

Bringing technology to life



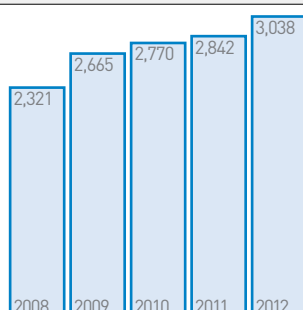
**Smiths Group is a global business listed on the London Stock Exchange. We develop advanced technologies that meet our customers' evolving needs.**

#### Headline revenue

£m

**£3,038m**  
**+7%**

(2011: £2,842m)



[Read more on page 19 and note 1](#)

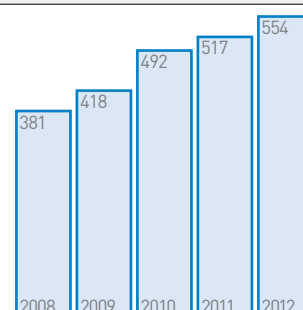


#### Headline operating profit

£m

**£554m**  
**+7%**

(2011: £517m)



[Read more on pages 19, 135 and note 1](#)

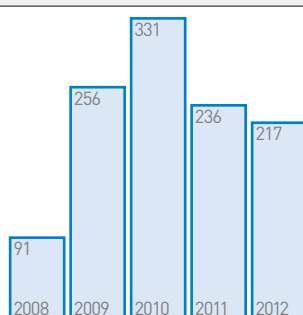


#### Free cash-flow

£m

**£217m**  
**-8%**

(2011: £236m)



[Read more on pages 50, 135 and note 27](#)

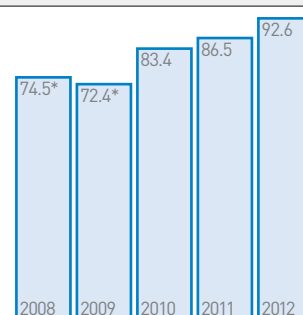


#### Headline earnings per share

Pence

**92.6p**  
**+7%**

(2011: 86.5p)



[Read more on pages 50, 135 and note 9](#)



[\\*Not restated to exclude financial charges and credits relating to retirement benefits. See note 3](#)



#### Continuing activities

	2012 £m	2011 £m
Headline revenue	<b>3,038</b>	2,842
Statutory revenue	<b>3,030</b>	2,842
Headline operating profit*	<b>554</b>	517
Statutory operating profit	<b>407</b>	438
Headline basic EPS*	<b>92.6p</b>	86.5p
Statutory basic EPS	<b>65.4p</b>	77.8p
Free cash-flow	<b>217</b>	236
Dividend	<b>38.00p</b>	36.25p
Return on capital employed	<b>16.5%</b>	16.4%

\*Headline revenue and profit is before exceptional items, amortisation and impairment of acquired intangible assets, profit/loss on disposal of businesses, costs of acquisitions, net pensions finance credit and financing gains/losses from currency hedging. Free cash-flow and return on capital employed are described in the Financial review. 2011 headline basic EPS and return on capital have been restated (see notes 1 and 3 to the accounts).

#### Operational highlights

- Headline revenue 7% higher; growth across all divisions
- Headline operating profit up 7% – as well as increased investment in growth drivers
- Company-funded investment in new product development up 9% to £107m
- Emerging market revenue up 14%; now representing 15% of Group revenue
- Performance improvement initiatives on track in Smiths Detection; improving order book
- Dividend up 5%

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

This report contains brands that are trademarks and are registered and/or otherwise protected in accordance with applicable law.



# Bringing technology to life

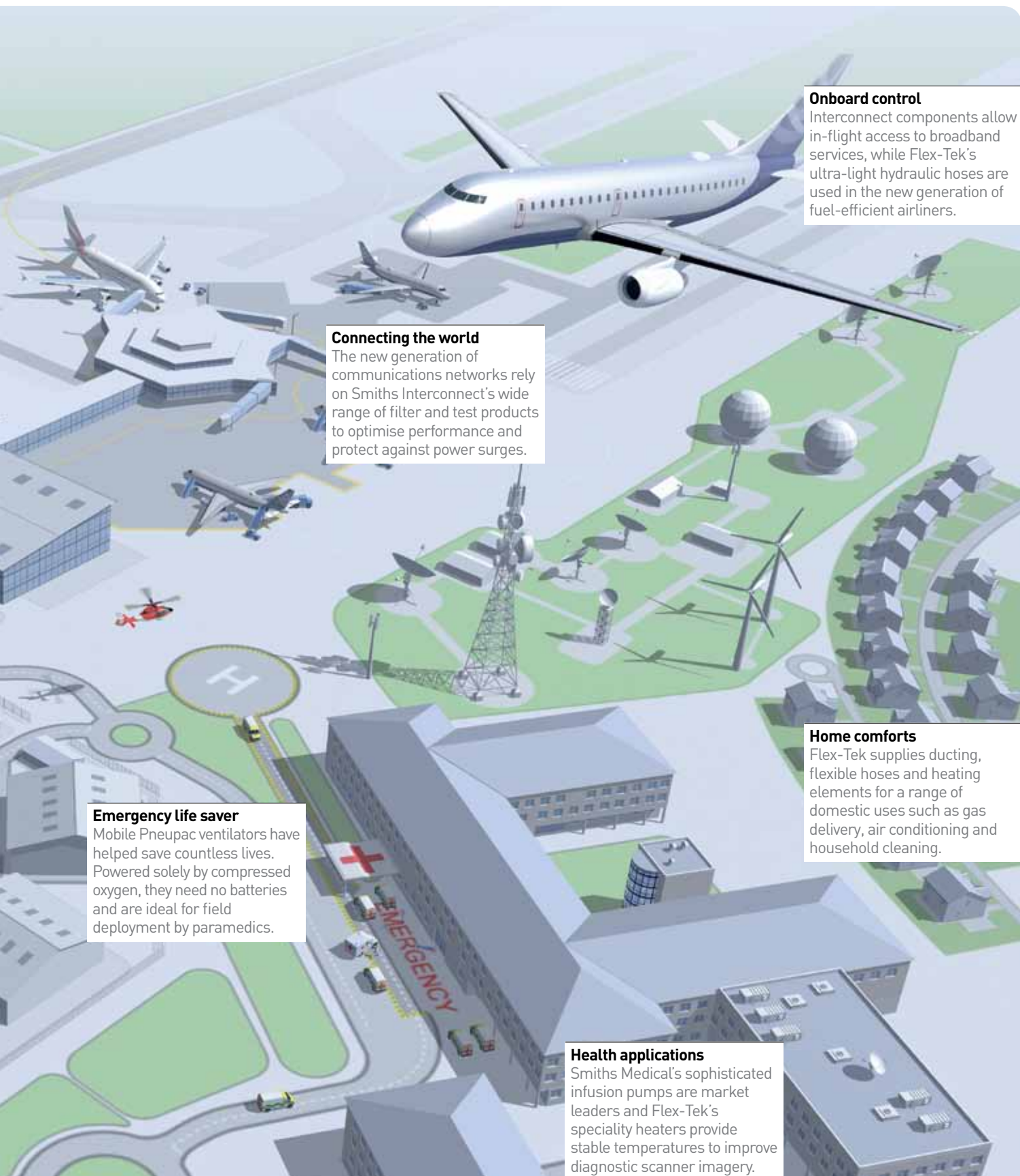
Smiths Group, through our five divisions, operates in more than 50 countries, serving a diverse array of customers ranging across the transport, military and petrochemical sectors to hospitals, telecommunications companies and equipment manufacturers. Our products and services touch the lives of millions of people every day and help make the world safer, healthier and more productive.

**Sealed and delivered**  
John Crane's market-leading seals are vital for the efficient and environmentally safe extraction and transportation of oil and gas across the world.

**Safer travel**  
Smiths Detection's advanced X-ray and trace detection scanners play a vital role in deterring weapons or explosives being smuggled aboard aircraft.

**Tested to extreme**  
High-performance seals used in some of the world's largest LNG plants are made by John Crane, designed specially to meet the demands of extreme pressure and temperatures.

**Ports and borders**  
90% of world trade is by sea and Smiths Detection's high-energy cargo scanners play a major role in deterring the illegal traffic of contraband and threat items at ports and borders.



**Onboard control**

Interconnect components allow in-flight access to broadband services, while Flex-Tek's ultra-light hydraulic hoses are used in the new generation of fuel-efficient airliners.

**Connecting the world**

The new generation of communications networks rely on Smiths Interconnect's wide range of filter and test products to optimise performance and protect against power surges.

**Emergency life saver**

Mobile Pneupac ventilators have helped save countless lives. Powered solely by compressed oxygen, they need no batteries and are ideal for field deployment by paramedics.

**Home comforts**

Flex-Tek supplies ducting, flexible hoses and heating elements for a range of domestic uses such as gas delivery, air conditioning and household cleaning.

**Health applications**

Smiths Medical's sophisticated infusion pumps are market leaders and Flex-Tek's speciality heaters provide stable temperatures to improve diagnostic scanner imagery.



# About Smiths Group

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.

## John Crane

2012 Revenue

£973m

Employees

7,000

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.

2012 Headline operating profit margin

21.6%

### 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



Read more on pages 20-25 or [www.johncrane.com](http://www.johncrane.com)



## Smiths Medical

2012 Headline revenue

£864m

Employees

7,750

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

2012 Headline operating profit margin

23.5%

### Strengths

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



Read more on pages 26-31 or [www.smiths-medical.com](http://www.smiths-medical.com)



## 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.**

**2012 Revenue**  
**£519m**

**2012 Headline operating profit margin**  
**13.3%**

**Employees**  
**2,300**

### 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



Read more on pages 32-37 or [www.smithsdetection.com](http://www.smithsdetection.com)

Group overview

Chairman and Chief Executive

## 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.**

**2012 Revenue**  
**£449m**

**2012 Headline operating profit margin**  
**14.7%**

**Employees**  
**4,100**

### 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, data centres, semiconductor test and aerospace



Read more on pages 38-43 or [www.smithsinterconnect.com](http://www.smithsinterconnect.com)

Business review

Risks and responsibility

## 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.**

**2012 Revenue**  
**£233m**

**2012 Headline operating profit margin**  
**16.3%**

**Employees**  
**2,000**

### 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



Read more on pages 44-49 or [www.flextekgroup.com](http://www.flextekgroup.com)

Governance

Accounts

# About Smiths Group

## Continued

The Group has operations in more than 50 countries, with a network of dealers and distributors in many more. Over half of our revenue comes from North America and we have an increasing exposure to higher-growth emerging markets.

### Divisional revenue

- 1 John Crane 32%
- 2 Smiths Medical 28%
- 3 Smiths Detection 17%
- 4 Smiths Interconnect 15%
- 5 Flex-Tek 8%



Read more in note 1 on page 102

### Divisional headline operating profit

- 1 John Crane 36%
- 2 Smiths Medical 35%
- 3 Smiths Detection 12%
- 4 Smiths Interconnect 11%
- 5 Flex-Tek 6%

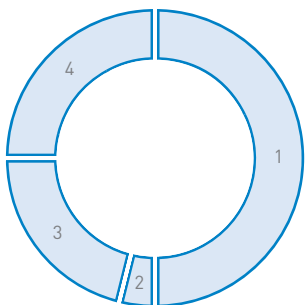


Percentage relates to headline operating profit before corporate costs

Read more in note 1 on page 102

### Group revenue by destination

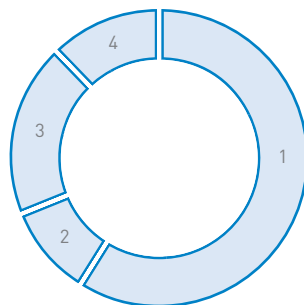
- 1 North America 50%
- 2 United Kingdom 4%
- 3 Europe other 21%
- 4 Rest of World 25%



Read more in note 1 on page 105

### Location of assets

- 1 North America 59%
- 2 United Kingdom 10%
- 3 Europe other 19%
- 4 Rest of World 12%



Analysis excludes cash and cash equivalents

### Group manufacturing and service locations

US Employees

8,600

Countries with direct operations

>50

Emerging markets revenue up

14%



# 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	<b>Strong market positions in sectors with long-term profitable growth</b>	<p>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:</p> <ul style="list-style-type: none"> <li>– global demand for energy</li> <li>– healthcare needs of ageing populations</li> <li>– threat of terrorism</li> <li>– expansion of wireless communications</li> <li>– aerospace demand</li> <li>– US residential construction.</li> </ul>
2	<b>Leading-edge technologies and service levels that command high margins</b>	<p>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.</p> <p>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.</p>
3	<b>Further scope for operational improvement and margin enhancement</b>	<p>Operational efficiencies will drive our margins higher. Our restructuring programme has already delivered significant value, with more to come in the next two years.</p> <p>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.</p>
4	<b>Opportunity to realise value through more active portfolio management</b>	<p>We also assess portfolio management opportunities where we see the potential to create a more focused portfolio through a targeted programme of acquisitions and disposals.</p> <p>We invest in business acquisitions to increase our exposure to attractive and adjacent growing sectors as well as to expand our current businesses.</p>
5	<b>High returns on capital employed</b>	<p>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.</p> <p>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.</p>
6	<b>Strong cash generation to reinvest in top-line growth and increase dividends</b>	<p>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.</p> <p>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.</p>

## Our strategy and indicators

We have a five-part strategy for creating long-term value for our shareholders and we measure our performance against this strategy through several key performance indicators.

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## Strategy

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### 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.

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### 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.

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### 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.

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### 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.

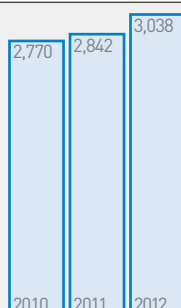
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### Promoting corporate responsibility

We promote a culture of responsibility throughout Smiths Group. This requires us all to work according to our Code of Ethics. The Group 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.

**Headline revenue £m**

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



Headline revenue grew 7% this year reflecting organic growth and the benefit of recent acquisitions.

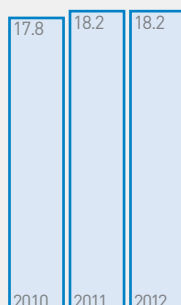
**Continued investment**

We aim to accelerate our top-line growth through continued investment in new product development and sales and marketing in high-growth markets.

Read more on pages 16-19 and in note 1 on page 102

**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 was maintained while we targeted significantly higher investment in sales, marketing and new product development.

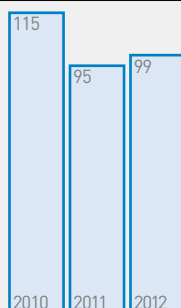
**Sustained improvement**

To deliver continuous improvements in margins.

Read more on pages 16-19, in note 1 on page 102 and page 135

**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 at the upper end of our guidance of 90% – 100% cash conversion. Conversion in 2010 benefited from reduced working capital arising from certain one-off initiatives.

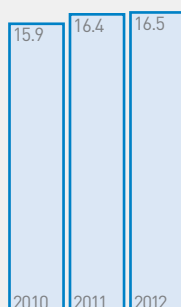
**Financial strength**

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

Read more on pages 16-19, in note 27 on page 132 and page 135

**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, litigation provisions relating to exceptional items and net debt. Return on capital for 2010 and 2011 has been restated.



Return on capital improved 10 basis points reflecting the improved profitability across most divisions more than offsetting the impact of lower profitability in Interconnect.

**Value creation**

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

Read more on pages 16-19, in note 1 on page 102-103 and page 135

**A range of indicators for safety and environmental impact****Recordable incident rate per 100 employees**

FY2013 target is to be below 0.5 per 100 employees

**0.60**  
FY2012 result

**Greenhouse gas emissions**

10% reduction FY2010 to FY2015

**Reduced by 19%**  
FY2012 v FY2010

**Total non-recycled waste**

10% reduction FY2010 to FY2015

**Reduced by 18%**  
FY2012 v FY2010

**Water consumption**

5% reduction FY2010 to FY2015

**Reduced by 19%**  
FY2012 v FY2010

**Achieve targets**

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

Read more on pages 60-62 and [www.smiths.com/responsibility](http://www.smiths.com/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 five divisions manage their businesses to meet customers' needs and create value for the Group.

## The Group's role

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.

## The divisional business model

Our 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.

Our decentralised structure ensures our businesses are close to their target markets and customers and encourages a culture of entrepreneurship. Our divisions are responsible for actively managing their risks, ensuring that a strong culture of ethics and compliance is embedded across their businesses, and developing and retaining their people, with regular reporting back to the Group centre.

# The Group's role

## Strategy

Sets Group strategy and ensures divisional strategies are aligned with Group strategy.

## Budgeting and planning

Agrees annual Group and divisional budgets.

## Governance

Provides an effective governance framework and ensures good governance is embedded across the business.

## Risk management

Sets risk appetite, ensures a strong risk management framework is in place and provides effective oversight.

## Performance monitoring

Reviews and regularly challenges divisional performance.

## Systems

Makes sure the right business systems and processes are in place so that decisions are made efficiently based on high-quality data.

## Ethics and compliance

Approves policies and provides oversight to ensure a strong culture of ethical behaviour and compliance.

## EHS, talent and retention

Sets the Group's environment, health and safety, and people development policies and monitors compliance and performance.

## Capital allocation

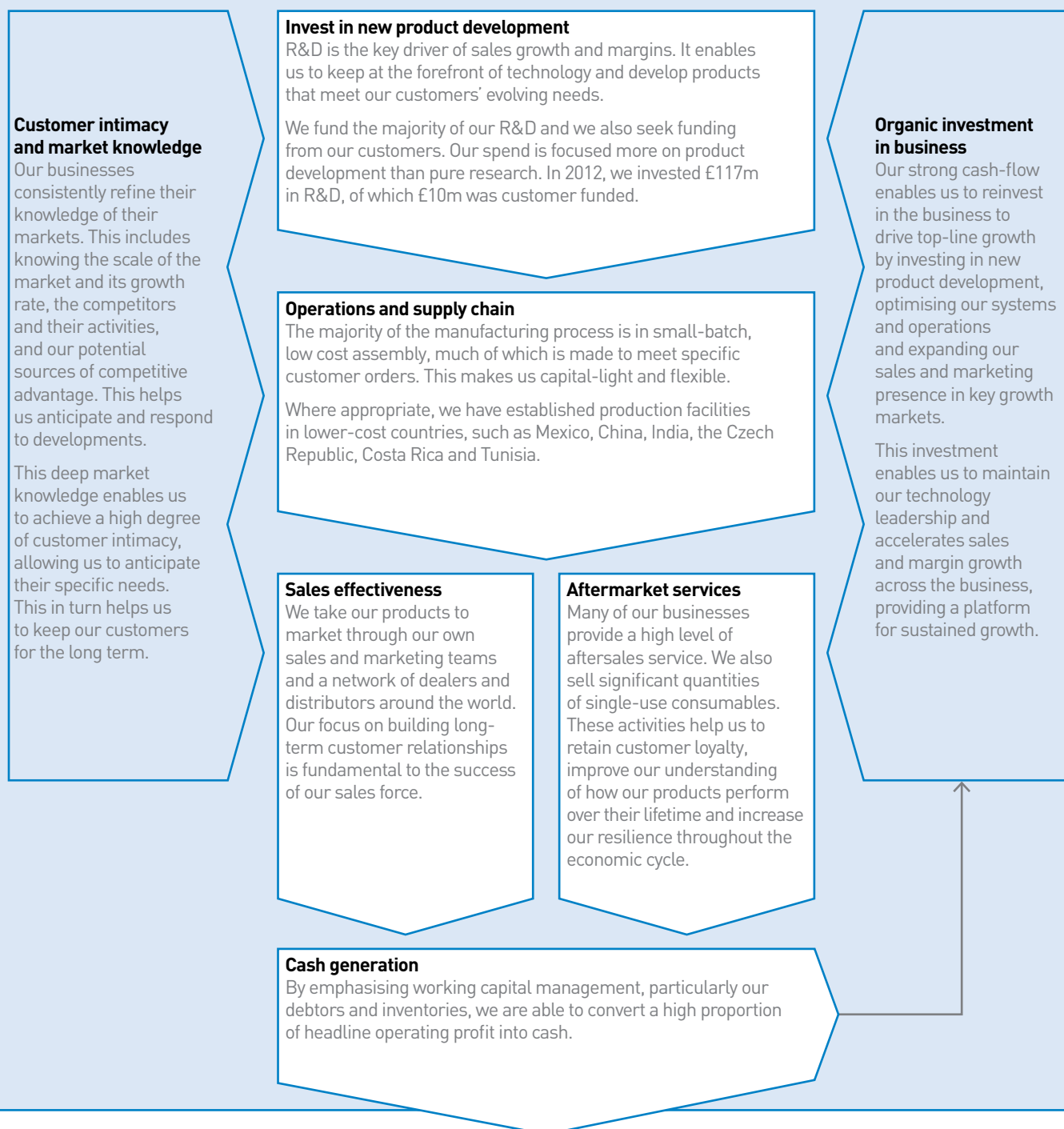
Allocates capital across the Group through investing in organic growth and acquisitions, managing our legacy liabilities and returning cash to shareholders.

## Financing and capital structure

Optimises the Group's capital structure and secures long-term financing. Seeks to maintain a strong investment-grade credit rating.



## The divisional business model



### Shareholder returns

Our focus on cash generation enables us to reinvest in the business to drive growth and to generate attractive shareholder returns, through both dividend payments and capital returns.

### Manage our legacy liabilities

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. These are managed at either Group or divisional level, as appropriate.

### Acquisitions and disposals

We buy businesses that add complementary technologies and products, expand our geographical footprint, particularly in emerging markets, or allow us to leverage our existing scale and infrastructure. We are also active in disposing of businesses that offer less attractive returns.

# Our business model in action

Smiths Medical –  
Bringing technology to life  
with Medfusion 4000



## Investing in new product development based on deep market knowledge

Medication delivery mistakes can happen due to a misread prescription, a wrong drug choice, or a mis-programmed infusion pump. Such errors can affect thousands of patients. This is why Medfusion smart pumps were developed as the first syringe pump to have medication safety software. Understanding our hospital customers' need to track pump performance and document improved safety led to the development of the Medfusion 4000 and PharmGuard software. Wireless connectivity allows every pump to be linked to the hospital's IT system, providing accurate infusions while transmitting all data to a dedicated server. For the first time, clinicians have a comprehensive record of all pumps, allowing them to spot trends or issues quickly, upgrade software, and take immediate action to improve clinical performance.

**Mark Vaughan** Director Global Product Management, Medication Delivery



## Building a strong supply chain and efficient operations

Wireless connectivity meant Smiths Medical had to source the appropriate radio and associated software as well as build in the communications security. Finding it was safer to separate the communications and clinical aspects, we created a new base for the Medfusion 4000 that houses extended memory, the wireless radio and associated software. In both our manufacturing and service designs, we created the key pieces in components that could, if necessary, easily be replaced in the future. Finally, we developed core competencies in Microsoft SQL server development, which required more servers and wireless access points in our manufacturing site to develop, test and manage this new product.

**Curt Akenson** Director of Operations, St. Paul, MN



## Selling Medfusion 4000 effectively

The Medfusion 3500 syringe pump is used in eight out of 10 neonatal intensive care units in the United States. Almost all of *US News and World Report's* top 10 children's hospitals use Medfusion syringe pumps. We have been able to leverage our large installed base of pumps with customers whose fleet is ageing and who want the new features that the Medfusion 4000 provides. We work closely with our customers to establish a checklist that prequalifies hospitals based on their wireless capability, approved budgets, age of current fleet, and interest. This approach ensured that our first-year launch plans were targeted to customers with the highest probability of purchase, allowing us to close prestigious and important reference accounts.

**Regina McIntosh** Vice President, Regional Marketing



## Providing aftermarket services

This launch has transformed what was a biomedical repair service into a new comprehensive world of Technical Service and Support involving the installation and maintenance of server software. We have a new customer among our hospital accounts – the IT department – that requires the kind of support we have not traditionally provided for our customers. SureLink, a remote diagnostic software installed on every PharmGuard server, is a key example. We can remotely monitor and manage server performance and proactively alert customers to maintenance issues that need to be addressed. The capacity to provide active support remotely to our customers saves Smiths Medical time and money.

**Paul Cabana** Vice President, Global Technical Service & Support



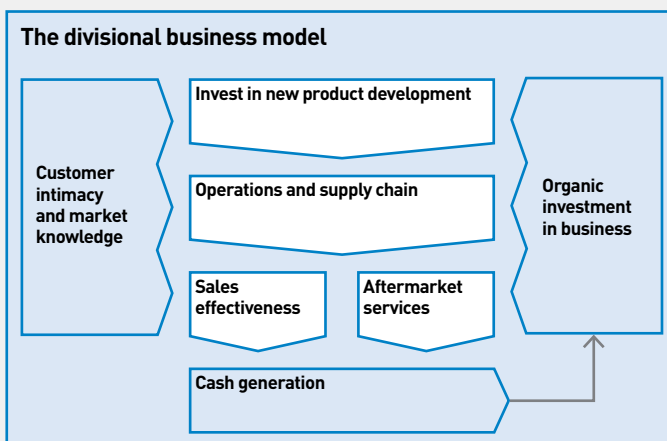
## Meeting customer needs

Compact, intuitive and easy to use, CHEO (Children's Hospital of Eastern Ontario) staff are happy with the Medfusion 4000. We appreciate the safety features and the various updates we've performed to optimise functionality. A key feature is the wireless capability. Having flexibility to review pump data at any time has improved our interpretation and response to changing practice needs. Although it is a lot of work to implement new technology, we can't imagine implementing a smart pump without wireless communication.

**Mary MacNeil** Director of Nursing Clinical Practice

**Kim Greenwood** Director of Clinical Engineering

**Dr Regis Vaillancourt** Director of Pharmacy



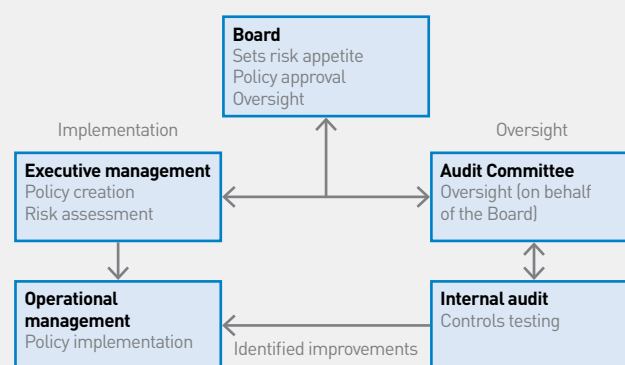
## Securing future returns

Smiths Group 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.



### The risks to our strategy

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

Risk	Strategy				
	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	■	■	■	■	
Eurozone break-up	■	■	■	■	
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.

[Read more on pages 54 to 58](#)



## Chairman's statement

Despite another year of challenging economic conditions, Smiths Group again delivered a generally strong performance by exploiting the benefits of its broad portfolio of businesses serving diverse markets, sectors and geographies.



**Donald Brydon**  
Chairman

Revenue grew across all divisions while margins improved in all but Smiths Interconnect. Our successful self-help programmes are delivering leaner business structures, enhanced global procurement, and improved information systems that have helped offset the impact of squeezed government budgets and weak or zero growth across much of the world.

The seemingly interminable Eurozone crisis and the continuing fallout from the 2008 financial collapse have continued to sap business confidence worldwide, serving only to underline the importance of maintaining our focus on greater operational efficiencies and accelerated revenue growth. Our efforts to manage and improve those business areas within our control continue to make impressive headway.

The Company continues to battle headwinds from legacy issues: quantitative easing is putting pressure on cash-flow in relation to pension funds and the unpredictable nature of the US legal system is making product liability management a priority. Nonetheless cash generation has remained very strong.

### Investing in new products

Investment in research and development, the lifeblood of a technology company like Smiths Group, now totals some £117m a year. This supports our strategy of channelling funds towards the high-margin products that will drive future sales.

The year has seen the launch of a number of exciting new products. These included a revolutionary checked baggage scanner which combines X-ray technology with CT (Computed Tomography). Smiths Detection's XCT scanner has now been certified by the EU and is due for US certification later this year. Smiths Medical has introduced a more sophisticated, but user-friendly, version of its safety catheter. The ViaValve protects not only against needlestick injuries but also blood contamination, a telling advantage as countries tighten their health safety regulations. In the fast-moving world of communications networks, Smiths Interconnect's new Kaelus filter allows greater two-way broadband traffic by minimising the breadth of the electronic 'median' needed to prevent interference between outgoing and incoming data.

Such breakthroughs highlight our strongly market-orientated R&D culture, focused firmly on products that generate the best returns and hold the most promise for long-term revenue. Consequently, Smiths Group is well placed to capitalise on the sales growth opportunities that will surely emerge when the global economy finally recovers on a sustainable basis.



### Headline revenue

Up to £3,038m

+7%

Read more on page 19  
and in note 1 on page 102



### Headline operating profit

Up to £554m

+7%

Read more on pages 19 and 50  
and in note 1 on page 102 and  
note 3 on page 106



### Statutory revenue

Up to £3,030m

+7%

Read more on page 19 and  
in note 1 on pages 104-105



### Statutory operating profit

Down to £407m

-7%

Read more on page 19 and  
in note 1 on page 102 and  
note 4 on page 107



### Expanding in emerging markets and through acquisitions

As western economies stagnate, the drive to expand our geographic footprint in the emerging, fast-growing markets of Asia and Latin America continues apace.

Smiths Medical has boosted sales and marketing in selected emerging markets with 250 additional staff and Smiths Detection has opened its first X-ray production facility in Malaysia to meet the rapidly increasing demand from the Asian aviation market. These moves help maintain a momentum already underpinned by the bolt-on purchases of a number of companies with significant presence in emerging markets and the integration of Smiths Detection's distributors in India and Brazil. The Board visited Brazil in May to learn first-hand about the market opportunities for John Crane, Smiths Medical and Smiths Detection.

Adding complementary technologies is another of our core strategic criteria, exemplified by Smiths Interconnect's \$235m purchase of Power Holdings Inc. (PDI), a leading designer and manufacturer of specialist power distribution systems.

The recent disposal of our stake in Cross Match Technologies for \$70m underlined our strategy of managing our portfolio more actively through acquisitions that meet our strategic objectives, as with PDI, and disposals that realise additional value for our shareholders.

### Changes to the Board

On behalf of the Board, I would like to thank Stuart Chambers for his valuable contribution over the past six years, particularly as Chair of the Remuneration Committee. Anne Quinn, a non-executive director since July 2009, will assume what is an ever more demanding role in the current corporate environment.

I also welcome Tanya Fratto to the Board. A qualified electrical engineer, Tanya brings a wealth of skills and international experience, particularly of operating in the US and in taking a range of new products to market. She will also serve on the Audit, Nomination and Remuneration Committees. With solid backgrounds in energy, defence, healthcare, international manufacturing and finance, your Board of Directors possesses an impressive bank of expertise as befits a global and inclusive company like Smiths Group.

The appointment of Tanya has the added bonus of lifting the representation of women on the Board to 25%, a central aspiration of the recent Davies Report.

We have included for the first time in this annual report statements from the Chairs of the key Board committees setting out their key activities during the year.

### Managing talent and promoting responsibility

Below Board level, recruitment and development of our people is equally imperative to the long-term future of the Group. We have two major new programmes designed to accelerate our employee development: a global 'Horizons' programme for emerging talent at junior levels and a senior Leadership Development programme, 'Aspire2', which will be operational this year. These are another sign of our determination to continue raising the performance bar at all levels.

The steady improvement in our business operations over the past four years has been matched by our safety record, driven by a continued focus on promoting a culture of responsibility. Lost time and recordable incident rates declined again and the trend is the same in the key environmental metrics of energy, greenhouse gas emissions, waste generation and water consumption. Detailed information on health, safety, environment and business ethics are contained in our corporate responsibility report.

Much as I would like to close my statement on an optimistic note, realism must prevail. The outlook for the global economy remains gloomy with few convincing signs of a sustained recovery.

Nonetheless, much has again been achieved in a difficult year and great credit goes to Philip Bowman and our employees. On behalf of the Board, I would like to thank our colleagues for their efforts in producing results that so clearly demonstrate their commitment to the long-term growth and prosperity of Smiths Group.

## Chief Executive's statement

This was another year of good progress with organic revenue growth. Cash generation and returns on capital have also strengthened. These results have been achieved in a challenging economic environment through a consistent focus on operational improvement.



**Philip Bowman**  
Chief Executive

Against a persistently tough macroeconomic backdrop, Smiths Group has performed well. The results reflect the benefit of the operational and margin improvement programmes implemented over the past four years. The focus on improved data-based decision making, performance enhancement and consistency of approach has delivered a significant and sustainable improvement in the underlying profitability, returns and quality of the Group's businesses. We have also continued to benefit from the strength and breadth of being a diversified industrial company, with our portfolio of leading-edge, technology-driven businesses serving a broad range of geographies and markets.

We achieved improvements on safety and environmental metrics and on sales, cash and returns. Our drive to accelerate revenue growth has begun to deliver results with revenue growing across all five divisions. Headline operating profit margins improved in all but Smiths Interconnect, as a result of volume leverage, better pricing and our continued focus on operational improvement and restructuring. Cash conversion remained strong and we delivered further improvements in return on capital employed.

John Crane grew revenue strongly on continued demand from its end markets, particularly the oil and gas sector; although the rate of growth eased during the second half. Margins progressed to record highs as a result of the higher volumes and better pricing, more than offsetting cost inflation and investment in specific OEM opportunities. Smiths Medical delivered an acceleration in revenue growth during the year with a strong contribution from new products such as Medfusion 4000 and CADD-Solis. Margins advanced slightly, while we substantially increased investment in future growth drivers, such as new product development and sales and marketing. This result has been achieved despite a tough operating environment, particularly in the mature markets of the US and Europe, where budget pressures and pricing have been difficult. Smiths Detection performed strongly in the second half in both sales and profit, driven by equipment sales to airports and critical infrastructure which more than offset declines in military and emergency responder revenue. The performance improvement programme, announced last year, also generated cost savings and operational enhancements. Smiths Interconnect also saw a better second half resulting in overall revenue growth despite declines in its military sales as a result of lower defence spending. However, margins suffered with adverse pricing/mix and the dilutive impact of the acquisition of Power Holdings Inc. (PDI). Flex-Tek grew revenue across the aerospace and construction markets, supporting higher margins as a result of its strong operational gearing.

### Headline earnings per share

Up 7%

92.6p

Read more on page 50 and  
in note 9 on page 111



### Dividend per share

Up 5%

38.0p

Read more on page 18 and  
in note 8 on page 111



### Statutory earnings per share

Down 16%

65.4p

Read more on page 50 and  
in note 9 on page 111



### Free cash-flow

From strong cash conversion

£217m

Read more on page 50 and  
in note 27 on page 132



### Employees around the world

In over 50 countries

23,200

Read more on page 63 and  
in note 11 on page 116



### Investing to accelerate revenue growth – new products

We have maintained technology leadership in many areas through a firm commitment to new product development and innovation, a key driver of future revenue and margin growth as new products typically command higher margins. We raised company-funded investment in R&D by 9% to £107m and secured a further £10m of customer-funded investment to take our total spend to £117m, or 3.8% of revenue (2011: 3.9%). This long-term investment is delivering results with several important new product launches. Smiths Medical saw an uplift in revenue driven by Medfusion 4000 in the US and the release of CADD-Solis PIB and VIP platforms outside the US. Smiths Detection unveiled several new products including a lightweight mobile X-ray system for cargo screening; GUARDION, a gas chromatography and mass spectrometry chemical identifier; and HazMatID Elite, an improved infra-red identifier for unknown chemical threats. Detection has also launched a new checked baggage screener, which received EU certification in September. It uses multi-view X-ray and three-dimensional computed tomography to achieve enhanced detection and throughput capabilities. 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.

### Investing to accelerate revenue growth – high-growth markets

We expanded our presence in emerging markets with an impressive 14% increase in revenue, so that they now represent around 15% of the Group. Investment in these high growth markets remains a priority. In Smiths Medical, we expanded our sales force by 250 in targeted markets such as China, India and Brazil. At the same time, we have a programme to register a greater proportion of our products in these markets. In John Crane, we opened a new state-of-the-art test and diagnostic facility for all seals at a key service centre in Dubai to serve the Middle East. This is additional to new and expanded facilities in Asia and Latin America, as well as an expanded product offering in China. Smiths Detection has opened a new X-ray manufacturing hub in Malaysia to serve the Asian market.

### Driving savings to enhance margins and invest in growth

Margins have continued to benefit from the major restructuring programme that began in 2008, delivering further savings of £14m in the period. This programme is now largely complete with annualised savings of £70m, against our total planned savings of £70m. The costs to achieve the programme were £55m.

Last year, we also launched a performance improvement programme in Smiths Detection which is scheduled to deliver annualised savings of £40m by the end of financial year 2014, at a cost of £40m. In its first year, the programme delivered savings of £15m with £11m expected in the coming financial year. This will lower the fixed cost base and enable the business to respond better to variations in demand while improving customer service.

### Improving capabilities through cross-divisional working

We intend to improve performance and capabilities in all five businesses through cross-divisional working groups who share best practice and a consistent approach to processes and reporting in areas of common interest. To date, groups focusing on quality and innovation have been established. One has developed a consistent approach to measuring the cost of 'unquality' and is identifying further opportunities to improve quality, thereby reducing costs. The other has adopted a common gate-driven approach for managing innovation projects. We will continue to evaluate what other areas of Smiths Group could benefit from such an approach.

### Enhancing talent throughout the organisation

We have progressively raised the bar in terms of fostering talent in order to drive our strategic initiatives forward. There are now more rigorous and consistent processes to assess talent and we are investing more in preparing and monitoring personal development plans. A new senior leadership programme has also been introduced to complement the existing scheme for junior managers. While this focus has helped strengthen the team, we will continue to challenge ourselves as to whether we have the appropriate skill sets across the organisation.

# Chief Executive's statement

Continued

## Strong cash generation

We achieved another strong year of cash generation. Headline operating cash generation improved by £60m to £549m resulting in headline operating cash conversion of 99% (2011: 95%). This was more than offset by the net impact of acquisitions and disposals, pension contributions and dividends, increasing net debt by £62m to £791m. The Group benefits from high cash conversion and a sound balance sheet.

## Allocating capital to maximise returns

Improving returns on capital by enhancing margins while operating an efficient capital base remains a key priority. Overall Group return on capital rose by 10 basis points to 16.5%. We achieved improved returns across all divisions except Smiths Interconnect where they declined as a result of lower profitability in its underlying business and the impact of the PDI acquisition.

Subject to suitable market conditions, we continue to manage the portfolio of businesses through a combination of acquisitions that satisfy our strategic and financial objectives and disposals that realise additional value for our shareholders. This is undertaken in the context of continuing to manage the legacy issues of the actuarial deficits on the defined benefit pension plans and ongoing historic product liability litigation.

During the year, the Group made two acquisitions and one significant disposal. Smiths Interconnect acquired Power Holdings Inc., a leading designer and manufacturer of specialist power distribution, conditioning and monitoring systems, for \$235m. The acquisition exemplifies the Group strategy to invest in complementary technologies and gain access to attractive markets. In October, John Crane acquired the business of Turbo Components and Engineering Inc. which services, repairs and builds replacement bearings and seals used in critical rotating equipment. It establishes a template for bearings aftermarket servicing that will accelerate the roll-out of John Crane's aftermarket offering through its global network. In July, Smiths Detection sold its interest in Cross Match Technologies Inc., a biometrics business that was considered non-core, raising £45m in cash.

## Managing our legacy liabilities

The Group manages two areas of material historic liabilities: actuarial deficits on our defined benefit pension plans and ongoing product liability litigation.

The net funding position for the pension schemes has deteriorated in recent years as a result of increased liabilities caused by low bond yields (exacerbated by quantitative easing) and increased longevity, and the weaker asset performance of equities relative to gilts. The funding position has worsened over the past five years despite the

actions the Group has taken to minimise liabilities, resulting in curtailment gains of around £75m, and cash contributions amounting to £378m over this period. The triennial reviews for the two main UK schemes with valuation dates of March and April 2012 are underway and are scheduled to complete this coming financial year.

For more than 30 years, John Crane, Inc. ('JCI'), a US subsidiary of John Crane, has defended product liability litigation relating to various sealing products containing asbestos that JCI ceased making in 1985. We disclose in our accounts details of recent claims experience and of the provisions established for these liabilities. During the period, the number of claims in which JCI is a defendant continued to fall.

Over recent years, Titeflex Corporation, a subsidiary of Flex-Tek, has also experienced subrogated product liability claims relating to alleged defects in its flexible gas piping products. The number of claims received each year and the cost of resolving them has varied but more recently has cost between £3m and £5m a year. A provision was recognised in the interim accounts to defend potential future claims over the next 10 years. Further details are given in notes 4 and 22 to the accounts.

## Dividend

The Board has adopted a progressive dividend policy for future payouts while maintaining a dividend cover of around 2.5 times. 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 26.25p per share giving a total for the year of 38.0p, an increase of 5%. The final dividend will be paid on 23 November to shareholders registered at the close of business on 26 October. The ex-dividend date is 24 October.

## Outlook

The economic environment remains uncertain. Pressures on government spending are expected to continue, particularly given the risk of budget sequestration in the US and widespread concerns over national debt levels in parts of Europe. These are likely to restrain those parts of our business with government-funded customers.

However, our investment initiatives are building a solid foundation to accelerate medium-term revenue growth. We will continue to deliver operational improvements and efficiencies, while balancing increased investment in the drivers of long-term profitable growth with opportunities to enhance margins and returns. Subject to economic conditions, I am confident we can continue to grow sales, deliver operational improvements, achieve strong cash conversion and improve returns. Outlook statements for the divisions are provided in the Business review.



## Business review: Group

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

### Company-funded R&D

Increased by 9% to

**£107m**

Read more on page 50



### Net debt

Up £62m to

**£791m**

Read more on page 52, in cash-flow statement on page 95 and in note 19 on pages 121-122



### Annual dividend

Up 5%

**38.0p**

Read more on page 18 and in note 8 on page 111



## Revenue

Headline revenue increased by 7%, or £196m, to £3,038m. The net impact of acquisitions and disposals contributed £52m and currency translation added a further £6m. On an underlying basis, excluding currency translation and acquisitions, revenue grew £138m. This increase was achieved by underlying revenue growth across all five divisions: John Crane (up £79m), Smiths Medical (up £20m), Detection (up £16m), Smiths Interconnect (up £13m) and Flex-Tek (up £10m). Reported revenue at £3,030m includes a one-off adjustment of £8m in respect of a change in the basis of estimating customer rebates at Smiths Medical (see note 4 to the accounts for further details). This change, which was reported at the half year, has been prompted by the availability of better data and estimation techniques.

