IMPORTANT NOTICE

THIS OFFERING IS AVAILABLE ONLY TO INVESTORS WHO ARE (1) QUALIFIED INSTITUTIONAL BUYERS ("QIBs") IN RELIANCE ON THE EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE US SECURITIES ACT OF 1933 (THE "SECURITIES ACT") PROVIDED BY RULE 144A THEREUNDER OR (2) OUTSIDE THE UNITED STATES AND NOT US PERSONS IN COMPLIANCE WITH REGULATION S UNDER THE SECURITIES ACT.

IMPORTANT: You must read the following disclaimer before continuing. The following disclaimer applies to the offering memorandum following this page. You are advised to read this disclaimer carefully before accessing, reading or making any other use of the offering memorandum. In accessing the offering memorandum, you agree to be bound by the following terms and conditions, including any modifications to them from time to time, each time you receive any information from us as a result of such access.

NOTHING IN THIS ELECTRONIC TRANSMISSION CONSTITUTES AN OFFER OF SECURITIES FOR SALE IN ANY JURISDICTION WHERE IT IS UNLAWFUL TO DO SO. ANY SECURITIES TO BE ISSUED HAVE NOT BEEN, AND WILL NOT BE, REGISTERED UNDER THE SECURITIES ACT, OR THE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES OR OTHER JURISDICTION AND MAY NOT BE OFFERED OR SOLD IN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, US PERSONS (AS SUCH TERMS ARE DEFINED IN REGULATION S UNDER THE SECURITIES ACT) EXCEPT PURSUANT TO AN EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT AND APPLICABLE STATE OR LOCAL SECURITIES LAWS.

YOU ARE NOT AUTHORISED TO AND YOU MAY NOT FORWARD OR DELIVER THE ATTACHED OFFERING MEMORANDUM, ELECTRONICALLY OR OTHERWISE, TO ANY OTHER PERSON OR REPRODUCE SUCH OFFERING MEMORANDUM IN ANY MANNER WHATSOEVER. ANY FORWARDING, DISTRIBUTION OR REPRODUCTION OF THIS DOCUMENT AND THE ATTACHED OFFERING MEMORANDUM IN WHOLE OR IN PART IS UNAUTHORISED. FAILURE TO COMPLY WITH THIS DIRECTIVE MAY RESULT IN A VIOLATION OF THE SECURITIES ACT OR THE APPLICABLE LAWS OF OTHER JURISDICTIONS.

Confirmation of your Representation: In order to be able to view this offering memorandum or make an investment decision with respect to the securities, investors must be (1) QIBs or (2) outside the United States and not a US Person, as defined in Regulation S under the Securities Act. This offering memorandum is being sent at your request and by accepting the e-mail and accessing this offering memorandum, you shall be deemed to have represented to us that (1) you and any customers you represent are (a) QIBs or (b) outside the United States and not a US Person in accordance with Regulation S under the Securities Act and that the e-mail address to which the offering memorandum has been delivered is not located in the United States of America, its territories or possessions, including Puerto Rico, the US Virgin Islands, Guam, American Samoa, Wake Island and the Northern Mariana Islands, and (2) you consent to delivery of the offering memorandum and any amendments or supplements thereto by electronic transmission.

You are reminded that the offering memorandum has been delivered to you on the basis that you are a person into whose possession the offering memorandum may be lawfully delivered in accordance with the laws of the jurisdiction in which you are located and you may not nor are you authorised to deliver this document, electronically or otherwise, to any other person. If you receive this document by e-mail, you should not reply by e-mail. Any reply e-mail communications, including those you generate by using the "Reply" function on your e-mail software, will be ignored or rejected. If you receive this document by e-mail, your use of this e-mail is at your own risk and it is your responsibility to take precautions to ensure that it is free from viruses and other items of a destructive nature.

No action has been or will be taken in any jurisdiction by the initial purchasers or the Company that would or is intended to, permit a public offering of the securities, or possession or distribution of the offering memorandum (in preliminary, proof or final form) or any other offering or publicity material relating to the securities, in any country or jurisdiction where action for that purpose is required. If a jurisdiction requires that the offering be made by a licensed broker or dealer and the initial purchaser or any affiliate of the initial purchasers is a licensed broker or dealer in that jurisdiction, the offering shall be deemed to be made by the initial purchasers or such affiliate on behalf of the Company in such jurisdiction.

This offering memorandum is being distributed only to and is directed at (a) (by means of an outgoing electronic commerce communication for the purposes of the Financial Services and Markets Act 2000 (Financial Promotion Order) 2005 (the "Order")) persons outside the European Economic Area, (b) (by means other than an outgoing electronic commerce communication) persons outside the United Kingdom, (c) persons who have professional experience in matters relating to investments who fall within Article 19(1) of the Order or (d) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(1) of the Order (all such persons together being referred to as "relevant persons"). The securities are available only to, and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such securities will be available only to or will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely on this offering memorandum or any of its contents.

The attached offering memorandum has been sent to you in an electronic format. You are reminded that documents transmitted in an electronic format may be altered or changed during the process of transmission and consequently none of the Company, the initial purchasers and their respective affiliates, directors, officers, employees, representatives and agents or any other person controlling the Company, the initial purchasers or any of their respective affiliates accepts any liability or responsibility whatsoever in respect of any discrepancies between the document distributed to you in electronic format and the hard-copy version.

Smiths Group plc

(incorporated as a public limited company in England and Wales with registered number 137013)

$400,000,000 3.625 per cent. Guaranteed Notes due 2022

Fully and Unconditionally Guaranteed by

Smiths Group International Holdings Limited

(incorporated as a limited company in England and Wales with registered number 01085153)

The $400,000,000 3.625 per cent. Guaranteed Notes due 2022 (the "Notes") will be issued by Smiths Group plc (the "Company"). The payment of all amounts due in respect of the Notes will be unconditionally and irrevocably guaranteed by Smiths Group International Holdings Limited (the "Guarantor" and the "Guarantee", respectively). Interest on the Notes will be payable on 12 April and 12 October of each year, beginning 12 April 2013. Payments in respect of the Notes will be made without withholding or deduction for or on account of taxes to the extent described under "Description of the Notes and the Guarantee – Payment of Additional Amounts".

The Notes will mature on 12 October 2022. The Company may redeem the Notes, in whole or in part, at any time prior to the maturity date of the Notes at the applicable redemption price as described in "Description of the Notes and the Guarantee – Optional Redemption". Upon the occurrence of certain change of control events, the Company will make an offer to each holder of the Notes to repurchase all or any part of the holder's Notes at the applicable repurchase price as described in "Description of the Notes and the Guarantee – Repurchase Upon a Change of Control Offer".

The Notes and the Guarantee will be direct, unsubordinated and unsecured indebtedness of the Company and the Guarantor, respectively, and will rank equally in right of payment among themselves and with all other existing and future unsubordinated and unsecured indebtedness of the Company and the Guarantor, respectively.

Application has been made to the Financial Services Authority in its capacity as competent authority under the Financial Services and Markets Act 2000 (the "UK Listing Authority") for the Notes to be admitted to the Official List of the UK Listing Authority (the "Official List") and to the London Stock Exchange plc (the "London Stock Exchange") for the Notes to be admitted to trading on the London Stock Exchange's Professional Securities Market (the "PSM"). References in this offering memorandum to the Notes being "listed" (and all related references) shall mean that the Notes have been admitted to the Official List and have been admitted to trading on the PSM. The PSM is not a regulated market for the purposes of Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments.

Investing in the Notes involves certain risks. For a discussion of these risks, see "Risk Factors" beginning on page 18.

Offer Price for the Notes: 99.784 per cent. plus accrued interest, if any, from 12 October 2012.

The Notes and the Guarantee have not been, and will not be, registered under the US Securities Act of 1933 (the "Securities Act"), or any state or other securities laws, and are being offered and sold within the United States only to qualified institutional buyers ("QIBs") in reliance on Rule 144A under the Securities Act ("Rule 144A"), and outside the United States to persons other than US persons in reliance on Regulation S under the Securities Act ("Regulation S"). Prospective purchasers are hereby notified that a seller of any Note may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A. For a description of certain restrictions on transfer of the Notes, see "Plan of Distribution" and "Transfer Restrictions".

The initial purchasers expect to deliver the Notes to purchasers in book-entry form through the facilities of The Depository Trust Company ("DTC"), including its participants Clearstream Banking, *société anonyme*, Luxembourg ("Clearstream") and Euroclear S.A./N.V. ("Euroclear") on or about 12 October 2012.

The long-term, senior obligations of the Issuer are rated Baa2 (stable outlook) by Moody's Deutschland GmbH ("Moody's") and BBB+ (stable outlook) by Standard & Poor's Credit Market Services Europe Limited ("S&P"). The Notes are expected to be rated Baa2 by Moody's and BBB+ by S&P. A rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency. Each of Moody's and S&P is established in the European Union and is registered under Regulation (EC) No. 1060/2009 (the "CRA Regulation").

Joint Bookrunners

Barclays **J.P. Morgan** **Morgan Stanley**

Mitsubishi UFJ Securities

5 October 2012

IMPORTANT INFORMATION

This offering memorandum does not constitute an offer of any securities other than those to which it relates or an offer to sell, or solicitation of an offer to buy, to any person in any jurisdiction where such an offer or solicitation would be unlawful. This offering memorandum comprises listing particulars given in compliance with the listing rules made under Section 73A of the Financial Services and Markets Act 2000 (the "FSMA") by the UK Listing Authority for the purpose of giving information with regard to the Company and the Guarantor and the Notes in connection with the application for admission of the Notes to the Official List and to trading on the PSM.

The Company and the Guarantor accept responsibility for the information contained in this offering memorandum. To the best of the knowledge and belief of each of the Company and the Guarantor (each of which has taken all reasonable care to ensure that such is the case), the information contained in this offering memorandum is in accordance with the facts and does not omit anything likely to affect the import of such information.

This offering memorandum has been prepared by the Company and the Guarantor solely for use in connection with the offering of the Notes, and you are authorised to use this offering memorandum solely for the purpose of considering the purchase of the Notes. This offering memorandum is personal to each offeree and does not constitute an offer or an invitation to any other person or to the public generally to subscribe for, purchase or otherwise acquire any Notes. Each prospective investor, by accepting delivery of this offering memorandum, agrees to the foregoing.

The initial purchasers make no representation or warranty, express or implied, as to the accuracy or completeness of the information contained in this offering memorandum. Nothing contained in this offering memorandum is, or shall be relied upon as, a promise or representation by the initial purchasers as to the past or future. The Company and the Guarantor have furnished the information contained in this offering memorandum. The initial purchasers assume no responsibility for the accuracy or completeness of information in this offering memorandum, except information which has been provided by the initial purchasers to the Company and the Guarantor for inclusion herein.

In making an investment decision, prospective investors must rely on their own examination of the Company and the Guarantor and the terms of the offering, including the merits and risks involved. Prospective investors should not construe anything in this offering memorandum as legal, business or tax advice. Each prospective investor should consult its own advisers as needed to make its investment decision and to determine whether it is legally permitted to purchase the Notes under applicable legal investment or similar laws or regulations. The laws of certain jurisdictions may restrict the distribution of this offering memorandum and the offer and sale of the Notes. Persons into whose possession this offering memorandum or any of the Notes come must inform themselves about, and observe, any such restrictions. None of the Company, the Guarantor, the initial purchasers or their respective representatives is making any representation to any offeree or any purchaser of the Notes regarding the legality of any investment in the Notes by such offeree or purchaser under applicable investment or similar laws or regulations. For a further description of certain restrictions on the offering and sale of the Notes and the distribution of this offering memorandum, see "Plan of Distribution" and "Transfer Restrictions".

Investors also acknowledge that they have not relied, and will not rely, on the initial purchasers in connection with their investigation of the accuracy of any information or their decision whether to invest in the Notes.

The information set out in the sections of this offering memorandum describing clearing and settlement arrangements reflects our understanding of the rules and procedures of DTC as they are currently in effect. DTC could change its rules and procedures at any time. If you wish to use the facilities of any clearing system you should confirm the applicability of the rules, regulations and procedures of the relevant clearing system. The Company and the Guarantor will not be responsible or liable for any aspect of the records relating to, or payments made on account of, book-entry interests held through the facilities of any clearing system or for maintaining, supervising or reviewing any records relating to such book-entry interests.

No dealer, salesperson or other person has been authorised to give any information or to make any representation not contained in this offering memorandum and, if given or made, any such information or representation must not be relied upon as having been authorised by the Company or the Guarantor, any of their respective affiliates or the initial purchasers. Neither the delivery of this offering memorandum nor any sale made under it shall, under any circumstances, create any implication that there has been no change in the affairs of the Company or the Guarantor since the date of this offering memorandum or of the information incorporated herein, as the case may be, or that the information contained in this offering memorandum is correct as at any time subsequent to the date of this offering memorandum.

This offering memorandum has been prepared on the basis that any offer of Notes in any Member State of the European Economic Area which has implemented the Prospectus Directive (each a "Relevant Member State") will be made pursuant to an exemption under the Prospectus Directive from the requirement to publish a prospectus for offers of Notes. Accordingly, any person making or intending to make an offer in that Relevant Member State of Notes which are the subject of the offering contemplated in this offering memorandum may only do so in circumstances in which no obligation arises for the Company, the Guarantor or any of the initial purchasers to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive, in each case, in relation to such offer. None of the Company, the Guarantor or the initial purchasers have authorised, nor do they authorise, the making of any offer of Notes in circumstances in which an obligation arises for the Company, the Guarantor or the initial purchasers to publish or supplement a prospectus for such offer. The expression "Prospectus Directive" means Directive 2003/71/EC (and amendments thereto, including the 2010 PD Amending Directive, to the extent implemented in the Relevant Member State), and includes any relevant implementing measure in the Relevant Member State, and the expression "2010 PD Amending Directive" means Directive 2010/73/EU.

In connection with the issue of the Notes, Barclays Capital Inc., J.P. Morgan Securities LLC and Morgan Stanley & Co. LLC (the "Stabilising Managers") (or any person acting on behalf of any Stabilising Manager) may over-allot Notes (provided that the aggregate principal amount of Notes allotted does not exceed 105 per cent. of the aggregate principal amount of the Notes) or effect transactions with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail. However, there is no assurance that the Stabilising Managers (or any person acting on behalf of any Stabilising Manager) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the terms of the offer of the Notes is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the Notes and 60 days after the date of the allotment of the Notes. Any stabilisation action or over-allotment must be conducted by the Stabilising Managers (or any person acting on behalf of any Stabilising Manager) in accordance with all applicable laws and rules.

The Notes will be issued initially in fully registered form without interest coupons, in denominations of $2,000 and integral multiples of $1,000 in excess thereof, as beneficial interests in Global Notes (defined below), which will be deposited with Citibank, N.A., as Fiscal Agent (the "Fiscal Agent") for DTC and registered in the name of Cede & Co., as nominee of DTC. Notes initially sold within the United States to QIBs will be represented by interests in a Global Note (each a "Rule 144A Global Note"), which will represent the Notes that are being sold within the United States to QIBs in reliance on the exemption from registration provided by Rule 144A. Notes initially sold to persons other than US persons will be evidenced by interests in a Global Note (each a "Regulation S Global Note" and, together with the Rule 144A Global Notes, the "Global Notes"), which will represent the Notes that are being sold to persons other than US persons in reliance on Regulation S. See "Book-Entry, Settlement and Clearance".

CERTAIN US MATTERS

This offering of Notes is being made in reliance upon an exemption from the registration requirements of the Securities Act for offers and sales of securities that do not involve a public offering. By purchasing the Notes, investors are deemed to have made the acknowledgments, representations, warranties and agreements set forth under "Transfer Restrictions".

The Notes and the Guarantee have not been and will not be registered with, recommended by or approved by the US Securities and Exchange Commission, any other state securities commission in the United States or any other US regulatory authority, nor have any of the foregoing authorities passed upon or endorsed the merits of the offering of the Notes or the accuracy or adequacy of this offering memorandum. Any representation to the contrary is a criminal offence in the United States.

The Notes and the Guarantee have not been registered under the Securities Act or any state securities laws and, subject to certain exceptions, may not be offered or sold in the United States. See "Plan of Distribution" and "Transfer Restrictions". Investors should be aware that they may be required to bear the financial risks of their investment in the Notes for an indefinite period of time. Prospective purchasers are hereby notified that the seller of any Note may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A.

Notice to New Hampshire Residents

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENCE HAS BEEN FILED UNDER RSA 421-B OF THE NEW HAMPSHIRE REVISED STATUTES WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE THAT ANY DOCUMENT FILED UNDER RSA 421-B IS TRUE, COMPLETE AND NOT MISLEADING, NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

United Kingdom

Each initial purchaser has represented, warranted and agreed with the Company and the Guarantor that:

- it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the FSMA) received by it in connection with the issue or sale of any Notes in circumstances in which section 21(1) of the FSMA does not apply to the Company or the Guarantor; and
- it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

European Economic Area

In relation to each Relevant Member State, each initial purchaser has represented, warranted and agreed with the Company and the Guarantor that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the "Relevant Implementation Date") it has not made and will not make an offer of Notes which are the subject of the offering contemplated by this offering memorandum to the public in that Relevant Member State other than:

(a) to any legal entity which is a qualified investor as defined in the Prospectus Directive;

(b) to fewer than 100 or, if the Relevant Member State has implemented the relevant provision of the 2010 PD Amending Directive, 150, natural or legal persons (other than qualified investors as defined in the Prospectus Directive), as permitted under the Prospectus Directive, subject to obtaining the prior consent of the initial purchasers for any such offer; or

(c) in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of Notes shall require the Company, the Guarantor or any of the initial purchasers to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.

For the purposes of this provision, the expression an "offer of Notes to the public" in relation to any Notes in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Notes to be offered so as to enable an investor to decide to purchase or subscribe for the Notes, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State, the expression "Prospectus Directive" means Directive 2003/71/EC (and amendments thereto, including the 2010 PD Amending Directive, to the extent implemented in the Relevant Member State), and includes any relevant implementing measure in the Relevant Member State and the expression "2010 PD Amending Directive" means Directive 2010/73/EU.

Investment Considerations

Each potential investor in the Notes must determine the suitability of that investment in light of their own circumstances. In particular, each potential investor should:

(i) have sufficient knowledge and experience to make a meaningful evaluation of the merits and risks of investing in the Notes;

(ii) have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of their particular financial situation, an investment in the Notes and the impact such investment will have on their overall investment portfolio;

(iii) have sufficient financial resources and liquidity to bear all of the risks of an investment in the Notes, including where principal or interest is payable in one or more currencies, or where the currency for principal or interest payments is different from the potential investor's currency;

(iv) understand thoroughly the terms of the Notes and be familiar with the behaviour of any relevant indices and financial markets; and

(v) be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic, interest rate and other factors that may affect their investment and their ability to bear the applicable risks.

Potential investors should not invest in the Notes unless they have the expertise (either alone or with the help of a financial adviser) to evaluate how the Notes will perform under changing conditions, the resulting effects on the value of such Notes and the impact this investment will have on the potential investor's overall investment portfolio. The investment activities of investors are subject to investment laws and regulations, or review or regulation by certain authorities and each potential investor should consult their legal advisers or the appropriate regulators.

Available Information

The Company and the Guarantor have agreed that, for so long as any Notes are "restricted securities" within the meaning of Rule 144(a)(3) under the Securities Act, the Company and the Guarantor will, during any period in which the Company is neither subject to Section 13 or 15(d) of the US Securities Exchange Act of 1934, as amended (the "Exchange Act"), nor exempt from reporting pursuant to Rule 12g3-2(b) thereunder, provide to any holder or beneficial owner of such restricted securities or to any prospective purchaser of such restricted securities designated by such holder or beneficial owner upon the request of such holder, beneficial owner or prospective purchaser, the information required to be provided by Rule 144A(d)(4) under the Securities Act.

TABLE OF CONTENTS

PRESENTATION OF FINANCIAL AND OTHER INFORMATION

Smiths Group plc

Smiths Group plc, the issuer of the Notes described herein, is referred to as the "Company". References to "Smiths Group", "the Group", "we", "our", "ours" and "us" refer to Smiths Group plc together with its subsidiaries. All our business activities are conducted through Smiths Group plc, its subsidiaries and associated companies.

The discussion of operating and financial results contained herein, unless otherwise specified, relates to the Group and should be considered alongside a careful review of our consolidated financial statements included elsewhere in this offering memorandum.

Unless otherwise stated, this offering memorandum's description of management, business activities, operating and financial review, capitalisation, related party transactions and certain other matters relate only to the Group.

Smiths Group International Holdings Limited

Smiths Group International Holdings Limited, the guarantor of the Notes described herein, is referred to as the "Guarantor". The Guarantor does not produce and has not published any consolidated financial statements. The Guarantor is fully consolidated in the Company's consolidated financial statements set out in this offering memorandum.

For a further description of the Guarantor, see "Description of the Guarantor".

Industry Information

The data included in this offering memorandum regarding markets and ranking, including our position and our competitors' positions within these markets, are based on independent industry publications or other published industry sources and our estimates are based on management's knowledge and experience in the markets in which we operate. Our estimates have been based on information obtained from customers, suppliers, trade and business organisations and other contacts in the markets in which we operate. We believe these estimates to be accurate in all material respects as of the date of this offering memorandum. However, this information may prove to be inaccurate because of the method by which we obtained some of the data for these estimates or because this information cannot always be verified with complete certainty owing to the limits on the availability and reliability of raw data, the voluntary nature of the data-gathering process and other inherent limitations and uncertainties.

Where information in this offering memorandum has been sourced from third parties this information has been accurately reproduced and, as far as the Company is aware and is able to ascertain from the information published by such third parties, no facts have been omitted which would render the reproduced information inaccurate or misleading. The source of third party information is identified where used.

Presentation of Financial Information

This offering memorandum contains our audited consolidated financial statements as at and for the years ended 31 July 2012, 31 July 2011 and 31 July 2010.

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the EU. IFRS as adopted by the EU differs in certain respects from IFRS as published by the International Accounting Standards Board (the "IASB"). We do not believe that our historical financial statements for the periods presented would be materially different had they been prepared in accordance with IFRS as published by the IASB. IFRS differs in significant respects from generally accepted accounting principles in the United States of America ("US GAAP").

Our financial statements and financial information as at and for the years ended 31 July 2012, 31 July 2011 and 31 July 2010 have been extracted without material adjustment from the UK statutory annual reports and financial statements of the Company for the years ended 31 July 2012, 31 July 2011 and 31 July 2010, respectively.

None of the financial statements was prepared in accordance with US GAAP or audited in accordance with auditing standards generally accepted in the United States ("US GAAS"). No opinion or any other assurance with regard to any financial information was expressed under US GAAS.

References to “full year 2012”, “full year 2011” and “full year 2010” or the “financial year 2012”, “financial year 2011” and “financial year 2010” refer to the years ended 31 July 2012, 31 July 2011 and 31 July 2010, respectively.

See “Independent Accountants” for a description of the independent auditors’ reports, including language limiting the auditors’ scope of responsibility in relation to such reports and the financial statements to which they relate. The financial statements included in this offering memorandum have been audited by PricewaterhouseCoopers LLP, our independent accountants who are members of the Institute of Chartered Accountants in England and Wales, with an address at 1 Embankment Place, London WC2N 6RH. In particular, in respect of their various audit reports relating to the annual financial statements reproduced herein, PricewaterhouseCoopers LLP, in accordance with guidance issued by the Institute of Chartered Accountants in England and Wales, provides: “This report, including the opinion, 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 this opinion, 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”. Investors in the Notes should understand that these statements are intended to disclaim any liability to parties (such as the purchasers of the Notes) other than the members of the Company with respect to those reports. In the context of the offering of the Notes, PricewaterhouseCoopers LLP has reconfirmed to us that it does not intend its duty of care to extend to any party other than those to whom its reports were originally addressed (i.e., to the members of the Company). The US Securities and Exchange Commission would not permit such limiting language to be included in a registration statement or a prospectus used in connection with an offering of securities registered under the Securities Act, or in a report filed under the Exchange Act. If a US court (or any other court) were to give effect to the language quoted above, the recourse that investors in the Notes may have against the independent accountants based on their reports or the financial statements to which they relate could be limited.

Trademarks

The following product names appearing in this offering memorandum and any variations thereon are registered trademarks of Smiths Group plc and its subsidiaries and are registered with, or subject to pending trademark applications with, the relevant registries of the United Kingdom and various other countries: Uni Perc™, Medfusion™, CADD®-Solis, GRIPPER®, Deltec®, Jelco®, PORT-ACATH®, P.A.S.®PORT, Pneupac® and paraPAC™, Portex®, Wallace®, Safematic®, SmartX® GUARDION, HazMatID Elite and HI-SCAN 10080 XCT.

Presentation of Other Information

Certain figures in this offering memorandum have been subject to rounding adjustments. Accordingly, amounts shown in tables or elsewhere may not be an arithmetic aggregation of the figures that precede them.

CURRENCIES AND EXCHANGE RATES

We publish our financial statements in pounds sterling. In this offering memorandum, references to "pounds sterling", "£", "pence" or "p" are to the lawful currency of the United Kingdom and references to "UK" mean the United Kingdom. References to "dollars", "US dollars", "USD", "$", "cents" or "¢" are to the lawful currency of the United States, and references to the "United States" and "US" mean the United States of America, its territories and possessions and any state of the United States and the District of Columbia.

The following table sets out, for the periods indicated, certain information concerning the exchange rate of pounds sterling expressed in pounds sterling per US dollar as provided by Bloomberg. These translations should not be construed as representations that the pound sterling amounts actually represent such US dollar amounts or could be converted into US dollars at the rate indicated.

Pounds sterling per US dollar exchange rates (£1.00 per USD) for each of the most recent six months:

Month	At Period End	Average Rate[1]	High	Low
April 2012	0.6160	0.6248	0.6318	0.6148
May 2012	0.6491	0.6288	0.6491	0.6165
June 2012	0.6367	0.6427	0.6509	0.6360
July 2012	0.6378	0.6411	0.6481	0.6350
August 2012	0.6305	0.6362	0.6446	0.6297
September 2012	0.6185	0.6206	0.6301	0.6154

Pounds sterling per US dollar exchange rates (£1.00 per USD) for each of the most recent three financial years:

Financial Year Ended	At Period End	Average Rate[1]	High	Low
31 July 2010	0.6373	0.6371	0.6981	0.5876
31 July 2011	0.6089	0.6260	0.6523	0.5986
31 July 2012	0.6378	0.6332	0.6528	0.6045

Note:

(1) The daily average of the exchange rates of pounds sterling as provided by Bloomberg during the relevant period.

We make no representation that the amounts referred to above could have been or could be converted into the foregoing currencies at any particular rate or at all.

FORWARD-LOOKING STATEMENTS

Statements included in this offering memorandum, which are not historical facts (including any statements concerning plans and objectives of management for future operations or economic performance, or assumptions related thereto), are "forward-looking statements" within the meaning of the US federal securities laws. Forward-looking statements can be identified by words such as "believes", "estimates", "anticipates", "expects", "intends", "may", "will", "plans", "outlook" and other words of similar meaning in connection with a discussion of future operating or financial performance. These may include, among others, statements relating to:

- the impact of the global financial crisis and the reactions of investors, national and transnational regulators and financial institutions to the crisis;
- our ability to improve our existing products and bring new products to market;
- spending by and contracts with governments and government agencies;
- changes in general economic and business conditions;
- our ability to expand our business through successful mergers or acquisitions;
- our ability to refinance in the bank or capital markets;
- changes and fluctuations in interest rates, share prices and exchange rates;
- political, governmental and regulatory changes or changes in political or social conditions;
- the impact of the economic downturn on our businesses and key markets, including the energy sector;
- the availability of raw materials and other vital components of our products;
- changes in the competitive environment;
- changes in our credit ratings;
- our ability to increase market share for our products and control our expenses;
- the occurrence of operational failures, such as fraud and system failures;
- competitive pressures;
- technological developments; and
- the expected outcome of contingencies, particularly litigation, intellectual property issues and pension liabilities.

The forward-looking statements in this offering memorandum are made based upon our expectations and beliefs concerning future events impacting us and therefore involve a number of known and unknown risks and uncertainties. Such forward-looking statements are based on numerous assumptions, including regarding our present and future business strategies and the environment in which we will operate, which, although believed to be reasonable, may prove not to be accurate. We caution that these forward-looking statements are not guarantees and that actual results could differ materially from those expressed or implied in these forward-looking statements.

Important factors that could cause our actual results of operations or financial condition to differ materially from those expressed or implied by forward-looking statements in this offering memorandum include, but are not limited to, the factors indicated in this offering memorandum under "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations of the Group" and include:

- changes in the social, economic or political conditions in the diverse locations in which we operate;
- competition in our key markets;
- the availability and adequacy of insurance coverage;
- foreign currency exchange and interest rate fluctuations; and
- the impact of existing and future legislation or regulation applicable to our products and businesses.

Some of the factors noted above are discussed elsewhere in this offering memorandum. The above list and those specified elsewhere in this offering memorandum should not be construed as exhaustive and undue reliance should not be placed on forward-looking statements.

Any forward-looking statements contained in this offering memorandum speak only as at the date hereof. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements, whether as a result of new information, future events or otherwise save as required under applicable laws and regulations. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this offering memorandum might not occur and actual results may differ materially from those described in the forward-looking statements.

SERVICE OF PROCESS AND ENFORCEMENT OF JUDGMENTS

The Company is a public limited company and the Guarantor is a limited company, both incorporated under the laws of England and Wales. A majority of the Company's and the Guarantor's directors and executive officers are citizens or residents of countries other than the United States. A substantial portion of the assets of such persons and many of our assets are located outside the United States. Although we have agreed, in accordance with the terms of the FPAA (as defined herein) and the Notes, to accept service of process in the United States by agents designated for such purpose, it may not be possible for holders of Notes (a) to effect service of process upon certain of the Company's and the Guarantor's directors or officers or (b) to enforce judgments of US courts predicated upon the civil liability of such persons under the US federal or state securities laws against any such persons in the courts of a foreign jurisdiction. There is doubt as to the direct enforceability in England against any of these persons, in an original action or in an action for the enforcement of judgments of US courts, of civil liabilities predicated solely upon US federal or state securities laws.

OVERVIEW

The following overview is qualified in its entirety by, and should be read in conjunction with, the more detailed information appearing elsewhere in this offering memorandum. Capitalised terms used but not defined in this overview are defined in the text of this offering memorandum.

Overview of the Smiths Group

We are a diversified global technology business serving the detection, energy, medical device, communications and engineered component markets. Our technology based businesses apply advanced industrial sciences to provide products to a range of highly sophisticated customers.

We operate through five divisions:

- *John Crane*, a 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;
- *Smiths Medical*, a supplier of specialist medical devices, consumables and equipment focused on the medication delivery, vital care and safety devices market segments;
- *Smiths Detection*, a leading designer and manufacturer of sensors that detect and identify explosives, narcotics, weapons, chemical agents, biohazards, nuclear and radioactive material and contraband;
- *Smiths Interconnect*, a designer and manufacturer of electronic components and sub-systems that connect, protect and control critical systems for wireless telecommunications, aerospace, defence, space, test, medical, rail and industrial markets; and
- *Flex-Tek*, a provider of engineered components that heat and move fluids and gases for the aerospace, medical, industrial, construction and domestic appliance markets.

We generated revenue of £3,030.1 million, £2,842.0 million and £2,769.6 million for the financial years 2012, 2011 and 2010, respectively. Our operating profit was £406.6 million, £438.0 million and £435.9 million for the financial years 2012, 2011 and 2010, respectively.

The Offering

The overview below describes the principal terms of the Notes and the Guarantee. Certain of the terms and conditions described below are subject to important limitations and exceptions. The "Description of the Notes and the Guarantee" section of this offering memorandum contains a more detailed description of the terms and conditions of the Notes and the Guarantee. Terms used in this overview and not otherwise defined herein have the meanings given to them in "Description of the Notes and the Guarantee".

Issuer	The Company, Smiths Group plc, is a public limited company incorporated under the laws of England and Wales with registration number 00137013. Its registered address and the business address of each of its directors is 2nd Floor, Cardinal Place, 80 Victoria Street, London SW1E 5JL, United Kingdom and its telephone number is +44 (0)20 7808 5500.
Guarantor	The Guarantor, Smiths Group International Holdings Limited, is a limited company incorporated under the laws of England and Wales with registration number 01085153 and is a wholly-owned subsidiary of the Company. Its registered address and the business address of each of its directors is 2nd Floor, Cardinal Place, 80 Victoria Street, London SW1E 5JL, United Kingdom and its telephone number is +44 (0)20 7808 5500.
Notes Offered	$400,000,000 aggregate principal amount of 3.625 per cent. Guaranteed Notes due 2022 (the "Notes"). The Notes will be issued under a Fiscal and Paying Agency Agreement expected to be dated as at 12 October 2012 (the "FPAA") among the Company, the Guarantor, the Agent and the Registrar.

Issue Date	12 October 2012.
Maturity Date	12 October 2022.
Interest Rate	The Notes will bear interest from the issue date at the rate of 3.625 per cent. per annum, payable semi-annually in arrears.
Interest Payment	Interest on the Notes will be paid semi-annually in arrears on 12 April and 12 October of each year, beginning on 12 April 2013 (each, an "Interest Payment Date").
Interest Periods	The first interest period for the Notes will be the period from and including the Issue Date to but excluding the first Interest Payment Date. Thereafter, the interest periods for the Notes will be the periods from and including each Interest Payment Date to but excluding the immediately succeeding Interest Payment Date. The final interest period will be the period from and including the Interest Payment Date immediately preceding the Maturity Date to the Maturity Date.
Regular Record Dates for Interest	The close of business on 1 April or 1 October (whether or not a Business Day) immediately preceding each Interest Payment Date.
Business Day	Any day which is not, in London, England or New York City, United States, or the place of payment of interest or principal, a Saturday, Sunday, legal holiday or a day on which banking institutions are authorised or obligated by law to close (a "Business Day").
Day Count Fraction	30/360.
Optional Redemption	The Company may redeem the Notes, in whole or in part, at its option, at any time and from time to time at a redemption price equal to the greater of (i) 100 per cent. of the principal amount of the Notes to be redeemed and (ii) as determined by an Independent Investment Banker, the sum of the present values of the applicable remaining scheduled payments discounted to the Redemption Date on a semi-annual basis (assuming a 360-day year consisting of 12 30-day months or, in the case of an incomplete month, the number of days elapsed) at the Treasury Rate plus 30 basis points, in each case together with accrued and unpaid interest on the principal amount of the Notes to be redeemed to the Redemption Date.
Repurchase Upon a Change of Control Offer	If a Change of Control Triggering Event occurs, unless the Company has exercised its option to redeem the Notes as described above under "– Optional Redemption" or the Notes have been redeemed in full for tax reasons as described below under "– Redemption for Tax Reasons", it will be required to make an offer (a "Change of Control Offer") to each holder of the Notes to repurchase all or any part (equal to $2,000 or an integral multiple of $1,000 in excess thereof) of that holder's Notes on the terms set forth in the Notes. In a Change of Control Offer, the Company will be required to offer payment in cash equal to 101 per cent. of the aggregate principal amount of Notes repurchased, plus accrued and unpaid interest, if any, on the Notes repurchased, to the date of repurchase.
Redemption for Tax Reasons	In the event of certain tax law changes that would require the Company or the Guarantor to pay Additional Amounts on the Notes, the Company may, under certain conditions, redeem in whole, but not in part, the Notes prior to maturity at a redemption price equal to 100 per cent. of the principal amount of the Notes to be redeemed plus accrued and unpaid interest to the date of redemption.

Payment of Additional Amounts	In the event Taxes are imposed, levied, withheld or collected by or within any Relevant Taxing Jurisdiction on the payment of principal, premium, if any, and interest on the Notes or under the Guarantee, the Company or the Guarantor, as the case may be, will, subject to certain exceptions, pay additional amounts to holders of the Notes, to cover the amounts so deducted or withheld.
Covenants of the Company	The Company and the Guarantor have each agreed to certain covenants with respect to the Notes, including limitations on liens, and on mergers, consolidations, amalgamations and combinations.
Ranking of the Notes	The Notes and the Guarantee will be the Company's and the Guarantor's unsecured and unsubordinated obligations, respectively, and will rank pari passu in right of payment among themselves and with the Company's and the Guarantor's other unsecured and unsubordinated indebtedness (save for certain obligations required to be preferred by law).
Denominations, Form and Registration of Notes	The Notes will be issued in fully registered form and only in denominations of $2,000 and integral multiples of $1,000 in excess thereof. The Notes will be initially issued as global notes. DTC will act as depositary for the Notes. Except as set forth herein, global notes will not be exchangeable for certificated Notes.
Governing Law	The FPAA, the Notes and the Guarantee will be governed by, and construed in accordance with, the laws of the State of New York.
Listing	Application has been made to obtain the listing of the Notes on the Official List and the admission of the Notes to trading on the Professional Securities Market of the London Stock Exchange.
Defeasance	The Notes will be subject to defeasance and covenant defeasance provisions in the FPAA.
Further Issuances	The Company may, from time to time, without notice to or the consent of the holders of the Notes, "reopen" the Notes and create and issue additional notes having identical terms and conditions as the Notes (or in all respects except for the issue date, issue price, payment of interest accruing prior to the issue date of such additional notes and/or the first payment of interest following the issue date of such additional notes), so that the additional notes are consolidated and form a single series of notes with the Notes. The Company will not issue any additional notes that are consolidated and form a single series with the Notes unless such additional notes are fungible with the Notes for US federal income tax purposes.
Use of Proceeds	It is expected that the net proceeds of the offering will be used for general corporate purposes, including to repay certain existing indebtedness of the Company. See "Use of Proceeds".
Agent	Citibank, N.A., collectively in its capacities as fiscal agent, paying agent and transfer agent.
Registrar	Citigroup Global Markets Deutschland AG.
Transfer Restrictions	The Notes have not been and will not be registered under the Securities Act and are subject to certain restrictions on resale and transfer.

Timing and Delivery	The Company expects delivery of the Notes to occur on 12 October 2012.
Ratings	It is expected that the Notes will be rated Baa2 by Moody's Deutschland GmbH ("Moody's") and BBB+ by Standard & Poor's Credit Market Services Europe Limited ("S&P"). A security rating is not a recommendation to buy, sell or hold the Notes and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency. Each of Moody's and S&P is established in the European Union and is registered under Regulation (EC) No. 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies.

Risk Factors

Investing in the Notes involves substantial risks. You should consider carefully all of the information in this offering memorandum and, in particular, before investing in the Notes, you should consider the following risk factors:

- We have operations in over 50 countries, and are thus exposed to a broad range of social, political and economic risks that are inherent in operating in a global market.
- Our revenues and financial condition depend to a significant degree on spending by governments and government agencies.
- A prolonged economic downturn and/or a continuation of volatile credit markets, both globally and as a consequence of the sovereign debt crisis in Europe, could continue to have a material adverse effect on our business, financial condition and results of operations.
- We are subject to a broad range of laws, regulations and standards in the jurisdictions in which we operate. Any unexpected changes in these laws or regulations or failure to comply with them could have significant adverse consequences for our business and results of operations.
- We may be adversely affected by environmental laws, regulations and liabilities.
- We operate in diverse locations which expose us to a broad range of operational and other external risks.
- We depend heavily on supplies of raw materials and purchased components and any disruption in supply or volatility in price could have a material adverse effect on our performance.
- We are subject to litigation including, but not limited to, asbestos and other product liability litigation.
- Defects or failures associated with our products could lead to recalls or safety alerts and negative publicity.
- Fluctuation in currency exchange and interest rates could have an adverse effect on our results of operations.
- We are exposed to credit risk from our credit counterparties, including customers, banks and insurers.
- We rely on insurance to manage many of the risks we are subject to in the course of our business. Such insurance may not be sufficient to cover our potential losses.
- Our ability to refinance our borrowings in the bank or capital markets may be materially adversely affected by a financial crisis in a particular geographic region, industry or economic sector.
- Our key markets are highly competitive and in order to remain competitive in our key markets, we must make frequent investments in new technologies, product improvements and other projects.
- Failure to meet targeted cost savings may reduce profitability.
- We may not be able to expand our portfolio through successful mergers or acquisitions and may become liable for claims arising from previously completed mergers or acquisitions.
- We may be subject to costs and liabilities as a result of disposals.
- We are subject to internal control, compliance, security and technology risks.
- We may be unable to protect our intellectual property rights or may infringe on the intellectual property rights of others.

- Lack of or delays in the award of new contracts, cancellation of contracts, breaches of contractual commitments or differences between estimated costs and actual costs of performing a contract could have an adverse effect on our business.
- We depend on the recruitment and retention of qualified personnel and any failure to attract and retain such personnel could seriously harm our business.
- We are exposed to pension funding risk including net liabilities under our retirement benefit schemes which may increase in the future due to a number of factors.
- Our business may be significantly impacted by changing tax laws and tax rates from around the world.
- Credit ratings may not reflect all risks, are not recommendations to buy or hold securities and may be subject to revision, suspension or withdrawal at any time. Downgrades of our debt ratings could adversely affect us.
- We may incur substantially more debt in the future.
- An active trading market for the Notes may not develop, and the transfer of the Notes will be subject to restrictions.
- The Notes will initially be held in book-entry form and therefore you must rely on the procedures of the relevant clearing systems to exercise any rights and remedies.
- Investors in the Notes may have limited recourse against our independent accountants.
- The Company and the Guarantor are holding companies with no revenue-generating operations of their own.
- A holder's effective yield on the Notes may be diminished by the tax impact on that holder of their investment in the Notes.
- A holder may be subject to the EU Savings Directive.
- The Notes are unsecured obligations of the Company and are subordinated to secured obligations on insolvency.
- The trading market for debt securities may be volatile and may be adversely impacted by many events.

OVERVIEW OF THE SMITHS GROUP

Overview of the Smiths Group

Overview/Summary

We are a diversified global technology business serving the energy, medical device, detection, communications and engineered component markets. We develop advanced technology and bring it to life to create products that meet our customers' evolving needs.

We operate through five divisions:

- *John Crane,* a 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;
- *Smiths Medical,* a supplier of specialist medical devices, consumables and equipment focused on the medication delivery, vital care and safety devices market segments;
- *Smiths Detection,* a leading designer and manufacturer of sensors that detect and identify explosives, narcotics, weapons, chemical agents, biohazards, nuclear and radioactive materials and contraband;
- *Smiths Interconnect,* a designer and manufacturer of electronic components and sub-systems that connect, protect and control critical systems for wireless telecommunications, aerospace, defence, space, test, medical, rail and industrial markets; and
- *Flex-Tek,* a provider of engineered components that heat and move fluids and gases for the aerospace, medical, industrial, construction and domestic appliance markets.

Our Strategy

We seek to create long term shareholder value by capitalising on our key strengths, including:

- Strong market positions in sectors with long-term profitable growth;
- Leading-edge technologies and service levels that command high margins;
- Further scope for operational improvement and margin enhancement;
- Opportunity to realise value through active portfolio management;
- High returns on capital employed; and
- Strong cash generation to reinvest in top-line growth and increase dividends.

We seek to deliver our strategy by focusing on our five key objectives:

- Driving top line growth;
- Enhancing margins;
- Generating cash and managing the balance sheet;
- Allocating capital to maximise returns; and
- Promoting corporate responsibility.

Summary Financial Data of the Group

The following summary historical consolidated financial data of the Group is derived from, should be read in conjunction with, and is qualified in its entirety by reference to our audited consolidated financial statements as at and for the years ended 31 July 2012, 2011 and 2010 and the accompanying notes thereto, all of which are included elsewhere in this offering memorandum. Our consolidated financial statements for the years ended 31 July 2012, 2011 and 2010 have been audited by PricewaterhouseCoopers LLP.

The summary financial and operating data set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations of the Group", our consolidated financial statements, and the accompanying notes thereto, each of which is included elsewhere in this offering memorandum. See "Selected Historical Financial Data of the Group".

	Financial Year		
	2012	**2011**	**2010**
	(£ million, except per share data)		
Income Statement Data			
Revenue	3,030.1	2,842.0	2,769.6
Operating profit	406.6	438.0	435.9
Profit for the period	258.2	385.1	310.6
Earnings per share			
Basic	65.4p	98.0p	79.5p
Basic – continuing operations	65.4p	77.8p	75.3p
Diluted	64.9p	97.1p	78.9p
Diluted – continuing operations	64.9p	77.1p	74.8p
Headline operating profit(1)	553.7	516.9	492.4
Restructuring programmes	(15.4)	(15.7)	(8.2)
Costs of acquisitions	(2.0)	(1.5)	(1.3)
Adjustment to contingent consideration provided on acquisitions	2.4	—	—
Sale of diabetes patents/release of diabetes provision	0.6	1.5	—
Gains on change of post retirement benefits	—	10.2	3.9
Revision of estimated rebates	(7.8)	—	—
Profit on disposal of businesses.	30.8	4.4	3.3
Profit on disposal of property	—	—	5.5
Amortisation and impairment of acquired intangible assets	(61.6)	(49.5)	(42.1)
Litigation			
Provision for Titeflex Corporation subrogation claims	(54.5)	—	—
Provision for John Crane, Inc. asbestos litigation	(39.6)	(28.3)	(17.6)
Operating profit	406.6	438.0	435.9
Balance sheet data			
Total assets	3,605.3	3,627.0	3,458.3
Total liabilities	2,624.5	(2,247.1)	(2,358.5)
Net assets	980.8	1,379.9	1,099.8
Cash Flow Statement data			
Net (decrease)/increase in cash and cash equivalents	(55.0)	85.8	153.3

Note:

(1) The following items, included in operating profit and profit before taxation, have been excluded from headline operating profit: exceptional items, including restructuring programmes, income and expenditure relating to John Crane, Inc. ("JCI") asbestos litigation, provision for costs of Titeflex Corporation subrogation claims (with effect from 1 August 2011), the amortisation and impairment of intangible assets acquired in a business combination, net retirement benefit finance charges and income (from 1 August 2011) and other financing gains and losses, which may be volatile, and are not subject to hedge accounting under IAS 39. "Headline" performance measures are non-GAAP measures that are not recognised as measures of financial performance under IFRS. Investors should not place undue reliance on these non-GAAP measures and should not consider these measures as an alternative to operating profit and profit before taxation as determined in accordance with IFRS. These measures are not indicative of our historical results of operations, nor are they meant to be predictive of future results. See "Management's Discussion and Analysis of Financial Condition and Results of Operations of the Group – Headline operating profit and headline profit before taxation – Reconciliation of headline operating profit to operating profit" for a reconciliation of headline operating profit to operating profit.

RISK FACTORS

We believe that the following factors may affect our ability to fulfil our obligations under the Notes. All of these factors are contingencies which may or may not occur and we are not in a position to express a view on the likelihood of any such contingency occurring. Factors which we believe may be material for the purpose of assessing the market risks associated with the Notes are also described below.

An investment in the Notes entails risk. There are a number of factors, including, but not limited to, those specified below, that may adversely affect our ability to make payments under the Notes. You could therefore lose a substantial portion or all of your investment in the Notes. Consequently, an investment in the Notes should be considered only by persons who can assume such risk. You should note that the risks described below are not the only risks we face. There may be additional risks that we currently consider immaterial or of which we are currently unaware, and any of these risks could have the effects set forth above. Prospective investors should also read the detailed information set out elsewhere in this offering memorandum and reach their own views prior to making any investment decision.

Risks Relating To Our Business

We have operations in over 50 countries, and are thus exposed to a broad range of social, political and economic risks that are inherent in operating in a global market.

We have operations in over 50 countries, including in the United States, which accounted for 45 per cent. of our revenue from continuing operations in the financial year 2012. Our results of operations and financial condition are influenced by the social, economic, regulatory and political situations in these and other markets and regions in which we have operations, which are often unpredictable and outside our control.

