |
| Depreciation | **9.1** | **14.5** | **25.9** | **8.0** | **4.9** | **1.0** | **63.4** |
| Amortisation | **12.6** | **2.9** | **11.1** | **0.6** | **0.1** | **45.0** | **72.3** |
| Other non-cash items | | | | | | | |
| – share-based payment | **(1.2)** | **5.6** | **3.3** | **0.5** | **0.7** | **4.9** | **13.8** |
| – asset impairments | | | | | | **5.5** | **5.5** |

| | Smiths Detection £m | John Crane £m | Smiths Medical £m | Smiths Interconnect £m | Flex-Tek £m | Reconciling items £m | Total £m |
|---|---|---|---|---|---|---|---|
| | | | | | | | Year ended 31 July 2010 |
| 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 |
| – asset impairments | | | | | | (2.1) | (2.1) |

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

The capital expenditure for each division is

| | Smiths Detection £m | John Crane £m | Smiths Medical £m | Smiths Interconnect £m | Flex-Tek £m | Reconciling items £m | Total £m |
|---|---|---|---|---|---|---|---|
| **Capital expenditure year ended 31 July 2011** | **22.7** | **16.2** | **31.2** | **8.1** | **3.5** | **8.8** | **90.5** |
| Capital expenditure year ended 31 July 2010 | 21.4 | 16.2 | 28.1 | 10.3 | 2.6 | 0.3 | 78.9 |

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

| | Smiths Detection £m | John Crane £m | Smiths Medical £m | Smiths Interconnect £m | Flex-Tek £m | Total £m |
|---|---|---|---|---|---|---|
| | | | | | | **31 July 2011** |
| Property, plant, equipment, development projects and other intangibles | **104.8** | **99.8** | **158.4** | **34.1** | **22.3** | **419.4** |
| Investments in associates | **18.5** | | | | | **18.5** |
| Working capital assets | **304.1** | **327.9** | **246.5** | **129.6** | **63.5** | **1,071.6** |
| **Operating assets** | **427.4** | **427.7** | **404.9** | **163.7** | **85.8** | **1,509.5** |
| Derivatives, tax and retirement benefit assets | | | | | | **343.9** |
| Goodwill and acquired intangibles | | | | | | **1,464.1** |
| Corporate assets | | | | | | **48.4** |
| Cash | | | | | | **261.1** |
| **Total assets** | | | | | | **3,627.0** |
| Working capital liabilities | **(152.2)** | **(160.1)** | **(93.6)** | **(61.5)** | **(34.8)** | **(502.2)** |
| Corporate and non-headline liabilities | | | | | | **(245.9)** |
| Derivatives, tax and retirement benefit liabilities | | | | | | **(508.9)** |
| Borrowings | | | | | | **(990.1)** |
| **Total liabilities** | | | | | | **(2,247.1)** |
| Average divisional capital employed | **664.8** | **742.5** | **1,159.4** | **431.2** | **126.1** | **3,124.0** |
| Average corporate capital employed | | | | | | **(86.3)** |
| **Average total capital employed** | | | | | | **3,037.7** |

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 (2010 £815.2m) and eliminate post-retirement benefit assets and liabilities, net of related tax, and net debt

# Notes to the accounts
continued

### 1 Segment information continued

| | Smiths Detection £m | John Crane £m | Smiths Medical £m | Smiths Interconnect £m | Flex-Tek £m | 31 July 2010 Total £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 |
| **Operating assets** | 386 4 | 389 4 | 426 7 | 153 5 | 90 8 | 1,446 8 |
| Derivatives, tax and retirement benefit assets | | | | | | 300 8 |
| Goodwill and acquired intangibles | | | | | | 1,502 4 |
| Corporate assets | | | | | | 35 4 |
| Cash | | | | | | 172 9 |
| **Total assets** | | | | | | 3,458 3 |
| 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) |
| **Total liabilities** | | | | | | (2,358 5) |
| Average divisional capital employed | 674 8 | 733 3 | 1,219 0 | 358 0 | 127 4 | 3,112 5 |
| Average corporate capital employed | | | | | | (154 0) |
| **Average total capital employed** | | | | | | 2,958 5 |

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

**Analysis of revenue**
The revenue for the main product and service lines for each division is

| **Smiths Detection** | Transportation £m | Ports and borders £m | Military £m | Emergency responders £m | Critical infrastructure £m | Non-security £m | Total £m |
|---|---|---|---|---|---|---|---|
| **Revenue year ended 31 July 2011** | **218 6** | **75.7** | **79.5** | **25.4** | **86.9** | **23.8** | **509 9** |
| Revenue year ended 31 July 2010 | 220 7 | 90 9 | 138 0 | 24 7 | 59 0 | 40 8 | 574 1 |

| | Original equipment manufacture | | | | Aftermarket | Total |
|---|---|---|---|---|---|---|
| **John Crane** | £m | Oil, gas and petrochemical £m | Chemical and pharmaceutical £m | Distributors £m | General industry £m | £m |
| **Revenue year ended 31 July 2011** | **330.1** | **344.0** | **74.0** | **62.6** | **83.2** | **893.9** |
| Revenue year ended 31 July 2010 | 287 5 | 298 6 | 69 4 | 52 0 | 78 6 | 786 1 |

| **Smiths Medical** | Medication delivery £m | Vital care £m | Safety devices £m | Total £m |
|---|---|---|---|---|
| **Revenue year ended 31 July 2011** | **233.1** | **345 6** | **259.7** | **838.4** |
| Revenue year ended 31 July 2010 | 235 0 | 351 8 | 270 8 | 857 6 |

| **Smiths Interconnect** | Telecom £m | Military and Aerospace £m | Rail, Medical Automation Test £m | Total £m |
|---|---|---|---|---|
| **Revenue year ended 31 July 2011** | **94 6** | **163.9** | **120.5** | **379.0** |
| Revenue year ended 31 July 2010 | 91 1 | 170 2 | 78 6 | 339 9 |

| **Flex-Tek** | Fluid Management £m | Flexible Solutions £m | Heat Solutions £m | Construction Products £m | Total £m |
|---|---|---|---|---|---|
| **Revenue year ended 31 July 2011** | **70.3** | **35 9** | **60.1** | **54.5** | **220.8** |
| Revenue year ended 31 July 2010 (restated) | 61 9 | 38 5 | 60 9 | 50 6 | 211 9 |

The analysis of Flex-Tek revenue for the year ended 31 July 2010 has been restated to reflect their current operating structure

## 1 Segment information continued

### Analysis of revenue continued

The Group s statutory revenue is analysed as follows

| | Year ended 31 July 2011 £m | Year ended 31 July 2010 £m |
|---|---|---|
| Sale of goods | **2,630.9** | 2,535 4 |
| Services | **178.3** | 162 4 |
| Contracts | **32.8** | 71 8 |
| | **2,842.0** | 2,769 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 plant and equipment and investments accounted for using the equity method | |
|---|---|---|---|---|
| | Year ended 31 July 2011 £m | Year ended 31 July 2010 £m | 31 July 2011 £m | 31 July 2010 £m |
| United Kingdom | **124 5** | 118 4 | **146 2** | 150 4 |
| Germany | **161.0** | 149 7 | **333.9** | 317 9 |
| France | **93.1** | 97 6 | **17.8** | 16 5 |
| Other European | **357.5** | 323 6 | **86.1** | 89 8 |
| United States of America | **1,275 4** | 1,274 1 | **1,135.5** | 1,211 8 |
| Canada | **119 6** | 142 2 | **12.9** | 15 4 |
| Mexico | **25.2** | 20 1 | **9.9** | 7 5 |
| Japan | **149.4** | 120 0 | **22.2** | 20 9 |
| China | **82.0** | 82 9 | **63.6** | 73 5 |
| Rest of the World | **454 3** | 441 0 | **83.4** | 51 2 |
| | **2,842 0** | 2,769 6 | **1,911.5** | 1,954 9 |

## 2 Operating profit is stated after charging

| | Year ended 31 July 2011 £m | Year ended 31 July 2010 £m |
|---|---|---|
| Research and development expense | **68.0** | 69 2 |
| Operating leases | | |
| – land and buildings | **25 3** | 24 4 |
| – other | **10 9** | 10 2 |

| | Year ended 31 July 2011 £m | Year ended 31 July 2010 £m |
|---|---|---|
| Audit services | | |
| Fees payable to the Company s auditors for the audit of the parent company and consolidated accounts | **0.5** | 0 5 |
| Fees payable to the Company s auditors and its associates for other services | | |
| – the audit of the Company s subsidiaries, pursuant to legislation | **3 5** | 3 4 |
| – other services pursuant to legislation | **0.1** | 0 1 |
| | **4 1** | 4 0 |
| Tax services | | |
| – advisory services | **0.5** | 0 3 |
| All other services | **0 5** | 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 and impairment of intangible assets acquired in a business combination – the charge is a non-cash item, and the directors believe that it should be added back to give a clearer picture of underlying performance, and
- other financing gains and losses, which represent the potentially volatile gains and losses on derivatives and other financial instruments which do not fall to be hedge accounted under IAS 39

The excluded items are referred to as non-headline items

| | Notes | Year ended 31 July 2011 £m | Year ended 31 July 2010 £m |
|---|---|---|---|
| **Operating profit** | | **438.0** | 435 9 |
| Exclude | | | |
| – exceptional operating items | 4 | **29.4** | 14 4 |
| – amortisation and impairment of acquired intangible assets | 12 | **49.5** | 42 1 |
| Non-headline items in operating profit | | **78.9** | 56 5 |
| **Headline operating profit** | | **516.9** | 492 4 |
| **Finance costs** | | **(44.4)** | (64 6) |
| Exclude | | | |
| – exceptional finance costs | 4 | **6.1** | 7 0 |
| – other financing gains and losses | 5 | **3.1** | (1 6) |
| Non-headline items in finance costs | | **9.2** | 5 4 |
| **Headline finance costs** | | **(35.2)** | (59 2) |
| **Profit before taxation** | | **397.9** | 373 1 |
| Non-headline items in operating profit | | **78 9** | 56 5 |
| Non-headline items in finance costs | | **9.2** | 5 4 |
| **Headline profit before taxation** | | **486 0** | 435 0 |
| **Profit after taxation – continuing operations** | | **306.1** | 294 2 |
| Exclude | | | |
| – non-headline items in profit before taxation | | **88.1** | 61 9 |
| – tax on excluded items | 6 | **(29.6)** | (25 4) |
| | | **58.5** | 36 5 |
| **Headline profit after taxation – continuing operations** | | **364.6** | 330 7 |

From 1 August 2011 the definition of headline profit will be amended to exclude financing credits and charges relating to retirement benefits For the year ended 31 July 2011 the retirement benefit credit included in finance costs is £23 3m (2010 £2 3m) The 2011 profit measures under the new definition are

- Headline finance costs £58 5m (2010 £61 5m),
- Headline profit before taxation £462 7m (2010 £432 7m),
- Headline profit after taxation £340 0m (2010 £325 9m), and
- Headline earnings per share 86 5p (2010 83 4p) basic and 85 7p (2010 82 8p) diluted

Headline EBITDA is calculated by adding back depreciation and amortisation of development costs, software, patents and intellectual property to headline operating profit

## 4 Exceptional items

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

| | Year ended 31 July 2011 £m | Year ended 31 July 2010 £m |
|---|---|---|
| **Operating items** | | |
| Restructuring of corporate headquarters and divisional reorganisation | **(15.7)** | (8 2) |
| Release of diabetes provision | **1.5** | |
| Gains on changes to post-retirement benefits (note 10) | **10.2** | 3 9 |
| Profit on disposal of businesses | **4.4** | 3 3 |
| Profit on disposal of property | | 5 5 |
| Costs of acquisitions | **(1.5)** | (1 3) |
| Litigation | | |
| – provision for John Crane, Inc asbestos litigation (note 23) | **(28 3)** | (17 6) |
| | **(29.4)** | (14 4) |
| **Financing items** | | |
| Exceptional finance costs – adjustment to discounted provision (note 23) | **(6 1)** | (7 0) |
| | **(35.5)** | (21 4) |

**Year ended 31 July 2011**

The restructuring of corporate headquarters and divisional reorganisation was announced in 2008, and a second phase of this project was introduced in 2010 The total cost of this restructuring, including redundancy, relocation and consolidation of manufacturing, was considered exceptional by virtue of its size Costs of £15 7m have been recognised in the year for the project, out of an expected total cost of £62m, of which £52m has been recognised to date

The profit on disposal of businesses includes £2 7m in respect of the disposal of a small Detection operation

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

The operating charge of £28 3m in respect of John Crane, Inc asbestos litigation comprises £6 1m in respect of increased provision for adverse legal judgments, £9 3m in respect of increased provision for legal defence costs, £11 9m arising from movements in the discounting and £1 0m in respect of legal fees in connection with litigation against insurers and defence strategy

**Year ended 31 July 2010**

On 3 June 2008 the Company announced a number of changes to its corporate centre and divisional organisation In the year ended 31 July 2010 £8 2m was charged in respect of the restructuring of corporate centre and divisional reorganisation This cost was reduced by a partial reversal of the impairment loss recognised in 2009

The UK defined benefit pension schemes were closed with effect from 31 October 2009, and a curtailment gain of £3 6m was recognised There was also a net gain of £0 3m due to the closure of a small US scheme

The profit on disposal of businesses included £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

Profit on property disposals comprised £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 comprised £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