## Profit

Headline operating profit rose £37m to £554m. Headline operating margin was maintained at 18.2% (2011: 18.2%). The growth comprises a £34m, or 7%, underlying increase in headline operating profit, a £2m benefit from the net impact of acquisitions and £1m from favourable currency translation. The main drivers of this £34m underlying improvement were higher volumes and pricing at John Crane (up £20m), higher volumes and a change in accounting treatment for litigation at Flex-Tek (up £10m), cost savings at Smiths Detection (up £8m), increased volumes offsetting adverse pricing and higher investment at Smiths Medical (up £5m), partly offset by adverse mix and price at Smiths Interconnect (down £6m). Corporate centre costs were up £3m on last year including £1m of cost in the captive insurer subsidiary from meeting operating company insurance claims.

Operating profit on a statutory basis, after taking account of the items excluded from the headline figures, was £407m (2011: £438m).

The net interest charge on debt increased to £63m (2011: £59m) reflecting the higher average levels of debt. Contribution from associates, which relates to our share of the post-tax profits of Cross Match Technologies Inc., increased by £2m to £6m. Our equity interest in this business was sold in July 2012. Headline profit before tax increased by £34m to £497m (2011: £463m – restated). On an underlying basis, headline profit before tax grew by 7%. Headline pre-tax profit now excludes the pension finance credit and the comparative figures have been restated accordingly.

The Group's tax rate on headline profit for the period was 26.5% (2011: 26.5% – restated). Headline earnings per share increased by 7% to 92.6p (2011: 86.5p – restated).

On a statutory basis, profit before tax decreased £32m to £366m (2011: £398m); it is stated after taking account of the pensions finance credit of £24m (2011: £23m) and other items excluded from the headline measure.

## Cash generation

Operating cash generation remained strong with headline operating cash of £549m (2011: £489m) representing 99% (2011: 95%) of headline operating profit (see note 27 to the accounts for a reconciliation of headline operating cash and free cash-flow to statutory cash-flow measures). Free cash-flow fell £19m to £217m (2011: £236m). Free cash-flow is stated after interest, tax and pensions financing, but before acquisitions, financing activities and dividends.

On a statutory basis, net cash inflow from continuing operations was £332m (2011: £322m).

Dividends paid in the year on ordinary shares amounted to £144m (2011: £136m).

Net debt at 31 July was £791m, up from £729m at 31 July 2011. The increase in net debt reflects strong cash generation that was more than offset by outflows from the net impact of acquisitions and disposals (£120m), dividends (£144m) and pension funding (£122m).

John Crane  
Bringing technology to life

Crude under pressure

Exploiting the vast oil and gas fields recently discovered off Brazil's southeastern coast poses daunting technical challenges and opportunities for Petrobras, the Brazilian energy giant, and its partners.

Lying some 6,000 metres beneath sea, rock and salt, the high-quality crude can be economically extracted using secondary recovery schemes, such as water injection, gas injection or water alternating gas (WAG). The first production unit, known as Lula Pilot, is already producing about 95,000 barrels per day. The CO<sub>2</sub> stream produced is being re-injected and the hydrocarbon gas exported to shore.

John Crane, a close commercial partner of Petrobras for 50 years, has won a prestigious contract to supply advanced seals, filtration systems and bearings for 80 compressor trains and 32 gas turbines operating from eight FPSO (Floating Production Storage and Offloading) units which are being built in Brazil.

Transferred from the FPSOs to tankers, the oil from the pre-salt fields can then be shipped to the Brazilian mainland or ultimately for export abroad.

Developing the field

The pre-salt development plan, operated by Petrobras, aims to deliver one million barrels of oil per day by 2017.



### Responding to market demands

John Crane's expanding service infrastructure in high-growth markets like Brazil supports customer needs for local service and expertise.

### High-performance seals

The non-contacting gas seals are designed to meet the most exacting demands. In particular, reinjection requires safe and highly reliable sealing of a CO<sub>2</sub>-rich gaseous mixture at pressures of up to 425bar – equivalent to more weight than a fully loaded jumbo jet on a manhole cover.



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.

Business features

Principal operations regions

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

Customers

John Crane serves oil and 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 revenue.

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 Crucible, CoorsTek, Penn United Carbide, Schunk, Metalized Carbon, ESK, Earle M. Jorgensen, Femax, BE Group, DuPont, Greene Tweed, and Ashland Chemical.

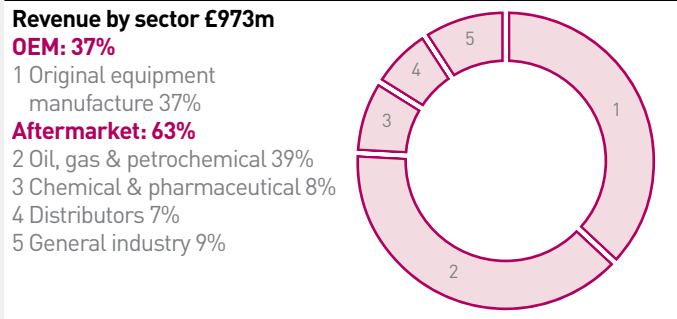
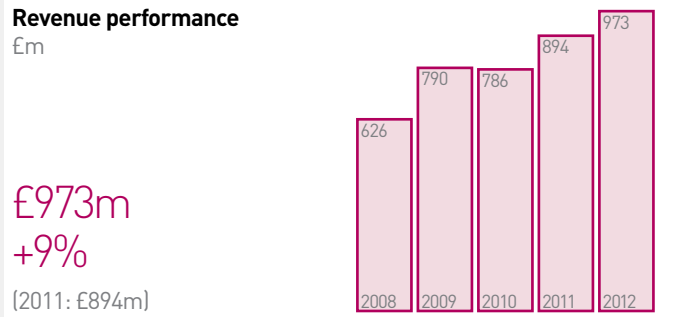
Contribution to 2012 Group revenue

32%

Contribution to 2012 Group headline operating profit

36%

Percentage relates to headline operating profit before corporate costs



Go to [www.johncrane.com](http://www.johncrane.com) for more information



## Markets and trends

John Crane is recognised worldwide across processing industries as a leading provider of engineered solutions, and is dedicated to driving rotating equipment reliability, safety and operational excellence to its customers. Its portfolio of highly engineered products includes mechanical seals, seal support systems, engineered bearings, power transmission couplings and specialist filtration systems.

Although primarily focused on the downstream oil and gas market, John Crane also maintains and enhances upstream oil and gas field site productivity through the servicing and provision of onshore down-hole 'artificial lift' pumping hardware and systems.

Critical to the real-time needs of customers today, these technologies are coupled with a global sales and service network that provides on-site performance-enhancing services leveraging John Crane's application expertise and proven field experience developed over decades. Service teams in more than 50 countries maintain and support the operation of critical customer assets throughout their economic lifetime.

Approximately two-thirds of John Crane's sales are direct to aftermarket customers servicing their existing installed base of equipment. The remaining one-third of sales represent the design and supply of products to original equipment manufacturers (OEM) including pumps, compressors, turbines, vessels and other rotating equipment.

The demand for John Crane products and services continues to expand regionally, driven by demographic and economic growth patterns. Demand also continues by industry where current factors including increased global energy demand, greater environmental controls, more stringent regulatory safety requirements and the development of market opportunities like shale oil and gas, drive the need for incremental processing capacity. Building upon the strategy of adding targeted complementary products to the mechanical seals, systems and couplings businesses, we have more than doubled our addressable market over the past four years with the inclusion of engineered bearings, specialist filters and upstream energy services. We continue leveraging the integration of these new product lines with a global service footprint and rotating equipment expertise. John Crane is also working to further strengthen and deepen its customer aftermarket presence. With a leading global market share position of approximately 30% in traditional product areas (mechanical seals, seal support systems and couplings), John Crane is well positioned to support, develop and grow share in the complementary product ranges.

Service responsiveness is a critical element to achieving and maintaining customer rotating equipment uptime. As an industry leader, John Crane's global service network is a key asset which allows for swift and effective execution of aftermarket service close to customers' operations. These facilities provide a range of 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.



## Expanding our Middle East presence

Committed to providing unrivalled customer service as locally as possible, John Crane has doubled the size of its regional headquarters in Dubai by establishing an adjoining state-of-the-art maintenance and manufacturing facility.

The expanded Middle East and Africa headquarters includes one of the world's most advanced gas seal test rigs which features a customer viewing suite, on-line wireless access for testing and reporting, plus full inspection services. The 4,000m<sup>2</sup> facility also houses custom diagnostic, inspection and refurbishment facilities for wet seals and metal bellows.

Gulf region customers will now benefit from easier access to a far more comprehensive inventory of John Crane spares than previously, as well as rapid connections to the company's extensive global spares network. The prestigious LEED (Leadership in Energy and Environmental Design) silver-certified facility, which employs over 80 people, helps ensure John Crane maintains its global status as provider of choice for engineered solutions among process and energy industry customers.

# Business review

Continued

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## John Crane

Continued



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### Tapping alternative power

While John Crane is rightly renowned for servicing the traditional oil and gas sector, its advanced equipment is also proving crucial to the development of one of the most promising sources of 'renewable' energy – concentrated solar power.

By 2050 around 15% of Europe's electricity demand could be met by solar energy and John Crane is already participating in projects in southern Spain and the United States.

Its patented HTC (High-Temperature Corrosion-resistant) seal technology allows reliable sealing of heat transfer fluids, critical to the success of concentrated power plants. John Crane sealing technology is also used in the 'power block' section, where a safely encased combination of molten salts and water produces high-powered steam to drive turbines and generators.

The intense heat of up to 400°C (752°F) is created by mirror-focusing the sun's rays on to an absorber tube filled with heat transfer fluid. This thermal energy can be stored in the form of melted salts so that generation can continue through the night or on cloudy days.

## Performance

	2012 £m	2011 £m	Reported growth	Underlying growth
Revenue	<b>973</b>	894	9%	9%
Headline operating profit	<b>210</b>	189	11%	11%
Headline operating margin	<b>21.6%</b>	21.1%	50 bps	
Statutory operating profit	<b>155</b>	143		
Return on capital employed	<b>24.0%</b>	21.8%	220 bps	

John Crane grew revenue by £79m (9%), driven by a £79m increase in underlying revenue, and a £6m benefit from the acquisition of the business of Turbo Components and Engineering Inc. (TCE), offset by £6m of adverse currency translation. Higher revenue from first-fit original equipment and increased aftermarket revenue across all end markets, particularly oil and gas, and chemical, drove the underlying growth.

Reported headline operating profit rose 11% driven by a £20m (11%) increase in underlying profit and a £2m contribution from TCE, offset by adverse currency translation (£1m). Margins increased 50 basis points to 21.6% from the prior year. This underlying improvement in profitability stems predominantly from increased volumes, benefits from our cost-saving initiatives and better pricing on aftermarket sales. These gains in margin occurred despite increased investment in highly competitive first-fit original equipment projects, higher sales and marketing spend and cost inflation. Return on capital employed improved 220 basis points to 24.0% because of improved profitability.

Statutory operating profit at £155m reflects the cost of John Crane, Inc. asbestos litigation (£40m).

Overall aftermarket revenue grew 9% on an underlying basis, benefiting principally from strong demand in the oil and gas, and chemical sectors. Aftermarket revenue from rotating equipment (seals, seal support systems, couplings, bearings and filtration, together representing 89% of revenue) increased 9% with growth across all sectors. Sales for John Crane Production Solutions, representing 11% of revenue, advanced 8% as a result of greater activity in US onshore oil and gas production.

First-fit original equipment revenue rose 9% on an underlying basis as customers continued to invest in new capital projects. We saw growth in activity across the globe, primarily centred on the oil and gas, and chemical sectors. John Crane continues to invest in targeted original equipment projects around the world to ensure a robust pipeline of future aftermarket activity.

Our sales and service network continues to expand in response to growing market demands in all regions. New service centres have opened in Turkey, Western Australia and Alaska. The greatly expanded Dubai facility was officially opened in February 2012.

In China, localised manufacturing and commercial impact of the 'Safematic' pulp and paper seal lines, and the new metal bellow seal line continue to strengthen our developing aftermarket position. The opening of a new training facility and the upgrade, relocation and opening of three other service facilities in China have strengthened our footprint and field support capabilities. Expansion work began on the Rio Claro plant in São Paulo, Brazil, for the manufacture of American Petroleum Institute (API) standard seal system reservoirs, and John Crane Indufil filtration systems.

This focus on emerging market expansion is delivering results with a 14% sales increase, such that these faster growth areas now represent over 20% of John Crane sales. Continued investment will enhance our sales and service capabilities as well as broadening our product range in these key markets in the Middle East, Asia and Latin America.

## Research and development

John Crane is committed to increasing investment in research and development. Investment in new product development increased 8% to over £11m. The company's focus remains on developing products that support reduced environmental impact, energy efficiency, condition monitoring and control, and provide engineered solutions to address our customers' growing processing demands.

The company is currently expanding its portfolio of seals offered to the mining and minerals, power generation and oil and gas markets. Developments in these areas include expanded split seal designs, slurry seals, uncooled boiler-feed seals and the use of innovative materials that enhance seal, bearing and coupling performance capabilities. John Crane is also investing in new product designs to meet the local needs of emerging markets.

John Crane additionally continues to research slow-roll conditions, face coatings, and bi-directional capabilities for turbo gas seals with a view to achieving step changes in sealing performance to extend uptime in difficult rotating equipment operating environments.

## 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. This was behind the acquisition of Houston-based Turbo Components and Engineering Inc. (TCE) in October 2011. TCE services, repairs and builds replacement bearings and seals used in critical rotating equipment and adds to our existing engineered bearings business which was formed through acquisitions in 2007 and 2009. The acquisition accelerates plans to develop an aftermarket services business to support our existing engineered bearings offering. Progress in market penetration of the expanded product line continues to advance globally, with several new accounts won in bearings and filtration.

The bearings and filters business is now integrated within rotating equipment, which is managed in three geographical units.

Paul Cox stepped down as Divisional General Manager of John Crane in May. The process to appoint a permanent replacement is well advanced and in the interim, Tedd Smith, the Divisional General Manager of Flex-Tek, is running the division. We remain convinced that there is significant unrealised potential within this business.

## Outlook

John Crane's order book is expected to support continued sales growth in the first half of the year. However, the outlook beyond that remains uncertain given the economic turbulence in Europe and slowdowns in several major economies around the world. Full-year sales growth will be dependent upon sustained maintenance and repair activity in our key end markets as well as continued investment in capital projects in high-growth regions. Margins will benefit from on-going operational efficiency efforts, 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.



Smiths Medical  
Bringing technology to life

Raising safety standards

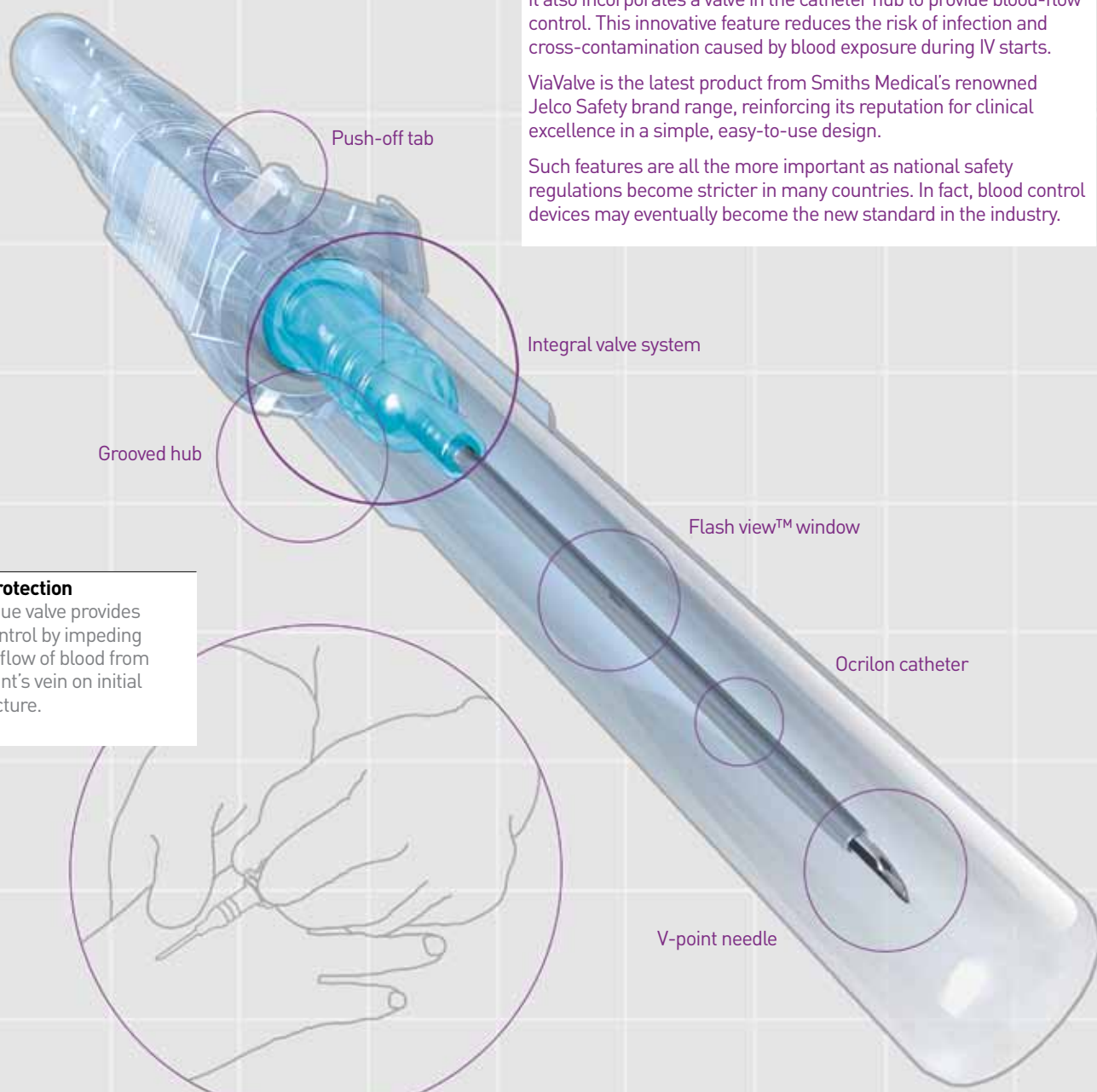
Catheters are the 'workhorse' device for clinical care the world over. Used in the treatment of around 90% of hospital in-patients, they administer fluids and medication or draw blood for analysis.

So with around 350 million disposable intravenous (IV) catheters used and discarded every year in the US alone, any major technological advance holds the potential for immediate traction in a market worth almost \$650m. Smiths Medical's ViaValve is one such breakthrough product, raising the safety benchmark for IV catheters.

Not only does the ViaValve Safety Catheter protect clinicians from needlestick injuries by providing fully encased needle protection, it also incorporates a valve in the catheter hub to provide blood-flow control. This innovative feature reduces the risk of infection and cross-contamination caused by blood exposure during IV starts.

ViaValve is the latest product from Smiths Medical's renowned Jelco Safety brand range, reinforcing its reputation for clinical excellence in a simple, easy-to-use design.

Such features are all the more important as national safety regulations become stricter in many countries. In fact, blood control devices may eventually become the new standard in the industry.

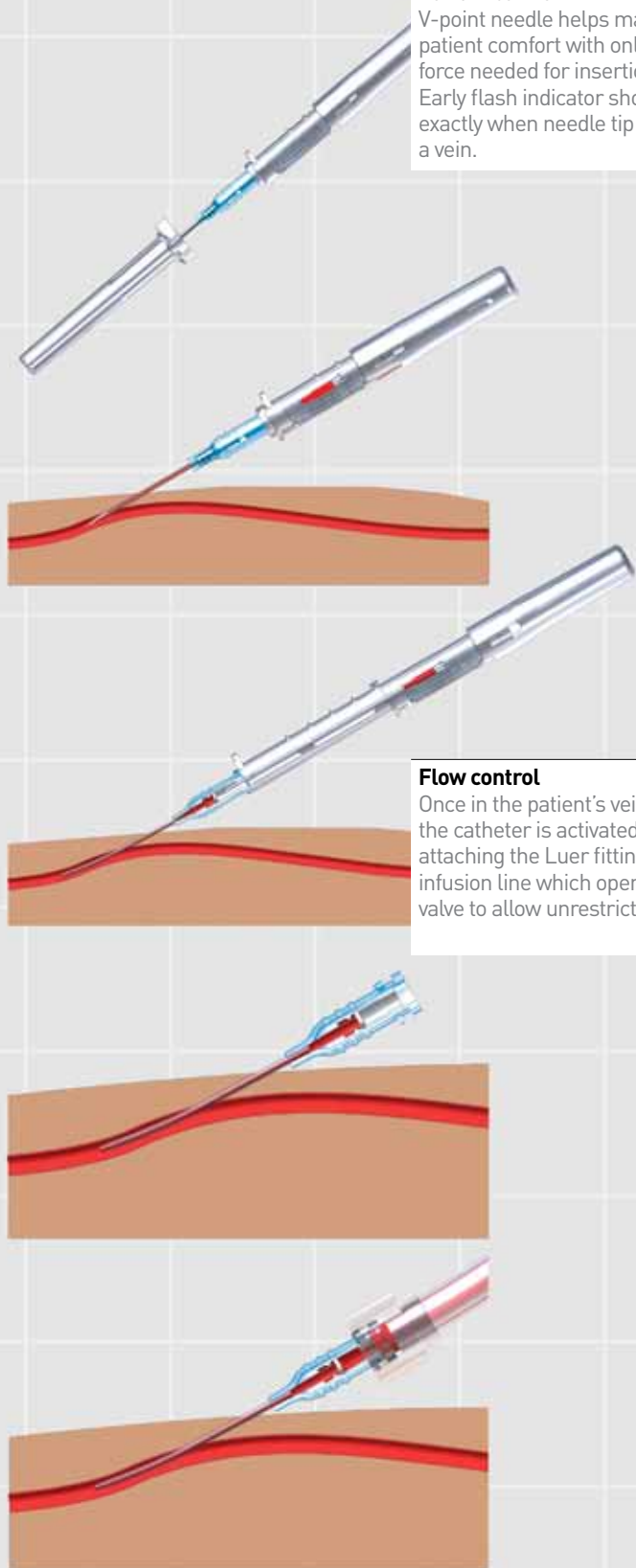


Blood protection

The unique valve provides blood control by impeding the backflow of blood from the patient's vein on initial venipuncture.

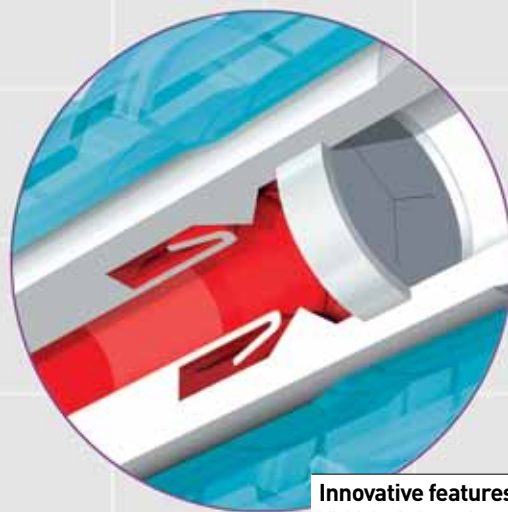
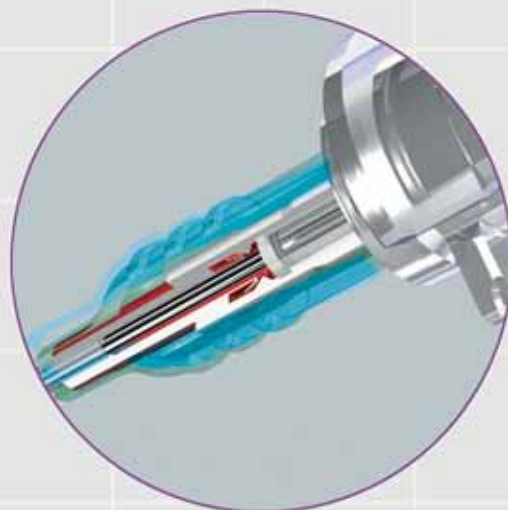
### Patient comfort

V-point needle helps maximise patient comfort with only light force needed for insertion. Early flash indicator shows exactly when needle tip enters a vein.



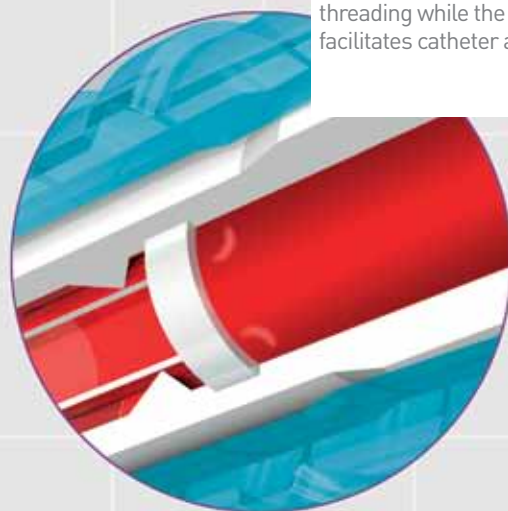
### Flow control

Once in the patient's vein, the catheter is activated by attaching the Luer fitting of an infusion line which opens the valve to allow unrestricted flow.

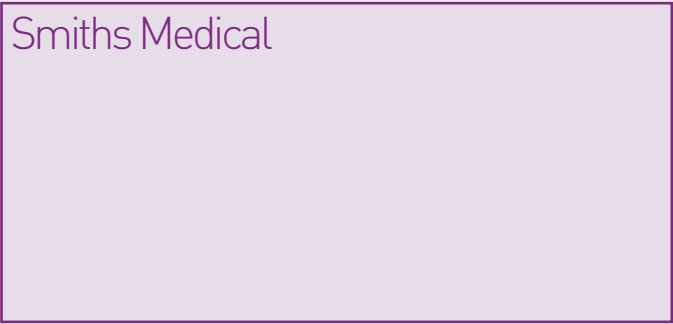


### Innovative features

ViaValve's introducer promotes one-handed insertion and threading while the ribbed hub facilitates catheter attachment.







Smiths Medical is a leading supplier of specialist medical devices, consumables 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 protect health workers by helping prevent needlestick injuries and reducing cross-infections.

Business features

Principal operations regions

We have operations in over 30 countries with manufacturing concentrated in Mexico, US, UK, Italy, Germany and China. We sell to approximately 120 markets and, while the US continues to be our largest single market with around 50% of sales, we are investing to build our presence in select emerging markets.

Customers

We estimate that 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 over 20 countries, and distribution arrangements in approximately 100 others.

Competitors

The competitive landscape for Smiths Medical is complex as we compete with different companies across the broad product portfolio. Our major competitors include Covidien, Teleflex, B Braun, Becton Dickinson, C R Bard, 3M (Arizant), Hospira and CareFusion. We often compete with a small portion of a major competitor's medical business, as well as with any number of smaller, single product line companies trying to gain entrance into a particular market. This makes comparison between peers far from straightforward. In emerging markets, we compete with both large multinational companies and smaller domestic players.

Suppliers

Our strategy is to actively 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 ensure supply continuity plans. The majority of our direct spending is on resins, plastic injection mouldings, and electronics. Among indirect purchases, freight, services, travel, temporary labour and capital equipment represent the majority.

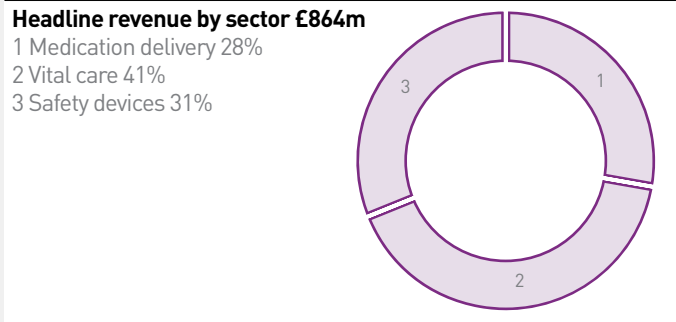
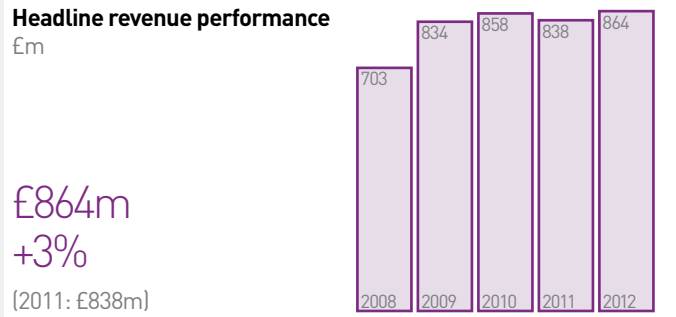
Contribution to 2012 Group revenue

28%

Contribution to 2012 Group headline operating profit

35%

Percentage relates to headline operating profit before corporate costs



Go to [www.smiths-medical.com](http://www.smiths-medical.com) for more information

## Markets and trends

Budgetary restrictions continue to constrain customers' capital spend and increase price pressure in many markets. Procedure growth rates have declined in some countries largely because of reduced budgets and high unemployment, although we are seeing evidence of increased numbers of procedures in some countries, including the US.

Despite the market challenges, the medical device sector continues to be attractive, driven by ageing populations with greater care needs, safety legislation, interoperability and increasing prosperity – particularly in emerging markets. The global market for Smiths Medical is estimated to be worth over £4bn, with opportunities in target adjacent markets that would double the size of the addressable market. Smiths Medical has sufficient reach in the design, production and distribution of medical device products to seize global opportunities.

Our product ranges serve three main markets – medication delivery, vital care and safety. Smiths Medical is particularly well placed in lower-risk, short-residency, interventional devices, applicable in a wide variety of procedures. Its broad portfolio includes strong brands in hardware and consumable products as well as software and services supporting customers in both hospital and alternate care settings.

### Medication delivery

Smiths Medical designs and manufactures drug delivery systems that relieve acute and chronic pain, treat the most at-risk patients in high care units around the world, and enable patients with cancer, pulmonary hypertension or Parkinson's disease to receive home treatment. The global market for medication delivery products in which Smiths Medical competes is estimated to be worth £1.2bn. We expect continued market growth because of an increase in treatment of chronic conditions, the integration of medication delivery devices with hospital IT systems, and the move to treat 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 Graseby and Medfusion products.

### Vital care

Smiths Medical's products manage patient airways before, during and after surgery (Portex), alleviate breathing difficulties (Portex, Pneupac), help maintain body temperature (Level 1), monitor vital signs such as blood pressure, blood oxygen saturation and heart rate (BCI, Medex) and assist reproduction through in-vitro fertilisation therapy (Wallace). The overall vital care market has been affected by a slowdown in procedure rate growth, but we expect future growth due to factors such as increasing chronic disease incidence rates and ageing populations. The market is estimated to be £1.7bn for the segments in which Smiths Medical competes.

### Safety

Smiths Medical makes 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 Smiths Medical related safety products is estimated to be £1.2bn. Looking ahead, the safety market is expected to grow as the focus on safety and reducing the risk of infection intensifies. Smiths Medical is well positioned to capitalise on the advancement of sharps safety initiatives, such as the EU directive and Brazil's NR32, which are implementing policies to protect healthcare workers from the risk of needlestick injuries. Our innovation pipeline is well positioned to capture growth from these trends.



## Engineering to add value

Smiths Group has embraced Value Engineering (VE) as a highly effective way to maximise margins across all its divisions, none more so than at Smiths Medical where a close review of cost-function ratios in production has led to a number of product enhancements.

A prime example is the EpiFuse Catheter Connector which accepts a range of epidural (spinal) needles. After a thorough VE evaluation of costs, productivity and quality, the number of parts used in production was cut by around 70%, resulting in a similar reduction in the cost of production combined with a marked improvement in end-design.

The new, two-material injection moulding process introduced for mass production of the EpiFuse connector enables it to click-lock securely yet unlock easily. The VE focus on improving quality as well as boosting productivity helped develop the one-hand activation for easy use by clinicians and a flat profile for increased patient comfort.

# Business review

Continued

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## Smiths Medical

Continued



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### Emerging medical markets

China is at the forefront of Smiths Medical's drive into emerging markets where the rapidly increasing quality and quantity of healthcare is driving long-term demand for devices and equipment customised to local needs.

A sales recruitment push has almost doubled the Chinese workforce to more than 400 and Smiths Medical's expanded Hangzhou-based plant is boosting production of its highly popular Graseby 2000 range of infusion pumps.

We achieved double-digit revenue growth in markets such as China, India, the Middle East and Latin America. Recruitment in targeted regions has also been stepped up to support the push for growth.

With subdued growth in North America and Europe, the accelerated investment in marketing, sales, and distribution in emerging economies leaves Smiths Medical well placed to service regions where increasing affluence is matched by improving medical infrastructure and access to healthcare.

## Performance

	2012 £m	2011 £m	Reported growth	Underlying growth
Headline revenue	<b>864</b>	838	3%	2%
Headline operating profit	<b>203</b>	196	3%	2%
Headline operating margin	<b>23.5%</b>	23.4%	10 bps	
Statutory revenue	<b>856</b>	838	2%	
Statutory operating profit	<b>180</b>	178		
Return on capital employed	<b>17.6%</b>	16.9%	70 bps	

Smiths Medical grew headline revenue 3%, or £26m, reflecting an underlying increase in revenue of £20m (2%), as well as a currency benefit of £6m. The underlying growth resulted from new product launches, particularly Medfusion 4000 and CADD-Solis PIB and VIP platforms, emerging market revenue (9% growth, now representing over 10% of revenue) and a broadening of our product sales efforts. Headline operating profit rose 3% (£7m) and headline operating margin increased 10 basis points to 23.5%. These results were achieved despite pricing pressure in many markets and increased investment in a range of growth initiatives, including new product development and sales capabilities in emerging markets. Margins benefited from initiatives to cut manufacturing costs and overheads, as well as a favourable product mix.

Statutory revenue and operating profit both include an £8m charge which reflects our decision to change the basis for estimating the accrual for rebates to distributors. This change was prompted by the availability of better data and estimation techniques; and was reflected in the interim accounts.

Return on capital employed improved 70 basis points to 17.6% as a result of the increased profits.

The underlying growth in revenue and profitability was achieved despite difficult trading conditions in the medical devices sector. These stemmed from adverse pricing, capital spending constraints and a slowdown in procedure growth rates in some countries. The pressures were particularly acute in Europe given the prevailing austerity measures and economic uncertainty. However, procedure rates in the US and some other markets have shown recent signs of improvement. Consumables sales, which represent almost 85% of our total revenue, were up 1%. Hardware revenue improved 6%, largely due to strong sales of the new wireless Medfusion 4000 syringe pumps, as well as CADD-Solis and VIP ambulatory pumps.

While developed markets remain testing, emerging markets continue to provide growth opportunities as the quality of and access to healthcare improves. We are expanding our efforts and presence in these markets, adding approximately 250 headcount this year into selected countries, including China, Brazil, India, and various Southeast Asia and Middle East markets in order to leverage our broad product portfolio. We are already seeing early signs of success with double digit revenue growth in India, China, the Middle East and Latin America.

Revenue from safety devices grew 4%, primarily due to the strong performance of safety needles and arterial blood sampling devices in many developed and emerging markets, as well as improved safety catheter sales in the US. Interest in both safety needle and catheter products remains high in developed markets and is growing in emerging markets. In Europe, Smiths Medical is also well positioned to benefit from the EU Directive, adopted in 2010, to improve workplace safety by preventing sharps-related injuries. We anticipate two safety catheter product launches in the coming year to capture global opportunities and replace declining conventional catheter sales. In addition, we have seen a recovery in vascular access, particularly huber needles and central venous catheters in most markets.

Medication delivery revenue experienced strong growth in the second half and, excluding diabetes, full year results improved 4%. Ambulatory infusion revenue rose 9% through the continued success of our CADD-Solis pumps and dedicated disposable sets, as well as CADD-Solis PIB and VIP sales outside the US. Infusion system revenue also grew, primarily due to Medfusion 4000. This new product continues to have a robust order pipeline, and we are well placed to capture further growth in this market.

Vital care underlying revenue was flat, despite relatively sluggish procedure volumes and pricing pressures in developed countries, particularly reimbursement pricing pressure in Japan. Assisted reproduction, general anaesthesia, invasive blood pressure monitoring, respiratory and tracheotomy businesses all grew. Patient monitoring posted a strong performance due to enhanced capnography sales. These gains were offset by a slight decline in temperature management and declines in veterinary and kitting product lines where we are eliminating low-margin stock-keeping units.

We also continue to optimise our manufacturing and distribution footprint to deliver a more efficient supply chain. Operational responsibility for our European distribution centre in Nijmegen, Netherlands, has been brought in-house to reduce costs and improve performance. We continue to pursue variable cost productivity initiatives aggressively, contributing to margin expansion and enabling further investment in sales and marketing resources.

## Research and development

Investment in R&D remains a priority, increasing 9%. Our total R&D spend of £34m (2011: £31m) comprised 3.9% of revenue (2011: 3.7%). We continued to narrow the number of pipeline projects to ensure there is adequate investment in the highest impact products. This is raising the rate of project execution and will continue to increase overall R&D effectiveness.

Revenue from products launched in the last three years totalled some 10.5%, an increase on the prior year. During the year, we launched two significant medication delivery products: our Medfusion 4000 syringe pump with wireless connectivity into the US and Canadian markets and the release of our CADD-Solis PIB and VIP platforms outside the US. These launches have driven significant growth, consolidating our leadership in the syringe and ambulatory pump markets. We received FDA 510(k) clearance for our new ViaValve Safety IV Catheter in North America, while in Europe we have CE clearance for our new Jelco IntuitIV Safety IV Catheter. We have also launched new blood collection products that extend our VeniPuncture Needle-Pro and Saf-T Wing blood collection range of products. In emerging markets, we have registered multiple safety product ranges in Brazil, China and India, where we are engaging our customers on the benefits of adopting safety devices. In the UK, we unveiled our CorrectInject Safety System, an innovative connection system designed to enhance patient safety through a reduction in the risk of misconnection, while minimising change in clinical technique. We anticipate further CorrectInject system-related product launches in the coming year.

## Outlook

Developed markets are likely to remain challenging in the short term as healthcare cost controls and unemployment put pressure on price and volumes. In the US, the medical device excise tax of 2.3% is expected to constrain growth and margins, though we will seek to offset the impact, primarily through operational improvements and increased focus on higher margin products. Against these trading conditions, our R&D pipeline is strong and we will seek to drive sales growth through increased investment and new product introductions, coupled with a continued emphasis on customer-facing resources and sales effectiveness.



### Smiths Detection

Bringing technology to life

#### Mobile, speedy detection of multiple threats

Smiths Detection's GUARDION was launched this year to meet the growing demand for a more portable chemical threat detector using next-generation technologies to provide speedier and more accurate identification of a wide array of threat.

Almost a quarter lighter than similar systems, GUARDION exploits its revolutionary combination of high-speed, high-resolution Gas Chromatography (GC) and miniaturised Mass Spectrometry (MS) to provide military and first responders with unparalleled on-site analysis.

Chemical warfare agents, toxic industrial chemicals and narcotics in complex gases, vapours, liquids and solids can all be identified. It can also identify trace-level components in materials previously found to be undetected by other technologies. Combined, the GC and MS technologies give a much finer degree of substance identification than used separately.

Smiths Detection has established a new GC/MS Centre of Excellence at one of its US facilities. It includes the integrated team who partnered with Utah-based Torion Technologies to miniaturise, ruggedise and optimise the GUARDION technology and specialised software.

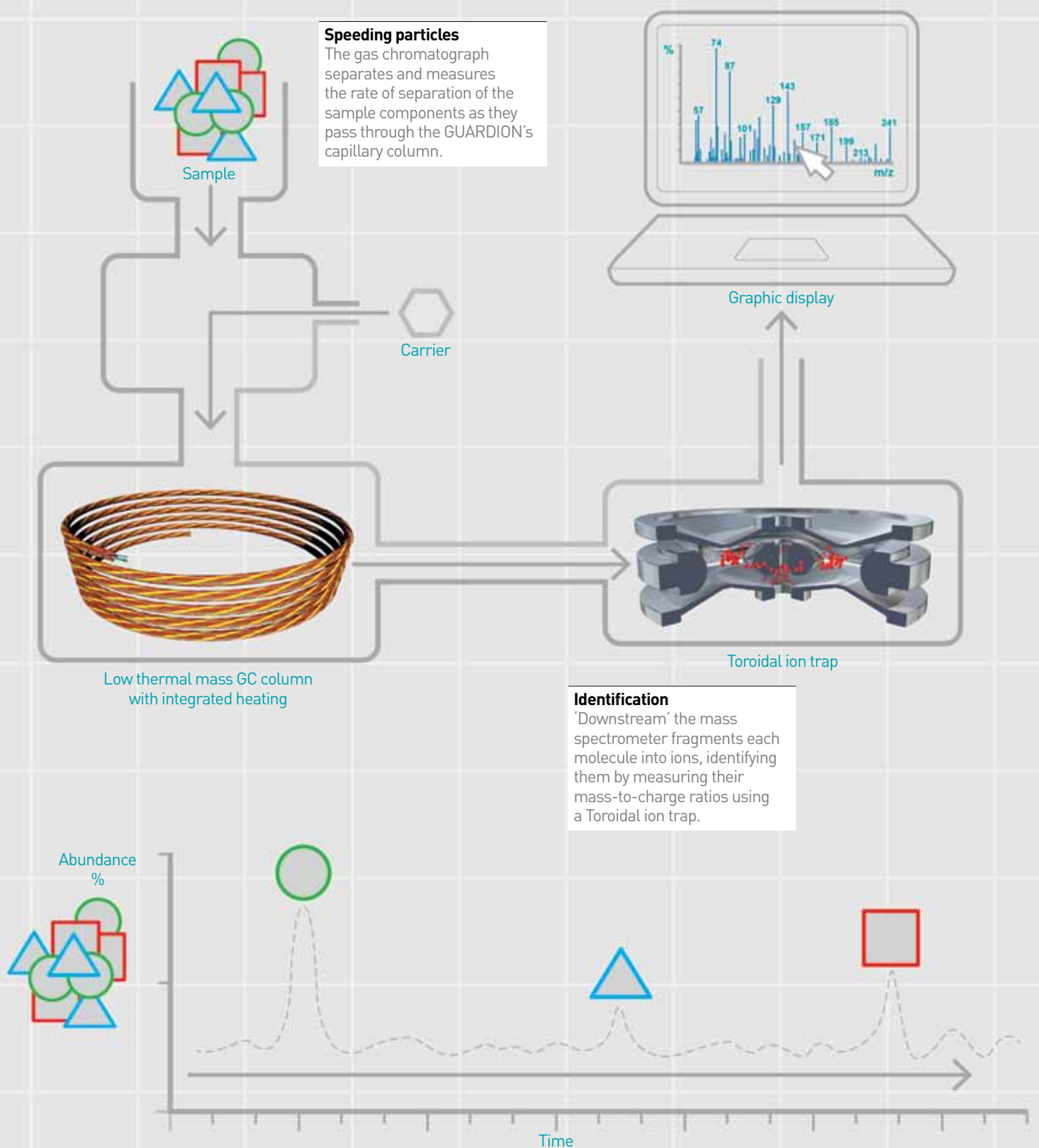
#### Easy-to-read results

GUARDION can be deployed in under five minutes and analyses up to 30 samples on a single battery charge.