Furthermore, we have operations in several developing economies, particularly in Asia and Latin America (including Mexico), and our strategy includes continuing to expand our operations in these regions, particularly in Brazil, China, India and Russia. However, many developing economies have recent histories of economic, social and political instability, including, for example, recent political unrest in North Africa and the Middle East and security concerns in Mexico, unexpected changes in local laws, regulations and standards, substantial depreciation and volatility in national currencies and the imposition of trade barriers and wage and price controls.

Our operations in all of these countries are subject to varying degrees of risk, including:

- exchange controls, currency restrictions and fluctuations in currency values;
- political instability;
- risk of sovereign default;
- trade protection measures;
- import or export requirements;
- subsidies or increased access to capital for firms who are currently or may emerge as competitors in countries in which we have operations;
- consumer confidence and consumer perception of economic conditions in our markets;
- legal, fiscal and regulatory change;
- differing labour regulations; and
- differing protection of intellectual property.

These and other factors may have a material adverse effect on our international operations, our supply chains or on our business, results of operations and financial condition generally.

Our revenues and financial condition depend to a significant degree on spending by governments and government agencies.

Approximately 35 per cent. of our revenues are from governments and their agencies or are influenced by government regulation; a significant part of the revenue for our Smiths Detection and Smiths Interconnect divisions is influenced by spending by governments and government agencies. As a result, our business is affected by government spending priorities and budgetary conflicts, in particular in the United States, and the willingness of governments to commit substantial resources to healthcare, homeland security and defence initiatives. In particular, for the financial years 2012 and 2011, the reductions in government spending around the world, most notably in the military sector, led to a decline in revenue from such sources and adversely affected revenue and operating margins in Smiths Detection and Smiths Interconnect.

Recently in the United States, government military expenditure is returning to more normal funding levels following the easing of recent conflicts, and in addition both Congress and the President have proposed defence budgets that contain significant reductions compared to previous baselines. Similarly in Europe, several countries have proposed further reductions in military spending as part of austerity measures. If these reductions are enacted, the declining defence budgets may have a negative impact on the availability of new defence contracts and our business, financial condition and results of operations.

Smiths Detection, Smiths Medical and Smiths Interconnect frequently need to tender for government contracts. Smiths Detection and Smiths Interconnect have observed delays and uncertainty in the timing of contracts and tender activities. The timing of the award of contracts and payments under such contracts may be uncertain and uneven over a given financial year, possibly resulting in uneven revenues which may distort our results of operations in a given period compared to prior periods. At times these divisions must bid for contracts prior to completing the necessary design, which may result in unforeseen technological difficulties and/or cost overruns.

Additionally, the risk that governmental purchases of our products may decline results from the terms of certain of our contracts with governments, including the US government. For example, a government body that is our counterparty to a contract may:

- terminate contracts at its convenience;
- terminate, reduce or modify contracts or subcontracts if its requirements or budgetary constraints change; and
- cancel multi-year contracts and related orders if funds become unavailable.

A prolonged economic downturn and/or a continuation of volatile credit markets, both globally and as a consequence of the sovereign debt crisis in Europe, could continue to have a material adverse effect on our business, financial condition and results of operations.

Current global economic and financial market conditions, including severe disruptions in the Eurozone and global credit markets, uncertainty surrounding the sovereign debt crises in Europe and the potential for a prolonged global economic downturn, have affected and may continue to materially and adversely affect our results of operations and financial condition.

These economic conditions, which could include a default or a significant decline in the credit rating of one or more sovereigns or financial institutions, may also materially impact our customers, suppliers and other parties with which we do business directly or indirectly and in ways which are difficult to predict. Economic and financial market conditions that adversely affect our customers may cause them to terminate existing purchase orders or to reduce the volume of products or services they purchase from us in the future.

Political and economic structural weaknesses in the Eurozone's single currency framework have heightened the risk that the Eurozone may not survive in its present form. One or more countries may leave the Euro and opt for a new currency. This may result in substantial defaults on existing Euro sovereign debt and could lead to economic dislocation. It could also result in capital exchange controls being imposed, domestic banking failures or the expropriation of assets. Smiths Group has approximately 5 to 6 per cent 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.

Adverse economic and financial market conditions may also cause our suppliers to be unable to meet their commitments to us or may cause suppliers to make changes in the credit terms they extend to us, such as shortening the required payment period for outstanding accounts receivable, or reducing the maximum amount of trade credit available to us or increasing costs reflected in the prices paid for raw materials and components. For example, budgetary pressure related to the Eurozone crisis has also caused payment terms to lengthen with some government-funded customers in southern Europe. Changes of this type could significantly affect our liquidity and could have a material adverse effect on our business, financial condition and results of operations. If we are unable to successfully anticipate changing economic and financial market conditions, we may be unable to effectively plan for and respond to those changes, and our business could be negatively affected.

We are subject to a broad range of laws, regulations and standards in the jurisdictions in which we operate. Any unexpected changes in these laws or regulations or failure to comply with them could have significant adverse consequences for our business and results of operations.

We operate in highly regulated business sectors. Our Smiths Detection, Smiths Interconnect and Smiths Medical divisions are particularly subject to regulation, with certain customers and regulatory or other enforcement bodies routinely inspecting our practices, processes and premises. Certain of our products, most notably devices produced by Smiths Medical, are subject to regulatory approval processes. Should a regulator's approval process take a particularly long time, our products may suffer a delay in getting to the market, which could give an advantage to a competitor with a similar product and negatively affect our results.

Due to the security functions served by their products, Smiths Detection and Smiths Interconnect are subject to numerous export control, technology licensing and other government regulations. Smiths Detection and Smiths Interconnect are also required to maintain a Special Security Agreement entity and "cleared sites" which must be operated in accordance with regulations and parameters, and are subject to periodic audit by the US Defense Security Service.

In addition, if a transaction involves countries, individuals or entities that are the target of US or other economic sanctions, or is intended to provide services to a sanctions target, licences or other approvals from the US Treasury Department's Office of Foreign Assets Control or other sanctions authority may be required and may not be granted.

In addition, new regulations or certification requirements may require additional expenses or restrict our commercial flexibility and planned business strategies. Efforts by the private and public sector, specifically in the United States, to control health care costs through legislation and regulatory initiatives may lead to lower reimbursements and increased utilisation controls related to the use, by health care providers, of a range of medical devices, including those produced by Smiths Medical. For example, in the United States, the medical device excise tax of 2.3 per cent. is expected to constrain growth and margins.

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.

Should any of our divisions, including their respective agents and distributors, fail to comply with the laws, regulations or standards of the jurisdictions in which we operate, including those related to national security, that division or the Group as a whole could be subject to civil and/or criminal penalties, administrative sanctions including disqualification from public procurement processes, the termination or modification of contracts or reputational damage.

Should we or any of our divisions, including their respective agents and distributors, fail to comply with applicable laws, regulations or standards or should we fail to obtain the necessary regulatory approvals or certifications, we could be subject to significant financial penalties, debarment from government contracts and/or reputational damage, which could have an adverse effect on our business, reputation, results and financial condition.

We may be adversely affected by environmental laws, regulations and liabilities.

We are subject to numerous foreign, international, national, regional and local environmental laws and regulations concerning emissions into the environment, including greenhouse gas emissions, discharges to the ground, air and surface and subsurface water, the generation, storage, handling, use, transportation, disposal and treatment of hazardous materials and waste, noise pollution and the health and safety of our employees. Pursuant to such laws and regulations, for certain activities, we are required to obtain permits from governmental authorities. We cannot assure you that we have been or will be at all times in complete compliance with such laws, regulations and permits. If we violate or fail to comply with these laws, regulations or permits, we could be fined or otherwise sanctioned by regulators. We cannot anticipate whether, and to what extent, these environmental requirements may become stricter over time, nor can we give any assurance that the cost of maintaining compliance with environmental laws, regulations or permits will not increase. Substantial increases in environmental compliance costs or our failure to comply with such environmental requirements could adversely affect our business, reputation, results of operations and financial condition.

Under certain environmental laws, we could be held responsible for any and all liabilities and consequences arising out of past or future releases of hazardous materials or waste, human exposure to such substances or other environmental damage, including potentially significant remedial costs. The environmental laws of the jurisdictions in which we operate impose liability for and actual and potential obligations to remediate releases of hazardous materials or contamination relating to our or our predecessors' past or present facilities or third-party waste disposal sites. We are currently involved in various investigation and remediation activities at such locations. There is a risk that such liabilities or remediation costs could prove greater than expected or that further contamination could be discovered with significant adverse consequences for the Group. We make provisions for expected liabilities and remediation costs based on independent professional advice, but there can be no assurance that such provisions will adequately cover such liabilities or costs.

Our liabilities or remediation costs arising from releases of or exposure to hazardous materials could have an adverse effect on our business, reputation, results of operations and financial condition.

We operate in diverse locations which expose us to a broad range of operational and other external risks.

Because of the location of our operations and manufacturing facilities, we are exposed to a number of natural catastrophe risks, such as earthquakes, floods, hurricanes and other types of storm, which, like other external events, such as terrorist attacks, nuclear catastrophe or a disease pandemic, could have significant adverse consequences for our business. Other operational risks we face include:

- equipment and systems failures including information technology failures;
- difficulty in enforcing legal claims and agreements through some national legal systems;
- labour force shortages or work stoppages;
- events impeding or increasing the cost of transporting products; and
- social unrest and civil disturbances.

Should any of these operational risks materialise, they could lead to delays in the delivery of our products or breaches in the provision of our services, including adverse effects on the quality of our products or services which could lead to the need for product recalls or liability claims from customers or third parties in connection with faults in the design or manufacture of the products, which could have an adverse effect on our business, reputation, results and financial condition.

We depend heavily on supplies of raw materials and purchased components and any disruption in supply or volatility in price could have a material adverse effect on our performance.

Our business is affected by the price, quality, availability and timely delivery of the various raw materials and purchased components, including electronic components, metals and plastics that we use in the manufacture of our products. Our business, therefore, could be adversely impacted by factors affecting our suppliers and supply chain, such as the destruction of suppliers' facilities or their distribution infrastructure, a work stoppage or strike by suppliers' employees, disruption of transportation and supply routes due to civil or political unrest or other factors, or the failure of suppliers to provide materials of the requisite quality or by increased costs of such raw materials or components.

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.

In particular, we rely on sole suppliers to provide raw materials or purchased components for some of our products. We cannot guarantee that we will not encounter loss of or shortage in supply or volatility in prices of these sourced materials in the future, in which case we may not be able to quickly establish additional or replacement sources for certain components or materials. A reduction or interruption in manufacturing, disruptions in transport, volatility in prices or an inability to secure alternative sources of raw materials or components could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We are subject to litigation including, but not limited to, asbestos and other product liability litigation.

In the ordinary course of business, we are subject to litigation such as product liability claims, employee disputes and other kinds of lawsuits, and face different types of legal issues in different jurisdictions. The high level of activity in the United States, for example, exposes us to the likelihood of various types of litigation commonplace in that country, such as a "mass tort" and "class action" litigation, and challenges to the scope and validity of patents. These types of proceedings (or the threat of them) are also used to create pressure to encourage negotiated settlement of disputes. Any claim brought against us, with or without merit, could be costly to defend and could result in an increase of our insurance premiums. Some claims brought against us might not be covered by our insurance policies. Furthermore, even where the claim is covered by our insurance, our insurance coverage might be inadequate and we would have to pay the amount of any settlement or judgment that is in excess of our policy limits.

John Crane, Inc. ("JCI"), an indirect subsidiary of Smiths Group, is currently one of many co-defendants in litigation relating to products previously manufactured which contained asbestos. This litigation began in the United States around 30 years ago and, typically, involves claims for a number of diseases including asbestosis, lung cancer and mesothelioma. In recent years, the litigation has focused increasingly on claims for mesothelioma, awards for which, when made, tend to be larger than those for the other diseases. Whilst the number of claims being filed against JCI and other defendants has been declining, the proportion of mesothelioma claims has increased, and JCI's ability to defend these cases is likely to have a significant impact on its annual aggregate adverse judgment and defence costs. JCI is actively monitoring the conduct and effect of its current and expected asbestos litigation, including the most efficacious presentation of its "safe product" defence. It has resisted all cases in which it is named and intends to continue to do so based upon a "safe product" defence. It has not always, however, been successful. JCI has incurred, and expects to continue to incur, significant adverse judgment and defence costs. While provision has been made for certain currently anticipated costs associated with this litigation, 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. We cannot give any assurance that the provision will be sufficient to cover the costs or losses arising from such litigation.

In addition to the JCI asbestos lawsuits, Titeflex Corporation, a part of the Group's 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. While provision has been made for certain currently anticipated costs associated with this litigation which can be reliably estimated, because of the significant uncertainty associated with the future level of subrogation 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. We cannot give any assurance that the provision will be sufficient to cover the costs or losses arising from such litigation. Other companies within the Group are also involved in product liability and other litigation for which no provision is required to be or is made based on currently available information. In addition, there is the risk that such litigation may prove more costly and time consuming than expected. There is also a risk that the current litigation, and any additional litigation instigated in the future, could have a material adverse impact on the Group. See "Our Business – Litigation".

Defects or failures associated with our products could lead to recalls or safety alerts and negative publicity.

Manufacturing flaws, component failures or design defects could require us to recall products (as we were required to do in recent years in Smiths Medical). Many of our products are used in critical applications such as products sold to aviation, security, health care, energy and consumer/domestic industries, where the consequences of a failure could be extremely serious and, in some cases, potentially catastrophic, particularly where our products have medical applications or have been supplied to government or military organisations.

Due to the strong name recognition of certain of our brands, an adverse event involving one of our products could result in reduced market acceptance and demand for all products within that brand, and could harm our reputation and our ability to market our products in the future. In some circumstances, adverse events arising from or associated with the design, manufacture or marketing of our products could result in the suspension or delay of regulatory reviews of our applications for new product approvals. We also may undertake voluntarily to recall products or temporarily shut down production lines based on internal safety and quality monitoring and testing data. These problems may arise from issues with our suppliers or other external parties who operate outside our control. Any of the foregoing problems could disrupt our business and have a material adverse effect on our business, results of operations, financial condition and cash flows.

Fluctuation in currency exchange and interest rates could have an adverse effect on our results of operations.

Exchange rate fluctuations have had, and could continue to have, a material impact on our operating results. The continuing global financial crisis and the recent Eurozone crisis have led to increased volatility in exchange rates, which makes it harder to predict exchange rates and thus do accurate financial planning. Changes in exchange rates can unpredictably and adversely affect our consolidated operating results, and could result in exchange losses.

We are exposed to two types of currency risk, transaction risk in respect of products manufactured in one currency region and sold in another currency, and translation risk in that the results of our non-UK businesses will translate into pounds sterling, our reporting currency, at differing values, depending on the exchange rate. Approximately 96 per cent. of our revenues for the financial year 2012 were derived from non-UK markets. Therefore, fluctuations in the exchange rate of the pound sterling against other currencies (particularly the US dollar and the euro) can have a significant impact on our manufacturing costs, and as a result on our revenues and operating results. In circumstances where our contracts are denominated in currencies other than pounds sterling, delays in payment can affect translation value if the relevant currency exchange rate fluctuates between the time the contract is signed and payment.

We are exposed to interest rate risk derived mainly from long-term indebtedness relating to borrowings which have been issued at floating interest rates. We aim to manage interest rate risk through fixed rate borrowings and interest rate swaps; however, there can be no assurance that these measures will be sufficient to cover our interest payment obligations.

Changes in currency values, including future exchange rate fluctuations between the pound sterling and the currencies of countries in which we operate, as well as changes in interest rates, may have an adverse impact on our business, financial condition and results of operations.

We are exposed to credit risk from our credit counterparties, including customers, banks and insurers.

Cash deposits and other financial instruments expose us to credit risk on the amounts due from counterparties such as suppliers, banks, insurers and customers, including governments and government agencies. Concerns about credit risk (including that of sovereigns) and the Eurozone crisis have recently intensified. The large sovereign debts and/or fiscal deficits of a number of European countries and of the United States have raised concerns regarding the financial condition of financial institutions, insurers and other corporates either (i) located in these countries, (ii) that have direct or indirect exposure to these countries and/or (iii) whose banks, counterparties, custodians, customers, service providers, sources of funding and/or suppliers have direct or indirect exposure to these countries. Continued constraints on government budgets due to the sovereign debt crisis in Europe may put pressure on public sector spending in areas such as healthcare, defence and homeland security in markets in which we operate. For example, budgetary pressure has caused payment periods to lengthen with some government-funded customers in southern Europe. The failure of any counterparty to meet its obligations to us could have an adverse effect on our financial condition or operations. There can be no guarantee that any particular credit risk will not have a material adverse effect on our financial condition.

We rely on insurance to manage many of the risks we are subject to in the course of our business. Such insurance may not be sufficient to cover our potential losses.

Where appropriate, we seek to insure against business risks and protect many of our assets and associated profits by purchasing insurance. The severity and frequency of various events, such as accidents and other mishaps, business interruptions or potential damage to our facilities, property and equipment caused by inclement weather, human error, pollution, labour disputes, natural catastrophes and other eventualities, may result in losses or expose us to liabilities in excess of our insurance coverage or significantly impair our reputation.

We cannot assure you that we will be able to obtain insurance on terms acceptable to us or at all since insurance varies in cost and can be difficult to obtain. Furthermore, we cannot assure you that our insurance coverage will respond or be sufficient to cover the loss arising from any or all of the above events. 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.

We aim to transfer certain legal liability risks such as product liability and employer's liability to insurers, but our claims under insurance policies are subject to policy limits, deductibles, retentions, exclusions and other conditions, and we cannot guarantee that our insurance will cover any or all such legal liability claims. In particular, because we and our subsidiaries have been in business for many years, there is a risk of latent injury claims that may not be covered by insurance. Furthermore, as we operate globally, we may not enjoy the protection of limited liability in certain instances afforded by statutes such as the US SAFETY Act in all jurisdictions. There can be no guarantee that the policies in place will be sufficient to cover any or all costs and financial awards we may be required to pay as a result of liability claims. Claims which are not covered or which significantly exceed the insurance policy coverage, or for which insurance companies demand reimbursement for costs and financial judgments against the Group could have a material adverse effect on the Group and its business, financial condition and results of operations.

Any accident, failure, incident or liability could significantly impact the cost and availability of adequate insurance in the future, which could have a material adverse effect on our business.

Our ability to refinance our borrowings in the bank or capital markets may be materially and adversely affected by a financial crisis in a particular geographic region, industry or economic sector.

Our ability to refinance our borrowings in the bank or capital markets to meet the financial requirements of the Group is dependent on favourable market conditions. Financial crises in particular geographic regions, such as the current Eurozone crisis, or in particular industries or economic sectors have, in the recent past, led and could, in the future, lead to sharp declines in the currencies, stock markets and other asset prices in those geographic regions, industries or economic sectors, in turn threatening affected financial systems and economies.

Global credit markets have continued to tighten with the concern over levels of sovereign debt, particularly in the Eurozone. Credit risks may continue to be larger and more pervasive than previously thought. The functioning of financial markets has also continued to become increasingly impaired and financial volatility has increased substantially.

The current economic slowdown may adversely impact our ability to refinance our borrowings in the bank or capital markets and may significantly increase the costs of such refinancing. If sufficient sources of financing are not available in the future for these or other reasons, we may not be able to meet our financial requirements, which could have an adverse effect on our funding and liquidity position, our credit ratings or our ability to finance acquisitions. This could materially and adversely affect our business, results of operations and financial condition.

Our key markets are highly competitive and in order to remain competitive in our key markets, we must make frequent investments in new technologies, product improvements and other projects.

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

In the financial years 2012 and 2011, we spent £116.5 million and £110.7 million, respectively, on R&D, which accounted for 3.8 per cent. and 3.9 per cent. of our revenue, respectively. Continued development of new products and improvements to existing products are critical to the future of our business and competitors, or potential competitors, may innovate in these areas more effectively than we do, including development of disruptive technology, with significant adverse consequences for our business and cash flow. The speed of innovation in certain markets may lead to shorter product lifecycles, increasing the need for innovation. Our growth depends on penetrating new markets, particularly in Brazil, China, India and Russia, adapting existing products to new requirements and introducing new products that achieve market acceptance.

We frequently develop new technologies and introduce new products or improve existing ones, in some cases contracting to supply the products to the customer before the design is established or proven. All new, or improvements to, technologies and products involve risk, including possible abortive expenditure, reputational risk and potential customer claims or onerous contracts. Further, our research and development programme may not produce successful results and our new products may not receive regulatory approval or achieve market acceptance, create additional revenue or become profitable, which could materially harm our reputation, business, results of operations and financial condition. The same is true for investment in new facilities and other major projects. Such risks, if they materialise, may have significant adverse consequences for our business.

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

If we are unable to pursue our growth strategy, unsuccessful in our research and development efforts to produce technologically superior products or unable to maintain a competitive cost structure, we will not be able to compete effectively on a global scale, which would harm our business, results of operations and financial condition.

Failure to meet targeted cost savings may reduce profitability.

Part of our strategy is to improve profitability through productivity and efficiency by reducing costs throughout the supply chain. For example, in September 2011, we announced the commencement of an improvement programme in Smiths Detection which was likely to cost approximately £40 million, of which £7 million has been charged to headline operating profit in the financial year 2012. The Smiths Detection improvement programme is expected to lead to annualised cost savings of approximately £40 million by the end of 2014; however, these savings may not be realised in full.

Our ability to gain additional efficiencies may become more difficult over time, such as when synergies from the restructuring programme and acquisitions are fully realised. In addition, objectives and limitations could be imposed over the scope of savings programmes by relevant stakeholders, which may jeopardise future savings programmes. Our failure to achieve such reductions in costs would have an adverse effect on our business, financial condition and results of operations.

We may not be able to expand our portfolio through successful mergers or acquisitions and may become liable for claims arising from previously completed mergers or acquisitions.

Our growth strategy includes a combination of organic growth and mergers and acquisitions. The success of this strategy depends, among other things, on the identification of suitable acquisition targets, obtaining the necessary authorisations and approvals and the ability to commit the necessary finance. We cannot assure you that the necessary acquisition financing would be available to us on acceptable terms if and when required.

Even if we are successful in making an acquisition, the products and technologies that we acquire may not be successful or may require significantly greater resources and investments than we originally anticipated. We may not be able to successfully integrate the businesses that we acquire or obtain the appropriate regulatory approvals for such acquisitions. Additionally, we cannot guarantee that any anticipated benefits from an acquisition will be realised. Integrating acquisitions is a complex, time consuming and expensive process that involves risks, including the risk that the integration may divert the focus of management and resources from our goals, and the risk that the integration may take longer and be more expensive than expected. We can also experience difficulties in integrating geographically separated organisations, systems and facilities, and personnel with diverse backgrounds. Our financial performance may suffer from goodwill or other acquisition-related impairment charges. Any of the foregoing risks could result in increased costs, decreased revenues or a loss of opportunities for us and have a material adverse effect on our business, results of operations and financial condition.

In addition, we may incur or assume significant debt or known, unknown or contingent liabilities, such as environmental liabilities, products liability, patent infringement claims or other unknown liabilities in the event that we are deemed to be a successor to the liabilities of the acquired company. Any such claim against us may adversely affect our business and financial condition.

We may be subject to costs and liabilities as a result of disposals.

In recent years, we have disposed of a number of businesses and divestitures remain part of our strategy going forward. In the course of such disposals, we have given and may, in the future, give certain indemnities, warranties and guarantees to counterparties relating to, among other matters, known and potential latent environmental liabilities. Additionally, we are party to a number of contracts relating to exited businesses which we have not novated to the purchasers of these businesses.

The extent to which we will be required in the future to incur costs under any of the indemnities, warranties, guarantees or contracts referred to above or any similar contractual provision which we entered into in connection with such disposals cannot be determined with certainty. If we should incur such costs, this could have an adverse effect on our results of operations, financial condition and cash flows.

We are subject to internal control, compliance, security and technology risks.

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

We and certain of our subsidiaries and affiliated entities conduct business in countries which experience corruption, including government corruption. We are committed to doing business in accordance with all applicable laws and our code of business ethics. However, there is a risk that we, our subsidiaries or affiliated entities or our respective officers, directors, employees and agents may take actions in violation of applicable laws or our code of business ethics. Any such violations could result in substantial civil and/or criminal penalties, loss of business licences or permits, exclusion from public contracts or other sanctions for the Group, our employees, management or agents and might materially adversely affect our reputation, business and results of operations or financial condition.

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

We may be unable to protect our intellectual property rights or may infringe the intellectual property rights of others.

Our results of operations are partially dependent on our ability to protect our intellectual property and other proprietary rights. We rely primarily on registered patents, trademarks, copyrights, trade secrets, know-how and unfair competition laws, as well as confidentiality and non-disclosure clauses and agreements and other contractual provisions to protect our intellectual and other proprietary rights. However, patent protection does not prevent competitors from developing equivalent or superior products without infringing our intellectual property rights. If we do not obtain sufficient protection for our intellectual property, or if we are unable to effectively enforce our intellectual property rights, our competitiveness could be impaired, which would limit our growth and future revenue.

Additionally, our trade secrets and know-how held by us and our employees are critical to our business. We cannot assure you that such persons will not reveal our trade secrets, breach their agreements with us or convey our know-how or other confidential information to competitors. In such cases, we may not have adequate remedies, if any, to compensate us for losses that we may suffer.

Whilst we endeavour to protect our own intellectual property rights and respect those of others, there can be no guarantee that our technology will not be found to infringe rights owned by or granted to others. Similarly, there can be no assurance that any of our currently patented products will not be the subject of intellectual property litigation or other disputes. If we cannot resolve an intellectual property dispute, we may be liable for damages, be required to obtain costly licences or be stopped from manufacturing, using or selling our products. Contesting such claims can be costly, even if we are successful.

Lack of or delays in the award of new contracts, cancellation of contracts, breaches of contractual commitments or differences between estimated costs and actual costs of performing a contract could have an adverse effect on our business.

Our long-term economic and financial performance depends, in part, on our ability to service our existing contracts and to win new contracts. Our contracts may be completed or expire, or they may be altered or terminated. We may be unable to replace these contracts with new contracts of comparable size or in a timely manner. The award of new contracts is often subject to competition and is affected by factors outside our control, such as government spending decisions and administrative procedures. Any failure to secure or any delay in securing a consistent number of contracts or any interruption to or termination of existing contracts would adversely affect our business, results of operations and financial condition.

Additionally, our ability to execute our contractual commitments, in a timely and satisfactory manner, depends on numerous factors, including our ability to develop necessary technologies. Failure to deliver, in a timely fashion or at all, the products and services we are obliged to deliver, or any fault in contract execution due to delays or breaches by our suppliers, may lead to higher costs or penalties. In particular, some of our contracts require compliance with a variety of complex laws, regulations and standards, including US and EU export controls, breaches of which could entail serious consequences for the Group not limited to the loss of the individual contract and including potential fines and other criminal sanctions. We may also face difficulty enforcing our contracts with customers, suppliers or other counterparties. Enforcing our contracts is especially challenging given the number of jurisdictions in which we operate.

Some of our business activities involve medium- and long-term contracts and programmes. Under many of our medium- and long-term contracts, revenues to be paid by the customer are typically established based on an estimate of costs made when the contract is awarded. Differences between the estimated costs and actual costs can have a substantial negative effect on our financial position and results of operations. These differences may arise from a number of factors including production delays, cost overruns and other items. Cost overruns, as well as contractual disputes, may continue to occur in the future which may have a material adverse effect on our business, financial condition and results of operations.

We depend on the recruitment and retention of qualified personnel and any failure to attract and retain such personnel could seriously harm our business.

We rely on senior management and other key employees to generate business, maintain good customer relations and identify new opportunities. Competition for personnel is intense and we 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 or perform certain tasks. The loss of key employees, our inability to attract new qualified employees, adequately trained employees, or a delay in hiring key personnel could seriously harm our business, results of operations and financial condition.

We are exposed to pension funding risk including net liabilities under our retirement benefit schemes which may increase in the future due to a number of factors.

We operate a number of retirement benefit plans worldwide. These arrangements have generally been developed in accordance with local practices in the relevant market. As a result of these retirement benefit arrangements, we are subject to various funding risks, including poor performance of the investments (particularly equity investments), increased longevity of members, changes in valuation and funding assumptions and changes in regulation.

The principal defined benefit pension plans are in the United Kingdom and the United States. The contributions to our defined benefit plans and their valuations are determined in accordance with the advice of independent, professionally qualified actuaries. Under our defined benefit plans, we are committed to pay a defined level of benefits to plan participants, thereby bearing the risk that the plans' assets, such as investments in equity and debt securities, will not be sufficient to cover the value of those benefits. At 31 July 2012, our retirement liabilities reported, including unfunded post retirement health care and unfunded pension plans, exceeded the retirement assets by £620.2 million, calculated in accordance with IFRS. The value of the plans' assets is affected by, among other things, developments in the equity and bond markets. The next triennial review of the two principal UK Pension plans have valuation dates at 31 March 2012 and 5 April 2012; the reviews have to be completed within 15 months of the respective valuation dates. Changes in asset returns, inflation, long-term interest rates and other actuarial assumptions could require us to make further contributions to the pension plans, and such contributions could be significant and have a negative impact on our cash flow and results of operations, our pension obligations could also constrain our investment ability and adversely affect our credit rating. See "Management's Discussion and Analysis of Financial Condition and Results of Operations of the Group–Key Factors Affecting Results of Operations–Funding of defined benefit pension plans".

Our business may be significantly impacted by changing tax laws and tax rates from around the world.

We operate in over 50 countries and pay tax in accordance with the tax legislation of those countries. Tax laws and tax rates around the world are constantly changing and we are exposed to the risk of changes in tax legislation, and its interpretation and increases in the rate of corporate and other taxes in the jurisdictions in which we operate.

Whilst in the financial year 2012 our effective tax rate on headline profits was 26.5 per cent., there can be no guarantee that this rate will be sustained. Indeed, increased profitability in areas with higher tax rates may cause the headline tax rate to increase over time. Action by governments to increase tax rates or to impose additional taxes would reduce our profitability. Revisions to tax legislation or to its interpretation might also affect our results in the future.

Credit ratings may not reflect all risks, are not recommendations to buy or hold securities and may be subject to revision, suspension or withdrawal at any time. Downgrades of our debt ratings could adversely affect us.

One or more independent credit rating agencies may assign credit ratings to the Notes. The ratings may not reflect the potential impact of all risks related to structure, market, additional factors discussed above and other factors that may affect the value of the Notes. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time.

While each of Moody's and S&P has recently maintained our ratings at Baa2 (stable) and BBB+ (stable), respectively, a downgrade by Moody's and/or S&P may increase our cost of borrowing and make it more difficult for us to obtain new financing which may have a material adverse effect on our business, financial condition and results of operations.

Risks Relating to the Notes

We may incur substantially more debt in the future.

We may incur substantial additional indebtedness in the future, some of which may be secured by some or all of our assets. The terms of the Notes will not limit the amount of indebtedness we may incur. Any such incurrence of additional indebtedness could exacerbate the related risks that we now face as described in this offering memorandum or pose new risks not described in this offering memorandum.

An active trading market for the Notes may not develop, and the transfer of the Notes will be subject to restrictions.

There can be no assurance regarding future development of a market for the Notes. An application has been made for the admission of the Notes to listing on the Official List and to trading on the PSM. However, we cannot assure you that the Notes will be listed on any exchange at the time the Notes are delivered to the initial purchasers or at any time. The initial purchasers have informed us that they intend to make a market in the Notes. However, they are not obligated to do so and may discontinue such market making at any time without notice. There can be no assurance that an active trading market for the Notes will develop, or if one does develop, that it will be sustained.

We have not registered the Notes under the Securities Act or any US state securities law, and we have not agreed to, and do not intend to register the Notes under the Securities Act or any US state securities law. Therefore, you may not offer or sell the Notes, except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and applicable state securities laws. You should read the discussion under the heading "Transfer Restrictions" for further information about the transfer restrictions that apply to the Notes. It is your obligation to ensure that your offers and sales of Notes within the United States and other countries comply with all applicable securities laws.

The Notes will initially be held in book-entry form and therefore you must rely on the procedures of the relevant clearing systems to exercise any rights and remedies.

Unless and until the Notes in definitive registered form, or definitive registered Notes, are issued in exchange for book-entry interests, owners of book-entry interests will not be considered owners or holders of Notes. DTC, or its nominee, will be the registered holder of the Global Notes for the benefit of its participants including

Euroclear and Clearstream, Luxembourg. After payment to the registered holder, we will have no responsibility or liability for the payment of interest, principal or other amounts to the owners of book-entry interests. Accordingly, if you own a book-entry interest, you must rely on the procedures of DTC, Euroclear and/or Clearstream, Luxembourg, and if you are not a participant in DTC, Euroclear and/or Clearstream, Luxembourg, on the procedures of the participant through which you own your interest, to exercise any rights and obligations of a holder of the Notes. See "Book-Entry, Settlement and Clearance".

Unlike holders of the Notes themselves, owners of book-entry interests will not have any direct rights to act upon our solicitations for consents, requests for waivers or other actions from holders of the Notes. Instead, if you own a book-entry interest, you will be permitted to act only to the extent you have received appropriate proxies to do so from DTC, Euroclear and/or Clearstream, Luxembourg or, if applicable, from a participant. There can be no assurance that procedures implemented for the granting of such proxies will be sufficient to enable you to vote on any matters on a timely basis.

Similarly, upon the occurrence of an event of default under the FPAA, unless and until definitive registered Notes are issued in respect of all book-entry interests, if you own a book-entry interest you will be restricted to acting through DTC, Euroclear and/or Clearstream, Luxembourg. We cannot assure you that the procedures to be implemented through DTC, Euroclear and/or Clearstream, Luxembourg will be adequate to ensure the timely exercise of rights under the Notes. See "Book-Entry, Settlement and Clearance".

Investors in the Notes may have limited recourse against our independent accountants.

See "Independent Accountants" for a description of the independent auditors' reports, including language limiting the accountants' scope of responsibility in relation to such reports and the financial statements to which they relate. In particular, in respect of the audit reports relating to the annual financial statements reproduced herein, PricewaterhouseCoopers LLP, in accordance with guidance issued by the Institute of Chartered Accountants in England and Wales, provides: "This report, including the opinion, 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 this opinion, 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".

Investors in the Notes should understand that these statements are intended to disclaim any liability to parties (such as purchasers of the Notes) other than members of the Company with respect to those reports. In the context of the offering of the Notes, our accountants have reconfirmed to us that they do not intend their duty of care to extend to any party other than those to whom their reports were originally addressed (i.e. to the members of the Company).

The US Securities and Exchange Commission would not permit such limiting language to be included in a registration statement or a prospectus used in connection with an offering of securities registered under the Securities Act, or in a report filed under the Securities Exchange Act. If a US court (or any other court) were to give effect to the language quoted above, the recourse that investors in the Notes may have against the independent auditors based on their reports or the consolidated financial statements to which they relate could be limited.

The Company and the Guarantor are holding companies with no revenue-generating operations of their own.

The business of the Group is carried out in large part through our operating subsidiaries and associated companies. We will depend upon operating subsidiaries to provide the funds necessary to pay the principal of, and the interest on, the Notes. These operating subsidiaries and associated companies have not guaranteed the Notes, and have no obligation, contingent or otherwise, to pay amounts due under the Notes or to make funds available for these payments, whether in the form of liens, dividends or otherwise. Payments from the operating subsidiaries to the Company and the Guarantor might not be able to be made in some circumstances, due to corporate law, contractual or other legal restrictions or other factors.

Holders of the Notes will have a direct claim based on the Notes against the Company and the Guarantor, but will not have a direct claim based on the Notes against any operating subsidiaries. The right of the holders of the Notes to receive payments under the Notes will be structurally subordinated to all liabilities of the operating subsidiaries and associated companies. These liabilities include debt that some of our subsidiaries have incurred under bank facilities. In the event of a bankruptcy, liquidation, reorganisation or similar proceeding relating to a subsidiary, the right of the holders of the Notes to participate in a distribution of the assets of such subsidiary will rank behind such subsidiary's and associated companies' creditors (including trade creditors) and preferred stockholders (if any), except to the extent that the Company or the Guarantor has a direct claim against such subsidiary.

A holder's effective yield on the Notes may be diminished by the tax impact on that holder of its investment in the Notes.

Payments of interest on the Notes, or profits realised by the holder upon the sale or repayment of the Notes, may be subject to taxation in its home jurisdiction or in other jurisdictions in which it is required to pay taxes. However, the tax impact on an individual holder may differ from the situation described for holders generally. We advise all investors to contact their own tax advisers for advice on the tax impact of an investment in the Notes. See "Taxation".

A holder may be subject to the EU Savings Directive.

Under measures implemented in order to comply with the EU Council Directive 2003/48/EC on the taxation of savings income (the "EU Savings Directive"), each EU Member State is required to provide to the tax authorities of another Member State details of payments of interest and other similar income paid by a person within its jurisdiction to (or for the benefit of) an individual resident in that other Member State or certain other persons established in that other Member State, except that for a transitional period, Luxembourg and Austria will instead operate a withholding system in relation to such payments (subject to a procedure whereby on meeting certain conditions, the beneficial owner of the interest or other income may request that no tax be withheld) unless during that period they elect otherwise (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other markets and territories).

The European Commission has proposed certain amendments to the EU Savings Directive which may, if implemented, amend or broaden the scope of the requirements described above.

If a payment were to be made or collected through a Member State which has opted for a withholding system and an amount of or in respect of tax were to be withheld from that payment pursuant to the EU Savings Directive or any law implementing or complying with, or introduced in order to conform to, the EU Savings Directive or any other directive implemented at the conclusion of the ECOFIN Council meeting of 26-27 November 2000, no Additional Amounts (as defined in "Description of the Notes and the Guarantee – Payment of Additional Amounts") would be payable by the Company, Guarantor, Agent or any other person.

The Notes are unsecured obligations of the Company and are subordinated to secured obligations on insolvency.

Holders of secured obligations of the Company will have claims that are prior to the claims of holders of the Notes to the extent of the value of the assets securing those other obligations. The Notes are effectively subordinated to secured indebtedness to the extent of the value of the assets securing those other obligations. In the event of any distribution of assets or payment in any foreclosure, dissolution, winding-up, liquidation, reorganisation, or other bankruptcy proceeding, the assets securing the claims of secured creditors will be available to satisfy the claims of those creditors, if any, before they are available to unsecured creditors, including the holders of the Notes. In any of the foregoing events, there is no assurance to holders of the Notes that there will be sufficient assets to pay amounts due on the Notes.

The trading market for debt securities may be volatile and may be adversely impacted by many events.

The market for debt securities is influenced by economic and market conditions, interest rates and currency exchange rates. Global events may lead to market volatility which may have an adverse effect on the price of the Notes.

USE OF PROCEEDS

The net proceeds from the sale of the Notes (net of issuance costs, issue discount and our expected out-of-pocket expenses which, together, total $3,500,000) are estimated to amount to approximately $396,500,000 (£245,200,000 million translated at the US$ exchange rate of £1.00 = $1.6168). We intend to use the net proceeds of the offering of the Notes for general corporate purposes, including to repay certain existing indebtedness of the Company.

CAPITALISATION AND INDEBTEDNESS

The table below presents our consolidated cash and cash equivalents, capitalisation and indebtedness as at 31 July 2012 on an actual basis and as adjusted to reflect the issuance of the Notes and the application of the net proceeds thereof as discussed under "Use of Proceeds" on page 31, as if the offering of Notes had been completed as at 31 July 2012. The unaudited consolidated "As adjusted" column below has been prepared for illustrative purposes only and, because of its nature, addresses a hypothetical situation and, therefore, does not represent the Group's actual financial position or results. You should read this table together with "Use of Proceeds", "Management's Discussion and Analysis of Financial Condition and Results of Operations of the Group – Liquidity and Capital Resources", "Description of the Notes and the Guarantee" and our consolidated financial statements and other financial information and the accompanying notes thereto, which are included elsewhere in this offering memorandum.

Other than as reflected below, there have been no material changes to our capitalisation since 31 July 2012.

	As at 31 July 2012 Actual	US$ Guaranteed Notes	As adjusted[(2)(3)]
		(unaudited) *(£ million)*	
Total cash and cash equivalents	205.6	83.5	289.1
Borrowings			
Bank overdrafts[(1)]	1.9	—	1.9
Bank and other loans	3.4	—	3.4
Interest accrual	10.5	—	10.5
5.45% US$ Private Placement 2013[(6)]	161.7	(161.7)	—
6.05% US$ Guaranteed notes due 2014	159.1	—	159.1
7.25% Sterling Eurobond 2016	149.4	—	149.4
4.125% Eurobond 2017	240.9	—	240.9
7.37% US$ Private Placement 2018	111.6	—	111.6
7.20% US$ Guaranteed notes due 2019	158.5	—	158.5
3.625% US$ Guaranteed notes due 2022	—	245.2	245.2
Total Borrowings[(4)]	997.0	83.5	1080.5
Shareholders' equity			
Share capital	147.3	—	147.3
Share premium account	331.9	—	331.9
Other reserves[(5)]	493.6	—	493.6
Total shareholders' equity	972.8	—	972.8
Non-controlling interest equity	8.0	—	8.0
Total equity	980.8	—	980.8
Total capitalisation and indebtedness	1,977.8	83.5	2,061.3

Notes:

(1) Includes impact of cash pooling gross up.

(2) To reflect the offering of the Notes and the use of proceeds as discussed in this offering memorandum.

(3) The unaudited consolidated As adjusted column has been prepared on a basis consistent with the accounting policies adopted by the Group in preparing its audited financial statements.

(4) Of the total indebtedness of £997.0 million (as at 31 July 2012), £175.3 million was due within one year.

(5) Other reserves include capital redemption reserve, revaluation reserve, merger reserve, retained earnings and hedge reserve.

(6) The 5.45% US$ Private Placement 2013 is expected to be repaid in full in January 2013 when it falls due.

SELECTED HISTORICAL FINANCIAL DATA OF THE GROUP

The following selected historical consolidated financial data is derived from, should be read in conjunction with, and is qualified in its entirety by reference to, our historical audited consolidated financial information for the financial years ended 31 July 2012, 31 July 2011 and 31 July 2010, and the accompanying notes thereto, all of which are included elsewhere in this offering memorandum. Our historical consolidated financial statements as at and for the years ended 31 July 2012, 31 July 2011 and 31 July 2010 have been audited by PricewaterhouseCoopers LLP whose opinions are included elsewhere in this offering memorandum.

The selected financial data set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations of the Group", our consolidated financial statements, and the accompanying notes thereto, each of which is included elsewhere in this offering memorandum.

Income Statement Data

	Financial Year		
	2012	**2011**	**2010**
	(£ million, except per share data)		
Revenue	3,030.1	2,842.0	2,769.6
Operating profit/(loss)	406.6	438.0	435.9
Profit for the period	258.2	385.1	310.6
Earnings per share			
Basic	65.4p	98.0p	79.5p
Basic – continuing operations	65.4p	77.8p	75.3p
Diluted	64.9p	97.1p	78.9p
Diluted – continuing operations	64.9p	77.1p	74.8p
Headline operating profit(1)	553.7	516.9	492.4
Restructuring programmes	(15.4)	(15.7)	(8.2)
Costs of acquisitions	(2.0)	(1.5)	(1.3)
Adjustment to contingent consideration provided on acquisitions	2.4	—	—
Sale of diabetes patents/release of diabetes provision	0.6	1.5	—
Gains on change of post retirement benefits	—	10.2	3.9
Revision of estimated rebates	(7.8)	—	—
Profit on disposal of businesses.	30.8	4.4	3.3
Profit on disposal of property	—	—	5.5
Amortisation and impairment of acquired intangible assets	(61.6)	(49.5)	(42.1)
Litigation			
Provision for Titeflex Corporation subrogation claims	(54.5)	—	—
Provision for John Crane, Inc. asbestos litigation	(39.6)	(28.3)	(17.6)
Operating profit	406.6	438.0	435.9

Note:

(1) The following items, included in operating profit and profit before taxation, have been excluded from headline operating profit: exceptional items, including restructuring programmes, income and expenditure relating to JCI asbestos litigation, provision for Titeflex Corporation subrogation claims, the amortisation and impairment of intangible assets acquired in a business combination, net retirement benefit finance charges and income (from 1 August 2011) and other financing gains and losses, which may be volatile, and are not subject to hedge accounting under IAS 39. "Headline" performance measures are non-GAAP measures that are not recognised as measures of financial performance under IFRS. Investors should not place undue reliance on these non-GAAP measures and should not consider these measures as an alternative to operating profit and profit before taxation as determined in accordance with IFRS. These measures are not indicative of our historical results of operations, nor are they meant to be predictive of future results. See "Management's Discussion and Analysis of Financial Condition and Results of Operations of the Group – Headline operating profit and headline profit before taxation – Reconciliation of headline operating profit to operating profit" for a reconciliation of headline operating profit to operating profit.

Revenue by Destination

	Financial Year		
	2012	2011	2010
		(£ million)	
United Kingdom	130.3	124.5	118.4
United States	1,353.0	1,275.4	1,274.1
Europe	642.4	611.6	570.9
Other overseas	904.4	830.5	806.2
	3,030.1	2,842.0	2,769.6

Balance Sheet Data

	Financial Year		
	2012	2011	2010
		(£ million)	
Balance sheet data			
Non-current assets	2,303.6	2,298.5	2,301.0
Current assets	1,301.7	1,328.5	1,157.3
Total assets	3,605.3	3,627.0	3,458.3
Non-current liabilities	(1,811.6)	(1,616.3)	(1,717.6)
Current liabilities	(812.9)	(630.8)	(640.9)
Total liabilities	(2,624.5)	(2,247.1)	(2,358.5)
Net assets	980.8	1,379.9	1,099.8
Total equity	980.8	1,379.9	1,099.8

Cash Flow Statement Data

	Financial Year		
	2012	2011	2010
		(£ million)	
Net cash generated from operating activities	331.5	321.7	410.5
Net cash used in investing activities	(235.0)	(106.7)	(191.1)
Net cash used in financing activities	(151.5)	(129.2)	(66.1)
Net (decrease)/increase in cash and cash equivalents	(55.0)	85.8	153.3
Cash and cash equivalents at the beginning of the period	260.7	172.2	19.7
Exchange differences	(2.0)	2.7	(0.8)
Cash and cash equivalents at the end of the period	203.7	260.7	172.2

Other Financial Data (unaudited)

Ratio of fixed charges to earnings

	Financial Year		
	2012	2011	2010
		(£ million except ratios)	
Fixed charge cover ratio	5.7x	6.5x	5.9x
Profit before taxation	365.9	397.9	373.1
Add back:			
(i) Associates	(5.7)	(4.3)	(1.8)
(ii) Fixed charges	76.6	72.2	76.0
Earnings.	436.8	465.8	447.3
Interest payable(1)	(64.8)	(60.3)	(65.1)
Operating lease payments (finance element)	(11.8)	(11.9)	(10.9)
Fixed charges	(76.6)	(72.2)	(76.0)

Note:

(1) Interest payable includes preference shares dividends and amortisation, premiums, discounts and capitalised expenses.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS OF THE GROUP

The following management's discussion and analysis of financial condition and results of operations is intended to convey management's perspective on the Group's operating performance and its financial condition as measured in accordance with IFRS as adopted by the EU. We intend this disclosure to assist readers in understanding and interpreting the financial statements of the Group included in this offering memorandum. The discussion should be read in conjunction with "Selected Historical Financial and Operating Data of the Group" and our consolidated financial statements and the accompanying notes appearing elsewhere in this offering memorandum. The following discussion contains certain forward-looking statements. We have based these forward-looking statements on our current projections and expectations about future events. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of many important factors including those set forth under "Risk Factors" and elsewhere in this offering memorandum.

References to "full year 2012", "full year 2011" and "full year 2010" or the "financial year 2012", "financial year 2011" and "financial year 2010" refer to the years ended 31 July 2012, 2011 and 2010, respectively.