# Notes to the accounts
continued

### 5 Net finance costs

| | Year ended 31 July 2011 £m | Year ended 31 July 2010 £m |
|---|---|---|
| **Interest receivable** | **1.8** | 3 6 |
| Interest payable | | |
| – bank loans and overdrafts | **(6 6)** | (7 7) |
| – other loans | **(53.7)** | (57 4) |
| **Interest payable** | **(60 3)** | (65 1) |
| Other financing gains/(losses) | | |
| – fair value gains/(losses) on hedged debt | **3 6** | (2 9) |
| – fair value (losses)/gains on fair value hedge | **(3.6)** | 2 9 |
| – net foreign exchange (losses)/gains | **(3.1)** | 1 6 |
| – exceptional finance costs – adjustment to discounted provision | **(6.1)** | (7 0) |
| **Other financing losses** | **(9.2)** | (5 4) |
| Retirement benefits | | |
| – return on plan assets | **198 4** | 183 7 |
| – interest cost | **(175.1)** | (181 4) |
| **Retirement benefits** | **23.3** | 2 3 |
| **Net finance costs** | **(44 4)** | (64 6) |

### 6 Taxation

| | Continuing Year ended 31 July 2011 £m | Continuing Year ended 31 July 2010 £m | Discontinued Year ended 31 July 2011 £m | Discontinued Year ended 31 July 2010 £m |
|---|---|---|---|---|
| The taxation charge for the year comprises | | | | |
| – current taxation | **67 0** | 81 1 | **(25.0)** | |
| – deferred taxation | **24.8** | (2 2) | | |
| **Total taxation expense in the income statement** | **91 8** | 78 9 | **(25.0)** | |
| Current taxation | | | | |
| – UK corporation tax | | | | |
| – foreign tax | **67.0** | 81 1 | | |
| – discontinued tax | | | **(25.0)** | |
| | **67.0** | 81 1 | **(25 0)** | |

**Reconciliation of the total tax charge**

The tax expense on the profit for the period is different from the standard rate of corporation tax in the UK of 27 3% (2010 28 0%) The difference is reconciled as follows

| | Continuing Year ended 31 July 2011 £m | Continuing Year ended 31 July 2010 £m | Discontinued Year ended 31 July 2011 £m | Discontinued Year ended 31 July 2010 £m |
|---|---|---|---|---|
| **Profit before tax** | **397.9** | 373 1 | **54 0** | 16 4 |
| Notional taxation expense at UK rate of 27 3% (2010 28 0%) | **108 6** | 104 5 | **14.7** | 4 6 |
| Effect of overseas taxation | **15 1** | 14 7 | | |
| Compliance benefits | **(16.1)** | (15 2) | | |
| Local incentives | **(10 1)** | (16 9) | | |
| Tax effect of other non-headline items | **(5 7)** | (8 2) | | |
| Tax effect of Aerospace sale | | | **(39.7)** | (4 6) |
| | **91.8** | 78 9 | **(25 0)** | |
| Comprising | | | | |
| – taxation on headline profit | **121.4** | 104 3 | | |
| – tax on non-headline profit/(loss) | **(29 6)** | (25 4) | | |
| – tax on sale of discontinued operations | | | **(25.0)** | |
| **Total taxation expense in the income statement** | **91 8** | 78 9 | **(25 0)** | |

## 6 Taxation continued

| | Year ended 31 July 2011 £m | Year ended 31 July 2010 £m |
|---|---|---|
| **Tax on items (charged)/credited to equity** | | |
| Deferred tax charge/(credit) | | |
| – retirement benefit schemes | **(10.9)** | (12 2) |
| – share options | **1.8** | (2 4) |
| | **(9.1)** | (14 6) |

Of the net £10 9m credited to equity for retirement benefits, £11 6m relates to UK schemes The UK schemes have now closed and this amount represents tax relief on payments that is being set off against previous amounts charged to equity to write off the deferred tax asset

**Deferred taxation**

| | Excess tax depreciation on fixed assets and goodwill £m | Share-based payment £m | Retirement benefit obligations £m | Capitalised development expenditure £m | Other £m | Total £m |
|---|---|---|---|---|---|---|
| At 31 July 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 |
| At 31 July 2010 | (53 6) | 9 1 | 67 1 | (22 4) | 116 2 | 116 4 |
| 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) |
| At 31 July 2010 | (53 6) | 9 1 | 67 1 | (22 4) | 116 2 | 116 4 |
| Credit/(charge) to income statement | (1 7) | 1 5 | (22 9) | (5 6) | 3 9 | (24 8) |
| Credit/(charge) to equity | | (1 8) | 10 9 | | | 9 1 |
| Business combinations | (1 4) | | | | | (1 4) |
| Exchange adjustments | 1 8 | | (2 4) | 1 1 | (2 6) | (2 1) |
| **At 31 July 2011** | **(54.9)** | **8.8** | **52.7** | **(26 9)** | **117 5** | **97.2** |
| Deferred tax assets | 9 6 | 8 6 | 52 0 | (5 6) | 110 2 | 174 8 |
| Deferred tax liabilities | (64 5) | 0 2 | 0 7 | (21 3) | 7 3 | (77 6) |
| **At 31 July 2011** | **(54.9)** | **8.8** | **52 7** | **(26 9)** | **117.5** | **97.2** |

Included in other deferred tax balances above is

- no deferred tax liability relating to unremitted overseas earnings has been recognised this year (2010 £4 0m) 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,
- a deferred tax asset of £26 0m (2010 £31 9m) relating to losses carried forward, and
- a deferred tax asset of £65 0m (2010 £60 3m) relating to provisions where current tax relief is only available as payments are made Of this asset, £50 6m (£47 4m) relates to the John Crane, Inc litigation provision See note 23 for additional information on provisions

The Group has not recognised deferred tax assets relating to tax losses of £225 4m (2010 £92 4m) and pensions and other long term liabilities of £96 9m (2010 £194 5m) 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**

| | 2011 £m | Expiry of losses | 2010 £m | Expiry of losses |
|---|---|---|---|---|
| Territory | | | | |
| – Americas | **13.3** | **2019-2025** | 13 9 | 2019-2025 |
| – Asia | **3.2** | **2014-2018** | 2 5 | 2014-2017 |
| **Total restricted losses** | **16.5** | | 16 4 | |
| Unrestricted losses | | | | |
| – operating losses | **208.9** | **No expiry** | 76 0 | No expiry |
| **Total** | **225 4** | | 92 4 | |

# Notes to the accounts
continued

**7 Discontinued operations**

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

**Profit/(loss) on disposal of operation**

| | Year ended 31 July 2011 £m | Year ended 31 July 2010 £m |
|---|---|---|
| Consideration | | 19 9 |
| Provisions and disposal costs | **54.0** | (3 5) |
| **Pre-tax profit on disposal** | **54.0** | 16 4 |
| Cash received from disposal of Aerospace operations | | 19 9 |
| Disposal costs | **(6.2)** | |
| **Net cash (outflow)/inflow on disposal** | **(6.2)** | 19 9 |

The profit on disposal in 2011 arises from the resolution and time barring of certain disposal indemnities The further consideration of £19 9m recognised in 2010 was received following settlement of prior year tax filings

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

**Results from discontinued operations**

| | Year ended 31 July 2011 £m | Year ended 31 July 2010 £m |
|---|---|---|
| Profit on disposal | **54.0** | 16 4 |
| Tax credit (note 6) | **25.0** | |
| **Profit for the period** | **79.0** | 16 4 |
| Earnings per share from discontinued operations – pence | | |
| Basic | **20.2p** | 4 2p |
| Diluted | **20 0p** | 4 1p |

The tax credit of £25 0m reflects the resolution of the tax treatment of the disposal profits

**Cash-flows from discontinued operations**

| | Year ended 31 July 2011 £m | Year ended 31 July 2010 £m |
|---|---|---|
| Profit before taxation (including profit on disposal of Aerospace operations) | **54.0** | 16 4 |
| Profit on disposal of discontinued operations | **(54.0)** | (16 4) |
| **Net cash inflow from operating activities** | | |

| | Year ended 31 July 2011 £m | Year ended 31 July 2010 £m |
|---|---|---|
| Investing activities | **(6 2)** | 19 9 |
| **Net cash (outflow)/inflow from investing activities** | **(6.2)** | 19 9 |

## 8 Dividends

The following dividends were declared and paid in the period

| | Year ended 31 July 2011 £m | Year ended 31 July 2010 £m |
|---|---|---|
| Ordinary final dividend of 23 50p for 2010 (2009 23 50p) paid 19 November 2010 | **91.9** | 91 6 |
| Ordinary interim dividend of 11 25p for 2011 (2010 10 5p) paid 21 April 2011 | **44.2** | 40 9 |
| | **136 1** | 132 5 |

The final dividend for the year ended 31 July 2011 of 25 0p per share was recommended by the Board on 27 September 2011 and will be paid to shareholders on 25 November 2011, 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 28 October 2011

## 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 31 July 2011 £m | Year ended 31 July 2010 £m |
|---|---|---|
| Profit attributable to equity shareholders for the year | | |
| – continuing | **304 8** | 293 6 |
| – total | **383.8** | 310 0 |
| Average number of shares in issue during the year | **391,718,941** | 390,034,777 |

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 395,240,785 (2010 392,773,151) 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 2011 options over no shares (2010 1,729,551) 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 2011 | | Year ended 31 July 2010 | |
|---|---|---|---|---|
| | £m | EPS (p) | £m | EPS (p) |
| Profit attributable to equity shareholders of the Parent Company | **304.8** | **77.8** | 293 6 | 75 3 |
| Exclude | | | | |
| Non-headline items and related tax (note 3) | **58.5** | **14.9** | 36 5 | 9 3 |
| Headline | **363 3** | **92.7** | 330 1 | 84 6 |
| Headline EPS – diluted (p) | | **91.9** | | 84 0 |

# Notes to the accounts
continued

### 10 Post-retirement benefits

Smiths provides post retirement benefits to employees in a number of countries throughout the world. The arrangements include defined benefit and defined contribution plans and, mainly in the United Kingdom (UK) and United States of America (US), post retirement healthcare.

The principal defined benefit pension plans are in the UK and in the US and these have been closed so that no future benefits are accrued.

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 2010. These valuations have been updated by independent qualified actuaries in order to assess the liabilities of the schemes as at 31 July 2011. Scheme assets are stated at their market values. Contributions to the schemes are made on the advice of the actuaries.

**The principal assumptions used in updating the valuations are set out below.**

| | UK | US | 2011 Other | UK | US | 2010 Other |
|---|---|---|---|---|---|---|
| Rate of increase in salaries | **n/a** | **n/a** | **2.9%** | n/a | n/a | 3.0% |
| Rate of increase for active deferred members | **4.4%** | **n/a** | **n/a** | 4.1% | n/a | n/a |
| Rate of increase in pensions in payment | **3.5%** | **n/a** | **1.3%** | 3.2% | n/a | 1.4% |
| Rate of increase in deferred pensions | **3.5%** | **n/a** | **0.6%** | 3.2% | n/a | 0.6% |
| Discount rate | **5.3%** | **5.1%** | **5.3%** | 5.4% | 5.2% | 5.2% |
| Inflation rate | **3.5%** | **n/a** | **1.8%** | 3.2% | n/a | 1.8% |
| Healthcare cost increases | **5.0%** | **n/a** | **2.5%** | 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 Male | UK Female | US Male | US 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 2011 were:

| | UK schemes Long-term rate of return | UK schemes Value £m | US schemes Long-term rate of return | US schemes Value £m | Other countries Long-term rate of return | Other countries Value £m | 31 July 2011 Total £m |
|---|---|---|---|---|---|---|---|
| Equities | **7.9%** | **1,349.9** | **8.8%** | **224.1** | **9.5%** | **21.0** | **1,595.0** |
| Government bonds | **3.9%** | **300.8** | **3.8%** | **47.5** | **5.8%** | **6.0** | **354.3** |
| Corporate bonds | **5.3%** | **173.8** | **5.1%** | **141.2** | **4.7%** | **3.8** | **318.8** |
| Insured liabilities | **5.3%** | **491.3** | | | | | **491.3** |
| Property | **7.5%** | **176.4** | | | **3.8%** | **0.3** | **176.7** |
| Other | **4.1%** | **321.4** | | | **2.0%** | **15.1** | **336.5** |
| Total market value | | **2,813.6** | | **412.8** | | **46.2** | **3,272.6** |
| Present value of funded scheme liabilities | | **(2,775.7)** | | **(543.8)** | | **(60.2)** | **(3,379.7)** |
| Surplus/(deficit) | | **37.9** | | **(131.0)** | | **(14.0)** | **(107.1)** |
| Unfunded pension plans | | **(40.2)** | | **(5.9)** | | **(22.1)** | **(68.2)** |
| Post-retirement healthcare | | **(8.5)** | | **(13.0)** | | **(1.0)** | **(22.5)** |
| Present value of unfunded obligations | | **(48.7)** | | **(18.9)** | | **(23.1)** | **(90.7)** |
| Unrecognised asset due to surplus restriction | | | | | | **(1.2)** | **(1.2)** |
| **Net pension liability** | | **(10.8)** | | **(149.9)** | | **(38.3)** | **(199.0)** |
| Post-retirement assets | | **140.6** | | | | | **140.6** |
| Post-retirement liabilities | | **(151.4)** | | **(149.9)** | | **(38.3)** | **(339.6)** |
| **Net pension liability** | | **(10.8)** | | **(149.9)** | | **(38.3)** | **(199.0)** |

Where any individual scheme shows a recoverable surplus under IAS 19, this is disclosed on the balance sheet as a retirement benefit asset. The IAS 19 surplus of any one scheme is not available to fund the IAS 19 deficit of another scheme. The retirement benefit asset disclosed arises from the rights of the employers to recover the surplus at the end of the life of the scheme. If the pension schemes were wound up while they had members, the schemes would need to buy out the benefits of all members. The buy outs would cost significantly more than the present value of the scheme liabilities calculated in accordance with IAS 19.