#### High-performance, low-cost

Advances in the detection technologies and software used by GUARDION have resulted in a sophisticated but low-cost system that requires minimal maintenance.





# Business review

Continued

## Smiths Detection

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

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

### Business features

#### Principal operations regions

Our nine manufacturing centres are concentrated in North America, Germany, France, Russia, Malaysia and the UK. We sell to over 180 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), Nuctech (ports and borders), AS&E (ports and borders), FLIR (air transportation, defence), SAIC (ports and borders), Chemring (military), Bruker (military, emergency responders), and 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. Our procurement team has now been centralised and our engagement with suppliers is being standardised across all business operations.

### Contribution to 2012 Group revenue

17%

### Contribution to 2012 Group headline operating profit

12%

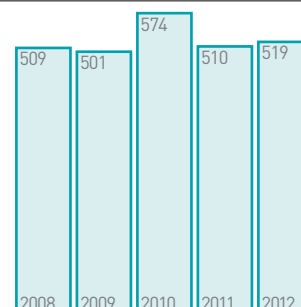
Percentage relates to headline operating profit before corporate costs

### Revenue performance

£m

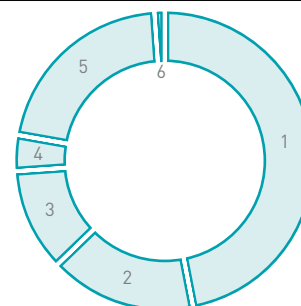
£519m  
+2%

(2011: £510m)



### Revenue by sector £519m

- 1 Transportation 47%
- 2 Ports and borders 16%
- 3 Military 11%
- 4 Emergency responders 4%
- 5 Critical infrastructure 21%
- 6 Non-security 1%



Go to [www.smithsdetection.com](http://www.smithsdetection.com) for more information



## 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 people and critical assets.

Demand for detection equipment in three of its principal markets, transportation, ports and borders and critical infrastructure (estimated at more than £1.6bn) is forecast to continue to grow at almost 7% per annum in the near-term because of ongoing geo-political unrest and the terrorist and criminal threats it creates. Government budgets and legislation can also affect demand for Detection products and cause the timing and profile of orders to vary.

The changing nature of the detection business sector is resulting in a growing volume of smaller contracts and fewer major programmes. Smiths Detection is actively adjusting its operations to meet the requirements of this 'run-rate' business model which benefits from lower volatility than areas which are more government controlled. It is also placing more emphasis on aftermarket sales, enhancing the level of customer service to meet opportunities arising from the extensive installed base of detection equipment across most regional markets.

The heavily regulated transportation sector is the largest market for the division. Rising passenger volumes are resulting in new airport investment, especially in the Middle East and South East Asia. This, together with continuing security threats, a strong replacement cycle and globalisation of trade, boosting freight volumes, is expected to continue to support market growth. In addition more stringent requirements from major regulatory bodies will increase the sophistication of security equipment.

In the ports and borders market, demand for detection equipment is expected to rise to address a variety of threats as governments become increasingly concerned about cross-border security involving the smuggling of explosives, weapons and radiological materials, while continuing to recognise the strong revenue-generating potential from contraband detection. A further benefit is expected from the recovery in worldwide trade using maritime, road and rail transportation.

Overall demand in the highly fragmented critical infrastructure market continues to grow strongly. Governments and other organisations are seeking to protect their assets within current terror threat levels 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 and the increasing requirement for ease of use by operators to be met.

A squeeze on defence spending by governments in developed markets means lower growth rates of around 3% per annum in the military and emergency response sectors in the near term. Defence budgets are returning to pre-conflict levels, impacting the division's sales of equipment to protect troops and assets from a range of chemical, biological, radiological, nuclear and explosive threats. The level of such threats remains high with demand shifting from defence and military applications to civilian incidents. This is accompanied by a move towards more commercial solutions and a growing requirement for software, training and support to simplify, accelerate and aid on-scene decision making.



## Size matters in cargo scanning

As government budget cuts squeeze spending on customs and border agencies, suppliers and contractors must innovate to maintain market share. To that end, Smiths Detection has launched an X-ray cargo scanner that is smaller, more cost-efficient and easier to operate than traditional mobile systems.

Unlike radioactive source-based scanners, the HCVM e uses the power of a 4MeV X-ray accelerator and can penetrate 200mm (eight inches) of steel to check both for threat items and that the cargo matches its manifest.

Fuel-efficient, lightweight and manoeuvrable, the HCVM e is the only system of its kind that can be driven in the US without the need for a commercial driver's licence. Its small footprint makes it ideal for operating in cramped urban environments. The HCVM e can scan up to 25 trucks an hour in mobile mode, traversing the parked vehicle, and up to 80 in pass-through mode, where the truck is driven through the scanner, to inspect only the cargo area behind the driver's cab.

# Business review

Continued

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## Smiths Detection

Continued



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### Next generation scanner wins key approval

Smiths Detection's revolutionary new scanner for screening checked baggage has gained a key EU approval, mandatory for long-term aviation security applications introduced from September 2014 onwards.

Developed in co-operation with Analogic Corporation, the HI-SCAN 10080 XCT uses Smiths Detection's expertise in multi-view, multi-energy x-ray technology, together with Analogic's three-dimensional Computed Tomography (CT).

The high-speed system, which can handle up to 1800 bags an hour, is designed to maximise both detection and throughput capabilities to help meet increasingly stringent security requirements and allow easy integration into existing baggage-handling configurations.

The EU Standard 3 approval, under its EDS (Explosives Detection Systems) categories, means that the 10080 XCT has passed the strictest performance requirements covering a range of detection capabilities and false alarm rates. It is scheduled to undergo evaluation for certification by the US Transportation Security Administration (TSA) later this year.

## Performance

	2012 £m	2011 £m	Reported growth	Underlying growth
Revenue	<b>519</b>	510	2%	3%
Headline operating profit	<b>69</b>	66	6%	13%
Headline operating margin	<b>13.3%</b>	12.8%	50 bps	
Statutory operating profit	<b>84</b>	64		
Return on capital employed	<b>10.3%</b>	9.8%	50 bps	

Revenue at Smiths Detection grew 3% (£16m) on an underlying basis, excluding the impact of acquisitions and disposals and currency translation. A £1m gain from foreign currency translation was offset by a £8m net impact from acquisitions and disposals, arising from the sale of the food inspection business in March 2011 and an optical analysis company in February 2012. The 17% recovery in underlying revenue in the second half was driven by growth in transportation, critical infrastructure and ports and borders, which more than offset declines in the military and emergency responder sectors.

Headline operating margins improved 50 basis points to 13.3% as headline operating profit rose by £3m, or 13%, on an underlying basis. This was driven by cost savings from the performance improvement programme, announced at the start of the period, which more than offset the impact of some low margin contracts negotiated in previous years, additional investment in sales resources and an unfavourable product mix from reduced military sales.

Statutory operating profit includes profits from the disposal of Cross Match Technologies Inc. (£27m) and exceptional restructuring costs (£13m).

The improvement in profitability resulted in a 50 basis point improvement in return on capital, which rose to 10.3%.

The performance improvement programme delivered £15m of savings and incurred £20m of costs, of which £13m was treated as exceptional. The programme is expected to deliver £40m of annualised savings by the end of the 2014 financial year. It will cost £40m overall, of which £9m is expected in the coming year, treated as exceptional costs.

Site rationalisation and an 8% headcount reduction significantly boosted cost savings. In the US, five business units have been closed or divested over an 18-month period, with continuing operations now focused at three main sites. We have begun to evaluate opportunities for value engineering projects and there was a close focus on all expenditure which delivered savings. A new global manufacturing initiative for X-ray machines, centred on three regional hubs, will also deliver performance improvements. This includes a new production facility for X-ray systems in Malaysia, which opened at the end of the period and will grow substantially during the coming year, eventually employing 170 people. The 130,000 sq. ft site will enable Smiths Detection to supply its technology directly to the world's fastest growing air transportation market, and respond quickly to customer requirements in the region.

Wiesbaden, Germany, will remain as a major X-ray production centre, while continuing as the R&D centre of excellence for the technology. The third hub is at the Edgewood facility in the US, which was expanded by 100,000 sq. ft with the addition of a manufacturing and training area, as part of a \$9m investment over the past five years. This will significantly expand X-ray systems production in the US.

Servicing the extensive installed base of our equipment is a major focus and, based on current growth levels, aftermarket operations are set to account for 30% of total revenues within three to four years. There was a 10% increase in aftermarket revenue in the year to 26% of revenue.

Revenue from emerging markets grew 10% driven by the Middle East, Brazil and Poland. Revenue in Brazil, including a major cargo screening equipment contract, was helped by investment in sales and marketing resources following the acquisition of our Brazilian distributor in the previous year.

The impact of government spending and legislative actions can be significant for Smiths Detection. In our largest market, the US, constrained budgets continue to affect key departments such as Homeland Security and Defense. Additional disruptions to government spending patterns are expected as a consequence of the forthcoming US elections. In Europe, there was a further postponement of legislation to adopt a uniform standard for detecting liquids in hand luggage, which could delay investment in the latest technologies ahead of the European Commission reconsidering its legislative plans later in the year.

Transportation revenue increased 12%, including a number of airport contracts from customers in Germany, Sweden, Austria, Poland and the US. Investment by most airport operators and governments has been curtailed but new airports and terminals are planned, mainly in the Middle East and Asia Pacific region.

A greater focus on sales to the critical infrastructure sector saw underlying revenue grow 21%. This market, which includes government buildings, public utilities, prisons, hotels and other strategic sites, is central to our drive to achieve a greater proportion of regular run-rate business. This will bring more stability to balance the unpredictability of major programmes and our target is more than 30% of revenue derived from such regular orders, within two to three years.

Underlying revenue in ports and borders also grew 7%, and although spending by national governments was reduced, enquiry levels are encouragingly high. Major contracts for high-energy cargo scanners were awarded by Brazil, India, Azerbaijan and Nigeria. Market opportunities should be improved by the launch of a lightweight mobile system enabling easier operation in the field than traditional systems.

In the military sector, underlying revenue fell 31% due to cuts in military budgets. This reflects reduced spending patterns in line with the lower number of conflicts involving US and international forces. However, contracts continue to be awarded under the US Army's long-running JCAD (Joint Chemical Agent Detector) programme, resulting in \$49m of orders since April 2012, of which \$39m was booked as revenue in 2012.

## Research and development

Smiths Detection remains committed to the funded development of its main technologies and new products and systems. The effectiveness of this investment was evidenced over the past year by the highest number of product launches in Smiths Detection's history.

Company-funded R&D increased 7% to £37m (2011: £35m), as a percentage of revenue reaching 7.2% (2011: 6.9%). This includes £15m of capitalised projects. Smiths Detection actively seeks customer and government support for R&D which totalled £6m in the period (2011: £8m). Total R&D spend was £43m (2011: £43m) or 8.3% of revenue.

Principal launches included GUARDION, a dual-technology chemical identifier; HazMatID Elite, a smaller, faster, lighter and more durable infrared identifier for unknown chemical threats; X-ray systems for air cargo screening; and a new mobile cargo inspection system.

At the start of the new financial year, the HI-SCAN 10080 XCT was launched. It is a next-generation explosives scanner for hold baggage which has recently received certification from the EU authorities. It combines multi-view X-ray technology and three-dimensional computed tomography (CT) in a single system, providing both greater security screening potential and high throughput – an extremely attractive offering for airport operators. Critical to its success will be certification and approvals from the TSA, the key agency in the US.

## Outlook

The current order book is comfortably ahead of the same time last year and is expected to support sales growth over the coming year, with the benefit of major contract wins. Future revenues should also be strengthened by the expansion of our aftermarket business, although overall sales growth may be affected by the level of government spending. Headline operating margins are expected to gain from the restructuring initiatives now underway in the performance improvement programme.



## Smiths Interconnect

Bringing technology to life

### Filters boost information highway

Like all telecommunications network operators, Telstra is constantly seeking ways of squeezing as much traffic as possible into its fixed frequency spectrum to meet the unprecedented increase in broadband demand from smartphones, tablets and laptops.

Smiths Interconnect helped the Australian company expand its two-way transmission and receiving 'highway' by supplying sophisticated filters which streamline the guard band separating opposing flows of traffic. This provides a crucial advantage to Telstra as global demand is forecast to grow fivefold in the next five years to meet the burgeoning market in mobile, wireless devices.

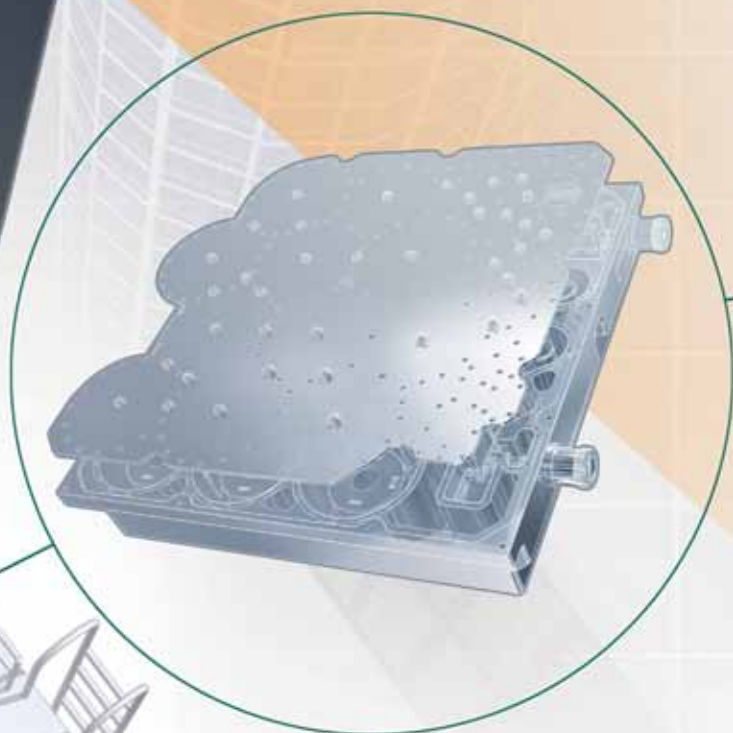
With more than 12,000 filters delivered over the past year, the Telstra delivery schedule was met by capitalising on Smiths Interconnect's expanded regional production facilities in China where capacity was quickly ramped up to allow delivery of 2,000 units per month during peak times.

### Expanding network capacity

Telstra is able to deploy additional transmission hardware at its existing sites without sacrificing network performance.

### Filtering more capacity

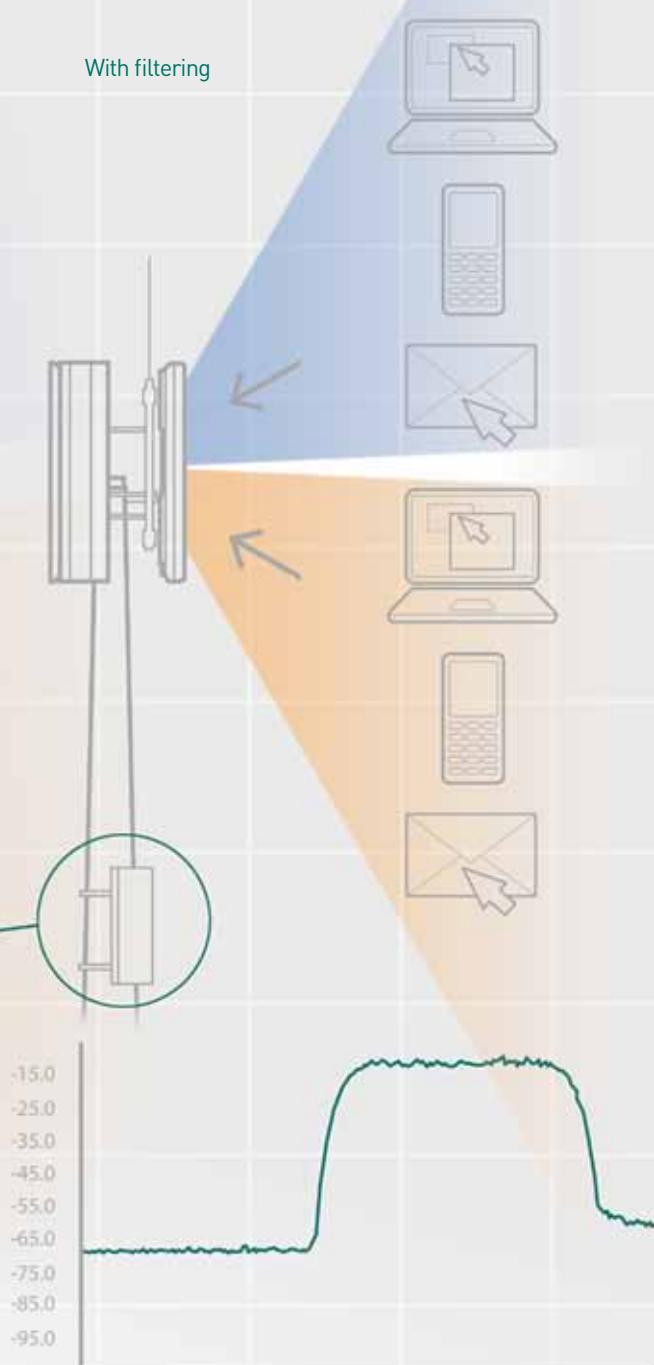
Kaelus filters allow Telstra to use three 850MHz carriers simultaneously while operating co-located 900MHz systems with no sacrifice of spectrum bandwidth or data capacity.



### Two-way traffic

Kaelus filters create a far narrower 'median' or 'central reservation' allowing the freed-up bandwidth to carry more of the lucrative data traffic features of the technology.

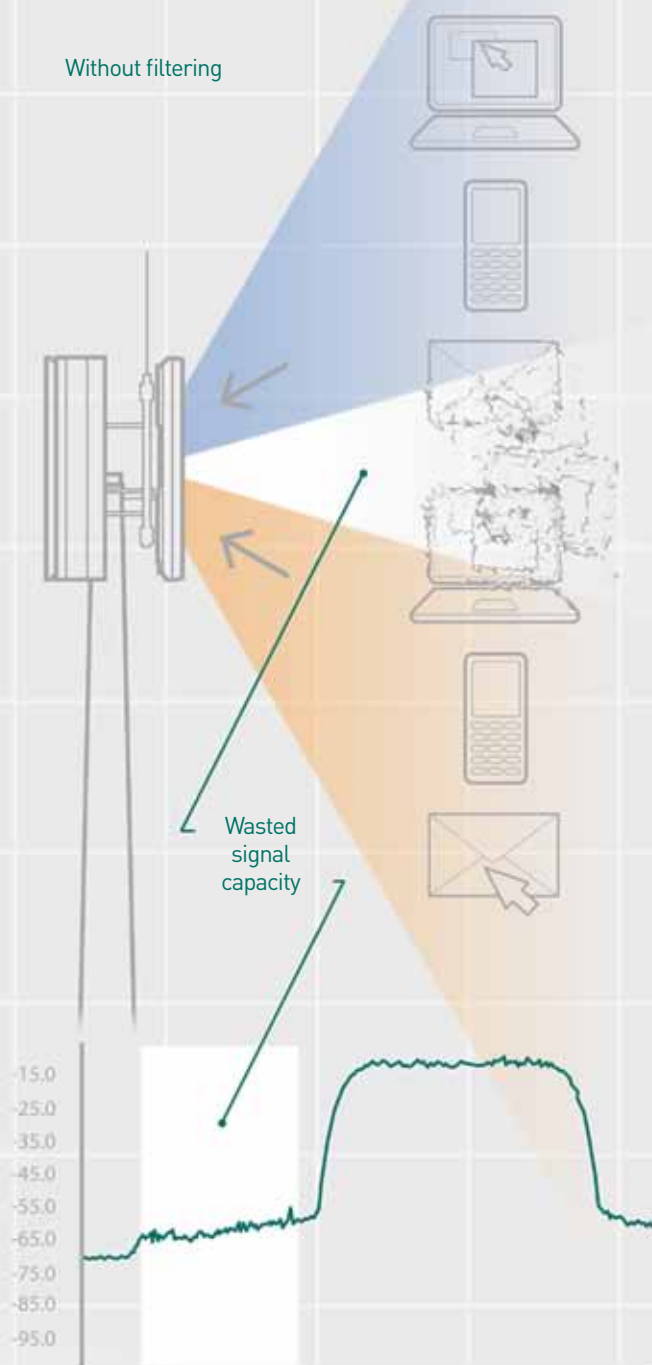
With filtering



### Interference

Soaring demand for wireless services is over-crowding broadband frequencies and prompting a search for innovative solutions.

Without filtering



# Business review

Continued

## Smiths Interconnect

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

**We design and manufacture products that connect, protect and control critical systems for the global data centre, 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.**

### 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, EADS, AAI/Textron, Northrop Grumman, General Dynamics, Lockheed Martin, Row44, Ericsson, Motorola, AT&T, Verizon, Sprint, ZTE, Huawei, Facebook, APC, Foxconn, GE Healthcare, 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 (part of TE Connectivity), Everett Charles (part of Dover), Glenair, ODU and Harting. Microwave competes with, amongst others, Anaren, PowerWave, KMW, Dover, CommScope, Cobham, EMS (part of Honeywell) and Teledyne. Emerson Network Power, Cyberex (part of ABB), Eaton, Starline (part of Universal Electric), Huber & Suhner, Dehn + Söhne and Phoenix Contact offer competitive power management 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.

### Contribution to 2012 Group revenue

15%

### Contribution to 2012 Group headline operating profit

11%

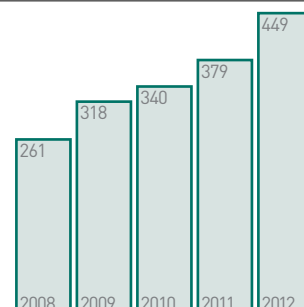
Percentage relates to headline operating profit before corporate costs

### Revenue performance

£m

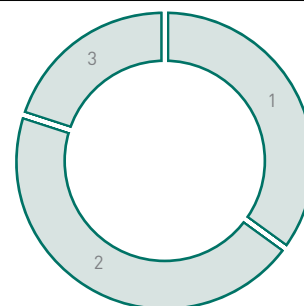
£449m  
+18%

(2011: £379m)



### Revenue by sector £449m

- 1 Connectors 35%
- 2 Microwave 45%
- 3 Power management 20%



Go to [www.smithsinterconnect.com](http://www.smithsinterconnect.com) for more information

## Markets and trends

Smiths Interconnect comprises three technology-focused business units:

- **Connectors** provides application-specific, high-reliability electrical interconnect solutions from highly integrated assemblies to microminiature connectors and spring probe contacts.
- **Microwave** provides components, sub-assemblies, antennas and systems solutions, primarily for defence and aerospace applications, and solutions that test, filter and process high-frequency signals for wireless telecommunication networks.
- **Power management** provides distribution, conditioning, protection and monitoring solutions for data centres, wireless communications and other critical or high-value electrical systems.

Smiths Interconnect addresses a variety of end markets, the most significant of which are military, aerospace and space (mil/aero), wireless telecommunications, data centres and semiconductor test.

Considerable pressure remains on government budgets, particularly on Western defence spending. While no area is likely to be immune, it is expected that investment will be more focused towards systems and capabilities upgrades rather than new platforms. Critical areas such as intelligence, surveillance and reconnaissance (ISR), improved battle space awareness, network-centric communications systems and force protection are likely to remain priorities. 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.

Despite challenging macroeconomic conditions, the commercial aerospace market continues to be strong, driven by increasing passenger and freight demand particularly in Asia and the Middle East, and the need for airlines to upgrade their fleets to newer, more efficient aircraft. Smiths Interconnect provides electrical and microwave connectivity solutions for various aircraft, space vehicles and satellites.

The wireless telecommunications infrastructure market continues to be driven by network improvements to enable higher data rates and bandwidth utilisation which in turn support the proliferation of mobile communication devices and their data-intensive applications. Smiths Interconnect supplies niche, high-performance microwave components used in base stations and cell sites, as well as solutions to optimise network performance and integrity, and to safeguard high-value infrastructure from the effects of lightning strikes and power surges.

Data centre demand is influenced by several factors including internet traffic growth due to the expansion of web-enabled devices and applications, virtualisation or cloud computing, and industry-specific regulatory drivers, for example in financial services and healthcare. Smiths Interconnect's conditioning, distribution, protection and monitoring solutions ensure power quality is delivered to sensitive IT equipment and enable accurate monitoring and metering, an increasingly important issue as electricity represents a higher proportion of data centre costs.

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.



### Improving supply chains

With most government budgets under severe pressure, the defence sector in particular is keen to explore innovative ways to improve affordability of major projects while maintaining all-important product quality.

The Eurofighter consortium has launched one such initiative and Smiths Interconnect, in partnership with General Dynamics UK, is playing an active role in it to help enhance supply chain efficiency.

Designed to cut the manufacturing costs of avionic systems used in the Eurofighter, the project involves Smiths Interconnect's Hypertac business and is backed by Supply Chain 21, a programme run by the UK's aerospace and defence trade body.

It comprises replacing legacy components with more economically sourced modern equivalents; the transfer of Hypertac's manufacturing lines to lower-cost facilities within Interconnect; and moving sub-assembly processes to streamline delivery times.

Overall, the partnership has resulted in cost removal from the supply chain with no impact on the profitability for suppliers, and a cut in the overall price tag for the aircraft itself.



# Business review

Continued

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## Smiths Interconnect

Continued



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### Vital power provision

Data centres, crucial to the IT and communications networks that support so much of modern life, can consume 20 times the electricity of an equivalent office. Already accounting for about 2% of total US electricity consumption, they need not only quantity of supply, but reliability and quality.

To complicate matters further, building new or expanding existing hubs can be difficult and costly as their often central location means both space and high-quality power supplies are scarce.

PDI, recently acquired by Smiths Interconnect, offers a cost-efficient solution that circumvents the traditional but time-consuming and expensive option of raised-floor configurations.

PDI's PowerWave Bus modules, as easy to install as an overhead light fixture system, are already providing sophisticated power management to data centres across the US and now increasingly in the UK and continental Europe.

Since launching two years ago PowerWave has generated more than \$16m in sales, with customers including leading companies in social networking, financial services, automotive and IT hardware and consulting.



## Performance

	2012 £m	2011 £m	Reported growth	Underlying growth
Revenue	<b>449</b>	379	18%	3%
Headline operating profit	<b>66</b>	68	(2)%	(9)%
Headline operating margin	<b>14.7%</b>	17.8%	(310) bps	
Statutory operating profit	<b>34</b>	49		
Return on capital employed	<b>12.3%</b>	15.7%	(340) bps	

Reported revenue for Smiths Interconnect grew 18%, or £70m, driven mainly by the acquisition of Power Holdings Inc. (PDI) which added £54m. Underlying revenue grew £13m, or 3%, reflecting a strong second half performance from Microwave partially offset by tough trading conditions continuing to impact both Connectors and Power.

Reported headline operating profit declined 2%, or £2m. Excluding the £4m profit benefit from the PDI acquisition (net of integration costs), underlying headline operating profit fell 9% (£6m). Margins declined 310 basis points to 14.7% due to a combination of adverse operational gearing caused by lower volumes, particularly in Connectors, and a 90 basis point dilutive impact from PDI. First half gross margins were weak because of sales mix and pricing pressure. In response, we cut costs including headcount reductions in several facilities, closed one production plant, started the closure of another, outsourced some non-core manufacturing processes and transferred selected production capacity to low-cost countries. In addition, procurement initiatives continue to offset cost inflation. These actions helped increase second half margins compared with the first half. Action plans are also in place to improve PDI's margins through operational and procurement initiatives.

Return on capital employed declined to 12.3% as a result of the lower profitability in the underlying business and the impact of the PDI acquisition.

As announced in the interim results, the Smiths Interconnect reporting segments now align with its three technology areas of Connectors, Microwave and Power. Following the acquisition of PDI, the business was reorganised into these three technology areas and divisional management monitor and control the business on this basis.

In Connectors, underlying revenue fell 10% due to a combination of factors. First half performance was affected by the impact of flooding in South East Asia on customer supply chains and the seasonal slowdown in the semiconductor test sector. Two major medical equipment customers also cut orders. These factors improved in the second half whilst European demand fell, particularly in industrial markets due to economic pressures. The defence segment remained challenging throughout the year although we gained significant orders for electronic warfare and phased-array radar applications and achieved design wins for new missile and radar programmes. Revenue from rail customers grew significantly with contract wins in locomotive, rolling stock and signalling applications.

Microwave performed strongly with underlying revenue growth of 20%. In wireless telecommunications, despite a difficult environment, we successfully leveraged our technical and commercial capabilities to perform strongly. The increasing worldwide demand for smartphones and wireless devices is driving growth in both broadband test equipment and network upgrades to provide additional capacity and speed to support data demands. In two larger projects we provided cable assemblies for a production test application, and filter products to increase network performance and capacity for an Australian operator. Although the defence sector generally remains weak, we continued to focus on technologies and applications deemed as investment priorities. For example, in UAV (Unmanned Aerial Vehicle) applications we won contracts for a tactical GPS receiver and a new datalink ground antenna. We also gained funding for the next phase of our US Navy satellite communication terminal production programme which continues to be a significant revenue contributor. In commercial aerospace, sales of the KuStream airborne satellite antenna system strengthened as we resolved programme and production issues that affected the first half.

The addition of PDI more than doubled revenue from Power management. However, on an underlying basis, revenue fell by 12% because of delays in US military orders, a strong previous comparator period which included a significant one-off military programme, and fierce competition in China. In addition, we experienced soft demand from the North American wireless telecommunications market. But during the year we developed next-generation products to provide protection for nascent remote radio head technology and radio frequency protectors for broadband applications. Power management also remains well placed to benefit from the mandated adoption of Positive Train Control technology on US railroads, with power protection products to be used in towers, signals, wayside station and communications applications.

From an end-market perspective across Smiths Interconnect, underlying revenue grew 1% in wireless telecoms, rose 4% in military and aerospace, and an aggregate 5% in the medical, rail, automation and test markets.

## Research and development

Total R&D spend increased to £27m or 6.0% of revenue (2011: £25m or 6.6% of revenue). Excluding PDI and customer-funding, which remained constant at £4m and was primarily defence project related, the underlying company-funded portion decreased to £20m (2011: £21m).

Investment focused more on commercial products and markets in accordance with Smiths Interconnect's strategy to allocate resources to higher growth sectors and opportunities offering the best returns. Examples include miniaturisation and high data rate connector technologies for semiconductor test applications; millimetre-wave components for a new radar system enabling helicopters to operate safely in poor visibility; and power and radio frequency protection devices for wireless telecommunications tower-top electronics. Innovation remains a core priority and the proportion of revenue from products or technologies developed in the last three years was maintained at over 30%.

## Business developments

In October 2011, Smiths Interconnect acquired PDI, a leading designer and manufacturer of specialist power distribution, conditioning and monitoring systems. Based in Richmond, Virginia, PDI also has facilities in Santa Ana, California and Howell, Michigan. The acquisition transforms our power offering, adding a new range of products and growth potential through access to more attractive and higher growth end markets such as data centres. It also offers sales and operational synergy opportunities and reduces the division's exposure to government-funded customers. Integration is essentially complete. Performance to date has fallen short of initial expectations due to a significant reduction in demand in the highly volatile alternative energy sector and flattening in PDI's core North American data centre market. This has led to a £11m impairment charge against statutory operating profit.

Data centre market growth projections remain positive for the medium to long term, which, combined with new international sales resources in Europe, India and China, will drive revenue improvements. Value creation opportunities have been identified and actions to improve manufacturing processes and margin performance are underway.

## Outlook

Despite a positive ratio of orders to sales in the year and a stronger order book to start the current year, many of our markets remain challenging. US defence spending is projected to fall and, although we are relatively well-placed in some key technology sectors and on some good long-term programmes, the military market faces a significant headwind. Similarly, this year's growth in wireless telecommunications will provide a tough comparator in an essentially flat market. The commercial markets of semiconductor test and data centres are expected to be more robust, but will also be hindered by macroeconomic conditions and consumer spending patterns. Although volumes may decline in some sectors, margins should benefit from prior-year restructuring actions and ongoing operational efficiency initiatives.

**Flex-Tek**  
Bringing technology to life

**Electric cores**

It is hardly surprising that at the heart of any electric vehicle is its battery. These are no ordinary batteries however, and their well-being has provided Flex-Tek a niche opening for its advanced, customised heating solutions.

Unlike in conventional cars, where the battery serves mainly to kick-start the engine and run accessories like a radio or air conditioner, the battery of an electric car runs virtually everything, including the crucial electric motor which actually powers the engine.

Ultra-reliable, robust, and easily-produced batteries that could make electric cars competitive with conventional vehicles remain the industry's 'holy grail' and Flex-Tek has worked closely with one leading car manufacturer to come up with a solution.

Temperature and condensation control are all-important because electric car batteries are particularly prone to 'galvanic corrosion' where rusting is accelerated by the presence of dissimilar metals and electric current (electrolyte).

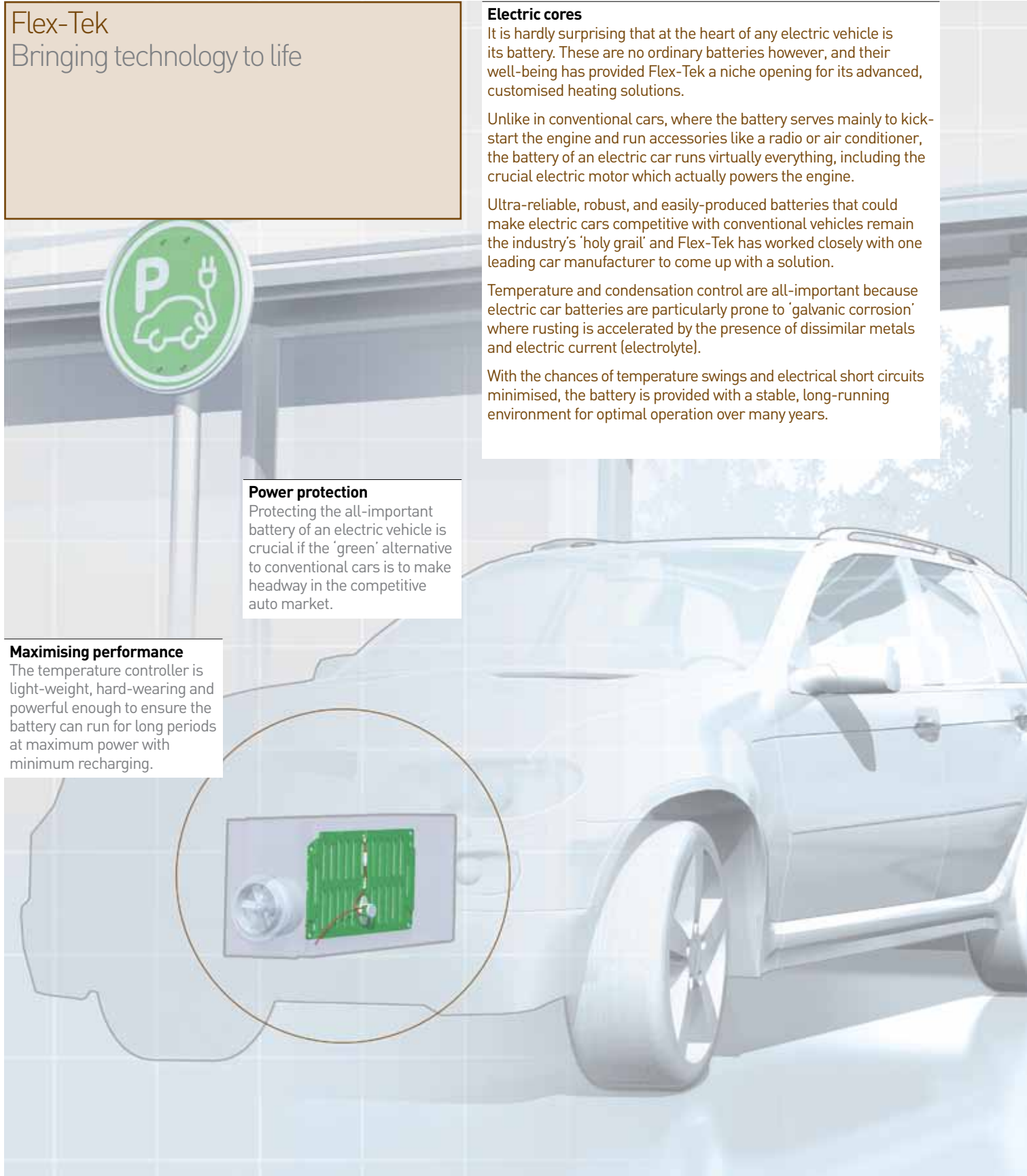
With the chances of temperature swings and electrical short circuits minimised, the battery is provided with a stable, long-running environment for optimal operation over many years.

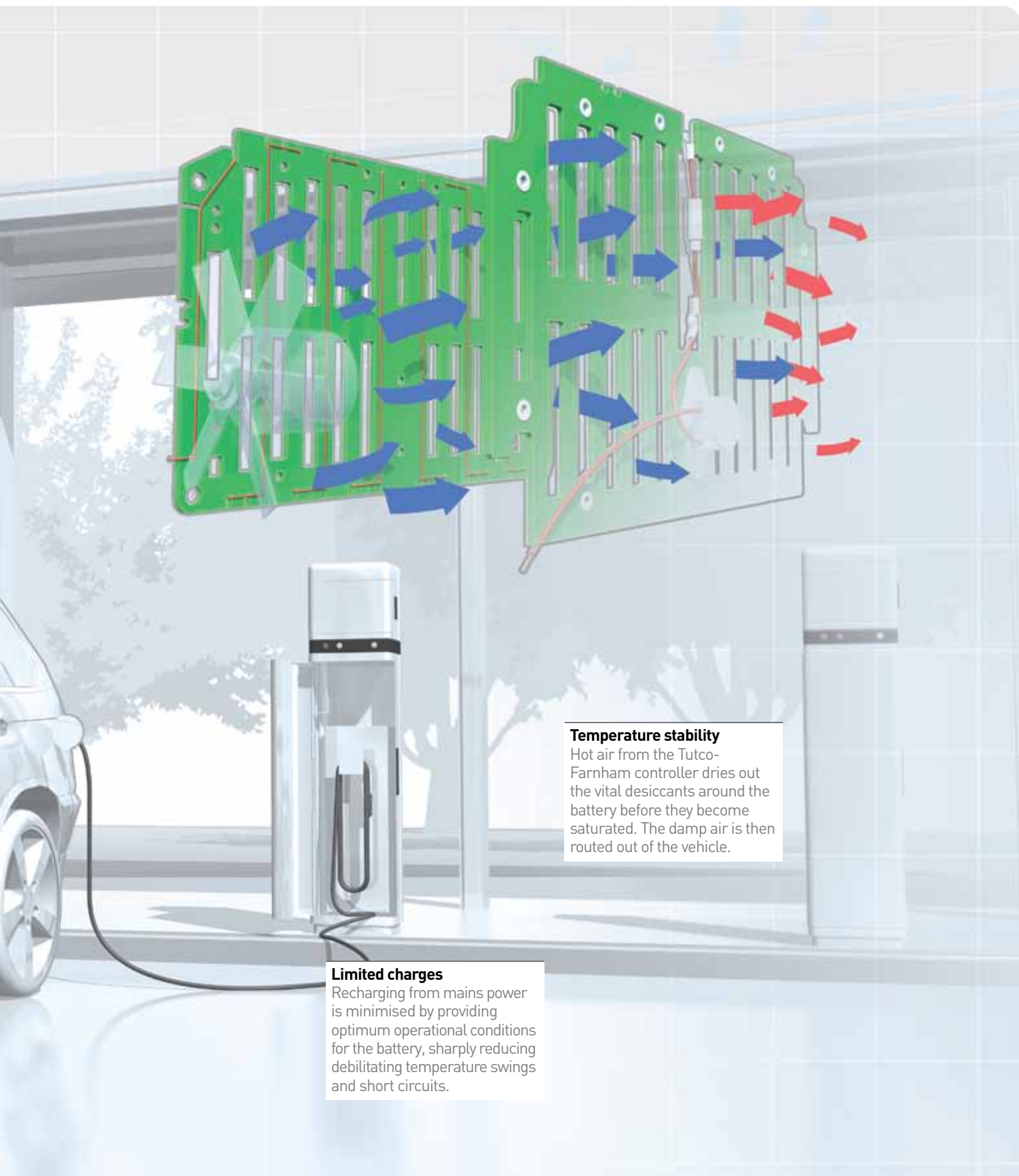
**Power protection**

Protecting the all-important battery of an electric vehicle is crucial if the 'green' alternative to conventional cars is to make headway in the competitive auto market.

**Maximising performance**

The temperature controller is light-weight, hard-wearing and powerful enough to ensure the battery can run for long periods at maximum power with minimum recharging.





#### Temperature stability

Hot air from the Tutco-Farnham controller dries out the vital desiccants around the battery before they become saturated. The damp air is then routed out of the vehicle.

#### Limited charges

Recharging from mains power is minimised by providing optimum operational conditions for the battery, sharply reducing debilitating temperature swings and short circuits.

# Business review

Continued



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 hoses 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 a range of devices; from medical and diagnostic equipment to domestic appliances such as clothes tumble dryers and HVAC equipment.

**Business features**  
**Principal operations regions**

Flex-Tek operations are mainly 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 competitors in the US include: Zoppas, Nibe, Watlow and Chromalox; and in China, Kawai and Dongfang manufacture a wide variety of electric heaters. Flex-Tek's Construction products compete 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.