Overview

We are a diversified global technology business serving the energy, medical device, detection, communications and engineered component markets. Our businesses are highly competitive with strong technology positions and operate in sectors we believe to have excellent opportunities for growth. The Group is organised into five divisions:

- *John Crane*, a leading provider of products and services for the major process industries, including oil and gas, power generation, chemical, pharmaceutical, pulp and paper and mining, which accounted for 31 per cent. of our revenue, 35 per cent. of our headline operating profit before corporate costs and 31 per cent. of our operating profit before corporate costs for the financial year 2011, and for 32 per cent. of our revenue, 36 per cent. of our headline operating profit before corporate costs and 36 per cent. of our operating profit before corporate costs for the financial year 2012;
- *Smiths Medical*, a supplier of specialist medical devices, consumables and equipment for global markets, which accounted for 30 per cent. of our revenue, 36 per cent. of our headline operating profit before corporate costs and 39 per cent. of our operating profit before corporate costs for the financial year 2011, and for 28 per cent. of our revenue, 35 per cent. of our headline operating profit before corporate costs and 41 per cent. of our operating profit before corporate costs for the financial year 2012;
- *Smiths Detection*, a leading designer and manufacturer of sensors that detect and identify explosives, narcotics, weapons, chemical agents, biohazards, nuclear and radioactive material and contraband, which accounted for 18 per cent. of our revenue, 12 per cent. of our headline operating profit before corporate costs and 14 per cent. of our operating profit before corporate costs for the financial year 2011, and for 17 per cent. of our revenue, 12 per cent. of our headline operating profit before corporate costs and 19 per cent. of our operating profit before corporate costs for the financial year 2012;
- *Smiths Interconnect*, a designer and manufacturer of electronic components and sub-systems that connect, protect and control critical systems for wireless telecommunication, aerospace, defence, space, test, medical, rail, data centre and industrial markets, which accounted for 13 per cent. of our revenue, 12 per cent. of our headline operating profit before corporate costs and 11 per cent. of our operating profit before corporate costs for the financial year 2011, and for 15 per cent. of our revenue, 11 per cent. of our headline operating profit before corporate costs and 8 per cent. of our operating profit before corporate costs for the financial year 2012; and
- *Flex-Tek*, a provider of engineered components that heat and move fluids and gases for the aerospace, medical, industrial, construction and domestic appliance markets, which accounted for 8 per cent. of our revenue, 5 per cent. of our headline operating profit before corporate costs and 6 per cent. of our operating profit before corporate costs for the financial year 2011, and for 8 per cent. of our revenue and 6 per cent. of our headline operating profit before corporate costs. Flex-Tek reported an operating loss of £16.7 million on a statutory basis for the financial year 2012.

We generated revenue of £3,030.1 million for the financial year 2012 compared with £2,842.0 million for the financial year 2011. Our operating profit decreased by 7.2 per cent. for the financial year 2012, to £406.6 million, compared to £438.0 million for the financial year 2011. Our profit for the period was £258.2 million for the financial year 2012 compared with £385.1 million for the financial year 2011.

Key Factors Affecting Results of Operations

The following is a discussion of the most significant factors that have affected, or are expected to affect, the financial condition and results of operations of the Group.

Exposure to foreign exchange movements

Our revenue and profit are impacted by currency exposure arising from the translation of results of our non-UK businesses that are denominated in foreign currencies into our reporting currency, pounds sterling. The majority of our translation exposure is to currency fluctuations between pounds sterling and US dollars, as four of our divisions are headquartered in the United States, we have substantial US operations and little of our revenue is generated in pounds sterling. We are also exposed to currency translation risk between pounds sterling and euros.

Our results are also impacted by foreign currency exposure arising from revenue or purchases by our businesses in currencies other than their functional currencies. Our transaction exposure is predominantly to currency fluctuations between pounds sterling and US dollars. However, we generate revenue and have a cost base in both pounds sterling and US dollars, which creates a natural hedge of some of this transaction risk. We also use forward foreign exchange contracts to minimise the risk that the profit generated from certain transactions will be affected by foreign exchange movements which occur after the price of the contract has been determined.

As a result of the global nature of our business, we expect to continue to be exposed to foreign currency fluctuations.

For further information on our foreign exchange risk and our hedging activities, please see "Risk Factors – Fluctuation in currency exchange and interest rates could have an adverse effect on our results of operations", "– Market Risk – Currency risk" below and note 20 to our consolidated financial statements for the financial year 2012.

Product innovation and evolution

Our capacity to improve our existing products and bring new products to market affects our ability to compete effectively, which has a significant impact on our results of operations.

In order to drive future growth through new product initiatives, we invest in targeted research and development, focusing on areas of higher growth potential. Our R&D expenditure is mostly self-funded, and partially government- and customer-funded. In our income statement, R&D funding is allocated to our divisions and R&D expenses are attributed to divisional level operating profit. We also capitalise and amortise certain expenditure incurred in respect of the development of major new products reasonably assessed to be viable and technically feasible over the estimated period of sale of each product commencing in the year that sales of the product are first made. All other research and development expenditure, other than amounts recoverable from third parties, is charged to the income statement in the year in which it occurs.

For further description of our R&D funding and expenditure including on development please see "Our Business – Research and Development".

Our approach to investment in improvements to existing products and in developing new products varies by division. Smiths Detection invests significantly in research and development as it needs to innovate to offer successive generations of technologically superior products to win large, periodic government tenders, particularly in the security market.

Demand for the products of our Smiths Medical division is driven by such factors as the ageing and other demographics of populations in the markets we serve, increased access to medical treatment in emerging markets, hospital budgets and regulation. In particular, current economic conditions have had an adverse effect on hospital capital budgets, which impacts Smiths Medical's hardware sales, although the market for its single use items, which is also affected, is considerably more stable. Smith Medical's revenues have been adversely affected as patients delay or cancel elective procedures due to the economic downturn and, especially in the United States, loss of health insurance.

Smiths Medical needs to design products that meet the specifications of various healthcare regulators, principally the United States Food and Drug Administration ("FDA") and to adapt its products to changes in regulations, which itself is a principal driver of product innovation and evolution. Moreover, Smiths Medical often benefits from an incumbent supplier advantage once its products are used at a particular hospital, as hospitals are often reluctant to switch suppliers once staff training has occurred and their staff gains a working knowledge of product use. Smiths Medical intellectual property rights allow it to benefit further from hospitals' reluctance to switch suppliers, as the majority of Smiths Medical's products are protected by intellectual property, and therefore competitors wanting to offer a similar, non-infringing product often must engineer around Smiths Medical's intellectual property, which requires them to present differently designed products to which hospital staff would be unaccustomed. However, this can act as a barrier to entry if a competitor of Smiths Medical is an incumbent supplier or has products protected by intellectual property rights. In addition, if regulations change, and one of Smiths Medical's products currently on the market no longer meets regulatory standards, Smiths Medical could have to invest in a potentially costly redesign of the product or else discontinue it.

John Crane has invested and continues to invest in incremental product innovation. This allows it to offer upgraded products to customers who have already made their initial investment in John Crane hardware, and therefore are more likely to purchase replacement or upgraded hardware from John Crane in order to ensure any new parts are compatible with their equipment. We believe that this serves as a significant barrier to entry for John Crane's competitors when John Crane's equipment has been initially chosen by a customer, although, similar to Smiths Medical, this also makes it more difficult for John Crane to sell products in the replacement market to companies which have initially chosen one of John Crane's competitors.

Government spending on defence, security and healthcare

Our results of operations, and in particular the results of our Smiths Detection division and our Smiths Interconnect division, are significantly affected by the level of government spending on security and defence programmes. Government investment in these areas is driven by the perception of security threats and governments' perceived need to secure their borders and protect their citizens.

Government contracts relating to the provision of security services, particularly in the area of ports and borders, are generally long term, increasingly large scale and awarded through competitive public tender and procurement processes. There is volatility in our revenues from such contracts in view of the number of projects, their size, and the fact that we may or may not be successful in our tender. Such volatility can lead to increases in our working capital requirements. Additionally, although Smiths Detection continues to see a healthy level of tender activity, we have observed continued delays and uncertainty in the timing of contracts and tender activities, particularly in the ports and borders area and in airport equipment outside the United States. During the financial years 2012 and 2011, capital spending constraints in some countries, in particular government budget reductions, most notably in the military sector, led to declines in revenue and adversely affected operating margins at Smiths Detection and Smiths Interconnect.

According to the terms of certain of our contracts with governments, including the US government, the government body that is our counterparty to the contract may terminate contracts at its convenience, terminate, reduce or modify contracts or subcontracts if its requirements or budgetary constraints change and cancel multi-year contracts and related orders if funds become unavailable. Recently in the United States, government military expenditure is returning to more normal funding levels following the easing of recent conflicts, and in addition both the Congress and President have proposed defence budgets that contain significant reductions compared to previous baselines. Similarly in Europe, several countries have proposed cutting military spending as part of austerity measures. If these reductions are enacted, the declining defence budgets may have a negative impact on our sales and the availability of new defence contracts.

The results of our Smiths Medical division are also affected, sometimes indirectly, by the level of government spending. This affects the level of hospital capital expenditure or, in some jurisdictions, directly impacts reimbursement pricing.

Capital goods investment in energy

Our results, in particular the results of our John Crane division, are affected by the investment in capital goods by customers in the energy sector. This is largely, but not exclusively, driven by the price of oil and gas. When natural resource prices are high, John Crane benefits from its customers' willingness to make capital investments in their businesses. However, if the price of crude oil decreases, some smaller players may defer or cancel their investments, although for the large energy companies, long term investments are not solely driven by short term volatility in the price of crude.

Funding of defined benefit pension plans

As a result of our retirement benefit arrangements, our cash flow and financial condition is affected by the performance of the investments (particularly equity investments), increased longevity of members and changes in valuation and funding assumptions. Under our defined benefit plans, we are committed to pay a defined level of benefits to plan participants, thereby bearing the risk that the plans' assets, such as investments in equity and debt securities, will not be sufficient to cover the value of those benefits. We may from time to time make additional voluntary contributions to our defined benefit pension plans and may need to engage in additional financing activities to do so. Further, 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. The value of the plans' assets is affected by, among other things, developments in the equity and bond markets.

At 31 July 2012, the Group had legacy defined benefit pension plans with aggregate liabilities in excess of £3.8 billion on an accounting basis. Our post retirement liabilities reported at 31 July 2012, including unfunded post retirement health care and unfunded pension plans, exceeded the post retirement assets by 620.2 million (£199 million at 31 July 2011), calculated in accordance with IFRS. We have taken steps to minimise this liability by closing the defined benefit schemes and capping obligations for post-retirement health benefits. The funding of the UK plans agreed at the last triennial actuarial review in 2009 included the requirement for a one off single payment of £50 million on 31 May 2012 as well as annual payments of £36 million, contingent payments of £16 million per annum and a further £24 million into an escrow account. For the financial year 2012, cash contributions to funded pension plans totalled £115.3 million not including the escrow account. For the financial year 2013, cash contributions to the scheme are expected to total approximately £90 million and a further £24 million into an escrow account. The next triennial reviews of the two principal UK Pension plans began in April 2012 and have valuation dates at 31 March 2012 and 5 April 2012. The triennial reviews may lead to larger pension funding requirements and subsequently further required pension contributions.

Restructuring

In September 2011, we announced the commencement of a performance improvement programme in Smiths Detection which is expected to cost approximately £40 million, of which £19.6 million was charged to operating profit for the financial year 2012 and £9 million is expected to be charged for the financial year 2013. The Smiths Detection performance improvement programme is expected to lead to annualised cost savings of approximately £40 million by the end of 2014 compared to the base in the financial year 2011.

Acquisitions and disposals

The following table shows the key acquisitions and disposals we made over the period under review together with their respective dates, price and Smiths Group division:

	Total Consideration *(million)*	Completion Date	Division
Financial Year 2010			
Acquisitions			
Channel Microwave	US$6.0	19 October 2009	Smiths Interconnect
Interconnect Devices Inc.	US$187.9	6 April 2010	Smiths Interconnect
Financial Year 2011			
Acquisitions			
Veecon IPA Gastechnik Limited[(1)]	£10.5	12 August 2010	Smiths Detection
SDBR Comercio de Equipamentos De Seguranca[(1)]	£15.8	12 May 2011	Smiths Detection
Disposal			
Product Inspection Division of Detection	£7.6	18 March 2011	Smiths Detection
Financial Year 2012			
Acquisition			
Turbo Components and Engineering	US$20.6	30 September 2011	John Crane
Power Holdings Inc.	US$241.9	11 October 2011	Smiths Interconnect
Disposal			
Equity interest in Cross Match Technologies Inc.[(1)]	US$70.0	16 July 2012	Smiths Detection

Note:

(1) The consideration listed includes an estimate of the value of contingent consideration.

We intend to continue to acquire new businesses or make dispositions in pursuit of our strategies to restructure our organisation and grow through bolt-on acquisitions as outlined at "Our Business – Strategy". In the event of a major disposal that generates significant cash proceeds, the Group may be required to make additional cash payments to our pension plans before we would be able to return any proceeds from such a disposition to shareholders.

Results from Operations

Consolidated income statement data

The following table presents selected consolidated income statement data for the financial years 2012, 2011 and 2010:

	Financial Year		
	2012	2011	2010
	(£ million, except per share data)		
Revenue	3,030.1	2,842.0	2,769.6
Operating profit	406.6	438.0	435.9
Finance costs[(1)]	(46.4)	(44.4)	(64.6)
Profit before taxation	365.9	397.9	373.1
Taxation	(107.6)	(91.8)	(78.9)
(Loss)/profit after taxation – discontinued operations	(0.1)	79.0	16.4
Profit for the period	258.2	385.1	310.6
Operating margin	13.4%	15.4%	15.7%
Headline operating profit margin[(2)]	18.2%	18.2%	17.8%

Notes:

(1) Finance costs include: interest receivable; interest payable, including on loans and overdrafts; other financing losses or gains, including net foreign exchange losses or gains, on hedging activities and the unwind of discounts and returns on plan assets and interest cost of retirement benefits.

(2) Headline operating profit margin is a non-GAAP measure and is defined as headline operating profit divided by revenue. See "– Headline operating profit and headline profit before taxation".

Financial year 2012 compared to financial year 2011

Revenue

Revenue was £3,030.1 million for the financial year 2012 as compared to £2,842.0 million for the financial year 2011, an increase of £188.1 million or 6.6 per cent. The net impact of acquisitions and disposals along with currency translation contributed £58.0 million. Excluding the effects of currency translation and acquisitions, revenue increased by 4.6 per cent., with all divisions showing increases in revenue.

Operating profit

Operating profit was £406.6 million for the financial year 2012 as compared to £438.0 million for the financial year 2011, a decrease of £31.4 million or 7.2 per cent. This decrease was primarily due a charge of £54.5 million made by Titeflex Corporation in respect of a provision to resolve potential future claims alleging product liability, partly offset by a profit of £26.8 million on the disposal of Cross Match Technologies, Inc.

Finance costs

Net finance costs were £46.4 million for the financial year 2012 as compared to £44.4 million for the financial year 2011, an increase of £2.0 million. This increase was primarily due to higher levels of net debt. Our total finance income was £205.2 million and our total finance costs were £251.6 million in the financial year 2012 compared to £200.2 million and £244.6 million, respectively, for the financial year 2011.

Profit before taxation

As a result of the factors described above, profit before taxation was £365.9 million for the financial year 2012 as compared to £397.9 million for the financial year 2011, a decrease of £32.0 million or 8.0 per cent.

Taxation

Our statutory tax charge was £107.6 million for the financial year 2012 as compared to £91.8 million for the financial year 2011, an increase of £15.8 million or 17.2 per cent. The increase was primarily because of the write-off of UK deferred tax assets of £37.7 million for the financial year 2012.

Profit after taxation – continuing operations

As a result of the factors described above, profit after taxation from continuing operations was £258.3 million for the financial year 2012 as compared to £306.1 million for the financial year 2011, a decrease of £47.8 million or 15.6 per cent.

Profit after taxation – discontinued operations

We had a loss after taxation from discontinued operations of £0.1 million for the financial year 2012 as compared to a profit of £79.0 million for the financial year 2011, a decrease of £79.1 million. The discontinued operations refer to our Aerospace operations which we disposed of in 2007, and the subsequent movements are a result of post disposal costs and provision movements, including foreign exchange movements on US$ denominated balances. In the financial year 2011, profits arose from the resolution and time barring of certain disposal indemnities.

Profit for the period

As a result of the factors described above, profit for the period was £258.2 million for the financial year 2012 as compared to £385.1 million for the financial year 2011, a decrease of £126.9 million or 33.0 per cent.

Financial year 2011 compared to financial year 2010

Revenue

Revenue was £2,842.0 million for the financial year 2011 as compared to £2,769.6 million for the financial year 2010, an increase of £72.4 million or 2.6 per cent. The net impact of acquisitions and disposals had a positive effect of £45.0 million, partly offset by adverse currency translation on overseas sales of £2.3 million. Excluding the effects of currency translation and acquisitions, revenue increased by £29.7 million, primarily due to the increased revenue generated by John Crane, Smiths Interconnect and Flex-Tek which was partly offset by declines in revenues in Smiths Detection and Smiths Medical.

Operating profit

Operating profit was £438.0 million for the financial year 2011 as compared to £435.9 million for the financial year 2010, an increase of £2.1 million or 0.5 per cent. This increase was partially due to increased operating profit in John Crane, Smiths Medical and Flex-Tek, partially offset by lower profit in Smiths Detection and Smiths Interconnect.

Finance costs

Net finance costs were £44.4 million for the financial year 2011 as compared to £64.6 million for the financial year 2010, a decrease of £20.2 million. This decrease was primarily due to lower average levels of debt and an increase in Other Financing Income – Retirement Benefits from £2.3 million in 2010 to £23.3 million in 2011, which reflected the higher funding position of our retirement benefits scheme at 1 August 2010 compared to the position at 1 August 2009. Our total finance income was £200.2 million and our total finance costs were £244.6 million in the financial year 2011 compared to £187.3 million and £251.9 million, respectively, for the financial year 2010.

Profit before taxation

As a result of the factors described above, profit before taxation for the financial year 2011 was £397.9 million as compared to £373.1 million for the financial year 2010, an increase of £24.8 million or 6.6 per cent.

Taxation

Our statutory tax charge was £91.8 million for the financial year 2011 as compared to £78.9 million for the financial year 2010. This increase was primarily due to higher taxable profits in 2011 over 2010 and underlying changes in the profit mix across our countries of operation.

Profit after taxation – continuing operations

As a result of the factors described above, profit after taxation from continuing operations was £306.1 million for the financial year 2011 as compared to £294.2 million for the financial year 2010, an increase of £11.9 million or 4.0 per cent.

Profit after taxation – discontinued operations

Profit after taxation from discontinued operations was £79.0 million for the financial year 2011 as compared to £16.4 million for the financial year 2010, an increase of £62.6 million or 381.7 per cent. This increase reflects the resolution and time barring of certain disposal indemnities in connection with the disposal of our Aerospace operations, completed on 5 May 2007.

Profit for the period

As a result of the factors described above, profit for the financial year 2011 was £385.1 million as compared to £310.6 million for the financial year 2010, an increase of £74.5 million or 24.0 per cent.

Headline operating profit and headline profit before taxation

We seek to present measures of underlying financial performance which are not impacted by exceptional items or items we consider non-operational. We call these measures "headline" and use them to measure and monitor our performance. The following principal items included in operating profit and profit before taxation, have been excluded from headline operating profit and headline profit before taxation:

- exceptional items, including income and expenditure relating to material litigation in respect of products no longer in production;
- the amortisation and impairment of intangible assets acquired in a business combination; other financing gains and losses, which may be volatile, and are not subject to hedge accounting under IAS 39; and
- with effect from 1 August 2011, financing credits and charges relating to retirement benefits.

"Headline" performance measures are non-GAAP measures that are not recognised as measures of financial performance under IFRS. Investors should not place undue reliance on these non-GAAP measures and should not consider these measures as an alternative to operating profit and profit before taxation as determined in accordance with IFRS. These measures are not indicative of our historical results of operations, nor are they meant to be predictive of future results. In addition, our use of "headline" operating profit may vary from other companies due to differences in accounting policies or differences in the calculation methodology of headline operating profit or headline profit before taxation by other companies.

We have included a reconciliation of headline operating profit to operating profit for each of our divisions in our discussion of our results of operation by segment below. The following tables present the reconciliation of headline operating profit to operating profit and headline profit before taxation to profit before taxation for the financial years 2012, 2011, and 2010:

Reconciliation of headline operating profit to operating profit

	Financial Year		
	2012	**2011**	**2010**
		(£ million)	
Headline Operating Profit	553.7	516.9	492.4
Restructuring programmes	(15.4)	(15.7)	(8.2)
Cost of acquisitions	(2.0)	(1.5)	(1.3)
Adjustment to contingent consideration provided on acquisitions	2.4	—	—
Sale of diabetes patents/release of diabetes provision	0.6	1.5	—
Gains on change of post retirement benefits	—	10.2	3.9
Revision of estimated rebates	(7.8)	—	—
Profit on disposal of business	30.8	4.4	3.3
Profit on disposal of property	—	—	5.5
Litigation			
Provision for John Crane, Inc. litigation	(39.6)	(28.3)	(17.6)
Provision for Titeflex Corporation subrogation claims	(54.5)	—	—
Amortisation and impairment of acquired intangible assets	(61.6)	(49.5)	(42.1)
Operating profit	406.6	438.0	435.9

Reconciliation of headline profit before tax to profit before tax

	Financial Year		
	2012	2011	2010
	(£ million, except per share data)		
Headline profit before tax[(1)]	496.8	486.0	435.0
Restructuring programmes	(15.4)	(15.7)	(8.2)
Cost of acquisitions	(2.0)	(1.5)	(1.3)
Adjustment to contingent consideration provided on acquisitions	2.4	—	—
Sale of diabetes patents/release of diabetes provision	0.6	1.5	—
Gains on change of post retirement benefits	—	10.2	3.9
Revision of estimated rebates	(7.8)	—	—
Profit on disposal of business	30.8	4.4	3.3
Profit on disposal of property	—	—	5.5
Litigation			
Provision for John Crane, Inc. litigation	(39.6)	(28.3)	(17.6)
Provision for Titeflex Corporation subrogation claims	(54.5)	—	—
Amortisation and impairment of acquired intangible assets	(61.6)	(49.5)	(42.1)
Other financing losses	(7.3)	(9.2)	(5.4)
Other finance income – retirement benefits[(1)]	23.5	—	—
Profit before tax	365.9	397.9	373.1

Note:

(1) For the financial year 2012, the definition of headline profit before taxation was amended to exclude financing credits and charges relating to retirement benefits. This financing credit ('Other finance income – retirement benefits') was £23.5 million in the financial year 2012. The comparative periods have not been restated in the table above and have been taken from previously published financial information. The Other finance income – retirement benefits income for the financial year 2011 was £23.3 million and £2.3 million for the financial year 2010. "Headline" performance measures are non-GAAP measures that are not recognised as measures of financial performance under IFRS. Investors should not place undue reliance on these non-GAAP measures and should not consider these measures as an alternative to operating profit and profit before taxation as determined in accordance with IFRS. These measures are not indicative of our historical results of operations, nor are they meant to be predictive of future results.

Headline operating profit was £553.7 million for the financial year 2012 as compared to £516.9 million in the financial year 2011, an increase of £36.8 million or 7.1 per cent. This increase is primarily due to increased operating profits at all divisions except Smiths Interconnect.

Headline operating profit was £516.9 million for the financial year 2011 as compared to £492.4 million for the financial year 2010, an increase of £24.5 million or 5.0 per cent. This increase was primarily due to John Crane, Smiths Medical and Flex-Tek's growth in headline operating profit, partly offset by a decrease in headline operating profit in Smiths Detection and Smiths Interconnect.

Results of operations by segments

Financial year 2012 compared to financial year 2011

The following table presents selected income data for our business segments for the financial years 2012 and 2011:

	Financial Year	
	2012	2011
	(£ million)	
Revenue		
John Crane	973.4	893.9
Smiths Medical	855.8	838.4
Smiths Detection	519.2	509.9
Smiths Interconnect	448.5	379.0
Flex-Tek	233.2	220.8
Total Revenue	3,030.1	2,842.0
Operating profit/(loss)		
John Crane	155.0	143.3
Smiths Medical	179.5	178.0
Smiths Detection	83.8	64.0
Smiths Interconnect	34.0	49.0
Flex-Tek	(16.7)	25.8
Corporate	(29.0)	(22.1)
Total	406.6	438.0
Headline operating profit		
John Crane	209.9	188.7
Smiths Medical	202.5	196.2
Smiths Detection	69.1	65.5
Smiths Interconnect	66.0	67.6
Flex-Tek	38.0	27.6
Corporate	(31.8)	(28.7)
Total	553.7	516.9

	Financial Year	
	2012	2011
	(%)	
Headline operating profit margin		
John Crane	21.6	21.1
Smiths Medical	23.5	23.4
Smiths Detection	13.3	12.8
Smiths Interconnect.	14.7	17.8
Flex-Tek	16.3	12.5
Total	**18.2**	**18.2**

	Financial Year	
	2012	2011
	(%)	
Operating profit margin		
John Crane	15.9	16.0
Smiths Medical	21.0	21.2
Smiths Detection	16.1	12.6
Smiths Interconnect.	7.6	12.9
Flex-Tek	(7.2)	11.7
Total	13.4	**15.4**

John Crane

Revenue for John Crane was £973.4 million for the financial year 2012 as compared to £893.9 million for the financial year 2011, an increase of £79.5 million or 8.9 per cent. This increase was primarily due to higher sales for first-fit original equipment and increased aftermarket revenue across all end markets, particularly oil, gas and petrochemical sectors. Revenue was also affected by a £6.0 million benefit from the acquisition of the business of Turbo Components and Engineering Inc., completed in October 2011 offset by £6.0 million of adverse currency translation.

The following table presents a reconciliation of headline operating profit to operating profit for John Crane for the financial years 2012 and 2011:

	Financial Year	
	2012	**2011**
	(£ million)	
Headline operating profit	209.9	188.7
Restructuring programme	—	(2.6)
Costs of acquisitions	(0.3)	—
John Crane, Inc. litigation provision	(39.6)	(28.3)
Amortisation of acquired intangible assets	(15.0)	(14.5)
Operating profit	155.0	143.3

Headline operating profit for John Crane was £209.9 million for the financial year 2012 as compared to £188.7 million for the financial year 2011, an increase of £21.2 million or 11.3 per cent. This increase was primarily due to increased volumes, benefits from cost-saving initiatives and improved pricing on aftermarket sales. These were partly offset by investment in lower margin original equipment projects which are expected to deliver long-term aftermarket revenue.

Operating profit for John Crane was £155.0 million for the financial year 2012 as compared to £143.3 million for the financial year 2011, an increase of £11.7 million or 8.2 per cent. This increase was primarily due to the factors set out in the discussion of John Crane's headline operating profit above, which were partly offset by a charge of £39.6 million in respect of the John Crane, Inc. asbestos litigation provision, comprising £28.3 million in respect of increased provision for adverse legal judgments and legal defence costs, £0.9 million in respect of legal fees in connection with litigation against insurers and £10.4 million arising from the reduction in US treasury rates, compared to a charge of £28.3 million in the financial year 2011 comprising £15.4 million in respect of increase provision for adverse legal judgments and legal defence costs and £1.0 million in respect of legal fees in connection with litigation against insurers and £11.9 million from movements in discounting.

Smiths Medical

Revenue for Smiths Medical was £855.8 million for the financial year 2012 as compared to £838.4 million for the financial year 2011, an increase of £17.4 million or 2.1 per cent. Excluding a £5.7 million gain from foreign currency translation, revenue grew by £11.7 million or 1.4 per cent. This increase resulted from new product launches, particularly Medfusion 4000 and CADD Solis PIB and VIP infusion pumps, as well as emerging market growth. Revenue for the financial year 2012 is stated after an exceptional charge of £7.8 million for the revision of estimated rebates to distributors.

The following table presents a reconciliation of headline operating profit to operating profit for Smiths Medical for the financial years 2012 and 2011:

	Financial Year	
	2012	2011
	(£ million)	
Headline operating profit	202.5	196.2
Revision of estimated rebates	(7.8)	—
Restructuring programme	(1.6)	(3.1)
Sale of diabetes patents/release of diabetes provision	0.6	1.5
Amortisation of acquired intangible assets	(14.2)	(16.6)
Operating profit	179.5	178.0

Headline operating profit for Smiths Medical was £202.5 million for the financial year 2012 as compared to £196.2 million for the financial year 2011, an increase of £6.3 million or 3.2 per cent. In addition to favourable product mix, this increase was due to efficiencies through lower overheads, manufacturing savings and value engineering as well as a favourable impact from foreign exchange movements.

Operating profit for Smiths Medical was £179.5 million for the financial year 2012 as compared to £178.0 million for the financial year 2011, an increase of £1.5 million or 0.8 per cent. This increase was primarily due to the factors set out in the discussion of Smiths Medical's headline operating profit above, as well as the effect of a £7.8 million one-off charge reflecting Smiths Medical's decision to change the historical basis for estimating the accrual for rebates to distributors.

Smiths Detection

Revenue for Smiths Detection was £519.2 million for the financial year 2012 as compared to £509.9 million for the financial year 2011, an increase of £9.3 million or 1.8 per cent. This increase was primarily due to growth in transportation, critical infrastructure and ports and borders which more than offset declines in the military sector. A £1.2 million gain from foreign currency translation was offset by a £8.0 million net decrease from acquisitions and disposals.

The following table presents a reconciliation of headline operating profit to operating profit for Smiths Detection for the financial years 2012 and 2011:

	Financial Year	
	2012	**2011**
	(£ million)	
Headline operating profit	69.1	65.5
Restructuring programme	(12.6)	(2.3)
Profit on disposal of business	26.9	2.7
Acquisition costs	—	(0.7)
Adjustment to contingent consideration provided on acquisitions	1.8	—
Amortisation of acquired intangible assets	(1.4)	(1.2)
Operating profit	83.8	64.0

Headline operating profit for Smiths Detection was £69.1 million for the financial year 2012 as compared to £65.5 million for the financial year 2011, an increase of £3.6 million or 5.6 per cent. This increase was a result of cost savings from the performance improvement programme, which 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.

Operating profit for Smiths Detection was £83.8 million for the financial year 2012 as compared to £64.0 million for the financial year 2011, an increase of £19.8 million or 30.9 per cent. This increase was due to the factors set out in the discussion of Smiths Detection's headline operating profit above as well as profit on disposal of the equity in Cross Match Technologies, Inc. of £26.8 million offset in part by the higher costs of exceptional restructuring charges of £12.6 million.

Smiths Interconnect

Revenue for Smiths Interconnect was £448.5 million for the financial year 2012 as compared to £379.0 million for the financial year 2011, an increase of £69.5 million or 18.3 per cent. This increase was primarily due to the acquisition of Power Holdings Inc. Excluding the benefit of the acquisition and the effects of exchange translation, revenue rose by £12.6 million despite challenging market conditions, particularly in Connectors and Power.

The following table presents a reconciliation of headline operating profit to operating profit for Smiths Interconnect for the financial years 2012 and 2011:

	Financial Year	
	2012	2011
	(£ million)	
Headline operating profit	66.0	67.6
Costs of acquisition	(1.7)	(0.8)
Adjustment to contingent consideration provided on acquisitions	0.5	—
Restructuring programme	—	(0.6)
Amortisation and impairment of acquired intangible assets	(30.8)	(17.2)
Operating profit	34.0	49.0

Headline operating profit for Smiths Interconnect was £66.0 million for the financial year 2012 as compared to £67.6 million for the financial year 2011, a decrease of £1.6 million or 2.4 per cent. The underlying decrease of £6.4 million was primarily due to lower volumes and the operational gearing, particularly in Connectors, caused by the challenge of reducing the cost base to address decreased revenue from the military sector. Associated headcount reductions were made in several facilities and one manufacturing plant was closed. The underlying decrease was partly offset by favourable currency translation and the contribution from Power Holdings Inc.

Operating profit for Smiths Interconnect was £34.0 million for the financial year 2012 as compared to £49.0 million for the financial year 2011, a decrease of £15.0 million or 30.6 per cent. This decrease was primarily due to the factors set out in the discussion of Smiths Interconnect's headline operating profit above as well as acquisition costs of £1.7 million related to Power Holdings Inc., increased amortisation costs and an impairment charge of £10.7 million in respect of Power Holdings Inc.

Flex-Tek

Revenue for Flex-Tek was £233.2 million for the financial year 2012 as compared to £220.8 million for the financial year 2011, an increase of £12.4 million or 5.6 per cent. This increase was primarily due to growth in the Fluid Management sector, countered somewhat by contraction in the Heat Solutions sector.

The following table presents a reconciliation of headline operating profit to operating profit for Flex-Tek for the financial years 2012 and 2011:

	Financial Year	
	2012	2011
	(£ million)	
Headline operating profit	38.0	27.6
Titeflex Corporation subrogation claims	(54.5)	—
Restructuring programme	—	(1.8)
Amortisation of acquired intangible assets	(0.2)	—
Operating (loss)/profit	(16.7)	25.8

Headline operating profit for Flex-Tek was £38.0 million for the financial year 2012 as compared to £27.6 million for the financial year 2011, an increase of £10.4 million or 37.5 per cent. This increase was due to increased revenue, the impact of cost initiatives and the reclassification of Titeflex Corporation subrogation claims, which in the financial year 2011 were treated as a charge to headline operating profits.

Operating loss for Flex-Tek was £16.7 million for the financial year 2012 as compared to an operating profit of £25.8 million for the financial year 2011, a decrease of £42.5 million. This decrease was due to the establishment of a provision to resolve future claims alleging product liability against Titeflex Corporation.

Financial years 2011 and 2010

The following table presents selected income data for our business segments for the financial years 2011 and 2010:

	Financial Year	
	2011	2010
	(£ million)	
Revenue		
John Crane	893.9	786.1
Smiths Medical	838.4	857.6
Smiths Detection	509.9	574.1
Smiths Interconnect	379.0	339.9
Flex-Tek	220.8	211.9
Total	2,842.0	2,769.6
Operating profit		
John Crane	143.3	124.2
Smiths Medical.	178.0	172.3
Smiths Detection	64.0	89.2
Smiths Interconnect	49.0	52.8
Flex-Tek	25.8	21.2
Corporate	(22.1)	(23.8)
Total	438.0	435.9
Headline operating profit		
John Crane	188.7	162.7
Smiths Medical	196.2	184.2
Smiths Detection	65.5	89.9
Smiths Interconnect	67.6	61.9
Flex-Tek	27.6	23.5
Corporate	(28.7)	(29.8)
Total	516.9	492.4

	Financial Year	
	2011	2010
Headline operating profit margin		
John Crane	21.1	20.7
Smiths Medical	23.4	21.5
Smiths Detection	12.8	15.7
Smiths Interconnect	17.8	18.2
Flex-Tek	12.5	11.1
Total	18.2	17.8

	Financial Year	
	2011	2010
	(%)	
Operating profit margin		
John Crane	16.0	15.8
Smiths Medical	21.2	20.1
Smiths Detection	12.6	15.5
Smiths Interconnect	12.9	15.5
Flex-Tek	11.7	10.0
Total	15.4	15.7

Financial year 2011 compared to financial year 2010

John Crane

Revenue for John Crane was £893.9 million for the financial year 2011 as compared to £786.1 million for the financial year 2010, an increase of £107.8 million or 13.7 per cent. This increase was primarily due to an increase in orders for first-fit original equipment and aftermarket sales across all end markets but particularly from the oil, gas and petrochemical sectors. Sales for John Crane Production Solutions, our upstream energy services business, increased 68 per cent. as a result of higher activity levels in US onshore gas and oil production and the full year effect of a contract to upgrade and maintain Petrom's wells in Romania.

The following table presents a reconciliation of headline operating profit to operating profit for John Crane for the financial years 2011 and 2010:

	Financial Year	
	2011	2010
	(£ million)	
Headline operating profit	188.7	162.7
Loss on disposal of business	—	(0.5)
Litigation:		
Provision for John Crane, Inc. asbestos litigation	(28.3)	(17.6)
Restructuring	(2.6)	(4.2)
Amortisation of acquisition intangibles	(14.5)	(16.2)
Operating profit	143.3	124.2

Headline operating profit for John Crane was £188.7 million for the financial year 2011 as compared to £162.7 million for the financial year 2010, an increase of £26.0 million or 15.9 per cent. The increased profitability was affected by increased revenues, benefits from on-going cost-saving initiatives and improved pricing on aftermarket sales as well as a £1.0 million benefit from foreign currency translation.

Operating profit for John Crane was £143.3 million for the financial year 2011 as compared to £124.2 million for the financial year 2010, an increase of £19.1 million. Operating profit was affected by the factors set out in the discussion of John Crane's headline operating profit above and by increased charges related to defending the John Crane, Inc. asbestos litigation.

Smiths Medical

Revenue for Smiths Medical was £838.4 million for the financial year 2011 as compared to £857.6 million for the financial year 2010, a decrease of £19.2 million or 2.2 per cent. After a benefit of £2.9 million from foreign currency translation, the decline in revenue of £22.1 million or 2.6 per cent. reflected the overall economic conditions, in particular unemployment and a slowdown in procedure growth rates in the United States and Europe. This decrease was also due to the portfolio management initiatives taken over the period, including an exit from the diabetes market and declines in other product lines such as patient monitoring, kitting and interventional imaging.

The following table presents a reconciliation of headline operating profit to operating profit for Smiths Medical for financial years 2011 and 2010:

	Financial Year	
	2011	2010
	(£ million)	
Headline operating profit	196.2	184.2
Restructuring	(3.1)	(0.1)
Release of diabetes provision	1.5	—
Profit on sale of property	—	5.5
Amortisation of acquisition intangibles	(16.6)	(17.3)
Operating profit	178.0	172.3

Headline operating profit for Smiths Medical was £196.2 million for the financial year 2011 as compared to £184.2 million for the financial year 2010, an increase of £12.0 million or 6.5 per cent. This increase reflects profit growth of £13.4 million before an adverse currency translation of £1.3 million. The increase was due to ongoing initiatives to reduce overheads and manufacturing costs, as well as portfolio profitability reviews.

Operating profit for Smiths Medical was £178.0 million for the financial year 2011 as compared to £172.3 million for the financial year 2010, an increase of £5.7 million or 3.3 per cent. This increase was primarily due to the factors set out in the discussion of Smiths Medical's headline operating profit above, offset by higher restructuring costs.

Smiths Detection

Revenue for Smiths Detection was £509.9 million for the financial year 2011 as compared to £574.1 million for the financial year 2010, a decrease of £64.2 million or 11.2 per cent. This decrease was caused by an adverse currency effect of £3.8 million, offset by a benefit from acquisitions and disposals of £12.2 million. Excluding these impacts, revenue fell by 12.7 per cent. This decrease in revenue was driven primarily by lower revenue from the military market as a result of a cyclical transition between mature and new programmes, as well as the return of US government's military expenditure to more normal levels following the easing of recent conflicts. There were smaller declines in other sectors, offsetting strong growth in the critical infrastructure segment. The following table presents a reconciliation of headline operating profit to operating profit for Smiths Detection for financial years 2011 and 2010:

	Financial Year	
	2011	**2010**
	(£ million)	
Headline operating profit	65.5	89.9
Profit on disposal of business	2.7	—
Costs of acquisitions	(0.7)	(0.3)
Restructuring	(2.3)	—
Amortisation of acquired intangible assets	(1.2)	(0.4)
Operating profit	64.0	89.2

Headline operating profit for Smiths Detection was £65.5 million for the financial year 2011 as compared to £89.9 million for the financial year 2010, a decrease of £24.4 million or 27.2 per cent. Decreased sales volumes and their effect on operational gearing was the principal cause of the decrease.

Operating profit for Smiths Detection was £64.0 million for the financial year 2011 as compared to £89.2 million for the financial year 2011, a decrease of £25.2 million or 28.3 per cent. This decrease was primarily due to the factors set out in the discussion of Smiths Detection's headline operating profit above.

Smiths Interconnect

Revenue for Smiths Interconnect was £379.0 million for the financial year 2011 as compared to £339.9 million for the financial year 2010, an increase of 39.1 million or 11.5 per cent. Acquisitions contributed £33.0 million and currency translation had a negative effect on revenue of £2.6 million. The remaining increase was primarily due to growth in the medical, rail, automation and test markets offsetting decreased revenues from the military and aerospace market, particularly in the second half of the year when the US Department of Defense budgetary cutbacks and the associated continuing resolution passed by the US Congress in April 2011 affected demand. The following table presents a reconciliation of headline operating profit to operating profit for Smiths Interconnect for financial years 2011 and 2010:

	Financial Year	
	2011	**2010**
	(£ million)	
Headline operating profit	67.6	61.9
Costs of acquisitions	(0.8)	(0.9)
Restructuring programmes	(0.6)	—
Amortisation and impairment of acquired intangible assets	(17.2)	(8.2)
Operating profit	49.0	52.8

Headline operating profit for Smiths Interconnect was £67.6 million for the financial year 2011 as compared to £61.9 million for the financial year 2010, an increase of £5.7 million or 9.2 per cent. Excluding the impact of currency translation and acquisitions, headline operating profit decreased by 2 per cent. The decrease was primarily driven by the difficulty of adjusting the cost base to address the lower military sales caused by the Continuing Resolution and slightly weaker gross margins due to sales mix and pricing pressure.

Operating profit for Smiths Interconnect was £49.0 million for the financial year 2011 as compared to £52.8 million for the financial year 2010, a decrease of £3.8 million or 7.2 per cent. The decrease was primarily due to the factors discussed in headline operating profit above as well as an impairment of acquired intangible assets taken in 2011 and increased amortisation with the acquisition of Interconnect Devices Inc.

Flex-Tek

Revenue for Flex-Tek was £220.8 million for the financial year 2011 as compared to £211.9 million for the financial year 2010, an increase of £8.9 million or 4.2 per cent. Excluding a £2.8 million decline from foreign exchange translation, this increase was primarily due to an increase in sales in the OEM aerospace market and the US residential construction sector.

The following table presents a reconciliation of headline operating profit to operating profit for Flex-Tek for the financial years 2011 and 2010:

	Financial Year	
	2011	2010
	(£ million)	
Headline operating profit	27.6	23.5
Restructuring programme	(1.8)	(2.3)
Operating profit	25.8	21.2

Headline operating profit for Flex-Tek was £27.6 million for the financial year 2011 as compared to £23.5 million for the financial year 2010, an increase of £4.1 million or 17.5 per cent. This increase was primarily due to an increase in sales, operational gearing from our prior restructurings and price increases which helped to offset raw material inflation.

Operating profit for Flex-Tek was £25.8 million for the financial year 2011 as compared to £21.2 million for the financial year 2010, an increase of £4.6 million or 21.7 per cent. This increase was due to the factors set out in the discussion of Flex-Tek's headline operating profit above.

Liquidity and Capital Resources

Our principal source of liquidity has been, and is expected to continue to be, cash generated from operations, together with short-and long-term borrowings. Our recent principal liquidity requirements have been for working capital, capital expenditure, interest and tax payments, acquisitions and dividends.

Cash and financing policy

We manage our liquidity and financing strategy on a centralised basis. We set policies regarding debt, liquidity, interest rate, currency and counterparty risk. We have cash management systems in place to minimise idle liquidity in the Group and to minimise short term borrowings at Group level.

We determine our financing policies with the aim of maintaining an investment grade credit rating over the medium term. Our financial policy objectives going forward include: keeping net debt levels, excluding the pension deficit, at less than two times headline EBITDA; maintaining a cash conversion rate of at least 90 per cent. of our headline operating profit; maintaining more than £200 million of net undrawn committed bank facilities at any time; ensuring our gross debt has an average life of more than four years; and ensuring that at least 70 per cent. of our net debt is from the public capital markets.

Our financing priorities currently include extending maturity profiles by proactively refinancing capital markets maturities with new issues with the objective of maintaining at all times an average maturity profile of more than four years. We continue to match the currency of our long term assets and liabilities to our funding by securing sources of funding in US dollars, euros and other currencies. These objectives are forward-looking and are based on numerous assumptions which, although believed to be reasonable, may prove not to be accurate. These priorities and objectives are not guarantees and our actual results could differ materially from our expressed objectives.

Cash flow analysis

	Financial Year		
	2012	2011	2010
		(£ million)	
Net cash generated from operating activities	331.5	321.7	410.5
Net cash (used in) investing activities	(235.0)	(106.7)	(191.1)
Net cash (used in) financing activities	(151.5)	(129.2)	(66.1)
Net (decrease)/increase in cash and cash equivalents	(55.0)	85.8	153.3
Cash and cash equivalents at the beginning of the period	260.7	172.2	19.7
Exchange differences	(2.0)	2.7	(0.8)
Cash and cash equivalents at the end of the period	(203.7)	260.7	172.2

Net cash flow from operating activities

Net cash inflow from operating activities was £331.5 million for the financial year 2012 as compared to £321.7 million for the financial year 2011, an increase of £9.8 million. This increase was primarily due to lower investment in working capital. However, company contributions to funded defined benefit pension plans for the financial year 2012 were £115.3 million as compared to £63.7 million for the financial year 2011. The increase was principally due to a single payment of £50 million to one of the principal UK pension plans.

Net cash inflow from operating activities was £321.7 million for the financial year 2011 as compared to £410.5 million for the financial year 2010, a decrease of £88.8 million or 21.6 per cent. This decrease was primarily due to higher investment in working capital than in the financial year 2010, which had benefited from one off initiatives. Company contributions to funded defined benefit pension plans for the financial year 2011 were £63.7 million as compared to £50.8 million for the financial year 2010.

In the financial year 2012, net debt increased by £62.4 million to £791.4 million. This was principally caused by the increase in operating cash generation in the year which was more than offset by the cash spent on acquisitions.

The following table presents our net debt for the financial years 2012, 2011 and 2010:

	Full Year		
	2012	**2011**	**2010**
		(£ million)	
Cash and cash equivalents			
Net cash and deposits	205.6	261.1	172.9
Short-term borrowings			
Bank overdrafts including impact of cash pooling gross up	(1.9)	(0.4)	(0.7)
$250 million 5.45% US$ Private placement 2013	(161.7)	—	—
Bank and other loans	(1.2)	(1.3)	(1.3)
Interest accrual	(10.5)	(10.1)	(12.7)
	(175.3)	(11.7)	(14.7)
Long-term borrowings			
$250 million 5.45% US$ Private placement 2013	—	(158.3)	(169.1)
$250 million 6.05% US$ Guaranteed notes 2014	(159.1)	(151.4)	(158.3)
£150 million 7.25% Sterling Eurobond 2016	(149.4)	(149.3)	(149.1)
€300 million 4.125% Eurobond 2017	(240.9)	(260.2)	(247.6)
$175 million 7.37% US$ Private placement 2018	(111.6)	(106.4)	(111.4)
$250 million 7.20% US$ Guaranteed notes 2019	(158.5)	(151.0)	(158.0)
Bank and other loans	(2.2)	(1.8)	(1.5)
	(821.7)	(978.4)	(995.0)
Borrowings	(997.0)	(990.1)	(1,009.7)
Net debt[(1)]	(791.4)	(729.0)	(836.8)

Note:
(1) The net debt figure includes accrued interest and the fair value adjustments relating to hedge accounting.

Net cash flow used in investing activities

Cash flow used in investing activities was £235.0 million for the financial year 2012 as compared to £106.7 million for the financial year 2011, an increase of £128.3 million. This increase was primarily due to expenditure on acquisitions and investment in financial assets as part of the funding arrangements for the UK retirement benefit schemes.

Cash flow used in investing activities was £106.7 million for the financial year 2011 as compared to £191.1 million for the financial year 2010, a decrease of £84.4 million. This decrease was primarily due to reduced spending on acquisitions.