## 10 Post-retirement benefits continued

| | UK schemes | | US schemes | | Other countries | | 31 July 2010 Total |
|---|---|---|---|---|---|---|---|
| | Long term rate of return | Value £m | Long-term rate of return | Value £m | Long term rate of return | Value £m | £m |
| Equities | 8 2% | 1,361 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) |
| **Net pension liability** | | (87 0) | | (177 3) | | (41 0) | (305 3) |
| Post-retirement assets | | 80 3 | | | | | 80 3 |
| Post-retirement liabilities | | (167 3) | | (177 3) | | (41 0) | (385 6) |
| **Net pension liability** | | (87 0) | | (177 3) | | (41 0) | (305 3) |

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 2011** | | | | Year ended 31 July 2010 | | | |
|---|---|---|---|---|---|---|---|---|
| | **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 |
| **Amounts (credited)/charged to operating profit** | | | | | | | | |
| Current service cost | **0.4** | **0 2** | **2.1** | **0.9** | 2 8 | 0 3 | 1 6 | 1 4 |
| Past service (gain)/cost | **(10.2)** | **0 1** | | | | 0 1 | | 0 3 |
| Curtailment (gains)/losses | | **(0.9)** | **(0.1)** | **0 1** | (3 7) | (0 3) | | 0 1 |
| **Total (credit)/charge** | **(9.8)** | **(0 6)** | **2.0** | **1.0** | (0 9) | 0 1 | 1 6 | 1 8 |
| **Amounts (credited)/charged to finance costs** | | | | | | | | |
| Expected return on pension scheme assets | **(169 9)** | **(26.0)** | **(2.5)** | | (156 4) | (25 0) | (2 3) | |
| Interest on pension scheme liabilities | **140 1** | **27.2** | **3.2** | **4.6** | 144 8 | 28 8 | 3 0 | 4 8 |
| **Net return** | **(29.8)** | **1.2** | **0.7** | **4 6** | (11 6) | 3 8 | 0 7 | 4 8 |
| **Total (credit)/charge to income statement** | **(39.6)** | **0.6** | **2.7** | **5.6** | (12 5) | 3 9 | 2 3 | 6 6 |

The UK past service gain of £10 2m in 2011 relates to changes in certain early retirement terms The curtailment gains in 2010 related to the closure of the UK and US defined benefit schemes The actual return on scheme assets was a profit of £337 8m (2010 profit of £351 2m)

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

| | **Year ended 31 July 2011 £m** | Year ended 31 July 2010 £m |
|---|---|---|
| Cost of sales | **0.5** | 3 4 |
| Sales and distribution costs | **0 4** | 2 6 |
| Administrative expenses | **1 9** | 0 5 |
| Exceptional operating items | **(10 2)** | (3 9) |
| | **(7.4)** | 2 6 |

# Notes to the accounts
continued

**10 Post-retirement benefits continued**

**Amounts recognised directly in the consolidated statement of comprehensive income**
Net actuarial losses of £0 2m (2010 losses of £15 2m) have been reported in the statement of comprehensive income This includes a loss of £0 5m (2010 gain of £1 3m) 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 5m (2010 cumulative losses of £558 3m)

**Changes in present value of defined benefit obligations**

| | Year ended 31 July 2011 | | | | Year ended 31 July 2010 | | | |
|---|---|---|---|---|---|---|---|---|
| | Funded defined benefit pension schemes | | | Unfunded pension/post-retirement healthcare plans | Funded defined benefit pension schemes | | | Unfunded pension/post-retirement healthcare plans |
| | UK £m | US £m | Other £m | £m | UK £m | US £m | Other £m | £m |
| At beginning of period | (2,658.0) | (543.4) | (57.1) | (89.2) | (2,531 8) | (462 6) | (33 2) | (84 5) |
| Reclassification of Irish pension scheme | | | | | 11 6 | | (11 6) | |
| Current service cost | (0 4) | (0.2) | (2.1) | (0.9) | (2 8) | (0 3) | (1 6) | (1 4) |
| Interest on obligations | (140.1) | (27.2) | (3.2) | (4 6) | (144 8) | (28 8) | (3 0) | (4 8) |
| Employee contributions | | | (0 4) | | | | (0 4) | |
| Past service gain/(cost) | 10.2 | (0.1) | | | | (0 1) | | (0 3) |
| Actuarial (loss)/gain on liabilities | (116 6) | (22.9) | 2.7 | (2.3) | (126 7) | (46 3) | (6 4) | (4 7) |
| Curtailment gain/(cost) | | 0.9 | 0.1 | (0.1) | 3 7 | 0 3 | | (0 1) |
| Exchange adjustments | | 25.3 | (2.5) | (0.3) | | (29 5) | (2 2) | (1 2) |
| Benefits paid | 129.2 | 23.8 | 2.3 | 6.7 | 132 8 | 23 9 | 1 3 | 7 8 |
| **At end of period** | (2,775.7) | (543 8) | (60.2) | (90.7) | (2,658 0) | (543 4) | (57 1) | (89 2) |

**Changes in present value of scheme assets**

| | Year ended 31 July 2011 | | | | Year ended 31 July 2010 | | | |
|---|---|---|---|---|---|---|---|---|
| | Funded defined benefit pension schemes | | | Unfunded pension/post-retirement healthcare plans | Funded defined benefit pension schemes | | | Unfunded pension/post-retirement healthcare plans |
| | UK £m | US £m | Other £m | £m | UK £m | US £m | Other £m | £m |
| At beginning of period | 2,616.3 | 386.6 | 40.2 | | 2,413 7 | 334 5 | 26 9 | |
| Reclassification of Irish pension scheme | | | | | (6 7) | | 6 7 | |
| Expected return on assets | 169.9 | 26.0 | 2.5 | | 156 4 | 25 0 | 2 3 | |
| Actuarial gain/(loss) on scheme assets | 115.8 | 22 6 | 1.0 | | 150 6 | 16 9 | | |
| Employer contributions | 40 8 | 20 0 | 2.9 | 6 7 | 35 1 | 12 7 | 3 0 | 7 8 |
| Employee contributions | | | 0.4 | | | | 0 4 | |
| Exchange adjustments | | (18.6) | 1.5 | | | 21 4 | 2 2 | |
| Benefits paid | (129.2) | (23.8) | (2.3) | (6.7) | (132 8) | (23 9) | (1 3) | (7 8) |
| **At end of period** | 2,813 6 | 412.8 | 46 2 | | 2,616 3 | 386 6 | 40 2 | |

**Cash contributions**
Company contributions to the funded defined benefit pension plans for 2011 totalled £63 7m (2010 £50 8m)

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 – held in an escrow account – with further ongoing monthly investments of £2m for nine years The first such instalment was paid in August 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 2012 the following cash contributions to the Group s principal defined benefit schemes are expected £36m to SIPS, a conditional £50m to TIGPS, and approximately £20m to the US defined benefit scheme Including payments to smaller schemes around the world, expected cash payments for 2012 total approximately £110m

## 10 Post-retirement benefits continued

### History of schemes

| | 2011 £m | 2010 £m | 2009 £m | 2008 £m | 2007 £m |
|---|---|---|---|---|---|
| Balance sheet | | | | | |
| Present value of defined benefit obligation | **(3,470.4)** | (3,347 7) | (3,112 1) | (2,968 9) | (3,132 9) |
| Fair value of scheme assets | **3,272.6** | 3,043 1 | 2,775 1 | 2,959 9 | 3,318 9 |
| Unrecognised asset due to surplus restriction | **(1.2)** | (0 7) | (2 0) | (1 5) | (2 4) |
| **(Deficit)/surplus** | **(199.0)** | (305 3) | (339 0) | (10 5) | 183 6 |
| Post-retirement assets | **140.6** | 80 3 | 39 2 | 174 2 | 333 7 |
| Post-retirement liabilities | **(339.6)** | (385 6) | (378 2) | (184 7) | (150 1) |
| **(Deficit)/surplus** | **(199.0)** | (305 3) | (339 0) | (10 5) | 183 6 |

| | Year ended 31 July 2011 £m | Year ended 31 July 2010 £m | Year ended 31 July 2009 £m | Period ended 31 July 2008 £m | Period ended 5 August 2007 £m |
|---|---|---|---|---|---|
| **Experience gains/(losses)** | | | | | |
| Experience gains/(losses) on scheme liabilities | **(25.5)** | 31 5 | 100 5 | (6 4) | (57 6) |
| Experience gains/(losses) on scheme assets | **139.4** | 167 5 | (345 4) | (350 0) | 95 7 |
| Movement on restricted surplus | **(0 5)** | 1 3 | (0 5) | 0 9 | (1 9) |

Experience gains on 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

The 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 2011 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 for year ended 31 July 2011 £m | Increase/ (decrease) in scheme assets £m | (Increase)/ decrease in scheme liabilities £m |
|---|---|---|---|
| Rate of mortality – 1 year increase in life expectancy | (4 0) | 25 4 | (101 2) |
| Rate of mortality – 1 year decrease in life expectancy | 4 0 | (26 1) | 102 4 |
| Rate of inflation – 0 25% increase | (4 0) | 8 6 | (85 6) |
| Discount rate – 0 25% increase | (0 8) | (10 7) | 127 0 |
| Expected return on scheme assets – 0 25% increase | 5 8 | | |
| Market value of scheme assets – 2 5% increase | 4 4 | 68 7 | (0 1) |
| Healthcare cost trends – 1% increase | | | (0 1) |
| Healthcare cost trends – 1% decrease | | | 0 1 |

The effect on profit before tax reflects the impact of current service cost, interest cost and expected return on assets

### Investment

In September 2011, the Trustees of the TIGPS invested approximately £147m in annuities which are matched with specific liabilities in the Scheme

### Defined contribution plans

The Group operates a number of defined contribution plans across many countries In the UK a defined contribution plan has been offered since the closure of the UK defined benefit pension plans In the US a 401k defined contribution plan operates The total expense recognised in the income statement in respect of all these plans was £29 6m (2010 £27 1m)

# Notes to the accounts
continued

### 11 Employees

| | Year ended 31 July 2011 £m | Year ended 31 July 2010 £m |
|---|---|---|
| **Staff costs during the penod** | | |
| Wages and salanes | **698.4** | 686 1 |
| Social secunty | **82 4** | 82 0 |
| Share-based payment (note 30) | **13.8** | 11 3 |
| Pension costs (including defined contnbution schemes) (note 10) | **32.9** | 33 8 |
| | **827.5** | 813 2 |

The average number of persons employed was

| | Year ended 31 July 2011 | Year ended 31 July 2010 |
|---|---|---|
| Smiths Detection | **2,500** | 2,400 |
| John Crane | **6,800** | 6,700 |
| Smiths Medical | **7,550** | 8,400 |
| Smiths Interconnect | **4,000** | 4,000 |
| Flex-Tek | **2,000** | 2,000 |
| Corporate | **50** | 50 |
| | **22,900** | 23,550 |

**Key management**
The key management of the Group compnses 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 76 to 84

| | Year ended 31 July 2011 £m | Year ended 31 July 2010 £m |
|---|---|---|
| **Key management compensation** | | |
| Salanes and short-term employee benefits | **9 2** | 10 3 |
| Cost of post-retirement benefits | **0 1** | 0 1 |
| Cost of share-based incentive plans | **4.0** | 2 4 |

No member of key management had any material interest dunng the penod in a contract of significance (other than a service contract or a qualifying third party indemnity provision) with the Company or any of its subsidianes Options and awards held at the end of the penod by key management in respect of the Companys share-based incentive plans were

| | Year ended 31 July 2011 | | Year ended 31 July 2010 | |
|---|---|---|---|---|
| | Number of instruments 000 | Weighted average price | Number of instruments 000 | Weighted average pnce |
| CIP | **540** | | 315 | |
| ESOS | **194** | **£8 81** | 220 | £8 73 |
| PSP | | | 241 | |
| VSP | **852** | | 753 | |
| SAYE | **4** | **£6.81** | 5 | £6 45 |

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 (2010 £0 2m) were incurred in respect of this arrangement

## 12 Intangible assets

| | Goodwill £m | Development costs £m | Acquired intangibles (see table below) £m | Software patents and intellectual property £m | Total £m |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| At 1 August 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) |
| At 31 July 2010 | 1,379 5 | 135 2 | 355 5 | 124 9 | 1,995 1 |
| Exchange adjustments | (12 2) | (3 7) | (7 7) | (0 7) | (24 3) |
| Business combinations | 22 4 | | 4 1 | | 26 5 |
| Additions | | 31 0 | | 10 2 | 41 2 |
| Disposals | | | | (2 2) | (2 2) |
| **At 31 July 2011** | **1,389.7** | **162.5** | **351.9** | **132.2** | **2,036 3** |
| **Amortisation** | | | | | |
| At 1 August 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) |
| At 31 July 2010 | 95 1 | 48 2 | 137 5 | 75 7 | 356 5 |
| Exchange adjustments | (1 2) | (1 0) | (3 4) | (0 5) | (6 1) |
| Charge for the year | | 16 2 | 44 0 | 12 1 | 72 3 |
| Impairment charge | | | 5 5 | | 5 5 |
| Disposals | | | | (2 1) | (2 1) |
| **At 31 July 2011** | **93.9** | **63 4** | **183.6** | **85.2** | **426 1** |
| **Net book value at 31 July 2011** | **1,295 8** | **99.1** | **168.3** | **47.0** | **1,610 2** |
| Net book value at 31 July 2010 | 1,284 4 | 87 0 | 218 0 | 49 2 | 1,638 6 |
| Net book value at 1 August 2009 | 1,174 5 | 73 8 | 199 0 | 53 0 | 1,500 3 |