**Contribution to 2012 Group revenue**

8%

**Contribution to 2012 Group headline operating profit**

6%

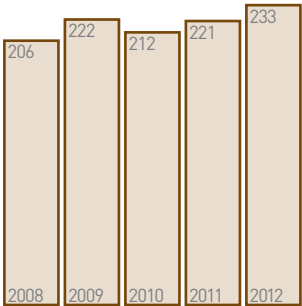
Percentage relates to headline operating profit before corporate costs

**Revenue performance**

£m

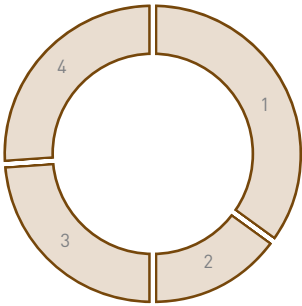
£233m  
+6%

(2011: £221m)



**Revenue by sector £233m**

- 1 Fluid Management 35%
- 2 Flexible Solutions 15%
- 3 Heat Solutions 24%
- 4 Construction Products 26%



Go to [www.flextekgroup.com](http://www.flextekgroup.com) for more information





## 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.

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 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 elements and thermal systems serve customers that manufacture tumble dryers, HVAC equipment, medical applications, and bespoke applications where consistent temperature controls improve system efficiency and performance. Revenue is largely dictated by household appliance demand in the US.

### Construction Products

Flex-Tek makes 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 driven by 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.



### Smooth operator

Tapping into its long expertise in gas hose components, Flex-Tek has developed a compressed air heating system that allows paint spray guns to apply a far smoother finish in auto bodyshop repair work.

The impact is more than merely aesthetic. The advanced high-temperature and controller elements combine to provide a more consistent and faster application, reduced drying time, less paint use, and – most important of all – up to 20% in cost savings.

The device was the fruit of close co-operation between Flex-Tek subsidiary Tutco and a leading US manufacturer of auto refinishing equipment. The company had been seeking ways of providing a more affordable service while simultaneously improving quality and durability, and satisfying new environmental mandates promoting water-based paint.

Though primarily geared towards the auto repair industry, the new device can also be used in a variety of sectors that commonly require spray finishing or coating, such as aerospace and furniture manufacture.



# Business review

Continued

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## Flex-Tek

Continued



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### Fuel-efficient market

The push by aeroplane makers towards lighter materials to save fuel and cut harmful emissions has opened complementary markets for Flex-Tek, a long-established supplier to the aviation industry.

Flex-Tek engineers have been working with their counterparts at Airbus and Boeing to develop new-generation, lightweight Kevlar high-pressure hoses that allow airlines to cut the weight of their hydraulic applications.

The use of Kevlar helps new airliners such as the Airbus A380 and Boeing 787 reduce their per passenger fuel consumption to around three litres per 100 km travelled – a more fuel-efficient level than even the latest family cars.

By combining greater strength with less weight, Kevlar hoses can pass a demanding set of dynamic and static tests involving stresses of more than 5,000 pounds per square inch and a temperature range of -65°F to 275°F.

## Performance

	2012 £m	2011 £m	Reported growth	Underlying growth
Revenue	<b>233</b>	221	6%	5%
Headline operating profit	<b>38</b>	28	38%	36%
Headline operating margin	<b>16.3%</b>	12.5%	380 bps	
Statutory operating (loss)/profit	<b>(17)</b>	26		
Return on capital employed	<b>28.4%</b>	21.9%	650 bps	

Flex-Tek's reported revenue grew 6%, or £12m, driven by an underlying increase of £10m (5%) and a £2m gain from currency translation. The improvement was generated by revenue growth from aerospace components and sales to the US residential construction market. This was partially offset by weakness in the household appliance sector of our heating element business. Headline operating margin rose 380 basis points to 16.3% as a result of the increased volumes and associated operational gearing and positive mix from the faster growing aerospace sales. The underlying increase in operating profit of £10m stemmed from higher volumes, pricing and the benefits of our cost-saving initiatives. There was also a £5m gain from the change in accounting treatment for the legal defence costs associated with the flexible gas piping business. In previous years these costs had been charged to headline operating profit but are now being treated as an exceptional item (see notes 4 and 22 to the accounts). Excluding this change in accounting treatment, the underlying headline operating profit rose 18%.

As announced at the half year, a provision has been established in these accounts to resolve future claims, resulting in a charge of £55m, leading to a statutory operating loss of £17m.

Return on capital employed rose 650 basis points on the back of the improved profitability.

In Fluid Management, sales of components to aerospace customers improved 13% on an underlying basis. This was achieved as a result of higher volumes on major airframe platforms from Airbus and Boeing and engines from Pratt & Whitney and GE. The order book for our commercial aviation OEM business remains strong and we have gained market share in our overhaul and repair service segment. Demand in the commercial aviation market continues to be driven by increased passenger traffic, fuel and operating efficiency, and lower noise levels. In addition, sales of our flexible hose assemblies to the US automotive market for both fuel and brake applications remain robust.

Sales of our flexible gas piping and HVAC ducting to the construction market rose 11%. According to the US Census Bureau, the July 2012 seasonally adjusted annual rate of new single family home starts was slightly above 500,000, a level that has been fairly constant in 2012. Growth has been achieved, resulting in increased market share, by cross-selling our ducting, flexible gas piping and HVAC heating element product lines to the US distribution market. In addition, our Construction Products division has benefited from consolidation at the distributor level. Our customers have been highly active acquirers of distributors in the US and Canada.

Heat Solutions underlying revenue was 9% lower than the prior year, primarily because sales of heating elements to residential HVAC customers remain weak in the US as a result of the uncertain economy. The lower revenue was also due to reduced nickel prices and the correspondingly lower surcharges passed along to customers (£2m). Consumer confidence remains cautious in the US and OEM appliance manufacturers continue to project low single growth rates in the US markets. We have seen an uptick in sales of our custom heating elements as our R&D investments have yielded new products and new applications. Also the cross-selling efforts to the US distributor market have increased our sales of replacement aftermarket HVAC heating elements.

Underlying revenue of the Flexible Solutions division was flat against the previous year. Sales of new medical hose products in the sleep apnoea market and share gains in the US industrial market were offset by continued weakness in the floor care market. We continue to see positive results from this division as it transitions from a focus in floor care to more specialty, engineered products and markets.

Flex-Tek continues to increase R&D spend in Heat Solutions and Fluid Management and is seeing commercial success from this investment. In our Asian manufacturing facilities, in China and India, our investments are showing positive results. We continue to seek new opportunities to grow our market share, expand our product portfolio, and target potential bolt-on acquisitions to build on the strength of the business and the management team.

## Outlook

The improved sales rate seen in the second half of the year is expected to continue. Fluid Management is in a robust aerospace sales cycle which is expected to be maintained for some time. The strong sales should deliver better margins. The US housing market appears to have levelled in the second half of the year and we expect a gradual improvement in the coming year. The backlog of unsold houses has decreased, mortgage rates remain at historic low levels, and credit is more widely available. These factors should help bolster the sales of our Heat Solutions and Construction Products divisions. Flexible Solutions is expected to deliver modest growth with the general improvement in the US economy.

# Financial review

## Earnings per share

Basic headline earnings per share from continuing activities were 92.6p (2011: 86.5p – restated), a growth of 7%. This reflects an increased headline operating profit which has been partly offset by a higher tax rate.

On a statutory basis, the basic earnings per share from continuing activities were 65.4p (2011: 77.8p).

## Exceptional and other items relating to continuing activities excluded from headline profit before tax

These items amounted to a charge of £131m compared to a charge of £65m in 2011. They comprised:

- Amortisation and impairment of intangible assets acquired in business combinations of £62m (2011: £50m). The charge relates principally to technology and customer relationships;
- A charge of £44m (2011: £34m) in connection with John Crane, Inc. asbestos litigation;
- A charge of £55m for the establishment of a provision to resolve potential future claims alleging product liability in Titeflex Corporation (2011: nil);
- A charge of £15m (2011: £16m) in respect of restructuring. This is part of two programmes: a Group-wide restructuring plan that began in 2008 and is now largely complete and a performance improvement programme in Smiths Detection that will conclude in 2014;
- A charge of £8m in relation to a change in the basis of estimating sales rebates in Smiths Medical (2011: nil);
- Acquisition costs of £2m (2011: £1m);
- £31m profit on disposal of businesses (2011: £4m)
- A £3m gain on reassessed contingent consideration;
- A credit of £24m for retirement benefit income (2011: £23m); and
- A financing loss of £3m (2011: £3m). This represents exchange movements on derivatives and other financing instruments not hedge accounted under IFRS.

## Cash generation and net debt

Operating cash generation remained strong with headline operating cash of £549m (2011: £489m), representing 99% (2011: 95%) of headline operating profit (see note 27 to the accounts for a reconciliation of headline operating cash and free cash-flow to statutory cash-flow measures). Free cash-flow fell £19m to £217m (2011: £236m). Free cash-flow is stated after interest and tax but before acquisitions, financing activities and dividends.

On a statutory basis, net cash inflow from continuing operations was £332m (2011: £322m).

Dividends paid in the year on ordinary shares amounted to £144m (2011: £136m).

Net debt at 31 July was £791m, up from £729m at 31 July 2011. The increase in net debt reflects strong cash generation that was more than offset by outflows from the net impact of acquisitions and disposals (£120m), dividends (£144m) and pension funding (£122m).

## Headline interest and other financing costs

Interest payable on debt, net of interest earned on cash deposits, was £63m compared with £59m in 2011. This increase reflects the higher average levels of debt. Interest costs were covered 8.8 times by headline operating profits.

The Group accounts for pensions using IAS19. As required by this standard, a finance credit is recognised reflecting the expected return on pension scheme assets and a finance charge is recognised reflecting the unwinding of the discount on the future pension liability. The net financing credit was £24m (2011: £23m). As of 1 August 2011, we now report headline pre-tax profit excluding this item and comparative figures have been adjusted accordingly. The headline measures are intended to report the underlying performance of the Group.

## 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 £117m in R&D (2011: £111m), equivalent to 3.8% of revenue (2011: 3.9%). Of that total, £107m was funded by the Company compared with £99m in 2011, an increase of 9%. We actively seek funding from customers to support R&D and this amounted to £10m (2011: £12m). Under IFRS, certain development costs are capitalised, and this amounted to £29m in the period (2011: £31m). 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 fundamental principles of the Group's approach to taxation remain unchanged. The Group seeks to mitigate the burden of taxation in a responsible manner to enhance its competitive position on a global basis while managing its relationships with tax authorities on the basis of full disclosure, co-operation and legal compliance. A semi-annual tax report is reviewed by the Audit Committee to monitor compliance with these principles to ensure the Group delivers its tax objectives.

The headline tax charge for 2012 of £132m (2011: £123m – restated) represented an effective rate of 26.5% on the headline profit before taxation (2011: 26.5% – restated). This is unchanged from the 2011 restated rate which now excludes financing credits and charges relating to retirement benefits, which are no longer part of headline profit before taxation. On a statutory basis, the tax charge on continuing activities was £108m (2011: £92m).

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. A rate of between 27% and 29% is expected in the year ending 31 July 2013.

## Exceptional taxation

At 31 July 2011 the Group recognised UK tax assets relating to revenue losses brought forward and deferred capital allowances of £37.7m. The value of these assets is reviewed regularly and is dependent on the ability to recover them against forecast UK taxable profits. Having considered the impact of the increased pension deficit on the outlook for the UK tax base, the Group has decided to derecognise the tax assets at 31 July 2012 as an exceptional non-headline tax charge because it is no longer probable that they will be recovered. These tax allowances however remain available to the Group and can be utilised should the UK tax base improve.

### Headline revenue

Up 7% to

**£3,038m**

Read more on page 19 and  
in note 1 on page 102



### Headline operating profit

Up to 7% to

**£554m**

Read more on pages 19 and 50  
and in note 1 on page 102 and  
note 3 on page 106



### Statutory revenue

Up 7% to

**£3,030m**

Read more on page 19 and  
in note 1 on pages 104-105



### Statutory operating profit

Down 7% to

**£407m**

Read more on pages 19 and 50  
and in note 1 on page 102 and  
note 4 on page 107



### 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, post-retirement benefit assets and liabilities net of tax, litigation provisions relating to exceptional items net of tax, and net debt. In the light of the recognition of the Titeflex litigation provision, the Board decided at the interim results to restate capital employed to exclude significant litigation provisions (see note 1 to the accounts). The restatement reduced the ROCE previously reported at 31 July 2011 from 17.0% to 16.4%. The ROCE improved 10 basis points to 16.5% (2011: 16.4%) as a result of improved profitability across most divisions which more than offset reduced profitability in Smiths Interconnect as well as the investment in the Power Holdings acquisition that completed in October 2011.

### 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 2012 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 increased to £620m at 31 July 2012 from £199m at 31 July 2011. The increase reflects the impact of poor asset returns and, particularly, the impact of very low corporate bond rates upon which the liability is calculated.

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 2012	28 January 2012	31 July 2011
Funded plans			
UK plans – funding status	<b>91%</b>	94%	101%
US plans – funding status	<b>67%</b>	70%	76%
Other plans – funding status	<b>67%</b>	77%	77%

	31 July 2012	28 January 2012	31 July 2011
Deficit			
Funded plans	<b>(516)</b>	(367)	(108)
Unfunded plans	<b>(104)</b>	(92)	(91)
Total deficit	<b>(620)</b>	(459)	(199)

	31 July 2012	28 January 2012	31 July 2011
Retirement benefit assets	<b>7</b>	51	141
Retirement benefit liabilities	<b>(627)</b>	(510)	(340)
	<b>(620)</b>	(459)	(199)

In the coming year, cash contributions to the schemes are expected to total approximately £90m (2012: £115m). 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 (SIPS).

The approximate pension membership for the three main schemes at around the end of July is set out in the table below:

Pension scheme members	SIPS	TIGPS	US plans	Total
Deferred active	680	320	3,590	<b>4,590</b>
Deferred	12,240	14,860	6,850	<b>33,950</b>
Pensioners	12,910	18,650	5,310	<b>36,870</b>
<b>Total</b>	<b>25,830</b>	<b>33,830</b>	<b>15,750</b>	<b>75,410</b>

### 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 2012	31 July 2011		28 January 2012
Average rates:				
US dollar	<b>1.58</b>	1.60	Dollar strengthened 1%	1.58
Euro	<b>1.20</b>	1.16	Euro weakened 3%	1.16
Year-end rates:				
US dollar	<b>1.57</b>	1.64	Dollar strengthened 4%	1.57
Euro	<b>1.27</b>	1.14	Euro weakened 11%	1.19



# Financial review

## Continued

### 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. The goodwill balance was tested for impairment in 2011 and 2012.

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. When indicators of impairments are identified, the intangible assets are tested and any impairment identified is charged in full. The impairment charge is excluded from the measure of headline profits. During the current year an impairment charge of £11m was identified in respect of the acquisition of Power Holdings Inc. (PDI). 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.

### 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 96-101.

### 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 pages 96-97.

### 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 efficiently across the divisions.

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 2012 were BBB+ / Baa2 (stable) from Standard & Poor's and Moody's respectively. An essential element of an investment-grade rating is consistent, robust cash-flow metrics. The Group's objective is to maintain a headline operating cash conversion of greater than 90% and net debt/headline EBITDA at less than two times. At 31 July 2012, these measures were 99% (2011: 95%) and 1.2 times (2011: 1.2 times) respectively.

### 2 Debt and interest rate management

The Group's financing is managed centrally. At 31 July 2012 net debt was £791m (2011: £729m). The core available financing for the Group is provided by a US\$800m committed revolving credit facility, provided by a group of 10 global banking partners, which matures in December 2015. The Group remains in full compliance with any covenants within its debt agreements. The Group's risk management objectives are to ensure that over time funding drawn from the bank market is less than 30% of net debt, the average maturity profile of gross debt is at or greater than four years and over 60% of net debt is at fixed rates. At 31 July 2012, these measures were 0% (2011: 0%); 3.9 years (2011: 4.9 years) and 92% (2011: 99%). 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 2012 was 73% (2011: 74%).

### 3 Liquidity management

At 31 July 2012, the US\$800m committed bank facility was 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 2012, this measure was £511m (2011: £487m). At 31 July 2012, cash resources were £206m (2011: £261m). The Group aims to ensure that these 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 with counterparty limits established by reference to their Standard & Poor's long-term debt rating. Compliance is measured and reported monthly to the Executive Committee and the Board. At 31 July 2012, 97% (2011: 97%) of cash resources were on deposit with the 10 global relationship banks and of these resources only £13m (2011: £3m) was invested with counterparties rated less than A+, of which £12m was invested with a counterparty rated 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 2012, 45% (2011: 45%) of total foreign currency assets were matched by related currency liabilities.

### Financial controls

While the Group's decentralised organisation delegates day-to-day control to local management, Smiths Group 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 54 to 58 and the Corporate governance statement on pages 71 to 79.

### 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 Group 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 Group aims to anticipate and meet the changing requirements of the markets it serves, as legal and regulatory reforms impact those markets.

### Legal issues

Smiths Group 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, legal challenges to the scope and validity of patents and product liability and insurance subrogation claims. 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 Group employs experienced lawyers both in its head office and in its divisions, and retains the services of major law firms around the world.

Read more in note 22  
on pages 128-130



### 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 221,000 claims against JCI have been dismissed before trial over the last 33 years. JCI is currently a defendant in cases involving approximately 86,000 claims. Despite these large numbers of claims, JCI has had final judgments against it in only 115 cases, and has had to pay awards amounting to approximately US \$111m.

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 2012, the aggregate provision for JCI asbestos litigation, including for adverse judgments and defence costs, amounted to £213m 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.

## Risk management

Smiths Group 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. An outline of this year's review process by the Board and Audit Committee is set out on page 77. A description of the Company's internal controls and risk management processes is given in the Corporate governance statement, on pages 75-76.

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.

### Changes to the Group's risk profile

Since the last annual report, the Group's assessment of its risks has incorporated the following risk areas:

- There has been a sustained risk that certain Eurozone members fail to meet their sovereign debt obligations, which could destabilise the Euro currency and result in currency devaluations in some of our Eurozone markets. If such devaluation took place, the Group's trading position might be adversely affected and investments in such markets may decrease in value. We are preparing plans to address these effects where it would be practical and economic to do so.
- Continued constraints on government budgets are likely to put pressure on public sector spending in areas such as healthcare, defence and homeland security in markets in which the Group operates. This budgetary pressure has also caused payment terms to lengthen with some government-funded customers, particularly in Southern Europe, although we continue to manage any overdue debts very closely. There may be other effects, such as changes in the fiscal and regulatory policies in the countries where the Group conducts its business.
- The incidence of cyber-security crime has increased in recent years and some Smiths Group companies operate in sectors where cyber-criminals have been active. We continue to monitor our systems closely and have introduced a Group-wide information security awareness programme.

### Economic outlook

#### Risk

The Group operates in more than 50 countries and is affected by global economic conditions, particularly in the US and Europe. Our business is also affected by government spending priorities, in particular in the US and Europe, 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 Group performance and financial condition. A recession may also materially affect our customers, suppliers and other parties with which we do business. Adverse economic and financial market conditions may cause our customers to terminate existing orders, to reduce their purchases from the Group, or to be unable to meet their obligations to pay outstanding amounts due to the Group. These market conditions may also cause our suppliers to be unable to meet their commitments to the Group 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 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. The Group is exposed to two types of currency risk: transaction and translation.

**Funding:** The Group's 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 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.

**Insurance:** The Group cannot be certain that it will be able to obtain insurance on acceptable terms or at all. Furthermore, the Group 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, the Group 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 2012, we had an undrawn revolving credit facility of \$800m.
- **Tax:** The Group's taxation staff co-ordinate 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.

Read more on page 52



## Eurozone break-up

### Risk

Political and economic structural weaknesses in the single currency framework have caused heightened risk that the Eurozone may not survive in its present form. If the Eurozone breaks up, one or more countries will leave the Euro, and opt for new currencies. This may result in substantial default on existing Euro sovereign debt and economic dislocation. It could also result in capital exchange controls being imposed, some domestic banking failures and expropriation of assets.

### Potential impact

Smiths Group has approximately 5-6% of its business (measured by sales, profit or net assets) in Spain, Ireland, Portugal, Italy and Greece, which could be adversely affected by currency devaluations.

It might affect the profitability of existing contracts and customers might be unable to repay debts according to agreed terms. A Eurozone break-up is likely to affect the wider economic environment, particularly in Europe, which could affect trading on a global basis.

### Risk management

- The diversified portfolio mitigates exposure to any single country or currency. We also have robust processes to monitor overdue debts.
- We have net investment hedging of c. 50% of our overseas currency exposure and assets.
- A project has identified further risk mitigation actions and reviewed opportunities to provide contractual protection.

## Global supply chain/concentration of manufacturing Risk

The Group's 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. The Group 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.
- The Group 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, around 35% of the Group's revenue is 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 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 a 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 and cyber-security

#### Risk

The Group's information systems, personnel and facilities are subject to security risk. The Group is dependent on information technology systems for both internal and external communications and for the day-to-day management of its operations. The incidence of cyber-security crime is on the rise and some Smiths Group companies operate in sectors where cyber-criminals are active.

#### Potential impact

Any disruption to the information systems could have significant adverse consequences for the Group's operations or its ability to trade. It could result in the loss of confidential information and intellectual property, which could affect the Group's competitive position and cause reputational damage.

#### 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.
- A Group-wide information security awareness programme has been launched.

### 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.

The Group 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, the Group has disposed of a number of businesses, including its Aerospace operations, where it has given indemnities, warranties and guarantees to counterparties. The Group 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 Group 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 the Group may not always be in complete compliance with laws, regulations or permits, for example concerning environmental or safety requirements.

The Group 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.

Smiths Detection and Smiths Interconnect manufacture security products and components, which 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

The Group 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. Corruption on the part of a single employee can entail severe consequences for the Group.

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 2012, the Group has legacy defined benefit pension plans, with aggregate liabilities in excess of £3bn on an accounting basis. 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. The 2012 triennial review of the principal UK pension schemes may result in higher cash payments from the Group.

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.

Read more in note 10  
on pages 112-115



# Risk management

## Continued

### Product liability and litigation

#### Risk

In the ordinary course of its business, the Group 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 the Group, 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 informed by crisis management planning workshops and rehearsals.
- The Group has insurance cover for certain product liability risks. 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 legal function. We have detailed action plans to manage actual or threatened litigation.

Read more on page 53 and  
in note 22 on pages 128-130



### 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 effect 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 the Group 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, the Group's 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.

Read more on pages 17 and 63



## Corporate responsibility

Conducting our business responsibly is one of our fundamental values and a key element of our five-part business strategy. The Code of Business Ethics (the Code) is at the heart of our corporate responsibility (CR) approach. 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 CR issues.

The Code applies to all of our businesses and employees worldwide. Complying with it enables us to meet our obligations to our stakeholders and to create long-term value for our shareholders, by delivering real business benefits. These include:

- helping our people to work productively in a safe and ethical 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 is also a business opportunity for us. Our customers value suppliers with strong CR performance and many of our products and services also benefit the environment and contribute to the safety, health and security of people around the world. For example, John Crane's seals help our customers to reduce their environmental impact.

### Communicating the Code

We make the Code available to employees in 12 languages, in both printed format and on the Group's 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 Group training portal accessible through the internet. The course is also available on CD-ROM.

The GLR and portal are designed to support future employee training in the areas of business ethics, compliance, safety and security. Several other compliance training courses are available in various formats. We regularly add new ethics and compliance training programmes and in 2011 we added an online Anti-Bribery and Corruption course.

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

Read more at  
[www.smiths.com/responsibility](http://www.smiths.com/responsibility)



# Corporate responsibility

## Continued

### 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.

The Senior Vice President, Ethics & Compliance periodically reports to the Audit Committee on ethical 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. Legal counsel provide compliance support to our businesses. They offer advice, education, training, guidance materials, export control policies and risk assessment tools.

The Group maintains a confidential Ethics Alertline, which answers queries and enables employees to report any concerns or allegations. The Alertline is available via email, the internet and toll-free phone numbers in 53 countries. Last year we engaged a company that specialises in ethics management to administer the Alertline, to provide continuous coverage and support in 35 languages. All issues are addressed promptly and referred, as required, to relevant functions so we can investigate them. Our non-retaliation policy means that any employee who, in good faith, reports apparent misconduct or unethical behaviour will not be victimised or treated adversely.

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

- 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.

### Environment, health and safety

The Group 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 have a Group EHS strategy, KPIs and goals, which support our business strategy and the Code. Our divisions adapt the Group EHS strategy to reflect their specific impacts and any needs to improve their EHS management and performance.

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

For several years, we implemented 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, 95 are required to implement systems and complete external certification. Some smaller sites voluntarily obtain certification. So far, 95 sites have completed certification. Sites that have not completed certification have action plans to do so. Most of these sites are new acquisitions or expanded operations and they have two years to obtain certification.



## Health and safety

Our Group-wide activities to reduce incidents have focused on leadership and employee safety awareness and involvement. We have recently implemented these activities and are monitoring them through our Safety Leading Indicator Activities Programme.

Starting in FY2012, we added a safety leading indicator activity score as a KPI for safety, complementing the recordable incident rate (RIR). Sites with more than 50 employees are required to complete a minimum number of each of the following activities, which count towards their score:

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

During FY2012, over 100 sites implemented these activities. Sites report their scores quarterly and are required to achieve annual targets. Performance against Leading Indicator Targets is reviewed quarterly by the Executive Committee and the Board.

Our FY2012 safety KPIs were the Safety Leading Indicator Activity Score, RIR and lost time incident rate (LTIR). Smiths Group and all its divisions completed the required number of safety leading indicator activities, which will support our efforts to improve our safety culture and risk management.

RIR and LTIR 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 FY2012 being our safest on record. Our goal is to reach an RIR of 0.5 by July 2013. We also set annual progress targets, with our FY2012 target at 0.58. We improved our RIR over the previous year, meeting our 0.58 target excluding acquired sites. When sites acquired during the year are included our RIR of 0.60 is still our best on record.

We have also continued to reduce our LTIR in recent years. Our LTIR has dropped from 0.54 in FY2008 to 0.21 in FY2012.

### Performance against safety targets

	FY2013 target	2012 result
<b>Recordable incident rate</b>	Better than 0.5 per 100 employees	<b>0.60*</b>
<b>Lost time incident rate</b>	No target	<b>0.21</b>

\*0.58 excluding recently acquired businesses

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

## 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 revenue against a baseline of FY2010. Where necessary, we adjust our baseline metrics to account for acquisitions and disposals.

In FY2010 we 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 are therefore slightly higher than FY2009, due to the inclusion of more of our business from this revised policy.

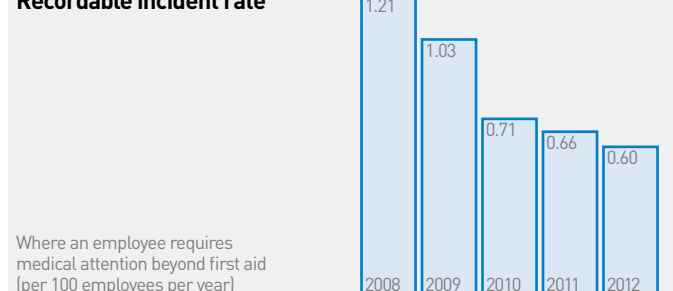
Our environmental performance through FY2012 continued to be very favourable, compared to our baseline year of FY2010. We have achieved significant reductions in all metrics, already exceeding our FY2015 goals. Our intention is now to establish new multi-year goals to reflect this outperformance. When analysing changes in our environmental metrics, absolute increases are mainly associated with higher production and acquired businesses and some decreases are associated with site closures and consolidations, as well as improved recycling and energy conservation.

### Performance against environment targets\*

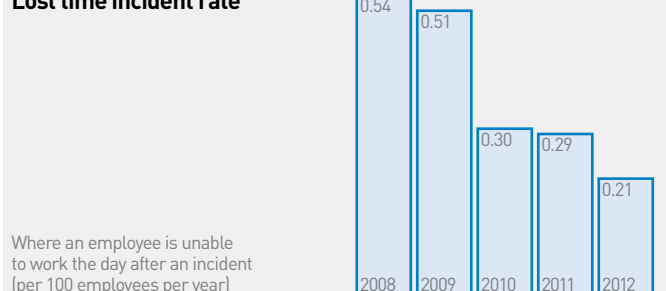
	Target FY2010-FY2015	2012 progress against FY2010
<b>Energy</b>	10% reduction over 5 years	<b>16% reduction</b>
<b>Greenhouse gas emissions</b>	10% reduction over 5 years	<b>19% reduction</b>
<b>Total non-recycled waste</b>	10% reduction over 5 years	<b>18% reduction</b>
<b>Water consumption</b>	5% reduction over 5 years	<b>19% reduction</b>

\*Reduction targets are compared to the FY2010 baseline year and normalised to revenue consolidated at FY2012 exchange rates

### Recordable incident rate



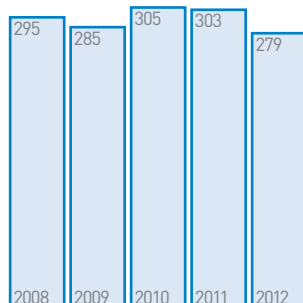
### Lost time incident rate



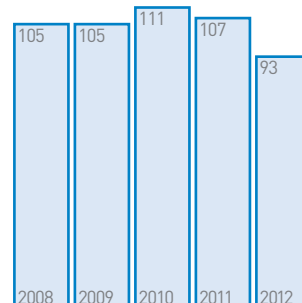
# Corporate responsibility

Continued

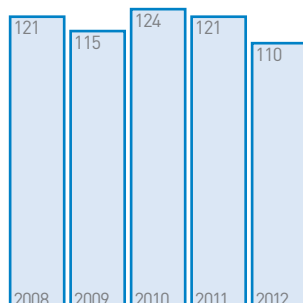
**Total energy**  
'000 MWh



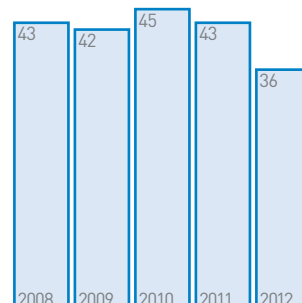
**Total energy efficiency**  
MWh/£m revenue



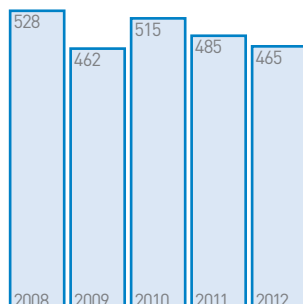
**Total CO<sub>2</sub> emissions**  
'000 Tonnes



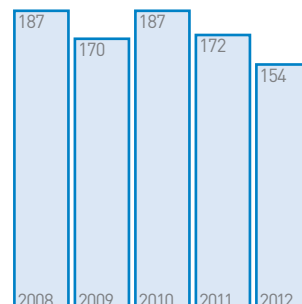
**Total CO<sub>2</sub> emissions**  
Tonnes/£m revenue



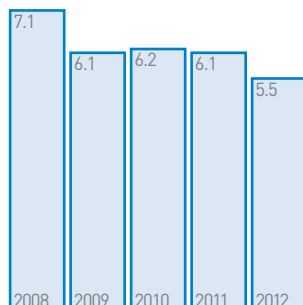
**Water use**  
'000m<sup>3</sup>



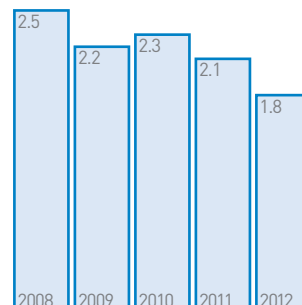
**Water consumption**  
m<sup>3</sup>/£m revenue



**Total non-recycled waste**  
'000 Tonnes



**Total non-recycled waste**  
Tonnes/£m revenue



Note: Environmental metrics are normalised to revenue consolidated at FY2012 exchange rates

## 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 the Group, we are taking action to achieve the best possible long-term performance for our shareholders. We invest in our people's skills and capabilities, and expect them to reflect that investment in their delivery of business results.

The Group periodically offers employees in the US and the UK opportunities to participate in share plans that enable them to benefit from increases in the Company's share price, aligning their interests more closely with those of shareholders.

### Career progression

As a global technology group, we offer a variety of ways for our people to progress their careers, 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 employment opportunities. The Group recruits, selects and promotes employees on the basis of their qualifications, skills, aptitude and attitude. In employment-related decisions, the Group complies with all applicable anti-discrimination requirements in the relevant jurisdictions, including those 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 the Group's employees are treated with respect and dignity. Accordingly, any harassment or bullying is unacceptable. The Group respects the right of each employee to join or not to join a trade union or other bona fide employee representative organisation.

### Succession management

The Group 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. Senior management monitor development plans, to optimise effective succession.

### Developing talent

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 ours. 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.

## Communication

Communication is crucial to helping employees engage with the business. The Group believes in good communication with employees and in promoting consultation, co-operation and teamwork on matters of mutual concern.

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 EHS issues.

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

### Employee engagement

In FY2012, the Group conducted its second global 'My Voice' employee engagement survey. 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 a participation rate of more than 91%.

Results were measured against the global norms for manufacturing industry and were communicated at divisional, local and functional levels. Action plans to address the most significant issues have been drawn up using focus groups and local champions. We will repeat our global surveys periodically, so we can monitor our progress.

### Acquisition integration

When new businesses are acquired, we implement plans to integrate them into the Group, ensuring that our business ethics, employee development and EHS 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. Building strong community links also benefits our business. It helps to enhance our reputation, foster employee engagement and attract new employees.

We primarily manage these activities at a divisional level. However, the Group 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. During the financial year, the Group made charitable donations of £570,000.

### Controls on defence sales

All sales and exports of defence equipment are undertaken in accordance with international trade regulations and national 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. The Group 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. The Group continues to be awarded membership of the index. While we are not complacent about the ongoing work required, we were pleased to receive this external recognition of our CR initiatives and business ethics programme.

# Board of directors



## **Donald Brydon, CBE** **Chairman**

Aged 67, Donald Brydon is British and has a BSc in Mathematical Science. He started his career in investment management and has chaired a number of major companies. He became Chairman of Smiths Group in 2004.

### **Strengths and experience**

Donald had a 20-year career with Barclays Group, during which time he was Chairman and Chief Executive of BZW Investment Management and acting Chief Executive of BZW. This was followed by 10 years with the AXA Group where he held the posts of Chairman and Chief Executive of AXA Investment Managers and was Chairman of AXA Framlington. He has recently retired from the Boards of AXA Investment Managers SA and AXA Rosenberg LLP. He was also formerly the chairman of the London Metal Exchange, Taylor Nelson Sofres plc and Amersham plc and a non-executive director of Allied Domecq plc and Scottish Power plc.

### **Committee membership**

- Chairman of the Nomination Committee
- Remuneration Committee

### **External appointments**

- Chairman of Royal Mail Group plc and Chairman of its Nominations committee
- Chairman of Sage Group plc
- Chairman Designate of the Medical Research Council (effective 1 October 2012)



## **Philip Bowman** **Chief Executive**

Aged 59, Philip Bowman is Australian with a MA in Natural Sciences. He has extensive experience of leadership at major international public companies and was appointed Chief Executive of Smiths Group in 2007.

### **Strengths and experience**

Philip was previously Chief Executive of Scottish Power plc and Allied Domecq plc. He also held non-executive directorships at British Sky Broadcasting Group plc, Scottish and Newcastle Group plc and Coles Myer Limited as well as having been Chairman of Liberty plc and Coral Eurobet plc. His earlier career included five years as a director of Bass plc, where he held the roles of Chief Financial Officer and subsequently Chief Executive of Bass Taverns.

### **External appointments**

- Senior Independent Director and Chairman of the Audit Committee of Burberry Group plc
- Non-executive director of Better Capital PCC Limited
- Chairman of The Miller Group Limited



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

Aged 42, Peter Turner is British with a BA in Natural Science – Chemistry. He qualified as a Chartered Accountant whilst working for PricewaterhouseCoopers. He became Finance Director of Smiths Group in 2010.

### **Strengths and experience**

Peter joined Smiths Group from the independent oil company, Venture Production plc, where he was the Finance Director. He previously held a number of senior finance posts at the global gases group, BOC Group plc, including Director of Taxation and Treasury and Finance Director of the Group's largest division. Peter has wide knowledge and experience of multi-national operations, including the oil and gas sector.



## **Bruno Angelici** **Non-executive director**

Aged 65, Bruno Angelici is French with a MBA (Kellogg School of Management) and Business and Law degrees from Reims. He was appointed to the Board of Smiths Group in 2010.

### **Strengths and experience**

Bruno's career includes senior management roles in pharmaceutical and medical device companies. Bruno retired from AstraZeneca in 2009 as Executive Vice President, International after a 20-year career. He was responsible for Europe, Japan, Asia Pacific, Latin America, Middle East and Africa and originally joined as President of ICI Pharma France. Prior to this, he was at Baxter, a US-based global supplier of medical devices. He has extensive international experience, including in the US, and brings a deep understanding to the Group of the medical device and pharmaceutical industries.

### **Committee memberships**

- Audit Committee
- Nomination Committee
- Remuneration Committee

### **External appointments**

- Member of the Global Advisory Board of Takeda Pharmaceutical Company Ltd, Japan
- Non-executive director of Novo Nordisk A/S, a Danish healthcare company
- Member of the Supervisory Board and the Audit Committee of Wolters Kluwer nv, a Dutch-based information services and publishing company



**David Challen, CBE**  
**Senior Independent Director**

Aged 69, David Challen CBE was appointed to the Board in 2004. He is British with a BA in Mathematics, a BSc in Natural Science – Physics and an MBA from Harvard.

**Strengths and experience**

David had a long and distinguished career in investment banking. He is a former Chairman of J Henry Schroder & Co, where he spent most of his professional career. He was the first chairman of the Financial Services Practitioner Panel set up under the act which created the Financial Services Authority. He has an in-depth understanding of capital markets and provides valuable support to the Group on key financial matters.

**Committee membership**

- Chairman of the Audit Committee
- Nomination Committee
- Remuneration Committee

**External appointments**

- Senior Independent Director and Chairman of the Audit Committee of Anglo American plc
- Chairman of the Citigroup EMEA Governance Committee
- Deputy Chairman of the Takeover Panel
- Member of the Financial Reporting Council's advisory group of audit committee chairmen



**Tanya Fratto**  
**Non-executive director**

Aged 51, Tanya Fratto was appointed to the Board in 2012. An American, she is a qualified electrical engineer with a BSc in Electrical Engineering.

**Strengths and experience**

Tanya was CEO of Diamond Innovations Inc., a world-leading manufacturer of super-abrasive products for the material removal industry, until 2010. Before that she enjoyed a successful 20-year career with GE. She held a number of senior positions in product management, operations, Six Sigma and supply chain management. Tanya provides Smiths with wide experience in product innovation and sales and marketing in a range of sectors.

**Committee membership**

- Audit Committee
- Nomination Committee
- Remuneration Committee

**External appointments**

- Non-executive director of Boart Longyear Ltd, an Australian-listed, US-based mining products and services company



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

Aged 61, Anne Quinn was appointed to the Board in 2009. She is from New Zealand and has a BCom and MSc in Management Science.

**Strengths and experience**

Anne spent her early career with NZ Forest Products Limited and the US management consulting company, Resource Planning Associates. She has extensive overseas experience in the oil and gas sector, having enjoyed a successful 20-year career with BP. She held a number of executive positions including Group Vice President in the US, Belgium, Colombia and the UK. Following her career with BP, Anne was a director of Riverstone LLP, an energy private equity group. Anne's experience is a great benefit to the Group in its development of new geographic markets and its exposure to the oil and gas sector.

**Committee memberships**

- Chair of the Remuneration Committee
- Audit Committee
- Nomination Committee

**External appointments**

- Senior Independent Director and Chair of the Remuneration Committee of Mondi plc and Mondi Limited, a company dual-listed in the UK and South Africa



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

Aged 65, Sir Kevin Tebbit was appointed to the Board in June 2006. Sir Kevin is British and has a BA in History.

**Strengths and experience**

Sir Kevin held policy management and finance posts in the MoD, Foreign and Commonwealth Office and NATO. These included three years service in Washington as Defence and European Counsellor at the British Embassy before becoming Director of GCHQ and finally Permanent Under Secretary at the Ministry of Defence from 1998 to 2005. Sir Kevin's career as a former senior British civil servant provides Smiths with considerable experience in the defence sector and in government relations issues.

**Committee memberships**

- Audit Committee
- Nomination Committee
- Remuneration Committee

**External appointments**

- Senior Adviser to URS Corporation
- Senior Associate Fellow at Royal United Services Institute
- Chairman of the Industry Advisory Group to the UKTI Defence and Security Organisation
- Visiting Professor at Queen Mary University, London
- Member of the Advisory Board of the Imperial College Institute for Security and Technology



# Group directors' report

## Principal activities

The principal activities of the Company and its subsidiaries (the Group) are and, during the year ended 31 July 2012, were the development, manufacture, sale and support of:

- detection technologies, including x-ray, trace detection, infrared and gamma ray spectroscopy and millimetre-wave, that detect and identify explosives, narcotics, weapons, chemical agents, biohazards, nuclear and radioactive materials and contraband;
- engineered products and services for the major process industries, including oil and gas, power generation, chemical, pharmaceutical, pulp and paper and mining sectors;
- medical devices and consumables for medication delivery; vital care; and the safety of health-workers and patients;
- technically differentiated electronic components and sub-systems providing signal, power and microwave solutions for the global data centre, 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 appliance 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 8 to 65 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 2012; 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 page 1 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 2012 are set out in the Consolidated income statement. Revenues for the year amounted to £3,030m (2011: £2,842m). The profit for the year after taxation amounted to £258.2m (2011: £385.1m).

An interim dividend of 11.75p per ordinary share of 37.5p was paid on 20 April 2012. The directors recommend for payment on 23 November 2012 a final cash dividend of 26.25p on each ordinary share of 37.5p, making a total dividend of 38p for the financial year.

The retained profit of £258.2m was transferred to Reserves.

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

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.

On 16 July 2012 the Company disposed of its minority equity stake in Cross Match Technologies, Inc. for US\$69m in cash plus up to US\$8m to be held in escrow to cover working capital adjustments and possible legal claims for up to 15 months.

## Post balance sheet events

There have been no reportable post balance sheet events.

## Charitable and political donations

During the financial year the Group made donations of £570,000 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 parties totalling £32,000 during the year. The political contributions were made on a bi-partisan basis in the US, in accordance with US state and federal election laws, in order to raise awareness and to promote the interests of the Company. The Group has a number of key manufacturing sites and approximately 8,600 employees in the US.