Net cash flows used in financing activities

Cash flow used in financing activities was £151.5 million for the financial year 2012 as compared to cash flow used in financing activities of £129.2 million for the financial year 2011, an increase of £22.3 million. This increase was primarily due to increased dividends and lower proceeds from share capital issues.

Cash flow used in financing activities was £129.2 million for the financial year 2011 as compared to £66.1 million for the financial year 2010, an increase of £63.1 million. This increase was primarily due to reduced borrowings.

Capital expenditures

The following table presents our capital expenditures relating only to continuing activities for the financial years 2012, 2011 and 2010:

	2012	2011	2010
		(£ million)	
Development[1]	28.5	31.0	24.3
Intangible Assets	13.5	10.2	7.6
PP&E	50.1	49.3	47.0
Total	92.1	90.5	78.9

Note:

(1) Development consists of our capital investment in new product development.

In the financial year 2012, we made capital expenditures of £92.1 million. The capitalised development spend included major projects in x-ray development (Smiths Detection) and infusion development (Smiths Medical). The investment in PP&E included capacity expansion at John Crane.

In the financial year 2011, we made capital expenditures of £90.5 million. The capitalised development spend included major projects in x-ray development (Smiths Detection) and infusion development (Smiths Medical). The investment in PP&E included capacity expansion in John Crane and machinery for new safety products in Smiths Medical.

In the financial year 2010, we made capital expenditures of £78.9 million. The capitalised development spend included new products in x-ray technology (Smiths Detection) and infusion development (Smiths Medical). The investment in PP&E included facility expansions and tooling and equipment for new products.

We estimate that capital expenditures in 2013 and 2014 will be approximately equal to the annual depreciation and amortisation charge for such years. Our depreciation and amortisation charge for the financial year 2012 (excluding amortisation in respect of intangible assets acquired through business combinations) was £91.2 million.

Borrowings and contractual commitments

The following table presents our contractual commitments in respect of borrowings and leases as at 31 July 2012:

	up to 1 year	1-2 years	2-3 years	3-4 years	4-5 years	Greater than 5 years	Total
				(unaudited) *(£ million)*			
Long-term borrowings[1]	39.6	210.9	41.4	190.3	265.0	302.4	1,049.6
Short-term borrowings	178.5	—	—	—	—	—	178.5
Operating lease obligations[2]	39.4	30.3	19.9	14.7	12.7	12.6	129.6
Total	257.5	241.2	61.3	205.0	277.7	315.0	1,357.7

Notes:

(1) Interest commitments have been calculated before accounting for interest rate swaps.

(2) Operating lease obligations are stated as at 31 July 2012, and the split of the leases between two and five years has been estimated.

The following describes the terms of our material long-term indebtedness.

5.45 per cent. US$ Private Placement due 2013

On 28 January 2003, Smiths Group PP, Inc., a subsidiary of Smiths Group plc incorporated in Delaware, issued US$250 million 5.45 per cent. Guaranteed Senior Notes in a private placement. The notes will mature on 28 January 2013. The notes are guaranteed by Smiths Group plc.

The terms of the notes contain a negative pledge, cross default and optional prepayment provisions.

The terms of the notes contain financial covenants that require Smiths Group plc, to ensure (i) a minimum ratio of profit before interest to net borrowing costs of not less than 3.0 to 1.0 for any 12-month period ending on the last day of its financial year or on the last day of the first six-month period of any such financial year, and (ii) that its net borrowings do not exceed 125 per cent. of gross shareholders' funds.

The notes contain customary representations, warranties and undertakings, including limits on operating subsidiaries incurring financial indebtedness, although this undertaking is subject to certain exceptions.

6.05 per cent. US$ Guaranteed notes due 2014

On 8 May 2009, Smiths Group plc issued US$250 million 6.05 per cent. guaranteed notes. The notes will mature 15 May 2014 and are guaranteed by Smiths Group International Holdings Limited. The notes were issued partly to repay certain existing indebtedness of the Group. The notes contain certain customary covenants and undertakings, including a negative pledge, limitations on mergers and consolidations and customary events of default. The covenants contained in the Notes offered hereby are expected to be substantially similar to those contained in such notes.

US$800 million Revolving Credit Facility 2015

On 10 December 2010, Smiths Group plc entered into a 5 year US$800 million committed revolving credit facility (the "Facility") with ten global banks. The Facility matures on 10 December 2015 and all drawings under the Facility are guaranteed by Smiths Group International Holdings Limited. The Facility was entered into as replacement for a £660 million revolving credit facility maturing in June 2012 which was cancelled on the 10 December 2010. The Facility provides committed liquidity and working capital financing over the medium term. As at 31 July 2012, there were no drawings under the facility.

7.25 per cent. Sterling Eurobond due 2016

On 30 May 2000, Smiths Industries plc, the predecessor to Smiths Group plc, issued £150 million 7.25 per cent. bonds due 2016 pursuant to a trust deed between Smiths Industries plc and The Law Debenture Trust Corporation plc, as trustee. The bonds have been admitted to the Official List and admitted to trading on the London Stock Exchange's Regulated Market. The bonds mature on 30 June 2016 and are held in bearer form. The bonds and coupons constitute unsecured obligations of the Company. On 6 May 2009, we entered into a supplemental trust deed to add Smiths Group International Holdings Limited as guarantor under such bonds.

The terms of the bonds contain a negative pledge and customary events of default, including a cross default provision.

4.125 per cent. Eurobond due 2017

On 4 May 2010, Smiths Group plc, issued €300 million 4.125 per cent. bonds due 2017 pursuant to a trust deed between Smiths Group plc, Smiths Group International Holdings Limited and BNP Paribas Trust Corporation UK Limited, as trustee. The bonds have been admitted to the Official List and admitted to trading on the London Stock Exchange's Regulated Market. The bonds mature on 5 May 2017 and are held in bearer form. The bonds and coupons constitute unsecured obligations of the Company.

The terms of the bonds contain a negative pledge and customary events of default, including a cross default provision.

7.37 per cent. Senior Notes due 2018

On 27 February 2009, Smiths Group plc issued $175 million 7.37 per cent. Senior Notes in a private placement. The notes were placed with various companies within the Prudential Insurance Company of America. The notes will mature on 27 February 2018 and are guaranteed by Smiths Group International Holdings Limited.

The terms of the Notes contain a negative pledge, customary events of default, including cross default, and optional prepayment provisions.

The terms of the notes contain financial covenants that require Smiths Group plc to ensure (i) a minimum ratio of profit before interest to net borrowing costs of not less than 3.0 to 1.0 for any 12 month period ending on the last day of its financial year or on the last day of the first six-month period of any such financial year, and (ii) that its net borrowings do not exceed 125 per cent. of gross shareholders' funds.

The notes contain customary covenants and undertakings, including limits on operating subsidiaries incurring financial indebtedness, although this undertaking is subject to certain exceptions.

7.20 per cent. US$ Guaranteed notes due 2019

On 8 May 2009, Smiths Group plc issued US$ 250 million 7.20 per cent. guaranteed notes. The notes will mature 15 May 2019. The notes were issued partly to repay certain existing indebtedness of the group.

The notes contain certain customary covenants and undertakings, including a negative pledge, limitations on mergers and consolidations and customary events of default. The covenants contained in the Notes offered hereby are expected to be substantially similar to those contained in such notes.

Intra-Group Loans

In the ordinary course of its business, the Guarantor acts as both lender and borrower in loans, made on commercial terms, to and from other companies within the Smiths Group to finance their operations. At 31 July 2012 it had loans of £4.5 million receivable and £6.1 million payable.

Off balance sheet arrangements

We have no material off balance sheet arrangements, other than operating leases. For a description of our operating leases which we enter into in the ordinary course of business see note 26 to the consolidated financial statements for the financial year 2012.

Market Risk

Liquidity risk

It is our policy to actively maintain at all times committed and unused bank credit facilities of at least £200 million to ensure we have sufficient available funds for operations, working capital and business development and expansion. As at 31 July 2012, the unused committed credit facilities were US$800 million.

Currency risk

We are exposed to two types of currency risk: transaction risk in respect of products manufactured in one currency region and sold in another currency and the translation risk that the results of non-UK businesses will translate into differing pounds sterling values depending on the exchange rate.

We are exposed to transactional foreign currency risks arising from revenue or purchases by businesses in currencies other than their functional currency. Our policy is that, when such a sale or purchase is certain or highly probable, the net foreign exchange exposure is hedged using forward foreign exchange contracts. The majority of net exposure is calculated by adjusting the expected cash-flow for payments or receipts in the same currency linked to 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 to do so. At 31 July 2012, the Group had outstanding forward foreign currency contracts with a nominal value of £249.9 million (which were being used to manage transactional foreign exchange exposures but were not accounted for as cash-flow hedges).

Our translational foreign currency risk is the result of our significant investment in overseas operations, particularly in the Americas and Europe. As a result, the sterling value of our balance sheet can be affected by movements in exchange rates. We seek to mitigate the effect of these translational currency exposures by partially 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 either directly in the local currency or indirectly through the use of rolling annual forward foreign exchange contracts.

Interest rate risk

Our interest rate policy is designed to reduce volatility over the medium term to earnings from significant changes in short term rates. Our normal policy is to require that fixed rate debt comprises more than 60 per cent. of the level of net debt. This is achieved partly through fixed rate borrowings and partly through the use of interest rate swaps. The weighted average interest rate on borrowings, including the impact of all interest rate, and cross currency swaps at 31 July 2012 was 5.5 per cent.

Credit risk

We are exposed to credit risk in relation to customers, banks and insurers which could result in significant adverse consequences for the Group.

We are also exposed to credit-related losses in the event of any non-performance by counterparties to financial instruments. Credit risk is mitigated by our Board-approved policy of only selecting counterparties with a strong investment grade long-term credit rating, the majority of which are at least A+ or equivalent. We assign financial exposure limits to each counterparty commensurate with its credit ratings. In the normal course of business, we operate notional cash pooling systems, where a legal right of set-off applies.

Our maximum credit risk exposure in the event of other parties failing to perform their obligations under financial assets, excluding insurance, trade and other receivables, was £266.5 million at 31 July 2012. This included cash deposits of £205.6 million. The maximum exposure with a single bank for cash deposits was £55.8 million at 31 July 2012, while the maximum mark to market exposure for foreign exchange contracts at 31 July 2012 to a single bank was £3.5 million.

Critical Accounting Policies

The preparation of our consolidated financial statements in accordance with IFRS requires us to make estimates and judgements that affect the application of policies and reported amounts. Critical accounting estimates and judgements are those which have the greatest impact on the financial information and require the most difficult, subjective and complex judgements about matters that are inherently uncertain. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ from these estimates. Our critical accounting policies are set out below.

Revenue recognition

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.

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 financial year 2012, 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.

Impairment

We test goodwill at least annually for impairment in accordance with the accounting policy for goodwill set out in the notes to our audited consolidated financial statements. The recoverable amounts of cash generating units are determined based on value in use calculations. These calculations require the use of estimates including projected future cash flows and other future events. Any impairment is recognised immediately in the income statement. Subsequent reversals of impairment losses for goodwill are not recognised. We also test intangible assets acquired in business combinations and all other assets if there are indications of impairment.

Provisions for liabilities and charges

Provisions are made for certain future anticipated legal defence costs associated with the John Crane, Inc. asbestos litigation and certain expected costs of potential future judgments against John Crane, Inc. in such cases. Assessing the appropriate level of such provisions requires assumptions to be made with respect to the following: time periods over which any expenditure can be reliably estimated; future trends of legal costs, allowing for inflation; rate of future claims filed; rate of claim resolution; and average amount of judgments awarded. Provision has also been made with effect from the financial year 2012 for the costs which Titeflex Corporation is expected to incur in respect of future claims from insurers seeking recompense on a subrogated basis for the effects of damage allegedly caused by lightning strikes in relation to its flexible gas piping product. However, because of the significant uncertainty associated with these issues, there can be no guarantee that the assumptions used to estimate these provisions will result in an accurate prediction of the actual costs that may be incurred and, as a result, the provisions will be subject to potentially material revisions from time to time if new information becomes available as a result of future events.

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

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

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

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, or the termination payment, if smaller.

Retirement benefits

We operate a number of defined benefit plans. Our principal schemes are in the United Kingdom and in the United States. Assets for these schemes are held in separate trustee administered funds. 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. We use previous experience and impartial actuarial advice to select the values of critical estimates. A retirement benefit asset is recognised where the fair value of the plan assets exceeds the present value of the defined benefit obligation; this arises from the rights of employers to recover the surplus at the end of the life of the plan. If the pension plans were wound up while they still had members, the plans 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 as set out below.

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

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

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

As stated above, assets of defined benefit plans are reported at their market value and retirement liabilities are reported after discounting based on the yield on high quality corporate bonds. At 31 July 2012, the discount rates were markedly lower than at 31 July 2011. As a result our retirement liabilities reported exceeded the retirement assets by £620.2 million, an increase of £421.2 million since 31 July 2011. This amount does not represent an obligation which is immediately payable by the Group. The £620.2 million referred to above is a net position across a number of individual plans. Where a plan shows a surplus, this is disclosed as a retirement benefit asset. The surplus of any one plan is not available to fund the liability of another plan.

Taxation

We recognised deferred tax assets of £26.0 million in the financial year 2011 and £16.1 million in the financial year 2012 relating to losses; further deferred tax assets of £50.6 million in the financial year 2011 and £51.1 million in the financial year 2012 were recognised relating to the John Crane, Inc. litigation provision. In addition for the financial year 2012, we recognised a deferred tax asset of £23.0 million relating to the Titeflex Corporation litigation. The recognition of assets pertaining to these items involves judgements 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.

At 31 July 2011 the Group recognised UK tax assets relating to revenue losses brought forward and deferred capital allowances of £37.7 million. The value of these assets is dependent upon the ability to recover them against future UK taxable profits. Having considered the impact of the increased pension deficit on the outlook for the UK tax base, the Group derecognised the tax UK deferred assets of £37.7 million at 31 July 2012. The derecognition does not affect the availability of such losses in the future.

OUR BUSINESS

Overview

We are a diversified global technology business serving the energy, medical device, detection, communications and engineered component markets. Our technology based businesses apply advanced industrial sciences to provide products to a range of highly sophisticated customers.

We operate through five divisions:

- *John Crane*, a 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;
- *Smiths Medical*, a supplier of specialist medical devices, consumables and equipment for global markets;
- *Smiths Detection*, a leading designer and manufacturer of sensors that detect and identify explosives, narcotics, weapons, chemical agents, biohazards, nuclear and radioactive material and contraband;
- *Smiths Interconnect*, a designer and manufacturer of electronic components and sub-systems that connect, protect and control critical systems for wireless telecommunications, aerospace, defence, space, test, medical, rail, data centre and industrial markets; and
- *Flex-Tek*, a provider of engineered components that heat and move fluids and gases for the aerospace, medical, industrial, construction and domestic appliance markets.

We generated revenue of £3,030.1 million, £2,842.0 million and £2,769.9 million for the financial years 2012, 2011 and 2010, respectively. Our operating profit was £406.6 million, £438.0 million and £435.9 million for the financial years 2012, 2011 and 2010, respectively.

We employ approximately 23,000 people in more than 50 countries. We serve a diverse range of global customers including governments and their agencies, petrochemical companies, hospitals, telecommunications companies and manufacturers in a variety of sectors around the world.

Background

We were founded in 1851 as a clock and watch business. In the first half of the twentieth century, we developed automotive, aviation and marine instruments businesses, which, among other things, developed Britain's first odometer and speedometer.

The Company was incorporated and registered on 15 July 1914 (previously known as Smiths Industries Public Limited Company). In 1958, we acquired a controlling interest in Portland Plastics, which was the beginning of what would become our Smiths Medical division. In 1960, our Industrial division, which manufactured industrial instrumentation, was formed.

Our business continued to evolve and, by the late 1970s, clocks and watches accounted for a minimal proportion of revenue. In 1983, we ceased to be a direct supplier of equipment to the European motor industry, and in 1984 we reorganised into three operating divisions: Industrial, Medical Systems and Aerospace and Defence, and proceeded to strengthen our divisions via acquisitions, buying US avionics business Lear Siegler Holdings Corp in 1987 and US medical devices business Deltec in 1994.

In December 2000, we merged with TI Group to become a larger UK participant in high performance engineering. In 2001, the business and assets of the Automotive Systems division of TI Group were demerged into a new private company named TI Automotive Limited.

In 2003, following our acquisition of Heimann in 2002, we established our detection operations as a stand-alone division, combining Heimann with our existing operations. The division is dedicated to the fast-changing market for equipment to detect explosives, narcotics, weapons, chemical agents, biohazards, nuclear and radioactive material and contraband. In 2003, we also reorganised John Crane, our mechanical seals business, our Smiths Interconnect electronic components, our Flex-Tek flexible technology products and our marine businesses (which comprised the Industrial division) into a Specialty Engineering division. We sold our Aerospace operations to GE Aviation UK in May 2007 and disposed of our Marine business in November 2007. As of 1 August 2008 we disbanded our Specialty Engineering division, integrated our two regional John Crane organisations and put in place a new management structure. Following this reorganisation, the Group is organised into five divisions, John Crane, Smiths Medical, Smiths Detection, Smiths Interconnect and Flex-Tek.

Each of these business divisions is responsible for the day-to-day operations and performance of its business. Our corporate centre has been significantly reduced in size and concentrates on three areas: setting the Group's strategic direction and capital allocation, leveraging the Group's scale where appropriate and ensuring our compliance as a UK-listed company. We believe these changes are improving the way we work by introducing better defined governance and decision-making.

Strategy

We seek to create long-term shareholder value by capitalising on our key strengths, including:

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

  Our businesses are either market leaders or operate in attractive niches. This allows us to benefit from the long-term growth drivers in their industries. Across our portfolio, these growth drivers include the global demand for energy, healthcare needs of ageing populations, threat of terrorism, expansion of wireless communications, aerospace demand and US residential construction.

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

  We seek to stay at the forefront of technology by understanding the needs of our customers and investing in research and development to meet those needs. Our technological strengths give us a competitive advantage and create customer loyalty, enabling us to earn attractive margins. Our businesses often provide significant levels of aftermarket service and essential consumables. This helps us retain customers and provide recurring income as well as insight into customer needs.

- *Further scope for operational improvement and margin enhancement*

  We believe operational efficiencies will drive our headline operating margins higher. Our restructuring programme has already delivered significant cost savings. 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 our operational efficiency.

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

  We also assess active portfolio management opportunities where we see the potential to create a more focused portfolio through a targeted programme of acquisitions and disposals. We invest in business acquisitions to increase our exposure to attractive and adjacent growing sectors as well as to expand our current businesses.

- *High returns on capital employed*

  The Group generates attractive headline operating margins and our divisions tend to specialise in small-batch, low-cost manufacturing. As a result, they have low capital intensity and deliver returns above our weighted average cost of capital. We believe 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.

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

  We believe that closely managing our working-capital enables us to convert most of our operating profit into cash-flow. Improved business data should continue to drive cash generation. Our focus on cash ensures that 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 maintain an efficient balance sheet and meet the obligations of our legacy liabilities, such as pensions and product liability litigation.

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. While this focus has helped strengthen the management team, we will continue to challenge ourselves as to whether we have the appropriate skill sets across the organisation.

We seek to deliver our strategy by focusing on five key strengths, including:

- *Driving top line growth*

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

- *Enhancing margins*

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

- *Generating cash and managing the balance sheet*

  By emphasising working-capital management, particularly our debtors and inventories, we are able to convert a high proportion of headline operating profit into cash. We also look to optimise our capital structure and secure long-term financing. Our borrowings are mainly through long term bonds rather than bank debt. We also closely match the currency of our debt with our assets and earnings.

- *Allocating capital to maximise returns*

  Smiths Group seeks to deliver high returns on capital 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 schemes and legacy product liability issues, so that we minimise their impact on our value creation.

- *Promoting corporate responsibility*

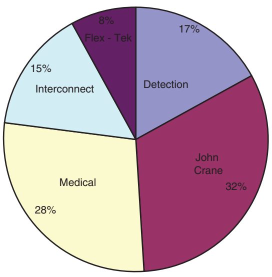
  We promote a culture of responsibility throughout Smiths Group. This requires us all to work according to our Code of Ethics. Smiths is also committed to working in a way that, as far as reasonably practicable, protects the health and safety of employees and reduces any environmental effects of its activities,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

Our Divisions

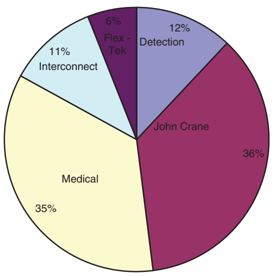
The following charts show the breakdown of our revenue and headline operating profit by division for the financial years 2012 and 2011.

Financial year 2012

Divisional revenue %



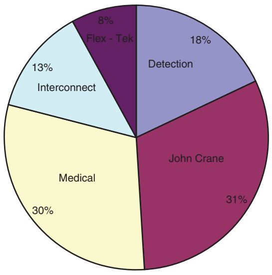
Divisional Headline Operating Profit %



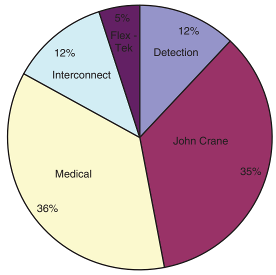
* Our headline performance measures are explained in "Management's Discussion and Analysis of Financial Condition and Results of Operations of the Group – Results from Operations – Headline operating profit and headline profit before taxation". Percentage relates to headline operating profit before corporate costs.

Financial year 2011

Divisional Revenue %



Divisional Headline Operating Profit %

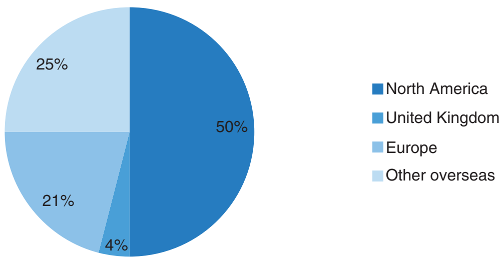


* Our headline performance measures are explained in "Management's Discussion and Analysis of Financial Condition and Results of Operations of the Group – Results from Operations – Headline operating profit and headline profit before taxation". Percentage relates to headline operating profit before corporate costs.

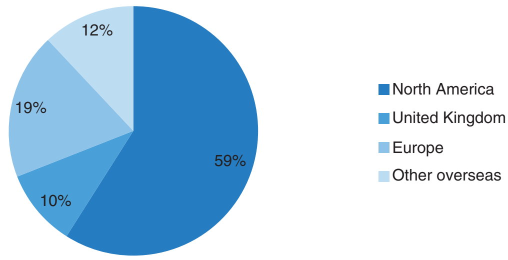
The following charts show the breakdown of our revenue by destination and the location of our assets for the financial years 2012 and 2011.

Financial year 2012

Group sales by destination

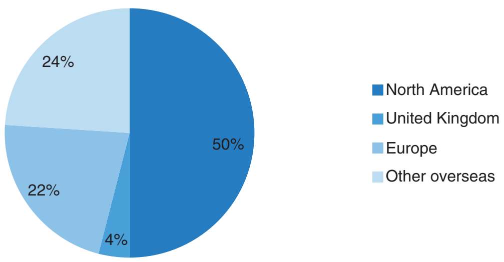


Location of assets % (excluding cash and cash equivalents)

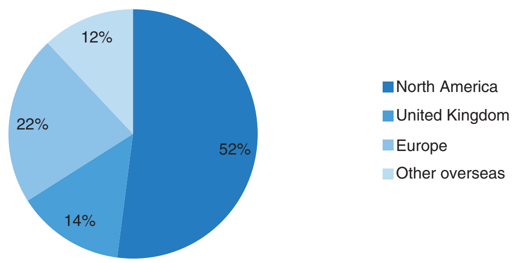


Financial year 2011

Group sales by destination



Location of assets % (excluding cash and cash equivalents)



John Crane

Overview

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

John Crane's products, including mechanical seals, seal support systems, engineered bearings, power transmission couplings and specialist filtration systems support its customers' rotating equipment and other machinery. John Crane also helps maintain oil and gas productivity through the provision of down-hole pumping hardware. John Crane's customers are supported by its global presence with 255 facilities in over 50 countries to maintain and support customer assets throughout their economic lifetime.

John Crane has approximately 7,000 employees and has 18 manufacturing centres and 154 service centres, including 61 centres in the Americas, 75 centres between Europe, the Middle East and Africa and 14 centres in the Asia Pacific region.

Markets and Customers

John Crane estimates that the global addressable market for all its products, including mechanical seals, seal support systems, power transmission couplings, engineered bearings, specialised filtration, artificial lift pumping equipment and value-added services, exceeds £5.0 billion.

John Crane operates across the major process industries. In the financial year 2012, first-fit original equipment manufacture accounted for 37 per cent. of John Crane's sales, with 63 per cent. of sales coming from aftermarket services. Of the aftermarket sales, the oil, gas and petrochemical sector accounted for 39 per cent. of John Crane's revenue in the financial year 2012. The chemical and pharmaceutical sector accounted for 8 per cent. of revenue and distributors and general industry accounted for 7 per cent. and 9 per cent. of revenue in the financial year 2012, respectively. John Crane serves the world's leading multinational oil and gas and power generation companies, government petroleum companies and major manufacturers of pumps and compressors. John Crane's main competitors are Flowserve and EagleBurgmann Industries (mechanical seals and systems), Kingsbury and Waukesha (engineered bearings), Pall and Hydac (filtration systems), and Emerson and Rexnord (couplings). For equipment in upstream energy, John Crane's principal competitors include Weatherford and Norris. John Crane's sale of original equipment for new production facilities creates subsequent aftermarket service opportunities that are delivered via John Crane's network of service centres and the business has continued to build this global service base. 154 local service centres are now located in 51 countries. This network allows John Crane to provide a range of services including repair, root cause analysis, alignment and condition monitoring, all designed to improve the performance of our customers' rotating equipment and reduce downtime.

Strengths

Strong position in key technology areas

John Crane has a globally recognised brand and a strong technology position, as its hardware is utilised in the process of moving material from extraction to refineries. Demand for John Crane's products and services has continued to grow in the past financial year, being influenced by a number of factors: the global demand for energy and an increased desire for national energy independence; more stringent environmental and safety regulations; the need to replace ageing infrastructure and deliver operational efficiencies; global demographics and regional economic growth. The long-term market dynamics, such as the increasing global demand for energy, are driving growth in original equipment investment in key end markets. These dynamics are expected to expand the processing equipment installed base and to underpin organic sales growth over the medium term, excluding the impact of any industry wide downturn.

As a result of a targeted acquisition strategy adding complementary products that leverage John Crane's service footprint and rotating equipment expertise, John Crane has added significantly to its addressable market over the past four years. The new lines, such as engineered bearings, specialist filters and upstream energy services, now enhance and benefit from the market leading position of its traditional portfolio of mechanical seals, couplings and seal support systems. These new product areas typically serve similar customers and offer scope for a strong aftermarket business. These new products also allow John Crane to leverage its global network of sales, service and manufacturing centres more effectively.

Market leader in its field with a blue chip customer base

John Crane is an acknowledged global leader in mechanical seals, and its other products capture a large share of their respective markets. Through its global sales and service footprint it sells to a long list of blue-chip customers, including 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.

Significant revenue from aftermarket service

Although investment levels in the upstream energy sector have started to slow, at the present stage in the capital investment cycle, sales of original equipment for new production facilities continue to grow. After customers make original investments with John Crane they need maintenance, replacement parts and upgrades, and have incentive to purchase the goods and services from John Crane in order to ensure any new parts are compatible with, and any maintenance is performed by engineers familiar with, their John Crane equipment. Revenues from aftermarket service are bolstered by product engineering improvements, which drive John Crane's investment in application engineering.

Global sales and marketing network

John Crane has a global network of customer sales, support and service centres which enables it to provide fast and local customer support. The recently opened Middle East and Saudi Arabian headquarters located in Dubai has been significantly expanded to increase manufacturing, service and training capabilities. With a leading global market share position of approximately 30 per cent. in traditional product areas (mechanical seals, seal support systems and couplings), we believe John Crane is positioned to support, develop and grow its share in the complementary product ranges.

Business Developments

John Crane has continued to pursue a strategy to expand its addressable market by making targeted acquisitions that add complementary technologies and products while also leveraging its extensive network of sales and service centres. In October 2011, we advanced this strategy by completing an acquisition of the business of Houston-based Turbo Components and Engineering Inc. which services, repairs and builds replacement bearings and seals used in critical rotating equipment. This acquisition is complementary to our existing engineered bearings business, which was formed through acquisitions in 2007 and 2009, and it is expected to accelerate our plans to develop an aftermarket services business to support our existing engineered bearings offering. Further progress was made within financial year 2012 to advance the penetration of our expanded product line with several new accounts achieved for bearings and filtration.

John Crane has continued to invest in infrastructure enhancement to expand our sales and service network. During financial year 2011, a new state of the art manufacturing and service centre was opened in Dammam, Saudi Arabia. In China, manufacturing of the well-known Safematic product line has been introduced in response to key pulp and paper customer requirements. Expansion of manufacturing in China continued with the introduction of a new metal bellows seal line which is meeting specific needs of the local market. In the United States, a new Indufil capability was added in the Deer Park facility in Texas, providing users of Indufil filtration equipment in the Americas with local technical and commercial support. In February 2012, the maintenance and manufacturing facility in Dubai including gas seal test rigs was opened.

The implementation of a new ERP system across Europe, Middle East, Africa and Asia was completed on schedule in July 2010. We have also benefited from moving manufacturing to lower cost locations in Eastern Europe, Asia and Mexico in recent years.

Research and Development

John Crane is committed to increasing investment in research and development. Investment in new product development increased 8 per cent. in the financial year 2012 to over £11 million. John Crane's investment in research and development continues to progress on several fronts: environmentally focused zero and low emission seals, rotating equipment condition monitoring with responsive control, advanced materials for seals and couplings, expansion of the performance range limit for compressor dry gas seals to extreme high pressures and engineered point solutions to target specific application services. Recent new product introductions include the launch of a non-contacting supercritical CO_2 pump seal used in enhanced oilfield recovery and a line of high-duty American Petroleum Institute (API) compliant couplings.

Outlook

John Crane's order book is expected to support continued sales growth in the first half of financial year 2013. However, the outlook beyond that remains uncertain given the economic turbulence in Europe and slowdowns in several major economies around the world. Full-year 2013 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 are expected to benefit from on-going operational efficiency efforts, offset by strategic investments in longer-term growth opportunities such as expansion of our sales and service network, targeted large projects and increasing our presence in growth markets.

We believe John Crane will capitalise on its market leadership in mechanical seals and continue to leverage its global sales and service network to promote the full product line.

Smiths Medical

Overview

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

Smiths Medical's products fall into three main market categories:

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

Smiths Medical's manufacturing is concentrated in Mexico, the United States, the United Kingdom, Italy, Germany and China. Smiths Medical sells to over 120 markets worldwide. The United States is its largest single market with approximately 50 per cent. of revenues in the financial year 2012. Smiths Medical has approximately 7,750 employees.

Markets and Customers

The following is a description of Smiths Medical's key markets:

Medication Delivery: Medication delivery accounted for 28 per cent. of Smiths Medical's revenue in financial year 2012. 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 is currently believed to be worth £1.2 billion. We expect continued market growth due to the increase in treatment of chronic conditions, integrating medication delivery devices with hospital IT systems, and the move to treating patients outside hospitals. Smiths Medical is a leader in ambulatory infusion, with a strong position in hospital infusion particularly in the syringe pump market.

Vital Care: Vital care accounted for 41 per cent. of Smiths Medical's revenue in financial year 2012. Smiths Medical's products manage patient airways before, during and after surgery (Portex), aid patients with breathing difficulties (Portex, Pneupac), help to maintain body temperature (Level 1), monitor vital signs such as blood pressure, blood oxygen levels and heart rate (BCI, Medex) and assist reproduction through IVF therapy (Wallace). The market for vital care products is expected to continue to grow, partly due to a steady increase in chronic respiratory diseases and obesity. Demand is increasing for single use devices such as Portex airway management products. The market is expected to continue growing as both the number of operations and intensive care beds increase in acute care settings. Smiths Medical is a market leader in airway products.

Safety Devices: Safety devices accounted for 31 per cent. of Smiths Medical's revenue in financial year 2012. Smiths Medical makes effective safety devices that cover a range of functions including drawing blood samples (Jelco), administering injections and vaccinations (Jelco) and delivering intravenous drugs (Deltec). Management expects the global market for safety products to continue to grow.

Smiths Medical estimates that around three-quarters of its end customers are hospitals with the remainder comprising the alternate care market such as home care, clinics and other surgery centres. It has a direct sales presence in 20 countries with distribution arrangements in some 100 others.

The competitive landscape for Smiths Medical is complex as it competes with different businesses across the wide range of product areas. Its competitors include Covidien, Teleflex, B Braun, Becton Dickinson, C R Bard, 3M (Arizant), Hospira, and CareFusion among many others.

Strengths

Secular market growth

We believe the long-term growth prospects of Smiths Medical's key markets are bolstered by many factors including the ageing population in developed markets and increasing prosperity in emerging markets, increased safety legislation and regulation, and the increased productivity needs of the healthcare industry, which contribute to increased healthcare spending worldwide. Smiths Medical has continued to grow its market share in several key market segments, even during the current economic downturn although overall revenue has fallen slightly since 2010, in part due to rationalisation of product lines and the previously announced exit from diabetes.

Approximately 84 per cent. of Smiths Medical sales are of single use consumable items. The market for these disposable products is relatively stable, as it includes many products hospitals and clinics use daily. Hardware products, such as infusion pumps, comprise the remaining 16 per cent. of Smiths Medical's revenue. Hardware devices are higher-margin products, and many of these operate in conjunction with disposable products, often designed solely for use in the hardware device. Once a customer has purchased hardware devices, it is more likely to continue to source its disposable component from Smiths Medical for the life of the hardware device.

In the United States, Smiths Medical is benefiting from the move towards treatment of illnesses in their chronic, rather than acute, stages and the growing recognition of the contribution that safety devices make to improving the safety and productivity of healthcare employees and patients. In other geographic markets, conversion to safety products is at an earlier stage, with opportunities for rapid future growth. Safety products are also being introduced into other areas of healthcare, such as dentistry.

Global sales and marketing network

Smiths Medical sells its products in more than 120 countries through direct sales and distribution agreements. Smiths Medical employs a global product management model with four strategic product categories: Infusion, within the medication delivery market category; Safety, within the safety devices market category; Pain and Temperature Management, within the vital care market category; and Airway, within the vital care market category. This structure allows the division to pursue business opportunities effectively, and focus its resources, including marketing and R&D, on the highest-potential areas of growth.

Established brands with practitioner loyalty

Smiths Medical has several brands with a history of practitioner preference and loyalty including:

- CADD in ambulatory and acute care and infusion pumps;
- Deltec in long-term vascular access;
- Jelco in vascular access and sharps safety products;
- Level 1 in fluid warming;
- Medfusion in ambulatory and acute care infusion pumps;
- Portex in airway management and respiratory care products, regional anaesthesia and peripheral block systems; and
- Wallace in assisted reproduction solutions.

In particular, Deltec, CADD, Level 1 and Wallace are market leading products.

Smiths Medical often benefits from an incumbent supplier advantage once its products are used by a particular hospital, as hospitals are often reluctant to switch suppliers once staff have been trained and have a working knowledge of product use. This investment of time by customers often creates loyalty to particular products, on which Smiths Medical is able to further capitalise through its presence in the single use products market. Smiths Medical's patents and trademarks allow it to benefit further from established customer loyalty. It has a broad portfolio of patents protecting its product ranges, which competitors need to design around in order not to infringe. This requires competitors to present differently designed products to which hospital staff would be unaccustomed. However, this can act as a barrier to entry if a competitor of Smiths Medical is an incumbent supplier or has products protected by intellectual property rights.

Focusing increased R&D investment on higher growth segments and markets

Total R&D investment has increased as a proportion of revenue from 3.7 per cent. in financial year 2011 to 3.9 per cent. in financial year 2012. Smiths Medical is now focusing its investment more tightly on product areas and segments which will deliver higher growth and improved profitability, including medication delivery.

Increasing roll out of new products

Smiths Medical has increased the rate of product launches with an improved new product development process. In financial year 2012, it launched approximately 10 new products or product ranges. At the same time, it significantly reduced the number of projects in the development pipeline, thereby increasing the investment on the highest impact products. This is enabling a higher level of project execution and is expected to increase overall R&D effectiveness.

Business Developments

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 United States.

Emerging markets are expected to continue to be a source of growth as the quality of and access to healthcare improves. Smiths Medical continues to expand its efforts and presence in emerging markets which now represent approximately 8 per cent. of revenue including by investing £7 million in additional sales capabilities in emerging markets. While it has had a presence in India for many years, it recently established an operating entity which includes a direct sales and marketing team to complement the existing distributor business, and it will continue to invest in emerging market opportunities, including increasing the number of employees working in emerging markets.

Smiths Medical has continued to manage its product portfolio aggressively to boost profitability and reduce complexity. Around 4,000 SKUs have been eliminated since financial year 2009, and in many cases customers have been successfully converted to alternative higher margin products, which has contributed to our significantly improved profitability. We believe that there are further opportunities for margin improvement through portfolio management.

The operational footprint has also been optimised to deliver a more efficient supply chain. During 2010, a distribution centre in Milan, Italy was merged into the central European distribution centre in Nijmegen, Netherlands. The Nijmegen distribution centre operations themselves were also in sourced at the end of financial year 2011 to reduce costs and improve performance. Additional initiatives to optimise the manufacturing and distribution network are currently in progress, with a focus on migrating the footprint closer to our markets, as well as cutting costs. Productivity initiatives have been aggressively pursued and variable costs reduced by some 4-5 per cent. in each of the last three financial years.

Research and Development

Investment in R&D continued to be a priority in financial year 2012. Total R&D spend of £34 million in financial year 2012 (2011: £31 million) comprised 3.9 per cent. of revenue in financial year 2012 (2011: 3.7 per cent.). At the same time, the number of pipeline projects was significantly reduced thereby increasing the investment on the highest impact products. This is enabling a higher level of project execution and is expected to increase overall R&D effectiveness.

Sales from products launched in the last three years represent 10.5 per cent. of sales. During 2012, two significant new medication delivery products were launched: the CADD®-Solis VIP ambulatory pump and Medfusion™ 4000 wireless syringe pump, generating new business and strengthening existing customer relationships. We have recently 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 InuitIV 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 years. Other recent product releases included the CT Marker in our PORT-ACATH® and P.A.S. PORT® POWER P.A.C. systems, Gripper®Micro Extension, and Pneupac® paraPAC™ plus, expanding our offerings in vascular access and mobile ventilation. During financial year 2012, Smiths Medical also continued to extend the reach of a number of existing products into new regions, broadening its offering particularly in emerging markets.

Outlook

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

Smiths Detection

Overview

Smiths Detection is a leading designer and manufacturer of sensors that detect and identify explosives, narcotics, weapons, chemical agents, biohazards, nuclear and radioactive material and contraband. Smiths Detection has developed a comprehensive range of detection technology, including trace detection, infra-red, biological detection and diagnostics. These technologies can be broadly divided into imaging, detection and identification. Core applications for the x-ray technologies are imaging of suspicious or dangerous objects – the technology differentiates itself through its ability to provide high resolution imaging and automatic detection of material. Smiths Detection holds a broad portfolio of trace detection innovations used in products to detect very small quantities of chemical substances, such as trace amounts of explosives, drugs, toxic industrial material or chemical warfare agents. Infrared technology is mainly used for the identification of visible materials where sample material is analysed by a spectroscopic analysis which compares the result with an "on-board" database of thousands of different materials. The biological detection portfolio is mainly applied in the security and military applications.

Smiths Detection's key markets are:

- global transportation, including airports;
- critical infrastructure, including mass transit, sports and events and government and military facilities;
- ports and borders;
- military; and
- emergency responders, including HAZMAT teams, law enforcement, and federal and local government agencies.

Smiths Detection has eight manufacturing centres concentrated in North America, Germany, France, Russia and the United Kingdom, and as at 31 July 2012 employed approximately 2,300 people.

Markets and Customers

The following is a description of Smiths Detection's key markets:

Global Transportation: Transportation is Smiths Detection's largest sector and accounted for 47 per cent. of its revenue in the financial year 2012. Smiths Detection's products help to reduce threats at airports, and are increasingly providing security solutions for mass-transit systems and passenger terminals across the world. The combination of its two principal technologies, trace detection and x-ray screening result in systems to detect explosives, weapons and illegal items in baggage or on passengers themselves.

Critical Infrastructure: Critical infrastructure accounted for 21 per cent. of Smiths Detection's revenue in the financial year 2012. Smiths Detection focuses on mass transit, government and military facilities as well as sports and other events. It has developed a comprehensive security solution enhancing existing access control checkpoints, screening mail, and allowing for 24/7 monitoring of heating ventilation and air conditioning ("HVAC") systems via a portfolio of products and systems to secure access points against accidents and potential threats to protect buildings, reduce the level of vulnerability and safeguard national or local infrastructure.

Ports and Border Protection: Ports and border protection accounted for 16 per cent. of Smiths Detection's revenue in the financial year 2012. Smiths Detection's screening systems provide support for a range of border control requirements, including traditional fiscal needs, such as the collection of excise duties, and the identification of threats to local and national security by monitoring cross-border cargo, reducing international shipments of contraband, screening for explosives, arms, dirty bombs and weapons of mass destruction. Smiths Detection's HCV x-ray systems are available in both mobile units and fixed installations.

Military: The military sector accounted for 11 per cent. of Smiths Detection's revenue in the financial year 2012. The military market for UK and US technology is restricted by export controls, and these two governments form a large part of the market which is characterised by tendering opportunities for large individual programmes that typically run for several years. Smiths Detection has developed a partnership with the UK and US military that has provided insight into the requirements of armed forces and the application of smart science on the battlefield. Smiths Detection has developed advanced integrated sensing technologies for potentially lethal chemical and biological warfare agents, including highly sensitive personal protection devices.

Emergency Responders: Emergency responders accounted for 4 per cent. of Smiths Detection's revenue in the financial year 2012. Over the same period, US revenue accounted for more than 50 per cent. of global demand for emergency responders. Smiths Detection provides equipment to HAZMAT teams, law enforcement, and federal and local government agencies around the world. Its products put laboratory power that requires minimal training into the hands of emergency responders, and it offers a partnership programme that provides access to its scientists and technicians.

Smiths Detection estimates the worldwide market for its products and services to be worth approximately £4 billion. Smiths Detection also estimates that its technology is deployed at the majority of the world's commercial airports. It sells to over 100 markets around the world through sales and marketing companies and third party distributors. A significant majority of its revenue is influenced by governments and their agencies, including homeland security authorities, customs authorities, emergency responders and the military.

In the combined transportation, critical infrastructure and ports and borders sensors markets, Smiths Detection has a 24 per cent. market share. Its major competitors in this sector are Morpho, L3 Security & Detection Systems, Rapiscan Systems, AS&E, FLIR, SAIC and Nuctech. In the combined military and emergency responder markets, the main competitors are Chemring, Bruker and Thermo Fisher.

At the beginning of 2011, Smiths Detection reorganised into global management structures in sales and programmes to deliver improved customer services across technologies and end markets.

Strengths

Global market growth and access to growing markets

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

The 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 government regulatory bodies is expected to 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. Further growth 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. 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 decrease in defence spending by governments in developed markets has led Smiths Detection to expect lower growth rates of around 3 per cent. per annum in the military and emergency response sectors in the near term. Defence budgets are returning to pre-conflict levels, impacting Smith Detection'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.

Strong technology positions and increased investment in R&D

Smiths Detection seeks to maintain its leadership in the sector through ongoing product innovation developed by in-house R&D, government-funded research and through partnerships and licences. Smiths Detection funds a significant portion of its own R&D, spending £37 million or 7.2 per cent. of revenue in financial year 2012, and actively seeks customer and government support for R&D, which totalled £6 million in financial year 2012.

Business Developments

The uncertainty in the US federal budget has caused procurement delays and the regulatory delays in Europe on air cargo and on the relaxation of liquids in passenger hand baggage has affected order flow. Technology upgrades and investment in enhanced security screening continue to fuel demand for advanced x-ray scanners for hold and carry-on baggage. Governments are also assessing a multi-layered approach to aviation security that combines the deployment of detection technologies for screening passengers, baggage and cargo with other measures, such as the training of airport security staff in behavioural analysis techniques and increased cooperation between international intelligence agencies to improve the sharing of information.

Smiths Detection's products are meeting the increasing needs of customers in the ports and borders segment for advanced, high-energy cargo screening solutions to inspect inbound and outbound shipping containers and trucks. The market sector will continue to be influenced by global economic conditions, with government customers reviewing their expenditure plans. Governments are committed to improve their border security and customs revenue protection but are being forced to adopt more cost-effective approaches, layered with different levels of technological support.

Smith Detection's military business saw revenue before currency translation and acquisitions fall in the financial year 2012 as a result of the return of US government military expenditure to more normal funding levels following the easing of recent conflicts. Nevertheless, opportunities for military programmes in the United States, Europe and Asia remain strong. Contracts continue to be awarded under the United States Department of Defense under the long-running Joint Chemical Agent Detector ("JCAD") programme, resulting in $49 million of orders since April 2012. This latest order was for enhanced JCAD detectors which are based on Smiths Detection's LCD 3.3, an advanced, detect-to-warn device that protects troops by sampling the air for chemical warfare agents. Critical infrastructure has grown substantially in recent years as a result of a number of contracts with public utilities, prisons, hotels and other sites. We see considerable opportunities in the critical infrastructure market in the immediate future and will be focusing strongly on this sector. To support growth opportunities in the Indian market, in financial year 2011, Smiths Detection acquired the detection sales, distribution and service business of Veecon IPA Gastechnik Limited. This business has acted as a distributor for Smiths Detection and helped to build a market-leading presence in this important market.

In financial year 2011, Smiths Detection also purchased its Brazilian distributor from EBCO Systems Limited, taking direct control over product sales in one of the world's fastest growing economies. EBCO, based in Sao Paulo, had been the exclusive distributor for Smiths Detection in Brazil since 1994, with a wide customer base that included customs authorities, airports, and prisons. The new company, Smiths Detection Brazil, employs about 55 people, managing a well-established sales and service network.

The performance improvement programme, announced in September 2011, is expected to deliver £40 million of annualised savings by the end of the 2014 financial year. The programme delivered annualised benefits of £15 million in financial year 2012.

The performance improvement programme is on track with site rationalisation and headcount reduction, notably in the United States with the closure or divestment of five business units. Value engineering projects are being widely adopted, and a close focus on daily operating expenditure is delivering significant savings.

At the end of financial year 2012, a new production facility in Malaysia for x-ray systems was opened, giving Smiths Detection a local supply of its core technology into the world's fastest growing air transportation market. Wiesbaden, Germany will remain as a major production centre and the R&D centre of excellence for x-ray technology. Production of x-ray systems has already been established as part of our global development strategy to create a flexible manufacturing base, where customer proximity provides a major competitive advantage.

Research and Development

Smiths Detection's total R&D spend was £43 million or 8.3 per cent. of revenues in financial year 2012. Smiths Detection's R&D programme has focused on x-ray screening for a variety of applications, including checkpoint and baggage screening at airports and cargo screening at ports and borders. Prototype machines have been placed in airports for preliminary data collection. Smiths Detection has developed technology that is designed to detect weapons, explosives and other potentially dangerous items concealed under layers of clothing without physical contact. The system is based on patented millimetre-wave technology. Pilot projects using this technology have been underway since 2010.

Principal launches in the financial year 2012 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.

Our next generation explosives detection system project with Analogic leverages our complementary expertise in multi-energy x-ray technology and three-dimensional computed tomography. Since 31 July 2012, the HI-SCAN 10080 XCT has been launched and has recently received certification from the EU authorities. It combines multi-view x-ray technology and three-dimensional computed tomography in a single system, providing both greater security screening potential and a high throughput. Critical to its success will be certification and approvals from the TSA.