In addition to goodwill, the acquired intangible assets comprise

| | Patents licences and trademarks £m | Technology £m | Customer relationships £m | Total acquired intangibles £m |
|---|---|---|---|---|
| **Cost** | | | | |
| At 1 August 2009 | 64 3 | 94 4 | 131 5 | 290 2 |
| Exchange adjustments | 4 4 | 5 3 | 4 1 | 13 8 |
| Business combinations (note 29) | | 22 8 | 28 7 | 51 5 |
| At 31 July 2010 | 68 7 | 122 5 | 164 3 | 355 5 |
| Exchange adjustments | (2 1) | (5 1) | (0 5) | (7 7) |
| Business combinations (note 29) | | | 4 1 | 4 1 |
| **At 31 July 2011** | **66 6** | **117.4** | **167.9** | **351 9** |
| **Amortisation** | | | | |
| At 1 August 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 |
| At 31 July 2010 | 20 0 | 46 0 | 71 5 | 137 5 |
| Exchange adjustments | (0 7) | (2 2) | (0 5) | (3 4) |
| Charge for the year | 5 1 | 13 3 | 25 6 | 44 0 |
| Impairment charge | 0 8 | | 4 7 | 5 5 |
| **At 31 July 2011** | **25 2** | **57 1** | **101.3** | **183.6** |
| **Net book value at 31 July 2011** | **41 4** | **60 3** | **66.6** | **168 3** |
| Net book value at 31 July 2010 | 48 7 | 76 5 | 92 8 | 218 0 |
| Net book value at 1 August 2009 | 50 5 | 62 1 | 86 4 | 199 0 |

## 12 Intangible assets continued

### Impairment testing

**Goodwill**

Goodwill is allocated by division as follows

| | 2011 £m | 2011 Number of CGUs | 2010 £m | 2010 Number of CGUs |
|---|---|---|---|---|
| Smiths Detection | **406 9** | **1** | 372 9 | 2 |
| John Crane | **132 9** | **6** | 130 8 | 6 |
| Smiths Medical | **497.2** | **1** | 512 5 | 2 |
| Smiths Interconnect | **237.5** | **4** | 245 9 | 4 |
| Flex-Tek | **21.3** | **2** | 22 3 | 2 |
| | **1,295.8** | **14** | 1,284 4 | 16 |

As discussed in the business review, both Smiths Detection and Smiths Medical adopted global organisations at the beginning of this year The divisions now have global management and reporting for sales and marketing, product management and operations Both divisions now report and review performance using these global structures As required by IAS 36, following these reorganisations, the allocation of goodwill to CGUs for impairment testing was reviewed, and it was established that goodwill is now monitored, and should be tested for impairment, at a divisional level

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 allocated to each group of cash generating units (CGU) Value in use is calculated as the net present value of the projected risk-adjusted cash-flows of the CGU These forecast cash-flows are based on the 2012 budget and the three year divisional strategic plan, which have both been approved by the Board

The key assumptions used in value in use calculations are

- Sales projected sales are built up with reference to markets and product categories They incorporate past performance, historical growth rates and developments in key markets
- Margins projected margins reflect historical performance and the impact of all completed projects to improve operational efficiency and leverage scale The projections do not include the impact of future restructuring projects to which the Group is not yet committed
- Discount rate the discount rates have been calculated based on the Group s weighted average cost of capital and risks specific to the CGU being tested Pre-tax rates of 11 1% to 14 1% (2010 9 8% to 12 8%) have been used for the impairment testing
- Long term growth rates As required by IAS 36, growth rates for the period after the detailed forecasts are based on the long-term GDP projections of the primary market for the CGU The average growth rate used in the testing was 2 42% (2010 2 25%) These rates do not reflect the long-term assumption used by the Group for investment planning

The assumptions used in the impairment testing of significant CGUs are as follows

| | Smiths Medical | | Smiths Detection | |
|---|---|---|---|---|
| | 2011 | 2010 (restated) | 2011 | 2010 (restated) |
| Net book value of goodwill (£m) | **497 2** | 512 5 | **406 9** | 372 9 |
| Discount rate | **11.2%** | 11 5% | **11 2%** | 11 7% |
| Period covered by management projections | **5 years** | 5 years | **5 years** | 5 years |
| Long-term growth rates | **2 47%** | 2 25% | **2.00%** | 2 25% |

The 2010 information has been restated to reflect the new CGU structure The 2010 discount and growth rates are weighted averages of the rates used for testing in that year The remaining balance of the goodwill represents smaller individual amounts which have been allocated to smaller CGUs

Sensitivity analysis performed around the base case assumptions has indicated that no reasonable changes in key assumptions would cause the carrying amount of any of the CGUs to exceed their respective recoverable amounts

**Other intangible assets**

The Group has no indefinite life intangible assets other than goodwill During the year impairment tests were carried out for development projects which have not yet started to be amortised, and acquired intangibles where there were indications of impairment

Impairment charges of £5 5m have been incurred on intangible assets acquired in two business combinations Value in use calculations were used to determine the recoverable values of these assets The impairment charges have arisen because current and forecast profitability is below the levels originally projected

## 13 Property, plant and equipment

| | Land and buildings £m | Plant and machinery £m | Fixtures fittings, tools and equipment £m | Total £m |
|---|---|---|---|---|
| **Cost or valuation** | | | | |
| At 1 August 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) |
| At 31 July 2010 | 187 0 | 493 6 | 210 0 | 890 6 |
| Exchange adjustments | (1 8) | (9 0) | 1 2 | (9 6) |
| Business combinations | | 0 2 | 0 1 | 0 3 |
| Additions | 7 8 | 26 6 | 14 9 | 49 3 |
| Disposals | (2 7) | (15 7) | (16 7) | (35 1) |
| **At 31 July 2011** | **190.3** | **495 7** | **209.5** | **895.5** |
| **Depreciation** | | | | |
| At 1 August 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 | (2 1) | | | (2 1) |
| Disposals | (6 4) | (12 7) | (13 3) | (32 4) |
| At 31 July 2010 | 82 5 | 345 0 | 160 4 | 587 9 |
| Exchange adjustments | (1 3) | (6 8) | 0 7 | (7 4) |
| Charge for the year | 7 8 | 38 9 | 16 7 | 63 4 |
| Disposals | (1 9) | (14 4) | (14 9) | (31 2) |
| **At 31 July 2011** | **87.1** | **362.7** | **162 9** | **612 7** |
| **Net book value at 31 July 2011** | **103 2** | **133.0** | **46.6** | **282.8** |
| Net book value at 31 July 2010 | 104 5 | 148 6 | 49 6 | 302 7 |
| Net book value at 1 August 2009 | 111 8 | 151 9 | 54 3 | 318 0 |

## 14 Investments accounted for using the equity method

| | **31 July 2011 £m** | 31 July 2010 £m |
|---|---|---|
| **Investments in associated companies** | | |
| At start of period | **13.6** | 11 2 |
| Exchange adjustment | **0.8** | 0 7 |
| Share of results after tax | **4 3** | 1 8 |
| Dividend received | **(0.2)** | (0 1) |
| **At end of period** | **18.5** | 13 6 |

The Group s share of the revenue of associates was £23 7m (2010 £22 5m) The total assets of associates are £59 9m (2010 £43 1m) and liabilities are £13 5m (2010 £17 6m) 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% (2010 35 6%)

# Notes to the accounts
continued

### 15 Financial assets

Available for sale financial assets include £29 1m (2010 £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

| | 31 July 2011 £m | 31 July 2010 £m |
|---|---|---|
| **Inventories comprise** | | |
| Raw materials and consumables | **145.1** | 129 3 |
| Work in progress | **94.7** | 72 4 |
| Finished goods | **197.2** | 190 5 |
| | **437.0** | 392 2 |
| Less payments on account | **(4.5)** | (2 2) |
| | **432 5** | 390 0 |

The Group consumed £1,332 6m (2010 £1,262 2m) of inventories during the period £11 3m (2010 £19 0m) was recognised as an expense resulting from the write-down of inventory and £3 0m (2010 £5 6m) was released to the income statement from inventory provisions charged in earlier years but no longer required

### 17 Trade and other receivables

| | 31 July 2011 £m | 31 July 2010 £m |
|---|---|---|
| **Non-current** | | |
| Trade receivables | **23.7** | 22 8 |
| Prepayments and accrued income | **5.3** | 6 0 |
| Other debtors | **4.6** | 5 0 |
| | **33.6** | 33 8 |
| **Current** | | |
| Trade receivables | **564.2** | 535 3 |
| Prepayments and accrued income | **32.9** | 30 5 |
| Other debtors | **15.7** | 13 1 |
| | **612.8** | 578 9 |

Trade receivables do not carry interest Management considers that the carrying value of trade and other receivables approximates to 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 £606 5m (2010 £575 8m)

Trade receivables are disclosed net of provisions for bad and doubtful debts The provisions for bad and doubtful debts are 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 6% (2010 8%) of Group revenue

**Ageing of trade receivables**

| | 31 July 2011 £m | 31 July 2010 £m |
|---|---|---|
| Trade receivables which are not impaired and not yet due | **472 4** | 447 3 |
| Trade receivables which are not impaired and less than three months overdue | **84.2** | 75 7 |
| Trade receivables which are not impaired and more than three months overdue | **28.5** | 31 8 |
| Gross value of partially and fully provided debtors | **16.8** | 17 9 |
| | **601.9** | 572 7 |
| Provision for bad and doubtful debts | **(14.0)** | (14 6) |
| Trade receivables | **587.9** | 558 1 |

## 18 Cash and cash equivalents

| | 31 July 2011 £m | 31 July 2010 £m |
|---|---|---|
| Cash at bank and in hand | **232.0** | 136 3 |
| Short-term deposits | **29 1** | 36 6 |
| Cash and cash equivalents | **261 1** | 172 9 |
| Bank overdrafts | **(0 4)** | (0 7) |
| Net cash and cash equivalents | **260.7** | 172 2 |

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

## 19 Trade and other payables

| | 31 July 2011 £m | 31 July 2010 £m |
|---|---|---|
| **Non-current** | | |
| Other creditors | **45.1** | 27 3 |
| **Current** | | |
| Trade creditors | **190.3** | 151 6 |
| Bills of exchange payable | **0.7** | 0 5 |
| Other creditors | **19.4** | 35 2 |
| Other taxation and social security costs | **22.5** | 21 2 |
| Accruals and deferred income | **221.3** | 219 7 |
| | **454.2** | 428 2 |

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

| | 31 July 2011 £m | 31 July 2010 £m |
|---|---|---|
| **Cash and cash equivalents** | | |
| Net cash and deposits (note 18) | **261.1** | 172 9 |
| **Short-term borrowings** | | |
| Bank overdrafts | **(0.4)** | (0 7) |
| Bank and other loans | **(1.2)** | (1 3) |
| Interest accrual | **(10 1)** | (12 7) |
| | **(11 7)** | (14 7) |
| **Long-term borrowings** | | |
| $250m 5 45% US$ Private placement 2013 | **(158 3)** | (169 1) |
| $250m 6 05% US$ Guaranteed notes 2014 | **(151 4)** | (158 3) |
| £150m 7 25% Sterling Eurobond 2016 | **(149.3)** | (149 1) |
| €300m 4 125% Eurobond 2017 | **(260.2)** | (247 6) |
| $175m 7 37% US$ Private placement 2018 | **(106 4)** | (111 4) |
| $250m 7 20% US$ Guaranteed notes 2019 | **(151 0)** | (158 0) |
| Bank and other loans | **(1.8)** | (1 5) |
| | **(978.4)** | (995 0) |
| **Borrowings** | **(990.1)** | (1,009 7) |
| **Net debt** | **(729.0)** | (836 8) |

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 2017 to 2019

Interest of £42 3m (2010 £43 2m) was charged to the consolidated income statement in this period in respect of public bonds

# Notes to the accounts
continued

## 20 Borrowings and net debt continued

### Movements in net debt

| | Net cash and cash equivalents £m | Other short term borrowing £m | Long-term borrowings £m | Net debt £m |
|---|---|---|---|---|
| At 31 July 2010 | 172.2 | (14.0) | (995.0) | (836.8) |
| Foreign exchange gains and losses | 2.7 | 0.1 | 13.3 | 16.1 |
| Net cash inflow/(outflow) | 85.8 | | | 85.8 |
| Repayment of borrowings | | 1.2 | | 1.2 |
| Drawdown of borrowings | | | (1.6) | (1.6) |
| Capitalisation, interest accruals and unwind of capitalised fees | | 2.6 | 0.1 | 2.7 |
| Fair value movement from interest rate hedging | | | 3.6 | 3.6 |
| Change in maturity analysis | | (1.2) | 1.2 | |
| **At 31 July 2011** | **260.7** | **(11.3)** | **(978.4)** | **(729.0)** |