## Directors

Messrs B.F.J. Angelici, P. Bowman, D.H. Brydon, CBE, D.J. Challen, CBE 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. Mr S.J. Chambers retired from the Board on 1 July 2012 and Ms T.D. Fratto was appointed as a non-executive director of the Company on the same date.

## Reappointment of directors

In accordance with the UK Corporate Governance Code, all the directors, other than Ms Fratto, will retire voluntarily from office at the AGM and will seek re-election. Ms Fratto will retire at the AGM under Article 49 of the Company's Articles of Association, following her appointment during the year, and will also seek re-election. Separate resolutions to re-elect each of them as a director of the Company will be proposed at the AGM. Biographical details of all the directors are set out on pages 64 and 65.

## Directors' remuneration report

The Directors' remuneration report is on pages 80 to 88.

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 85. Details of the interests of the executive directors in the Company's share option schemes and plans are shown in the Directors' remuneration report on pages 87 and 88.

Qualifying third-party indemnity provisions (as defined by section 234 of the Companies Act 2006 (the '2006 Act')) have remained in force for the directors during the financial year ended 31 July 2012 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 for the Company.

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 2012 the Company had been notified, pursuant to the FSA's Disclosure & Transparency Rules, of notifiable voting rights in its issued share capital or had received disclosures pursuant to the 2006 Act of interests in its share capital, as follows:

	Number of shares	Percentage of issued ordinary share capital*
BlackRock Investment Management (UK) Ltd	16.4m	4.2%
Ameriprise Financial / Threadneedle Asset Management	18.3m	4.7%
Legal & General Group plc	19.2m	4.9%
Massachusetts Financial Services Company	17.9m	4.6%
Newton Investment Management Limited	15.2m	3.9%

\*Percentage of ordinary share capital in issue on 31 July 2012.

On 29 August 2012 M&G Investment disclosed to the Company that it had interests in 17.4 million shares (approximately 4.4% of the issued share capital). As at 31 August 2012 Morgan Stanley Investment Management disclosed it had indirect interests as a discretionary fund manager in 14.2 million shares (3.6% of issued share capital) and Massachusetts Financial Services Company disclosed that it had interests in 18.5 million shares (4.7% of the 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 17 September 2012.

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 85.

## Corporate governance statement

The Corporate governance statement is on pages 71 to 79 and is incorporated in this Directors' report by reference. PricewaterhouseCoopers LLP has reviewed the Company's 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 90.

## 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 20 of the Group accounts.

## Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Business review on pages 19 to 49. The financial position of the Company, its cash-flows, liquidity position and borrowing facilities are described in the Financial review on pages 50 to 52. In addition, the notes to the accounts include the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk.

At 31 July 2012 the Group had available cash and short-term deposit resources of £206m 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 54 to 58). In coming to this conclusion, the directors have taken account of the Group's risk management process, described on pages 75 to 78, and have paid particular attention to the financial and pension funding risks and their mitigation (see pages 55 and 57).

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

## Policy on payment of creditors

The Company's policy and practice is to pay creditors (including suppliers) promptly in accordance with agreed terms of business. The average time taken to pay an invoice was 41 days (2011: 23) for the parent Company and 41 days (2011: 43) for the Group as a whole.

## Share capital and control

As at 31 July 2012, the Company's issued share capital was £147,272,228.625 and comprised 392,725,943 ordinary shares of 37.5p each nominal value (ordinary shares). The ordinary shares are listed on the London Stock Exchange.

The holders of ordinary shares are entitled to receive the Company's reports and accounts; to attend and speak at general meetings of the Company; to appoint proxies and to exercise voting rights.

There are no restrictions on transfer or limitations on the holding of any class of shares and no requirements for prior approval of any transfers. None of the shares carries any special rights with regard to control of the Company. There are no restrictions on the voting rights attaching to the ordinary shares. There are no arrangements of which the directors are aware under which financial rights are held by a person other than the holder of the shares and no known agreements relating to or restrictions on share transfers or voting rights.

Shares acquired through Company share schemes and plans rank pari passu with the shares in issue and have no special rights. The Company operates an employee benefit trust, with an independent trustee, to hold shares pending employees becoming entitled to them under the Company's share schemes and plans. On 31 July 2012 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 67 sets out the notifications, received by the Company pursuant to the FSA's Disclosure & Transparency Rules and the 2006 Act, as at 31 July 2012 and any changes thereto up to 17 September 2012, from persons with significant direct or indirect holdings in the Company's share capital.

# Group directors' report

## Continued

The rules about the appointment and replacement of directors are contained in the Company's Articles of Association. Changes to the Articles of Association must be approved by the shareholders in accordance with the legislation in force from time to time.

The powers of the directors are determined by English law and the Articles of Association of the Company in force from time to time. The directors have been authorised to issue and allot ordinary shares, pursuant to Article 5. The directors have authority to make market purchases of ordinary shares. The powers to issue and allot shares and, subject to specified limits, to allot shares on a non pre-emptive basis, are referred to the shareholders at the AGM each year for renewal. At the AGM the shareholders are also requested to renew the power to make market purchases of ordinary shares. Any ordinary shares so purchased may be cancelled or held in treasury.

The Company has in place credit facility agreements under which a change in control would trigger prepayment clauses and has bonds in issue the terms of which would allow bondholders to exercise put options and require the Company to buy back the bonds at their principal amount plus interest if a rating downgrade occurs at the same time as a change of control takes effect. The Company's share schemes and plans contain clauses which may cause options and awards to vest on a change in control, 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 Company's share schemes and in default the Company must indemnify Mr Bowman for the value of any awards that do not vest on the change in control.

No other director or employee is contractually entitled to compensation for loss of office or employment as a result of a change in control except that provisions of the Company's share schemes may cause options and awards granted to employees under such schemes to vest on a change in control, 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 2012.

### 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 and health and safety matters, including key performance indicators, is contained in the Corporate responsibility summary on pages 59 to 63. The full Corporate responsibility report is available online at [www.smiths.com/responsibility](http://www.smiths.com/responsibility).

### Annual General Meeting ('AGM')

The 2012 AGM will be held at The Thomas Lord Suite, Lord's Cricket Ground, Grace Gate, St John's Wood Road, London NW8 8QN on Tuesday 20 November 2012 at 2:30 pm. The Notice of the AGM will be published on the Company's website, [www.smiths.com](http://www.smiths.com), on or around 12 October 2012.

### 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 which is equivalent to approximately one-third of the total issued ordinary share capital of the Company as at the latest practical date prior to the publication of the Notice of AGM.

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 nominal value which is equivalent to approximately one-third of the total issued ordinary share capital of the Company as at the latest practical date prior to the publication of the Notice of AGM. This is in line with corporate governance guidelines. The Board has undertaken to seek the re-election of each director annually by the shareholders, whether or not this authority were to be used.

At 17 September 2012, 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 2014 and the end of the next AGM, due to be held in 2013.

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 equivalent to 5% of the total issued ordinary share capital of the Company as at the latest practical date prior to the publication of the Notice of AGM,

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 2012, the following ordinary shares in the Company were issued:

- 375,540 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 until the next AGM (due to be held in 2013) or 31 January 2014 whichever is the earlier. This authority is limited to 10% of the ordinary shares in issue as at the latest practical date prior to the publication of the Notice of AGM 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 resell 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.

### 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.

# Group directors' report

## Continued

### 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 Company's 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 Company's auditors are aware of that information.

### Electronic communications at [www.smiths.com](http://www.smiths.com)

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

Electronic copies of the Annual Report 2012 and the Notice of AGM will be posted on the Company's website, [www.smiths.com](http://www.smiths.com). The Company's announcements to the Stock Exchange and press releases are available online through the website. Shareholding details and practical help on share transfers and changes of address can be found at [www.shareview.co.uk](http://www.shareview.co.uk).

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

### Electronic proxy voting

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

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

Shareholders who will not be able to attend the AGM on 20 November 2012 in person are encouraged to vote their shares by appointing a proxy and issuing voting instructions (either electronically or by completing and returning their proxy cards). Electronic and paper proxy appointments and voting instructions must be received by the Company's Registrar not later than 48 hours before the AGM in order to be valid.

### Registrar

The address and contact details of Equiniti Limited, the Company's Registrar, are listed on the inside back cover of this report. Individual shareholders' access to their personal shareholder information is available online, through the [www.shareview.co.uk](http://www.shareview.co.uk) website. 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.) The international shareholder helpline telephone number is +44 (0) 121 415 7047.

### 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

18 September 2012



# Corporate governance statement

## Chairman's introduction

The Board of the Company is committed to ensuring that it provides sound and effective leadership. One of the ways in which the Board achieves this is by making clear that the principles, processes and practices of good governance must be adhered to throughout the Company. 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."

The directors are aware of, and keep in constant view, their accountability to the Company's stakeholders, in particular the providers of the Company's capital, and the importance of good governance in serving the shareholders' interests. The Board is updated regularly on shareholders' views through detailed briefings from the Director, Investor Relations (which includes verbatim feedback from investors). In 2011 an independent research agency was commissioned to carry out an investor perception study for the Company. The Board considered the findings of the study and the expectations of shareholders, as set out in the report, have influenced the Board's thinking on governance, financial performance and strategy throughout the year. To enhance its performance, in 2011 the Board set itself explicit objectives – distinct from the Company's – and has monitored at each meeting the extent to which its activity has furthered these objectives. It has found this process adds value. This will be an annual process.

**Donald Brydon, CBE**  
Chairman

# Corporate governance statement

## Continued

### Compliance with the UK Corporate Governance Code

Throughout the period 1 August 2011 to 31 July 2012 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](http://www.frc.org.uk), except that the value of any fees received by executive directors in respect of external non-executive directorships is not disclosed in the Directors' remuneration report, as this is not considered relevant to the Company. The Company intends to continue to explain rather than comply with the Code in this limited area.

### Disclosure & Transparency Rule 7

This statement complies with sub-sections 2.1; 2.2(1); 2.3(1); 2.5; 2.7; and 2.10 of Rule 7 of the UK Listing Authority Disclosure & Transparency Rules. The information required to be disclosed by sub-section 2.6 of Rule 7 is shown in the Group directors' report on pages 67 and 68 and is incorporated in this Corporate governance statement by reference.

### Directors

#### The Board

As at 17 September 2012, the Board comprises Mr Brydon (Chairman), Mr Bowman (Chief Executive), Mr Turner (Finance Director) and five independent non-executive directors: Messrs Angelici and Challen; Ms Fratto and 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 64 and 65. 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. The Board also holds regular additional meetings to consider the strategy of the divisions. The Board 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. Further meetings are arranged as necessary to deal with urgent items.

The Board sets the Company's values and standards and has adopted a Code of Business Ethics which is referred to on pages 59 and 60.

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 and is available to provide support to the Chairman and to serve as an intermediary for the other directors, if required.

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

### Board activities

The Board regularly reviews:

- Environment, health and safety
- Financial performance
- Divisional performance and current issues
- Feedback from meetings with investors
- Financial risk and treasury matters
- Tax risk and status
- Pensions matters
- Acquisition and divestment opportunities
- Litigation
- Directors' conflicts
- Corporate governance and compliance
- Share register

In addition to these areas of focus, the Board regularly considered the strategy and risks of each division and the Group as a whole, including the opportunities for portfolio rationalisation and for growth through increased penetration of new markets and through new product launches and service offerings. Examples of various specific items considered by the Board during the year are listed below. The activities of the Board Committees are individually outlined on pages 77 to 79.

Month	Activity
September 2011	<ul style="list-style-type: none"> <li>– Annual results, Annual Report and Corporate Responsibility Report</li> <li>– Smiths Detection strategy and risk review</li> <li>– Investor perception survey</li> </ul>
November 2011	<ul style="list-style-type: none"> <li>– Interim management statement</li> <li>– AGM issues</li> <li>– Additional meeting to discuss external Board evaluation findings and agree Board objectives</li> </ul>
January 2012	<ul style="list-style-type: none"> <li>– John Crane strategy and risk review</li> <li>– Additional meeting to review Group's IT function</li> </ul>
March 2012	<ul style="list-style-type: none"> <li>– Interim results</li> <li>– Smiths Medical strategy and risk review</li> </ul>
May 2012	<ul style="list-style-type: none"> <li>– Board visit to Brazil, including tour of John Crane and Smiths Detection sites and visit to Smiths Medical customer</li> <li>– Group strategy and risk review</li> <li>– Interim management statement</li> <li>– Government relations</li> </ul>
July 2012	<ul style="list-style-type: none"> <li>– Smiths Interconnect and Flex-Tek strategy and risk reviews</li> <li>– Group-level risks</li> <li>– FY2013 budget</li> <li>– Report from cross-divisional best practice working groups</li> </ul>

The table below shows the number of board meetings held during the financial year ended 31 July 2012 and, opposite each director's name, the number of meetings they were eligible to attend and the number actually attended. However, the Board regards attendance at meetings as only one measure of directors' contributions to the Company. In addition to formal board meetings, the directors attend many other meetings and make site visits during the year. For example, as part of her induction and familiarisation process, Ms Fratto has visited a number of the Company's sites in the USA and Europe and has met employees and management in all five divisions.

In May 2012, as part of the Company's focus on growth in emerging markets, the Board visited the John Crane facility in Rio Claro, Brazil, which was celebrating the 50th anniversary of John Crane in Brazil. The Board also visited the Smiths Detection headquarters in Brazil and saw Smiths Medical's products in use at the Hospital Beneficência Portuguesa in São Paulo.

	Board meetings	
	Eligible to attend	Attended
D.H. Brydon (Chairman)	12	11
P. Bowman	12	12
P.A. Turner	12	12
B.F.J. Angelici	12	12
D.J. Challen	12	12
S.J. Chambers (retired 1 July 2012)	10	9
T.D. Fratto (appointed 1 July 2012)	2	2
A.C. Quinn	12	11
K.R. Tebbit	12	12

#### 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. The table on page 74 indicates the service, to 31 July 2012, of each of the directors. All the non-executive directors are considered to be independent and Mr Brydon was considered independent at the time of his appointment as Chairman.

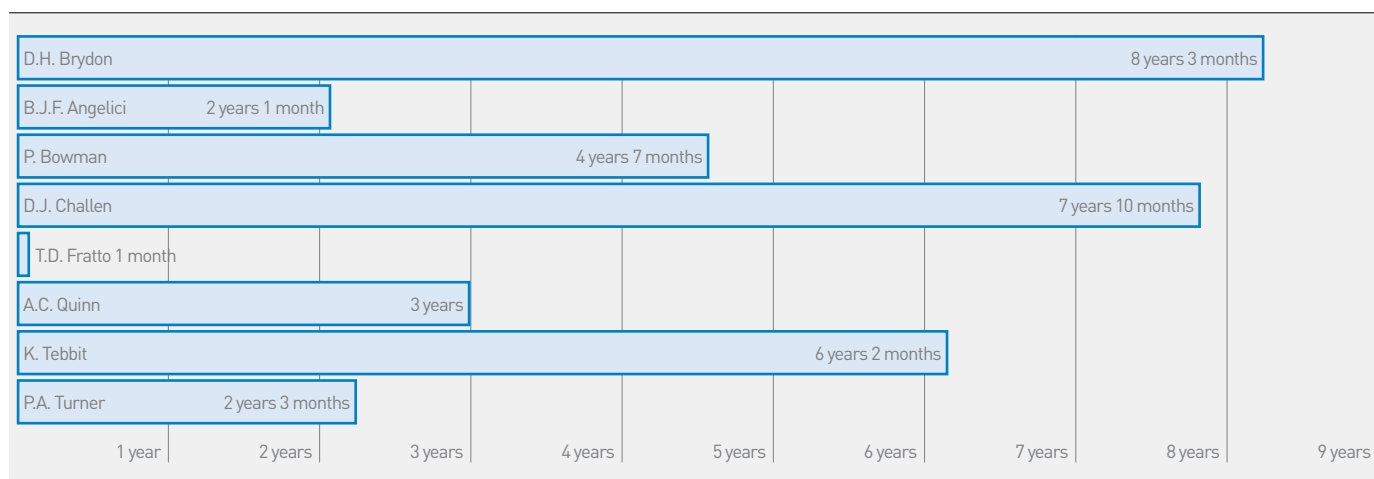


#### Board visit to Brazil

As part of the 2012 programme of visits to the Group's businesses, the Board visited John Crane and Smiths Detection operations and a key Smiths Medical customer in Brazil, a fast-growing market for the Group. The visit included a tour of the John Crane operations and service facility in Rio Claro, where the directors met senior management and employees and received an update on business performance and strategy, as well as taking the opportunity to mark John Crane's 50th year of operation in the country.

# Corporate governance statement

## Continued



### 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. This procedure was followed in the appointment of Ms Fratto as an independent non-executive director on 1 July 2012. 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 each considered the recommendations of the Davies Report entitled 'Women on Boards' when this was published in 2011 and the subsequent discussion and debate in regulatory and media circles. The Chairman made clear in his Chairman's Statement in last year's Annual Report that when the Company had cause to recruit a new director it would do so with Lord Davies' objectives in mind consistent with the needs of the Company at that time. The Nomination Committee, after an externally facilitated search by an independent agency (as further described in the Nomination Committee report below) was pleased to recommend to the Board the appointment of Ms Fratto. The Board also considered Mr Brydon's appointment as the Chairman of The Sage Group plc and concluded that, in the light of his broad experience, in general; his wide knowledge of the Company, in particular; and his retirement from his responsibilities at AXA Investment Management SA and AXA Rosenberg LLP, the changes to his external commitments were unlikely to have an effect on his role as the Chairman of the Company. The Board also considered other appointments and proposed appointments of the directors as part of the Directors' conflicts of interest procedure.

### 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 and other senior corporate staff. During the year the Company Secretary led a detailed review and selection process of electronic Board administration systems for the provision of 'virtual' Board and Board Committee packs. This included a comprehensive review and challenge of the security aspects of the shortlisted systems. In early 2012 a provider was selected, and in May the Board meeting papers were provided to all the directors (after appropriate training) in electronic format on iPads through the secure Board portal.

Non-executive directors are also 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, as well as meetings and site visits to business locations. 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 all directors.

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

### Conflicts of interest

Under the 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 (including such conditions as the Board may determine in each case), 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. The external Board evaluation facilitated by Professor Rob Goffee of the London Business School in respect of the year ended 31 July 2011 identified a number of key strengths of the Board, including the strong and effective leadership provided by the Chairman; the mix of the non-executive directors' experience and its relevance to the different businesses and strategic priorities of the Company; and the balance of challenge and support provided in board meetings. Following on from the review the Board noted a number of points which it considered could enhance its performance and set itself a series of written objectives for the year ended 31 July 2012.

These objectives, and the Board performance against them, included:

Objective	2012 Performance
Address Board succession issues, including appointment of new Remuneration Committee Chair and (in conjunction with the Nomination Committee) the recruitment of new Board member(s).	The Nomination Committee, with the support of an independent external search consultant, carried out a recruitment process for a new non-executive director and made recommendations to the Board. Ms Tanya Fratto joined the Board on 1 July 2012. Ms Anne Quinn succeeded Mr Stuart Chambers (who retired from the Board on 1 July 2012) as Chair of the Remuneration Committee.
In conjunction with the Nomination Committee, give input and guidance to in-depth reviews of members of senior management.	In July 2012 the Nomination Committee considered a detailed review of the Company's senior managers, including independent third-party assessments and 360° reviews of the individuals in question.
Take full ownership of the risk reviews procured by the Audit Committee, including in particular macro and Group-wide issues.	The Board specifically reviewed Group-wide risks in July 2012, and was kept updated throughout the year on issues raised in the Risk reports tendered to each Audit Committee meeting.
Improve understanding of the Group's IT function and its relevance to profitability.	The Board convened an additional meeting in January 2012 to consider the Group's IT function. An update was provided to the Board in May on points arising from the January meeting.

In respect of the year ended 31 July 2012 the Board evaluation was conducted by the Company Secretary using internally administered questionnaires, but based on the evaluation conducted the previous year by Professor Goffee and having regard to the objectives set by the Board for the year. The evaluation considered the balance of skills, experience, independence and knowledge of the Company on the Board and its diversity (in the widest sense) and other factors relevant to its effectiveness. The questionnaire required each of the directors to consider the performance of the Board and each of the main Board committees against a number of criteria, including effectiveness of leadership, efficiency of meetings, time and focus given to particular areas, information issues, corporate governance standards and the extent to which the objectives set by the Board had been met. It also looked at how well the Board works together as a unit and the performance of each individual director against a number of criteria. The results of the evaluation are used to inform the Board's approach going forward.

The directorships in listed companies and other significant commitments of the Chairman and the non-executive directors are shown on pages 64 and 65. It is confirmed that the Chairman and the non-executive directors have sufficient time to fulfil their commitments to the 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 79 and the Directors' remuneration report is on pages 80 to 88.

## 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 89.

The 'going concern' statement required by the Code is set out in the Group directors' report on page 67.

### 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 2012. 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.



# Corporate governance statement

## Continued

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 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 as shown in the table below. 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 2012 AGM. The audited, final results of the poll votes will be released to the London Stock Exchange and published on the Company's website, [www.smiths.com](http://www.smiths.com), as soon as is practicable after the conclusion of the AGM.

All the directors, including the Chairmen of the Audit, Nomination and Remuneration Committees, were available at the 2011 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.

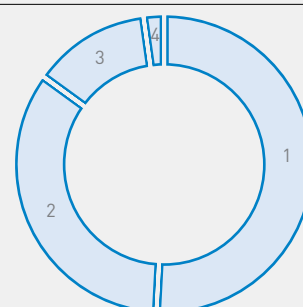
#### Investor relations activities timeline 2011-2012

	Roadshows	Presentations
July 2012	US	
June 2012	Netherlands and Sweden	
May 2012		Smiths Detection Investor Day
April 2012	UK, Germany, France	
March 2012	US, Canada, UK	Interim results
February 2012		
January 2012		
December 2011	UK Private Client Brokers	
November 2011	France, UK, Germany	AGM, John Crane site visit
October 2011	UK, US, Canada	
September 2011	UK	Annual results
August 2011	US	

**During financial year 2012, senior management and the investor relations team had contact with over 400 analysts and investors.**

#### Contact with investors/analysts

- 1 United Kingdom 51%
- 2 US and Canada 34%
- 3 Rest of Europe 13%
- 4 Rest of World 2%



## Board Committees

The full terms of reference of the following Board Committees are available upon request and on the Company's website, [www.smiths.com](http://www.smiths.com).

### Audit Committee

#### Introduction from the Chairman of the Audit Committee

The role of the Audit Committee includes monitoring and reviewing (1) the integrity of the Company's financial statements and its accounting policies and methods; (2) the Company's systems of internal controls and risk management; (3) the Company's Code of Business Ethics and Business Ethics Programme; (4) the Company's internal audit function; and (5) the appointment of and the Company's working relationship with the external auditors, including their remuneration, terms of engagement, independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements. Over the past financial year the Audit Committee has met three times in order to discharge its responsibilities.

During the year it was agreed that the Audit Committee would concentrate on monitoring operational risks and that the review of strategic risk would become a matter for the full Board to consider on a regular basis. The Committee has carefully reviewed annual risk presentations from each of the five divisions and from BIS (Business Information Services, the Company's IT function). In order to be satisfied that risk management is fully embedded in the thinking and planning of the management teams of each of the divisions and of BIS, the Committee has challenged the divisional general managers and BIS to show that they have properly identified all the significant risks to their business and have put in place measures and contingency plans to manage them satisfactorily.

The Committee has monitored the activities of the Company in promoting and policing its Business Ethics Programme. Over 98% of the Company's employees have been trained in the Code of Business Ethics and the Company is seeking to promote the adoption and maintenance by its agents and distributors of equivalent ethical standards. The Committee has reviewed the treatment of allegations of unethical and non-compliant behaviour that are dealt with by the Company's Code Compliance Council. The level of allegations received and their materiality are considered to be low in the context of the size and scope of the Company.

#### David Challen, CBE

Chairman of the Audit Committee

	Audit Committee	
	Eligible to attend	Attended
D.J. Challen (Chairman)	3	3
B.F.J. Angelici	3	3
S.J. Chambers (retired 1 July 2012)	2	2
T.D. Fratto (appointed 1 July 2012)	1	1
A.C. Quinn	3	3
K.R. Tebbit	3	3

The members of the Committee during the financial year were Mr Challen (Chairman of the Committee), Mr Angelici, Ms Quinn and Sir Kevin Tebbit. Mr Chambers ceased to be a member of the Committee when he retired from the Board on 1 July 2012. Ms Fratto was appointed to the Committee at the same time as her appointment to the Board on 1 July 2012.

The Board has determined that the Committee members have the skills and experience, including knowledge and experience of financial reporting and internal business, necessary to contribute meaningfully to the Committee's deliberations. In addition, the Chairman of the Committee has the 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 2012.

In the year to 31 July 2012, 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 2011/12 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 2011/12 work programme and regular reports on the key issues arising from its work during the year.

# Corporate governance statement

## Continued

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

No-one other than the members of the Committee is entitled to be present at meetings. However, the Chairman; Finance Director; Group Financial Controller; Director, Tax and Treasury; Director, Internal Audit; and external 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 Senior Vice President & General Counsel – Ethics & Compliance 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.

## Nomination Committee

### Introduction from the Chairman of the Nomination Committee

The role of the Nomination Committee is to review the structure, size and composition of the Board and the Board Committees and consider succession planning for directors and senior management, to ensure that the Company has the correct balance of skills, experience and knowledge to meet the changing needs of the Company. The Nomination Committee supports the Board with the review of the 'talent pipeline' for senior management roles. This is particularly important in a multi-industry global company with a five division structure, where talented individuals in one division may not be personally known to the leadership team in another division.

In July 2012 the Nomination Committee carried out a detailed review of talent management and succession planning across the Group, facilitated by the Group HR director and the Group Director of Leadership and Talent. Particular focus was given to the resources available to the Company in emerging markets and the challenges of retaining managers in fast-growing economies.

During the year the Nomination Committee also considered diversity issues, in the context of Lord Davies' Report entitled 'Women on Boards' and the particular challenges facing the engineering industry, with its bias towards male candidates from entry level upwards. Further information about the Board's policy on diversity is set out below.

### Donald Brydon, CBE

Chairman of the Nomination Committee

	Nomination Committee	
	Eligible to attend	Attended
D.H. Brydon (Chairman)	4	4
B.F.J. Angelici	4	3
D.J. Challen	4	4
S.J. Chambers (retired 1 July 2012)	3	3
T.D. Fratto (appointed 1 July 2012)	1	1
A.C. Quinn	4	3
K.R. Tebbit	4	4

During the financial year the members of the Committee were: Mr Brydon (Chairman of the Committee), Mr Angelici, Mr Challen, Ms Quinn and Sir Kevin Tebbit. Mr Chambers ceased to be a member of the Committee when he retired from the Board on 1 July 2012. Ms Fratto was appointed to the Committee at the same time as her appointment to the Board on 1 July 2012.

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 (and their removal or retirement), 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 Nomination Committee instructed an independent recruitment agency to search for an additional member of the Board with a detailed brief of the capabilities and attributes required, which included the benefits to the Board of diversity in its widest sense (gender, nationality, age, experience, background). After an extensive search and interview process, which involved almost every member of the Board, the Nomination Committee was pleased to recommend to the Board the appointment of Ms Tanya Fratto as a non-executive director and as a member of the Audit, Nomination and Remuneration Committees. This means that two out of the Company's eight directors (i.e. 25%) are women and five nationalities are represented on the Board.

In his Chairman's Statement last year, the Chairman explained that the Board supported Lord Davies' aspiration for female board representation, but this presented a particular challenge for a small board. He also explained that the proportion of women executives in senior positions in the Company was a reflection of the masculine nature of the engineering industry globally. Nonetheless, as described above, when the Nomination Committee came to recruit for a new Board director, it included the diversity of the Board amongst several criteria and considerations and was successful in recruiting Ms Fratto. The Nomination Committee and the Board are committed to ensuring diversity is included within the remit for appointments at all levels in the Company, but does not think it is appropriate to set specific Group-wide targets or objectives at this stage.

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

The Committee has access to such information and advice both from within the Group and externally, at the cost of the Company, as it deems necessary. This may include the appointment of external search consultants, where appropriate. The Committee reviews annually its terms of reference and effectiveness and recommends to the Board any changes required as a result of such review. The annual review of the Committee's terms of reference was conducted in July 2012.

## Remuneration Committee

### Introduction from the Chair of the Remuneration Committee

The role of the Remuneration Committee is to make recommendations to the Board on the Company's remuneration framework, giving full consideration to the matters set out in the Code. The Committee also agrees with the Board the policy for the remuneration of the Chairman, the Chief Executive, the Finance Director and senior management. The Committee sets the remuneration for these individuals within the agreed policy having regard to a number of factors, including their performance, remuneration across the Company and market positioning. The Committee takes note of the policies and trends in remuneration across the whole Group in relation to all levels of employees. Further information about the activities and focus of the Remuneration Committee during the year is set out in the Directors' remuneration report.

### Anne Quinn, CBE

Chair of the Remuneration Committee

	Remuneration Committee	
	Eligible to attend	Attended
A.C. Quinn (Chair from 10 July 2012)	5	5
S.J. Chambers (retired 1 July 2012) (Chairman until 1 July 2012)	4	4
D.H. Brydon	5	4
B.F.J. Angelici	5	5
D.J. Challen	5	5
T.D. Fratto (appointed 1 July 2012)	1	1
K.R. Tebbit	5	4

Mr Angelici, Mr Brydon, Mr Challen, Ms Quinn and Sir Kevin Tebbit were members of the Committee throughout the financial year. Mr Chambers ceased to be a member of the Committee when he retired from the Board on 1 July 2012. Ms Fratto was appointed to the Committee at the same time as her appointment to the Board on 1 July 2012. Ms Quinn was appointed as Chair of the Committee in succession to Mr Chambers.

The Committee's responsibilities and terms of reference are described in the Directors' remuneration report on page 80. 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 2012.

# Directors' remuneration report

## Introduction

As the new Chair of the Remuneration Committee, I am pleased to introduce the report of the Remuneration Committee for the year to 31 July 2012.

The Remuneration Committee periodically reviews senior executive remuneration arrangements at Smiths to ensure that they reflect and closely support our evolving business strategy, whilst aligning management incentives with shareholders' longer-term interests. This resulted last year in the introduction of the new Long-Term Incentive Plan (LTIP) which, together with the annual bonus and the Co-Investment Plan (CIP), supports Smiths current strategy of creating value through four key drivers: revenue growth, operating margin, cash conversion and ROCE.

For the coming year, the Committee is satisfied that these existing arrangements remain appropriately aligned to the Group's strategy, and no structural changes are proposed for FY2013.

Continuing a pattern of Group restraint on salary increases, there have been no salary increases for executive directors from 1 August 2012.

Annual bonuses for FY2012 recognise Smiths financial performance and the personal achievements of individual executive directors. The Group has seen a 5% underlying increase in headline revenue, a 7% increase in headline EPS, and strong cash conversion. As in previous years, half of the annual bonus awarded to executive directors is in Smiths shares, deferred for three years. If after three years, a challenging financial benchmark has been achieved, these shares will be matched on a 2:1 basis.

Shareholders will be aware of the Group's solid and sustainable growth in profits and EPS over the last three years. In addition, and in the difficult economic climate, shareholder returns have exceeded the FTSE 100 Index. This performance has resulted in a payout under the three-year element of the 2008 Group Value Sharing Plan (VSP), which vested in October 2011.

The Committee would be pleased to have your support for the policies and practices detailed in our report.

## Anne Quinn, CBE

Chair of the Remuneration Committee

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 20 November 2012 inviting them to approve this report.

## Remuneration policy and arrangements

### The Remuneration Committee

Responsibilities of the Committee include making recommendations to the Board on the Group's executive remuneration policy and determining, on behalf of the Board, specific remuneration packages for the executive directors and Chairman. In doing so, the Committee takes into account pay and employment conditions elsewhere in the Company and operates within agreed terms of reference which are available for inspection on the Company's website. The Company complied with the provisions of the UK Corporate Governance Code relating to directors' remuneration throughout the financial year except as is disclosed in the Corporate governance statement on page 72.

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 2011
- Annual Incentive Plan structure and performance targets for the financial year ended 31 July 2012
- Framework of executive total remuneration
- Principles to govern the Annual Incentive Plan for the financial year ending 31 July 2013
- Structure, performance targets and payments for Long-Term Incentives

In 2011/12 the Committee consisted of:

- Stuart Chambers (Chair of the Committee until his retirement from the Board and Committee on 1 July 2012)
- Anne Quinn (a member during the year and the Chair of the Committee from 10 July 2012)
- Bruno Angelici
- Donald Brydon
- David Challen
- Kevin Tebbit
- Tanya Fratto (from 1 July 2012)

Each member's attendance at meetings held during the year is set out in the Corporate governance statement on page 73.

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.

The Committee received material assistance and advice from the Chief Executive; the HR Director (who is also Secretary to the Committee); Kepler Associates, the Committee's appointed independent remuneration adviser; Freshfields Bruckhaus Deringer LLP; and Linklaters LLP. Kepler Associates does not provide any other services to the Group. Freshfields Bruckhaus Deringer LLP and Linklaters LLP were 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 the following objectives:

- to align the interests of executives with those of shareholders;
- to focus on top-line growth, margin improvement, cash conversion and capital discipline;
- to link a significant proportion of remuneration to short- and long-term financial and individual performance;
- 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.

The Committee takes 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.



## Elements of remuneration

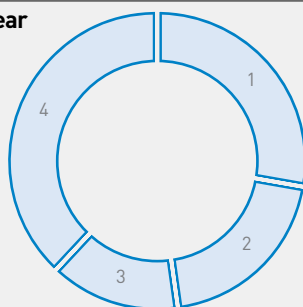
The main elements of remuneration for executive directors in 2011/12 are summarised below:

Element: 2011/12 policy	Objective
<p>Base salary: increased by 2.5% in August 2011 for the Chief Executive (in line with increases awarded elsewhere in the Group and the first awarded since his appointment in 2007) and unchanged for the Finance Director (appointed in 2010)</p> <p>(see Base salary and benefits on page 81)</p>	<ul style="list-style-type: none"> <li>– Reflect size and nature of the role, individual performance and experience</li> <li>– Restraint in increasing salaries reflects Company's desire to shift remuneration towards long-term variable pay over time</li> </ul>
<p>Annual bonus: maximum opportunity of 180% of salary for the Chief Executive and 125% for the Finance Director</p> <p>(see Annual bonus on page 82)</p>	<ul style="list-style-type: none"> <li>– Incentivise short-term operational, financial and personal performance</li> </ul>
<p>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 [gross] matching opportunity after three years, subject to average ROCE exceeding WACC+3% p.a.</p> <p>(see Co-investment Plan (CIP) on page 82)</p>	<ul style="list-style-type: none"> <li>– Help align short- and long-term remuneration through compulsory deferral of 50% of net earned bonus into Smiths shares</li> <li>– Reward operating efficiency</li> <li>– Support executives in building a shareholding in the Company</li> </ul>
<p>The Long-Term Incentive Plan (LTIP): following shareholder approval at the 2011 AGM, executives were granted conditional awards of 300% of salary for the Chief Executive and 200% for the Finance Director under the new LTIP. For executive directors, 50% of an award is based on EPS growth, 30% on TSR relative to the FTSE 100 (excluding financial services companies) and 20% on cash conversion. Awards vest on performance over the three-year period 1 August 2011 – 31 July 2014</p> <p>(see Long-Term Incentive Plan (LTIP) on page 82)</p>	<ul style="list-style-type: none"> <li>– Incentivise senior executives to drive long-term value creation for shareholders</li> <li>– Reinforce and reward delivery of strategic goals</li> <li>– Align the interests of senior executives with those of shareholders</li> </ul>
<p>Pension allowance</p> <p>(see Pensions on page 83)</p>	<ul style="list-style-type: none"> <li>– Enables executive directors to arrange their own personal pension provision.</li> </ul>
<p>Share ownership guidelines: 200% of salary for the Chief Executive and 150% of salary for the Finance Director</p> <p>(see Share ownership guidelines on page 83)</p>	<ul style="list-style-type: none"> <li>– Require executives to build and maintain a significant shareholding in Smiths</li> <li>– Support alignment with shareholder interests</li> </ul>

The following charts illustrate the proportions of the 2011/12 remuneration packages comprising fixed (ie base salary) and variable elements of pay, assuming target annual bonus and expected values of long-term incentives. For 2011/12, 60% to 70% of the fair value of executive directors' total remuneration was performance related.

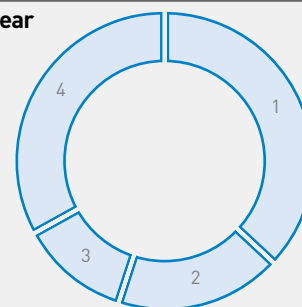
### CEO pay mix, 2011/12 financial year

- 1 Base salary 28%
- 2 Annual bonus 20%
- 3 Co-Investment Plan (CIP) 14%
- 4 2011 Long-Term Incentive Plan 38%



### CFO pay mix, 2011/12 financial year

- 1 Base salary 37%
- 2 Annual bonus 18%
- 3 Co-Investment Plan (CIP) 12%
- 4 2011 Long-Term Incentive Plan 33%



## Base salary and benefits

Salaries are reviewed (but not necessarily increased) annually, taking into account the size and nature of the role, individual performance and experience, the relative performance of the Company, remuneration policy within the Company and salaries at comparator companies. Salaries are benchmarked against comparable roles at other FTSE 100 companies of similar market capitalisation, revenues and complexity to Smiths. In 2011/12, and taking these matters into account, the Committee determined that the Chief Executive's salary would be increased to £820,000. For 2012/13, the Committee has decided that the base salary for the CEO and Finance Director would remain at 2011/12 levels as set out in the table below:

Executive director	Salary last reviewed	2008/09	2009/10	2010/11	2011/12	2012/13
P. Bowman	10 July 2012	£800,000	£800,000	£800,000	£820,000	£820,000
P.A. Turner	10 July 2012	n/a	£400,000	£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.

# Directors' remuneration report

## Continued

### 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 the achievement of personal objectives. The maximum annual bonus opportunity for the Chief Executive is 180% of salary and for the Finance Director is 125% of salary. The table below summarises the structure of the 2011/12 annual bonus plan and the awards receivable for performance in 2011/12.

### 2011/12 annual bonus outcome as a percentage of salary earned in 2011/12

Executive director	Group EPS		Cash conversion		Personal objectives		Total (% of salary)	
	Maximum	Actual	Maximum	Actual	Maximum	Actual	Maximum	Actual
P. Bowman	90%	68.8%	36%	28.8%	54%	44.8%	180%	142.4%
P.A. Turner	62.5%	47.7%	30%	24%	32.5%	25.7%	125%	97.4%

For the annual bonus plan for 2012/13, it is proposed to increase the maximum bonus opportunity for the Finance Director to 150% of salary. This change follows a review by the Committee, taking into consideration the appropriate positioning of his total package relative to the external market and is consistent with the Committee's approach of pay for performance.

### Co-Investment Plan (CIP)

Executive directors and selected senior executives are required to invest 50% of any net bonus earned in Smiths shares under the rules of the CIP. Invested amounts are eligible for a 2-for-1 matching share award after three years (based on the pre-tax amount of deferred bonus), 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.

### Long-Term Incentive Plan

Following feedback from shareholders in 2011, the Remuneration Committee sought the approval of shareholders for a new Long-Term Incentive Plan (LTIP). Approved by shareholders at the 2011 AGM, the LTIP is a conventional share plan under which an award over a capped number of shares will vest if demanding performance conditions are met.

Under the LTIP, selected senior executives (including the executive directors) are eligible to receive annual conditional awards of shares with face values of up to 300% of salary. Normal annual grants will be 300% of salary for the Chief Executive and 200% for the Finance Director.

Awards made in 2011/12 are disclosed on page 87. LTIP awards granted to executive directors in 2011/12 will vest on the achievement of the following performance conditions:

Performance measure	Weighting	Threshold performance target (25% vesting of element)	Maximum performance target (full vesting of element)
3-year EPS growth	50%	6% p.a.	14% p.a.
3-year TSR rank vs. the FTSE 100 companies (excluding financial services companies)	30%	Median	Upper quartile
3-year average annual cash conversion	20%	85%	100%

For performance between 'threshold' and 'maximum', awards vest on a straight-line sliding scale.

To the extent that the performance targets are not met over the three-year performance period, awards will lapse. There is no re-testing of the performance conditions.

### Performance measure selection

The combination of measures used in the LTIP reinforces Smiths current strategy to create value through four key drivers: revenue growth and operating margin (captured by EPS, which the Committee considers to be a more complete and appropriate measure of performance), cash conversion and ROCE (currently incentivised by the CIP). 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. The Committee believes that this combination of measures provides an appropriate balance between internal and external performance, and between absolute and relative performance.

For awards to be made in 2012, the Committee is currently consulting Smiths largest shareholders on a proposal to amend the EPS performance targets to help ensure they closely align with the Board's strategy of driving growth through increased investment in emerging markets and new product development. It is proposed that the three-year EPS growth target would be set at a threshold level of 4% p.a. and a maximum of 12% p.a. No other changes to the LTIP are proposed.

### Leaving and change-of-control provisions

For good leavers, LTIP awards will typically vest at the normal vesting date to the extent that the TSR, EPS and cash conversion performance conditions are met, but will normally be pro-rated on the basis of actual service within the performance period. For those not regarded as 'good leavers' eg voluntary resignations, dismissals, awards automatically lapse.

In the event of a change of control, performance would be measured over the performance period to the date of change of control and awards will vest to the extent that each of the performance conditions is met at that date. Awards will also normally be pro-rated to reflect the time that has elapsed between the grant of the award and the date of change of control. The Committee will also have discretion, in relation to the EPS and cash conversion elements, to adjust the vesting level if it considers that the performance conditions would have been met to a greater or lesser extent at the end of the full three-year performance period. The Committee retains discretion to vary these provisions.

### 2008 and 2010 Value Sharing Plans (VSPs)

The historical VSPs were approved by shareholders in 2008 and 2010. 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. No further awards will be made under these plans.

Awards made under the historical Group VSPs reward selected senior executives (including the Chief Executive and Finance Director) with a pre-determined number of shares for every £5m of value created above a performance hurdle. Performance under the four-year tranche of the 2008 awards will be tested in 2012 and performance over the performance period of the 2010 awards will be tested in 2013.