Outlook

Smith Detection's order book is improving and is expected to support sales growth over financial year 2013, with the benefit of major contract wins. Smith Detection expects that its future revenues will be strengthened by the expansion of its 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 underway in the performance improvement programme.

Smiths Interconnect

Overview

Smiths Interconnect is a designer and manufacturer of technically differentiated electronic components and sub-systems providing signal, power and microwave solutions. Smiths Interconnect designs and manufactures products that connect, protect, and control critical systems for the global wireless telecommunications, aerospace, defence, space, medical, rail, data centre, test and industrial markets.

Smiths Interconnect comprises three technology focused, cohesive business units:

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

Smiths Interconnect operates globally and has locations in the United States, Mexico, Costa Rica, Ireland, the United Kingdom, France, Germany, Italy, Tunisia, India, China and Australia. As at 31 July 2012, Smiths Interconnect had approximately 4,100 employees.

Markets and customers

The largest markets for Smiths Interconnect are military/aerospace, which accounted for 38 per cent. of its revenue in financial year 2012; wireless telecommunications which accounted for 22 per cent. of its revenue in financial year 2012; and medical, power and other sectors which accounted for the remaining 40 per cent. of revenue in financial year 2012.

Typical military applications for its technology include unmanned aerial systems ("UAS"), next-generation ground vehicles, communications systems, surveillance systems and self-protection systems. Its rugged connectors and radio frequency products are deployed in the most extreme environments, such as keeping military personnel and systems connected in areas of conflict.

Smiths Interconnect connectors are used as the high reliability standard for certain NASA space applications and are used extensively in medical MRI scanners, civil aerospace systems and rail traction safety applications.

In wireless telecommunications, Smiths Interconnect provides products that protect and enhance the operating performance of cellular networks. Its advanced microwave filters and tower mounted amplifiers improve base station sensitivity, effectively enabling connectivity at low signal strength and in noisy conditions where there is considerable interference. Lightning protection devices guard network operations in severe weather conditions, and transient voltage suppression devices protect base station electronics from power surges and spikes. Smiths Interconnect also provides test solutions that enable network operators to trouble shoot passive intermodulation issues at the cellular base stations, thereby improving the operating performance of their networks.

Smiths Interconnect supplies to multiple levels of the supply chain, and its blue chip customers include prime contractors and service providers, original equipment manufacturers ("OEMs") and system suppliers and sub-system manufacturers. Amongst its 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, Varian, Facebook, APC, GE Healthcare, Qualcomm, NVIDIA and Alstom. Smiths Interconnect operates in a fragmented market with many small and medium sized competitors. Connector competitors include Amphenol, Deutsch, Everett Charles, Glenair, ODU and Harting. Our microwave components and sub-systems compete with, amongst others, Anaren, PowerWave, KMW, Dover, CommScope, EMS, Herley, Cobham and Teledyne. Network Power, Eaton, Starline, Huber & Suhner, Dehn, SL Industries and Emerson offer competitive power solutions.

Strengths

Technical differentiation providing barriers to entry for competition

Smiths Interconnect combines its core technological capabilities developed through self-funded R&D with application specific engineering to provide innovative solutions. Smiths Interconnect works closely with customers' design teams to provide solutions that address customers' specific needs. Both the core capabilities and the bespoke nature of many of Smiths Interconnects' products provide a high degree of technical differentiation, a significant barrier to entry for potential competitors.

Strong brands recognised by customers as partners and solution providers

Smiths Interconnect has retained the strong individual brands that it has gained through acquisition. Many of these are world leaders in their specific field and in some cases, the brand has become synonymous with the technology and products they supply. For example, in the wireless telecommunications market PolyPhaser is renowned as being a world leading brand for lightning protection devices.

Positive market dynamics in wireless infrastructure and defence and excellent military programme positions

In the wireless telecommunications market, the demand for more data and services through wireless devices is expected to drive the introduction of upgraded networks such as LTE and network optimisation projects. Further growth is expected to be driven by new networks being built out in developing regions. In the military market sector, Smiths Interconnect is focused on electronics and communications. These are key concerns for most governments as they attempt to improve connectivity and situational awareness within their forces, including networking all assets, improving battlefield communications, improving sensors and force protection systems. Despite government budget pressures, we believe that spending will refocus on upgrading electronic systems on existing platforms.

Business Developments

In October 2011, Smiths Interconnect acquired Power Holdings Inc. (PDI), a leading designer and manufacturer of specialist power distribution, conditioning and monitoring systems. Based in Richmond, Virginia, PDI is the parent company for Power Distribution. Inc., Marelco Power Systems, Inc. and Onyx Power, Inc. It produces power distribution units, static transfer switches, remote power panels, power conditioning units, medium and low voltage transformers and patented power monitors used mainly in data centre and alternative energy applications. The acquisition of PDI transforms the existing power protection group with a new range of products and growth opportunities. It strengthens Smiths Interconnect's offering of technically differentiated solutions for applications requiring ultra-reliable and precise power performance, broadening its high reliability power quality capabilities to include conditioning, protection, distribution, filtering and monitoring to ensure the optimum function of advanced electrical systems. PDI, which also has facilities in Santa Ana, California and Howell, Michigan, employs around 370 people and more than 90 per cent. of revenues come from non-government funded markets.

Smiths Interconnect's 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, Smiths Interconnect expects, will drive revenue improvements. Value creation opportunities have been identified and actions to improve manufacturing processes and margin performance are underway.

Research and Development

Total R&D spend in financial year 2012 was £27 million or 6.0 per cent. of revenue. The customer-funded portion, predominantly within the Microwave Defence group, was maintained from financial year 2011 to financial year 2012 despite US Department of Defense budget reductions and the completion of some programmes.

Investment in recent years, focused more on commercial products and markets in accordance with Smith 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 telecommunication tower-top electronics. Innovation remains a core priority and the proportion of revenue from products or technologies developed in the last three years has maintained at over 30 per cent.

Outlook

Despite a positive ratio of orders to sales in financial year 2012 and a stronger order book to start financial year 2013, many of our markets remain challenging. US defence spending is projected to fall and, although we believe we are relatively well-placed in some key technology sectors and on some long-term programmes, the military market faces a significant headwind. Similarly, the growth in wireless telecommunications in the financial year 2013 is expected to provide a tough comparator in an essentially flat market. We expect the commercial markets of semiconductor test and data centres are expected to be more robust, but also expect they may be hindered by macroeconomic conditions and consumer spending patterns. Although volumes may decline in some sectors, margins should benefit from restructuring actions in the financial year 2012 and ongoing operational efficiency initiatives.

Flex-Tek

Overview

Flex-Tek is a provider of engineered components that heat and move fluids and gases for the aerospace, medical, industrial, construction and domestic appliance markets. Its products include flexible hosing and rigid tubing deployed on commercial and military aircraft, in motorsport vehicles for fuel and hydraulic applications, as well as engineered thermal systems and heating elements. Flex-Tek's technology is used in the housing and domestic products market in domestic equipment such as vacuum cleaners, tumble dryers, piping for gas installations and HVAC systems support. The US housing and domestic products market accounts for approximately half of Flex-Tek's business.

Flex-Tek conducts most of its business in the United States and Mexico but also has manufacturing operations in France, Germany, Malaysia, India and China. As at 31 July 2012, Flex-Tek had approximately 2,000 employees.

Markets and Customers

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's reliance on any specific technology, although Flex-Tek is highly leveraged to the US economy and particularly, US residential construction.

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

Fluid Management

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

Heat Solutions

Flex-Tek's specialised heating elements and thermal systems serve customers that manufacture tumble dryers, HVAC equipment, medical applications, and bespoke applications. Revenue is largely dictated by household appliance demand in the United States.

Construction Products

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

Flexible Solutions

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

In financial year 2012, Flex-Tek derived 35 per cent. of its revenue from Fluid Management, 15 per cent. from Flexible Solutions, 24 per cent. from Heat Solutions and 26 per cent. from Construction.

Flex-Tek serves 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. Its notable distributors in the US construction market include Ferguson and Watsco. Fluid management competitors include segments of Parker-Hannifin, Eaton, and Kongsberg. Heat Solutions noteworthy competitors in the United States include: Zoppas, Nibe, Watlow and Chromalox as well as vertically integrated capacity from key customers. In China, Kawai and Dongfang manufacture a wide variety of electric heaters. Flex-Tek's Construction products competes with US manufacturers: Hitachi, Atco, Omega-Flex, Hart & Cooley and Goodman. Flexible Solutions competes globally with a number of smaller privately owned businesses which manufacture specialty hoses.

Strengths

Lean manufacturing and cost control

Flex-Tek is focused on lean manufacturing and cost control. As part of this cost reduction strategy, the business implemented a reorganisation and consolidation of management and operating sites across the division under a plan commenced at the beginning of 2008 and completed in 2011. Flex-Tek continued to rationalise its manufacturing portfolio, refurbish facilities and deliver productivity improvements.

Exposure to markets other than US construction

While Flex-Tek's revenue and profit were adversely affected by the recession in the US residential construction and household appliances markets, which began in 2008, the Fluid Management technology group has delivered growth in financial year 2012 due to demand for fluid distribution components and services for commercial and military aircraft.

Business Developments

As part of the Group reorganisation, Flex-Tek has undertaken a programme to reorganise its operations to drive efficiency improvements.

The order book for the commercial aviation OEM business remains strong and we have gained market share in our overhaul and repair service segment in the past financial year.

Flex-Tek has benefited from an improvement in underlying housing starts which began to show some growth from the end of 2009. This improvement was supported by the Homebuyer Tax Credit Program, particularly as builders increased housing inventories to support demand ahead of the expiry of the tax credit at the end of April 2010. The improving trend stabilised in mid-2010 following withdrawal of the tax credit. In addition, a sharper focus on low-cost manufacturing and combined product marketing programmes helped to preserve margins in the past financial year. In financial year 2011 Flex-Tek also launched a new product for the US construction market, FlashShield™, which offers leading-edge lightning protection for flexible gas piping products used in residential installations. Flex-Tek has invested in its global footprint in Asia, where its existing plant in Malaysia continues to expand. It has manufacturing facilities in Bangalore, India and Changzhou, China. The facility in India is aimed at better serving aerospace customers, following increased demand due to the growth of air traffic in Asia. The facility in Changzhou is focused on the growing HVAC and household appliance market in China.

Outlook

Improved sales from Flex-Tek are expected to continue. Fluid Management is in a robust aerospace sales cycle which is expected to be maintained for some time and Flex-Tek believes that strong sales will deliver better margins. The US housing market is expected to gradually improve in financial year 2013. The backlog of unsold houses has decreased, mortgage rates remain at historic low levels and credit is more widely available. Flex-Tek expects that these factors should help bolster the sales of its Heat Solutions and Construction Products divisions. Flexible Solutions is expected to deliver modest growth with the general improvement in the US economy.

Employees

	Financial Year		
	2012	**2011**	**2010**
John Crane	7,020	6,837	6,676
Smiths Medical	7,946	7,590	8,222
Smiths Detection	2,240	2,427	2,432
Smiths Interconnect	4,066	3,884	3,963
Flex-Tek	2,021	2,005	2,022
Central	73	71	65
Total	**23,366**	**22,814**	**23,380**

At 31 July 2012, Smiths Group employed 23,336 people worldwide, of whom over 40 per cent. were based in North America (Canada, the United States and Mexico). In the United States, separate collective bargaining agreements are in operation in four locations covering approximately 200 people. Collective bargaining agreements in the United States are for three years. Relationships with unions are constructive. In Europe, collective bargaining agreements or works councils operate in a number of countries. In Wiesbaden, Germany and in Vitry sur Seine, France employee terms and conditions are regulated by national agreements, covering approximately 625 people. In both cases local relationships are managed through on site union and works council representatives. In other European locations, works council representatives engage with management. Relationships with unions and works councils are constructive; recent changes in Wiesbaden, as a result of Smiths Detection's improvement programme, prompted a brief and temporary work to rule.

Intellectual Property

Intellectual property is among Smiths Group's most important assets. As at the date of this offering memorandum, the Group has in excess of 3,400 utility patents and approximately 200 design patents (registered and pending), and in excess of 2,000 registered or pending trademarks/service marks. Intellectual property also includes copyrights, trade secrets and know-how and other proprietary information. It is the Group's policy, and procedures are in place, to identify, protect (by patent and trademark registration, and maintenance of proprietary information), defend and manage its intellectual property. It is the Group's policy that new and re-designed products, processes or software are thoroughly reviewed at regular points throughout development to safeguard against the potential infringement of the intellectual property rights of third parties.

Facilities

The table below shows the location, size and number of employees at our major facilities.

Division	Location	Size (Sq. ft)	Number of Employees
John Crane	Morton Grove, Illinois, US	453,024	694
John Crane	Tianjin, China	213,237	348
John Crane	Lutin, Czech Republic	134,560	366
John Crane	Grafton, Wisconsin, US	89,500	171
Smiths Medical	Keene, New Hampshire, US	243,397	526
Smiths Medical	St. Paul, Minnesota, US	213,642	647
Smiths Medical	Dublin, Ohio, US	187,067	527
Smiths Medical	Southington, Connecticut, US	134,200	301
Smiths Detection	Wiesbaden, Germany	417,626	625
Smiths Detection	Edgewood, Maryland, US	228,991	202
Smiths Detection	Watford, UK	93,000	208
Smiths Interconnect	Hayden Lake, Idaho, US	174,240	244
Smiths Interconnect	Tampa, Florida, US	123,897	242
Smiths Interconnect	St Aubin, France	79,615	212
Flex-Tek	Abbeville, South Carolina, US	458,000	283
Flex-Tek	Cookeville, Tennessee, US	196,560	270
Flex-Tek	Portland, Tennessee, US	153,600	47
Flex-Tek	Reynosa, Mexico	145,750	320
Flex-Tek	Laconia, New Hampshire, US	131,800	313

Regulation

Certain of the divisions in which we operate are subject to substantial government regulation. Our Smiths Medical, Smiths Interconnect and Smiths Detection divisions are particularly subject to regulation, with certain customers and regulatory or other enforcement bodies routinely inspecting our practices, processes and premises. Certain of our products, most notably devices produced by Smiths Medical, are subject to US Food and Drug Administration ("FDA"), equivalent European and other approval processes. Smiths Detection and Smiths Interconnect are subject to governmental procurement regulations and technology export controls compliance which may require us to incur additional expenses or restrict our commercial flexibility and planned business strategies.

Smiths Medical is principally subject to FDA regulations in the United States and the European Medical Devices Directive in the European Union. Broadly, both sets of regulations require the development of internal systems to ensure that proper risk assessments are performed on the design, manufacture and sale of medical devices to certify their safety and fitness for purpose. These regulations also require that the product remains safe over its lifetime. In addition to regulations concerning the safe manufacture and use of medical devices, Smiths Medical is also subject to US laws prohibiting the improper inducement of healthcare professionals to purchase its products. Comparable regulations are also expected to come into force in the European Union.

Due to the security functions served by their products, Smiths Detection and Smiths Interconnect are subject to numerous export control, technology licensing and other government regulations. Both businesses are subject to the International Traffic in Arms Regulation ("ITAR"), which governs the import and export of military and defence related technology from the United States. Smiths Detection and Smiths Interconnect are also required to maintain a Special Security Agreement entity and "cleared sites" that must access classified information in order to perform certain contracts with the US government. The "cleared sites" must be operated in accordance with regulations and parameters and are subject to periodic audit by the US Defense Security Service.

Because both businesses sell to the US government and government agencies, they are subject to Federal Acquisition Regulations ("FAR"). FAR provides highly structured guidelines for the US government acquisition process. Although FAR's primary objective is to guide government employees through the acquisition process, in practice many of its provisions are incorporated into proposals and ultimately into government contracts.

These regulations are constantly developing and any material changes have the potential to impact the way our divisions are subject to such regulations conduct their business.

Environmental

We are subject to numerous foreign, international, national, regional and local environmental laws and regulations, and, in connection with certain of our activities, permits. With respect to some of our properties, our activities may have caused environmental damage or we may be exposed to environmental liability on the basis of the activities of prior owners or operators. Under certain environmental laws, including those in the United States, United Kingdom and EU, as current or prior owners or operators of real property or as the generators or transporters of hazardous materials that are placed on real property, we could be held responsible for any and all liabilities and consequences arising out of past or future releases of hazardous materials or wastes, human exposure to such substances or other environmental damage at such properties, including potentially significant investigation and remedial costs. We are currently involved, directly or indirectly, in investigation and remediation activities at various locations and have reserves of £2.8 million in respect of these activities. Environmental laws and regulations are continuously changing and have tended to become more stringent over time. The development of new facts or further changes in environmental laws and regulations, or the enforcement of such laws and regulations, could have a material impact on our business, reputation, results of operations or financial condition.

Litigation

In the ordinary course of business, we are subject to litigation such as intellectual property, product liability claims and lawsuits, including potential class actions, alleging that our products have resulted or could result in an unsafe condition or injury.

John Crane, Inc. Litigation

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. A provision of £213.1 million has been made at 31 July 2012 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 sufficiently certain to permit recognition as an asset for these purposes.

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 causes JCI to believe, based on tests conducted on its behalf, that the products were safe. JCI ceased manufacturing products containing asbestos in 1985.

JCI is actively monitoring the conduct and effect of its current and expected asbestos litigation, including the most efficacious presentation of its "safe product" defence, and intends to continue to resist all asbestos claims based upon this defence. Approximately 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$111 million. JCI has also incurred significant additional defence costs and, whilst the number of claims being filed against JCI and other defendants has been declining, the proportion of mesothelioma claims has increased, and JCI's ability to defend these cases is likely to have a significant impact on its annual aggregate adverse judgment and defence costs.

Assessing the appropriate levels of such provisions requires assumptions to be made with respect to the following: time periods over which any expenditures can be reliably estimated; future trends of legal costs; rate of future claims filed; rate of successful resolution of claims; and 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 valuations 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. 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.

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 £3 million and £5 million 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 periods over which expenditure can be reliably estimated, the number of future settlements and 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 reliably estimable beyond this time horizon. 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, which as at 31 July 2012 amounted to £61.8 million, 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.

In addition to the JCI asbestos and Titeflex Corporation law suits, other companies within the Group are also involved in product liability and other litigation for which no provision is made due to the inherent uncertainty of the outcome.

Research and development

Information regarding our research and development activities is set out in the discussion of each of our divisions above. In addition, the following tables present our research and development spending for the financial years 2012, 2011 and 2010.

	Financial Year		
	2012	2011	2010
		(£ million)	
Expenditure on capitalised development	28.5	31.0	24.2
Company funded R&D spend charged to profit			
John Crane	11.1	10.3	10.2
Smiths Medical	20.1	17.2	16.2
Smiths Detection	22.7	18.3	25.1
Smiths Interconnect	22.6	20.8	16.6
Flex-Tek	2.0	1.3	1.0
	78.5	67.9	69.1
Third party funded R&D spend			
John Crane	—	—	—
Smiths Medical	—	—	—
Smiths Detection	5.5	7.7	8.3
Smiths Interconnect	4.0	4.1	5.0
Flex-Tek	—	—	—
	9.5	11.8	13.3
Total R&D	116.5	110.7	106.6

MANAGEMENT AND CORPORATE GOVERNANCE OF THE GROUP

As at the date of this offering memorandum, the members of the Company's Board of Directors (the "Board") are:

Name	Age	Position	Year appointed as Director
Donald Brydon, CBE	67	Chairman	2004
Philip Bowman	59	Chief Executive	2007
Peter Turner	42	Finance Director	2010
David Challen, CBE	69	Senior Independent Director	2004
Anne Quinn, CBE	61	Non-Executive Director	2009
Sir Kevin Tebbit, KCB, CMG	65	Non-Executive Director	2006
Bruno Angelici	65	Non-Executive Director	2010
Tanya Fratto	52	Non-Executive Director	2012

Donald Brydon, CBE, Chairman. Aged 67. Donald Brydon was appointed to the Board in April 2004, becoming Chairman in September 2004. He is Chairman of Royal Mail Group plc, Sage Group plc and the Medical Research Council. He had a 20 year career with Barclays Group, during which time he was Chairman and Chief Executive of BZW Investment Management, followed by 10 years with the AXA Group. He was also formerly Chairman of Amersham plc and the London Metal Exchange and a Director of Allied Domecq plc and Scottish Power plc.

Philip Bowman, Chief Executive. Aged 59. Philip Bowman was appointed Chief Executive in December 2007. He previously held the positions of Chief Executive at Scottish Power plc from early 2006 until mid 2007 and Chief Executive at Allied Domecq plc between 1999 and 2005. He is currently the senior independent director and Chairman of the Audit Committee of Burberry Group plc, Chairman of The Miller Group Limited and a non-executive director of Better Capital PCC Limited. Past board appointments include British Sky Broadcasting Group plc, Scottish & Newcastle Group plc and Coles Myer Limited as well as Chairman of Liberty plc and Coral Eurobet plc. His earlier career includes five years as a director of Bass plc (now Mitchells & Butler plc and Intercontinental Hotel Group plc), where he held roles of Chief Financial Officer and subsequently Chief Executive of Bass Taverns.

Peter Turner, Finance Director. Aged 42. Peter Turner was appointed an executive director of the Board in April 2010 and, after a brief handover period, became Finance Director in June 2010. He was Finance Director for Venture Production plc from 2007 until its acquisition by Centrica plc in 2009. He spent the previous 11 years at BOC plc where he held a number of senior finance posts including Director of Taxation and Treasury, and Finance Director of the group's largest division. Before that, he was an auditor at PricewaterhouseCoopers where he qualified as a Chartered Accountant.

David Challen, CBE, Senior Independent Director. Aged 69. David Challen was appointed to the Board in September 2004. He is Chairman of the EMEA Governance Committee at Citi and former Chairman of J Henry Schroder & Co Ltd. He is Senior Independent Director and Chairman of the Audit Committee at Anglo American plc. He is also Deputy Chairman of the Takeover Panel.

Anne Quinn, CBE, Non-Executive Director. Aged 61. Anne Quinn was appointed to the Board as a non-executive director in August 2009. She worked for BP in the UK, USA, Belgium and Colombia and held a number of positions including Group Vice President of Gas and Natural Gas Liquids. She has also been a managing director of the energy private equity group, Riverstone LLP. She was a non-executive director of BOC and is currently a non-executive director of Mondi plc and Mondi Limited. She also serves on the President's Advisory Committee to the Sloan School, MIT.

Sir Kevin Tebbit, KCB, CMG, Non-Executive Director. Aged 65. Sir Kevin Tebbit was appointed to the Board in June 2006. He served widely in policy, management and finance posts in the MoD, Foreign & Commonwealth Office and NATO before becoming Director of GCHQ and finally Permanent Secretary at the Ministry of Defence from July 1998 to November 2005. He is Senior Adviser to URS Corporation, and Chairman of the Industry Advisory Group to the UKTI Defence and Security Organisation. He is also a Visiting Professor at Queen Mary, University of London and a member of the Advisory Board of the Imperial College Institute for Security Science and Technology.

Bruno Angelici, Non-Executive Director. Aged 65. Bruno Angelici was appointed to the Board in July 2010. He pursued a 20-year career with AstraZeneca plc before retiring in 2009 as Executive Vice President, International, after holding responsibility for its operations in France and Japan. Prior to this, he held a number of senior management roles during a decade at Baxter, a US based global supplier of medical devices. He currently sits on the Supervisory Board of Wolters Kluwer, a Dutch-based information services and publishing company, and on the Global Advisory Board of Takeda Pharmaceutical Company Ltd, based in Japan. He is a non-executive director of Novo Nordisk A/S, a Danish healthcare company. He holds an MBA from the Kellogg School of Management in Chicago and has Business and Law degrees from Reims. He was received into the Legion d'honneur in December 2009.

Tanya Fratto, Non-Executive Director. Aged 52. Tanya Fratto was appointed to the Board in July 2012. She 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, becoming an officer in the company in 2000. Over the course of her career, she held a number of senior positions in product management, operations, Six Sigma, supply chain management and managed several profit and loss centres. She is a non-executive director of Boart Longyear Ltd, a company based in Utah, United States which provides mineral exploration drilling services and drilling products and is listed on the Australian Securities Exchange.

The business address of each member of the Board of Directors is 2nd Floor, Cardinal Place, 80 Victoria Street, London SW1E 5JL.

None of the members of the Board of Directors has any potential conflict of interests between duties to the Company and their private interests or other duties.

Compliance with the UK Corporate Governance Code

As at 31 July 2012, the Company was in full compliance with the UK Corporate Governance Code (the "Code"), published by the Financial Reporting Council and available on its website www.frc.org.uk, except that the value of any fees received by executive directors in respect of external non-executive directorships is not disclosed in the Directors' remuneration report, as this is not considered relevant to the Company.

Directors

The Board

The Board comprises Mr Brydon (Chairman), Mr Bowman (Chief Executive), Mr Turner (Finance Director) and five independent non-executive directors; Messrs Angelici and Challen; Ms Quinn and Ms Fratto; and Sir Kevin Tebbit. Mr Challen is the senior independent director. The Board and its committees have the appropriate balance of skills, experience, independence and knowledge of the Company to enable them to discharge their respective duties and responsibilities effectively. The wide-ranging experience and backgrounds of the non-executive directors ensure that they can debate and constructively challenge management in relation to both the development of strategy and the evaluation of performance against the goals set by the Board. The Board normally holds formal meetings at least six times a year to make and review major business decisions and monitor current trading against plans which it has approved. It additionally exercises control by determining matters specifically reserved to it in a formal schedule which only the Board may change: these matters include the acquisition or divestment of significant companies or businesses, the issue of shares, significant contractual commitments, the review of the effectiveness of risk management processes and major capital expenditure. Once a year, the Board meets with a particular focus on long-term strategy and developments affecting the Company. Additional meetings are arranged as necessary to deal with urgent items.

The executive directors and senior management team are responsible for the Company's financial performance, the day-to-day management of the Company's businesses and implementation of the strategy and direction set by the Board. The Chairman meets the non-executive directors without the executive directors present at least twice a year. The senior independent director meets the other non-executive directors without the Chairman present at least annually. Directors and officers of the Company and its subsidiaries have the benefit of a directors' and officers' liability insurance policy.

The following table shows the number of Board and Board Committee meetings held during the financial year ended 31 July 2012 and opposite each director's name the number of meetings they were eligible to attend and the number actually attended. However, directors attend many other meetings and make site visits during the year. For example, as part of her induction and familiarisation process, Ms Fratto has visited a number of the Company's sites in the United States 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 Beneficiência Portuguesa in São Paulo.

	Board Meetings		Audit Committee		Remuneration Committee		Nomination Committee	
Name	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended
D H Brydon	12	11	—	—	5	4	4	4
P Bowman	12	12	—	—	—	—	—	—
P A Turner	12	12	—	—	—	—	—	—
B F J Angelici	12	12	3	3	5	5	4	3
D J Challen	12	12	3	3	5	5	4	4
A C Quinn	12	11	3	3	5	5	4	3
K R Tebbit	12	12	3	3	5	4	4	4
T Fratto	2	2	1	1	1	1	1	1
S J Chambers (retired 1 July 2012)	10	9	2	2	4	4	3	3

Note: — indicates not a member of that Committee in the financial year 2012

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 2012, at least half the Board, excluding the Chairman, has comprised independent non-executive directors. In deciding the chairmanship and membership of the Board Committees, the need to refresh membership of the Committees is taken into account. All the non-executive directors are considered to be independent and Mr Brydon was considered independent at the time of his appointment as Chairman.

Appointments to the Board

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

Information and professional development

The Board is provided with detailed information several days in advance on matters to be considered at its meetings and non-executive directors have ready access to the executive directors. Non-executive directors are provided with information and updates between meetings. Regular site visits are arranged and non-executive directors are encouraged to visit sites independently. During site visits, briefings are arranged and the Directors are free to discuss aspects of the business with employees at all levels. Newly-appointed directors undergo an induction programme to ensure that they have the necessary knowledge and understanding of the Company and its activities. They undertake briefing sessions on corporate governance, strategy, stakeholder issues, finance and risk management and HR strategy, as well as meetings and site visits to business locations in the UK and overseas. Each director's individual experience and background is taken into account in developing a programme tailored to his or her own requirements. The Chairman consults with the directors on their respective training and development requirements. The suitability of external courses is kept under review by the Company Secretary who is charged with facilitating the induction of new directors and with assisting in the ongoing training and development of directors. All directors have access to the advice and services of the Company Secretary and a procedure is in place for them to take independent professional advice at the Company's expense should this be required.

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."

Conflicts of Interest

Under the Companies Act 2006 (the "2006 Act") a director must avoid a situation where he or she has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the company's interests. The requirement is very broad, and could apply, for example, if a director becomes a director of another company or a trustee of another organisation. The 2006 Act allows directors of public companies to authorise conflicts and potential conflicts where appropriate and where the articles of association contain a provision to this effect, as the Company's Articles do. The Board has put procedures in place for directors to report any potential or actual conflicts to the other members of the Board for their authorisation where appropriate. Each director is aware of the requirement to seek approval of the Board for any new conflict situations, as they may arise. The process of reviewing conflicts disclosed, and authorisations given, is repeated at least annually. Any conflicts or potential conflicts considered by the Board and any authorisations given are recorded in the Board minutes and in a register of directors' conflicts which is maintained by the Company Secretary.

Performance evaluation

The Board undertakes a formal and rigorous annual evaluation of its own performance and that of its Committees and each director. In respect of the year ended 31 July 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 Rob Goffee of the London Business School and having regard to the objectives set by the Board for the year. The results of the evaluation are used to inform the Board's approach going forward.

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.

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 in the Annual Report 2012.

The "going concern" statement required by the Code is set out in the Group directors' report in the Annual Report 2012.

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 IFRS; require representatives of the businesses to certify that their reported information gives a true and fair view of the state of affairs of the business and its results for the period; and review and reconcile reported data. The Audit Committee is responsible for monitoring these internal control and risk management systems. The Company's internal control is based on assessment of risk and a framework of control procedures to manage risks and to monitor compliance with procedures. The procedures for accountability and control are outlined below. The Company's internal control systems are designed to meet the Company's particular needs and the risks to which it is exposed and, by their nature, can provide only reasonable, not absolute, assurance against material loss to the Company or material misstatement in the financial accounts. The Group has an embedded process for the identification, evaluation and management of significant business risks. The process is reviewed through the Audit Committee and monitored by the Group Internal Audit Department. The Company has identified and evaluated the key risks, including ethical matters and information provision, and has ensured that effective controls and procedures are in place to manage these risks. In the highly regulated environment of the industries in which the Company operates, procedures are codified in detailed operating procedures manuals and are reinforced by training programmes. These are designed to ensure compliance not only with the regulatory requirements but also with general principles of business integrity. A key element in any system is communication: the executive directors and senior corporate staff meet regularly with representatives from the businesses to address financial, human resource, legal, risk management and other control issues. Throughout the financial year 2012, 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

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, United States and continental Europe, as well as timely Stock Exchange announcements, meetings with management and site visits. Members of the Board, and in particular non-executive directors, are kept informed of investors' views, in the main through distribution of analysts' and brokers' briefings. At least twice a year a report is made to the Board on the number and types of meetings between the Company and institutional shareholders. The Chairman, the Senior Independent Director and the other non-executive directors are available to meet shareholders on request.

Constructive use of the Annual General Meeting

All directors normally attend the Company's AGM and shareholders are invited to ask questions during the meeting and to meet directors after the formal proceedings have ended. There was a poll vote on each resolution at the 2011 AGM. The audited, final results of the poll votes were released to the London Stock Exchange and published on the Company's website, www.smiths.com, as soon as was 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.

Board Committees

The full terms of reference of the following Board Committees are available upon request.

Audit Committee

The members of the Committee are Mr Challen (Chairman of the Committee), Mr Angelici, Ms Quinn and Sir Kevin Tebbit. Ms Fratto was appointed to the Committee on 1 July 2012.

The Board has determined that the Committee members have the skills and experience necessary to contribute meaningfully to the Committee's deliberations. In addition, the Chairman of the Committee has requisite experience in accounting and financial management. The Committee meets at least three times a year to monitor the integrity of the Company's financial statements and the effectiveness of the external audit process, corporate governance issues and, in particular, the implementation of the Company's Code of Business Ethics and the arrangements for employees to raise confidentially (and anonymously, if they so choose) concerns about possible wrongdoing in financial reporting and other matters. It is responsible for ensuring that an appropriate relationship between the Company and the external auditors is maintained, including reviewing non-audit services and fees and implementing the Company's audit partner rotation policy. The Committee has primary responsibility for making recommendations to the Board on the appointment, reappointment and removal of the external auditors. The Committee also reviews annually the Group's systems of internal control; the processes for monitoring and evaluating the risks facing the Group; and the effectiveness of the internal audit function: it is responsible for approving the appointment and removal of the Director, Internal Audit. The Committee reviews annually its terms of reference and its effectiveness and recommends to the Board any changes required as a result of such review. The annual review of the Committee's terms of reference was last 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 financial year 2012 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 financial year 2012 work programme and regular reports on the key issues arising from its work during the year.

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

No-one other than the members of the Committee is entitled to be present at meetings. However, the Chairman; Finance Director; Group Financial Controller; Director, Tax and Treasury; Director, Internal Audit; and external auditors are normally invited to attend. Others may be invited to attend by the Committee. The papers for and minutes of each Committee meeting are sent to all directors. At least once a year, there is an opportunity for the external auditors, the Director, Internal Audit and the Director of Business Ethics to discuss matters with the Committee without any executive management being present. The Director, Internal Audit, the Director of Business Ethics and the external auditors have direct access to the Chairman of the Committee outside formal Committee meetings. The Committee reviews the nature and extent of non-audit services provided by the external auditors in order to ensure that objectivity and independence are maintained. Under the audit independence policy, approved by the Committee, certain non-audit services may not be provided by the external auditors, certain services, not exceeding £10,000 in fees, require the approval of the Finance Director and all other services require the approval of the Chairman of the Committee. Where the cost of the services is expected to exceed £100,000, the engagement will normally be subject to competitive tender. The external auditors have in place processes to ensure that their independence is maintained including safeguards to ensure that where they provide non-audit services, their independence is not threatened. The external auditors have written to the Audit Committee confirming that, in their opinion, they are independent and the Audit Committee concurs with that view.

Remuneration Committee

The members of the Committee are: Mr Angelici, Mr Brydon, Mr Challen, Ms Quinn, and Sir Kevin Tebbit. Ms Fratto was appointed to the Committee on 1 July 2012. Ms Quinn was appointed as Chair of the Committee on 10 July 2012.

The 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 last financial year except as was disclosed in the Corporate governance statement.

The Committee met five times in financial year 2012 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;

- Committee terms of reference; and
- Structure, performance targets and payments from Long-Term Incentives.

Mr Brydon is absent when his own remuneration as Chairman of the Company is under consideration. The Chief Executive attends meetings of the Committee by invitation; he is absent when his own remuneration is under consideration. During the year, the Committee received material assistance and advice from the Chief Executive and the HR Director (who is also Secretary to the Committee). The Committee and the Company also received advice from Kepler Associates, the Committee's independent remuneration adviser, and Freshfields Bruckhaus Deringer LLP. Kepler does not provide any other services to the Group. Freshfields Bruckhaus Deringer LLP was appointed by the Company to advise the Group on various legal matters during the year. 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 last annual review of the Committee's Terms of Reference was conducted in July 2012.

Remuneration policy

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

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

It is the Company's policy to take into account the pay and conditions of employees throughout the Group when determining directors' remuneration. During the year, the Committee received a paper from the Group HR Director and noted the pay policy applicable in the Group's main areas of operation in determining the remuneration of the Board, including the Executive Directors.

Nomination Committee

The members of the Committee are: Mr Brydon, as Chairman of the Committee, Mr Angelici, Mr Challen, Ms Quinn, Ms Fratto and Sir Kevin Tebbit.

The Committee leads the process for identifying and makes recommendations to the Board regarding candidates for appointment as directors of the Company and as Company Secretary, giving full consideration to succession planning and the leadership needs of the Group. It also makes recommendations to the Board on the composition of the Nomination Committee and the composition and chairmanship of the Audit and Remuneration Committees. It reviews regularly the structure, size and composition of the Board, including the balance of skills, knowledge and experience and the independence of the non-executive directors, and makes recommendations to the Board with regard to any changes. The Committee meets periodically when required. No-one other than members of the Committee is entitled to be present at meetings but the Chief Executive is normally invited to attend and external advisers may be invited by the Committee to attend. During the last financial year, the Committee reviewed the Company's talent management and succession plans. The Committee agreed to amend Mr Bowman's service contract to remove the references to a retirement age; the remaining terms of the contract, including the notice periods, remained unaltered. The Committee has access to such information and advice both from within the Group and externally, at the cost of the Company, as it deems necessary. This may include the appointment of external search consultants, where appropriate. The Committee reviews annually its terms of reference and effectiveness and recommends to the Board any changes required as a result of such review. The last such annual review of the Committee's terms of reference was conducted in July 2012.

Senior Management

In addition to Philip Bowman and Peter Turner, our senior management team includes the general managers of our five divisions: Mal Maginnis of Smiths Detection, Tedd Smith of John Crane, Srini Seshadri of Smiths Medical, Ralph Phillips of Smiths Interconnect and Pat McCaffrey of Flex-Tek, as well as our General Counsel, Michael Herlihy, Chief Information Officer, Brian Jones, Strategy Director, Mark Reckitt and Director of Human Resources, Terry Nolan.

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.

Executive directors' remuneration comprise basic salary, benefits in kind, annual bonus and pension benefits. In addition, executive directors and senior executives participate in share-based incentive schemes, which in financial year 2012 included the Smiths Group Sharesave Scheme, the Smiths Group Co-Investment Plan ("CIP"), the Smiths Group 2008 Value Sharing Plan and the 2010 Smiths Group Value Sharing Plan ("VSP").

Co-Investment Plan (CIP)

Executive directors and selected senior executives are required to invest 50 per cent. of any net bonus earned in Smiths shares. Invested amounts are eligible for a 2-for-1 matching share award after three years (based on the pre-tax amount of deferred bonus in question), subject to continued employment in the Group and the Company's average return on capital employed ("ROCE") over the performance period exceeding the Company's weighted average cost of capital ("WACC"), which the Committee regards as appropriately reflecting the operating efficiency of the Company. Matching share awards vest in full if ROCE exceeds WACC by an average margin of at least 3 per cent. a year; a 1-for-1 matching share award vests if ROCE is between WACC+1 per cent. and WACC+3 per cent. p.a. Dividends accrue on matching shares that vest. The Committee reviews these targets prior to the start of each award cycle to ensure they remain appropriately stretching. For 2007/08 and earlier years, executive directors and selected senior executives were able to invest up to 100 per cent. of any net bonus earned (or if greater, 25 per cent. of salary) in Smiths shares. Invested amounts were eligible for a 1-for-1 matching share award after three years (based on the pretax amount of salary or deferred bonus in question) subject to continued employment in the Group and the Company's average ROCE over the performance period exceeding the Company's WACC over the same period by an average margin of at least 1 per cent. p.a.

Value Sharing Plans (VSPs)

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

2008 Group VSP

Awards made under the Group VSP reward selected senior executives (including the CEO) with a pre-determined number of shares for every £5 million of value created above a hurdle over the three-year and four-year performance periods from 1 August 2008. One-third of the award will depend on the growth, over each performance period, in Smiths market capitalisation plus net equity cash-flows to shareholders (i.e. dividends plus share buybacks less share issues) over and above the median total shareholder return of the FTSE 100 companies (excluding financial services companies). The remaining two-thirds of each award will be determined by the growth, over each performance period, in adjusted Profit Before Tax ("PBT") (from a baseline PBT of £338.6 million in financial year 2008) multiplied by a fixed multiple of 12.0 plus net equity cash-flows to shareholders over and above a cost of equity hurdle return of 9.5 per cent. a year. No retesting of either performance condition is permitted. In line with the commitment made to shareholders at the time, no subsequent grants were made under the 2008 VSPs during the financial years ended 31 July 2010; 31 July 2011; or 31 July 2012. In 2010, the Committee reviewed the Group's long-term incentive arrangements. The Committee felt that the broad structure of the VSP remained appropriate going forward, and shareholders approved a new VSP at the 2010 AGM.

2010 Group VSP

Messrs Bowman and Turner are participants in the 2010 Group VSP, which rewards executive directors and selected senior executives with a pre-determined number of shares for every £5 million of value created above a hurdle over a three-year performance period.

TSR Element

30 per cent. of the award will depend on the three year growth in Smiths market capitalisation plus net equity cash-flows to shareholders (i.e. dividends plus share buybacks less share issues) over and above the median total

shareholder return of the FTSE 100 companies (excluding financial services companies). Participants will only be entitled to a vesting of shares under the TSR Element if the Committee is satisfied that this is justified by the underlying financial performance of the Company over the performance period.

Earnings Element

The remaining 70 per cent. of the award will be determined by the three year growth in adjusted Profit Before Tax (PBT) (from a baseline PBT of £432.7 million in financial year 2010) multiplied by a fixed multiple of 10.1 (representing the ratio of Smiths market capitalisation at the start of the performance period to the baseline PBT) plus net equity cash-flows to shareholders over and above a cost of equity hurdle return of 8.5 per cent. a year. The Committee determined this hurdle rate of return to be sufficiently challenging, whilst taking into account the substantial fall in the risk free rate over the two years since the grant of the 2008 VSP, and its impact on the Group's cost of equity. The Committee may reduce the payout of the Earnings Element if an acquisition results in a material reduction in return on invested capital. No retesting of either performance condition is permitted.

2010 Divisional VSPs

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

Leaving and change-of-control provisions

The treatment of awards on leaving or a change of control is the same for both the 2008 and 2010 VSPs. For "bad leavers", awards lapse. In the event of ill health, permanent disability or death, awards would be pro-rated for time and the performance period would run its normal course (except on death where the performance period would be curtailed). For other leavers, the treatment of awards remains subject to Committee discretion. In the event of a change of control, performance would be measured over the period from grant to change of control. As the plan is based on increasing value over time faster than a benchmark, the curtailing of the performance period naturally reduces the value of the plan and in such circumstances there is no need for additional time pro-rating. The Committee retains discretion to vary these approaches if it deems it appropriate to do so.

2011 Long-Term Incentive Plan ("LTIP")

The LTIP was approved by shareholders at the AGM on 22 November 2011. The first LTIP awards were made on 16 December 2011 to the executive directors and certain senior executives. Mr Bowman was granted a conditional share award over 275,321 shares and Mr Turner was granted a conditional share award over 89,535 shares. For participants with group-wide responsibilities vesting will be dependent on achievement of three separate performance conditions over a three-year period: relative total shareholder return (30 per cent. of the award), growth in earnings per share (50 per cent. of the award) and cash conversion (20 per cent. of the award), as further set out in the Notice of the 2011 AGM: for participants with divisional responsibilities, the vesting will be dependent upon three separate performance conditions relating to the participant's division over a three-year period: growth in revenue less currency translation and acquisitions, operating margin and cash conversion.

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 per cent. discount to the market price.

Directors' Compensation

The elements of the compensation of the directors are set out below for the periods indicated:

	Fees/salary		Benefits	Bonus	Payments in lieu of pension contributions	Total compensation	
	2012	2011	2012	2012	2012	2012	2011
				(£ thousands)			
Chairman							
D H Brydon	305	305	32	—	—	337	328
Chief Executive							
P Bowman	820	800	39	1,168	344	2,371	2,294
Executive director							
P A Turner	400	400	1	390	100	891	826
Non-executive directors							
D J Challen	69	69	—	—	—	69	69
T Fratto[(1)] (appointed 01/07/12)	5	—	—	—	—	5	—
Sir Kevin Tebbit	54	54	—	—	—	54	54
A C Quinn	55	54	—	—	—	55	54
B F J Angelici	54	54	—	—	—	54	54
S Chambers[(2)]	63	69	—	—	—	63	69
Total	1,825	1,805	72	1,558	444	3,899	3,748

Notes:

(1) Tanya Fratto's total emoluments for 2012 were for a part year, covering the period from her appointment on 1 July 2012 until the end of the 2012 financial year on 31 July 2012.

(2) Stuart Chambers' total emoluments are for a part year, covering the period from 1 August 2011 until his retirement from the Board on 1 July 2012.

Total remuneration of directors, excluding the value of shares to which certain directors may become entitled under the Value Sharing Plan, Performance Share Plan and Co Investment Plan and pension allowances, was as follows:

	Financial Year		
	2012	2011	2010
		(£ thousands)	
Fees, salaries and benefits, compensation for loss of office	1,897	1,868	1,920
Performance-related bonuses	1,558	1,444	2,021
Aggregate gain from exercise of share options and vesting of share awards	2,144	1,123	398
Payments in lieu of pension contribution	444	436	365
Total	6,043	4,871	4,704

PRINCIPAL SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

Principal Shareholders

Share Capital

As at 21 September 2012, the Company had issued share capital of £147,247,011 comprised of 392,658,695 ordinary shares and no preference shares.

Shareholders

As at 21 September 2012, the Company had been notified, pursuant to the FSA's Disclosure & Transparency Rules and the Companies Act of 2006, of the notifiable voting rights in its issued share capital listed in the table below. The aggregated beneficial interests of the directors and their families and connected persons, as a group, in the Company's issued share capital is listed below.

Name	Number of Shares Held	Percentage of Ownership
BlackRock, Inc.	19.0 million	4.8%
Legal & General Group plc	19.2 million	4.9%
Lloyds Banking Group plc	—	less than 5.0%
Massachusetts Financial Services Company	17.9 million	4.6%
Newton Investment Management Limited	15.2 million	3.9%
Directors as a group	331,477	0.08%

On 26 January 2012, Lloyds Banking Group plc advised that its direct and indirect interests over the voting rights in Smiths shares had reduced below 5 per cent. of the issued share capital. On 24 April 2012, TIAA-CREF Investment Management LLC / Teachers Advisors, Inc. advised that its direct and indirect interests over the voting rights in Smiths shares had reduced below 3 per cent. of the issued share capital.

The voting rights of these shareholders do not differ from the voting rights of any other holders of the Company's ordinary shares, and we are not aware of any agreements or restrictions on share transfers or on voting rights relating to ordinary shares.

Related Party Transactions

The Group has a service contract with a company connected to a member of the Executive Committee. Costs of £0.3 million in the financial year 2012 (2011: £0.2 million) were incurred in respect of this arrangement.

DESCRIPTION OF THE GUARANTOR

Incorporation, Registered Office, and Purpose

Smiths Group International Holdings Limited (the "Guarantor") was incorporated and registered as a private limited company in England and Wales under the name of Alamahda Investments Limited with the registered number 01085153 on 5 December 1972, and operates under the Companies Act 2006. It changed its name to Smiths Group International Holdings Limited on 14 November 2002. The registered office of the Guarantor is located at 2nd Floor, Cardinal Place, 80 Victoria Street, London SW1E 5JL, United Kingdom and the telephone number of its registered office is +44 20 7808 5500.

The Guarantor's principal activity is that of an investment holding company with limited assets of its own and conducts substantially all of its business through operating entities. The objects of the Guarantor as stated in its memorandum are among others, to carry on business as a holding company. As at 31 July 2012 the Guarantor had investments of £3,204 million. Since that date the Guarantor has invested £53.5 million in Smiths Finance Limited, a new financing company.

As at 31 July 2012, the Company owned 100 per cent. of the shares of the Guarantor.

Board of Directors

The directors of the Guarantor and their functions and principal directorships outside the Guarantor are as follows:

Name	Position	Principal activities outside the Guarantor
Donald Andrew Robertson Broad	Director	Group Financial Controller, Smiths Group plc
Sarah Louise Cameron	Director	Company Secretary, Smiths Group plc
Michael Hugh Creedon Herlihy	Director	General Counsel, Smiths Group plc

The business address of each of the above directors is 2nd Floor, Cardinal Place, 80 Victoria Street, London SW1E 5JL, United Kingdom.