### Secured loans

Loans amounting to £3.0m (2010 £2.8m) were secured on plant and equipment with a book value of £2.9m (2010 £2.6m)

## 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 2011 |
|---|---|---|---|---|---|
| | **Sterling £m** | **US$ £m** | **Euro £m** | **Other £m** | **Total £m** |
| **Financial assets and liabilities** | | | | | |
| Financial instruments included in trade and other receivables | **35.3** | **290.7** | **144.2** | **136.3** | **606.5** |
| Financial instruments included in trade and other payables | **(50.3)** | **(141.4)** | **(78.8)** | **(64.6)** | **(335.1)** |
| Cash and cash equivalents | **55.8** | **58.5** | **32.9** | **113.9** | **261.1** |
| Borrowings not designated as net investment hedges | **(149.0)** | **(10.8)** | **(3.0)** | | **(162.8)** |
| | **(108.2)** | **197.0** | **95.3** | **185.6** | **369.7** |
| Exclude balances held in operations with the same functional currency | **108.5** | **(147.8)** | **(98.4)** | **(183.4)** | **(321.1)** |
| Exposure arising from intra-group loans | | **(93.5)** | **(8.8)** | **8.7** | **(93.6)** |
| Forward foreign exchange contracts | **(104.4)** | **65.1** | **62.9** | **(23.6)** | |
| | **(104.1)** | **20.8** | **51.0** | **(12.7)** | **(45.0)** |

## 21 Financial risk management continued

| | At 31 July 2010 | | | | |
|---|---|---|---|---|---|
| | Sterling £m | US$ £m | Euro £m | Other £m | Total £m |
| **Financial assets and liabilities** | | | | | |
| 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 |

Financial instruments included in trade and other receivables comprise trade receivables, accrued income and other debtors which qualify as financial instruments Similarly financial instruments included in trade and other payables comprise trade payables, accrued expenses and other creditors which qualify as financial instruments

Based on the assets and liabilities held at the year end, if the specified currencies were to strengthen 10% while all other market rates remained constant, the change in the fair value of financial instruments not designated as net investment hedges would have the following effect

| | **Impact on profit for the year 31 July 2011 £m** | **Gain/(loss) recognised in reserves 31 July 2011 £m** | Impact on profit for the year 31 July 2010 £m | Gain/(loss) recognised in reserves 31 July 2010 £m |
|---|---|---|---|---|
| US dollar | **5 9** | **(3.4)** | 1 5 | (1 8) |
| Euro | **(1 8)** | **4.2** | 1 0 | 2 9 |
| Sterling | **0.5** | **1 6** | 1 3 | 1 8 |

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

Cash-flow hedging
The Group uses foreign currency contracts to hedge future foreign currency sales and purchases At 31 July 2011 contracts with a nominal value of £217 7m (2010 £292 7m) were designated as hedging instruments In addition, the Group had outstanding foreign currency contracts with a nominal value of £241 0m (2010 £152 1m) which were being used to manage transactional foreign exchange exposures, but were not accounted for as cash-flow hedges The fair value of the contracts is disclosed in note 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 9% are for periods of 12 months or less (2010 99 6%)

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

| | **Year ended 31 July 2011 £m** | Year ended 31 July 2010 £m |
|---|---|---|
| Brought forward cash-flow hedge reserve at start of year | **(0.6)** | 1 8 |
| Exchange adjustments | **0.1** | 0 2 |
| Gains and losses on effective cash-flow hedges recognised in equity | **0.4** | (2 3) |
| Amounts removed from the hedge reserve and recognised in the following lines on the income statement | | |
| – revenue | **0.2** | 0 1 |
| – cost of sales | **(0 4)** | 0 9 |
| – administrative expenses | | (1 3) |
| **Carried forward cash-flow hedge reserve at end of year** | **(0.3)** | (0 6) |

## 21 Financial risk management continued

### 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 2011 |
|---|---|---|---|---|---|
| | **Sterling £m** | **US$ £m** | **Euro £m** | **Other £m** | **Total £m** |
| Loans designated as net investment hedges | | **(567.2)** | **(260.1)** | | **(827.3)** |
| Currency swap contracts | **192.6** | **(45 6)** | **(39.2)** | **(107.8)** | |
| | **192.6** | **(612 8)** | **(299.3)** | **(107.8)** | **(827.3)** |

| | | | | | At 31 July 2010 |
|---|---|---|---|---|---|
| | Sterling £m | US$ £m | Euro £m | Other £m | Total £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 2011 and 31 July 2010 swap contracts in other currencies hedged the Group s exposure to Australian dollars, Canadian dollars, Japanese yen and Chinese renminbi

Of the contracts designated as net investment hedges, 54% (2010 56%) are current and the balance matures over the next three years (2010 three years)

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

| | **Year ended 31 July 2011 £m** | Year ended 31 July 2010 £m |
|---|---|---|
| Brought forward net investment hedge reserve at start of year | **(128.2)** | (88 9) |
| Amounts deferred in the period on effective net investment hedges | **7.9** | (39 3) |
| **Carried forward net investment hedge reserve at end of year** | **(120.3)** | (128 2) |

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 recognised in hedge reserve 31 July 2011 £m** | Loss recognised in hedge reserve 31 July 2010 £m |
|---|---|---|
| US dollar | **60.4** | 61 8 |
| Euro | **27.6** | 26 0 |

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

## 21 Financial risk management continued

### (b) Interest rate risk

The Group operates an interest rate policy designed to optimise interest cost and reduce volatility in reported earnings The Groups current policy is to require interest rates to be fixed for greater than 60% 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 2011 98 5% (2010 91 5%) 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 2011, after interest rate swaps, is 5 5% (2010 5 4%)

**Interest rate profile of financial assets and liabilities and the fair value of borrowings**

The following table shows the interest rate risk exposure of cash and borrowings The other financial assets and liabilities do not earn or bear interest and for all financial instruments except for borrowings the carrying value is not materially different from their fair value

| | **Cash and cash equivalents 31 July 2011 £m** | **Borrowings 31 July 2011 £m** | **Fair value of borrowings 31 July 2011 £m** | Cash and cash equivalents 31 July 2010 £m | Borrowings 31 July 2010 £m | Fair value of borrowings 31 July 2010 £m |
|---|---|---|---|---|---|---|
| Fixed interest (adjusted for interest rate hedging) | | | | | | |
| Less than one year | | **(1.2)** | **(1.2)** | | (1 3) | (1 3) |
| Between one and five years | | **(363.4)** | **(403.6)** | | (223 5) | (244 3) |
| Greater than five years | | **(414 2)** | **(463.0)** | | (566 9) | (643 7) |
| Total fixed interest financial assets/(liabilities) (adjusted for interest rate hedging) | | **(778.8)** | **(867.8)** | | (791 7) | (889 3) |
| Floating rate interest financial assets/(liabilities) | **243.1** | **(211.3)** | **(211 3)** | 156 4 | (218 0) | (218 0) |
| Total interest bearing financial assets/(liabilities) | **243.1** | **(990.1)** | **(1,079.1)** | 156 4 | (1,009 7) | (1,107 3) |
| Non-interest bearing assets/(liabilities) in the same category | **18.0** | | | 16 5 | | |
| **Total** | **261.1** | **(990.1)** | **(1,079.1)** | 172 9 | (1,009 7) | (1,107 3) |

**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 £196 3m (2010 £195 3m) 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 2011, 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 £nil (2010 £0 2m) impact on the Group s profit before tax

### (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 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 £292 7m at 31 July 2011 (2010 £199 9m)

| | **31 July 2011 £m** | 31 July 2010 £m |
|---|---|---|
| Cash at banks with at least a AA- credit rating | **236 6** | 120 9 |
| Cash at banks with a A+ credit rating | **21.1** | 47 4 |
| Cash at other banks | **3.4** | 4 7 |
| UK government bonds with a AAA credit rating (note 15) | **29 1** | 25 2 |
| Other investments | **2 5** | 1 7 |
| | **292.7** | 199 9 |

At 31 July 2011 the maximum exposure with a single bank for deposits and cash is £57 1m (2010 £41 6m), whilst the maximum mark to market exposure for derivatives is £5 3m (2010 £6 8m) These banks have AA- and AA credit rating, respectively (2010 AA and AA)

# Notes to the accounts
continued

## 21 Financial risk management continued

### (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 On 14 December 2010 the £660m Revolving Credit Facility 2012 was refinanced with a new US$800m multi-currency revolving credit facility The new facility, which matures in December 2015, is undrawn At the balance sheet date the Group had the following undrawn credit facilities

| | **31 July 2011 £m** | 31 July 2010 £m |
|---|---|---|
| Expiring within one year | | |
| Expiring between one and two years | | 660 0 |
| Expiring after two years | **486.8** | |
| | **486.8** | 660 0 |

**Cash deposits**

As at 31 July 2011, £29 1m (2010 £36 6m) of cash and cash equivalents was on deposit with various banks of which £4 5m (2010 £20 8m) was on deposit in the UK

**Gross contractual cash-flows for borrowings**

| | **Borrowings (Note 20) 31 July 2011 £m** | **Fair value adjustments 31 July 2011 £m** | **Contractual interest payments 31 July 2011 £m** | **Total contractual cash-flows 31 July 2011 £m** | Borrowings (Note 20) 31 July 2010 £m | Fair value adjustments 31 July 2010 £m | Contractual interest payments 31 July 2010 £m | Total contractual cash-flows 31 July 2010 £m |
|---|---|---|---|---|---|---|---|---|
| Less than one year | **(11.7)** | **(1 1)** | **(46.9)** | **(59 7)** | (14 7) | 1 3 | (47 9) | (61 3) |
| Between one and two years | **(159.2)** | **6 2** | **(54.0)** | **(207 0)** | (1 0) | | (59 2) | (60 2) |
| Between two and three years | **(152.3)** | **(0.7)** | **(49.8)** | **(202.8)** | (169 6) | 9 8 | (54 9) | (214 7) |
| Between three and four years | | | **(40 5)** | **(40.5)** | (158 3) | (1 0) | (50 5) | (209 8) |
| Between four and five years | **(149.3)** | **(0.7)** | **(40.5)** | **(190.5)** | | | (40 8) | (40 8) |
| Greater than five years | **(517.6)** | **(3.6)** | **(59.4)** | **(580 6)** | (666 1) | (4 0) | (102 0) | (772 1) |
| **Total** | **(990.1)** | **0.1** | **(291.1)** | **(1,281.1)** | (1,009 7) | 6 1 | (355 3) | (1,358 9) |

The figures presented in the borrowings column include the non-cash adjustments which are highlighted in the adjacent column The contractual interest reported for borrowings is before the effect of interest rate swaps

**Gross contractual cash-flows for derivative financial instruments**

| | **Receipts 31 July 2011 £m** | **Payments 31 July 2011 £m** | **Net cash-flow 31 July 2011 £m** | Receipts 31 July 2010 £m | Payments 31 July 2010 £m | Net cash-flow 31 July 2010 £m |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Less than one year | **182 3** | **(166.6)** | **15.7** | 375 2 | (354 0) | 21 2 |
| Greater than one year | **102.4** | **(92 5)** | **9.9** | 78 7 | (60 7) | 18 0 |
| **Liabilities** | | | | | | |
| Less than one year | **351.3** | **(359 5)** | **(8.2)** | 362 5 | (377 8) | (15 3) |
| Greater than one year | **26 8** | **(27.0)** | **(0.2)** | 30 2 | (31 3) | (1 1) |
| **Total** | **662.8** | **(645.6)** | **17.2** | 846 6 | (823 8) | 22 8 |

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 £309 9m (2010 £284 5m) due in less than one year, £20 9m (2010 £8 2m) due between one and five years and £4 3m (2010 £4 0m) due after more than five years

## 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 2011 |
|---|---|---|---|---|
| | Contract or underlying nominal amount | | | Fair value |
| | £m | Assets £m | Liabilities £m | Net £m |
| Foreign exchange contracts (cash-flow hedges) | **217.7** | **3.2** | **(4.5)** | **(1.3)** |
| Foreign exchange contracts (not hedge accounted) | **241 0** | **1.6** | **(2.6)** | **(1.0)** |
| Total foreign exchange contracts | **458.7** | **4 8** | **(7 1)** | **(2.3)** |
| Currency swaps (net investment hedges) | **192.6** | **1 9** | **(2.3)** | **(0.4)** |
| Interest rate swaps (fair value hedges) | **196.3** | **5.4** | **(1.0)** | **4.4** |
| **Total financial derivatives** | **847.6** | **12.1** | **(10.4)** | **1.7** |
| Balance sheet entries | | | | |
| Non-current | | **6.4** | **(1.5)** | **4.9** |
| Current | | **5.7** | **(8.9)** | **(3.2)** |
| **Total financial derivatives** | | **12 1** | **(10.4)** | **1.7** |

| | | | | 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) |
| Total foreign exchange contracts | 444 8 | 6 4 | (9 3) | (2 9) |
| 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 |
| Total currency swap contracts | 387 4 | 11 6 | (6 4) | 5 2 |
| Interest rate swaps (fair value hedges) | 195 3 | 8 3 | (0 3) | 8 0 |
| **Total financial derivatives** | 1,027 5 | 26 3 | (16 0) | 10 3 |
| Balance sheet entries | | | | |
| Non-current | | 10 8 | (1 1) | 9 7 |
| Current | | 15 5 | (14 9) | 0 6 |
| **Total financial derivatives** | | 26 3 | (16 0) | 10 3 |