### TSR Element

For the 2008 awards, one-third of the award will depend on the growth, over the four-year performance period, in Smiths market capitalisation plus net equity cash-flows to shareholders (ie dividends plus share buybacks less share issues) over and above the median total shareholder return of the FTSE 100 companies (excluding financial services companies). For the 2010 awards, the TSR proportion of the total is 30%.

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

For the 2008 awards, two-thirds of the award will be determined by the growth, over the four-year performance period, in adjusted Profit Before Tax (PBT).

For awards granted in 2010, 70% of the award will be tested against adjusted PBT growth.

No retesting of awards under either performance condition is permitted.

### 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

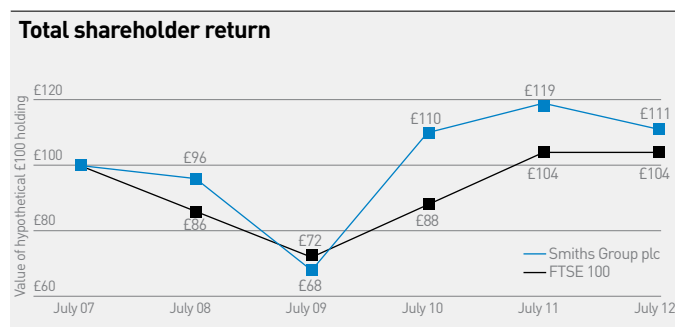
The Company follows the guidelines laid down by the Association of British Insurers. These restrict the issue of new shares under all the Company's share schemes in any 10-year period to 10% of the issued ordinary share capital and under the Company's discretionary schemes to 5% in any 10-year period. As at 31 July 2012, the headroom available under these limits was 5.4% and 1.3%, respectively (excluding the conditional share awards granted under the 2008 and 2010 VSPs).

### Pension

No director accrues pension entitlements under a defined benefit scheme. The Company operates pension supplement 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.

### 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 were £104 and £111 respectively.



# Directors' remuneration report

## Continued

### Remuneration

The total remuneration of directors, excluding the value of shares to which certain directors may become entitled under the Long-Term Incentive Plan, Value Sharing Plan and Co Investment Plan and pension allowances, was as follows:

	2012 £000	2011 £000
Fees, salaries and benefits	<b>1,897</b>	1,868
Performance-related bonuses	<b>1,558</b>	1,444
Aggregate gain from exercise of share options and vesting of share awards	<b>2,144</b>	1,123
Payments in lieu of pension contribution	<b>444</b>	436
	<b>6,043</b>	4,871

The emoluments of the directors are set out below:

		Fees/salary	Benefits	Bonus	Payments in lieu of pension contribution	Total emoluments	
	2011 £000	2012 £000	2012 £000	2012 £000	2012 £000	2012 £000	2011 £000
<b>Chairman</b>							
D.H. Brydon	305	<b>305</b>	<b>32</b>			<b>337</b>	328
<b>Chief Executive</b>							
P. Bowman	800	<b>820</b>	<b>39</b>	<b>1,168</b>	<b>344</b>	<b>2,371</b>	2,294
<b>Executive director</b>							
P.A. Turner	400	<b>400</b>	<b>1</b>	<b>390</b>	<b>100</b>	<b>891</b>	826
<b>Non-executive directors</b>							
D.J. Challen	69	<b>69</b>				<b>69</b>	69
S.J. Chambers <sup>1</sup>	69	<b>63</b>				<b>63</b>	69
K.R. Tebbit	54	<b>54</b>				<b>54</b>	54
A.C. Quinn	54	<b>55</b>				<b>55</b>	54
B.F.J. Angelici	54	<b>54</b>				<b>54</b>	54
T.D. Fratto <sup>2</sup>		<b>5</b>				<b>5</b>	–
<b>Total</b>	<b>1,805</b>	<b>1,825</b>	<b>72</b>	<b>1,558</b>	<b>444</b>	<b>3,899</b>	<b>3,748</b>

<sup>1</sup>Stuart Chambers' total emoluments for 2012 are for a part year, covering the period from 1 August 2011 until his retirement from the Board on 1 July 2012.

<sup>2</sup>Tanya Fratto's total emoluments for 2012 are for a part year, covering the period from her appointment on 1 July 2012 until the end of the financial year on 31 July 2012.

## Directors' interests in the Company's shares

	Ordinary shares of 37.5p each 31 July 2012	Ordinary shares of 37.5p each 31 July 2011
B.F.J. Angelici	2,000	2,000
D.H. Brydon	8,000	8,000
P. Bowman	293,997	160,069
D.J. Challen	1,333	1,333
S.J. Chambers	1,333	1,333
T.D. Fratto	1,500	1,500*
A.C. Quinn	1,024	1,024
K. R. Tebbit	1,000	1,000
P.A. Turner	22,790	5,888

\*interest at appointment on 1 July 2012

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

The Company has not been notified of any changes to the holdings of the current directors, their families and any connected persons between 1 August and 17 September 2012

### Service contracts

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

#### Mr Bowman

Mr Bowman is employed under a service contract with the Company dated 15 November 2007 and effective from 10 December 2007. 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 Turner's personal circumstances, the financial performance of Smiths Group, applicable corporate governance best practice, the likelihood of Mr Turner obtaining alternative employment, and various other matters relating to Mr Turner's financial loss. The amount of compensation, as so determined, will not be less than 12 months' basic salary.

### 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.



# Directors' remuneration report

## Continued

### 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	21 November 2011
D.H. Brydon	19 April 2004	2013	21 November 2011
D.J. Challen	21 September 2004	2013	21 November 2011
T.D. Fratto	1 July 2012	2015	n/a
A.C. Quinn	1 August 2009	2012	21 November 2011
K.R. Tebbit	14 June 2006	2012	21 November 2011

\*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 2011/12 comprised the following:

Non-executive director	Basic fee	Committee chairmanship fee	Total
D.H. Brydon	£305,000	–	<b>£305,000</b>
B.F.J. Angelici	£54,000	–	<b>£54,000</b>
D.J. Challen <sup>1</sup>	£54,000	£15,000	<b>£69,000</b>
S.J. Chambers <sup>2</sup>	£49,500	£13,750	<b>£63,250</b>
A.C. Quinn <sup>3</sup>	£54,000	£1,250	<b>£55,250</b>
K.R. Tebbit	£54,000	–	<b>£54,000</b>
T.D. Fratto <sup>4</sup>	£4,500	–	<b>£4,500</b>

<sup>1</sup>The fee payable to the Senior Independent Director was not paid to Mr Challen in addition to that paid for his chairmanship of the Audit Committee

<sup>2</sup>The fee payable to Mr Chambers was pro-rated to reflect the period of the year to his retirement from the Board on 1 July 2012

<sup>3</sup>Ms Quinn's fee for the year reflected her chairing the Remuneration Committee from 10 to 31 July 2012 (for which an annualised fee of £15,000 was payable)

<sup>4</sup>Ms Fratto's fee for the year was pro-rated to reflect the period of her appointment.

The fee payable to the Chairman is reviewed by the Committee each year. The Chairman's fee was set at £305,000 for the year commencing 1 August 2008 and has been frozen at that level since then. The Board reviewed the fee against the background of the market movements, based on independent data provided by Kepler Associates, which have taken place since the last review and set the fee for 2012/13 at £315,000. This is an increase of 3.2% and is within the range expected to apply to those UK employees receiving pay increases this year.

The Board reviewed the fees payable to non-executive directors, the Senior Independent Director and Committee Chairs. These fees were last reviewed on 1 August 2009 and have been frozen at that level since then. Taking into account market movements based on independent data and the need to be able to attract high quality, appropriately qualified people, the Board set the fees for non-executive directors at £60,000 for the year 2012/13. No change was made to the fees for the Senior Independent Director and Committee Chairs. The Board also corrected an anomaly in the fees structure. Under the existing arrangements where the Senior Independent Director is also a Committee Chair only one fee has been payable. Henceforward where the Senior Independent Director is also a Committee Chair £15,000 will be payable in respect of each position.

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 84 and 86; the directors' pensions allowances and accompanying notes on page 83; and the directors' share options and awards table on page 87 have been audited.

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

**Anne Quinn, CBE**

18 September 2012

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

	Options and awards held on 31 July 2012	Options and awards held on 31 July 2011	Option and award data							Awards vested 2011/12		
Director and Plans	Number	Number	Performance test	Exercise price	Grant date	Vesting date*	Expiry date**	Exercise/ vesting date	Number	Exercise price	Market price at date of grant***	Market price at date of exercise#
<b>P. Bowman</b>												
LTIP	137,661	0	A	n/a	16/12/11	Oct 2014	Oct 2014					
	82,596	0	B	n/a	16/12/11	Oct 2014	Oct 2014					
	55,064	0	C	n/a	16/12/11	Oct 2014	Oct 2014					
CIP	0	78,199	D	n/a	20/10/08			24/10/11	78,199	n/a	777.50p	936.62p
	62,919	62,919	D	n/a	15/10/09	Oct 2012	Oct 2012					
	112,169	112,169	D	n/a	05/10/10	Oct 2013	Oct 2013					
SAYE	95,377	0	D	n/a	24/10/11	Oct 2014	Oct 2014					
	2,750	2,750	–	569.00p	21/05/09	01/08/14	01/02/15					
<b>P.A. Turner</b>												
LTIP	44,768	0	A	n/a	16/12/11	Oct 2014	Oct 2014					
	26,860	0	B	n/a	16/12/11	Oct 2014	Oct 2014					
	17,907	0	C	n/a	16/12/11	Oct 2014	Oct 2014					
CIP	11,764	11,764	D	n/a	05/10/10	Oct 2013	Oct 2013					
	33,781	0	D	n/a	24/10/11	Oct 2014	Oct 2014					

## Value sharing plans

Director and Plans	VSP awards held on 31 July 2012	VSP awards held on 31 July 2011	Award data						Awards vested 2011/12			
	Shares per £5m surplus value	Shares per £5m surplus Number	Performance test	Exercise price	Grant date	Vesting date*	Expiry date	Exercise/ vesting date	Number	Exercise price	Market price at date of grant**	Market price at date of exercise#
<b>P. Bowman</b>												
VSP 2008	0	417	E	n/a	28/07/08			24/10/11	6,755	n/a	1045.00p	936.62p
	0	833	F	n/a	28/07/08			24/10/11	143,939	n/a	1045.00p	936.62p
	417	417	E	n/a	28/07/08	Oct 2012	Oct 2012					
	833	833	F	n/a	28/07/08	Oct 2012	Oct 2012					
VSP 2010												
	240	240	G	n/a	17/12/10	Oct 2013	Oct 2013					
	560	560	H	n/a	17/12/10	Oct 2013	Oct 2013					
<b>P.A. Turner</b>												
VSP 2010	96	96	G	n/a	17/12/10	Oct 2013	Oct 2013					
	224	224	H	n/a	17/12/10	Oct 2013	Oct 2013					

## Key

LTIP The Smiths Group Long-Term Incentive 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 LTIP, CIP, VSP 2008 and VSP 2010 are subject to the relevant performance test(s) 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 17 September 2012

\*\*\* 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 option exercise or vesting of award.

# Directors' remuneration report

## Continued

### Performance tests

A	LTIP Earnings Per Share (EPS) growth test
B	LTIP Total Shareholder Return (TSR) rank test
C	LTIP Cash Conversion test
D	CIP Return on Capital Employed (ROCE) test
E	Surplus Shareholder Value – VSP 2008 TSR Test
F	Surplus Internal Value – VSP 2008 PBT Test
G	Surplus Shareholder Value – VSP 2010 TSR Test
H	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 2011 to 31 July 2012 were 852p and 1154p respectively.

The mid-market closing price on 31 July 2011 was 1135p and on 31 July 2012 was 1067p.

The mid-market closing prices of a Smiths share on the dates of awards made to directors in the 2011/12 financial year were 964p (for the CIP Awards) and 890p (for the LTIP Awards).

The option over 2,750 shares granted to and held by directors under SAYE at 31 July 2012 was granted at an exercise price below the market price of a Smiths Group share on 17 September 2012 (1041p).

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

No options or awards held by any director lapsed during the period 1 August 2011 to 31 July 2012.

No other Director held any options over the Company's shares during the period 1 August 2011 to 31 July 2012.

No options or awards have been granted to or exercised by directors or have lapsed during the period 1 August to 17 September 2012.

At 31 July 2012 the trustee of the Employee Share Trust held 855 shares (none of the directors had an interest in these shares at 31 July 2012). The market value of the shares held by the trustee on 31 July 2012 was £9,123 and dividends of approximately £313 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.

Over the three-year period from 1 August 2008 to 31 July 2011, Smiths TSR outperformed the median of the FTSE 100 companies, resulting in £81.0m of value creation over the three-year performance period of the 2008 Group VSP. On 24 October 2011, 6,755 shares vested to the Chief Executive in relation to this element. Under the three-year Earnings Element of the 2008 Group VSP, performance is measured in terms of absolute growth in Adjusted Headline Profit times a multiple, plus net equity cash-flows to shareholders. During the year, the Earnings Element was adjusted to reflect additional payments that were made to further reduce the pension deficit during the performance period. Smiths performance resulted in £864m of value created above the of 9.5% p.a. hurdle rate resulting in 143,939 shares vesting to the Chief Executive on 24 October 2011. Under the three-year portion of the 2008 Group VSP, therefore, the total number of shares vesting to the Chief Executive was 150,694.

Smiths' ROCE over the performance period for the 2008 CIP awards (1 August 2008 to 31 July 2011) exceeded the Company's weighted average costs of capital (WACC) over the period by more than 3% p.a. Accordingly the 2008 CIP Awards vested in full. The 2008 awards were the final awards outstanding under the 1 for 1 share matching scheme.

# 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 as adopted by the European Union and give a true and fair view of the Group's assets, liabilities and financial position as at 31 July 2012 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**  
18 September 2012

**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 2012 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 2012 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

## Opinion on other matter prescribed by the Companies Act 2006

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

## Matters on which we are required to report by exception

We have nothing to report in respect of the following:

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

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

Under the Listing Rules we are required to review:

- the Directors' statement in relation to going concern;
- 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 2012 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

18 September 2012

## 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 2012 £m	Year ended 31 July 2011 £m
<b>Continuing operations</b>			
Revenue	1	3,030.1	2,842.0
Cost of sales		(1,645.9)	(1,534.0)
Gross profit		1,384.2	1,308.0
Sales and distribution costs		(411.9)	(384.3)
Administrative expenses		(596.5)	(490.1)
Profit on disposal of businesses	4	30.8	4.4
<b>Operating profit</b>	2	406.6	438.0
Comprising			
– headline operating profit	3	553.7	516.9
– exceptional items, amortisation of acquired intangibles	3	(147.1)	(78.9)
		406.6	438.0
Interest receivable		2.2	1.8
Interest payable		(64.8)	(60.3)
Other financing losses		(7.3)	(9.2)
Other finance income – retirement benefits		23.5	23.3
Finance costs	5	(46.4)	(44.4)
Share of post-tax profits of associated companies	14	5.7	4.3
<b>Profit before taxation</b>		365.9	397.9
Comprising			
– headline profit before taxation (restated)*	3	496.8	462.7
– exceptional items, amortisation of acquired intangibles and other financing gains and losses (restated)*	3	(130.9)	(64.8)
		365.9	397.9
Taxation	6	(107.6)	(91.8)
<b>Profit after taxation – continuing operations</b>		258.3	306.1
(Loss)/profit – discontinued operations	7	(0.1)	79.0
<b>Profit for the year</b>		258.2	385.1
Attributable to			
Smiths Group shareholders		256.6	383.8
Non-controlling interests		1.6	1.3
		258.2	385.1
<b>Earnings per share</b>	9		
Basic		65.4p	98.0p
Basic – continuing operations		65.4p	77.8p
Diluted		64.9p	97.1p
Diluted – continuing operations		64.9p	77.1p

References in the consolidated income statement, consolidated statement of comprehensive income, consolidated balance sheet, consolidated statement of changes in equity and consolidated cash-flow statement relate to notes on pages 102 to 134, which form an integral part of the consolidated accounts.

\*As disclosed in the Annual report 2011, from 1 August 2011 the definition of headline profit has been amended to exclude financing credits and charges relating to retirement benefits, see note 3.

# Consolidated statement of comprehensive income

	Notes	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Profit for the period		<b>258.2</b>	385.1
Exchange losses		<b>(9.9)</b>	(9.3)
Cumulative exchange gains recycled on disposals		<b>(4.9)</b>	
Actuarial losses on retirement benefits	10	<b>(559.0)</b>	(0.2)
Taxation recognised on actuarial movements	6	<b>52.4</b>	10.9
Fair value gains/(losses)			
– on available for sale financial assets		<b>4.4</b>	4.1
– deferred in the period on cash-flow and net investment hedges		<b>(10.7)</b>	8.3
– reclassified to income statement		<b>6.4</b>	(0.2)
Taxation recognised on fair value gains and losses		<b>1.5</b>	
<b>Total other comprehensive income</b>		<b>(519.8)</b>	13.6
<b>Total comprehensive income</b>		<b>(261.6)</b>	398.7
Attributable to			
Smiths Group shareholders		<b>(263.5)</b>	397.0
Non-controlling interests		<b>1.9</b>	1.7
		<b>(261.6)</b>	398.7

# Consolidated balance sheet

	Notes	31 July 2012 £m	31 July 2011 £m
<b>Non-current assets</b>			
Intangible assets	12	1,717.1	1,610.2
Property, plant and equipment	13	270.5	282.8
Investments accounted for using the equity method	14		18.5
Financial assets – other investments	15	60.9	31.6
Retirement benefit assets	10	7.2	140.6
Deferred tax assets	6	203.3	174.8
Trade and other receivables	17	37.4	33.6
Financial derivatives	21	7.2	6.4
		<b>2,303.6</b>	<b>2,298.5</b>
<b>Current assets</b>			
Inventories	16	438.5	432.5
Current tax receivable		15.3	16.4
Trade and other receivables	17	634.4	612.8
Cash and cash equivalents	19	205.6	261.1
Financial derivatives	21	7.9	5.7
		<b>1,301.7</b>	<b>1,328.5</b>
<b>Total assets</b>		<b>3,605.3</b>	<b>3,627.0</b>
<b>Non-current liabilities</b>			
Financial liabilities			
– borrowings	19	(821.7)	(978.4)
– financial derivatives	21	(1.1)	(1.5)
Provisions for liabilities and charges	22	(254.4)	(174.1)
Retirement benefit obligations	10	(627.4)	(339.6)
Deferred tax liabilities	6	(69.5)	(77.6)
Trade and other payables	18	(37.5)	(45.1)
		<b>(1,811.6)</b>	<b>(1,616.3)</b>
<b>Current liabilities</b>			
Financial liabilities			
– borrowings	19	(175.3)	(11.7)
– financial derivatives	21	(10.6)	(8.9)
Provisions for liabilities and charges	22	(77.3)	(74.7)
Trade and other payables	18	(468.2)	(454.2)
Current tax payable		(81.5)	(81.3)
		<b>(812.9)</b>	<b>(630.8)</b>
<b>Total liabilities</b>		<b>(2,624.5)</b>	<b>(2,247.1)</b>
<b>Net assets</b>		<b>980.8</b>	<b>1,379.9</b>
<b>Shareholders' equity</b>			
Share capital	23	147.3	147.1
Share premium account		331.9	329.1
Capital redemption reserve		5.8	5.8
Revaluation reserve		1.7	1.7
Merger reserve		234.8	234.8
Retained earnings	24	376.1	775.6
Hedge reserve	24	(124.8)	(120.6)
Total shareholders' equity		<b>972.8</b>	<b>1,373.5</b>
Non-controlling interest equity		<b>8.0</b>	<b>6.4</b>
<b>Total equity</b>		<b>980.8</b>	<b>1,379.9</b>

The accounts on pages 91 to 134 were approved by the Board of Directors on 18 September 2012 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 2011		476.2	242.3	775.6	(120.6)	1,373.5	6.4	1,379.9
Profit for the year				256.6		256.6	1.6	258.2
Other comprehensive income								
Exchange (losses)/gains				(15.2)	0.1	(15.1)	0.3	(14.8)
Actuarial losses on retirement benefits and related tax				(506.6)		(506.6)		(506.6)
Fair value gains/(losses) and related tax				5.9	(4.3)	1.6		1.6
<b>Total comprehensive income for the year</b>				<b>(259.3)</b>	<b>(4.2)</b>	<b>(263.5)</b>	<b>1.9</b>	<b>(261.6)</b>
Transactions relating to ownership interests								
Exercises of share options	23	3.0				3.0		3.0
Taxation recognised on share options	6			(0.8)		(0.8)		(0.8)
Purchase of own shares	24			(9.7)		(9.7)		(9.7)
Dividends								
– equity shareholders	8			(144.1)		(144.1)		(144.1)
– non-controlling interest							(0.3)	(0.3)
Share-based payment	29			14.4		14.4		14.4
<b>At 31 July 2012</b>		<b>479.2</b>	<b>242.3</b>	<b>376.1</b>	<b>(124.8)</b>	<b>972.8</b>	<b>8.0</b>	<b>980.8</b>

	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
<b>Total comprehensive income for the year</b>				<b>388.8</b>	<b>8.2</b>	<b>397.0</b>	<b>1.7</b>	<b>398.7</b>
Transactions relating to ownership interest								
Exercises of share options	23	14.4				14.4		14.4
Taxation recognised on share options	6			(1.8)		(1.8)		(1.8)
Purchase of own shares	24			(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	29			13.8		13.8		13.8
<b>At 31 July 2011</b>		<b>476.2</b>	<b>242.3</b>	<b>775.6</b>	<b>(120.6)</b>	<b>1,373.5</b>	<b>6.4</b>	<b>1,379.9</b>

# Consolidated cash-flow statement

	Notes	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
<b>Net cash inflow from operating activities</b>	27	<b>331.5</b>	321.7
<b>Cash-flows from investing activities</b>			
Expenditure on capitalised development		(27.6)	(30.6)
Expenditure on other intangible assets		(13.5)	(10.2)
Purchases of property, plant and equipment	13	(50.1)	(49.3)
Disposals of property, plant and equipment		0.7	4.5
Investment in financial assets		(24.3)	(0.3)
Acquisition of businesses	28	(167.5)	(18.5)
Disposal of Aerospace	7		(6.2)
Disposals of businesses		47.3	3.9
<b>Net cash-flow used in investing activities</b>		<b>(235.0)</b>	(106.7)
<b>Cash-flows from financing activities</b>			
Proceeds from exercise of share options	23	3.0	14.4
Purchase of own shares		(9.7)	(8.6)
Dividends paid to equity shareholders	8	(144.1)	(136.1)
Dividends paid to non-controlling interests		(0.3)	(0.3)
Cash (outflow)/inflow from matured derivative financial instruments		(1.7)	1.0
Increase in new borrowings		174.8	1.6
Reduction and repayment of borrowings		(173.5)	(1.2)
<b>Net cash-flow used in financing activities</b>		<b>(151.5)</b>	(129.2)
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>(55.0)</b>	85.8
Cash and cash equivalents at beginning of year		260.7	172.2
Exchange (loss)/gain		(2.0)	2.7
<b>Cash and cash equivalents at end of year</b>	19	<b>203.7</b>	260.7
Cash and cash equivalents at end of year comprise			
– cash at bank and in hand		130.8	232.0
– short-term deposits		74.8	29.1
– bank overdrafts		(1.9)	(0.4)
		<b>203.7</b>	260.7
Included in cash and cash equivalents per the balance sheet		205.6	261.1
Included in overdrafts per the balance sheet		(1.9)	(0.4)
		<b>203.7</b>	260.7

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

## Reconciliation of net cash-flow to movement in net debt

	Notes	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>(55.0)</b>	85.8
Net decrease/(increase) in borrowings resulting from cash-flows		(1.3)	(0.4)
<b>Movement in net debt resulting from cash-flows</b>		<b>(56.3)</b>	85.4
Capitalisation, interest accruals and unwind of capitalisation fees		(0.5)	2.7
Movement from fair value hedging		(4.2)	3.6
Exchange differences		(1.4)	16.1
<b>Movement in net debt in the year</b>	19	<b>(62.4)</b>	107.8
Net debt at start of year		(729.0)	(836.8)
<b>Net debt at end of year</b>	19	<b>(791.4)</b>	(729.0)



# 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 (IFRS IC) 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 for the adoption of:

- Amendment to IFRIC 14, 'Prepayment of a Minimum Funding Requirement';
- IAS 24 (revised) 'Related party disclosures'; and
- Amendment to IFRS 7, 'Financial instruments: Disclosures'

The adoption of new standards has not materially affected reported financial position or performance.

In addition, following the inclusion of net expenditure relating to Titeflex Corporation litigation in exceptional items the description of the relevant category of exceptional items has been amended from: "income and expenditure relating to John Crane, Inc. asbestos litigation" to "income and expenditure relating to material litigation in respect of products no longer in production".

## 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 £34.5m (2011: £27.9m) has been recognised in respect of contracts in progress at the year end with a total expected value of £172.2m (2011: £129.3m). A 5% increase in the proportion of the contract activity recognised in the current year would have increased operating profit by an estimated £0.7m (2011: £1.1m).

Revenue recognition requires the estimation of rebates that will be provided in respect of sales which have been made before the balance sheet date. Smiths Medical has rebate arrangements in place with some distributors in respect of sales to end customers where the sales prices have been negotiated directly with Smiths Medical. During the year, as a result of the availability of better information, the basis of estimating these rebates was revised. The estimation is based on the level of discount derived from the sales data from the distributor, the amount of inventory held by distributors and the time lag between the initial sale to the distributor and the rebate being claimed. The rebate accrual at 31 July 2012 was £18.8m (2011: £10.2m).

## Impairment

Goodwill is tested at least annually for impairment and intangible assets acquired in business combinations are tested if there are any indications of impairment, in accordance with the accounting policy set out below. The recoverable amounts of cash generating units and intangible assets 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 £278.0m (2011: £196.1m), see note 22.

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 recent years Titeflex Corporation, a subsidiary of the Group in the Flex-Tek division, has received a number of claims from insurance companies seeking recompense on a subrogated basis for the effects of damage allegedly caused by lightning strikes in relation to its flexible gas piping product. Titeflex Corporation believes that its products are a safe and effective means of delivering gas when installed in accordance with the manufacturer's instructions and local and national codes, however some claims have been settled on an individual basis without admission of liability. As disclosed in note 4, provision has now been made for the costs which the Group is expected to incur in respect of future subrogation claims. However because of the significant uncertainty associated with the future level of subrogation claims, 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. As a result the provision may be subject to potentially material revisions if new information becomes available.

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 2012 there is a retirement benefit asset of £7.2m (2011: £140.6m) 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 £16.1m (2011: £26.0m) relating to losses and £74.1m (2011: £50.6m) relating to the John Crane, Inc. and Titeflex Corporation litigation provisions. 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 Company's presentational currency is sterling. The results and financial position of all subsidiaries and associates that have a functional currency different from sterling are translated into sterling as follows:

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

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

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

## Revenue

Revenue 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.

# Accounting policies

## Continued

### 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.

#### Pension obligations and post-retirement benefits

The Group has defined benefit plans, defined contribution plans and post-retirement healthcare schemes.

For defined benefit plans and post-retirement healthcare schemes the liability for each scheme recognised in the balance sheet is the present value of the obligation at the balance sheet date less the fair value of any plan assets. The obligation is calculated annually by independent actuaries using the projected unit credit method. The present value 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 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.

### 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.

### Exceptional items

Items which are material either because of their size or their nature, and material items 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 material litigation in respect of products no longer in production; and
- other particularly significant or unusual items.

Exceptional items are excluded from the headline profit measures used by the Group. See note 3 for the basis of calculation of these measures.

### 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.

### 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.

## 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 useful lives 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.

## 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.

# Accounting policies

## Continued

### 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.

### 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.

### 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.

### 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.



### 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.

### 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.

### 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.

- '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)'
- 'Amendment to IAS 1: Presentation of Financial Statements – Presentation of items of other comprehensive income'

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 is likely to result in the recognition of a financing charge in respect of retirement benefits. For the year ended 31 July 2012, calculating the finance charge in accordance with the new requirements would have increased finance costs by £36.1m (2011: £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 137 to 145.

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: John Crane, Smiths Medical, Smiths Detection, Smiths Interconnect and Flex-Tek. These divisions design and manufacture the following products:

- 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 Detection – sensors that detect and identify explosives, narcotics, weapons, chemical agents, biohazards and contraband;
- 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 2012						Total £m
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	
Revenue	973.4	855.8	519.2	448.5	233.2		3,030.1
Divisional headline operating profit	209.9	202.5	69.1	66.0	38.0		585.5
Corporate headline operating costs						(31.8)	(31.8)
<b>Headline operating profit/(loss)</b>	<b>209.9</b>	<b>202.5</b>	<b>69.1</b>	<b>66.0</b>	<b>38.0</b>	<b>(31.8)</b>	<b>553.7</b>
Exceptional operating items (note 4)	(39.9)	(8.8)	16.1	(1.2)	(54.5)	2.8	(85.5)
Amortisation and impairment of acquired intangible assets	(15.0)	(14.2)	(1.4)	(30.8)	(0.2)		(61.6)
<b>Operating profit/(loss)</b>	<b>155.0</b>	<b>179.5</b>	<b>83.8</b>	<b>34.0</b>	<b>(16.7)</b>	<b>(29.0)</b>	<b>406.6</b>
Exceptional finance costs							
– adjustment to discounted provision (note 4)	(4.0)				(0.5)		(4.5)
Net finance costs – other							(41.9)
Share of post-tax profits of associate companies			5.7				5.7
<b>Profit before taxation</b>							<b>365.9</b>

Smiths Medical revenue includes the impact of the £7.8m charge for revision of estimated rebates, which has been included in divisional exceptional operating items (see note 4). Revenue calculated on the same basis as headline operating profit would be £863.6m for Smiths Medical and £3,037.9m for Smiths Group.

	Year ended 31 July 2011						Total £m
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	
Revenue	893.9	838.4	509.9	379.0	220.8		2,842.0
Divisional headline operating profit	188.7	196.2	65.5	67.6	27.6		545.6
Corporate headline operating costs						(28.7)	(28.7)
<b>Headline operating profit/(loss)</b>	<b>188.7</b>	<b>196.2</b>	<b>65.5</b>	<b>67.6</b>	<b>27.6</b>	<b>(28.7)</b>	<b>516.9</b>
Exceptional operating items (note 4)	(30.9)	(1.6)	(0.3)	(1.4)	(1.8)	6.6	(29.4)
Amortisation and impairment of acquired intangible assets	(14.5)	(16.6)	(1.2)	(17.2)			(49.5)
<b>Operating profit/(loss)</b>	<b>143.3</b>	<b>178.0</b>	<b>64.0</b>	<b>49.0</b>	<b>25.8</b>	<b>(22.1)</b>	<b>438.0</b>
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
<b>Profit before taxation</b>							<b>397.9</b>

## 1 Segment information continued

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

	Year ended 31 July 2012						
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
Depreciation	14.1	23.8	8.4	7.9	3.7	1.1	59.0
Amortisation	2.7	13.4	13.0	0.8	0.1	53.1	83.1
Other non-cash items							
– share-based payment	3.4	2.1	0.3	0.7	1.5	6.3	14.3
– asset impairments						10.7	10.7

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

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

The capital expenditure for each division is:

	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
<b>Capital expenditure year ended 31 July 2012</b>	<b>16.8</b>	<b>31.7</b>	<b>20.2</b>	<b>7.9</b>	<b>2.9</b>	<b>12.6</b>	<b>92.1</b>
Capital expenditure year ended 31 July 2011	16.2	31.2	22.7	8.1	3.5	8.8	90.5

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

	31 July 2012					
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Property, plant, equipment, development projects and other intangibles	98.1	155.9	99.4	34.7	22.1	410.2
Working capital assets	338.2	243.4	293.6	159.1	68.2	1,102.5
<b>Operating assets</b>	<b>436.3</b>	<b>399.3</b>	<b>393.0</b>	<b>193.8</b>	<b>90.3</b>	<b>1,512.7</b>
Derivatives, tax and retirement benefit assets						240.9
Goodwill and acquired intangibles						1,558.9
Corporate assets						87.2
Cash						205.6
<b>Total assets</b>						<b>3,605.3</b>
Working capital liabilities	(160.3)	(95.3)	(143.1)	(70.6)	(24.7)	(494.0)
Corporate and non-headline liabilities						(343.4)
Derivatives, tax and retirement benefit liabilities						(790.1)
Borrowings						(997.0)
<b>Total liabilities</b>						<b>(2,624.5)</b>
Average divisional capital employed	875.7	1,152.0	668.6	535.5	133.7	3,365.5
Average corporate capital employed						(16.1)
<b>Average total capital employed</b>						<b>3,349.4</b>

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

Capital employed is a non-statutory measure of invested resources. It comprises statutory net assets adjusted to add goodwill recognised directly in reserves in respect of subsidiaries acquired before 1 August 1998 of £815.2m (2011: £815.2m) and eliminate post-retirement benefit assets and liabilities and litigation provisions relating to exceptional items, both net of related tax, and net debt. In the light of the recognition of the Titeflex litigation provision in 2012, the board has decided to exclude significant litigation provisions from the definition of capital employed. Accordingly, capital employed in 2011 has been restated to exclude the John Crane, Inc. litigation provision and related deferred tax.

# Notes to the accounts

## Continued

### 1 Segment information continued

	31 July 2011					
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Property, plant, equipment, development projects and other intangibles	99.8	158.4	104.8	34.1	22.3	419.4
Investments in associates			18.5			18.5
Working capital assets	327.9	246.5	304.1	129.6	63.5	1,071.6
<b>Operating assets</b>	<b>427.7</b>	<b>404.9</b>	<b>427.4</b>	<b>163.7</b>	<b>85.8</b>	<b>1,509.5</b>
Derivatives, tax and retirement benefit assets						343.9
Goodwill and acquired intangibles						1,464.1
Corporate assets						48.4
Cash						261.1
<b>Total assets</b>						<b>3,627.0</b>
Working capital liabilities	(160.1)	(93.6)	(152.2)	(61.5)	(34.8)	(502.2)
Corporate and non-headline liabilities						(245.9)
Derivatives, tax and retirement benefit liabilities						(508.9)
Borrowings						(990.1)
<b>Total liabilities</b>						<b>(2,247.1)</b>
Average divisional capital employed (restated)	863.9	1,159.4	664.8	431.2	126.1	3,245.4
Average corporate capital employed						(86.3)
<b>Average total capital employed (restated)</b>						<b>3,159.1</b>

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:

	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 2012	359.5	374.2	80.6	68.6	90.5		973.4
Revenue year ended 31 July 2011	330.1	344.0	74.0	62.6	83.2		893.9
Smiths Medical			Medication delivery £m	Vital care £m	Safety devices £m		Total £m
Revenue year ended 31 July 2012			241.2	346.6	268.0		855.8
Revenue year ended 31 July 2011			233.1	345.6	259.7		838.4
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 2012	245.4	81.4	55.6	20.2	110.1	6.5	519.2
Revenue year ended 31 July 2011	218.6	75.7	79.5	25.4	86.9	23.8	509.9
Smiths Interconnect			Connectors £m	Microwave £m	Power management £m		Total £m
Revenue year ended 31 July 2012			156.3	202.9	89.3		448.5
Revenue year ended 31 July 2011			173.1	165.8	40.1		379.0
Flex-Tek		Fluid Management £m	Flexible Solutions £m	Heat Solutions £m	Construction Products £m		Total £m
Revenue year ended 31 July 2012		80.1	36.0	55.6	61.5		233.2
Revenue year ended 31 July 2011		70.3	35.9	60.1	54.5		220.8

Following the acquisition of Power Holdings Inc, Smiths Interconnect has reviewed its product groupings, and determined that reporting sales by technology sub-group would provide more consistent information about trends in sales of similar products. Consequently, the 31 July 2011 sales, which were previously reported by end-market, have been restated into the current technology sub-group structure. Revenue for the period by end market is: telecom £97.4m (2011: £94.6m); military and aerospace £170.9m (2011: £163.9m); and rail, medical, automation, test and data centres £180.2m (2011: £120.5m).

## 1 Segment information continued

### Analysis of revenue continued

The Group's statutory revenue is analysed as follows:

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Sale of goods	2,792.0	2,630.9
Services	212.5	178.3
Contracts	25.6	32.8
	<b>3,030.1</b>	<b>2,842.0</b>

### Analysis by geographical areas

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

	Year ended 31 July 2012 £m	Revenue Year ended 31 July 2011 £m	Intangible assets, property plant and equipment and investments accounted for using the equity method Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
United Kingdom	130.3	124.5	143.8	146.2
Germany	171.8	161.0	299.4	333.9
France	95.8	93.1	15.8	17.8
Other European	374.8	357.5	72.0	86.1
United States of America	1,353.0	1,275.4	1,276.0	1,135.5
Canada	125.8	119.6	10.7	12.9
Mexico	34.7	25.2	9.2	9.9
Japan	129.5	149.4	22.7	22.2
China	92.8	82.0	60.3	63.6
Rest of the World	521.6	454.3	77.7	83.4
	<b>3,030.1</b>	<b>2,842.0</b>	<b>1,987.6</b>	<b>1,911.5</b>

## 2 Operating profit is stated after charging

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Research and development expense	78.5	68.0
Operating leases		
– land and buildings	27.0	25.3
– other	11.6	10.9

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Audit services		
Fees payable to the Company's auditors for the audit of the parent company and consolidated accounts	0.5	0.5
Fees payable to the Company's auditors and its associates for other services		
– the audit of the Company's subsidiaries, pursuant to legislation	3.4	3.5
– other services pursuant to legislation	0.1	0.1
	<b>4.0</b>	<b>4.1</b>
Tax services		
– advisory services	0.1	0.5
– compliance services	0.1	
All other services	0.5	0.5

Other services relate to one-off projects.



# Notes to the accounts

## Continued

### 3 Headline profit measures

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

The following items have been excluded from the headline measure:

- exceptional items, including income and expenditure relating to material litigation in respect of products no longer in production;
- 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;
- 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; and
- financing credits and charges relating to retirement benefits.

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

	Notes	Year ended 31 July 2012 £m	Year ended 31 July 2011 (restated) £m
<b>Operating profit</b>		<b>406.6</b>	438.0
Exclude			
– exceptional operating items	4	<b>85.5</b>	29.4
– amortisation and impairment of acquired intangible assets	12	<b>61.6</b>	49.5
Non-headline items in operating profit		<b>147.1</b>	78.9
<b>Headline operating profit</b>		<b>553.7</b>	516.9
<b>Finance costs</b>		<b>(46.4)</b>	(44.4)
Exclude			
– exceptional finance costs	4	<b>4.5</b>	6.1
– other financing gains and losses		<b>2.8</b>	3.1
– other financing income – retirement benefits	5	<b>(23.5)</b>	(23.3)
Non-headline items in finance costs		<b>(16.2)</b>	(14.1)
<b>Headline finance costs</b>		<b>(62.6)</b>	(58.5)
<b>Profit before taxation</b>		<b>365.9</b>	397.9
Non-headline items in operating profit		<b>147.1</b>	78.9
Non-headline items in finance costs		<b>(16.2)</b>	(14.1)
<b>Headline profit before taxation</b>		<b>496.8</b>	462.7
<b>Profit after taxation – continuing operations</b>		<b>258.3</b>	306.1
Exclude			
– non-headline items in profit before taxation		<b>130.9</b>	64.8
– tax on excluded items	6	<b>(62.0)</b>	(30.9)
– exceptional taxation items	4, 6	<b>37.7</b>	
		<b>106.6</b>	33.9
<b>Headline profit after taxation – continuing operations</b>		<b>364.9</b>	340.0

The comparative figures disclosed in the table above have been restated to exclude financing credits and charges relating to retirement benefits from headline profit measures.

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 2012 £m	Year ended 31 July 2011 £m
<b>Operating items</b>		
Restructuring programmes	(15.4)	(15.7)
Revision of estimated rebates	(7.8)	
Diabetes	0.6	1.5
Gains on changes to post-retirement benefits (note 10)		10.2
Profit on disposal of businesses	30.8	4.4
Adjustment to contingent consideration provided on acquisitions	2.4	
Costs of acquisitions	(2.0)	(1.5)
Litigation		
– provision for Titeflex Corporation subrogation claims (note 22)	(54.5)	
– provision for John Crane, Inc. asbestos litigation (note 22)	(39.6)	(28.3)
	(85.5)	(29.4)
<b>Financing items</b>		
Exceptional finance costs – adjustment to discounted provision		
– provision for Titeflex Corporation subrogation claims (note 22)	(0.5)	
– provision for John Crane, Inc. asbestos litigation (note 22)	(4.0)	(6.1)
	(90.0)	(35.5)
<b>Taxation items</b>		
Exceptional tax costs – write off UK deferred tax asset	(37.7)	
	(127.7)	(35.5)

### Year ended 31 July 2012

Restructuring costs comprise £12.6m in respect of the improvement programme in Smiths Detection announced in September 2011 and £2.8m in respect of the divisional reorganisation which began in 2008. These two programmes, which involve redundancy, relocation and consolidation of manufacturing, are considered exceptional by virtue of their size.

A charge of £7.8m has been made by Smiths Medical to reflect a change to the historical basis of estimating the accrual for rebates to distributors (see note 1). This change has arisen due to the availability of improved data from distributors. Had this approach been used in previous years, there would have been no material impact on the revenue or operating profits of Smiths Medical in any of the prior five financial years and no material impact is expected on future revenue or profit. The charge, which has been recognised as a reduction in revenue, has been treated as an exceptional item on the basis that it is an unusual non-recurring item that distorts the current year trading performance.

The profit on disposal of businesses comprises £26.8m profit on the sale of the Group's interest in Cross Match (see note 14), £0.1m relating to small non-core business sold in the year and £3.9m from the resolution of indemnities in respect of disposals in previous years.

A charge of £54.5m has been made by Titeflex Corporation in respect of the estimated cost of future claims from insurance companies seeking recompense for damage allegedly caused by lightning strikes (see note 22).

The operating charge in respect of John Crane, Inc. litigation comprises £28.3m in respect of increased provisions for adverse judgments and legal defence costs, £0.9m in respect of legal fees in connection with litigation against insurers, and £10.4m arising from the reduction in US risk free rates.

At 31 July 2011 the Group recognised UK tax assets relating to revenue losses brought forward and deferred capital allowances of £37.7m. The value of these assets is reviewed regularly and is dependent on the ability to recover them against forecast UK taxable profits. Having considered the impact of the increased pension deficit on the outlook for the UK tax base, the Group has decided to derecognise the tax assets at 31 July 2012 as an exceptional non-headline tax charge because it is no longer probable that they will be recovered.