None of the members of the Board of Directors has any potential conflict of interests between duties to the Guarantor and their private interests or other duties.

Employees

As at the date of this offering memorandum, the Guarantor has no active employees. Employees of other Group companies perform all administration of the Guarantor's affairs.

Share Capital

As at 31 July 2012, the Guarantor's authorised share capital was unlimited consisting of unlimited shares of £1.00 each, of which 397,756,371 shares were in issue and fully paid-up as at the date of this offering memorandum. All of the Guarantor's issued shares are beneficially owned by the Company.

Financial Statements

PricewaterhouseCoopers LLP has audited the Guarantor's unconsolidated financial statements, without qualification, in accordance with generally accepted auditing standards in the United Kingdom as at and for the years ended 31 July 2011 and 31 July 2010, respectively.

DESCRIPTION OF THE NOTES AND THE GUARANTEE

The following is a summary of the material provisions of the Notes, the Guarantee and the Fiscal and Paying Agency Agreement (as described below). The summary does not purport to be complete and is qualified in its entirety by reference to all of the provisions of the Notes, the Guarantee and the Fiscal and Paying Agency Agreement. It does not restate the agreement in its entirety. Copies of the Fiscal and Paying Agency Agreement will be available for inspection during normal business hours at any time after the initial issuance date of the Notes at the offices of the Agent at the address below. Any capitalised term used herein but not defined shall have the meaning assigned to such term in the Fiscal and Paying Agency Agreement.

General

The $400,000,000 3.625 per cent. senior notes due 12 October 2022 (the "Notes") will be issued in registered form under a Fiscal and Paying Agency Agreement to be dated as at 12 October 2012 (the "FPAA") between Smiths Group plc (the "Company"), Smiths Group International Holdings Limited, as guarantor (the "Guarantor"), and Citibank, N.A., as fiscal agent (the "Fiscal Agent"), paying agent (the "Paying Agent") and transfer agent (the "Transfer Agent") and referred to collectively in such capacities as the Agent (the "Agent") and, in each such several capacities as the Fiscal Agent, the Paying Agent and the Transfer Agent and Citigroup Global Markets Deutschland AG, as registrar (the "Registrar"). The FPAA is not required to be and will not be qualified under the US Trust Indenture Act of 1939, as amended (the "Trust Indenture Act"), and will not incorporate by reference the provisions of the Trust Indenture Act. Consequently, the holders of Notes generally will not be entitled to the protections provided under the Trust Indenture Act to holders of debt securities issued under a qualified indenture, including those requiring a trustee to resign in the event of certain conflicts of interest and to inform the holders of Notes of certain relationships between it and the Company. In this "Description of the Notes and the Guarantee", the terms holder, Noteholder and other similar terms refer to a registered holder of Notes, and not to a beneficial owner of a book-entry interest in any Notes, unless the context otherwise clearly requires. In this "Description of the Notes and the Guarantee", references to Notes include both the Notes and the Guarantee, except where otherwise indicated or as the context otherwise requires.

For so long as any Notes remain outstanding and are "restricted securities" within the meaning of Rule 144(a)(3) under the Securities Act, the Company will, during any period in which it is neither subject to Section 13 or 15(d) of the US Securities Exchange Act of 1934, as amended (the "Exchange Act"), nor exempt from reporting pursuant to Rule 12g3-2(b) under the Exchange Act, make available to any holder (or any beneficial owner of a book-entry interest in such Notes designated by the holder thereof) in connection with any sale thereof and to any prospective purchaser of Notes or a book-entry interest in Notes designated by such holder, in each case upon request of such holder, the information specified in, and meeting the requirements of, Rule 144A(d)(4) under the Securities Act. As at the date of this offering memorandum, the Company is exempt from reporting pursuant to Rule 12g3-2(b) under the Exchange Act.

The Regulation S Notes will be resold only to non-US persons located outside the United States in offshore transactions in reliance on Regulation S under the Securities Act.

Principal, Maturity and Interest

The Notes will be unsecured and unsubordinated obligations of the Company and will be unconditionally guaranteed on a senior, unsecured basis by the Guarantor (the "Guarantee"). The Notes are initially issuable in aggregate principal amounts not to exceed $400,000,000 and will mature on 12 October 2022. The Notes will bear interest at 3.625 per cent. per annum from the date of the initial issuance of the Notes or from the most recent Interest Payment Date to which interest has been paid or provided for, payable semi-annually in arrears on 12 April and 12 October commencing on 12 April 2013 (each, an "Interest Payment Date") to the person in whose name any Note is registered at the close of business on 1 April or 1 October (whether or not a Business Day) immediately preceding such Interest Payment Date (each, a "Record Date"), notwithstanding any transfer or exchange of such Notes subsequent to the Record Date and prior to such Interest Payment Date. If and to the extent the Company shall default in the payment of the interest due on such Interest Payment Date and the applicable grace period shall have expired, such defaulted interest shall be paid to the persons in whose names Notes are registered at the close of business on a subsequent Record Date (which shall not be less than 10 days prior to the date of payment of such defaulted interest) established by notice given by mail by or on behalf of the Company to the holders (which term means registered holders) of the Notes, as applicable, not less than 15 days preceding such subsequent Record Date. Interest will be computed on the basis of a 360-day year consisting of twelve 30-day months or in the case of an incomplete month, the number of days elapsed. If the date on which any interest payment or principal payment is to be made is not a Business Day in New York City, New York, London, England and the place of payment of such interest or principal, such payment will be made on the next day which is a Business Day in New York City, New York, London, England and the place of payment of such interest or principal without any further interest or other amounts being paid or payable in connection therewith.

Maturity

Unless previously purchased or redeemed by the Company, and cancelled, the principal amount of the Notes will mature and become due and payable on 12 October 2022 in an amount equal to their principal amount, with accrued and unpaid interest to such date.

The Guarantee

The Guarantor will fully, absolutely and unconditionally guarantee the due and punctual payment of the principal of and premium (if any) and interest on the Notes (including Additional Amounts, if any) when and as the same shall become due and payable, whether on the fixed date on which such principal, premium or interest is due and payable (the "Stated Maturity"), by declaration of acceleration, call for redemption or otherwise.

Optional Redemption

The Company may redeem the Notes in whole or in part, at the Company's option, at any time and from time to time at a redemption price equal to the greater of (a) 100 per cent. of the principal amount of the Notes to be redeemed and (b) as determined by the Independent Investment Banker, the sum of the present values of the applicable Remaining Scheduled Payments discounted to the date of redemption (the "Redemption Date") on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months or, in the case of an incomplete month, the number of days elapsed) at the Treasury Rate plus 30 basis points, in each case together with accrued and unpaid interest on the principal amount of the Notes to be redeemed to the Redemption Date. In connection with such optional redemption the following defined terms apply:

- "Comparable Treasury Issue" means the United States Treasury security selected by the Independent Investment Banker that would be utilised, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities of comparable maturity to the remaining term of the Notes.
- "Comparable Treasury Price" means, with respect to any Redemption Date, (a) the average of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) on the third Business Day preceding that Redemption Date, as set forth in the daily statistical release designated H.15 (519) (or any successor release) published by the Federal Reserve Bank of New York and designated "Composite 3.30 p.m. Quotations for US Government Notes" or (b) if such release (or any successor release) is not published or does not contain such prices on such Business Day, (i) the average of the Reference Treasury Dealer Quotations for that Redemption Date, after excluding the highest (or, if there is more than one such highest quotation, only one of such quotations) and lowest (or, if there is more than one such lowest quotation, only one of such quotations) of such Reference Treasury Dealer Quotations or (ii) if the Independent Investment Banker for the Notes obtains fewer than four such Reference Treasury Dealer Quotations, the average of all such Quotations.
- "Independent Investment Banker" means one of the Reference Treasury Dealers appointed by the Company to act as the Independent Investment Banker.
- "Reference Treasury Dealer" means each of Barclays Capital Inc., J.P. Morgan Securities LLC and Morgan Stanley & Co. LLC their respective successors and two other nationally recognised investment banking firms that are Primary Treasury Dealers specified from time to time by the Company; provided, however, that if any of the foregoing shall cease to be a primary US Government securities dealer in New York City (a "Primary Treasury Dealer"), the Company shall substitute therefor another nationally recognised investment banking firm that is a Primary Treasury Dealer.
- "Reference Treasury Dealer Quotation" means, with respect to each Reference Treasury Dealer and any Redemption Date, the average, as determined by the Independent Investment Banker, of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) quoted in writing to the Independent Investment Banker by such Reference Treasury Dealer at 3.30 p.m., New York City time, on the third Business Day preceding that Redemption Date.
- "Remaining Scheduled Payments" means, with respect to each Note to be redeemed, the remaining scheduled payments of the principal thereof and interest thereon that would be due after the related Redemption Date but for such redemption; provided, however, that if that Redemption Date is not an Interest Payment Date with respect to such Notes, the amount of the next succeeding scheduled interest payment thereon will be reduced by the amount of interest accrued thereon to that Redemption Date.

- "Treasury Rate" means, with respect to any Redemption Date, the rate per annum equal to the semi-annual equivalent yield to maturity (computed as of the third Business Day immediately preceding that Redemption Date) of the Comparable Treasury Issue, assuming a price for the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price for that Redemption Date.

Notice of any optional redemption will be given in accordance with "– Notice" below at least 30 days but not more than 60 days before the Redemption Date to each holder of the Notes to be redeemed.

Repurchase Upon a Change of Control Offer

If a Change of Control Triggering Event occurs with respect to the Notes, unless the Company has exercised its option to redeem the Notes as described above or the Notes have been redeemed in full for tax reasons as described below, the Company will be required to make an offer (a "Change of Control Offer") to each holder of the applicable Notes to repurchase all or any part (equal to $2,000 or an integral multiple of $1,000 in excess thereof) of that holder's Notes on the terms set forth in such Notes. In a Change of Control Offer, the Company will be required to offer payment in cash equal to 101 per cent. of the aggregate principal amount of Notes repurchased, plus accrued and unpaid interest, if any, on the Notes repurchased to the date of repurchase (a "Change of Control Payment").

Within 30 days following any Change of Control Triggering Event or, at the Company's option, prior to any Change of Control, but after public announcement of the transaction that constitutes or may constitute the Change of Control, a notice will be mailed to holders of the Notes describing the transaction that constitutes or may constitute the Change of Control Triggering Event and offering to repurchase such Notes on the date specified in the applicable notice, which date will be no earlier than 30 days and no later than 60 days from the date such notice is mailed (a "Change of Control Payment Date").

The notice will if mailed prior to the date of consummation of the Change of Control, state that the Change of Control Offer is conditioned on the Change of Control Triggering Event occurring on or prior to the applicable Change of Control Payment Date.

On the Change of Control Payment Date, the Company will, to the extent lawful:

- accept for payment all Notes or portions of Notes properly tendered and not withdrawn pursuant to the applicable Change of Control Offer;
- deposit with the Agent, in its capacity as paying agent, an amount equal to the Change of Control Payment in respect of all Notes or portions of Notes properly tendered; and
- deliver or cause to be delivered to the Agent, in its capacity as paying and transfer agent, the Notes properly accepted together with an officers' certificate stating the aggregate principal amount of Notes or portions of Notes being repurchased.

The Agent will promptly mail to each Holder of Notes properly tendered the purchase price for the Notes, and will promptly authenticate and mail (or cause to be transferred by book-entry) to each Holder a new note equal in principal amount to any unpurchased portion of any Notes surrendered; provided that each new Note will be in the principal amount of $2,000 or an integral multiple of $1,000 in excess thereof.

If the Change of Control Payment Date is on or after an Interest Record Date and on or before the related Interest Payment Date, any accrued and unpaid interest, if any, will be paid to the person in whose name the Note is registered at the close of business on such Record Date, and no additional interest will be payable to Holders who tender pursuant to the Change of Control Offer.

The Company will not be required to make a Change of Control Offer upon the occurrence of a Change of Control Triggering Event if a third party makes such an offer in the manner, at the times and otherwise in compliance with the requirements for an offer made by the Company and the third party repurchases all Notes properly tendered and not withdrawn under its offer. In addition, the Company will not repurchase any Notes if there has occurred and is continuing on the Change of Control Payment Date an Event of Default under the FPAA, other than a default in the payment of the Change of Control Payment upon a Change of Control Triggering Event.

An offer to repurchase the Notes upon a Change of Control Triggering Event may be made in advance of a Change of Control Triggering Event, if a definitive agreement is in place for a Change of Control at the time of the making of such an offer.

The Company has no present intention to engage in a transaction involving a Change of Control, although it is possible that the Company would decide to do so in the future. The Company could, in the future, enter into certain transactions, including acquisitions, refinancings or other recapitalisations, that would constitute a Change of Control, but that could increase the amount of debt outstanding at such time or otherwise affect the Company's capital structure or credit rating.

The Change of Control provisions above may deter certain mergers, tender offers and other take-over attempts involving the Company by increasing the capital required to effectuate such transactions.

The Company will comply with the requirements of Rule 14e-l under the Exchange Act and any other securities laws and regulations thereunder to the extent those laws and regulations are applicable in connection with the repurchase of the Notes as a result of a Change of Control Triggering Event. To the extent that the provisions of any securities laws or regulations conflict with the Change of Control Offer provisions of the Notes, the Company will comply with those securities laws and regulations and will not be deemed to have breached its obligations under the Change of Control Offer provisions of the applicable Notes by virtue of any such conflict.

For purposes of the Change of Control Offer provisions of the Notes, the following terms will be applicable:

"Change of Control" means the occurrence of any of the following:

(a) the direct or indirect sale, lease, transfer, conveyance or other disposition (other than by way of merger or consolidation), in one or more series of related transactions, of all or substantially all of the Company's assets and the assets of its Subsidiaries, taken as a whole, to any person, other than the Company or one of its Subsidiaries;

(b) the consummation of any transaction (including, without limitation, any merger, consolidation, amalgamation or other combination) the result of which is that any person becomes the beneficial owner (as defined in Rules 13d-3 and 13d-5 under the Exchange Act), directly or indirectly, of more than 50 per cent. of the Company's outstanding voting stock or other voting stock into which the Company's voting stock is reclassified, consolidated, exchanged or changed measured by voting power rather than number of shares;

(c) the Company consolidates with, or merges with or into, any person, or any person consolidates with, or merges with or into, the Company, in any such event pursuant to a transaction in which any of the Company's outstanding voting stock or the voting stock of such other person is converted into or exchanged for cash, securities or other property, other than any such transaction where the shares of the Company's voting stock outstanding immediately prior to such transaction constitute, or are converted into or exchanged for, a majority of the voting stock of the surviving person or any direct or indirect parent company of the surviving person, immediately after giving effect to such transaction; or

(d) the first day on which a majority of the members of the Company's Board of Directors are not Continuing Directors.

Notwithstanding the foregoing, a transaction will not be deemed to involve a Change of Control under clause (b) above if (i) the Company becomes a direct or indirect wholly-owned subsidiary of a holding company and (ii)(A) the direct or indirect holders of the voting stock of such holding company immediately following that transaction are substantially the same as the holders of the Company's voting stock immediately prior to that transaction or (B) immediately following that transaction no person (other than a holding company satisfying the requirements of this sentence) is the beneficial owner, directly or indirectly, of more than 50 per cent. of the voting stock of such holding company. The term person, as used in this definition, has the meaning given thereto in Section 13(d)(3) of the Exchange Act.

"Change of Control Triggering Event" with respect to the Notes means the occurrence of both a Change of Control and a Rating Event with respect to the Notes.

"Continuing Directors" means, as of any date of determination, any member of the Company's Board of Directors who (a) was a member of such Board of Directors on the date the Notes were issued or (b) was nominated for election, elected or appointed to such Board of Directors with the approval of a majority of the Continuing Directors who were members of such Board of Directors at the time of such nomination, election or appointment (either by a specific vote or by approval of the Company's notice of annual general meeting in which such member was named as a nominee for election as a director, without objection to such nomination).

"Investment Grade Rating" means a rating equal to or higher than Baa3 (or the equivalent) by Moody's and a rating equal to or higher than BBB- (or the equivalent) by S&P, and a rating equal to or higher than the equivalent investment grade credit rating from any replacement rating agency or rating agencies selected by the Company.

"Moody's" means Moody's Deutschland GmbH and its successors.

"Rating Agencies" means (a) each of Moody's and S&P and (b) if either of Moody's or S&P ceases to rate the Notes or fails to make a rating of the Notes publicly available for reasons outside of the Company's control, a "nationally recognised statistical rating organisation" within the meaning of Section 3(a)(62) of the Exchange Act selected by the Company (as certified by a resolution of its Board of Directors) as a replacement agency for Moody's or S&P, or both of them, as the case may be.

"Rating Event" means, with respect to the Notes, that on any day during the period (the "Trigger Period") commencing 60 days prior to the first public announcement by the Company of any Change of Control (or pending Change of Control) and ending 60 days following consummation of such Change of Control (which Trigger Period will be extended following consummation of a Change of Control for so long as any of the Rating Agencies has publicly announced that it is considering a possible ratings change), the Notes cease to have an Investment Grade Rating from both of the two Rating Agencies: provided, however, that a Rating Event otherwise arising by virtue of a particular Change of Control will not be deemed a Rating Event for the purposes of the definition of Change of Control Triggering Event if the rating agencies making the reduction in rating to which this definition would otherwise apply do not announce or publicly confirm or inform the Agent in writing at the Company's or the Agent's request that the reduction was the result, in whole or in part, of any event or circumstance comprised of or arising as a result of, or in respect of, the applicable Change of Control (whether or not the applicable Change of Control has occurred at the time of the Rating Event).

"S&P" means Standard & Poor's Credit Market Services Europe Limited, and its successors.

"Voting stock" means, with respect to any specified person (as that term is used in Section 13(d)(3) of the Exchange Act) as of any date, the capital stock of such person that is at the time entitled to vote generally in the election of the board of directors of such person.

The definition of Change of Control includes a phrase relating to the direct or indirect sale, lease, transfer, conveyance or other disposition of "all or substantially all" of the Company's assets and those of its Subsidiaries taken as a whole. Although there is a limited body of case law interpreting the phrase "substantially all" there is no precise established definition of the phrase under applicable law. Accordingly, the ability of a holder of Notes to require the Company to repurchase its Notes as a result of a sale, lease, transfer, conveyance or other disposition of less than all of assets and those of its Subsidiaries taken as a whole to another person or group may be uncertain.

Form and Denomination

The Notes will be issued in fully registered form and only in denominations of $2,000 and integral multiples of $1,000 in excess thereof. The Notes will be issued initially as global notes.

Further Issues

The aggregate principal amount of Notes issuable under the FPAA is unlimited. The Company may, from time to time, without notice to or the consent of the holders of the Notes, reopen the Notes and create and issue additional notes having identical terms and conditions as the Notes (or in all respects except for the issue date, issue price, payment of interest accruing prior to the issue date of such additional notes and/or the first payment of interest following the issue date of such additional notes) so that the additional notes are consolidated and form a single series of notes with the Notes.

The Company will not issue any additional notes that are consolidated and form a single series with the Notes unless such additional notes are fungible with the Notes for US federal income tax purposes.

Status of the Notes and the Guarantee

The Notes will be unsecured and unsubordinated obligations of the Company and will rank *pari passu* in right of payment among themselves and with all other direct, unsecured and unsubordinated obligations of the Company (except those obligations preferred by statute or operation of law). The Guarantee will be an unsecured and unsubordinated obligation of the Guarantor and will rank *pari passu* in right of payment with all other direct, unsecured and unsubordinated obligations of the Guarantor (except those obligations preferred by statute or operation of law). The Company and the Guarantor will be subject to a negative pledge with respect to certain types of indebtedness, which are discussed in "– Covenants of the Company and the Guarantor – Negative Pledge" below.

Payment of Additional Amounts

All payments of, or in respect of, principal, premium (if any) and interest on the Notes or under the Guarantee, as the case may be, will be made free and clear of, and without withholding or deduction for or on account of any present or future tax, levy, impost duty, assessment or governmental charge whatsoever imposed, assessed, levied, withheld or collected ("Taxes"), unless such withholding or deduction is required by law.

In the event such Taxes are imposed, assessed, levied, withheld or collected by or within any Relevant Taxing Jurisdiction (as defined below) or any jurisdiction through which the Company or the Guarantor makes payment in respect of the Notes, the Company or Guarantor, as the case may be, will pay to a holder of a Note such additional amounts ("Additional Amounts") as may be necessary so that the net amount received by such holder will not be less than the amount such holder would have received if such Taxes had not been imposed, assessed, levied, withheld or collected; provided, however, that neither the Company nor Guarantor, as the case may be, shall be required to pay any Additional Amounts for or on account of:

(a) any Taxes that would not have been so imposed, assessed, levied, withheld or collected but for the fact that the holder or beneficial owner of the Note (or a fiduciary, settlor, beneficiary, member or shareholder of, or possessor of a power over, such holder, if such holder is an estate, trust, partnership or corporation) has or has had some connection with a Relevant Taxing Jurisdiction other than the mere holding or ownership of, or the collection of principal of, and premium (if any) or interest on, a Note or the enforcement of the Guarantee, as the case may be;

(b) any Taxes that would not have been so imposed, assessed, levied, withheld or collected but for the fact that, where presentation is required in order to receive payment, the Note or Guarantee was presented more than 30 days after the Relevant Date (as defined below), except to the extent that the holder or beneficial owner thereof would have been entitled to Additional Amounts had the Note or Guarantee been presented for payment on the last day of such 30-day period;

(c) any estate, inheritance, gift, sales, transfer, personal property or similar Taxes;

(d) any Taxes that are payable otherwise than by deduction or withholding from payments on or in respect of the Note or Guarantee;

(e) any Taxes that would not have been so imposed, assessed, levied, withheld or collected but for the failure of the registered holder or the beneficial owner to comply with a written request by the Company to the holders of the Notes (but not, for the avoidance of doubt, to beneficial owners) to (i) provide any certification, identification, information, documents or other evidence concerning the nationality, residence or identity of the holder or the beneficial owner or its connection with the Relevant Taxing Jurisdiction or (ii) make any valid or timely declaration or claim or satisfy any other reporting, information or procedural requirements relating to such matters if, in either case, compliance is required by statute, regulation or administrative practice of the Relevant Taxing Jurisdiction as a condition to relief or exemption from such Taxes;

(f) any withholding or deduction imposed on a payment to or for the benefit of an individual that is required to be made pursuant to Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive;

(g) any withholding or deduction that is imposed on the Note or Guarantee that is presented for payment, where presentation is required, by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting such Note or Guarantee, as the case may be, to another paying agent in a member state of the EU; or

(h) any combination of the Taxes and/or withholdings or deductions described in paragraphs (a) through (g) above.

In addition, Additional Amounts will not be paid in respect of any payment in respect of the Notes or Guarantee to any holder of the Notes that is a fiduciary, a partnership, a limited liability company or any person other than the sole beneficial owner of such Notes to the extent such payment would be required by the laws of any Relevant Taxing Jurisdiction to be included in the income for tax purposes of a beneficiary or settlor with respect to such fiduciary, a member of such partnership, an interestholder in such limited liability company or a beneficial owner that would not have been entitled to such amounts had such beneficiary, settlor, member, interestholder or beneficial owner been the holder of such Notes or Guarantee.

For purposes hereof:

"Relevant Date" means whichever is the later of (i) the date on which such payment first becomes due and (ii) if the full amount payable has not been duly received by the Paying Agent on or prior to such due date, the date on which, the full amount having been so received, notice to that effect shall have been given to the Noteholders or holders of the Guarantee, as the case may be; and

"Relevant Taxing Jurisdiction" means (i) the United Kingdom or any other jurisdiction in which the Company, in the case of payments by the Company, or the Guarantor, in the case of payments by the Guarantor, is considered to be resident for tax purposes (or any political subdivision or authority thereof or therein having the power to tax) or (ii) if and only if the Company or the Guarantor has consolidated, merged, amalgamated or combined with, or transferred or leased its assets substantially as an entirety to, any person and as a consequence thereof such person becomes the successor obligor to the Company or the Guarantor in respect of payments pursuant to the Notes or the Guarantee, in the case of payments by such successor to the Company or Guarantor, as the case may be, any jurisdiction where any such successor obligor is organised or otherwise considered to be resident for tax purposes (or any political subdivision or any authority therein or thereof having the power to tax).

Unless otherwise stated, references in any context to the payment of principal of, and any premium or interest on, any Note, or any payment pursuant to the Guarantee, will be deemed to include payment of Additional Amounts to the extent that, in such context, Additional Amounts are, were or would be payable in respect thereof.

Redemption for Tax Reasons

The Notes are also redeemable by the Company, in whole but not in part, upon not less than 30 nor more than 60 days' notice, at 100 per cent. of the principal amount of such Notes plus accrued and unpaid interest to the applicable Redemption Date and any unpaid Additional Amounts at the Company's option at any time prior to their maturity if due to a Change in Tax Law (as defined below) (a) the Company or the Guarantor, as the case may be, in accordance with the terms of the Notes or Guarantee has, or would, become obligated to pay any Additional Amounts on the Notes; (b) in the case of the Guarantor, the Guarantor would be unable, for reasons outside its control, to procure payment by the Company, and (c) such obligation cannot be avoided by the Company or by the Guarantor taking reasonable measures available to it; provided, that, (i) no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Company or Guarantor would be obligated to pay any such Additional Amounts were a payment in respect of the Notes or Guarantee then due and (ii) at the time such notice is given, such obligation to pay such Additional Amounts remains in effect. Prior to the giving of any such notice of redemption, the Company must deliver to the Agent (A) an officers' certificate stating that the Company is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Company so to redeem have occurred and (B) an opinion of independent counsel of recognised standing with respect to tax matters of the Relevant Taxing Jurisdiction to the effect that the Company or the Guarantor, as the case may be, has or would become obligated to pay such Additional Amounts as a result of such Change in Tax Law.

For purposes hereof "Change in Tax Law" shall mean (a) any change in, or amendment to, any law of a Relevant Taxing Jurisdiction, or any political subdivision or any authority thereof or therein having power to tax (including any regulations or rulings promulgated thereunder or any amendment to or change in the application or official interpretation (including judicial or administrative interpretation) of such law, which change or amendment becomes effective or, in the case of an official interpretation, is announced, on or after the Issue Date, or (b) in the case of a successor obligor, any change in, or amendment to, any law of a Relevant Taxing Jurisdiction, or any political subdivision or any authority thereof or therein having power to tax (including any regulations or rulings promulgated thereunder), or any amendment to or change in the application or official interpretation (including judicial or administrative interpretation) of such law, which change or amendment becomes effective or, in the case of an official interpretation, is announced, on or after the date of the relevant consolidation, merger, amalgamation, combination or other transaction referred to in the definition of Relevant Taxing Jurisdiction above.

Redemption – General

Upon presentation of any Note redeemed in part only, the Company will execute and the Agent or Registrar will authenticate and deliver (or cause to be transferred by book-entry) to or on the order of the holder thereof, at the expense of the Company, a new Note or Notes, of authorised denominations, in principal amount equal to the unredeemed portion of the Note so presented.

On or before any Redemption Date (as defined above), the Company shall deposit with the Agent money sufficient to pay the redemption price of and accrued and unpaid interest on the Notes to be redeemed on such date. If less than all the Notes are to be redeemed, the Agent will select Notes for redemption pro rata, by lot, or by such other method as the Agent in its sole discretion shall deem fair and appropriate and is consistent with the rules of DTC and/or Euroclear and/or Clearstream, Luxembourg. The redemption price shall be calculated by the Independent Investment Banker and the Company, and the Agent shall be entitled to rely on such calculation.

On and after any Redemption Date, interest will cease to accrue on the Notes or any portion thereof called for redemption.

Reacquisition

There is no restriction on the ability of the Company to purchase or repurchase Notes, provided that any Notes so repurchased shall be cancelled and not reissued.

Covenants of the Company and the Guarantor

Negative Pledge

The FPAA provides that, for so long as any of the Notes remain outstanding none of the Company, the Guarantor and the Company's Subsidiaries will create any mortgage, charge, pledge, lien or other form of encumbrance or security interest upon the whole or any part of its undertaking, assets or revenues present or future to secure any indebtedness for borrowed money or any guarantee of or indemnity in respect of any indebtedness for borrowed money (other than Permitted Liens or Liens arising by operation of law) unless, at the same time or prior thereto, (i) the Company's obligations under the Notes are secured equally and rateably therewith or (ii) have the benefit of such other security, guarantee, indemnity or other arrangement as shall be approved by holders of a majority of the principal amount of the Notes.

Limitation on Mergers, Consolidations, Amalgamations and Combinations

The FPAA provides that, so long as any of the Notes remain outstanding, neither the Company nor the Guarantor may consolidate with or merge into any other person or sell, convey, transfer or lease its properties and assets as an entirety or substantially as an entirety to any person (other than any sale or conveyance by way of a lease in the ordinary course of business), unless (a) in the case of the Company, any successor person assumes the Company's obligations on the applicable Notes and under the FPAA and, in the case of the Guarantor, any successor person assumes the Guarantor's obligations under the relevant Guarantee and under the FPAA, (b) immediately after giving effect to such transaction, no Event of Default, and no event which, after notice or lapse of time or both, would become an Event of Default, shall have occurred and be continuing, (c) such successor person is organised under the laws of the United States, the United Kingdom or any other member state of the European Union as of 28 January 2003 (other than Greece and Spain), (d) such successor person agrees to pay any Additional Amounts imposed by the jurisdiction in which such successor person is incorporated or otherwise a resident for tax purposes or through which payments are made and resulting therefrom or otherwise and (e) such successor person is an entity treated as a corporation for US federal income tax purposes.

The Notes will not contain covenants or other provisions to afford protection to holders of the Notes in the event of a highly leveraged transaction or a change in control of the Company or the Guarantor except as provided above.

Upon certain mergers or consolidations involving the Company or the Guarantor, or upon certain sales or conveyances of the properties of the Company or the Guarantor, the obligations of the Company under the Notes or of the Guarantor under the Guarantee, as the case may be, shall be assumed by the person formed by such merger or consolidation or which shall have acquired such property and upon such assumptions such person shall succeed to and be substituted for the Company or the Guarantor, as the case may be, and then the Company or Guarantor will be relieved from all obligations under the Notes or Guarantee, as the case may be. The terms Company and Guarantor, as used in the Notes, the Guarantee and the FPAA, also refer to any such successors or assigns so substituted.

Certain Definitions

Set forth below is a summary of certain of the defined terms used in the Notes and the FPAA. You should refer to the Notes and the FPAA for the full definition of all defined terms as well as any other terms used herein for which no definition is provided.

"Group" means, at any time, the Company together with its Subsidiaries.

"Lien" means any mortgage or deed of trust, pledge, lien, charge, encumbrance or similar security interest.

"Net Assets" means, at any time, the gross assets of the Group less the liabilities of the Group at that time excluding (a) assets or liabilities representing the fair value of derivative financial instruments and (b) any liability or asset in respect of retirement benefits obligations and (c) any related deferred tax asset or liability, each as determined in accordance with generally accepted accounting principles in the United Kingdom (including IFRS) as applied in connection with the Group's financial statements, as calculated by reference to the most recent annual or interim consolidated accounts of the Group.

"Permitted Liens" of any person at any particular time means:

(a) Liens existing on the date of issue of the Notes;

(b) Liens arising by operation of law or incidental to the conduct of the business of that person or any Subsidiary of that person or the ownership of their property or assets, that do not materially impair the usefulness or marketability of such property or assets to that person;

(c) Liens securing taxes, assessments, governmental charges, levies or claims, which are not yet delinquent or which are being contested in good faith by appropriate proceedings, if adequate reserves or provisions, if any, as shall be required in conformity with applicable generally accepted accounting principles shall have been established or made;

(d) Liens in favour of the Company or Liens in favour of a Subsidiary securing debt owed by another Subsidiary (other than the Company) to such Subsidiary;

(e) Liens created upon any property or assets of the person or any shares or stock of a Subsidiary to secure or securing the whole or any part of the purchase price of the property or assets or shares or stock or the whole or any part of the cost of constructing or installing fixed improvements on such property or assets or to secure or securing the repayment of money borrowed to pay the whole or any part of such purchase price or cost or any vendor's privilege or Lien on that property or assets or shares or stock securing all or any part of the purchase price or cost including title retention agreements and leases in the nature of title retention agreements when recourse is limited solely to such Lien;

(f) Liens on property or assets or shares or stock or other equity equivalents existing at the time the property or assets or shares or stock or other equity equivalents were acquired by that person; provided that those Liens were not incurred or increased in anticipation of the acquisition;

(g) Liens on property or assets or shares or stock or other equity equivalents of a corporation or other legal entity existing at the time that corporation or other legal entity becomes a Subsidiary of that person, or is liquidated or merged into, or amalgamated or consolidated with, that person or a Subsidiary of that person or at the time of the sale, lease or other disposition to that person or a Subsidiary of that person of all or substantially all of the properties and assets of that corporation or other legal entity;

(h) any Lien created by or relating to legal proceedings so long as that Lien is discharged, vacated or bonded within 90 days of attachment;

(i) Liens on any property subject to sale and leaseback transactions not otherwise prohibited under the FPAA;

(j) Liens in favour of a governmental entity or holders of securities issued by a government entity pursuant to any contract or statute, including (but not limited to) Liens securing or relating to industrial revenue, pollution control or other tax exempt bonds;

(k) Liens required in connection with state or local governmental programmes which provide financial tax benefits, as long as substantially all of the obligations secured are in lieu of or reduce an obligation that would have been secured by a Lien otherwise permitted hereunder;

(l) rights of financial institutions to offset credit balances in connection with the operation of cash management programmes established for the benefit of the Company, or any Subsidiary or Liens in connection with the issuance of letters of credit for the benefit of the Company or any Subsidiary;

(m) Liens over margin stock, as defined in Regulation U of the Board of Governors of the Federal Reserve System;

(n) Liens incurred or deposits made to secure the performance of tenders, bids, leases, statutory or regulatory obligations, bankers' acceptances, Guarantee, surety and appeal bonds, government contracts, performance and return-of-money bonds and other obligations of a similar nature incurred in the ordinary course of business (exclusive of obligations for the payment of indebtedness for borrowed money);

(o) Liens created over any commodities and/or related contracts or documents in favour of any bank or other financial institution as security for limited recourse finance for the purchase of those commodities by any member of the Company or its Subsidiaries;

(p) Liens created by any member of the Group (the "Depositor") over a cash deposit, financial instrument, right of recovery or other like asset owned or deemed to be owned by the Depositor to the extent that it secures the payment by the Depositor or any other member of the Company or its Subsidiaries of amounts by way of principal or interest in respect of a borrowing by the Depositor or other member of the Company or its Subsidiaries; provided, that:

   (i) the value of the asset securing the Lien is equivalent to the amount of the obligation in respect of the borrowing it secures (the "Relevant Obligation");

   (ii) the creditor in respect of the Relevant Obligation has limited its recourse against the Company or its Subsidiaries for the Relevant Obligation to the proceeds of the Lien;

   (iii) the Lien, or the proceeds from its exercise, cannot be applied by the creditor against any obligation owed to it by the Depositor or any other member of the Company or its Subsidiaries other than the Relevant Obligation;

   (iv) the assets securing the Lien are acquired (or are deemed to be acquired) at or about the same time as the borrowing is made and the Lien granted; and

   (v) arrangements are in place to ensure that the Lien will be released to the extent of any reduction from time to time in the amount of the Relevant Obligation (other than through an exercise or partial exercise of the Lien);

(q) Liens on assets transferred to a person or on assets of a person, in either case, incurred in connection with a Qualified Receivables Transaction;

(r) any renewal, refunding or extension of any Lien referred to in the foregoing clauses (a) through (q); provided, that the principal amount of indebtedness secured by that Lien after the renewal, refunding or extension is not increased and the Lien is limited to the property or assets originally subject to the Lien and any improvements on the property or assets; and

(s) Liens, other than those referred to in the foregoing clauses (a) through (r), not exceeding 15 per cent. of the Company's Net Assets.

"Person" means any individual, corporation, partnership, joint venture, association, limited liability company, joint stock company, trust, unincorporated organisation or government or any agency or political subdivision thereof.

"Principal Subsidiary" means a Subsidiary of the Company at any relevant date:

(a) which has been a Subsidiary of the Company for more than 60 days; and

(b) whose turnover attributable to the Group for the then latest year or other period in respect of which accounts of such Subsidiary have been prepared for inclusion in the audited consolidated accounts of the Company (and as derived by reference to such accounts) represent 10 per cent. or more of the consolidated turnover of the Group for the then latest year or other period (or proportionately if the then latest accounting period of the relevant Subsidiary for which turnover is included in consolidated turnover shall have been for a shorter period than the then latest year or other period of the Group) in respect of which consolidated accounts of the Company shall have been audited; or

(c) whose gross assets as shown by the then latest accounts of such Subsidiary which have been prepared for inclusion in the audited consolidated accounts of the Company represent 10 per cent. or more of the consolidated gross assets of the Group, as derived by reference to the then latest audited consolidated accounts of the Company; or

(d) to which has been transferred (whether by one transaction or a series of transactions, related or not) the whole or substantially the whole of the assets of a Subsidiary of the Company which immediately prior to those transactions was a Principal Subsidiary.

However:

(i) a determination of whether a company which becomes a Subsidiary of the Company is or is not a Principal Subsidiary may be made at any time after the 60th day following that company becoming a Subsidiary of the Company by reference to its latest audited accounts and the latest audited consolidated accounts of the Company; and

(ii) in the case of paragraph (d) above, the transferring Subsidiary shall, upon the transferee Subsidiary becoming a Principal Subsidiary, cease to be a Principal Subsidiary.

A certificate from two Authorised Officers (as defined in the FPAA) that in their opinion a Subsidiary is, or is not, or was, or was not, at any particular time, or throughout any particular period, a Principal Subsidiary may, in the absence of manifest error, be conclusive and binding on all parties.

The FPAA provides that the Agent may rely on certificates or reports from such Authorised Officers in accordance with the provisions of the FPAA.

"Qualified Receivables Transaction" means any transaction or series of transactions that may be entered into by the Company or any of its Subsidiaries pursuant to which the Company or any of its Subsidiaries may sell, convey or otherwise transfer to any other person, or may grant a security interest in, any Receivables (whether now existing or arising in the future) of the Company or any of its Subsidiaries and any assets related thereto including, without limitation, all collateral securing such Receivables, all contracts and all guarantees or other obligations in respect of such accounts receivable, the proceeds of such Receivables and other assets which are customarily transferred, or in respect of which security interests are customarily granted, in connection with asset securitisation involving Receivables; provided, that the aggregate value of all such transactions shall not exceed £200 million.

"Receivable" means a right to receive a payment arising from a sale or lease of goods or the performance of services by a person pursuant to an arrangement with another person pursuant to which such other person is obligated to pay for goods and services under terms that permit the purchase of such goods or services on credit.

"Subsidiary" of any person means a subsidiary within the meaning of Section 736 of the UK Companies Act 1985.

Events of Default

The following will be Events of Default (each an Event of Default) with respect to the Notes:

(a) **Non-Payment:** default is made for more than 14 days in the payment on the due date of interest or Additional Amounts in respect of the Notes, or default is made in the payment of all or any part of the principal or premium, if any, of any Note as and when the same shall become due and payable either at maturity, upon any redemption, by declaration or otherwise; or

(b) **Breach of Other Obligations:** the Company or the Guarantor does not perform or comply with any one or more of its other obligations under the Notes or the FPAA which is not remedied within 30 days after notice of such default shall have been given to the Company by the Agent; or

(c) **Cross-Default:** (i) any other present or future indebtedness for borrowed money of the Company, the Guarantor or any of the Principal Subsidiaries becomes due and payable prior to its stated maturity by reason of any default or event of default (howsoever described) and remains unpaid, or (ii) any such indebtedness for borrowed money is not paid when due or, as the case may be, within any applicable grace period, or (iii) the Company, the Guarantor or any of the Principal Subsidiaries fails to pay when due and called upon (after the expiry of any applicable grace period) any amount payable by it under any present or future guarantee for, or indemnity in respect of, any indebtedness for borrowed money and which remains unpaid, *provided* that (x) payment of the relevant indebtedness for borrowed money is not being contested in good faith and in accordance with legal advice or (y) the aggregate amount of the relevant indebtedness for borrowed money, guarantees and indemnities in respect of which one or more of the events mentioned above in clauses (i), (ii) and (iii) has or have occurred and is or are continuing, equals or exceeds £25,000,000 or its equivalent in any other currency of the relevant indebtedness for borrowed money or, if greater, 3 per cent. of the Net Assets of the Company; or

(d) **Cessation of Guarantee:** the Guarantee ceases to be in full force and effect (except as contemplated by the terms of the FPAA) or the Guarantor denies or disaffirms in writing its obligations under the FPAA or Guarantee; or

(e) **Security Enforced:** any mortgage, charge, pledge, lien or other encumbrance, present or future, created or assumed by the Company, the Guarantor or any of the Principal Subsidiaries becomes enforceable and any step is taken to enforce it (including the taking of possession or the appointment of a receiver, administrative receiver, manager or other similar person) against all or substantially all of the assets of the Company, the Guarantor or any of the Principal Subsidiaries and is not discharged within 45 days; or

(f) **Insolvency:** any of the Company, the Guarantor or the Principal Subsidiaries is insolvent or bankrupt or unable to pay its debts (within the meaning of Section 123(1)(b) or (e) or Section 123(2) of the UK Insolvency Act 1986), stops, suspends or threatens to stop or suspend payment of all or a material part of its debts, proposes or makes a general assignment or an arrangement or composition (otherwise than for the purposes of reconstruction, amalgamation, reorganisation, merger or consolidation or other similar arrangement or in the case of a Principal Subsidiary, whereby the undertaking and assets of the Principal Subsidiary are transferred to or otherwise vested in the Company or another of its Subsidiaries) with or for the benefit of the relevant creditors in respect of any of such debts or a moratorium is agreed or declared in respect of or affecting all or a material part of the debts of the Company, the Guarantor or any of the Principal Subsidiaries; or

(g) **Winding-up:** an order is made, or an effective resolution passed or a plan adopted for the winding-up, liquidation or dissolution or administration of the Company, the Guarantor or any of the Principal Subsidiaries, or the Company, the Guarantor or any of the Principal Subsidiaries shall apply, propose a plan or petition for a winding-up, liquidation or administration order in respect of itself or ceases or threatens to cease to carry on all or substantially all of its business or operations, in each case except for the purpose of and followed by a reconstruction, amalgamation, reorganisation, merger or consolidation or other similar arrangement, or in the case of a Principal Subsidiary, whereby the undertaking and assets of the Principal Subsidiary are transferred to or otherwise vested in the Company or another of its Subsidiaries; or

(h) **Analogous Events:** any event occurs that under the laws of any relevant jurisdiction has an analogous effect to any of the events referred to in any of the foregoing paragraphs (a) to (f).

The FPAA provides that if an Event of Default occurs and is continuing, then and in each and every such case (other than certain Events of Default specified in paragraphs (f) and (g) above, or any other event that under the laws of any relevant jurisdiction has an analogous effect to any of the events specified in paragraphs (f) and (g) above, with respect to the Company or the Guarantor), unless the principal of all the Notes shall have already become due and payable, either the Agent or the holders of not less than 25 per cent. in aggregate principal amount of the Notes then outstanding, by notice in writing to the Company (and to the Agent if given by the holders), may, and the Agent at the request of such holders shall, subject to its receiving indemnification and/or security to its satisfaction, declare the entire principal amount of all Notes issued pursuant to the FPAA and interest accrued and unpaid thereon, if any, to be due and payable immediately, and upon any such declaration the same shall become immediately due and payable, without any further declaration or other act on the part of the Agent or any holder. If certain Events of Default described in paragraph (f) or (g) above, or any other event that under the laws of any relevant jurisdiction has an analogous effect to any of the events specified in paragraphs (f) and (g) above, occur with respect to the Company or the Guarantor and are continuing, the principal amount of and accrued and unpaid interest on all the Notes issued pursuant to the FPAA shall become immediately due and payable, without any declaration or other act on the part of the Agent or any holder. Under certain circumstances, the holders of a majority in aggregate principal amount of the Notes then outstanding, by written notice to the Company, the Guarantor and the Agent, may waive defaults and rescind and annul declarations of acceleration and its consequences, but no such waiver or rescission and annulment shall extend to or shall affect any subsequent default or shall impart any right consequent thereon.

The holders of a majority in aggregate principal amount of the Notes then outstanding will have the right to direct the time, method and place of conducting any proceeding for any remedy available to the Agent, or exercising any trust or power conferred on the Agent, subject to certain limitations to be specified in the FPAA.

The FPAA provides that no holder of any Note may institute any action or proceeding at law or in equity or in bankruptcy or otherwise upon or under or with respect to the Notes, the Guarantee endorsed thereon, or the FPAA, or for the appointment of a trustee, receiver, liquidator, custodian or other similar official or for any other remedy under the FPAA (except suits for the enforcement of payment of overdue principal or interest) unless such holder previously shall have given to the Agent written notice of an Event of Default and continuance thereof and unless the holders of not less than 25 per cent. in aggregate principal amount of the Notes then outstanding shall have made written request upon the Agent to institute such action or proceedings in its own name as Agent and shall have offered the Agent indemnity and/or security satisfactory to the Agent, the Agent shall not have instituted any such action or proceeding within 60 days of its receipt of such notice, request and offer of indemnity and/or security and the Agent shall not have received direction inconsistent with such written request by the holders of a majority in aggregate principal amount of the Notes at the time outstanding.

Defeasance

The FPAA will provide that the Company will have the option either (a) to be deemed (together with the Guarantor) to have paid and discharged the entire indebtedness represented by, and obligations under, the Notes and the Guarantee and to have satisfied all the obligations under the FPAA (except for certain obligations, including those relating to the defeasance trust and obligations to register the transfer or exchange of Notes, to replace mutilated, destroyed, lost or stolen Notes and to maintain paying agencies) and the Guarantee, on the 91st day after the applicable conditions described below have been satisfied or (b) to cease (together with the Guarantor) to be under any obligation to comply with the covenants described above under "– Covenants of the Company and the Guarantor – Negative Pledge" and the condition relating to the absence of any events of default under "– Covenants of the Company and the Guarantor – Limitation on Merger, Consolidations, Amalgamations and Combinations" under the Notes, and non-compliance with such covenants and the occurrence of certain events described above under "– Events of Default" will not give rise to any Event of Default under the Notes, at any time after the applicable conditions described below have been satisfied.

In order to exercise either defeasance option, the Company must deposit with the Agent, irrevocably in trust, money or Government Obligations (as defined in the FPAA) for the payment of principal of, premium, if any, and interest on the relevant outstanding Notes to and including the Redemption Date irrevocably designated by the Company on or prior to the date of deposit of such money or Government Obligations, and must (a) comply with certain other conditions as stated in the FPAA, including delivering to the Agent an opinion of US counsel, or a ruling received from the United States Internal Revenue Service, to the effect that holders of the Notes will not recognise income, gain or loss for United States federal income tax purposes as a result of the exercise of such option and will be subject to United States federal income tax on the same amount and in the same manner and at the same time as would have been the case if such option had not been exercised and which, in the case of (a) above, such opinion is based on a change of law after the initial issuance of the Notes and (b) pay in full all other amounts due and owing under the FPAA.