**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

# Notes to the accounts
continued

## 23 Provisions for liabilities and charges

| | Warranty provision and product liability £m | Reorganisation £m | Property £m | Disposal £m | John Crane Inc. litigation £m | Other litigation £m | Total £m |
|---|---|---|---|---|---|---|---|
| At 31 July 2010 | 37 5 | 11 4 | 4 7 | 56 2 | 175 7 | 15 7 | 301 2 |
| Exchange adjustments | 0 5 | (0 2) | | | (8 3) | (0 4) | (8 4) |
| Provision charged | 22 9 | 4 8 | 0 8 | | 27 3 | 5 0 | 60 8 |
| Provision released | (5 8) | (2 0) | (0 8) | (43 8) | | (2 1) | (54 5) |
| Unwind of provision discount | | | | | 6 1 | | 6 1 |
| Utilisation | (17 5) | (6 2) | (1 3) | (8 5) | (19 1) | (3 8) | (56 4) |
| **At 31 July 2011** | **37.6** | **7.8** | **3.4** | **3.9** | **181.7** | **14.4** | **248.8** |

Analysed as

| | 31 July 2011 £m | 31 July 2010 £m |
|---|---|---|
| Current liabilities | **74 7** | 70 4 |
| Non-current liabilities | **174.1** | 230 8 |
| | **248 8** | 301 2 |

**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**
The restructuring of corporate and divisional headquarters was announced on 3 June 2008, and a second phase of this project was introduced in 2010 At 31 July 2011 there is a provision of £4 7m (2010 £8 6m) relating to the two phases of this project

Reorganisation provisions include £1 8m (2010 £2 8m) costs relating to restructuring supply arrangements following the automotive seals disposal These costs are expected to be spread over the next two 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 continues to actively monitor 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 these asbestos claims based upon this defence Approximately 202,000 claims against JCI have been dismissed before trial over the last 32 years JCI is currently a defendant in cases involving approximately 101,000 claims Despite the large number of claims brought against JCI, it has had final judgments against it, after appeals in only 107 cases over the period, and has had to pay awards amounting to approximately US$103m 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 successfully is likely to have a significant impact on its annual aggregate adverse judgment and defence costs

## 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 period over which the expenditure can be reliably estimated
- The future trend of legal costs
- 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 levels of new claims based on published tables of asbestos incidence projections and is determined using asbestos valuation experts, Bates White LLC In the current period the method used to calculate the expected costs of defending claims has been conformed to the approach used to calculate the expected cost of adverse judgments following the appointment of Bates White LLC to value both elements of JCI s exposure The projections use a 10 year time horizon (see note 26), compared to time horizons of up to 16 years used in previous estimates, on the basis that Bates White LLC consider that there is substantial uncertainty in the asbestos litigation environment so probable expenditures are not reasonably estimable beyond this time horizon The Income Statement charge arising from movements in discounting (see note 4) incorporates the impact of the change in the time frame of the projections The movement in the gross provision reflects the higher expected annual defence costs offset by the change in the time horizon

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

| | **31 July 2011 £m** | 31 July 2010 £m |
|---|---|---|
| Gross provision | **203.1** | 214 5 |
| Discount | **(21.4)** | (38 8) |
| Discounted pre-tax provision | **181.7** | 175 7 |
| Deferred tax | **(50 6)** | (47 4) |
| Discounted post-tax provision | **131.1** | 128 3 |

**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 Share capital

| | Number of shares | Issued capital £m | Consideration £m |
|---|---|---|---|
| **Ordinary shares of 37.5p each** | | | |
| At 31 July 2010 | 390,728,043 | 146 5 | |
| Exercise of share options | 1,622,360 | 0 6 | 14 4 |
| **Total share capital at 31 July 2011** | **392,350,403** | **147 1** | |

At 31 July 2011 all of the issued share capital was in free issue All issued shares are fully paid

## 25 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 nil (2010 558,754) shares to the Trust, and the Trust purchased 700,892 (2010 nil shares) in the market At 31 July 2011 the Trust held 855 (2010 32,858) ordinary shares with a market value of £0 0m (2010 £0 4m)

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

## 25 Reserves continued

**Capital management**

Capital employed comprises total equity adjusted for goodwill recognised directly in reserves, net post-retirement benefit assets and liabilities and net debt The efficiency of the allocation of the capital to the divisions is monitored through the headline return on capital employed (ROCE) This ratio is calculated over a rolling 12-month period and is the percentage that headline operating profit comprises of monthly average capital employed The ROCE was 17 0% (2010 16 6%)

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 15% (2010 19%)

As part of its capital management the Group strategy is to maintain a solid investment grade credit rating to ensure access to the widest possible sources of financing and to minimise the resulting cost of capital At 31 July 2011 the Group had a credit rating of BBB+/Baa2 (2010 BBB+/Baa2 – negative outlook) with Standard & Poor s and Moody s respectively The credit rating is managed through the following cash-flow targets headline operating cash conversion of greater than 80% and a ratio of net debt to headline EBITDA of less than two For the year ended 31 July 2011 these measures were 95% (2010 115%) and 1 2 (2010 1 4)

The Board aims for dividend cover of around 2 5 times, to ensure that the Group retains sufficient cash to finance investment in growth

**Hedge reserve**

| | 31 July 2011 £m | 31 July 2010 £m |
|---|---|---|
| The hedge reserve on the balance sheet comprises | | |
| – cash-flow hedge reserve | **(0.3)** | (0 6) |
| – net investment hedge reserve | **(120.3)** | (128 2) |
| | **(120.6)** | (128 8) |

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

## 26 Contingent liabilities and commitments

**John Crane, Inc.**

As stated in note 23, John Crane, Inc ( JCI ) is involved in numerous lawsuits 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 future defence costs and 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 costs 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 judgement 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 2011, contingent liabilities, comprising bonds and guarantees arising in the normal course of business, amounted to £137 8m (2010 £143 5m), including pension commitments of £43 1m (2010 £40 6m)

From time to time the Group co-operates with relevant authorities in investigating business conduct issues The Group is not aware of any issues which are expected to generate material financial exposures

## 27 Operating lease commitments – minimum lease payments

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

| | 31 July 2011 | | 31 July 2010 | |
|---|---|---|---|---|
| | Land and buildings £m | Other £m | Land and buildings £m | Other £m |
| Payments due | | | | |
| – not later than one year | **30.4** | **9.1** | 27 3 | 9 0 |
| – later than one year and not later than five years | **64.1** | **8 8** | 63 7 | 10 7 |
| – later than five years | **22.7** | **0.1** | 27 7 | 0 1 |
| | **117 2** | **18.0** | 118 7 | 19 8 |

## 28 Cash-flow

### Cash-flow from operating activities

| | Year ended 31 July 2011 £m | Year ended 31 July 2010 £m |
|---|---|---|
| Operating profit – continuing | **438.0** | 435 9 |
| Amortisation of intangible assets | **72.3** | 67 6 |
| Impairment of intangible assets | **5.5** | |
| Profit on disposal of property, plant and equipment | **(0.7)** | (3 1) |
| Profit on disposal of business | **(4.4)** | (3 3) |
| Depreciation of property, plant and equipment | **63.4** | 65 7 |
| Impairment of property, plant and equipment | | (2 1) |
| Share-based payment expense | **13.8** | 10 3 |
| Retirement benefits | **(77.6)** | (56 1) |
| (Increase)/decrease in inventories | **(46 7)** | 46 1 |
| Increase in trade and other receivables | **(33.1)** | (16 5) |
| Increase in trade and other payables | **43.7** | 27 0 |
| Increase/(decrease) in provisions | **5.2** | (21 8) |
| Cash generated from operations | **479.4** | 549 7 |
| Interest | **(66.8)** | (52 8) |
| Tax paid | **(90 9)** | (86 4) |
| **Net cash inflow from operating activities** | **321.7** | 410 5 |

### Smiths Group cash-flow measures

The Group uses two non-statutory cash-flow measures to monitor performance headline operating cash-flow and free cash-flow Headline operating cash-flow is net cash inflow from headline operating activities less capital expenditure See note 3 for a description of headline profit measures Free cash-flow is cash-flow after interest and tax but before acquisitions, financing activities and dividends The tables below reconcile these two measures to statutory cash-flow measures

### Headline operating cash-flow

| | Year ended 31 July 2011 £m | Year ended 31 July 2010 £m |
|---|---|---|
| **Net cash inflow from operating activities** | **321.7** | 410 5 |
| Exclude | | |
| Interest | **66.8** | 52 8 |
| Tax paid | **90.9** | 86 4 |
| Cash outflow in respect of exceptional operating items | **34.8** | 45 7 |
| Pension deficit payments | **60.1** | 44 7 |
| Include | | |
| Expenditure on capitalised development, other intangible assets and property, plant and equipment | **(90.1)** | (78 9) |
| Disposals of property, plant and equipment in the ordinary course of business | **4.5** | 3 6 |
| **Headline operating cash-flow** | **488 7** | 564 8 |

### Free cash-flow

| | Year ended 31 July 2011 £m | Year ended 31 July 2010 £m |
|---|---|---|
| Net cash inflow from operating activities | **321.7** | 410 5 |
| Expenditure on capitalised development, other intangible assets and property, plant and equipment | **(90.1)** | (78 9) |
| Disposals of property, plant and equipment | **4.5** | 24 8 |
| Investment in financial assets relating to pensions financing | | (25 0) |
| **Free cash-flow** | **236.1** | 331 4 |
| Investment in other financial assets | **(0.3)** | (0 3) |
| Acquisition of businesses | **(18.5)** | (132 7) |
| Disposal of Aerospace | **(6.2)** | 19 9 |
| Disposal of businesses | **3 9** | 1 1 |
| Net cash-flow used in financing activities | **(129.2)** | (66 1) |
| **Net increase in cash and cash equivalents** | **85 8** | 153 3 |

# Notes to the accounts
continued

## 29 Acquisitions

During the period ended 31 July 2011, the Group acquired the detection sales, distribution and servicing business of Veecon IPA Gastchnik Limited (August 2010) and the entire issued share capital of SDBR Comercio De Equipamentos De Seguanca LTDA (May 2011) on behalf of Smiths Detection The acquired businesses are the Indian and Brazilian distributors for Smiths Detection, and this will continue to be their principal business activity The acquisitions give Smiths Detection direct control over sales of its products in two major fast-growing economies

The consideration for these acquisitions comprises

- cash of £12 0m,
- fixed deferred consideration of which £1 5m is outstanding at 31 July 2011 This is due to be paid over the next two years,
- contingent consideration based on the sales the acquired businesses achieve over the next five years This consideration is denominated in US dollars The fair value of $14 7m at acquisition has been calculated using probability weighted forecasts of potential future sales by target customers and market sectors The maximum potential contingent consideration payable is $23 0m, and
- non-equity shares in one of the new subsidiaries, which were valued at £3 5m on acquisition

From the date of acquisition to 31 July 2011, the acquisitions contributed £15 1m to revenue, £1 6m to headline profit before taxation and £0 1m to profit before taxation If Smiths had acquired the businesses at the beginning of the financial period, the acquisitions would have contributed £19 4m to revenue and £1 7m to headline profit before taxation

The intangible assets recognised comprise £4 1m in respect of customer relationships, orders and contractual non-compete arrangements with the vendors The assets recognised include the current value of the maintenance contracts acquired Goodwill represents the value of future growth opportunities in these markets The goodwill recognised is not expected to be deductible for tax purposes

The values set out below are provisional pending finalisation of the fair values attributable and working capital adjustments, and will be finalised in the year ending 31 July 2012

| | | | Acquisitions |
|---|---|---|---|
| | Book value £m | Fair value adjustments £m | Provisional fair value £m |
| Intangible assets | | 4 1 | **4.1** |
| Property, plant and equipment | 0 3 | | **0.3** |
| Current assets | 0 9 | | **0.9** |
| Non-current liabilities | | (1 4) | **(1 4)** |
| **Net assets acquired** | 1 2 | 2 7 | **3.9** |
| Goodwill on current year acquisitions | | | **22 4** |
| **Total consideration** | | | **26.3** |
| Cash paid during the period – current year acquisitions | | | **12.0** |
| Deferred consideration – current year acquisitions | | | **10.8** |
| Other financial instruments – current year acquisitions | | | **3.5** |
| **Total consideration** | | | **26.3** |

## 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

**2008 Value Sharing Plan (2008 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 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 fixed rate 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 performance conditions are measured over three-year and four-year periods commencing with the financial year 2008/09 For the Group scheme, the growth in internal value is tested against a hurdle rate of 9 5% a year

**2010 Value Sharing Plan (2010 VSP)**
The 2010 VSP is a long-term incentive plan approved by the shareholders at the Annual General Meeting on 16 November 2010 rewarding executives for value creation at Group and Divisional levels The awards have the same structure and calculation methods as the 2008 VSP The performance conditions are measured over a three-year period commencing with the financial year 2010/11, and the Group scheme hurdle rate is 8 5% a year