### 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 were recognised in the year ended 31 July 2011.

The profit on disposal of businesses included £2.7m in respect of the disposal of a small Detection operation.

Costs of acquisition comprised 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 comprised £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.

# Notes to the accounts

## Continued

### 5 Net finance costs

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
<b>Interest receivable</b>	<b>2.2</b>	1.8
Interest payable		
– bank loans and overdrafts, including associated fees	<b>(7.1)</b>	(6.6)
– other loans	<b>(57.7)</b>	(53.7)
<b>Interest payable</b>	<b>(64.8)</b>	(60.3)
Other financing gains/(losses)		
– fair value (losses)/gains on hedged debt	<b>(4.0)</b>	3.6
– fair value gains/(losses) on fair value hedge	<b>4.0</b>	(3.6)
– net foreign exchange (losses)/gains	<b>(2.8)</b>	(3.1)
– exceptional finance costs – adjustment to discounted provision	<b>(4.5)</b>	(6.1)
<b>Other financing losses</b>	<b>(7.3)</b>	(9.2)
Retirement benefits		
– return on plan assets	<b>203.0</b>	198.4
– interest cost	<b>(179.5)</b>	(175.1)
<b>Retirement benefits</b>	<b>23.5</b>	23.3
<b>Net finance costs</b>	<b>(46.4)</b>	(44.4)

### 6 Taxation

	Continuing Year ended 31 July 2012 £m	Continuing Year ended 31 July 2011 £m	Discontinued Year ended 31 July 2012 £m	Discontinued Year ended 31 July 2011 £m
The taxation charge for the year comprises				
– current taxation	<b>95.5</b>	67.0		(25.0)
– deferred taxation	<b>12.1</b>	24.8		
<b>Total taxation expense in the income statement</b>	<b>107.6</b>	91.8		(25.0)
Current taxation				
– UK corporation tax				
– foreign tax	<b>95.5</b>	67.0		
– discontinued tax				(25.0)
	<b>95.5</b>	67.0		(25.0)

#### Reconciliation of the total tax charge

The tax expense on the profit for the year is different from the standard rate of corporation tax in the UK of 25.3% (2011: 27.3%). The difference is reconciled as follows:

	Continuing Year ended 31 July 2012 £m	Continuing Year ended 31 July 2011 £m	Discontinued Year ended 31 July 2012 £m	Discontinued Year ended 31 July 2011 £m
<b>Profit before tax</b>	<b>365.9</b>	397.9	<b>(0.1)</b>	54.0
Notional taxation expense at UK rate of 25.3% (2011: 27.3%)	<b>92.6</b>	108.6		14.7
Effect of overseas taxation	<b>12.7</b>	15.1		
Compliance benefits	<b>(16.1)</b>	(16.1)		
Local incentives	<b>(9.8)</b>	(10.1)		
Tax effect of other non-headline items	<b>(9.5)</b>	(5.7)		
Exceptional tax costs	<b>37.7</b>			
Tax effect of Aerospace sale				(39.7)
	<b>107.6</b>	91.8		(25.0)
Comprising				
– taxation on headline profit (restated – see note 3)	<b>131.9</b>	122.7		
– tax on non-headline loss (restated – see note 3)	<b>(62.0)</b>	(30.9)		
– exceptional taxation items (see note 4)	<b>37.7</b>			
– tax on sale of discontinued operations				(25.0)
<b>Total taxation expense in the income statement</b>	<b>107.6</b>	91.8		(25.0)

## 6 Taxation continued

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
<b>Tax on items (charged)/credited to equity</b>		
Deferred tax charge/(credit)		
– retirement benefit schemes	<b>(52.4)</b>	(10.9)
– losses deferred in the period on cash-flow hedges	<b>(1.5)</b>	
– share options	<b>0.8</b>	1.8
	<b>(53.1)</b>	(9.1)

The net retirement benefit credit to equity includes £6.5m (2011: £11.6m) relating to UK schemes. The UK schemes are closed and this amount represents tax relief that was set off against amounts previously charged to equity.

### 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 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
Credit/(charge) to income statement	(6.5)	(3.8)	(13.5)	(5.6)	17.3	(12.1)
Credit/(charge) to equity		(0.8)	52.4		1.5	53.1
Business combinations	(12.3)				4.7	(7.6)
Exchange adjustments	(1.7)		1.2	(1.2)	4.9	3.2
<b>At 31 July 2012</b>	<b>(75.4)</b>	<b>4.2</b>	<b>92.8</b>	<b>(33.7)</b>	<b>145.9</b>	<b>133.8</b>
Deferred tax assets	(9.2)	4.1	89.7	(8.4)	127.1	203.3
Deferred tax liabilities	(66.2)	0.1	3.1	(25.3)	18.8	(69.5)
<b>At 31 July 2012</b>	<b>(75.4)</b>	<b>4.2</b>	<b>92.8</b>	<b>(33.7)</b>	<b>145.9</b>	<b>133.8</b>

Included in other deferred tax balances above is:

- a deferred tax asset of £16.1m (2011: £26.0m) relating to losses carried forward. The reduction mainly relates to £23.5m of deferred tax no longer recognised on UK losses (see below) offset by £10.1m deferred tax relating to additional loss recognition in the US; and
- a deferred tax asset of £76.2m (2011: £65.0m) relating to provisions where current tax relief is only available as payments are made. Of this asset, £51.1m (2011: £50.6m) relates to the John Crane, Inc. litigation provision, and £23.0m (2011: £3.7m) relates to Titeflex Corporation. See note 22 for additional information on provisions.

The Group has not recognised deferred tax assets relating to tax losses of £380.4m (2011: £225.4m) and pensions and other long term liabilities of £504.3m (2011: £96.9m) due to uncertainty as to their recoverability. This includes £327.1m (2011: £2.3m) relating to the UK pension deficit.

The large increase in unrecognised deferred tax on losses mainly relates to the UK. Deferred tax of £23.5m on UK losses and £14.2m on other assets has been derecognised this year as potentially higher contributions to retirement benefit schemes mean the UK is unlikely to generate sufficient taxable profits to utilise the deductible temporary differences related to the deferred tax assets. The resulting charge of £37.7m has been treated as an exceptional tax item (note 4). These tax allowances remain available to the Group and can be utilised should the UK tax base improve.

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

	2012 £m	Expiry of losses	2011 £m	Expiry of losses
Territory				
– Americas	<b>13.5</b>	<b>2019-2025</b>	13.3	2019-2025
– Asia	<b>4.2</b>	<b>2016-2019</b>	3.2	2014-2018
Total restricted losses	<b>17.7</b>		16.5	
Unrestricted losses				
– operating losses	<b>362.7</b>	<b>No expiry</b>	208.9	No expiry
<b>Total</b>	<b>380.4</b>		225.4	

# 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.

#### (Loss)/profit on disposal of operation

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Provisions and disposal costs	(0.1)	54.0
<b>Pre-tax (loss)/profit on disposal</b>	<b>(0.1)</b>	<b>54.0</b>

Cash received from disposal of Aerospace operations

Disposal costs

(6.2)

#### **Net cash outflow on disposal**

(6.2)

The profit on disposal in 2011 arises from the resolution and time barring of certain disposal indemnities.

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

#### Results from discontinued operations

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
(Loss)/profit on disposal	(0.1)	54.0
Tax credit (note 6)		25.0
<b>Profit for the period</b>	<b>(0.1)</b>	<b>79.0</b>

Earnings per share from discontinued operations – pence

Basic

0.0p 20.2p

Diluted

0.0p 20.0p

The tax credit of £25.0m in 2011 reflects the resolution of the tax treatment of the disposal profits.

#### Cash-flows from discontinued operations

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
(Loss)/profit before taxation (including (loss)/profit on disposal of Aerospace operations)	(0.1)	54.0
(Loss)/profit on disposal of discontinued operations	0.1	(54.0)
<b>Net cash inflow from operating activities</b>		

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Investing activities		(6.2)
<b>Net cash outflow from investing activities</b>		<b>(6.2)</b>



## 8 Dividends

The following dividends were declared and paid in the period:

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Ordinary final dividend of 25.0p for 2011 (2010: 23.50p) paid 25 November 2011	98.1	91.9
Ordinary interim dividend of 11.75p for 2012 (2011: 11.25p) paid 20 April 2012	46.0	44.2
	<b>144.1</b>	136.1

The final dividend for the year ended 31 July 2012 of 26.25p per share was recommended by the Board on 18 September 2012 and will be paid to shareholders on 23 November 2012, 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 26 October 2012.

## 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 2012 £m	Year ended 31 July 2011 £m
Profit attributable to equity shareholders for the year		
– continuing	256.7	304.8
– total	<b>256.6</b>	383.8
Average number of shares in issue during the year	<b>392,583,140</b>	391,718,941

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 395,479,272 (2011: 395,240,785) 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 2012 options over 869,284 (2011: no shares) were excluded from this calculation because their effect was anti-dilutive for continuing operations.

A reconciliation of basic and headline earnings per share – continuing is as follows:

	Year ended 31 July 2012		Year ended 31 July 2011 (restated)	
	£m	EPS (p)	£m	EPS (p)
Profit attributable to equity shareholders of the Parent Company	256.7	65.4	304.8	77.8
Exclude				
Non-headline items and related tax (note 3)	106.6	27.2	33.9	8.7
Headline	<b>363.3</b>	<b>92.6</b>	338.7	86.5
Headline EPS – diluted (p)		<b>91.9</b>		85.7

The figures for 31 July 2011 have been restated to reflect the change in the definition of headline profit, see note 3.

# 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 (SIPS and TIGPS) were performed using the Projected Unit Method as at 31 March 2009 and 5 April 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 2012. The triennial valuations of the principal UK schemes at 31 March 2012 and 5 April 2012 are in progress. 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	2012 Other	UK	US	2011 Other
Rate of increase in salaries	n/a	n/a	3.1%	n/a	n/a	2.9%
Rate of increase for active deferred members	3.7%	n/a	n/a	4.4%	n/a	n/a
Rate of increase in pensions in payment	2.8%	n/a	0.8%	3.5%	n/a	1.3%
Rate of increase in deferred pensions	2.8%	n/a	0.8%	3.5%	n/a	0.6%
Discount rate	4.1%	3.8%	4.1%	5.3%	5.1%	5.3%
Inflation rate	2.8%	n/a	1.6%	3.5%	n/a	1.8%
Healthcare cost increases	5.0%	n/a	2.3%	5.0%	n/a	2.5%

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 recent actual mortality experience of members within each scheme. The assumptions are based on the new SAPS All birth year 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 the 2011 CMI projections blended to a long term rate of 1% for SIPS, and in line with 80%/60% of the Long Cohort for males/ females respectively with an annual underpin of 1% for TIGPS. The mortality assumptions used in the principal US schemes are based on the most recent mortality study table produced for retired pensioners in the US (RP 2000 table). The table selected allows for future mortality improvements and applies an adjustment for job classification (blue collar versus white collar). The assumptions give the following:

Expected further years of life	UK		US	
	Male	Female	Male	Female
Member who retires next year at age 65 (in UK TIGPS/SIPS)	22/23	24/25	19	21
Member, currently 45, when they retire in 20 years time	24	26	19	21

The assets in the scheme and the expected rates of return as at 31 July 2012 were:

	31 July 2012					
	UK schemes		US schemes		Other countries	
	Long-term rate of return	Value £m	Long-term rate of return	Value £m	Long-term rate of return	Value £m
Equities	7.2%	1,294.1	7.3%	245.1	9.2%	12.9
Government bonds	2.5%	168.0	2.3%	43.5	4.8%	7.0
Corporate bonds	4.1%	81.8	3.8%	169.5	5.0%	0.5
Insured liabilities	4.1%	665.7			4.1%	3.7
Property	6.8%	177.1			10.4%	0.8
Other	2.9%	458.2			3.7%	19.7
<b>Total market value</b>		<b>2,844.9</b>		<b>458.1</b>		<b>44.6</b>
Present value of funded scheme liabilities		(3,116.7)		(680.6)		(66.3)
<b>Deficit</b>		<b>(271.8)</b>		<b>(222.5)</b>		<b>(21.7)</b>
Unfunded pension plans		(46.1)		(6.9)		(28.0)
Post-retirement healthcare		(9.2)		(13.0)		(0.9)
Present value of unfunded obligations		(55.3)		(19.9)		(28.9)
Unrecognised asset due to surplus restriction						(0.1)
<b>Net pension liability</b>		<b>(327.1)</b>		<b>(242.4)</b>		<b>(50.7)</b>
Post-retirement assets		7.2				7.2
Post-retirement liabilities		(334.3)		(242.4)		(50.7)
<b>Net pension liability</b>		<b>(327.1)</b>		<b>(242.4)</b>		<b>(50.7)</b>

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

							31 July 2011
	UK schemes		US schemes		Other countries		Total
	Long-term rate of return	Value £m	Long-term rate of return	Value £m	Long-term rate of return	Value £m	£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)
<b>Net pension liability</b>		(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)
<b>Net pension liability</b>		(10.8)		(149.9)		(38.3)	(199.0)

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 2012				Year ended 31 July 2011			
	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans
	UK £m	US £m	Other £m	£m	UK £m	US £m	Other £m	£m
<b>Amounts (credited)/charged to operating profit</b>								
Current service cost	0.3		2.0	1.1	0.4	0.2	2.1	0.9
Past service (gain)/cost			(0.4)		(10.2)	0.1		
Curtailment (gains)/losses			(0.1)			(0.9)	(0.1)	0.1
<b>Total (credit)/charge</b>	<b>0.3</b>		<b>1.5</b>	<b>1.1</b>	<b>(9.8)</b>	<b>(0.6)</b>	<b>2.0</b>	<b>1.0</b>
<b>Amounts (credited)/charged to finance costs</b>								
Expected return on pension scheme assets	(170.4)	(29.9)	(2.7)		(169.9)	(26.0)	(2.5)	
Interest on pension scheme liabilities	143.6	28.2	3.2	4.5	140.1	27.2	3.2	4.6
<b>Net return</b>	<b>(26.8)</b>	<b>(1.7)</b>	<b>0.5</b>	<b>4.5</b>	<b>(29.8)</b>	<b>1.2</b>	<b>0.7</b>	<b>4.6</b>
<b>Total (credit)/charge to income statement</b>	<b>(26.5)</b>	<b>(1.7)</b>	<b>2.0</b>	<b>5.6</b>	<b>(39.6)</b>	<b>0.6</b>	<b>2.7</b>	<b>5.6</b>

The UK past service gain of £10.2m in 2011 relates to changes in certain early retirement terms. The actual return on scheme assets was a profit of £104.4m (2011: profit of £337.8m).

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

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Cost of sales	0.7	0.5
Sales and distribution costs	0.8	0.4
Administrative expenses	1.4	1.9
Exceptional operating items		(10.2)
	<b>2.9</b>	<b>(7.4)</b>

# Notes to the accounts

## Continued

### 10 Post-retirement benefits continued

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

Net actuarial losses of £559.0m (2011: losses of £0.2m) have been reported in the statement of comprehensive income. This includes a gain of £1.1m (2011: loss of £0.5m) in respect of unrecognised assets owing to surplus restriction. Cumulative actuarial losses from 1 August 2004 reported in the statement of comprehensive income are £1,117.5m (2011: cumulative losses of £558.5m).

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

	Year ended 31 July 2012				Year ended 31 July 2011			
	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	(2,775.7)	(543.8)	(60.2)	(90.7)	(2,658.0)	(543.4)	(57.1)	(89.2)
Current service cost	(0.3)		(2.0)	(1.1)	(0.4)	(0.2)	(2.1)	(0.9)
Interest on obligations	(143.6)	(28.2)	(3.2)	(4.5)	(140.1)	(27.2)	(3.2)	(4.6)
Employee contributions			(0.4)				(0.4)	
Past service gain/(cost)			0.4		10.2	(0.1)		
Actuarial (loss)/gain on liabilities	(330.2)	(107.9)	(7.5)	(15.8)	(116.6)	(22.9)	2.7	(2.3)
Curtailment gain/(cost)			0.1			0.9	0.1	(0.1)
Exchange adjustments		(27.4)	4.2	1.7		25.3	(2.5)	(0.3)
Benefits paid	133.1	26.7	2.3	6.3	129.2	23.8	2.3	6.7
<b>At end of period</b>	<b>(3,116.7)</b>	<b>(680.6)</b>	<b>(66.3)</b>	<b>(104.1)</b>	<b>(2,775.7)</b>	<b>(543.8)</b>	<b>(60.2)</b>	<b>(90.7)</b>

#### Changes in present value of scheme assets

	Year ended 31 July 2012				Year ended 31 July 2011			
	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	2,813.6	412.8	46.2		2,616.3	386.6	40.2	
Expected return on assets	170.4	29.9	2.7		169.9	26.0	2.5	
Actuarial gain/(loss) on scheme assets	(94.2)	(1.6)	(2.9)		115.8	22.6	1.0	
Employer contributions	88.2	23.3	3.8	6.3	40.8	20.0	2.9	6.7
Employee contributions			0.4				0.4	
Exchange adjustments		20.4	(3.3)			(18.6)	1.5	
Benefits paid	(133.1)	(26.7)	(2.3)	(6.3)	(129.2)	(23.8)	(2.3)	(6.7)
<b>At end of period</b>	<b>2,844.9</b>	<b>458.1</b>	<b>44.6</b>		<b>2,813.6</b>	<b>412.8</b>	<b>46.2</b>	

#### Cash contributions

Company contributions to the funded defined benefit pension plans for 2012 totalled £115.3m (2011: £63.7m), including £50m to the TIGPS.

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 monthly 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 cash contribution to the TIGPS of £50m which was paid in May 2012, with further biannual payments of £8m thereafter. These payments were subject to the funding position of the Scheme in the six months ended 5 April 2012.

Triennial valuations of the principal UK schemes as at 31 March 2012 and 5 April 2012 are currently in progress, and the Group will negotiate new funding plans with the scheme trustees based on these valuations.

In addition to the funding plans referred to above, the Group agreed to make cash contributions to other schemes in respect of any future service cost based on actuarial advice.

In 2013 the following cash contributions to the Group's principal defined benefit schemes are expected: £36m to SIPS; £16m to TIGPS; and approximately £38m to other plans, including the US defined benefit scheme. Expected cash payments for 2013 total £90m. In addition, £24m will be invested in UK government bonds held in escrow, in accordance with the funding plan explained above.

## 10 Post-retirement benefits continued

### History of schemes

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Balance sheet					
Present value of defined benefit obligations	<b>(3,967.7)</b>	(3,470.4)	(3,347.7)	(3,112.1)	(2,968.9)
Fair value of scheme assets	<b>3,347.6</b>	3,272.6	3,043.1	2,775.1	2,959.9
Unrecognised asset due to surplus restriction	<b>(0.1)</b>	(1.2)	(0.7)	(2.0)	(1.5)
<b>Deficit</b>	<b>(620.2)</b>	(199.0)	(305.3)	(339.0)	(10.5)
Post-retirement assets	<b>7.2</b>	140.6	80.3	39.2	174.2
Post-retirement liabilities	<b>(627.4)</b>	(339.6)	(385.6)	(378.2)	(184.7)
<b>Deficit</b>	<b>(620.2)</b>	(199.0)	(305.3)	(339.0)	(10.5)
	<b>Year ended 31 July 2012 £m</b>	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m	Period ended 31 July 2009 £m	Period ended 31 July 2008 £m
<b>Experience gains/(losses)</b>					
Experience gains/(losses) on scheme liabilities	<b>45.4</b>	(25.5)	31.5	100.5	(6.4)
Experience gains/(losses) on scheme assets	<b>(98.7)</b>	139.4	167.5	(345.4)	(350.0)
Movement on restricted surplus	<b>1.1</b>	(0.5)	1.3	(0.5)	0.9

Experience gains on liabilities in 2012 and 2009 include the impact of using the latest available member data for the UK triennial valuations which were in progress at 31 July 2012 and 31 July 2009 respectively.

### 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 2012 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 2012 £m	Increase/ (decrease) in scheme assets £m	(Increase)/ decrease in scheme liabilities £m
Rate of mortality – 1 year increase in life expectancy	(3.5)	39.3	(128.4)
Rate of mortality – 1 year decrease in life expectancy	3.7	(40.3)	130.3
Rate of inflation – 0.25% increase	(2.9)	12.5	(87.0)
Discount rate – 0.25% increase	(2.5)	(16.7)	141.0
Expected return on scheme assets – 0.25% increase	5.4		
Market value of scheme assets – 2.5% increase	3.5	66.0	(0.1)
Healthcare cost trends – 1% increase			
Healthcare cost trends – 1% decrease			

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

### Defined contribution plans

The Group operates a number of defined contribution plans 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 £29.0m (2011: £29.6m).



# Notes to the accounts

## Continued

### 11 Employees

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
<b>Staff costs during the period</b>		
Wages and salaries	<b>740.5</b>	698.4
Social security	<b>84.4</b>	82.4
Share-based payment (note 29)	<b>14.3</b>	13.8
Pension costs (including defined contribution schemes) (note 10)	<b>32.4</b>	32.9
	<b>871.6</b>	827.5

The average number of persons employed was:

	Year ended 31 July 2012	Year ended 31 July 2011
John Crane	<b>7,000</b>	6,800
Smiths Medical	<b>7,750</b>	7,550
Smiths Detection	<b>2,300</b>	2,500
Smiths Interconnect	<b>4,100</b>	4,000
Flex-Tek	<b>2,000</b>	2,000
Corporate	<b>50</b>	50
	<b>23,200</b>	22,900

### Key management

The key management of the Group comprises Smiths Group plc Board directors and Executive Committee members. Their aggregate compensation is shown below. Details of directors' remuneration are contained in the report of the Remuneration Committee on pages 80 to 88.

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
<b>Key management compensation</b>		
Salaries and short-term employee benefits	<b>10.1</b>	9.2
Cost of post-retirement benefits	<b>0.1</b>	0.1
Cost of share-based incentive plans	<b>5.7</b>	4.0

No member of key management had any material interest during the period in a contract of significance (other than a service contract or a qualifying third party indemnity provision) with the Company or any of its subsidiaries. Options and awards held at the end of the period by key management in respect of the Company's share-based incentive plans were:

	Year ended 31 July 2012		Year ended 31 July 2011	
	Number of instruments '000	Weighted average price	Number of instruments '000	Weighted average price
CIP	<b>778</b>		540	
ESOS	<b>168</b>	<b>£8.93</b>	194	£8.81
VSP	<b>611</b>		852	
LTIP	<b>728</b>			
SAYE	<b>5</b>	<b>£7.28</b>	4	£6.81

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 £0.3m (2011: £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
<b>Cost</b>					
At 1 August 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
Exchange adjustments	(1.4)	3.5	8.5	0.3	10.9
Business combinations	100.2		53.2		153.4
Additions		28.5		13.5	42.0
Disposals	(0.4)	(13.2)		(2.6)	(16.2)
<b>At 31 July 2012</b>	<b>1,488.1</b>	<b>181.3</b>	<b>413.6</b>	<b>143.4</b>	<b>2,226.4</b>
<b>Amortisation</b>					
At 1 August 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
Exchange adjustments	(0.2)	1.1	3.9	(0.1)	4.7
Charge for the year		19.3	50.9	12.9	83.1
Impairment charge			10.7		10.7
Disposals		(13.2)		(2.1)	(15.3)
<b>At 31 July 2012</b>	<b>93.7</b>	<b>70.6</b>	<b>249.1</b>	<b>95.9</b>	<b>509.3</b>
<b>Net book value at 31 July 2012</b>	<b>1,394.4</b>	<b>110.7</b>	<b>164.5</b>	<b>47.5</b>	<b>1,717.1</b>
Net book value at 31 July 2011	1,295.8	99.1	168.3	47.0	1,610.2
Net book value at 1 August 2010	1,284.4	87.0	218.0	49.2	1,638.6

In addition to goodwill, the acquired intangible assets comprise:

	Patents, licences and trademarks £m	Technology £m	Customer relationships £m	Total acquired intangibles £m
<b>Cost</b>				
At 1 August 2010	68.7	122.5	164.3	355.5
Exchange adjustments	(2.1)	(5.1)	(0.5)	(7.7)
Business combinations			4.1	4.1
At 31 July 2011	66.6	117.4	167.9	351.9
Exchange adjustments	3.0	5.5		8.5
Business combinations (note 28)	3.8	16.1	33.3	53.2
<b>At 31 July 2012</b>	<b>73.4</b>	<b>139.0</b>	<b>201.2</b>	<b>413.6</b>
<b>Amortisation</b>				
At 1 August 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
Exchange adjustments	1.1	2.7	0.1	3.9
Charge for the year	6.0	15.4	29.5	50.9
Impairment charge	0.9	2.7	7.1	10.7
<b>At 31 July 2012</b>	<b>33.2</b>	<b>77.9</b>	<b>138.0</b>	<b>249.1</b>
<b>Net book value at 31 July 2012</b>	<b>40.2</b>	<b>61.1</b>	<b>63.2</b>	<b>164.5</b>
Net book value at 31 July 2011	41.4	60.3	66.6	168.3
Net book value at 1 August 2010	48.7	76.5	92.8	218.0

# Notes to the accounts

## Continued

### 12 Intangible assets continued

#### Impairment testing

##### Goodwill

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 2013 budget and the four year divisional strategic plan, which have both been approved by the Board. Goodwill is allocated by division as follows:

	2012 £m	2012 Number of CGUs	2011 £m	2011 Number of CGUs
John Crane	139.2	4	132.9	6
Smiths Medical	514.5	1	497.2	1
Smiths Detection	376.9	1	406.9	1
Smiths Interconnect	341.5	3	237.5	4
Flex-Tek	22.3	2	21.3	2
	<b>1,394.4</b>	<b>11</b>	<b>1,295.8</b>	<b>14</b>

As discussed in the business review, both John Crane and Smiths Interconnect have changed their sub-divisional reporting structure this year. The divisions now report and review performance using fewer regional groups and business units. 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, using the new reporting structures.

John Crane and Smiths Medical have strong aftermarket and consumables businesses, with consistent sales trends. Smiths Detection and Smiths Interconnect have greater sales and margin volatility due to lower levels of recurring revenue and involvement in government funded programmes, particularly defence, and customer led technology innovation. 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 projections of 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 12.3% to 14.1% (2011: 11.1% to 14.1%) 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 2.29% (2011: 2.42%). These rates do not reflect the long-term assumptions used by the Group for investment planning.

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

	Smiths Medical	Smiths Detection	Smiths Interconnect		
			Microwave	Connectors	Power management
	Year ended 31 July 2012				
Net book value of goodwill (£m)	514.5	376.9	134.2	84.7	122.6
Discount rate	12.3%	13.5%	14.1%	14.1%	13.1%
Period covered by management projections	5 years	5 years	5 years	5 years	5 years
Long-term growth rates	2.20%	2.50%	2.72%	2.32%	2.59%
	Year ended 31 July 2011				
Net book value of goodwill (£m)	497.2	406.9	128.4	80.8	28.3
Discount rate	11.2%	11.2%	13.0%	11.1%	13.0%
Period covered by management projections	5 years	5 years	5 years	5 years	5 years
Long-term growth rates	2.47%	2.00%	2.25%	2.25%	2.25%

The 2011 information for Smiths Interconnect has been restated to reflect the new CGU structure, with weighted averages disclosed for the discount rate and growth rates. The remaining balance of the goodwill represents smaller individual amounts which have been allocated to smaller CGUs.

## 12 Intangible assets continued

### Impairment testing continued

#### Goodwill continued

##### Sensitivity analysis

Sensitivity analysis performed around the base case assumptions has indicated that for Smiths Interconnect Power management, the following changes in assumptions (in isolation), would cause the value in use to fall below the carrying value:

	Change required to trigger impairment
Forecast operating cash-flow	12% reduction
Discount rate	1.4% higher
Long-term growth rates	2.8% lower

For the other 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.

In the year ended 31 July 2012 impairment charges of £10.7m were incurred on intangible assets arising from the PDI acquisition. Value in use calculations were used to determine the recoverable values of these assets. The impairment charges arose because product sales have been lower than expected with a consequential impact on the future value of the technology, customer relationships and brands. The impairment charge has been included in Smiths Interconnect administrative expenses and it is excluded from the calculation of headline operating profit.

In the year ended 31 July 2011 impairment charges of £5.5m were incurred on intangible assets acquired in two other business combinations. Value in use calculations were used to determine the recoverable values of these assets. The impairment charges arose because current and forecast profitability was below the levels originally projected. The impairment charge was included in Smiths Interconnect administrative expenses and excluded from the calculation of headline operating profit.

## 13 Property, plant and equipment

	Land and buildings £m	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
<b>Cost or valuation</b>				
At 1 August 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
Exchange adjustments	0.6	5.7	(3.4)	2.9
Business combinations	0.3	1.0	0.2	1.5
Additions	6.0	27.8	16.3	50.1
Disposals	(4.3)	(12.9)	(8.9)	(26.1)
Business disposals	(0.2)	(1.3)		(1.5)
<b>At 31 July 2012</b>	<b>192.7</b>	<b>516.0</b>	<b>213.7</b>	<b>922.4</b>
<b>Depreciation</b>				
At 1 August 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
Exchange adjustments	1.0	5.1	(2.4)	3.7
Charge for the year	7.5	34.7	16.8	59.0
Disposals	(2.7)	(12.1)	(7.7)	(22.5)
Business disposals	(0.2)	(0.8)		(1.0)
<b>At 31 July 2012</b>	<b>92.7</b>	<b>389.6</b>	<b>169.6</b>	<b>651.9</b>
<b>Net book value at 31 July 2012</b>	<b>100.0</b>	<b>126.4</b>	<b>44.1</b>	<b>270.5</b>
Net book value at 31 July 2011	103.2	133.0	46.6	282.8
Net book value at 1 August 2010	104.5	148.6	49.6	302.7

# Notes to the accounts

## Continued

### 14 Investments accounted for using the equity method

	31 July 2012 £m	31 July 2011 £m
<b>Investments in associated companies</b>		
At start of period	18.5	13.6
Exchange adjustment	(0.9)	0.8
Share of results after tax	5.7	4.3
Disposal	(23.3)	
Dividend received		(0.2)
<b>At end of period</b>		18.5

On 16 July 2012 the Group disposed of its interest in Cross Match Technologies, Inc., incorporated in the United States, for a consideration of £45.0m.

The Group's share of the revenue of associates was £28.8m (2011: £23.7m). At 31 July 2011 the total assets of associates were £59.9m and liabilities were £13.5m, representing Cross Match Technologies, Inc, and 35.6% of these assets and liabilities were attributable to Smiths Group.

### 15 Financial assets

Available for sale financial assets include £58.4m (2011: £29.1m) 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 2012 £m	31 July 2011 £m
<b>Inventories comprise</b>		
Raw materials and consumables	147.9	145.1
Work in progress	91.3	94.7
Finished goods	209.5	197.2
	448.7	437.0
Less: payments on account	(10.2)	(4.5)
	438.5	432.5

The Group consumed £1,397.7m (2011: £1,332.6m) of inventories during the period. £10.9m (2011: £11.3m) was recognised as an expense resulting from the write-down of inventory and £2.9m (2011: £3.0m) was released to the income statement from inventory provisions charged in earlier years but no longer required.

### 17 Trade and other receivables

	31 July 2012 £m	31 July 2011 £m
<b>Non-current</b>		
Trade receivables	27.9	23.7
Prepayments and accrued income	4.1	5.3
Other receivables	5.4	4.6
	37.4	33.6
<b>Current</b>		
Trade receivables	578.9	564.2
Prepayments and accrued income	40.6	32.9
Other receivables	14.9	15.7
	634.4	612.8

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 £628.4m (2011: £606.5m).

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 4% (2011: 6%) of Group revenue.



## 17 Trade and other receivables continued

### Ageing of trade receivables

	31 July 2012 £m	31 July 2011 £m
Trade receivables which are not impaired and not yet due	485.7	472.4
Trade receivables which are not impaired and less than three months overdue	89.0	84.2
Trade receivables which are not impaired and more than three months overdue	28.5	28.5
Gross value of partially and fully provided receivables	21.2	16.8
	624.4	601.9
Provision for bad and doubtful debts	(17.6)	(14.0)
<b>Trade receivables</b>	<b>606.8</b>	<b>587.9</b>

## 18 Trade and other payables

	31 July 2012 £m	31 July 2011 £m
<b>Non-current</b>		
Other creditors	37.5	45.1
<b>Current</b>		
Trade creditors	193.8	190.3
Bills of exchange payable	2.2	0.7
Other creditors	15.4	19.4
Other taxation and social security costs	21.3	22.5
Accruals and deferred income	235.5	221.3
	468.2	454.2

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.

## 19 Borrowings and net debt

This note sets out the calculation of net debt, an important measure in explaining our financing position. The net debt figure includes accrued interest and the fair value adjustments relating to hedge accounting.

	31 July 2012 £m	31 July 2011 £m
<b>Cash and cash equivalents</b>		
Net cash and deposits	205.6	261.1
<b>Short-term borrowings</b>		
Bank overdrafts	(1.9)	(0.4)
\$250m 5.45% US\$ Private placement 2013	(161.7)	
Bank and other loans	(1.2)	(1.2)
Interest accrual	(10.5)	(10.1)
	(175.3)	(11.7)
<b>Long-term borrowings</b>		
\$250m 5.45% US\$ Private placement 2013		(158.3)
\$250m 6.05% US\$ Guaranteed notes 2014	(159.1)	(151.4)
£150m 7.25% Sterling Eurobond 2016	(149.4)	(149.3)
€300m 4.125% Eurobond 2017	(240.9)	(260.2)
\$175m 7.37% US\$ Private placement 2018	(111.6)	(106.4)
\$250m 7.20% US\$ Guaranteed notes 2019	(158.5)	(151.0)
Bank and other loans	(2.2)	(1.8)
	(821.7)	(978.4)
<b>Borrowings</b>	<b>(997.0)</b>	<b>(990.1)</b>
<b>Net debt</b>	<b>(791.4)</b>	<b>(729.0)</b>

Borrowings are accounted for at amortised cost and are categorised as other financial liabilities. See note 20 for a maturity analysis of borrowings. The repayment dates on borrowings repayable after five years range from 2018 to 2019.

Interest of £42.1m (2011: £42.3m) was charged to the consolidated income statement in this period in respect of public bonds.

# Notes to the accounts

## Continued

### 19 Borrowings and net debt continued

#### Net cash and cash equivalents

	31 July 2012 £m	31 July 2011 £m
Cash at bank and in hand	130.8	232.0
Short-term deposits	74.8	29.1
Cash and cash equivalents	205.6	261.1
Bank overdrafts	(1.9)	(0.4)
<b>Net cash and cash equivalents</b>	<b>203.7</b>	<b>260.7</b>

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

#### 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 2011	260.7	(11.3)	(978.4)	(729.0)
Foreign exchange gains and losses	(2.0)	(0.4)	1.0	(1.4)
Net cash inflow/(outflow)	(55.0)			(55.0)
Repayment of borrowings		2.8	170.7	173.5
Drawdown of borrowings		(1.5)	(173.3)	(174.8)
Capitalisation, interest accruals and unwind of capitalised fees			(0.5)	(0.5)
Fair value movement from interest rate hedging		1.6	(5.8)	(4.2)
Change in maturity analysis		(164.6)	164.6	
<b>At 31 July 2012</b>	<b>203.7</b>	<b>(173.4)</b>	<b>(821.7)</b>	<b>(791.4)</b>

#### Secured loans

Loans amounting to £3.4m (2011: £3.0m) were secured on plant and equipment with a book value of £3.3m (2011: £2.9m).

### 20 Financial risk management

The Group's international operations and debt financing expose it to financial risks which include the effects of changes in foreign exchange rates, changes in debt market prices, interest rates, credit risks and liquidity risks.

Treasury and risk management policies are set by the Board. The policy sets out specific guidelines to manage foreign exchange risk, interest rate risk, credit risk and the use of financial instruments to manage risk. The instruments and techniques used to manage exposures include foreign currency derivatives, debt and other interest rate derivatives. The central treasury function monitors financial risks and compliance with risk management policies. The management of operational credit risk is discussed in note 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 2012				
	Sterling £m	US\$ £m	Euro £m	Other £m	Total £m
<b>Financial assets and liabilities</b>					
Financial instruments included in trade and other receivables	30.4	327.3	127.8	142.9	628.4
Financial instruments included in trade and other payables	(42.4)	(170.9)	(69.4)	(68.3)	(351.0)
Cash and cash equivalents	18.5	88.8	24.4	73.9	205.6
Borrowings not designated as net investment hedges	(149.4)	(11.4)	(4.0)	(0.4)	(165.2)
	(142.9)	233.8	78.8	148.1	317.8
Exclude balances held in operations with the same functional currency	142.6	(154.2)	(78.8)	(143.1)	(233.5)
Exposure arising from intra-group loans		(144.0)		(20.5)	(164.5)
Forward foreign exchange contracts	(48.0)	(34.7)	95.0	(12.3)	
	(48.3)	(99.1)	95.0	(27.8)	(80.2)

## 20 Financial risk management continued

	At 31 July 2011				
	Sterling £m	US\$ £m	Euro £m	Other £m	Total £m
<b>Financial assets and liabilities</b>					
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)

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 2012 £m	Gain/(loss) recognised in reserves 31 July 2012 £m	Impact on profit for the year 31 July 2011 £m	Gain/(loss) recognised in reserves 31 July 2011 £m
US dollar	0.1	(4.2)	5.9	(3.4)
Euro	3.6	4.1	(1.8)	4.2
Sterling	(4.1)	0.9	0.5	1.6

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 2012 contracts with a nominal value of £279.4m (2011: £217.7m) were designated as hedging instruments. In addition, the Group had outstanding foreign currency contracts with a nominal value of £249.9m (2011: £241.0m) which were being used to manage transactional foreign exchange exposures, but were not accounted for as cash-flow hedges. The fair value of the contracts is disclosed in note 21.

The majority of hedged transactions will be recognised in the income statement in the same period that the cash-flows are expected to occur, with the only differences arising as a result of normal commercial credit terms on sales and purchases. Of the foreign exchange contracts designated as hedging instruments 98.5% are for periods of 12 months or less (2011: 99.9%).

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

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Brought forward cash-flow hedge reserve at start of year	(0.3)	(0.6)
Exchange adjustments	0.1	0.1
Gains/(losses) on effective cash-flow hedges recognised in equity	(10.9)	0.4
Amounts removed from the hedge reserve and recognised in the following lines on the income statement		
– revenue	5.5	0.2
– cost of sales	0.9	(0.4)
<b>Carried forward cash-flow hedge reserve at end of year</b>	<b>(4.7)</b>	<b>(0.3)</b>

# Notes to the accounts

## Continued

### 20 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 2012				
	Sterling £m	US\$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges		(590.9)	(240.9)		(831.8)
Currency swap contracts	192.4	(69.4)	(39.2)	(83.8)	
	192.4	(660.3)	(280.1)	(83.8)	(831.8)

	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 2012 swap contracts in other currencies hedged the Group's exposure to Canadian dollars, Japanese yen and Chinese renminbi (31 July 2011: Australian dollars, Canadian dollars, Japanese yen and Chinese renminbi).

Of the contracts designated as net investment hedges, 55% (2011: 54%) are current and the balance matures over the next three years (2011: 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 2012 £m	Year ended 31 July 2011 £m
Brought forward net investment hedge reserve at start of year	(120.3)	(128.2)
Amounts deferred in the period on effective net investment hedges	0.2	7.9
<b>Carried forward net investment hedge reserve at end of year</b>	<b>(120.1)</b>	<b>(120.3)</b>

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 2012 £m	Loss recognised in hedge reserve 31 July 2011 £m
US dollar	65.6	60.4
Euro	25.0	27.6

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.

## 20 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 Group's 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 2012 92.0% (2011: 98.5%) 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 2012, after interest rate swaps, is 5.5% (2011: 5.5%).

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

The following table shows the interest rate risk exposure of investments, 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.

	Available for sale investments 31 July 2012 £m	Cash and cash equivalents 31 July 2012 £m	Borrowings 31 July 2012 £m	Fair value of borrowings 31 July 2012 £m	Available for sale investments 31 July 2011 £m	Cash and cash equivalents 31 July 2011 £m	Borrowings 31 July 2011 £m	Fair value of borrowings 31 July 2011 £m
Fixed interest (adjusted for interest rate hedging)								
Less than one year			(65.0)	(66.1)			(1.2)	(1.2)
Between one and five years			(451.5)	(500.8)			(363.4)	(403.6)
Greater than five years	58.4		(270.2)	(333.4)	29.1		(414.2)	(463.0)
Total fixed interest financial assets/(liabilities) (adjusted for interest rate hedging)	58.4		(786.7)	(900.3)	29.1		(778.8)	(867.8)
Floating rate interest financial assets/(liabilities)		189.0	(210.3)	(210.3)		243.1	(211.3)	(211.3)
Total interest bearing financial assets/(liabilities)	58.4	189.0	(997.0)	(1,110.6)	29.1	243.1	(990.1)	(1,079.1)
Non-interest bearing assets/(liabilities) in the same category	2.5	16.6			2.5	18.0		
<b>Total</b>	<b>60.9</b>	<b>205.6</b>	<b>(997.0)</b>	<b>(1,110.6)</b>	<b>31.6</b>	<b>261.1</b>	<b>(990.1)</b>	<b>(1,079.1)</b>

### 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 21. The effect of the swaps is to convert £190.0m (2011: £196.3m) 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 income statement exposure to interest rate movements for any individual currency. Based on the composition of net debt and foreign exchange rates at 31 July 2012, and taking into consideration all fixed rate borrowings and interest rate swaps in place, a one percentage point (100 basis points) change in average floating interest rates for all three currencies would have a £0.6m (2011: £nil) impact on the Group's profit before tax.

Based on the investments held at 31 July 2012 a one percentage point (100 basis points) increase in sterling interest rates would reduce the carrying value of investments by £8.7m, generating a corresponding charge to reserves.

### (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 £266.5m at 31 July 2012 (2011: £292.7m).

	31 July 2012 £m	31 July 2011 £m
UK government bonds with a AAA credit rating (note 15)	58.4	29.1
Cash at banks with at least a AA- credit rating	135.1	236.6
Cash at banks with a A+ credit rating	57.4	21.1
Cash at other banks	13.1	3.4
Other investments	2.5	2.5
	<b>266.5</b>	<b>292.7</b>

At 31 July 2012 the maximum exposure with a single bank for deposits and cash is £55.8m (2011: £57.1m), whilst the maximum mark to market exposure for derivatives is £3.5m (2011: £5.3m). These banks have AA- and A+ credit rating, respectively (2011: AA- and AA).