Modification and Waiver

Without Consent of Noteholders

The FPAA will contain provisions permitting the Company, the Guarantor, the Agent and the Registrar, without notice to or the consent of the holders of any of the Notes at any time outstanding, from time to time and at any time, to enter into a fiscal and paying agency agreement or agreements supplemental thereto:

- to convey, transfer, assign, mortgage or pledge to the holders of the relevant Notes or any person acting on their behalf as security for the Notes any property or assets;
- to evidence the succession of another person to the Company or the Guarantor or successive successions, and the assumption by the successor person(s) of the covenants, agreements and obligations of the Company or the Guarantor pursuant to the FPAA;
- to evidence and provide for the acceptance of appointment of a successor or successors to the Agent and/or the Paying Agent, Transfer Agent or Registrar, as applicable;
- to add to the covenants of the Company and the Guarantor, such further covenants, restrictions, conditions or provisions as the Company and the Guarantor, as the case may be, and the Agent shall consider to be for the protection of the holders of the Notes, and to make the occurrence, or the occurrence and continuance, of a default in any such additional covenants, restrictions, conditions or provisions an Event of Default under the Notes permitting the enforcement of all or any of the several remedies provided in the FPAA; provided that, in respect of any such additional covenant, restriction, condition or provision, such supplemental fiscal and paying agency agreement or agreements may provide for a particular period of grace after default (which may be shorter or longer than that allowed in the case of other defaults) or may limit the remedies available to the Agent upon such an Event of Default or may limit the right of holders of a majority in aggregate principal amount of the Notes to waive such an Event of Default;

- to modify the restrictions on, and procedures for, resale and other transfers of the Notes pursuant to law, regulation or practice relating to the resale or transfer of restricted securities generally;
- to cure any ambiguity or to correct or supplement any provision contained in the FPAA which may be defective or inconsistent with any other provision contained therein or the description thereof in this offering memorandum to make such other provision in regard to matters or questions arising under the Notes as the Company, the Guarantor, the Agent or the Registrar may deem necessary or desirable and which will not adversely affect the interests of the holders of the Notes in any material respect; and
- to reopen the Notes and create and issue additional notes having identical terms and conditions as the Notes (or in all respects except for the issue date, issue price, payment of interest accruing prior to the issue date of such additional notes and/or the first payment of interest following the issue date of such additional notes) so that the additional notes are consolidated and form a single series with the outstanding Notes.

With Consent of Noteholders

The FPAA will contain provisions permitting the Company, the Guarantor, the Agent and the Registrar, with the consent of the holders of not less than a majority in aggregate principal amount of the Notes at the time outstanding (including consents obtained in connection with a tender offer or exchange offer for the Notes), from time to time and at any time, to enter into a fiscal and paying agency agreement or agreements supplemental thereto for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions of the Notes or of modifying in any manner the rights of the holders of the Notes, provided, that no such fiscal and paying agency agreement or agreements may, without the consent of the holder of each of the Notes so affected:

- change the stated maturity of, or the date for payment of any principal of, or instalment of interest on, any Note; or
- reduce the principal amount of or the rate or amount of interest on any Note or Additional Amounts payable with respect thereto or reduce the amount payable thereon in the event of redemption or default; or
- change the currency of payment of principal of or interest on any Note or Additional Amounts payable with respect thereto; or
- change the obligation of the Company or the Guarantor to pay Additional Amounts (except as otherwise permitted by such Note); or
- impair the right to institute suit for the enforcement of any such payment on or with respect to any relevant Note; or
- reduce the percentage of the aggregate principal amount of the Notes outstanding, the consent of whose holders is required for any such supplemental fiscal and paying agency agreement; or
- reduce the aggregate principal amount of any Note outstanding necessary to modify or amend the FPAA or any such Note or to waive any future compliance or past default or reduce the quorum requirements or the percentage of aggregate principal amount of any Notes outstanding required for the adoption of any action at any meeting of holders of such Notes or to reduce the percentage of the aggregate principal amount of such Notes outstanding necessary to rescind or annul any declaration of the principal of all accrued and unpaid interest on any relevant Note to be due and payable;

provided, that no consent of any holder of any Note shall be necessary to permit the Agent, the Registrar, the Guarantor and the Company to execute supplemental fiscal and paying agency agreement or agreements as described under "– Modification and Waiver – Without Consent of Noteholders" above.

Any modifications, amendments or waivers to the FPAA or to the conditions of the Notes will be conclusive and binding on all holders of the Notes, whether or not they have consented to such action or were present at the meeting at which such action was taken, and on all future holders of the relevant Notes, whether or not notation of such modifications, amendments or waivers is made upon such Notes. Any instrument given by or on behalf of any holder of such a Note in connection with any consent to any such modification, amendment or waiver will be irrevocable once given and will be conclusive and binding on all subsequent registered holders of such Note.

Restrictions on Transfer

The initial purchasers propose to resell the Rule 144A Notes (as defined below) to certain institutions in the United States in reliance upon Rule 144A under the Securities Act. Notes that are initially offered and sold in the

United States to "qualified institutional buyers", or "QIBs" (the "Rule 144A Notes") may not be sold or otherwise transferred except, in the United States, pursuant to registration under the Securities Act or in accordance with Rule 144A or, outside the United States to non-US persons, pursuant to Rule 903 or Rule 904 of Regulation S thereunder (the "Regulation S Notes") or, in either case, in a resale transaction that is otherwise exempt from such registration requirements, and each of the Global Notes will bear a legend to this effect. In light of current US securities laws, subject to certain exceptions, an exemption should be available for a sale or transfer of a Rule 144A Note after its Specified Date. The Specified Date means, (A) with respect to any Rule 144A Note, the date which is one year (or such other period as shall constitute the required holding period pursuant to Rule 144 of the Securities Act) (such period, the "applicable holding period") after the later of (i) the date of acquisition of such Rule 144A Note from the Company or an affiliate of the Company, or (ii) any resale of such Rule 144A Note in reliance on Rule 144 under the Securities Act for the account of either the acquirer or any subsequent holder of such Rule 144A Note, in each case demonstrated to the reasonable satisfaction of the Company or applicable Guarantor (which may require delivery of legal opinions); or (B) with respect to any Regulation S Note, the date which is 40 days after the later of the commencement of the offering or the closing date (such period, the "distribution compliance period").

Unless a holder of a Rule 144A Note holds such Rule 144A Note for the entire applicable holding period, such holder may not be able to determine the Specified Date because such holder may not be able to determine the last date on which the Company, the Guarantor, or any affiliate thereof, was the beneficial holder of such holder's Rule 144A Note. The Agent will not be required to accept for registration or transfer any Rule 144A Notes, except upon presentation of satisfactory evidence (which may include legal opinions) that the restrictions on transfer have been complied with, all in accordance with such reasonable regulations as the Company and the Guarantor may from time to time agree with the Agent.

Prescription

Under New York's statute of limitations, any legal action upon the Notes in respect of interest or principal must be commenced within six years after the payment thereof is due. Thereafter the Notes will become generally unenforceable.

Notice

So long as the Notes are listed on the Official List of the UK Listing Authority and admitted to trading on the PSM, notices regarding the Notes will be given to holders by publication in a leading newspaper having general circulation in London, England (which is expected initially to be the *Financial Times*) as so required by the rules and regulations of the London Stock Exchange. Notices to holders of Notes will also be given by first-class mail postage prepaid to the last addresses of such holders as they appear in the Notes register. Such notices will be deemed to have been given on the date of such publication or mailing.

So long as any global notes representing the Notes are held in their entirety on behalf of a clearing system, or any of its participants, there may be substituted for the publication described above the delivery of the relevant notices to the clearing system, and its participants, for communication by them to the entitled accountholders. Any such notice shall be deemed to have been given to the accountholders on the third day after the day on which the said notice was given to the clearing system, and its participants.

Listing

Application has been made for the admission of the Notes to listing on the Official List of the UK Listing Authority and for the admission of the Notes to trading on the PSM. The Company has agreed to use its reasonable best efforts to maintain any such listing and admission to trading of the Notes for so long as any of the Notes remain outstanding.

Consent to Service

The Company and the Guarantor will initially designate CT Corporation System, whose address is 111 Eighth Avenue, New York, New York 10011, United States, as their authorised agent for service of process in any legal suit, action or proceeding arising out of or relating to the performance of its obligations under the FPAA, the Notes and the Guarantee brought in any state or federal court in the Borough of Manhattan, the City of New York. The Company and the Guarantor will irrevocably submit (but for those purposes only) to the non-exclusive jurisdiction of any such court in any such suit, action or proceeding.

Governing Law

The FPAA, the Notes and the Guarantee shall be governed by and construed in accordance with the laws of the State of New York, without regard to principles of conflicts of laws thereof.

Regarding the Fiscal and Paying Agent

In acting under the FPAA and in connection with the Notes, the Agent and the Registrar are acting solely as agents of the Company and the Guarantor and do not assume any obligation towards or relationship of agency or trust for or with the owners or holders of the Notes, except that any funds held by the Agent for payment of principal of or interest on the Notes or Additional Amounts with respect thereto shall be held as a banker by it for such owners and such holders and applied as set forth in the Notes, but need not be segregated from other funds held by it except as required by law. For a description of the duties and immunities and rights of the Agent under the FPAA, reference is made to the FPAA, and the obligations of the Agent are subject to such immunities and rights.

BOOK-ENTRY, SETTLEMENT AND CLEARANCE

Global Notes

The Notes will initially be issued in the form of two permanent global notes in fully registered form, without interest coupons, as follows:

- Notes sold to qualified institutional buyers in reliance on Rule 144A will be represented by Global Notes, each of which we refer to in this offering memorandum as a "Rule 144A Global Note"; and
- Notes sold in offshore transactions to non-US persons in reliance on Regulation S will be represented by Global Notes, each of which we refer to in this offering memorandum as a "Regulation S Global Note" (the Rule 144A Global Note and the Regulation S Global Note, each a "Global Note").

Upon issuance, each of the Global Notes will be deposited with the Fiscal Agent as custodian for DTC and registered in the name of Cede & Co., as nominee of DTC. The Notes (including beneficial interests in the Global Notes) will be subject to certain restrictions on transfer set forth therein and in the FPAA and will bear a legend regarding such restrictions as set forth under "Transfer Restrictions", unless DTC or its nominee determines otherwise in accordance with applicable law. Under certain circumstances, transfers may be made only upon receipt by the Transfer Agent of a written certification (in the form set out in the FPAA).

Ownership of beneficial interests in each Global Note will be limited to persons who have accounts with DTC (which we refer to in this offering memorandum as the "DTC participants") or persons who hold interests through DTC participants. We expect that under procedures established by DTC:

- upon deposit of each Global Note with DTC's custodian, DTC will credit portions of the principal amount of the Global Note to the accounts of the DTC participants designated by the initial purchaser; and
- ownership of beneficial interests in each Global Note will be shown on, and transfer of ownership of those interests will be effected only through, records maintained by DTC (with respect to interests of DTC participants) and the records of DTC participants (with respect to other owners of beneficial interests in each Global Note).

During the 40-day period commencing on the date of delivery of the Notes (which we refer to in this offering memorandum as the "Distribution Compliance Period"), beneficial interests in a Regulation S Global Note may be transferred only to non-US persons under Regulation S or to qualified institutional buyers under Rule 144A.

Beneficial interests in the Global Notes may not be exchanged for notes in definitive, certificated form, except in the limited circumstances described under "– Certificated Notes" below.

Each Global Note and beneficial interests in each Global Note will be subject to restrictions on transfer as described under "Transfer Restrictions".

Exchanges Between the Global Notes

Beneficial interests in one Global Note may generally be exchanged for interests in another Global Note of the same series.

On or before the end of the Distribution Compliance Period, a beneficial interest in a Regulation S Global Note may be transferred to a person who takes delivery in the form of an interest in a Rule 144A Global Note of the relevant series only upon receipt by the Fiscal Agent of a written certification from the transferor (in the applicable form provided in the FPAA) to the effect that such transfer is being made to a person whom the transferor reasonably believes is a QIB within the meaning of Rule 144A and in a transaction otherwise meeting the requirements of Rule 144A and any applicable securities laws of any state of the United States or any other jurisdiction. After the end of the Distribution Compliance Period, the certification requirement will no longer apply to such transfers, but transfers will continue to be subject to all applicable transfer restrictions under the federal securities laws of the United States and the securities laws of other relevant jurisdictions.

Beneficial interests in a Rule 144A Global Note may be transferred to a person who takes delivery in the form of an interest in a Regulation S Global Note of the relevant series, whether before or after the end of the Distribution Compliance Period, only upon receipt by the Fiscal Agent of a written certification from the transferor (in the applicable form provided in the FPAA) to the effect that such transfer is being made in accordance with Rule 903 or Rule 904 of Regulation S or other exemption from registration requirements under the Securities Act (if available).

A beneficial interest in a Global Note that is transferred to a person who takes delivery through another Global Note of the relevant series will, upon transfer, become subject to any transfer restrictions and other procedures applicable to beneficial interests in the other Global Note.

Book-Entry Procedures for the Global Notes

All interests in the Global Notes will be subject to the operations and procedures of DTC. We provide the following summaries of those operations and procedures solely for the convenience of investors. The operations and procedures of each clearing system are controlled by each such clearing system and may be changed at any time. Neither we nor the initial purchasers are responsible for those operations or procedures.

DTC has advised that it is:

- a limited purpose trust company organised under the laws of the State of New York;
- a "banking organization" within the meaning of the New York State Banking Law;
- a member of the US Federal Reserve System;
- a "clearing corporation" within the meaning of the Uniform Commercial Code; and
- a "clearing agency" registered pursuant to Section 17A of the Exchange Act.

DTC was created to hold securities for its participants and to facilitate the clearance and settlement of securities transactions between its participants through electronic book-entry changes to the accounts of its participants. DTC participants include securities brokers and dealers, including the initial purchasers; banks and trust companies; clearing corporations; and other organisations. Indirect access to DTC's system is also available to others such as banks, brokers, dealers and trust companies; these indirect participants clear through or maintain a custodial relationship with a DTC participant, either directly or indirectly. Investors who are not DTC participants may beneficially own securities held by or on behalf of DTC only through DTC participants or indirect participants in DTC.

So long as DTC's nominee is the registered owner of a Global Note, that nominee will be considered the sole owner or holder of the applicable Notes represented by that Global Note for all purposes under the FPAA. Except as provided below, owners of beneficial interests in a Global Note:

- will not be entitled to have Notes represented by the Global Note registered in their names;
- will not receive or be entitled to receive definitive, certificated Notes; and
- will not be considered the owners or holders of the applicable Notes under the FPAA for any purpose, including with respect to the giving of any direction, instruction or approval to the Fiscal Agent under the FPAA.

As a result, each investor who owns a beneficial interest in a Global Note must rely on the procedures of DTC to exercise any rights of a holder of Notes under the FPAA (and, if the investor is not a participant or an indirect participant in DTC, on the procedures of the DTC participant through which the investor owns its interest in the Notes). Neither we nor the initial purchasers will have any responsibility or liability for any aspect of the records relating to, or payments made on account of interests in the Notes held through the facilities of any clearing system or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

Payments of principal and interest with respect to the Notes represented by a Global Note will be made by the Fiscal Agent to DTC's nominee as the registered holder of the Global Note. Neither we nor the Fiscal Agent will have any responsibility or liability for the payment of amounts to owners of beneficial interests in a Global Note, for any aspect of the records relating to or payments made on account of those interests by DTC, or for maintaining, supervising or reviewing any records of DTC relating to those interests.

Payments by participants and indirect participants in DTC to the owners of beneficial interests in a Global Note will be governed by standing instructions and customary industry practice and will be the responsibility of those participants or indirect participants and DTC.

Transfers between DTC participants will be effected under DTC's procedures and will be settled in same-day funds. Transfers between accountholders in Euroclear and/or Clearstream, Luxembourg will be effected in the ordinary way under the rules and operating procedures of those systems.

Cross-market transfers between DTC participants, on the one hand, and participants in Euroclear or Clearstream, Luxembourg, on the other hand, will be effected within DTC through the DTC participants that are acting as depositaries for Euroclear and Clearstream, Luxembourg. To deliver or receive an interest in a Global Note held in a Euroclear or Clearstream, Luxembourg account, an investor must send transfer instructions to Euroclear or Clearstream, Luxembourg, as the case may be, under the rules and procedures of that system and within the established deadlines of that system. If the transaction meets its settlement requirements, Euroclear or Clearstream, Luxembourg, as the case may be, will send instructions to its DTC participant that is acting as depositary to take action to effect final settlement by delivering or receiving interests in the relevant Global Note in DTC, and making or receiving payment under normal procedures for same-day funds settlement applicable to DTC. Euroclear and Clearstream, Luxembourg participants may not deliver instructions directly to the DTC participant that is acting as depositary for Euroclear or Clearstream, Luxembourg.

Because of time zone differences, the securities account of a Euroclear or Clearstream, Luxembourg participant that purchases an interest in a Global Note from a DTC participant or someone holding through a DTC participant will be credited on the business day for Euroclear or Clearstream, Luxembourg immediately following the DTC settlement date. Cash received in Euroclear or Clearstream, Luxembourg from the sale of an interest in a Global Note to a DTC participant will be received with value on the DTC settlement date but will be available in the relevant Euroclear or Clearstream, Luxembourg cash account as of the business day for Euroclear or Clearstream, Luxembourg following the DTC settlement date.

DTC, Euroclear and Clearstream, Luxembourg have agreed to the above procedures to facilitate transfers of interests in the Global Notes among participants in those clearing systems. However, the clearing systems are not obliged to perform these procedures and may discontinue or change these procedures at any time. Neither we nor the Fiscal Agent will have any responsibility for the performance by DTC, Euroclear or Clearstream, Luxembourg or their accountholders or indirect participants of their obligations under the rules and procedures governing their operations.

Certificated Notes

Notes in definitive, certificated form will be issued and delivered to each person that DTC identifies as a beneficial owner of the related Notes only if:

- DTC notifies us at any time that it is unwilling or unable to hold the Global Notes and a successor depositary is not appointed within 90 days;
- DTC ceases to be registered as a clearing agency under the Exchange Act and a successor depositary is not appointed within 90 days;
- an Event of Default (as defined in the FPAA) has occurred and is continuing;
- in the event of a bankruptcy default, the Company fails to make payment on the Notes when due; or
- we, at our option, notify the Fiscal Agent that we elect to cause the issuance of definitive, certificated Notes.

In any of these cases the Company and the Guarantor will execute and the Registrar or Fiscal Agent will authenticate and deliver definitive, certificated Notes:

- registered in the name of each holder;
- without interest coupons; and
- in the same authorised denominations as the Global Notes.

The holder of a Definitive Note (as defined in the FPAA) may transfer such Note by surrendering it at the specified office of the Registrar or the Transfer Agent. Upon the transfer, exchange or replacement of Definitive Notes bearing the applicable legend set forth under "Transfer Restrictions" herein, or upon specific request for removal of such legend on a Definitive Note, the Company will deliver only Definitive Notes that bear such legend, or will refuse to remove such legend, as the case may be, unless there is delivered to the Company and the Registrar such satisfactory evidence, which may include an opinion of counsel, as may reasonably be required by the Company, that neither the legend nor the restrictions on transfer set forth therein are required to ensure compliance with the provisions of the Securities Act.

Each such Definitive Note will be endorsed with the Guarantee from the Guarantor in the form set out in the FPAA and will include terms substantially in the form of those set forth in the FPAA.

Payments

So long as any of the Notes remains outstanding, the Company and the Guarantor will maintain in London, England, an office or agency where the applicable Notes may be presented or surrendered for payment, registration of transfer or exchange and where notices and demands to or upon the Company or the Guarantor in respect of the Notes, the Guarantee and the FPAA may be served. The Company will give the Agent written notice of the location of any such office or agency and of any change of location thereof. The Company will initially designate the Agent for such purposes. The Company may also from time to time designate one or more other offices or agencies where the Notes may be presented or surrendered for any or all such purposes or where such notices or demands may be served and may from time to time rescind such designations; provided, however, that no such designation or rescission shall in any manner relieve the Company of any obligation to maintain an office or agency in London, England for such purposes.

A holder of Notes may transfer or exchange Notes in accordance with their terms. The Agent for the Notes will not be required to accept for registration or transfer any Notes, except upon presentation of satisfactory evidence (which may include legal opinions) that the restrictions on transfer have been complied with, all in accordance with such reasonable regulations as the Company may from time to time agree with the Agent.

Notwithstanding any statement herein, the Company reserves the right to impose or remove such transfer, certification, substitution or other requirements, and to require such restrictive legends on the Notes, as they may determine are necessary to ensure compliance with the securities laws of the United States and the states therein and any other applicable laws or as may be required by any stock exchange on which the Notes are listed. The Company may require payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in connection with any exchange or registration of transfer of Notes and any other expenses (including the fees and expenses of the Agent). No service charge will be made for any such transaction.

The Agent will not be required to exchange or register a transfer of (i) any Notes for a period of 15 days ending the due date for any payment of principal in respect of the Notes or the first mailing of any notice of redemption of Notes to be redeemed or (ii) any Notes selected, called or being called for redemption.

The Notes will be issued in registered form without coupons and transferable in denominations of $2,000 and integral multiples of $1,000 in excess thereof.

The laws of some jurisdictions require that certain persons take physical delivery in definitive form of securities which they own. Consequently, the ability to transfer beneficial interests in the Global Notes is limited to such extent.

TAXATION

UK Taxation

The comments below are of a general nature based on current UK tax law as applied in England and Wales and HM Revenue & Customs ("HMRC") practice (which may not be binding on HMRC) and are not intended to be exhaustive. They do not necessarily apply where the income is deemed for tax purposes to be the income of any other person. They relate only to the position of persons who are the absolute beneficial owners of their Notes and may not apply to certain classes of persons such as dealers or certain professional investors or persons who are connected with the Company for UK tax purposes. Any Noteholders who are in doubt as to their own tax position, or who may be subject to tax in a jurisdiction other than the UK, should consult their professional advisers.

Interest

While the Notes continue to be listed on a recognised stock exchange within the meaning of Section 1005 Income Tax Act 2007, payments of interest by the Company may be made without withholding or deduction for or on account of UK income tax. The London Stock Exchange is a recognised stock exchange for these purposes. Securities will be treated as listed on the London Stock Exchange if they are included in the Official List by the UK Listing Authority and are admitted to trading on the PSM.

If the Notes cease to be listed, interest will generally be paid by the Company under deduction of income tax at the basic rate (currently 20 per cent.) unless the Company has received a direction to the contrary from HMRC in respect of such relief as may be available pursuant to the provisions of any applicable double taxation treaty or unless another relief applies in light of the circumstances of a particular Noteholder.

Persons in the UK paying interest to or receiving interest on behalf of another person who is an individual may be required to provide certain information to HMRC regarding the identity of the payee or person entitled to the interest and, in certain circumstances, such information may be exchanged with tax authorities in other countries.

If the Guarantor is required to make payments under the Guarantee and any such payment can be characterised as interest or an annual payment, in either case, with a UK source, it may have to be paid under deduction of UK income tax at the basic rate, subject to the availability of exemptions, including a direction from HMRC pursuant to the provisions of an applicable double taxation treaty.

The interest has a UK source and accordingly may be chargeable to UK tax by direct assessment. Where the interest is paid without withholding or deduction, the interest will not be assessed to UK tax in the hands of holders of the Notes who are not resident in the UK, except where the Noteholder carries on a trade, profession or vocation through a branch or agency, or in the case of a corporate holder, carries on a trade through a permanent establishment in the UK, in connection with which the interest is received or to which the Notes are attributable, in which case (subject to exemptions for interest received by certain categories of agent) tax may be levied on the UK branch or agency, or permanent establishment.

If interest were paid under deduction of UK income tax (e.g. if the Notes lost their listing), Noteholders who are not resident in the UK may be able to recover all or part of the tax deducted if there is an appropriate provision in an applicable double taxation treaty. For example, under the current US-UK income tax treaty, eligible US Noteholders will generally be entitled to receive interest payments free of UK taxes and may be entitled to a refund of any UK tax withheld from interest payments.

Noteholders should note that the provisions relating to additional amounts referred to in "Description of the Notes and the Guarantee – Payment of Additional Amounts" above would not apply if HMRC sought to assess directly the person entitled to the relevant interest to UK tax. However exemption from, or reduction of, such UK tax liability might be available under an applicable double taxation treaty.

EU Savings Directive

The EU Savings Directive requires Member States to provide to the tax authorities of other Member States details of payments of interest and other similar income paid by a person established within its jurisdiction to (or for the benefit of) an individual or to certain other persons in another Member State, except that Austria and Luxembourg will instead impose a withholding system for a transitional period (subject to a procedure whereby, on meeting certain conditions, the beneficial owner of the interest or other income may request that no tax be withheld) unless during such period they elect otherwise.

The European Commission has proposed certain amendments to the Savings Directive, which may, if implemented, amend or broaden the scope of the requirements described above.

Taxation of Disposal (including redemption)

Corporate Noteholders

Noteholders within the charge to UK corporation tax (including non-resident Noteholders whose Notes are used, held or acquired for the purposes of a trade carried on in the UK though a permanent establishment) will be subject to tax as income on all profits and gains from the Notes broadly in accordance with their statutory accounting treatment. Such Noteholders will generally be charged in each accounting period by reference to interest and other amounts which, in accordance with generally accepted accounting practice, are recognised in determining the Noteholder's profit or loss for that period. Fluctuations in value relating to foreign exchange gains and losses in respect of the Notes will be brought into account as income.

Non-corporate Noteholders

The Notes should not constitute "Deeply Discounted Securities" within the meaning of Chapter 8 of Part 4 of the Income Tax (Trading and Other Income) Act 2005.

Accordingly, a disposal of a Note by a Noteholder resident or ordinarily resident for tax purposes in the UK or who carries on a trade, profession or vocation in the UK through a branch or agency to which the Note is attributable may give rise to a chargeable gain or allowable loss for the purposes of UK taxation of capital gains. In calculating any gain or loss on disposal of a Note, sterling values are compared at acquisition and transfer. Accordingly, a taxable profit could arise even where the foreign currency amount received on a disposal is less than or the same as the amount paid for the Note. Any accrued interest at the date of disposal should be taxed under the provisions of Chapter 2 of Part 12 of the Income Tax Act 2007 (Accrued Income Profits and Losses).

A transfer of a Note by a Noteholder resident or ordinarily resident for tax purposes in the UK or who carries on a trade, profession or vocation in the UK through a branch or agency to which the Note is attributable may give rise to a charge to tax on income in respect of an amount representing interest on the Note which has accrued since the preceding interest payment date. This amount should be taken into account in reducing any capital gain arising on the disposal of the Note.

Noteholders outside the charge to UK Corporation or Capital Gains Tax

Corporate Noteholders who are not resident for tax purposes in the UK, and whose Notes are not used, held or acquired for the purposes of a trade carried on in the UK through a permanent establishment, are outside the charge to UK corporation tax with respect to any disposal (including redemption) of the Notes.

Subject to the following paragraph relating to temporary non-residents, non-corporate Noteholders who are not resident or ordinarily resident for tax purposes in the UK, and who do not carry on a trade, profession or vocation in the UK through a branch or agency to which the Notes are attributable, are outside the charge to UK capital gains tax with respect to the disposal (including redemption) of the Notes.

Non-corporate Noteholders who cease to be resident or ordinarily resident in the UK for a period of less than five years of assessment may, depending on their circumstances (including the availability of exemptions or reliefs), be liable to UK capital gains tax with respect to the disposal (including redemption) of the Notes.

UK Stamp Duty and Stamp Duty Reserve Tax

No UK Stamp Duty or Stamp Duty Reserve Tax is payable on the issue or transfer by delivery of a Note or on its redemption.

US Federal Income Taxation

TO ENSURE COMPLIANCE WITH TREASURY DEPARTMENT CIRCULAR 230, HOLDERS ARE HEREBY NOTIFIED THAT: (A) ANY DISCUSSION OF FEDERAL TAX ISSUES IN THIS OFFERING MEMORANDUM IS NOT INTENDED OR WRITTEN TO BE RELIED UPON, AND CANNOT BE RELIED UPON, BY HOLDERS FOR THE PURPOSE OF AVOIDING PENALTIES THAT MAY BE IMPOSED ON

HOLDERS UNDER THE INTERNAL REVENUE CODE; (B) SUCH DISCUSSION IS INCLUDED HEREIN BY THE COMPANY IN CONNECTION WITH THE PROMOTION OR MARKETING (WITHIN THE MEANING OF CIRCULAR 230) BY THE COMPANY OF THE TRANSACTIONS OR MATTERS ADDRESSED HEREIN; AND (C) HOLDERS SHOULD SEEK ADVICE BASED ON THEIR PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISOR.

The following is a summary of certain material US federal income tax consequences of the acquisition, ownership and disposition of Notes by a US Holder (as defined below). This summary deals only with initial purchasers of Notes at the "issue price" (generally, the first price at which a substantial part of the Notes is sold to investors for cash, excluding sales to bond houses, brokers or similar persons or organisations acting in the capacity of underwriters, placement agents or wholesalers) that are US Holders that will hold the Notes as capital assets. The discussion does not cover all aspects of US federal income taxation that may be relevant to, or the actual tax effect that any of the matters described herein will have on, the acquisition, ownership or disposition of Notes by particular investors, and does not address state, local, foreign or other tax laws. This summary also does not discuss all of the tax considerations that may be relevant to certain types of investors subject to special treatment under the US federal income tax laws (such as certain financial institutions, insurance companies, investors liable for the alternative minimum tax, individual retirement accounts and other tax-deferred accounts, tax- exempt organisations, dealers in securities or currencies, investors that will hold the Notes as part of straddles, hedging transactions or conversion transactions for US federal income tax purposes or investors whose functional currency is not the US dollar).

As used herein, the term "US Holder" means a beneficial owner of Notes that is, for US federal income tax purposes, (i) an individual citizen or resident of the United States, (ii) a corporation created or organised under the laws of the United States or any State thereof, (iii) an estate the income of which is subject to US federal income tax without regard to its source or (iv) a trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more US persons have the authority to control all substantial decisions of the trust, or the trust has elected to be treated as a domestic trust for US federal income tax purposes.

The US federal income tax treatment of a partner in a partnership that holds Notes will depend on the status of the partner and the activities of the partnership. Prospective purchasers that are partnerships and their partners should consult their tax advisers concerning the US federal income tax consequences of the acquisition, ownership and disposition of Notes by the partnership.

The summary is based on the tax laws of the United States, including the Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations thereunder, published rulings and court decisions, all as of the date hereof and all subject to change at any time, possibly with retroactive effect.

THE SUMMARY OF US FEDERAL INCOME TAX CONSEQUENCES SET OUT BELOW IS FOR GENERAL INFORMATION ONLY. ALL PROSPECTIVE PURCHASERS SHOULD CONSULT THEIR TAX ADVISERS AS TO THE PARTICULAR TAX CONSEQUENCES TO THEM OF OWNING THE NOTES, INCLUDING THE APPLICABILITY AND EFFECT OF STATE, LOCAL, FOREIGN AND OTHER TAX LAWS AND POSSIBLE CHANGES IN TAX LAW.

Notes

Payments of Interest

Interest on a Note will be taxable to a US Holder as ordinary income at the time it is received or accrued, depending on the holder's method of accounting for tax purposes. Interest paid by the Company on the Notes constitutes income from sources outside the United States. Prospective purchasers should consult their tax advisers concerning the applicability of the foreign tax credit and source of income rules to income attributable to the Notes.

Sale and Retirement of the Notes

A US Holder will generally recognise gain or loss on the sale or retirement of a Note equal to the difference between the amount realised on the sale or retirement and the tax basis of the Note. A US Holder's tax basis in a Note will generally be its cost. The amount realised does not include the amount attributable to accrued but unpaid interest, which will be taxable as interest income to the extent not previously included in income. Gain or loss recognised by a US Holder on the sale or retirement of a Note will be capital gain or loss and will be long-term capital gain or loss if the Note was held by the US Holder for more than one year. Gain or loss realised by a US Holder on the sale or retirement of a Note generally will be US source for purposes of the foreign tax credit rules.

Backup Withholding and Information Reporting

Payments of principal and interest on, and the proceeds of sale or other disposition of Notes by a US paying agent or other US intermediary will be reported to the Internal Revenue Service and to the US Holder as may be required under applicable regulations. Backup withholding may apply to these payments if the US Holder fails to provide an accurate taxpayer identification number or certification of exempt status or fails to report all interest and dividends required to be shown on its US federal income tax returns. Certain US Holders (including, among others, corporations) are not subject to backup withholding. US Holders should consult their tax advisers as to their qualification for exemption from backup withholding and the procedure for obtaining an exemption.

Foreign Financial Asset Reporting

The holding of certain foreign financial assets, including debt of foreign entities, are subject to reporting requirements if the aggregate value of all of these assets exceeds $50,000 at the end of the taxable year or $75,000 at any time during the taxable year. The thresholds are higher for individuals living outside of the United States and married couples filing jointly. The Notes are expected to constitute foreign financial assets subject to these requirements unless the Notes are held in an account at a financial institution (in which case the account may be reportable if maintained by a foreign financial institution). US Holders should consult their tax advisors regarding the application of this legislation.

PLAN OF DISTRIBUTION

Pursuant to a purchase agreement dated 4 October 2012 (the "Purchase Agreement"), the initial purchasers have severally agreed with the Company and the Guarantor, subject to the satisfaction of certain conditions, to purchase $400,000,000 principal amount of the Notes. The principal amount of Notes to be purchased by each of the initial purchasers from the Company is set forth opposite their respective names below:

Initial Purchaser	Principal Amount of Notes
Barclays Capital Inc.	$120,000,000
J.P. Morgan Securities LLC	$120,000,000
Morgan Stanley & Co. LLC	$120,000,000
Mitsubishi UFJ Securities (USA), Inc.	$ 40,000,000
Total.	$400,000,000

The Purchase Agreement entitles the initial purchasers to terminate the purchase of the Notes in certain circumstances prior to payment to the Company. The Company and the Guarantor have agreed to indemnify the initial purchasers against certain liabilities in connection with the offer and sale of the Notes, including liabilities under the Securities Act, and may be required to contribute to payments the initial purchasers may be required to make in respect thereof.

The initial purchasers initially propose to offer the Notes at the offering price set forth on the cover page hereof. After the initial offering of the Notes, the offering price and other selling terms may from time to time be varied by the initial purchasers.

The Company and the Guarantor have agreed that neither of them and no person acting on their behalf will for a period of 15 days following the Closing Date, without the prior written consent of the initial purchasers directly or indirectly, issue, sell, offer to sell, grant any option for the sale of or otherwise dispose of, any debt securities of or guaranteed by the Company or the Guarantor that are substantially similar to the Notes (including, without limitation, with respect to the maturity, currency, interest rate and other material terms thereof).

The Notes are new issues of securities with no established trading market. The Notes are expected to be admitted to the Official List and to trading on the PSM. The initial purchasers are not obligated to make a market in the Notes and, accordingly, no assurance can be given as to the liquidity of, or trading market for, the Notes. In connection with the offering, the initial purchasers may purchase and sell Notes in the open market. These transactions may include over-allotment, syndicate covering transactions and stabilising transactions. Over-allotment involves syndicate sales of notes in excess of the principal amount of the Notes to be purchased by the initial purchasers in the offering, which creates a syndicate short position. Syndicate covering transactions involve purchases of the Notes in the open market after the distribution has been completed in order to cover syndicate short positions. Stabilising transactions consist of certain bids or purchases of Notes made for the purpose of pegging, fixing or maintaining the price of the Notes.

The initial purchasers may impose a penalty bid. Penalty bids permit the initial purchasers to reclaim selling concessions from a syndicate member when they, in covering syndicate positions or making stabilising purchases, repurchase Notes originally sold by that syndicate member.

Any of these activities may cause the price of the Notes to be higher than the price that otherwise would exist in the open market in the absence of such transactions. These transactions may be effected in the over-the-counter market or otherwise and, if commenced, may be discontinued at any time at the sole discretion of the initial purchasers, as applicable.

No action has been or will be taken in any jurisdiction that would permit a public offering of the Notes or the possession, circulation or distribution of any material relating to the Company in any jurisdiction where action for such purpose is required. Accordingly, the Notes may not be offered or sold, directly or indirectly, nor may any offering material or advertisement in connection with the Notes (including this offering memorandum and any amendment or supplement hereto) be distributed or published, in or from any country or jurisdiction, except under circumstances that will result in compliance with any applicable rules and regulations of any such country or jurisdiction.

The initial purchasers and their affiliates have performed certain investment and commercial banking or financial advisory services for the Company and its affiliates from time to time, for which they have received customary fees and commissions, and they expect to provide these services to the Company and its affiliates in the future, for which they expect to receive customary fees and commissions.

In addition, affiliates of the initial purchasers act as lenders under the Company's revolving credit facility and have received customary fees for their services in such capacity. The Company intends to use the net proceeds from the offering of the Notes for general corporate purposes. In the event that the Company repays amounts due under the revolving credit facility under which affiliates of the initial purchasers are lenders, such affiliates of the initial purchasers will receive a portion of the net proceeds from the offering.

United States

The Notes have not been and will not be registered under the Securities Act and may not be offered, sold or delivered within the United States except in certain transactions exempt from the registration requirements of the Securities Act. Accordingly, the Notes are being offered and sold only (i) to non-US persons outside the United States in reliance on Regulation S and (ii) within the United States to QIBs in accordance with Rule 144A (collectively, the "Eligible Purchasers").

Each initial purchaser has represented and agreed with the Company that it is a "qualified institutional buyer" as defined in Rule 144A with such knowledge and experience in financial and business matters as are necessary in order to evaluate the merits and risks of an investment in the Notes; (ii) is purchasing the Notes in a transaction exempt from, or not subject to, the registration requirements of Securities Act; (iii) will solicit offers to buy the Notes only from, and will offer to sell the Notes only to, the Eligible Purchasers in accordance with the purchase agreement and on the terms contemplated by the disclosure package; and (iv) will not offer or sell the Notes, nor has it offered or sold the Notes by, or otherwise engaged in, any form of general solicitation or general advertising (within the meaning of Regulation D of the Securities Act), including, without limitation, advertisements, articles, notices or other communications published in any newspaper, magazine, or similar medium or broadcast over television or radio, or any seminar or meeting whose attendees have been invited by any general solicitation or general advertising and will not engage in any directed selling efforts (within the meaning of Rule 902 of Regulation S), in connection with the offering of the Notes.

Terms used in the preceding two paragraphs have the meanings ascribed to them by Rule 144A and Regulation S, as applicable.

In addition, until 40 days after the commencement of the offering of the Notes, an offer or sale of Notes within the United States by any dealer (whether or not participating in the offering of the Notes) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A.

We expect that delivery of the Notes and the Guarantee will be made against payment therefor on or about the Closing Date, which will be the fifth business day following the date of pricing of the Notes. Pursuant to Rule 15c6-1 under the Exchange Act, trades in the secondary market generally are required to settle in three business days, unless the parties to any such trade expressly agree otherwise. Accordingly, purchasers who wish to trade Notes on the date of pricing or the next succeeding business day will be required, by virtue of the fact that the Notes initially will settle five business days following the pricing date (T+5), to specify an alternate settlement cycle at the time of any such trade to prevent a failed settlement. Purchasers of Notes who wish to trade Notes on the date of pricing or the next succeeding business day should consult their own advisor.

United Kingdom

Each initial purchaser has represented, warranted and agreed with the Company and the Guarantor that:

- it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the FSMA) received by it in connection with the issue or sale of any Note in circumstances in which section 21(1) of the FSMA does not apply to the Company or the Guarantor; and
- it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

European Economic Area

In relation to each Relevant Member State, each initial purchaser has represented, warranted and agreed with the Company and the Guarantor that with effect from and including the Relevant Implementation Date it has not made and will not make an offer of Notes which are the subject of the offering contemplated by this offering memorandum to the public in that Relevant Member State other than:

(a) to any legal entity which is a qualified investor as defined in the Prospectus Directive;

(b) to fewer than 100 or, if the Relevant Member State has implemented the relevant provision of the 2010 PD Amending Directive, 150, natural or legal persons (other than qualified investors as defined in the Prospectus Directive), as permitted under the Prospectus Directive, subject to obtaining the prior consent of the initial purchasers for any such offer; or

(c) in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of Notes shall require the Company, the Guarantor or any of the initial purchasers to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.

For the purposes of this provision, the expression an "offer of Notes to the public" in relation to any Notes in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Notes to be offered so as to enable an investor to decide to purchase or subscribe for the Notes, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State, the expression "Prospectus Directive" means Directive 2003/71/EC (and amendments thereto, including the 2010 PD Amending Directive, to the extent implemented in the Relevant Member State), and includes any relevant implementing measure in the Relevant Member State and the expression "2010 PD Amending Directive" means Directive 2010/73/EU.

TRANSFER RESTRICTIONS

Each purchaser of the Notes and the Guarantee, by accepting delivery of this offering memorandum, will be deemed to have represented, agreed and acknowledged that:

(a) It understands that such Notes and the Guarantee have not been and will not be registered under the Securities Act or with any securities regulatory authority of any state or other jurisdiction of the United States and may not be offered, sold, pledged or otherwise transferred except (a) in accordance with Rule 144A to a person that it and any person acting on its behalf reasonably believe is a QIB purchasing for its own account or for the account of a QIB, (b) in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S or (c) pursuant to an exemption from registration under the Securities Act provided by Rule 144 thereunder (if available), in each case in accordance with any applicable securities laws of any state of the United States.

(b) It represents that it is not an "affiliate" (as defined in Rule 144 under the Securities Act) of the Company, that it is not acting on the Company's behalf and that either:

- it is a qualified institutional buyer (as defined in Rule 144A) ("QIB") and is purchasing Notes for its own account or for the account of another qualified institutional buyer, and it is aware that the initial purchasers are selling the Notes to it in reliance on Rule 144A; or
- if the offer or sale of the Notes is being made (i) as part of the initial purchasers' distribution at any time or (ii) otherwise before the expiration of 40 days after the later of the commencement of the offering of the Notes and the closing date, it is not a US person (as defined in Regulation S) or purchasing for the account or benefit of a US person, other than a distributor, and it is purchasing Notes in an offshore transaction in accordance with Regulation S.

(i) It is purchasing the Notes for its own account, or for one or more investor accounts for which it is acting as a fiduciary or agent, in each case for investment, and not with a view to, or for offer or sale in connection with, any distribution thereof in violation of the Securities Act or any state securities laws, subject to any requirement of law that the disposition of its property or the property of such investor account or accounts be at all times within its or their control and subject to its or their ability to resell such Notes pursuant to Rule 144A, Regulation S or any other exemption from registration available under the Securities Act.

(ii) It understands that:

- each Rule 144A Global Note will contain a legend substantially to the following effect:

  THIS NOTE HAS NOT BEEN REGISTERED UNDER THE US SECURITIES ACT OF 1933 (THE "SECURITIES ACT"), OR ANY STATE SECURITIES LAWS. NEITHER THIS NOTE NOR ANY INTEREST OR PARTICIPATION HEREIN MAY BE REOFFERED, SOLD, ASSIGNED, TRANSFERRED, PLEDGED, ENCUMBERED OR OTHERWISE DISPOSED OF IN THE ABSENCE OF SUCH REGISTRATION OR UNLESS SUCH TRANSACTION IS EXEMPT FROM, OR NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT. THE HOLDER OR THIS NOTE BY ITS ACCEPTANCE HEREOF AGREES TO OFFER, SELL OR OTHERWISE TRANSFER SUCH NOTE, PRIOR TO THE DATE WHICH IS ONE YEAR AFTER THE LATER OF THE ORIGINAL ISSUED DATE HEREOF (OR SUCH OTHER PERIOD AS SHALL CONSTITUTE THE REQUIRED HOLDING PERIOD PURSUANT TO RULE 144 OF THE SECURITIES ACT) AND THE LAST DATE ON WHICH THE ISSUER OR ANY AFFILIATE OF THE ISSUER WAS THE OWNER OF THIS NOTE (OR ANY PREDECESSOR OF THIS NOTE) ONLY (A) TO THE ISSUER OR THE GUARANTOR, (B) PURSUANT TO A REGISTRATION STATEMENT WHICH HAS BEEN DECLARED EFFECTIVE UNDER THE SECURITIES ACT, (C) FOR SO LONG AS THE SECURITIES ARE ELIGIBLE FOR RESALE PURSUANT TO RULE 144A UNDER THE SECURITIES ACT ("RULE 144A"), TO A PERSON IT REASONABLY BELIEVES IS A "QUALIFIED INSTITUTIONAL BUYER" AS DEFINED IN RULE 144A THAT PURCHASES FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER TO WHOM NOTICE IS GIVEN THAT THE TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A, (D) PURSUANT TO OFFERS AND SALES THAT OCCUR OUTSIDE THE UNITED STATES IN COMPLIANCE WITH REGULATION S UNDER THE SECURITIES ACT OR (E) PURSUANT TO ANY OTHER AVAILABLE EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT, IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES. THE FOREGOING RESTRICTIONS ON RESALE WILL NOT APPLY SUBSEQUENT TO THE RESALE RESTRICTION TERMINATION DATE.

- each Regulation S Global Note will contain a legend substantially to the following effect:

  THIS NOTE HAS NOT BEEN REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933 (THE "SECURITIES ACT") AND MAY NOT BE OFFERED, SOLD OR DELIVERED IN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF ANY US PERSON,

  UNLESS SUCH NOTES ARE REGISTERED UNDER THE SECURITIES ACT OR AN EXEMPTION FROM THE REGISTRATION REQUIREMENTS THEREOF IS AVAILABLE. THIS LEGEND SHALL BE REMOVED AFTER THE EXPIRATION OF 40 DAYS FROM THE LATER OF (i) THE DATE ON WHICH THIS NOTE WAS FIRST OFFERED AND (ii) THE DATE OF ISSUANCE OF THIS NOTE.

(iii) It will deliver to each person to whom it transfers Notes notice of any restrictions on transfer of such Notes.

(iv) The Company, the Agent, the initial purchasers and their affiliates, and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements. If it is acquiring any Notes and the Guarantee for the account of one or more QIBs, it represents that it has sole investment discretion with respect to each such account and that it has full power to make the foregoing acknowledgements, representations and agreements on behalf of each such account.

(v) It understands that the Notes offered in reliance on Rule 144A will be represented by the DTC Rule 144A Global Note. Before any interest in the DTC Rule 144A Global Note may be offered, sold, pledged or otherwise transferred to a person who takes delivery in the form of an interest in the DTC Regulation S Global Note, it will be required to provide a Transfer Agent with a written certification (in the form provided in the FPAA) as to compliance with applicable securities laws.

(vi) Represents and agrees that (i) it is able to fend for itself in the transactions contemplated by this offering memorandum; (ii) no other representation with respect to the offer or sale of the Notes has been made, other than the information contained in this offering memorandum; (iii) the investment decision is solely based on the information contained in the offering memorandum; (iv) the initial purchasers make no representation or warranty as to the accuracy or completeness of this offering memorandum; and it has such knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of its prospective investment and can afford the complete loss of such investment.

(vii) It acknowledges that the Fiscal Agent will not be required to accept for registration of transfer any Notes except upon presentation of evidence satisfactory to the Company and the Fiscal Agent that the restrictions set forth therein have been complied with.

(viii) It acknowledges that until 40 days after the commencement of the offering, any offer or sale of the Notes within the United States by a dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A under the Securities Act.

(ix) Represents and agrees that it has received a copy of this offering memorandum and acknowledges that it has had access to such financial and other information and has been afforded the opportunity to ask questions of the Company and the Guarantor and receive answers thereto, as it deemed necessary in connection with its decision to purchase the Notes.

Prospective purchasers are hereby notified that sellers of the Notes and the Guarantee may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A.

LEGAL MATTERS

Certain legal matters in connection with the offering will be passed upon for us by Linklaters LLP, London, United Kingdom, as to matters of United States federal law, New York State law and English law. Certain legal matters in connection with the offering will be passed upon for the initial purchasers as to United States federal law and New York State law by Davis Polk & Wardwell London LLP, London, United Kingdom.

INDEPENDENT ACCOUNTANTS

Our consolidated financial statements relating to the financial years 2012, 2011 and 2010 included in this offering memorandum have been audited by PricewaterhouseCoopers LLP, our independent accountants and members of the Institute of Chartered Accountants in England and Wales, with an address at 1 Embankment Place, London, WC2N 6RH, as stated in their annual reports appearing herein.

Our financial statements have been extracted without material adjustment from the UK statutory annual reports and financial statements of Smiths Group plc for the financial years 2012, 2011 and 2010.