## 30 Employee share schemes continued

### Smiths Group Co-Investment Plan (CIP)

Under the CIP, as introduced in October 2005, the executive directors and senior executives are able, if invited, to use their after tax bonus or 25% of their basic salary after tax, whichever is the greater, to invest in the Company s shares at the prevailing market price At the end of a three year period, if the executive is still in office and provided the performance test is passed, matching shares will be awarded in respect of any invested shares retained for that period The number of matching shares to be awarded is determined by the Remuneration Committee at the end of the year in which the bonus is earned by reference to annual bonus, and other corporate financial criteria The maximum award will not exceed the value, before tax, of the bonus or salary invested in shares by the executive Vesting of matching shares will occur and the matching shares will be released at the end of the three year period if the Group s Return on Capital Employed ( ROCE ) over the Performance Period exceeds the Group s weighted average cost of capital ( WACC ) over the Performance Period by an average margin of at least 1% per annum

In July 2008 the CIP was amended From 2009 participants 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 | Long term incentive plans | Other share schemes | Total | Weighted average price for option plans £ |
|---|---|---|---|---|---|
| Ordinary shares under option ( 000) | | | | | |
| 1 August 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 |
| 31 July 2010 | 877 | 1,770 | 6,432 | 9,079 | £6 15 |
| Granted | 730 | 785 | 123 | 1,638 | £0 78 |
| Update of estimates | | 122 | | 122 | £0 00 |
| Exercised | (216) | (517) | (1,744) | (2,477) | £6 28 |
| Lapsed | (51) | (303) | (373) | (727) | £6 46 |
| **31 July 2011** | **1,340** | **1,857** | **4,438** | **7,635** | **£5.37** |

Options were exercised on an irregular basis during the period The average closing share price over the financial year was 1,240 24p (2010 1,000 61p) There has been no change to the effective option price of any of the outstanding options during the period

| Range of exercise prices | Total shares under option ( 000) | Weighted average remaining contractual life (months) | **Options exercisable at 31 July 2011 ( 000)** | Options exercisable at 31 July 2010 ( 000) | **Exercisable weighted average exercise price for options exercisable at 31 July 2011** |
|---|---|---|---|---|---|
| £0 00 – £2 00 | 3,197 | 18 | | | **£0.00** |
| £2 01 – £6 00 | 532 | 27 | **2** | 2 | **£5.69** |
| £6 01 – £10 00 | 2,786 | 40 | **2,106** | 1,667 | **£8.19** |
| £10 01 – £14 00 | 1,120 | 73 | **907** | 51 | **£10 97** |

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 2011 and 2010 are volatility of 30% (2010 30%) and dividend yield of 3 33% (2010 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 £12 40 (2010 £9 45) and VSP of £13 86 (2010 £11 21) The fair value disclosed for the CIP award treats the two matching shares as separate options

Included within staff costs is an expense arising from share-based payment transactions of £13 8m (2010 £11 3m), of which £13 8m (2010 £10 3m) relates to equity-settled share-based payment

At 31 July 2011 the creditor relating to cash-settled schemes is £0 6m (2010 £0 9m)

## 31 Events after the balance sheet date

On 2 September 2011 Smiths Interconnect agreed to purchase Power Holdings Inc a leading designer and manufacturer of specialist power distribution, conditioning and monitoring systems The purchase price of $235m will be subject to post closing adjustments with respect to working capital at completion The acquisition is subject to regulatory approval

On 17 August 2011 John Crane agreed to purchase the business and assets of Turbo Components and Engineering Inc ( TCE ) which services, repairs and builds replacement bearings and seals used in critical rotating equipment The purchase price of $20m will be subject to post closing adjustments TCE has gross assets of approximately $3 2m and expected sales of $10m for the current calendar year This acquisition is subject to regulatory approval

# Group financial record 2007-2011

| | **Year ended 31 July 2011 £m** | Year ended 31 July 2010 £m | Year ended 31 July 2009 £m | Year ended 31 July 2008 £m | Period ended 31 July 2007 £m |
|---|---|---|---|---|---|
| Revenue | **2,842.0** | 2,769 6 | 2,664 6 | 2,321 2 | 2,160 9 |
| **Headline operating profit** | **516.9** | 492 4 | 417 5 | 380 6 | 347 6 |
| Amortisation of acquired intangible assets | **(49.5)** | (42 1) | (34 6) | (19 2) | (14 8) |
| Exceptional items (including profit on sale/impairment of financial asset) | **(29.4)** | (14 4) | 45 6 | (35 4) | (74 2) |
| Financing losses | | | | (0 3) | (1 5) |
| **Operating profit** | **438 0** | 435 9 | 428 5 | 325 7 | 257 1 |
| Net finance costs | **(44.4)** | (64 6) | (58 1) | (5 4) | (0 6) |
| Share of post-tax profits/(losses) of associated companies | **4 3** | 1 8 | 0 4 | (1 0) | (0 5) |
| **Profit before taxation** | **397 9** | 373 1 | 370 8 | 319 3 | 256 0 |
| Taxation | **(91.8)** | (78 9) | (94 9) | (75 0) | (53 1) |
| **Profit after taxation – continuing operations** | **306 1** | 294 2 | 275 9 | 244 3 | 202 9 |
| **Profit after taxation – discontinued operations** | **79.0** | 16 4 | (5 9) | 24 5 | 1,525 2 |
| **Shareholders' equity** | **1,373 6** | 1,094 8 | 859 0 | 915 9 | 903 3 |
| Represented by | | | | | |
| – intangible assets | **1,610.2** | 1,638 6 | 1,500 3 | 1,253 2 | 1,021 3 |
| – property, plant & equipment and investments | **332.9** | 343 3 | 337 0 | 309 0 | 273 6 |
| – net current assets/provisions/retirement benefit liabilities | **159.5** | (50 3) | (93 4) | 124 3 | 198 3 |
| Net borrowings | **(729.0)** | (836 8) | (884 9) | (770 6) | (589 9) |
| **Funds employed** | **1,373 6** | 1,094 8 | 859 0 | 915 9 | 903 3 |
| **Ratios** | | | | | |
| Headline operating profit turnover (%) | **18 2** | 17 8 | 15 7 | 16 4 | 16 1 |
| Headline effective tax rate (%) | **25.0** | 24 0 | 24 0 | 24 0 | 25 1 |
| Return on capital employed (%) | **17.0** | 16 6 | 14 7 | 16 4 | |
| Return on shareholders funds (%) | **17.7** | 18 4 | 16 5 | 16 7 | 14 9 |
| **Cash-flow** | | | | | |
| Headline operating cash | **488.7** | 564 8 | 435 0 | 272 5 | 259 2 |
| Headline operating cash conversion (%) | **95** | 115 | 104 | | |
| Free cash-flow (before acquisitions and dividends, after capital expenditure) | **236.1** | 331 3 | 256 1 | 90 6 | 100 7 |
| Free cash-flow per share (p) | **60 4** | 84 9 | 65 9 | 23 4 | 18 3 |
| **Earnings per share** | | | | | |
| Headline earnings per share (p) | **92.7** | 84 6 | 72 4 | 74 5 | 47 0 |
| **Dividends** | | | | | |
| Pence per share | **36.25** | 34 00 | 34 00 | 34 00 | 34 00 |
| Headline dividend cover | **2.6** | 2 5 | 2 1 | 2 2 | 1 4 |
| **Number of employees (000s)** | | | | | |
| United Kingdom | **2.0** | 2 0 | 2 0 | 2 2 | 2 8 |
| Overseas | **20.9** | 21 6 | 19 8 | 20 6 | 18 6 |
| | **22.9** | 23 6 | 21 8 | 22 8 | 21 4 |

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.

# 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 2011 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 and express an opinion on 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 In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report

**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 2011,
- 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 2011

**Martin Hodgson (Senior Statutory Auditor)**
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London

27 September 2011

**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 2011 £m | 31 July 2010 (restated) £m |
|---|---|---|---|
| **Fixed assets** | | | |
| Tangible assets | 2 | **4.2** | 4 6 |
| Investments and advances | 3 | **3,037.9** | 3,735 2 |
| Available for sale financial assets | 4 | **29.5** | 25 2 |
| | | **3,071 6** | 3,765 0 |
| **Current assets** | | | |
| Debtors | | | |
| – amounts falling due within one year | 5 | **120.0** | 115 0 |
| – amounts falling due after more than one year | 5 | **31.8** | 27 5 |
| Cash at bank and on deposit | | **51.6** | 20 2 |
| Financial derivatives | | | |
| – amounts falling due within one year | | **1 1** | 9 1 |
| – amounts falling due after more than one year | | **6 4** | 10 7 |
| | | **210.9** | 182 5 |
| Creditors amounts falling due within one year | 6 | **(115 9)** | (113 4) |
| **Net current assets** | | **95.0** | 69 1 |
| **Total assets less current liabilities** | | **3,166.6** | 3,834 1 |
| Creditors amounts falling due after more than one year | 6 | **(967 3)** | (1,484 5) |
| Provisions for liabilities and charges | 7 | **(2.6)** | (4 3) |
| Financial derivatives | | **(1 5)** | (1 0) |
| **Net assets excluding pension liabilities** | | **2,195 2** | 2,344 3 |
| Retirement benefit liabilities | 8 | **(148.7)** | (164 3) |
| **Net assets including pension liabilities** | | **2,046.5** | 2,180 0 |
| **Capital and reserves** | | | |
| Called up share capital | 9 | **147.1** | 146 5 |
| Share premium account | 10 | **329.1** | 315 3 |
| Capital redemption reserve | 10 | **5.8** | 5 8 |
| Other reserves | 10 | **180.5** | 180 5 |
| Profit and loss account | 10 | **1,384.0** | 1,531 9 |
| **Shareholders' equity** | | **2,046.5** | 2,180 0 |

The accounts on pages 132 to 140 were approved by the Board of Directors on 27 September 2011 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

The 31 July 2010 balance sheet has been restated Certain amounts owed to dormant and semi-dormant subsidiaries, previously netted off investments and advances, have been disclosed as creditors due after more than one year This has no effect on profit and loss, cash-flows, net current assets, net assets or shareholders equity The change in presentation has no effect on the balance sheet at 31 July 2011 See note 3 for additional information

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 92 to 97 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

# Accounting policies
continued

**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 (2010 £0 1m)

## 2 Property, plant and equipment

| | Plant and machinery £m | Fixtures fittings tools and equipment £m | Total £m |
|---|---|---|---|
| **Cost or valuation** | | | |
| At 31 July 2010 | 7 1 | 0 5 | 7 6 |
| Additions | 1 0 | 0 1 | 1 1 |
| Disposals | (0 2) | | (0 2) |
| **At 31 July 2011** | **7.9** | **0.6** | **8.5** |
| **Depreciation** | | | |
| At 31 July 2010 | 2 6 | 0 4 | 3 0 |
| Charge for the period | 1 5 | | 1 5 |
| Disposals | (0 2) | | (0 2) |
| **At 31 July 2011** | **3.9** | **0.4** | **4.3** |
| **Net book value at 31 July 2011** | **4 0** | **0.2** | **4 2** |
| Net book value at 31 July 2010 | 4 5 | 0 1 | 4 6 |

## 3 Investments and advances

| | Shares at cost £m | Due from subsidiaries £m | Due to subsidiaries £m | Total £m |
|---|---|---|---|---|
| **Cost or valuation** | | | | |
| At 31 July 2010 (as previously reported) | 2,366 6 | 2,044 2 | (1,153 0) | 3,257 8 |
| Adjustment | | | 500 3 | 500 3 |
| At 31 July 2010 (as restated) | 2,366 6 | 2,044 2 | (652 7) | 3,758 1 |
| Exchange adjustments | | (7 1) | | (7 1) |
| Increases in advances due from/(due to) subsidiaries | | 848 6 | (1,474 6) | (626 0) |
| Contribution through share options | 9 0 | | | 9 0 |
| Reduction in advances (due from)/due to subsidiaries | | (792 9) | 719 7 | (73 2) |
| **At 31 July 2011** | **2,375.6** | **2,092.8** | **(1,407.6)** | **3,060.8** |
| **Provision for impairment** | | | | |
| **At 31 July 2010 and 31 July 2011** | **22.0** | **0.9** | | **22 9** |
| **Net book value at 31 July 2011** | **2,353.6** | **2,091 9** | **(1,407.6)** | **3,037.9** |
| Net book value at 31 July 2010 (restated) | 2,344 6 | 2,043 3 | (652 7) | 3,735 2 |

Advances due to dormant and semi-dormant subsidiaries, of £500 3m at 31 July 2010, which the directors believe would have been settled only when the reserves of the subsidiaries were distributed on liquidation, were previously netted off the Company's investments in the subsidiaries The directors consider that this presentation appropriately reflected the economic substance Following discussions with the Financial Reporting Review Panel, these advances have now been reported in creditors due after more than one year because the Company did not have a strict legally enforceable right of set off, as required by accounting standards Only advances due to subsidiaries where there is an unambiguous legal right of set off are now offset against advances due from subsidiaries As a result, the amounts of investments and advances and creditors falling due after more than one year have been restated Investments and advances at 31 July 2010 have increased by £500 3m, with a corresponding increase in creditors due after more than one year, and total assets less current liabilities have increased by £500 3m to £3,834 1m There is no impact on the profit and loss account, net current assets, net assets or shareholders equity in the current or previous financial year

The change in presentation has no impact on the 31 July 2011 balance sheet because the Group re-organised these inter-group advances during the year

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

# Notes to the Company accounts
continued

### 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)
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
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 2011 £m | 31 July 2010 £m |
|---|---|---|
| **Amounts falling due within one year** | | |
| Amounts owed by subsidiaries | **100.7** | 96 2 |
| Other debtors | **9.3** | 7 8 |
| Corporation tax | **5.9** | 10 2 |
| Prepayments and accrued income | **4.1** | 0 8 |
| | **120 0** | 115 0 |
| **Amounts falling after more than one year** | | |
| Deferred taxation | **31.8** | 27 5 |
| | **151 8** | 142 5 |