# Notes to the accounts

## Continued

### 20 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. This is provided by a US\$800m multi-currency revolving credit facility, which matures in December 2015. At the balance sheet date the Group had the following undrawn credit facilities:

	31 July 2012 £m	31 July 2011 £m
Expiring within one year		
Expiring between one and two years		
Expiring after two years	<b>510.6</b>	486.8
	<b>510.6</b>	486.8

##### Cash deposits

As at 31 July 2012, £74.8m (2011: £29.1m) of cash and cash equivalents was on deposit with various banks of which £35.9m (2011: £4.5m) was on deposit in the UK.

##### Gross contractual cash-flows for borrowings

	Borrowings (Note 19) 31 July 2012 £m	Fair value adjustments 31 July 2012 £m	Contractual interest payments 31 July 2012 £m	Total contractual cash-flows 31 July 2012 £m	Borrowings (Note 19) 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
Less than one year	(175.3)	1.2	(44.0)	(218.1)	(11.7)	(1.1)	(46.9)	(59.7)
Between one and two years	(160.3)	(0.5)	(50.1)	(210.9)	(159.2)	6.2	(54.0)	(207.0)
Between two and three years	(1.0)		(40.4)	(41.4)	(152.3)	(0.7)	(49.8)	(202.8)
Between three and four years	(149.4)	(0.6)	(40.3)	(190.3)			(40.5)	(40.5)
Between four and five years	(240.9)	5.3	(29.4)	(265.0)	(149.3)	(0.7)	(40.5)	(190.5)
Greater than five years	(270.1)	(1.1)	(31.2)	(302.4)	(517.6)	(3.6)	(59.4)	(580.6)
<b>Total</b>	<b>(997.0)</b>	<b>4.3</b>	<b>(235.4)</b>	<b>(1,228.1)</b>	<b>(990.1)</b>	<b>0.1</b>	<b>(291.1)</b>	<b>(1,281.1)</b>

The figures presented in the borrowings column include the non-cash adjustments which are highlighted in the adjacent column. The contractual interest reported for borrowings is before the effect of interest rate swaps.

##### Gross contractual cash-flows for derivative financial instruments

	Receipts 31 July 2012 £m	Payments 31 July 2012 £m	Net cash-flow 31 July 2012 £m	Receipts 31 July 2011 £m	Payments 31 July 2011 £m	Net cash-flow 31 July 2011 £m
<b>Assets</b>						
Less than one year	285.9	(276.4)	9.5	182.3	(166.6)	15.7
Greater than one year	76.3	(69.5)	6.8	102.4	(92.5)	9.9
<b>Liabilities</b>						
Less than one year	295.8	(306.4)	(10.6)	351.3	(359.5)	(8.2)
Greater than one year	30.2	(31.1)	(0.9)	26.8	(27.0)	(0.2)
<b>Total</b>	<b>688.2</b>	<b>(683.4)</b>	<b>4.8</b>	<b>662.8</b>	<b>(645.6)</b>	<b>17.2</b>

This table presents the undiscounted future contractual cash-flows for all derivative financial instruments. For this disclosure, cash-flows in foreign currencies are translated using the spot rates at the balance sheet date. The fair values of these financial instruments are presented in note 21.

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

The contractual cash-flows for financial liabilities included in trade and other payables are: £328.4m (2011: £309.9m) due in less than one year, £18.4m (2011: £20.9m) due between one and five years and £4.2m (2011: £4.3m) due after more than five years.

## 21 Financial derivatives

The tables below set out the nominal amount and fair value of derivative contracts held by the Group, identifying the derivative contracts which qualify for hedge accounting treatment:

	At 31 July 2012			
	Contract or underlying nominal amount	Fair value		
		Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	279.4	2.7	(8.6)	(5.9)
Foreign exchange contracts (not hedge accounted)	249.9	1.4	(1.7)	(0.3)
<b>Total foreign exchange contracts</b>	<b>529.3</b>	<b>4.1</b>	<b>(10.3)</b>	<b>(6.2)</b>
Currency swaps (net investment hedges)	192.5	2.6	(1.4)	1.2
Interest rate swaps (fair value hedges)	190.0	8.4		8.4
<b>Total financial derivatives</b>	<b>911.8</b>	<b>15.1</b>	<b>(11.7)</b>	<b>3.4</b>
Balance sheet entries				
Non-current		7.2	(1.1)	6.1
Current		7.9	(10.6)	(2.7)
<b>Total financial derivatives</b>		<b>15.1</b>	<b>(11.7)</b>	<b>3.4</b>

	At 31 July 2011			
	Contract or underlying nominal amount	Fair value		
		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)
<b>Total foreign exchange contracts</b>	<b>458.7</b>	<b>4.8</b>	<b>(7.1)</b>	<b>(2.3)</b>
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
<b>Total financial derivatives</b>	<b>847.6</b>	<b>12.1</b>	<b>(10.4)</b>	<b>1.7</b>
Balance sheet entries				
Non-current		6.4	(1.5)	4.9
Current		5.7	(8.9)	(3.2)
<b>Total financial derivatives</b>		<b>12.1</b>	<b>(10.4)</b>	<b>1.7</b>

### Currency swaps not hedge accounted

These contracts comprise derivatives which were previously part of the net investment hedging programme and matching contracts to eliminate this exposure. There is no further net exposure arising from these contracts.

### Accounting for other derivative contracts

Any foreign exchange contracts which are not formally designated as hedges and tested are classified as 'held for trading' and not hedge accounted.

### Fair value hierarchy

All derivatives values are calculated using valuation methodologies in which all the inputs are either market data or derived from market data.

# Notes to the accounts

## Continued

### 22 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 2011	37.6	7.8	3.4	3.9	181.7	14.4	248.8
Exchange adjustments	(1.0)	0.1	0.1	0.1	9.0	0.9	9.2
Business combinations	0.4						0.4
Provision charged	22.4	11.3	6.9		42.5	55.2	138.3
Provision released	(6.0)	(0.7)	(0.5)		(3.7)	(0.2)	(11.1)
Unwind of provision discount					4.0	0.5	4.5
Utilisation	(18.9)	(12.7)	(0.5)		(20.4)	(5.9)	(58.4)
<b>At 31 July 2012</b>	<b>34.5</b>	<b>5.8</b>	<b>9.4</b>	<b>4.0</b>	<b>213.1</b>	<b>64.9</b>	<b>331.7</b>

Analysed as:

	31 July 2012 £m	31 July 2011 £m
Current liabilities	<b>77.3</b>	74.7
Non-current liabilities	<b>254.4</b>	174.1
	<b>331.7</b>	248.8

#### 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 and property

At 31 July 2012 a provision of £9.4m (2011: £nil) relates to the performance improvement programme in Smiths Detection.

#### 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 221,000 claims against JCI have been dismissed before trial over the last 33 years. JCI is currently a defendant in cases involving approximately 86,000 claims. Despite the large number of claims brought against JCI, it has had final judgments against it, after appeals, in only 115 cases over the period, and has had to pay awards amounting to approximately US\$111m. 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.

## 22 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. The projections use a 10 year time horizon 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, see note 25.

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 2012 £m	31 July 2011 £m
Gross provision	<b>226.3</b>	203.1
Discount	<b>(13.2)</b>	(21.4)
Discounted pre-tax provision	<b>213.1</b>	181.7
Deferred tax	<b>(51.1)</b>	(50.6)
Discounted post-tax provision	<b>162.0</b>	131.1

#### Titeflex Corporation

In recent years Titeflex Corporation, a subsidiary of the Group in the Flex-Tek division, has received a number of claims from insurance companies seeking recompense on a subrogated basis for the effects of damage allegedly caused by lightning strikes in relation to its flexible gas piping product. Titeflex Corporation believes that its products are a safe and effective means of delivering gas when installed in accordance with the manufacturer's instructions and local and national codes, however some claims have been settled on an individual basis without admission of liability. The number of claims received each year and the cost of resolving them has varied but, more recently, has cost between £3m and £5m a year. These costs have historically been charged against headline operating profit. Equivalent third-party products in the US marketplace face similar challenges with the profile of legal activity appearing to increase in recent times. The continuing progress of claims and the pattern of settlement, together with the recent market place activity, now provide sufficient evidence to recognise a liability in the accounts. Therefore provision has been made for the costs which the Group is expected to incur in respect of future subrogation claims to the extent that such costs can be reliably estimated. Titeflex Corporation sells flexible gas piping with extensive installation and safety guidance (revised in 2008) designed to assure the safety of the product and minimise the risk of damage associated with lightning strikes.

The assumptions made in assessing the appropriate level of provision, which are based on past experience, include:

- The period over which expenditure can be reliably estimated
- The number of future settlements
- The average amount of settlements

The projections use a rolling 10 year time horizon on the basis that there is substantial uncertainty in the US litigation environment so probable expenditures are not reasonably estimable beyond this time horizon, see note 25.

However, because of the significant uncertainty associated with the future level of 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 of £61.8m (£11.2m) is a discounted pre-tax provision using discount rates, being the risk-free rate on US debt instruments for the appropriate period.

# Notes to the accounts

## Continued

### 22 Provisions for liabilities and charges continued

#### Litigation continued

##### 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.

The JCI and Titeflex Corporation litigation provisions are the only provisions which are discounted.

### 23 Share capital

	Issued capital Number of shares	Consideration £m	£m
<b>Ordinary shares of 37.5p each</b>			
At 31 July 2011	392,350,403	147.1	
Exercise of share options	375,540	0.2	3.0
<b>Total share capital at 31 July 2012</b>	<b>392,725,943</b>	<b>147.3</b>	

At 31 July 2012 all of the issued share capital was in free issue. All issued shares are fully paid.

### 24 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 (2011: nil) shares to the Trust, and the Trust purchased 1,026,514 (2011: 700,892 shares) in the market. At 31 July 2012 the Trust held 855 (2011: 855) ordinary shares with a market value of £0.0m (2011: £0.0m).

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

#### Capital management

Capital employed comprises total equity adjusted for goodwill recognised directly in reserves, net post-retirement benefit assets and liabilities, net litigation provisions relating to exceptional items and net debt. Capital employed has been restated, see note 1. The efficiency of the allocation of the capital to the divisions is monitored through the 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 16.5% (2011: 16.4% restated). See note 1 for details of the restatement of capital employed.

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 17% (2011: 15%).

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 2012 the Group had a credit rating of BBB+/Baa2 (2011: BBB+/Baa2) 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 2012 these measures were 99% (2011: 95%) and 1.2 (2011: 1.2).

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 2012 £m	31 July 2011 £m
The hedge reserve on the balance sheet comprises		
– cash-flow hedge reserve	(4.7)	(0.3)
– net investment hedge reserve	(120.1)	(120.3)
	<b>(124.8)</b>	<b>(120.6)</b>

See transactional currency exposure risk management disclosures in note 20 for additional details of cash-flow hedges, and translational currency exposure risk management disclosure also in note 20 for additional details of net investment hedges.



## 25 Contingent liabilities and commitments

### John Crane, Inc.

As stated in note 22, 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.

### Titeflex Corporation

As stated in Note 22, Titeflex Corporation has made provision for the cost of expected future subrogation claims. The Group considers claims might continue beyond the period covered by the provision; however because of the uncertainty surrounding the US litigation environment 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, legal challenges to the scope and validity of patents, and product liability and insurance subrogation claims. 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 2012, contingent liabilities, comprising bonds and guarantees arising in the normal course of business, amounted to £167.4m (2011: £137.8m), including pension commitments of £49.5m (2011: £43.1m).

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.

## 26 Operating lease commitments – minimum lease payments

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

	31 July 2012		31 July 2011	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Payments due				
– not later than one year	31.0	8.4	30.4	9.1
– later than one year and not later than five years	66.8	10.8	64.1	8.8
– later than five years	12.6		22.7	0.1
	110.4	19.2	117.2	18.0

## 27 Cash-flow

### Cash-flow from operating activities

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Operating profit – continuing	406.6	438.0
Amortisation of intangible assets	83.1	72.3
Impairment of intangible assets	10.7	5.5
Loss/(profit) on disposal of property, plant and equipment	3.7	(0.7)
Profit on disposal of business	(30.8)	(4.4)
Depreciation of property, plant and equipment	59.0	63.4
Share-based payment expense	14.4	13.8
Retirement benefits	(118.6)	(77.6)
Increase in inventories	(4.3)	(46.7)
Increase in trade and other receivables	(6.8)	(33.1)
Increase in trade and other payables	0.9	43.7
Increase in provisions	71.8	5.2
Cash generated from operations	489.7	479.4
Interest	(64.5)	(66.8)
Tax paid	(93.7)	(90.9)
<b>Net cash inflow from operating activities</b>	<b>331.5</b>	<b>321.7</b>

# Notes to the accounts

## Continued

### 27 Cash-flow continued

#### 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 2012 £m	Year ended 31 July 2011 £m
<b>Net cash inflow from operating activities</b>	<b>331.5</b>	321.7
Exclude:		
Interest	<b>64.5</b>	66.8
Tax paid	<b>93.7</b>	90.9
Cash outflow in respect of exceptional operating items	<b>38.2</b>	34.8
Pension deficit payments	<b>111.2</b>	60.1
Include:		
Expenditure on capitalised development, other intangible assets and property, plant and equipment	<b>(91.2)</b>	(90.1)
Disposals of property, plant and equipment in the ordinary course of business	<b>0.7</b>	4.5
<b>Headline operating cash-flow</b>	<b>548.6</b>	488.7

#### Free cash-flow

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Net cash inflow from operating activities	<b>331.5</b>	321.7
Expenditure on capitalised development, other intangible assets and property, plant and equipment	<b>(91.2)</b>	(90.1)
Disposals of property, plant and equipment	<b>0.7</b>	4.5
Investment in financial assets relating to pensions financing	<b>(24.0)</b>	
<b>Free cash-flow</b>	<b>217.0</b>	236.1
Investment in other financial assets	<b>(0.3)</b>	(0.3)
Acquisition of businesses	<b>(167.5)</b>	(18.5)
Disposal of Aerospace		(6.2)
Disposal of businesses	<b>47.3</b>	3.9
Net cash-flow used in financing activities	<b>(151.5)</b>	(129.2)
<b>Net (decrease)/increase in cash and cash equivalents</b>	<b>(55.0)</b>	85.8

### 28 Acquisitions

During the year ended 31 July 2012, the Group acquired the business of Turbo Components and Engineering Inc. ("TCE") (October 2011) on behalf of John Crane and 100% of the equity share capital of Power Holdings Inc. ("PDI") (October 2011) on behalf of Smiths Interconnect.

TCE services, repairs and builds replacement bearings and seals used in critical rotating equipment. This acquisition adds capability for servicing bearings to the John Crane aftermarket platform, creating an end-to-end product and service solution for John Crane's customers. The intangible assets recognised on this acquisition comprise the order book on acquisition, customer relationships and a contractual non-compete agreement. Goodwill represents the potential future growth from expanding the business through the John Crane global service network. The goodwill recognised is expected to be deductible for tax purposes.

PDI designs and manufactures specialist power distribution, conditioning and monitoring systems. PDI will be incorporated into Smiths Interconnect's Power management group, where it expands the range of power quality technologies into new, specialised, high growth markets. The intangible assets recognised on this acquisition comprise technology, customer relationships and trademarks. Goodwill represents the potential future growth from expanding the customer base and developing new technologies. £28.0m of the goodwill recognised is expected to be deductible for tax purposes.

From the date of acquisition to 31 July 2012, the acquisitions contributed £60.1m to revenue, £4.4m to headline profit before taxation and loss of £16.1m to profit before taxation due to the amortisation and impairment of acquired intangible assets. If Smiths had acquired the businesses at the beginning of the financial period, the acquisitions would have contributed £78.7m to revenue and a loss of £22.7m to profit before tax.

## 28 Acquisitions continued

	Power Holdings Inc.			Other acquisitions			Total
	Book value £m	Fair value adjustments £m	Fair value £m	Book value £m	Fair value adjustments £m	Fair value £m	£m
<b>Non-current assets</b>							
– intangible assets		49.5	49.5		3.7	3.7	<b>53.2</b>
– land and buildings	0.3		0.3				<b>0.3</b>
– plant and equipment	0.8		0.8	0.5	(0.1)	0.4	<b>1.2</b>
<b>Current assets</b>							
– trade and other receivables	24.4	(0.2)	24.2	1.8		1.8	<b>26.0</b>
– other current assets	7.3	(1.0)	6.3	0.4	(0.1)	0.3	<b>6.6</b>
<b>Non-current liabilities</b>							
– other liabilities	(0.4)	(7.6)	(8.0)				<b>(8.0)</b>
<b>Current liabilities</b>							
– overdrafts				(0.1)		(0.1)	<b>(0.1)</b>
– other current liabilities	(11.9)	(0.1)	(12.0)	(0.4)		(0.4)	<b>(12.4)</b>
<b>Net assets acquired</b>	20.5	40.6	61.1	2.2	3.5	5.7	<b>66.8</b>
Goodwill on current year acquisitions			92.8			7.4	<b>100.2</b>
<b>Total consideration</b>			153.9			13.1	<b>167.0</b>
Cash paid during the period – current year acquisitions							<b>167.0</b>
Deferred consideration paid – prior year acquisitions							<b>0.5</b>
<b>Total consideration</b>							<b>167.5</b>

## 29 Employee share schemes

The Group operates share schemes and plans for the benefit of employees. The nature of the principal schemes and plans, including general conditions, is set out below:

### Long-Term Incentive Plan (LTIP)

The LTIP is a share plan under which an award over a capped number of shares will vest after the end of the three year performance period if performance conditions are met. Group LTIP awards are made to selected senior corporate executives, including the executive directors. These awards have three performance conditions: 50% of the award is conditional on 3-year headline EPS growth; 30% of the award is conditional on 3-year TSR relative to the FTSE 100 (excluding financial services companies); and 20% of the award is conditional on 3-year average annual headline cash conversion.

Divisional LTIP awards are made to selected divisional senior executives. These awards also have three performance conditions, and the relative significance of the conditions reflects the strategic priorities for each division: 20% to 40% of the awards are conditional on 3-year revenue growth; 30% to 40% of the awards are conditional on 3-year average annual headline operating margins; and 30% to 40% of the awards are conditional on 3-year average annual headline cash conversion.

Each performance condition has a threshold below which no shares vest and a maximum performance target at or above which the award vests in full. For performance between 'threshold' and 'maximum', awards vest on a straight-line sliding scale. The performance conditions are assessed separately, so performance on one condition does not affect the vesting of the other elements of the award. To the extent that the performance targets are not met over the 3-year performance period, awards will lapse. There is no re-testing of the performance conditions.

### 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.

### 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.

# Notes to the accounts

## Continued

### 29 Employee share schemes continued

#### Smiths Group Co-Investment Plan (CIP)

Under the CIP, as introduced in October 2005, the executive directors and senior executives are able, if invited, to use their after tax bonus or 25% of their basic salary after tax, whichever is the greater, to invest in the Company's shares at the prevailing market price. At the end of a three year period, if the executive is still in office and provided the performance test is passed, matching shares will be awarded in respect of any invested shares retained for that period. The number of matching shares to be awarded is determined by the Remuneration Committee at the end of the year in which the bonus is earned by reference to annual bonus, and other corporate financial criteria. The maximum award will not exceed the value, before tax, of the bonus or salary invested in shares by the executive. Vesting of matching shares will occur and the matching shares will be released at the end of the three year period if the Group's Return on Capital Employed ('ROCE') over the Performance Period exceeds the Group's weighted average cost of capital ('WACC') over the Performance Period by an average margin of at least 1% per annum.

In July 2008 the CIP was amended. From 2009 participants 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 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
Granted	752	1,133	257	2,142	£0.97
Update of estimates		96		96	£0.00
Exercised	(254)	(773)	(393)	(1,420)	£2.20
Lapsed	(130)	(14)	(827)	(971)	£7.07
<b>31 July 2012</b>	<b>1,708</b>	<b>2,299</b>	<b>3,475</b>	<b>7,482</b>	<b>£4.10</b>

Options were exercised on an irregular basis during the period. The average closing share price over the financial year was 992.15p (2011: 1,240.24p). 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 2012 ('000)	Options exercisable at 31 July 2011 ('000)	Exercisable weighted average exercise price for options exercisable at 31 July 2012
£0.00 – £2.00	4,008	18			<b>£0.00</b>
£2.01 – £6.00	463	17	<b>2</b>	2	<b>£5.69</b>
£6.01 – £10.00	1,979	42	<b>1,387</b>	2,106	<b>£8.52</b>
£10.01 – £14.00	1,032	62	<b>947</b>	907	<b>£10.97</b>

For the purposes of valuing options to arrive at the share-based payment charge, the Binomial option pricing model has been used for most schemes and the Monte Carlo method is used for schemes with total shareholder return performance targets. The key assumptions used in the models for 2012 and 2011 are volatility of 27% to 30% (2011: 30%) and dividend yield of 3.75% (2011: 3.33%). 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 £9.44 (2011: £12.40), group long term incentive plans of £7.14 (2011: £13.86) and divisional long term incentive plans of £8.94 (2011: £12.35). 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 £14.3m (2011: £13.8m), of which £14.4m (2011: £13.8m) relates to equity-settled share-based payment.

At 31 July 2012 the creditor relating to cash-settled schemes is £0.4m (2011: £0.6m).

# Group financial record 2008-2012

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m	Year ended 31 July 2008 £m
Revenue	3,030.1	2,842.0	2,769.6	2,664.6	2,321.2
<b>Headline operating profit</b>	<b>553.7</b>	516.9	492.4	417.5	380.6
Amortisation of acquired intangible assets	(61.6)	(49.5)	(42.1)	(34.6)	(19.2)
Exceptional items (including profit on sale/impairment of financial asset)	(85.5)	(29.4)	(14.4)	45.6	(35.4)
Financing losses					(0.3)
<b>Operating profit</b>	<b>406.6</b>	438.0	435.9	428.5	325.7
Net finance costs	(46.4)	(44.4)	(64.6)	(58.1)	(5.4)
Share of post-tax profits/(losses) of associated companies	5.7	4.3	1.8	0.4	(1.0)
<b>Profit before taxation</b>	<b>365.9</b>	397.9	373.1	370.8	319.3
Taxation	(107.6)	(91.8)	(78.9)	(94.9)	(75.0)
<b>Profit after taxation – continuing operations</b>	<b>258.3</b>	306.1	294.2	275.9	244.3
<b>Profit after taxation – discontinued operations</b>	<b>(0.1)</b>	79.0	16.4	(5.9)	24.5
<b>Shareholders' equity</b>	<b>972.8</b>	1,373.5	1,094.8	859.0	915.9
Represented by					
– intangible assets	1,717.1	1,610.2	1,638.6	1,500.3	1,253.2
– property, plant & equipment and investments	331.4	332.9	343.3	337.0	309.0
– net current assets/provisions/retirement benefit liabilities	(284.3)	159.4	(50.3)	(93.4)	124.3
Net borrowings	(791.4)	(729.0)	(836.8)	(884.9)	(770.6)
<b>Funds employed</b>	<b>972.8</b>	1,373.5	1,094.8	859.0	915.9
<b>Ratios</b>					
Headline operating profit: turnover (%)	18.2	18.2	17.8	15.7	16.4
Headline effective tax rate (2011 and 2010 restated) (%)	26.5	26.5	24.7	24.0*	24.0*
Return on capital employed (2011 and 2010 restated) (%)	16.5	16.4	15.9	14.7*	16.4*
Return on shareholders' funds (%)	18.3	17.7	18.4	16.5	16.7
<b>Cash-flow</b>					
Headline operating cash	548.6	488.7	564.8	435.0	272.5
Headline operating cash conversion (%)	99	95	115	104	
Free cash-flow (before acquisitions and dividends, after capital expenditure)	217.0	236.1	331.3	256.1	90.6
Free cash-flow per share (p)	55.3	60.4	84.9	65.9	23.4
<b>Earnings per share</b>					
Headline earnings per share (p) (2011 and 2010 restated)	92.6	86.5	83.4	72.4*	74.5*
<b>Dividends</b>					
Pence per share	38.00	36.25	34.00	34.00	34.00
Headline dividend cover (2011 and 2010 restated)	2.4	2.4	2.5	2.1*	2.2*
<b>Number of employees (000s)</b>					
United Kingdom	1.9	2.0	2.0	2.0	2.2
Overseas	21.3	20.9	21.6	19.8	20.6
	23.2	22.9	23.6	21.8	22.8

\*Headline effective tax rate, return on capital employed, headline earnings per share and headline dividend cover for 2011 and 2010 have been restated because the definition of headline profit has been amended to exclude financing credits and charges relating to retirement benefits. Headline earnings per share for 2009 and 2008 are calculated on the old basis.

# 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 2012 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 2012;
- 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 2012.

**Martin Hodgson** (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors

London

18 September 2012

## 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 2012 £m	31 July 2011 £m
<b>Fixed assets</b>			
Tangible assets	2	2.8	4.2
Investments and advances	3	3,217.9	3,037.9
Available for sale financial assets	4	58.4	29.5
		<b>3,279.1</b>	<b>3,071.6</b>
<b>Current assets</b>			
Debtors			
– amounts falling due within one year	5	123.3	120.0
– amounts falling due after more than one year	5		31.8
Cash at bank and on deposit		40.9	51.6
Financial derivatives			
– amounts falling due within one year		4.1	1.1
– amounts falling due after more than one year		7.2	6.4
		<b>175.5</b>	<b>210.9</b>
Creditors: amounts falling due within one year	6	(262.3)	(115.9)
<b>Net current (liabilities)/assets</b>		<b>(86.8)</b>	<b>95.0</b>
<b>Total assets less current liabilities</b>		<b>3,192.3</b>	<b>3,166.6</b>
Creditors: amounts falling due after more than one year	6	(820.1)	(967.3)
Provisions for liabilities and charges	7	(2.6)	(2.6)
Financial derivatives		(0.4)	(1.5)
<b>Net assets excluding pension liabilities</b>		<b>2,369.2</b>	<b>2,195.2</b>
Retirement benefit liabilities	8	(330.2)	(148.7)
<b>Net assets including pension liabilities</b>		<b>2,039.0</b>	<b>2,046.5</b>
<b>Capital and reserves</b>			
Called up share capital	9	147.3	147.1
Share premium account	10	331.9	329.1
Capital redemption reserve	10	5.8	5.8
Other reserves	10	180.5	180.5
Profit and loss account	10	1,373.5	1,384.0
<b>Shareholders' equity</b>		<b>2,039.0</b>	<b>2,046.5</b>

The accounts on pages 137 to 145 were approved by the Board of Directors on 18 September 2012 and were signed on its behalf by:

**Philip Bowman**  
Chief Executive

**Peter Turner**  
Finance Director

# Company accounting policies

## Basis of preparation

The accounts have been prepared in accordance with the Companies Act 2006 and all applicable accounting standards in the United Kingdom (UK GAAP).

These accounts have been prepared on a going concern basis and under the historical cost convention modified to include revaluation of certain financial instruments, share options and pension assets and liabilities held at fair value.

As permitted by Section 408(3) of the Companies Act 2006, the Company's entity profit and loss account and statement of total recognised gains and losses have not been presented. As permitted by Section 408(2) information about the Company's employee numbers and costs is not presented.

The Company has taken advantage of the exemption in 'FRS 8: Related Party Disclosures' not to disclose transactions with other wholly owned members of the Smiths Group.

## Foreign currencies

Foreign currency transactions are recorded at the exchange rate ruling on the date of transaction. Foreign exchange gains and losses resulting from the settlement of such transactions, and from the retranslation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies, are recognised in the profit and loss account.

## Operating leases

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

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

## Tangible fixed assets

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

## Fixed asset investments

The Company's investments in shares in group companies are stated at cost less provision for impairment. Any impairment is charged to the profit and loss account as it arises.

## Financial instruments

The policies disclosed in the Group accounting policies on pages 96 to 101 for recognition, measurement and presentation of financial instruments are applied in the Company accounts.

Where there are no differences between the disclosures required for the Group and the Company in respect of a class of financial instruments, an appropriate cross-reference is made to the Group accounts.

## Taxation

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

Deferred tax is not recognised on any fixed assets that have been revalued unless there is a binding agreement to sell the asset.

## Provisions

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

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

### Post-retirement benefits

The Company has both defined benefit and defined contribution plans.

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

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

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

### Share-based payment

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

The fair value of the shares or share options granted is recognised over the vesting period to reflect the value of the employee services received. The charge relating to grants to employees of the Company is recognised as an expense in the profit and loss account and the charge for grants to employees of other group companies is recognised as an investment in the relevant subsidiary.

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

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

### Dividends

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

# Notes to the Company accounts

## 1 Audit fee

The audit fee for the parent company was £0.1m (2011: £0.1m).

## 2 Property, plant and equipment

	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
<b>Cost or valuation</b>			
At 31 July 2011	7.9	0.6	8.5
Additions		0.1	0.1
Disposals	(1.3)	(0.3)	(1.6)
<b>At 31 July 2012</b>	<b>6.6</b>	<b>0.4</b>	<b>7.0</b>
<b>Depreciation</b>			
At 31 July 2011	3.9	0.4	4.3
Charge for the period	1.5		1.5
Disposals	(1.3)	(0.3)	(1.6)
<b>At 31 July 2012</b>	<b>4.1</b>	<b>0.1</b>	<b>4.2</b>
<b>Net book value at 31 July 2012</b>	<b>2.5</b>	<b>0.3</b>	<b>2.8</b>
Net book value at 31 July 2011	4.0	0.2	4.2

## 3 Investments and advances

	Shares at cost £m	Due from subsidiaries £m	Due to subsidiaries £m	Total £m
<b>Cost or valuation</b>				
At 31 July 2011	2,375.6	2,092.8	(1,407.6)	3,060.8
Exchange adjustments		(5.8)		(5.8)
Increases in advances due from/(due to) subsidiaries		139.3		139.3
Contribution through share options	9.1			9.1
Reduction in advances (due from)/due to subsidiaries			37.4	37.4
<b>At 31 July 2012</b>	<b>2,384.7</b>	<b>2,226.3</b>	<b>(1,370.2)</b>	<b>3,240.8</b>
<b>Provision for impairment</b>				
At 31 July 2011 and 31 July 2012	22.0	0.9		22.9
<b>Net book value at 31 July 2012</b>	<b>2,362.7</b>	<b>2,225.4</b>	<b>(1,370.2)</b>	<b>3,217.9</b>
Net book value at 31 July 2011	2,353.6	2,091.9	(1,407.6)	3,037.9

Loans due to subsidiaries are only offset against loans due from subsidiaries to the extent that there is a legal right of set off and an intention to settle the balances net. The Company has large offsetting loan balances because it uses loans to reduce its foreign currency exposures and separately monitor net cash generated from trading activities.

The Company's subsidiaries are largely held according to business lines by the following holding companies, which are incorporated in England:

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

### 3 Investments and advances continued

The principal subsidiaries and their countries of incorporation are:

#### England

Smiths Detection – Watford Ltd  
Smiths Medical International Limited  
John Crane UK Limited

#### Europe

Smiths Heimann SAS (France)  
Smiths Heimann GmbH (Germany)  
Smiths Medical France SA (France)  
Smiths Medical Deutschland GmbH (Germany)  
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.  
Power Distribution, 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 2012 £m	31 July 2011 £m
<b>Amounts falling due within one year</b>		
Amounts owed by subsidiaries	101.5	100.7
Other debtors	4.0	9.3
Corporation tax	12.0	5.9
Prepayments and accrued income	5.8	4.1
	<b>123.3</b>	<b>120.0</b>
<b>Amounts falling after more than one year</b>		
Deferred taxation		31.8
	<b>123.3</b>	<b>151.8</b>

### 6 Creditors

	31 July 2012 £m	31 July 2011 £m
<b>Amounts falling due within one year</b>		
Term loans	151.8	
Amounts owed to subsidiaries	84.7	83.8
Other creditors	16.5	22.4
Other taxation and social security costs	0.4	0.8
Accruals and deferred income	8.9	8.9
	<b>262.3</b>	<b>115.9</b>

# Notes to the Company accounts

## Continued

### 6 Creditors continued

	31 July 2012 £m	31 July 2011 £m
<b>Amounts falling due after more than one year</b>		
Term loans	<b>820.1</b>	967.3
	<b>820.1</b>	967.3

#### Term loans

The currency and coupons for the term loans are disclosed in note 19 of the Group accounts.

	31 July 2012 £m	31 July 2011 £m
Less than one year	<b>151.8</b>	
Between one and two years	<b>159.1</b>	148.5
Between two and three years		151.4
Between three and four years	<b>149.4</b>	
Between four and five years	<b>241.4</b>	149.3
Greater than five years	<b>270.2</b>	518.1
Smiths Group plc term loans	<b>971.9</b>	967.3

See the liquidity risk disclosures in note 20 in the Group accounts for information on the cash and borrowing facilities available to the Group. The Company can borrow under the undrawn US\$800m multi-currency revolving credit facility, which matures in December 2015.

### 7 Provisions for liabilities and charges

	At 31 July 2011 £m	Provisions released £m	Utilisation £m	At 31 July 2012 £m
Disposals	2.6			<b>2.6</b>
	2.6			<b>2.6</b>

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

### 8 Post-retirement benefits

The Company operates three defined benefit plans in the UK. The largest of them is a funded scheme with assets held in a separate trustee-administered fund. The Company is the sole employer in that scheme and, accordingly, accounts for it as a defined benefit pension plan, in accordance with FRS 17. The UK defined benefit pension schemes were closed with effect from 31 October 2009.

Pension costs are assessed in accordance with the advice of independent, professionally qualified actuaries. The most recent actuarial valuation of the funded scheme was performed using the Projected Unit Method as at 31 March 2009. This valuation has been updated by independent qualified actuaries in order to assess the liabilities of the scheme as at 31 July 2012. The triennial valuation of the scheme at 31 March 2012 is in progress. 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:

	31 July 2012	31 July 2011
Rate of increase in salaries	<b>n/a</b>	n/a
Rate of increase for active deferred members	<b>3.7%</b>	4.4%
Rate of increase in pensions in payment	<b>2.8%</b>	3.5%
Rate of increase in deferred pensions	<b>2.8%</b>	3.5%
Discount rate	<b>4.1%</b>	5.3%
Inflation rate	<b>2.8%</b>	3.5%
Healthcare cost increases	<b>5.0%</b>	5.0%

The assumptions used are estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily occur in practice.

The mortality assumptions used are based on the recent actual mortality experience of members. The assumptions are based on the new SAPS All birth year 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 the 2011 CMI projections blended to a long term rate of 1%. The assumptions give the following:

Expected further years of life	UK	
	Male	Female
Member who retires next year at age 65	23	25
Member, currently 45, when they retire in 20 years time	24	26



## 8 Post-retirement benefits continued

The assets in the scheme and the expected rates of return as at 31 July 2012 were:

	31 July 2012		31 July 2011	
	Long-term rate of return	Value £m	Long-term rate of return	Value £m
Equities	7.2%	720.0	7.9%	732.9
Government bonds	2.5%	4.9	3.9%	16.7
Corporate bonds	4.1%	81.3	5.3%	173.5
Property	6.8%	176.7	7.5%	176.0
Other	2.9%	430.0	4.1%	339.8
Total market value		1,412.9		1,438.9
Present value of funded pension scheme liabilities		(1,687.8)		(1,538.9)
Deficit		(274.9)		(100.0)
Unfunded pension plans		(46.1)		(40.2)
Post-retirement healthcare		(9.2)		(8.5)
<b>Net retirement benefit liability</b>		<b>(330.2)</b>		<b>(148.7)</b>

The scheme assets do not include any of the Group's own financial instruments, nor any property occupied by, nor other assets used by, the Group. The expected rates of return on individual categories of scheme assets are determined by reference to relevant industries. The overall rate of return is calculated by weighting the individual rates in accordance with the anticipated balance in the scheme's investment portfolios.

### History of experience gains and losses

	31 July 2012 £m	31 July 2011 £m	31 July 2010 £m	31 July 2009 £m	31 July 2008 £m
Fair value of scheme assets	1,412.9	1,438.9	1,325.6	1,188.9	1,311.0
Present value of pension and post-retirement healthcare obligations	(1,743.1)	(1,587.6)	(1,489.9)	(1,382.6)	(1,383.0)
Net retirement benefit liability	(330.2)	(148.7)	(164.3)	(193.7)	(72.0)
Actual return less expected return on pension scheme assets	(87.5)	45.6	84.2	(180.9)	(183.9)
As a percentage of scheme assets	(6%)	3%	6%	(15%)	(14%)
Experience gains and losses arising on the scheme liabilities	78.9	(15.5)	7.1	98.4	(4.5)
As a percentage of present value scheme liabilities	5%	(1%)	0%	7%	0%

### Changes in present value of scheme assets and defined benefit obligations

	Assets 31 July 2012 £m	Assets 31 July 2011 £m	Obligations 31 July 2012 £m	Obligations 31 July 2011 £m
At beginning of the period	1,438.9	1,325.6	(1,587.6)	(1,489.9)
Current service cost			(0.1)	(0.2)
Expected return on assets	89.8	91.7		
Interest on obligations			(82.3)	(78.8)
Actuarial gain/(loss)	(87.5)	45.6	(140.4)	(82.1)
Contributions by employer	39.0	39.4		
Benefits paid	(67.3)	(63.4)	67.3	63.4
At end of the period	1,412.9	1,438.9	(1,743.1)	(1,587.6)

# Notes to the Company accounts

## Continued

### 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	0.2	(0.2)

### 9 Share capital

	Number of shares	Issued capital £m	Consideration £m
<b>Ordinary shares of 37.5p each</b>			
At 31 July 2011	392,350,403	147.1	
Exercise of share options	375,540	0.2	3.0
<b>Total share capital at 31 July 2012</b>	<b>392,725,943</b>	<b>147.3</b>	

At 31 July 2012 all of the issued share capital was in free issue. All issued shares are fully paid.

	31 July 2012	31 July 2011
Number of ordinary shares issuable under outstanding options	<b>3,184,363</b>	3,927,550

	Year issued	Number of shares	Subscription prices	Dates normally exercisable
Smiths Sharesave Scheme	2005	13,755	704.00p	2008/2012
	2006	16,660	798.00p	2009/2013
	2007	34,615	868.00p	2010/2014
	2008	46,267	724.00p	2011/2015
	2009	463,375	569.00p	2012/2016
	2010	95,479	894.00p	2013/2017
	2011	86,195	1035.00p	2014/2018
	2012	256,074	811.00p	2015/2019
Smiths Industries Executive Share Option Schemes	2002	23,000	654.00p	2005/2012
	2003	38,044	669.00p	2006/2013
	2004	250,161	774.00p	2007/2014
	2005	321,500	901.00p	2008/2015
	2006	561,787	896.50p	2009/2016
	2007	851,160	1,097.00p	2010/2017
	2009	126,291	871.00p	2012/2019

## 10 Share premium account and reserves

	Share premium £m	Capital redemption reserve £m	Other reserves £m	Profit and loss account £m
At 31 July 2011	329.1	5.8	180.5	1,384.0
Exercise of share options	2.8			
Purchase of own shares				(9.7)
Profit for the period				352.3
Dividends paid to equity shareholders				(144.1)
Actuarial loss on retirement benefits				(227.9)
Fair value gains/(losses) on available for sale financial assets				4.5
Share-based payment				14.4
<b>At 31 July 2012</b>	<b>331.9</b>	<b>5.8</b>	<b>180.5</b>	<b>1,373.5</b>

The retained earnings include the purchase of Smiths Group plc shares by the Smiths Industries Employee Benefit Trust, and the issue of these shares upon the exercise of share options. The consideration paid was £9.7m (2011: £8.6m) and £nil (2011: £nil) was received as a result of the issue of shares. At 31 July 2012 the Trust held 855 (2011: 855) ordinary shares with a market value of £0.0m (2011: £0.0m).

The Company's profit and loss reserve of £1,373.5m includes £923.6m (2011: £933.5m) not available for distribution as dividend.

During the year, the Company received £3.0m (2011: £14.4m) 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 2012 £m	Year ended 31 July 2011 £m
<b>Deferred taxation</b>		
At beginning of period	<b>31.8</b>	27.5
Charge to profit and loss account	<b>(31.8)</b>	(5.6)
Credit to equity		9.9
<b>At end of period</b>		<b>31.8</b>
Analysed as follows		
Excess tax depreciation on fixed assets		0.7
Share-based payment		2.8
Losses carried forward		27.8
Short-term timing differences		0.5
		<b>31.8</b>

The Company is part of a UK tax group including all its UK based subsidiaries. At 31 July 2011 the Company recognised UK tax assets relating to revenue losses brought forward of £27.8m, and other timing differences of £4.0m. The value of these assets is reviewed regularly and is dependent on the ability to recover them against forecast UK taxable profits of the tax group. Having considered the impact of the increased pension deficit on the outlook for the UK tax base, the Company has decided to derecognise the tax assets at 31 July 2012 because it is no longer probable that they will be recovered.

At 31 July 2012 the Company has unrecognised deferred tax assets of £127.9m (2011: £35.1m) relating to:

- retirement benefit obligations £76.9m (2011: £35.1m)
- losses carried forward £47.1m (2011: £nil);
- share based payments £2.4m (2011: £nil); and
- other timing differences £1.5m (2011: £nil).

These tax allowances remain available to the Company and can be utilised should the UK tax base improve.

## 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 £49.5m (2011: £43.1m).

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 26.25p per share (totalling approximately £103m) for the year ended 31 July 2012. The dividend will be submitted for formal approval at the Annual General Meeting to be held on 20 November 2012.

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 2013. During the year ended 31 July 2012, a final dividend of 25.0p per share (totalling £98.1m) was paid in respect of the dividend declared for the year ended 31 July 2011.

# Financial calendar

	2012
Preliminary announcement of results for 2011/12	19 September
Ordinary shares final dividend ex-dividend date	24 October
Ordinary shares final dividend record date	26 October
Annual General Meeting	20 November
Ordinary shares final dividend payment date	23 November
	2013
2012/13 interim results announced	20 March (provisional)
Ordinary shares interim dividend ex-dividend date	27 March (provisional)
Ordinary shares interim dividend record date	2 April (provisional)
Ordinary shares interim dividend payment date	26 April (provisional)
Smiths Group financial year end	31 July
Preliminary announcement of results for 2012/13	18 September (provisional)
Ordinary shares final dividend ex-dividend date	23 October (provisional)
Ordinary shares final dividend record date	25 October (provisional)
Annual General Meeting	19 November (provisional)
Ordinary shares final dividend payment date	22 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 2012 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 20 November 2012 at 2:30pm.

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## Auditor

PricewaterhouseCoopers LLP

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# smiths

bringing technology to life

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