### 6 Creditors

| | 31 July 2011 £m | 31 July 2010 £m |
|---|---|---|
| **Amounts falling due within one year** | | |
| Amounts owed to subsidiaries | **83 8** | 76 0 |
| Other creditors | **22 4** | 27 2 |
| Other taxation and social security costs | **0.8** | 1 2 |
| Accruals and deferred income | **8.9** | 9 0 |
| | **115.9** | 113 4 |

**6 Creditors continued**

| | 31 July 2011 £m | 31 July 2010 (restated) £m |
|---|---|---|
| **Amounts falling due after more than one year** | | |
| Term loans | **967 3** | 984 2 |
| Amounts owed to subsidiaries | | 500 3 |
| | **967.3** | 1,484 5 |

**Term loans**

The currency and coupons for the term loans are disclosed in note 20 of the Group accounts

| | 31 July 2011 £m | 31 July 2010 £m |
|---|---|---|
| Between one and two years | **148.5** | |
| Between two and three years | **151 4** | 159 3 |
| Between three and four years | | 158 3 |
| Between four and five years | **149.3** | |
| Greater than five years | **518.1** | 666 6 |
| Smiths Group plc term loans | **967.3** | 984 2 |

**Amounts owed to subsidiaries**

These are long-term loans from dormant and semi-dormant subsidiaries lending up their non-distributable resources All these loans are sterling denominated Of these loans £nil (2010 £133 5m) are interest free On the balance interest is payable at 12 month GBP LIBID on £nil (2010 £357 2m) of the loans and 3 month GBP LIBID on the remaining £nil (2010 £9 6m)

**7 Provisions for liabilities and charges**

| | At 31 July 2010 £m | Provisions released £m | Utilisation £m | At 31 July 2011 £m |
|---|---|---|---|---|
| Disposals | 4 3 | | (1 7) | **2.6** |
| | 4 3 | | (1 7) | **2 6** |

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 2011

The principal assumptions used in updating the valuations are set out below

| | 31 July 2011 | 31 July 2010 |
|---|---|---|
| Rate of increase in salaries | **n/a** | n/a |
| Rate of increase for active deferred members | **4 4%** | 4 1% |
| Rate of increase in pensions in payment | **3.5%** | 3 2% |
| Rate of increase in deferred pensions | **3.5%** | 3 2% |
| Discount rate | **5 3%** | 5 4% |
| Inflation rate | **3.5%** | 3 2% |
| Healthcare cost increases | **5 0%** | 5 0% |

The assumptions used are estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily occur in practice

The mortality assumptions used in the principal UK schemes are based on the recent actual mortality experience of members within each scheme The assumptions are based on the 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

**8 Post-retirement benefits continued**

The assets in the scheme and the expected rates of return as at 31 July 2011 were

| | 31 July 2011 | | 31 July 2010 | |
|---|---|---|---|---|
| | Long-term rate of return | Value £m | Long term rate of return | Value £m |
| Equities | **7.9%** | **732.9** | 8 2% | 783 3 |
| Government bonds | **3.9%** | **16 7** | 4 2% | 22 2 |
| Corporate bonds | **5.3%** | **173 5** | 5 4% | 272 5 |
| Property | **7.5%** | **176 0** | 7 2% | 155 5 |
| Other | **4.1%** | **339.8** | 4 6% | 92 1 |
| Total market value | | **1,438 9** | | 1,325 6 |
| Present value of funded pension scheme liabilities | | **(1,538.9)** | | (1,444 6) |
| Deficit | | **(100 0)** | | (119 0) |
| Unfunded pension plans | | **(40.2)** | | (37 3) |
| Post-retirement healthcare | | **(8.5)** | | (8 0) |
| | | **(148.7)** | | (164 3) |
| Related deferred tax asset | | | | |
| **Net retirement benefit liability** | | **(148 7)** | | (164 3) |

The scheme assets do not include any of the Groups own financial instruments, nor any property occupied by, nor other assets used by, the Group The expected rates of return on individual categories of scheme assets are determined by reference to relevant industries The overall rate of return is calculated by weighting the individual rates in accordance with the anticipated balance in the scheme s investment portfolios

**History of experience gains and losses**

| | 31 July 2011 £m | 31 July 2010 £m | 31 July 2009 £m | 31 July 2008 £m | 31 July 2007 £m |
|---|---|---|---|---|---|
| Fair value of scheme assets | **1,438.9** | 1,325 6 | 1,188 9 | 1,311 0 | 1,527 5 |
| Present value of pension and post-retirement healthcare obligations | **(1,587.6)** | (1,489 9) | (1,382 6) | (1,383 0) | (1,492 8) |
| Net retirement benefit liability | **(148.7)** | (164 3) | (193 7) | (72 0) | 34 7 |
| Actual return less expected return on pension scheme assets | **45 6** | 84 2 | (180 9) | (183 9) | 52 6 |
| As a percentage of scheme assets | **3%** | 6% | (15%) | (14%) | 3% |
| Experience gains and losses arising on the scheme liabilities | **(15.5)** | 7 1 | 98 4 | (4 5) | (36 7) |
| As a percentage of present value scheme liabilities | **(1%)** | 0% | 7% | 0% | (2%) |

**Changes in present value of scheme assets and defined benefit obligations**

| | Assets 31 July 2011 £m | Assets 31 July 2010 £m | Obligations 31 July 2011 £m | Obligations 31 July 2010 £m |
|---|---|---|---|---|
| At beginning of the period | **1,325.6** | 1,188 9 | **(1,489.9)** | (1,382 6) |
| Current service cost | | | **(0.2)** | (1 7) |
| Past service cost | | | | (0 3) |
| Expected return on assets | **91.7** | 80 7 | | |
| Interest on obligations | | | **(78.8)** | (79 8) |
| Actuarial gain/(loss) | **45.6** | 84 2 | **(82.1)** | (90 5) |
| Contributions by employer | **39.4** | 36 8 | | |
| Benefits paid | **(63.4)** | (65 0) | **63.4** | 65 0 |
| **At end of the period** | **1,438.9** | 1,325 6 | **(1,587 6)** | (1,489 9) |

## 8 Post-retirement benefits continued

### 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 – held in an escrow account – with further ongoing monthly investments of £2m for nine years The first such instalment was paid in August 2011 The escrow account remains an asset of the Group 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

Contributions to the scheme are made on the advice of the scheme actuaries

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

| | One percentage point increase £m | One percentage point decrease £m |
|---|---|---|
| Effect on the aggregate of service cost and interest cost | | |
| Effect on defined benefit obligations | 0 1 | (0 1) |

## 9 Share capital

| | Number of shares | Issued capital £m | Consideration £m |
|---|---|---|---|
| **Ordinary shares of 37 5p each** | | | |
| At 31 July 2010 | 390,728,043 | 146 5 | |
| Exercise of share options | 1,622,360 | 0 6 | 14 4 |
| **Total share capital at 31 July 2011** | **392,350,403** | **147 1** | |

At 31 July 2011 all of the issued share capital was in free issue All issued shares are fully paid

| | 31 July 2011 | 31 July 2010 |
|---|---|---|
| Number of ordinary shares issuable under outstanding options | **3,927,550** | 5,785,689 |

| | Year issued | Number of shares | Subscription prices | Dates normally exercisable |
|---|---|---|---|---|
| Smiths Sharesave Scheme | 2004 | 26,204 | 525 00p | 2007/2011 |
| | 2005 | 17,003 | 704 00p | 2008/2012 |
| | 2006 | 60,697 | 798 00p | 2009/2013 |
| | 2007 | 39,548 | 868 00p | 2010/2014 |
| | 2008 | 134,718 | 724 00p | 2011/2015 |
| | 2009 | 505,906 | 569 00p | 2012/2016 |
| | 2010 | 109,709 | 894 00p | 2013/2017 |
| | 2011 | 121 649 | 1035 00p | 2014/2018 |
| Smiths Industries Executive Share Option Schemes | 2002 | 459,423 | 806 00p | 2005/2012 |
| | 2002 | 23,000 | 654 00p | 2005/2012 |
| | 2003 | 48,044 | 669 00p | 2006/2013 |
| | 2004 | 288,661 | 774 00p | 2007/2014 |
| | 2005 | 393,250 | 901 00p | 2008/2015 |
| | 2006 | 663,037 | 896 50p | 2009/2016 |
| | 2007 | 897,910 | 1,097 00p | 2010/2017 |
| | 2008 | 12,500 | 835 50p | 2011/2018 |
| | 2009 | 126,291 | 871 00p | 2012/2019 |

# Notes to the Company accounts
continued

## 10 Share premium account and reserves

| | Share premium £m | Capital redemption reserve £m | Other reserves £m | Profit and loss account £m |
|---|---|---|---|---|
| At 31 July 2010 | 315 3 | 5 8 | 180 5 | 1,531 9 |
| Exercise of share options | 13 8 | | | |
| Purchase of own shares | | | | (8 6) |
| Profit for the period | | | | 5 6 |
| Dividends paid to equity shareholders | | | | (136 1) |
| Actuarial loss on retirement benefits | | | | (36 5) |
| Taxation recognised on actuarial movements | | | | 9 9 |
| Fair value gains/(losses) on available for sale financial assets | | | | 4 0 |
| Share-based payment | | | | 13 8 |
| **At 31 July 2011** | **329.1** | **5.8** | **180 5** | **1,384.0** |

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 £8 6m (2010 £0 2m) and £nil (2010 £0 6m) was received as a result of the issue of shares At 31 July 2011 the Trust held 855 (2010 32,858) ordinary shares with a market value of £0 0m (2010 £0 4m)

The Company s profit and loss reserve of £1,384 0m includes £933 5m (2010 £895 7m) not available for distribution as dividend

During the year, the Company received £14 4m (2010 £9 1m) 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 31 July 2011 £m | Year ended 31 July 2010 £m |
|---|---|---|
| **Deferred taxation** | | |
| At beginning of period | **27 5** | 41 9 |
| Charge to profit and loss account | **(5.6)** | (14 4) |
| Credit to equity | **9.9** | |
| **At end of period** | **31.8** | 27 5 |
| Analysed as follows | | |
| Excess tax depreciation on fixed assets | **0.7** | 1 0 |
| Share-based payment | **2.8** | 2 8 |
| Losses carried forward | **27.8** | 23 1 |
| Short-term timing differences | **0 5** | 0 6 |
| | **31 8** | 27 5 |

## 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 £43 1m (2010 £40 6m)

The Company has guaranteed the US$800m revolving credit facility available to a subsidiary

## 13 Post balance sheet event

The directors propose a final dividend of 25 0p per share (totalling approximately £98 1m) for the year ended 31 July 2011 The dividend will be submitted for formal approval at the Annual General Meeting to be held on 22 November 2011

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 2012 During the year ended 31 July 2011, a final dividend of 23 5p per share (totalling £91 9m) was paid in respect of the dividend declared for the period ended 31 July 2010

# Financial calendar

| | 2011 |
|---|---|
| Preliminary announcement of results for 2010/11 | 28 September |
| Ordinary shares final dividend ex-dividend date | 26 October |
| Ordinary shares final dividend record date | 28 October |
| Annual General Meeting | 22 November |
| Ordinary shares final dividend payment date | 25 November |

| | 2012 |
|---|---|
| 2011/12 interim results announced | 14 March (provisional) |
| Ordinary shares interim dividend ex-dividend date | 21 March (provisional) |
| Ordinary shares interim dividend record date | 23 March (provisional) |
| Ordinary shares interim dividend payment date | 20 April (provisional) |
| Smiths Group financial year end | 31 July |
| Preliminary announcement of results for 2011/12 | 19 September (provisional) |
| Ordinary shares final dividend ex-dividend date | 24 October (provisional) |
| Ordinary shares final dividend record date | 26 October (provisional) |
| Annual General Meeting | 20 November (provisional) |
| Ordinary shares final dividend payment date | 23 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 2011 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 22 November 2011 at 2 30pm

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

T +44 (0)20 7808 5500
F +44 (0)20 7808 5544
www smiths com

Incorporated in England No 137013

**Registrars**
Equiniti Limited
Aspect House
Spencer Road
Lancing
West Sussex BN99 6DA, UK

T 0871 384 2943 (United Kingdom)
Calls to this number cost 8p per minute from a BT landline other providers costs may vary Lines open 8 30am to 5 30pm Monday to Friday

T +44 (0)121 415 7047
Textel 0870 384 2255
www shareview co uk
www equiniti com

**Auditor**
PricewaterhouseCoopers LLP

This report is printed on Claro Silk which has FSC certification The FSC (Forest Stewardship Council) is a worldwide label which identifies products obtained from sustainable and responsible forest management Claro also has PEFC accreditation The PEFC Council (Programme for the Endorsement of Forest Certification schemes) is an independent non-profit non-governmental organisation which promotes sustainably managed forests through independent third party certification

Designed and produced by Langsford 020 7378 1457 www langsford co uk

Printed by Moore, an FSC (Forest Stewardship Council) accredited printer using vegetable based inks

Location photography by Peter Tenzer and Charlie Fawell

Illustration by Ian Naylor

smiths

bringing technology to life

Smiths Group plc
Cardinal Place
80 Victoria Street
London SW1E 5JL, UK
T +44 (0)20 7808 5500
F +44 (0)20 7808 5544
www.smiths.com