In the audit reports in respect of the financial statements of Smiths Group plc for the financial years 2012, 2011, and 2010, respectively, PricewaterhouseCoopers LLP, our accountants, with respect to such audited financial statements, in accordance with guidance issued by the Institute of Chartered Accountants in England and Wales, state: "This report, including the opinion, 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 this opinion, 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". Investors in the Notes should understand that these statements are intended to disclaim any liability to parties (such as the purchasers of the Notes) other than the members of the Company with respect to those reports. In the context of the offering, our accountants have reconfirmed to us that they do not intend their duty of care to extend to any party other than those to whom their reports were originally addressed (i.e. the members of the Company).

The US Securities and Exchange Commission would not permit the language quoted in the above paragraph to be included in a registration statement or a prospectus used in connection with an offering of securities registered under the Securities Act or in a report filed under the Exchange Act. The effect of such language is untested by a US court (or any other court). If a US court (or any other court) were to give effect to the language quoted above, the recourse that investors in the Notes may have against the independent accountants based on their reports or the financial statements to which they relate could be limited.

GENERAL INFORMATION

Authorisations

Each of the Company and the Guarantor has obtained all necessary consents, approvals and authorisations in the United Kingdom in connection with the issue and performance of the Notes and the Guarantee. The issue of the Notes was authorised by the Board of the Company in resolutions passed on 18 September 2012 and a committee of the Board of the Company in resolutions dated 1 October 2012, and the giving of the Guarantee relating to the Notes by the Guarantor was authorised by the Board of Directors of the Guarantor in a resolution passed on 1 October 2012.

Listing

The listing of the Notes on the Official List will be expressed in US dollars as a percentage of their principal amount (excluding accrued interest). Transactions will normally be effected for settlement in US dollars and, under current practice, for delivery on the third business day after the day of the transaction.

It is expected that listing on the Official List and admission of the Notes to trading on the PSM will be granted on or about 12 October 2012, subject only to the issue of the Notes.

If the Notes are not issued as mentioned in this offering memorandum, the listing and admission to trading of the Notes may be cancelled. Prior to official listing and admission to trading, however, dealings in the Notes will be permitted by the London Stock Exchange in accordance with its rules. We have agreed to use all reasonable efforts to maintain any such listing and admission to trading of the Notes for so long as any of the Notes remain outstanding.

Clearing Reference Numbers

The Notes have been accepted for clearance through DTC's book-entry settlement system. The CUSIP and ISIN numbers for the Notes are as follows:

	CUSIP Number	ISIN Number
Notes represented by Rule 144A Global Notes	83238PAD6	US83238PAD69
Notes represented by Regulation S Global Notes	G82401AH6	USG82401AH63

Financial and Trading Positions and Prospects

There has been (i) no significant change in the financial or trading position of the Company or of the Group since 31 July 2012 and (ii) no material adverse change in the financial position or prospects of the Company or of the Group since 31 July 2012.

Litigation

Except as disclosed in the subsections entitled "John Crane, Inc. Litigation" and "Titeflex Corporation" of the section entitled "Our Business – Litigation" on pages 76 and 77 of this offering memorandum, none of the Company nor any of its subsidiaries nor the Guarantor has been involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Company or the Guarantor is aware) during the 12 months preceding the date of this offering memorandum which may have or have had in the recent past significant effects on the financial position or profitability of the Company, the Guarantor or the Group.

Material Contracts

There are no material contracts entered into other than in the ordinary course of the Company's or Guarantor's business, which could result in any member of the Group being under an obligation or entitlement that is material to the Company's or Guarantor's ability to meet its obligations to holders of the Notes in respect of the Notes being issued.

Third-Party Information

Where information in this offering memorandum has been sourced from third parties this information has been accurately reproduced and, as far as the Company is aware and is able to ascertain from the information published by such third parties, no facts have been omitted which would render the reproduced information inaccurate or misleading. The source of third party information is identified where used.

Yield

The yield of the Notes is 3.651 per cent. on an annual basis. The yield is calculated as at 4 October 2012 on the basis of the Offer Price set out on the cover of this offering memorandum. It is not an indication of future yield.

Expenses

Our out-of-pocket expenses in connection with the transaction are expected to amount to £517,071.

Documents on Display

For 12 months starting on the date of this offering memorandum, the following documents (with English translations where necessary) may be inspected during normal business hours (local time) on any weekday (Saturdays, Sundays and public holidays excluded) at our office and the office of the Paying Agent, namely:

- this offering memorandum;
- the Company's and the Guarantor's memorandum and articles of association;
- our consolidated financial statements for the financial years ended 31 July 2012, 31 July 2011 and 31 July 2010, respectively;
- the FPAA; and
- the form of the Notes, including the Guarantee thereon.

This offering memorandum will be published on the website of the Regulatory News Service operated by the London Stock Exchange at www.londonstockexchange.com.

INDEX TO FINANCIAL STATEMENTS

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
Continuing operations			
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
Operating profit	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
Profit before taxation		**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)
Profit after taxation – continuing operations		**258.3**	306.1
(Loss)/profit – discontinued operations	7	**(0.1)**	79.0
Profit for the year		**258.2**	385.1
Attributable to			
Smiths Group shareholders		**256.6**	383.8
Non-controlling interests		**1.6**	1.3
		258.2	385.1
Earnings per share	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

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

Consolidated balance sheet

	Notes	**31 July 2012 £m**	31 July 2011 £m
Non-current assets			
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
		2,303.6	2,298.5
Current assets			
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
		1,301.7	1,328.5
Total assets		**3,605.3**	3,627.0
Non-current liabilities			
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)
		(1,811.6)	(1,616.3)
Current liabilities			
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)
		(812.9)	(630.8)
Total liabilities		**(2,624.5)**	(2,247.1)
Net assets		**980.8**	1,379.9
Shareholders' equity			
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		**972.8**	1,373.5
Non-controlling interest equity		**8.0**	6.4
Total equity		**980.8**	1,379.9

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
Total comprehensive income for the year				(259.3)	(4.2)	(263.5)	1.9	(261.6)
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
At 31 July 2012		**479.2**	**242.3**	**376.1**	**(124.8)**	**972.8**	**8.0**	**980.8**

	Notes	Share capital and share premium £m	Other reserves £m	Retained earnings £m	Hedge reserve £m	Equity shareholders' funds £m	Non-controlling Interest £m	Total equity £m
At 31 July 2010		461.8	242.3	519.5	(128.8)	1,094.8	5.0	1,099.8
Profit for the year				383.8		383.8	1.3	385.1
Other comprehensive income								
Exchange (losses)/gains				(9.8)	0.1	(9.7)	0.4	(9.3)
Actuarial losses on retirement benefits and related tax				10.7		10.7		10.7
Fair value gains/(losses)				4.1	8.1	12.2		12.2
Total comprehensive income for the year				388.8	8.2	397.0	1.7	398.7
Transactions relating to ownership 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
At 31 July 2011		**476.2**	**242.3**	**775.6**	**(120.6)**	**1,373.5**	**6.4**	**1,379.9**

Consolidated cash-flow statement

	Notes	**Year ended 31 July 2012 £m**	Year ended 31 July 2011 £m
Net cash inflow from operating activities	27	**331.5**	321.7
Cash-flows from investing activities			
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
Net cash-flow used in investing activities		**(235.0)**	(106.7)
Cash-flows from financing activities			
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)
Net cash-flow used in financing activities		**(151.5)**	(129.2)
Net (decrease)/increase in cash and cash equivalents		**(55.0)**	85.8
Cash and cash equivalents at beginning of year		**260.7**	172.2
Exchange (loss)/gain		**(2.0)**	2.7
Cash and cash equivalents at end of year	19	**203.7**	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)
		203.7	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)
		203.7	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
Net (decrease)/increase in cash and cash equivalents		**(55.0)**	85.8
Net decrease/(increase) in borrowings resulting from cash-flows		**(1.3)**	(0.4)
Movement in net debt resulting from cash-flows		**(56.3)**	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
Movement in net debt in the year	19	**(62.4)**	107.8
Net debt at start of year		**(729.0)**	(836.8)
Net debt at end of year	19	**(791.4)**	(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.

Accounting policies
continued

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.

Accounting policies
continued

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

Employee benefits

Share-based compensation

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

The fair value of the shares or share options granted is recognised as an expense over the vesting period to reflect the value of the employee services received. The fair value of options granted, excluding the impact of any non-market vesting conditions, is calculated using established option pricing models, principally binomial models. The probability of meeting non-market vesting conditions, which include profitability targets, is used to estimate the number of share options which are likely to vest.

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

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;

Accounting policies
continued

- 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.

Accounting policies
continued

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.

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.

Accounting policies
continued

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.

Accounting policies
continued

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.

Accounting policies
continued

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.

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						
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £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)**
Headline operating profit/(loss)	**209.9**	**202.5**	**69.1**	**66.0**	**38.0**	**(31.8)**	**553.7**
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)**
Operating profit/(loss)	**155.0**	**179.5**	**83.8**	**34.0**	**(16.7)**	**(29.0)**	**406.6**
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**
Profit before taxation							**365.9**

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						
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £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)
Headline operating profit/(loss)	188.7	196.2	65.5	67.6	27.6	(28.7)	516.9
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)
Operating profit/(loss)	143.3	178.0	64.0	49.0	25.8	(22.1)	438.0
Exceptional finance costs – adjustment to discounted provision (note 4)	(6.1)						(6.1)
Net finance costs – other							(38.3)
Share of post-tax profits of associate companies			4.3				4.3
Profit before taxation							397.9

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
Capital expenditure year ended 31 July 2012	**16.8**	**31.7**	**20.2**	**7.9**	**2.9**	**12.6**	**92.1**
Capital expenditure year ended 31 July 2011	16.2	31.2	22.7	8.1	3.5	8.8	90.5

Notes to the accounts
continued

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**
Operating assets	**436.3**	**399.3**	**393.0**	**193.8**	**90.3**	**1,512.7**
Derivatives, tax and retirement benefit assets						**240.9**
Goodwill and acquired intangibles						**1,558.9**
Corporate assets						**87.2**
Cash						**205.6**
Total assets						**3,605.3**
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)**
Total liabilities						**(2,624.5)**
Average divisional capital employed	**875.7**	**1,152.0**	**668.6**	**535.5**	**133.7**	**3,365.5**
Average corporate capital employed						**(16.1)**
Average total capital employed						**3,349.4**

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.

	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
Operating assets	427.7	404.9	427.4	163.7	85.8	1,509.5
Derivatives, tax and retirement benefit assets						343.9
Goodwill and acquired intangibles						1,464.1
Corporate assets						48.4
Cash						261.1
Total assets						3,627.0
Working capital liabilities	(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)
Total liabilities						(2,247.1)
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)
Average total capital employed (restated)						3,159.1

Notes to the accounts
continued

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:

John Crane	Original equipment manufacture £m	Aftermarket: Oil, gas and petrochemical £m	Aftermarket: Chemical and pharmaceutical £m	Aftermarket: Distributors £m	Aftermarket: General industry £m	Total £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).

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
	3,030.1	2,842.0

Notes to the accounts
continued

Analysis by geographical areas

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

	Revenue		Intangible assets, property plant and equipment and investments accounted for using the equity method	
	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m	**31 July 2012 £m**	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
	3,030.1	2,842.0	**1,987.6**	1,911.5

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
	4.0	4.1
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.

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;

Notes to the accounts
continued

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

5 Net finance costs

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Interest receivable	**2.2**	1.8
Interest payable		
– bank loans and overdrafts, including associated fees	**(7.1)**	(6.6)
– other loans	**(57.7)**	(53.7)
Interest payable	**(64.8)**	(60.3)
Other financing gains/(losses)		
– fair value (losses)/gains on hedged debt	**(4.0)**	3.6
– fair value gains/(losses) on fair value hedge	**4.0**	(3.6)
– net foreign exchange (losses)/gains	**(2.8)**	(3.1)
– exceptional finance costs – adjustment to discounted provision	**(4.5)**	(6.1)
Other financing losses	**(7.3)**	(9.2)
Retirement benefits		
– return on plan assets	**203.0**	198.4
– interest cost	**(179.5)**	(175.1)
Retirement benefits	**23.5**	23.3
Net finance costs	**(46.4)**	(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	**95.5**	67.0		(25.0)
– deferred taxation	**12.1**	24.8		
Total taxation expense in the income statement	**107.6**	91.8		(25.0)
Current taxation				
– UK corporation tax				
– foreign tax	**95.5**	67.0		
– discontinued tax				(25.0)
	95.5	67.0		(25.0)

Notes to the accounts
continued

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

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

Notes to the accounts
continued

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
At 31 July 2012	**(75.4)**	**4.2**	**92.8**	**(33.7)**	**145.9**	**133.8**
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)
At 31 July 2012	**(75.4)**	**4.2**	**92.8**	**(33.7)**	**145.9**	**133.8**

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.

Notes to the accounts
continued

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	**13.5**	**2019-2025**	13.3	2019-2025
– Asia	**4.2**	**2016-2019**	3.2	2014-2018
Total restricted losses	**17.7**		16.5	
Unrestricted losses				
– operating losses	**362.7**	**No expiry**	208.9	No expiry
Total	**380.4**		225.4	

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
Pre-tax (loss)/profit on disposal	**(0.1)**	54.0
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
Profit for the period	**(0.1)**	79.0
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.

Notes to the accounts
continued

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)
Net cash inflow from operating activities		

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Investing activities	—	(6.2)
Net cash outflow from investing activities	—	(6.2)

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
	144.1	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	**256.6**	383.8
Average number of shares in issue during the year	**392,583,140**	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	**363.3**	**92.6**	338.7	86.5
Headline EPS – diluted (p)		**91.9**		85.7

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

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:

			2012			2011
	UK	**US**	**Other**	UK	US	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.

Notes to the accounts
continued

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		Total
	Long-term rate of return	Value £m	Long-term rate of return	Value £m	Long-term rate of return	Value £m	£m
Equities	7.2%	1,294.1	7.3%	245.1	9.2%	12.9	1,552.1
Government bonds	2.5%	168.0	2.3%	43.5	4.8%	7.0	218.5
Corporate bonds	4.1%	81.8	3.8%	169.5	5.0%	0.5	251.8
Insured liabilities	4.1%	665.7			4.1%	3.7	669.4
Property	6.8%	177.1			10.4%	0.8	177.9
Other	2.9%	458.2			3.7%	19.7	477.9
Total market value		2,844.9		458.1		44.6	3,347.6
Present value of funded scheme liabilities		(3,116.7)		(680.6)		(66.3)	(3,863.6)
Deficit		(271.8)		(222.5)		(21.7)	(516.0)
Unfunded pension plans		(46.1)		(6.9)		(28.0)	(81.0)
Post-retirement healthcare		(9.2)		(13.0)		(0.9)	(23.1)
Present value of unfunded obligations		(55.3)		(19.9)		(28.9)	(104.1)
Unrecognised asset due to surplus restriction						(0.1)	(0.1)
Net pension liability		(327.1)		(242.4)		(50.7)	(620.2)
Post-retirement assets		7.2					7.2
Post-retirement liabilities		(334.3)		(242.4)		(50.7)	(627.4)
Net pension liability		(327.1)		(242.4)		(50.7)	(620.2)

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.

Notes to the accounts
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)
Net pension liability		(10.8)		(149.9)		(38.3)	(199.0)
Post-retirement assets		140.6					140.6
Post-retirement liabilities		(151.4)		(149.9)		(38.3)	(339.6)
Net pension liability		(10.8)		(149.9)		(38.3)	(199.0)

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
Amounts (credited)/charged to operating profit								
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
Total (credit)/charge	**0.3**		**1.5**	**1.1**	(9.8)	(0.6)	2.0	1.0
Amounts (credited)/charged to finance costs								
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
Net return	**(26.8)**	**(1.7)**	**0.5**	**4.5**	(29.8)	1.2	0.7	4.6
Total (credit)/charge to income statement	**(26.5)**	**(1.7)**	**2.0**	**5.6**	(39.6)	0.6	2.7	5.6

Notes to the accounts
continued

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)
	2.9	(7.4)

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
At end of period	**(3,116.7)**	**(680.6)**	**(66.3)**	**(104.1)**	(2,775.7)	(543.8)	(60.2)	(90.7)

Notes to the accounts
continued

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)
At end of period	**2,844.9**	**458.1**	**44.6**		2,813.6	412.8	46.2	

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.

Notes to the accounts
continued

History of schemes

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Balance sheet					
Present value of defined benefit obligations	**(3,967.7)**	(3,470.4)	(3,347.7)	(3,112.1)	(2,968.9)
Fair value of scheme assets	**3,347.6**	3,272.6	3,043.1	2,775.1	2,959.9
Unrecognised asset due to surplus restriction	**(0.1)**	(1.2)	(0.7)	(2.0)	(1.5)
Deficit	**(620.2)**	(199.0)	(305.3)	(339.0)	(10.5)
Post-retirement assets	**7.2**	140.6	80.3	39.2	174.2
Post-retirement liabilities	**(627.4)**	(339.6)	(385.6)	(378.2)	(184.7)
Deficit	**(620.2)**	(199.0)	(305.3)	(339.0)	(10.5)

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m	Period ended 31 July 2009 £m	Period ended 31 July 2008 £m
Experience gains/(losses)					
Experience gains/(losses) on scheme liabilities	**45.4**	(25.5)	31.5	100.5	(6.4)
Experience gains/(losses) on scheme assets	**(98.7)**	139.4	167.5	(345.4)	(350.0)
Movement on restricted surplus	**1.1**	(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
Staff costs during the period		
Wages and salaries	**740.5**	698.4
Social security	**84.4**	82.4
Share-based payment (note 29)	**14.3**	13.8
Pension costs (including defined contribution schemes) (note 10)	**32.4**	32.9
	871.6	827.5

The average number of persons employed was:

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

Key management

The key management of the Group comprises Smiths Group plc Board directors and Executive Committee members.

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Key management compensation		
Salaries and short-term employee benefits	**10.1**	9.2
Cost of post-retirement benefits	**0.1**	0.1
Cost of share-based incentive plans	**5.7**	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	**778**		540	
ESOS	**168**	**£8.93**	194	£8.81
VSP	**611**		852	
LTIP	**728**			
SAYE	**5**	**£7.28**	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.

Notes to the accounts
continued

12 Intangible assets

	Goodwill £m	Development costs £m	Acquired intangibles (see table below) £m	Software, patents and intellectual property £m	Total £m
Cost					
At 1 August 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)
At 31 July 2012	**1,488.1**	**181.3**	**413.6**	**143.4**	**2,226.4**
Amortisation					
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)
At 31 July 2012	**93.7**	**70.6**	**249.1**	**95.9**	**509.3**
Net book value at 31 July 2012	**1,394.4**	**110.7**	**164.5**	**47.5**	**1,717.1**
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
Cost				
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
At 31 July 2012	**73.4**	**139.0**	**201.2**	**413.6**
Amortisation				
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
At 31 July 2012	**33.2**	**77.9**	**138.0**	**249.1**
Net book value at 31 July 2012	**40.2**	**61.1**	**63.2**	**164.5**
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

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
	1,394.4	**11**	1,295.8	14

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.

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.

Notes to the accounts
continued

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
Cost or valuation				
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)
At 31 July 2012	**192.7**	**516.0**	**213.7**	**922.4**
Depreciation				
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)
At 31 July 2012	**92.7**	**389.6**	**169.6**	**651.9**
Net book value at 31 July 2012	**100.0**	**126.4**	**44.1**	**270.5**
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

14 Investments accounted for using the equity method

	31 July 2012 £m	31 July 2011 £m
Investments in associated companies		
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)
At end of period		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
Inventories comprise		
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
Non-current		
Trade receivables	**27.9**	23.7
Prepayments and accrued income	**4.1**	5.3
Other receivables	**5.4**	4.6
	37.4	33.6
Current		
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.

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)
Trade receivables	**606.8**	587.9

18 Trade and other payables

	31 July 2012 £m	31 July 2011 £m
Non-current		
Other creditors	**37.5**	45.1
Current		
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
Cash and cash equivalents		
Net cash and deposits	**205.6**	261.1
Short-term borrowings		
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)
Long-term borrowings		
\$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)
Borrowings	**(997.0)**	(990.1)
Net debt	**(791.4)**	(729.0)

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.

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)
Net cash and cash equivalents	**203.7**	260.7

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	
At 31 July 2012	**203.7**	**(173.4)**	**(821.7)**	**(791.4)**

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**
Financial assets and liabilities					
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)**

	At 31 July 2011				
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Financial assets and liabilities					
Financial instruments included in trade and other receivables	35.3	290.7	144.2	136.3	606.5
Financial instruments included in trade and other payables	(50.3)	(141.4)	(78.8)	(64.6)	(335.1)
Cash and cash equivalents	55.8	58.5	32.9	113.9	261.1
Borrowings not designated as net investment hedges	(149.0)	(10.8)	(3.0)		(162.8)
	(108.2)	197.0	95.3	185.6	369.7
Exclude balances held in operations with the same functional currency	108.5	(147.8)	(98.4)	(183.4)	(321.1)
Exposure arising from intra-group loans		(93.5)	(8.8)	8.7	(93.6)
Forward foreign exchange contracts	(104.4)	65.1	62.9	(23.6)	
	(104.1)	20.8	51.0	(12.7)	(45.0)

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)
Carried forward cash-flow hedge reserve at end of year	**(4.7)**	(0.3)

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
Carried forward net investment hedge reserve at end of year	**(120.1)**	(120.3)

The fair values of these net investment hedges are subject to exchange rate movements. Based on the hedging instruments in place at the year end, 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.

(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%).

Notes to the accounts
continued

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		
Total	**60.9**	**205.6**	**(997.0)**	**(1,110.6)**	31.6	261.1	(990.1)	(1,079.1)

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 exposure income statement 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.

Notes to the accounts
continued

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
	266.5	292.7

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).

(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	**510.6**	486.8
	510.6	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)
Total	**(997.0)**	**4.3**	**(235.4)**	**(1,228.1)**	(990.1)	0.1	(291.1)	(1,281.1)

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
Assets						
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
Liabilities						
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)
Total	**688.2**	**(683.4)**	**4.8**	662.8	(645.6)	17.2

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**		
	£m	**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)**
Total foreign exchange contracts	**529.3**	**4.1**	**(10.3)**	**(6.2)**
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**
Total financial derivatives	**911.8**	**15.1**	**(11.7)**	**3.4**
Balance sheet entries				
Non-current		**7.2**	**(1.1)**	**6.1**
Current		**7.9**	**(10.6)**	**(2.7)**
Total financial derivatives		**15.1**	**(11.7)**	**3.4**

	At 31 July 2011			
	Contract or underlying nominal amount	Fair value		
	£m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	217.7	3.2	(4.5)	(1.3)
Foreign exchange contracts (not hedge accounted)	241.0	1.6	(2.6)	(1.0)
Total foreign exchange contracts	458.7	4.8	(7.1)	(2.3)
Currency swaps (net investment hedges)	192.6	1.9	(2.3)	(0.4)
Interest rate swaps (fair value hedges)	196.3	5.4	(1.0)	4.4
Total financial derivatives	847.6	12.1	(10.4)	1.7
Balance sheet entries				
Non-current		6.4	(1.5)	4.9
Current		5.7	(8.9)	(3.2)
Total financial derivatives		12.1	(10.4)	1.7

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.

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)
At 31 July 2012	**34.5**	**5.8**	**9.4**	**4.0**	**213.1**	**64.9**	**331.7**

Analysed as:

	31 July 2012 £m	31 July 2011 £m
Current liabilities	**77.3**	74.7
Non-current liabilities	**254.4**	174.1
	331.7	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.

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.

Notes to the accounts
continued

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	**226.3**	203.1
Discount	**(13.2)**	(21.4)
Discounted pre-tax provision	**213.1**	181.7
Deferred tax	**(51.1)**	(50.6)
Discounted post-tax provision	**162.0**	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.

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

	Number of shares	Issued capital £m	Consideration £m
Ordinary shares of 37.5p each			
At 31 July 2011	392,350,403	147.1	
Exercise of share options	375,540	0.2	3.0
Total share capital at 31 July 2012	**392,725,943**	**147.3**	

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)
	(124.8)	(120.6)

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)
Net cash inflow from operating activities	**331.5**	321.7

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
Net cash inflow from operating activities	**331.5**	321.7
Exclude:		
Interest	**64.5**	66.8
Tax paid	**93.7**	90.9
Cash outflow in respect of exceptional operating items	**38.2**	34.8
Pension deficit payments	**111.2**	60.1
Include:		
Expenditure on capitalised development, other intangible assets and property, plant and equipment	**(91.2)**	(90.1)
Disposals of property, plant and equipment in the ordinary course of business	**0.7**	4.5
Headline operating cash-flow	**548.6**	488.7

Free cash-flow

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Net cash inflow from operating activities	**331.5**	321.7
Expenditure on capitalised development, other intangible assets and property, plant and equipment	**(91.2)**	(90.1)
Disposals of property, plant and equipment	**0.7**	4.5
Investment in financial assets relating to pensions financing	**(24.0)**	
Free cash-flow	**217.0**	236.1
Investment in other financial assets	**(0.3)**	(0.3)
Acquisition of businesses	**(167.5)**	(18.5)
Disposal of Aerospace		(6.2)
Disposal of businesses	**47.3**	3.9
Net cash-flow used in financing activities	**(151.5)**	(129.2)
Net (decrease)/increase in cash and cash equivalents	**(55.0)**	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.

Notes to the accounts
continued

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.

	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**
Non-current assets							
– intangible assets		49.5	49.5		3.7	3.7	**53.2**
– land and buildings	0.3		0.3				**0.3**
– plant and equipment	0.8		0.8	0.5	(0.1)	0.4	**1.2**
Current assets							
– trade and other receivables	24.4	(0.2)	24.2	1.8		1.8	**26.0**
– other current assets	7.3	(1.0)	6.3	0.4	(0.1)	0.3	**6.6**
Non-current liabilities							
– other liabilities	(0.4)	(7.6)	(8.0)				**(8.0)**
Current liabilities							
– overdrafts				(0.1)		(0.1)	**(0.1)**
– other current liabilities	(11.9)	(0.1)	(12.0)	(0.4)		(0.4)	**(12.4)**
Net assets acquired	20.5	40.6	61.1	2.2	3.5	5.7	**66.8**
Goodwill on current year acquisitions			92.8			7.4	**100.2**
Total consideration			153.9			13.1	**167.0**
Cash paid during the period – current year acquisitions							**167.0**
Deferred consideration paid – prior year acquisitions							**0.5**
Total consideration							**167.5**

29 Employee share schemes

The Group operates share schemes and plans for the benefit of employees. The nature of the principal schemes and plans, including general conditions, is set out below:

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.

Notes to the accounts
continued

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.

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
31 July 2012	**1,708**	**2,299**	**3,475**	**7,482**	**£4.10**

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			**£ 0.00**
£2.01 – £6.00	463	17	**2**	2	**£ 5.69**
£6.01 – £10.00	1,979	42	**1,387**	2,106	**£ 8.52**
£10.01 – £14.00	1,032	62	**947**	907	**£10.97**

For the purposes of valuing options to arrive at the share-based payment charge, the Binomial option pricing model has been used for most schemes and the Monte Carlo method is used for schemes with total shareholder return performance targets. The key assumptions used in the models for 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).

Independent auditors' report to the members of Smiths Group plc

We have audited the Group financial statements of Smiths Group plc for the year ended 31 July 2011 which comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated balance sheet, the consolidated statement of changes in equity, the consolidated cash-flow statement, the accounting policies and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Respective responsibilities of directors and auditors

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

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the Group financial statements:

- give a true and fair view of the state of the Group's affairs as at 31 July 2011 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

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

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

Under the Listing Rules we are required to review:

- the Directors' statement in relation to going concern;

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

Other matter

We have reported separately on the Parent Company financial statements of Smiths Group plc for the year ended 31 July 2011 and on the information in the Directors' remuneration report that is described as having been audited.

Martin Hodgson (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London

27 September 2011

Notes

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

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

Consolidated income statement

	Notes	**Year ended 31 July 2011 £m**	Year ended 31 July 2010 £m
Continuing operations			
Revenue	1	**2,842.0**	2,769.6
Cost of sales		**(1,534.0)**	(1,476.3)
Gross profit		**1,308.0**	1,293.3
Sales and distribution costs		**(384.3)**	(369.7)
Administrative expenses		**(490.1)**	(491.0)
Profit on disposal of businesses	4	**4.4**	3.3
Operating profit	2	**438.0**	435.9
Comprising			
– headline operating profit	3	**516.9**	492.4
– exceptional items, amortisation of acquired intangibles	3	**(78.9)**	(56.5)
		438.0	435.9
Interest receivable		**1.8**	3.6
Interest payable		**(60.3)**	(65.1)
Other financing losses		**(9.2)**	(5.4)
Other finance income – retirement benefits		**23.3**	2.3
Finance costs	5	**(44.4)**	(64.6)
Share of post-tax profits of associated companies	14	**4.3**	1.8
Profit before taxation		**397.9**	373.1
Comprising			
– headline profit before taxation	3	**486.0**	435.0
– exceptional items, amortisation of acquired intangibles and other financing gains and losses	3	**(88.1)**	(61.9)
		397.9	373.1
Taxation	6	**(91.8)**	(78.9)
Profit after taxation – continuing operations		**306.1**	294.2
Profit – discontinued operations	7	**79.0**	16.4
Profit for the year		**385.1**	310.6
Attributable to			
Smiths Group shareholders		**383.8**	310.0
Non-controlling interests		**1.3**	0.6
		385.1	310.6
Earnings per share	9		
Basic		**98.0p**	79.5p
Basic – continuing operations		**77.8p**	75.3p
Diluted		**97.1p**	78.9p
Diluted – continuing operations		**77.1p**	74.8p

References in the consolidated income statement, consolidated statement of comprehensive income, consolidated balance sheet, consolidated statement of changes in equity and consolidated cash-flow statement relate to notes on pages 98 to 129, which form an integral part of the consolidated accounts.

Consolidated statement of comprehensive income

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

Consolidated balance sheet

	Notes	**31 July 2011 £m**	31 July 2010 £m
Non-current assets			
Intangible assets	12	**1,610.2**	1,638.6
Property, plant and equipment	13	**282.8**	302.7
Investments accounted for using the equity method	14	**18.5**	13.6
Financial assets – other investments	15	**31.6**	27.0
Retirement benefit assets	10	**140.6**	80.3
Deferred tax assets	6	**174.8**	194.2
Trade and other receivables	17	**33.6**	33.8
Financial derivatives	22	**6.4**	10.8
		2,298.5	2,301.0
Current assets			
Inventories	16	**432.5**	390.0
Current tax receivable		**16.4**	
Trade and other receivables	17	**612.8**	578.9
Cash and cash equivalents	18	**261.1**	172.9
Financial derivatives	22	**5.7**	15.5
		1,328.5	1,157.3
Total assets		**3,627.0**	3,458.3
Non-current liabilities			
Financial liabilities			
– borrowings	20	**(978.4)**	(995.0)
– financial derivatives	22	**(1.5)**	(1.1)
Provisions for liabilities and charges	23	**(174.1)**	(230.8)
Retirement benefit obligations	10	**(339.6)**	(385.6)
Deferred tax liabilities	6	**(77.6)**	(77.8)
Trade and other payables	19	**(45.1)**	(27.3)
		(1,616.3)	(1,717.6)
Current liabilities			
Financial liabilities			
– borrowings	20	**(11.7)**	(14.7)
– financial derivatives	22	**(8.9)**	(14.9)
Provisions for liabilities and charges	23	**(74.7)**	(70.4)
Trade and other payables	19	**(454.2)**	(428.2)
Current tax payable		**(81.3)**	(112.7)
		(630.8)	(640.9)
Total liabilities		**(2,247.1)**	(2,358.5)
Net assets		**1,379.9**	1,099.8
Shareholders' equity			
Share capital	24	**147.1**	146.5
Share premium account		**329.1**	315.3
Capital redemption reserve		**5.8**	5.8
Revaluation reserve		**1.7**	1.7
Merger reserve		**234.8**	234.8
Retained earnings	25	**775.6**	519.5
Hedge reserve	25	**(120.6)**	(128.8)
Total shareholders' equity		**1,373.5**	1,094.8
Non-controlling interest equity		**6.4**	5.0
Total equity		**1,379.9**	1,099.8

The accounts on pages 87 to 129 were approved by the Board of Directors on 27 September 2011 and were signed on its behalf by:

Philip Bowman
Chief Executive

Peter Turner
Finance Director

Consolidated statement of changes in equity

	Notes	Share capital and share premium £m	Other reserves £m	Retained earnings £m	Hedge reserve £m	Equity shareholders' funds £m	Non-controlling Interest £m	Total equity £m
At 31 July 2010		461.8	242.3	519.5	(128.8)	1,094.8	5.0	1,099.8
Profit for the year				383.8		383.8	1.3	385.1
Other comprehensive income								
Exchange (losses)/gains				(9.8)	0.1	(9.7)	0.4	(9.3)
Actuarial losses on retirement benefits and related tax				10.7		10.7		10.7
Fair value gains/(losses)				4.1	8.1	12.2		12.2
Total comprehensive income for the year				388.8	8.2	397.0	1.7	398.7
Transactions relating to ownership interests								
Exercises of share options	24	14.4				14.4		14.4
Taxation recognised on share options	6			(1.8)		(1.8)		(1.8)
Purchase of own shares	25			(8.6)		(8.6)		(8.6)
Dividends								
– equity shareholders	8			(136.1)		(136.1)		(136.1)
– non-controlling interest							(0.3)	(0.3)
Share-based payment	30			13.8		13.8		13.8
At 31 July 2011		**476.2**	**242.3**	**775.6**	**(120.6)**	**1,373.5**	**6.4**	**1,379.9**

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

Consolidated cash-flow statement

	Notes	**Year ended 31 July 2011 £m**	Year ended 31 July 2010 £m
Net cash inflow from operating activities	28	**321.7**	410.5
Cash-flows from investing activities			
Expenditure on capitalised development		**(30.6)**	(24.3)
Expenditure on other intangible assets		**(10.2)**	(7.6)
Purchases of property, plant and equipment		**(49.3)**	(47.0)
Disposals of property, plant and equipment		**4.5**	24.8
Investment in financial assets		**(0.3)**	(25.3)
Acquisition of businesses		**(18.5)**	(132.7)
Disposal of Aerospace	7	**(6.2)**	19.9
Disposals of businesses		**3.9**	1.1
Net cash-flow used in investing activities		**(106.7)**	(191.1)
Cash-flows from financing activities			
Proceeds from exercise of share options	24	**14.4**	9.7
Purchase of own shares		**(8.6)**	
Dividends paid to equity shareholders	8	**(136.1)**	(132.5)
Dividends paid to non-controlling interests		**(0.3)**	(0.2)
Cash inflow/(outflow) from matured derivative financial instruments		**1.0**	(1.5)
Increase in new borrowings		**1.6**	466.8
Reduction and repayment of borrowings		**(1.2)**	(408.4)
Net cash-flow used in financing activities		**(129.2)**	(66.1)
Net increase in cash and cash equivalents		**85.8**	153.3
Cash and cash equivalents at beginning of year		**172.2**	19.7
Exchange differences		**2.7**	(0.8)
Cash and cash equivalents at end of year	18	**260.7**	172.2
Cash and cash equivalents at end of year comprise			
– cash at bank and in hand		**232.0**	136.3
– short-term deposits		**29.1**	36.6
– bank overdrafts		**(0.4)**	(0.7)
		260.7	172.2
Included in cash and cash equivalents per the balance sheet		**261.1**	172.9
Included in overdrafts per the balance sheet		**(0.4)**	(0.7)
		260.7	172.2

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

Accounting policies

Basis of preparation

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

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

- Amendment to 'IAS 32: Financial instruments: Presentation' on classification of rights issues
- 'IFRIC 19: Extinguishing financial liabilities with equity instruments'
- 'IFRS 2: Share-based payment' – Group cash-settled share-based payment transactions

These changes have not materially affected reported financial position or performance.

Significant judgements, key assumptions and estimates

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

Revenue recognition

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

Revenue of £27.9m (2010: £23.6m) has been recognised in respect of contracts in progress at the year end with a total expected value of £129.3m (2010: £116.2m). A 5% increase in the proportion of the contract activity recognised in the current year would have increased operating profit by an estimated £1.1m (2010: £0.4m).

Impairment

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

Provisions for liabilities and charges

The consolidated financial statements include a provision for litigation of £196.1m (2010: £191.4m).

As previously reported, John Crane, Inc., a subsidiary of the Group, is currently one of many co-defendants in litigation relating to products previously manufactured which contained asbestos. Provision has been made for the future defence costs which the Group is expected to incur and the expected costs of future adverse judgments against John Crane, Inc. However, because of the significant uncertainty associated with the future level of asbestos claims and of the costs arising out of the related litigation, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred and, as a result, the provision may be subject to potentially material revisions from time to time if new information becomes available as a result of future events. John Crane, Inc. takes account of the advice of an expert in asbestos liability estimation in quantifying the expected costs. In the current period the method used to calculate the expected costs of defending claims has been conformed to the approach used to calculate the expected cost of adverse judgments following the appointment of Bates White LLC to value both elements of John Crane, Inc.'s exposure. See note 23 for details.

Accounting policies
continued

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

Retirement benefits

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

At 31 July 2011 there is a retirement benefit asset of £140.6m (2010: £80.3m) which arises from the rights of the employers to recover the surplus at the end of the life of the scheme. If the pension schemes were wound up while they still had members, the schemes would need to buy out the benefits of all members. The buy outs would cost significantly more than the present value of the scheme liabilities calculated in accordance with IAS 19: Employee benefits.

Taxation

The Group has recognised deferred tax assets of £26.0m (2010: £31.9m) relating to losses and £50.6m (2010: £47.4m) relating to the John Crane, Inc. litigation provision. The recognition of assets pertaining to these items involves judgement by management as to the likelihood of realisation of these deferred tax assets and this is based on a number of factors, which seek to assess the expectation that the benefit of these assets will be realised, including appropriate taxable temporary timing differences and it has been concluded that there are sufficient taxable profits in future periods to support recognition. Further detail on the Group's deferred taxation position is included in note 6.

Accounting policies

Basis of consolidation

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

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

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

Foreign currencies

The 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.

Accounting policies
continued

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

Revenue

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

Sale of goods

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

Services

Revenue from services is recognised in accounting periods in which the services are rendered, by reference to completion of the specific transaction, assessed on the basis of the actual service provided as a proportion of the total services to be provided. Depending on the nature of the contract, revenue will be recognised on the basis of the proportion of the contract term completed, the proportion of the contract costs incurred or the specific services provided to date.

Construction contracts

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

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

Employee benefits

Share-based compensation

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

The fair value of the shares or share options granted is recognised as an expense over the vesting period to reflect the value of the employee services received. The fair value of options granted, excluding the impact of any non-market vesting conditions, is calculated using established option pricing models, principally binomial models. The probability of meeting non-market vesting conditions, which include profitability targets, is used to estimate the number of share options which are likely to vest.

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

Pension obligations and post-retirement benefits

The Group has both defined benefit and defined contribution plans.

Accounting policies
continued

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

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

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

Exceptional items

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

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

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

Discontinued operations

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

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

Assets and businesses held for sale

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

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

Accounting policies
continued

Intangible assets

Goodwill

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

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

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

Research and development

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

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

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

Intangible assets acquired in business combinations

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

The estimated useful lives are as follows:

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

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

Software, patents and intellectual property

The estimated useful lives are as follows:

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

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

Property, plant and equipment

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

Accounting policies
continued

Land is not depreciated. Depreciation is provided on other assets estimated to write off the depreciable amount of relevant assets by equal annual instalments over their estimated useful lives. In general, the rates used are: Freehold and long leasehold buildings – 2%; Short leasehold property – over the period of the lease; Plant, machinery, etc. – 10% to 20%; Fixtures, fittings, tools and other equipment – 10% to 33%.

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

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

Leases

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

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in, first-out (FIFO) method. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). The cost of items of inventory which take a substantial period of time to complete includes attributable borrowing costs for all items whose production began after 1 August 2009. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

Trade and other receivables

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

Provisions

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

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

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

Taxation

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

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

Accounting policies
continued

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.

Cash and cash equivalents

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

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

Financial assets

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

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

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

Financial assets are derecognised when the right to receive cash-flows from the assets has expired, or has been transferred, and the Company has transferred substantially all of the risks and rewards of ownership. When securities classified as available for sale are sold or impaired, the accumulated fair value adjustments previously taken to reserves are included in the income statement.

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

Financial liabilities

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

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

Derivative financial instruments and hedging activities

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

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

Fair value hedge

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

Cash-flow hedge

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

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

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

Net investment hedge

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

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

Fair value of financial assets and liabilities

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

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

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

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

- cash, trade receivables and payables and floating rate borrowings – the carrying value is a good approximation of the fair value;
- government bonds – quoted market prices (level 1);
- fixed rate borrowings – quoted market prices of equivalent instruments (level 2); and
- forward exchange contracts, currency swaps, interest rate instruments and embedded derivatives – net present value of the future cash-flows, calculated using market data at the balance sheet date (principally exchange rates and yield curves) (level 2).

Accounting policies
continued

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

Financial guarantees

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

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

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

Dividends

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

Recent accounting developments

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

- Amendment to IFRIC 14, IAS 19 – Prepayments of a minimum funding requirement
- Amendment to 'IAS 24: Related party disclosures'
- Amendment to 'IFRS 7: Financial instruments: Disclosures' on derecognition
- 'IFRS 9: Financial instruments'
- 'IFRS 10: Consolidated financial statements'
- 'IAS 27 (Revised 2011): Separate financial statements'
- 'IFRS 11: Joint arrangements'
- 'IAS 28 (Revised 2011): Associates and joint ventures'
- 'IFRS 12: Disclosure of interests in other entities'
- 'IFRS 13: Fair value measurement'
- 'IAS 19: Employee benefits (revised 2011)'

A review of the impact of these standards and interpretations is being undertaken, and the impact of adopting them will be determined once this review has been completed. Based on the work completed to date, the changes are not expected to have a material impact on the Group's reported position or performance, except for the implementation of IAS 19: Employee benefits (revised 2011). This standard, which is expected to be implemented in the year ending 31 July 2014, subject to EU approval, may then result in the recognition of a financing charge in respect of retirement benefits. For the year ended 31 July 2011, calculating the finance charge in accordance with the new requirements would have increased finance costs by £39.2m. Under the current accounting policies the Group recognises actuarial gains and losses directly in Other comprehensive income, as required by the new standard.

Parent company

The accounts of the parent company, Smiths Group plc, have been prepared in accordance with UK GAAP. The Company accounts are presented in separate financial statements on pages 132 to 140.

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

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

Notes to the accounts

1 Segment information

Analysis by operating segment

The Group is organised into five divisions: Smiths Detection, John Crane, Smiths Medical, Smiths Interconnect and Flex-Tek. These divisions design and manufacture the following products:

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

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

Intersegment sales and transfers are charged at arm's length prices.

	Year ended 31 July 2011					
	Smiths Detection £m	**John Crane £m**	**Smiths Medical £m**	**Smiths Interconnect £m**	**Flex-Tek £m**	**Total £m**
Revenue	**509.9**	**893.9**	**838.4**	**379.0**	**220.8**	**2,842.0**
Divisional headline operating profit	**65.5**	**188.7**	**196.2**	**67.6**	**27.6**	**545.6**
Corporate headline operating costs						**(28.7)**
Headline operating profit	**65.5**	**188.7**	**196.2**	**67.6**	**27.6**	**516.9**
Divisional exceptional operating items (note 4)	**(0.3)**	**(30.9)**	**(1.6)**	**(1.4)**	**(1.8)**	**(36.0)**
Corporate exceptional operating items (note 4)						**6.6**
Amortisation of acquired intangible assets	**(1.2)**	**(14.5)**	**(16.6)**	**(17.2)**		**(49.5)**
Operating profit	**64.0**	**143.3**	**178.0**	**49.0**	**25.8**	**438.0**
Exceptional finance costs – adjustment to discounted provision (note 4)		**(6.1)**				**(6.1)**
Net finance costs – other						**(38.3)**
Share of post-tax profits of associate companies	**4.3**					**4.3**
Profit before taxation						**397.9**

Notes to the accounts
continued

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

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

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

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

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

The capital expenditure for each division is:

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

Notes to the accounts
continued

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

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

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

Capital employed is a non-statutory measure of invested resources. It comprises statutory net assets adjusted to add goodwill recognised directly in reserves in respect of subsidiaries acquired before 1 August 1998 of £815.2m (2010: £815.2m) and eliminate post-retirement benefit assets and liabilities, net of related tax, and net debt.

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

Notes to the accounts
continued

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

Analysis of revenue

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

Smiths Detection	Transportation £m	Ports and borders £m	Military £m	Emergency responders £m	Critical infrastructure £m	Non-security £m	Total £m
Revenue year ended 31 July 2011	**218.6**	**75.7**	**79.5**	**25.4**	**86.9**	**23.8**	**509.9**
Revenue year ended 31 July 2010	220.7	90.9	138.0	24.7	59.0	40.8	574.1

	Original equipment manufacture	Aftermarket				Total
John Crane	£m	Oil, gas and petrochemical £m	Chemical and pharmaceutical £m	Distributors £m	General industry £m	£m
Revenue year ended 31 July 2011	**330.1**	**344.0**	**74.0**	**62.6**	**83.2**	**893.9**
Revenue year ended 31 July 2010	287.5	298.6	69.4	52.0	78.6	786.1

Smiths Medical	Medication delivery £m	Vital care £m	Safety devices £m	Total £m
Revenue year ended 31 July 2011	**233.1**	**345.6**	**259.7**	**838.4**
Revenue year ended 31 July 2010	235.0	351.8	270.8	857.6

Smiths Interconnect	Telecom £m	Military and Aerospace £m	Rail, Medical Automation, Test £m	Total £m
Revenue year ended 31 July 2011	**94.6**	**163.9**	**120.5**	**379.0**
Revenue year ended 31 July 2010	91.1	170.2	78.6	339.9

Flex-Tek	Fluid Management £m	Flexible Solutions £m	Heat Solutions £m	Construction Products £m	Total £m
Revenue year ended 31 July 2011	**70.3**	**35.9**	**60.1**	**54.5**	**220.8**
Revenue year ended 31 July 2010 (restated)	61.9	38.5	60.9	50.6	211.9

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

The Group's statutory revenue is analysed as follows:

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Sale of goods	**2,630.9**	2,535.4
Services	**178.3**	162.4
Contracts	**32.8**	71.8
	2,842.0	2,769.6

Notes to the accounts
continued

Analysis by geographical areas

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

	Revenue		Intangible assets, property plant and equipment and investments accounted for using the equity method	
	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m	**31 July 2011 £m**	31 July 2010 £m
United Kingdom	**124.5**	118.4	**146.2**	150.4
Germany	**161.0**	149.7	**333.9**	317.9
France	**93.1**	97.6	**17.8**	16.5
Other European	**357.5**	323.6	**86.1**	89.8
United States of America	**1,275.4**	1,274.1	**1,135.5**	1,211.8
Canada	**119.6**	142.2	**12.9**	15.4
Mexico	**25.2**	20.1	**9.9**	7.5
Japan	**149.4**	120.0	**22.2**	20.9
China	**82.0**	82.9	**63.6**	73.5
Rest of the World	**454.3**	441.0	**83.4**	51.2
	2,842.0	2,769.6	**1,911.5**	1,954.9

2 Operating profit is stated after charging

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Research and development expense	**68.0**	69.2
Operating leases		
– land and buildings	**25.3**	24.4
– other	**10.9**	10.2

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Audit services		
Fees payable to the Company's auditors for the audit of the parent company and consolidated accounts	**0.5**	0.5
Fees payable to the Company's auditors and its associates for other services		
– the audit of the Company's subsidiaries, pursuant to legislation	**3.5**	3.4
– other services pursuant to legislation	**0.1**	0.1
	4.1	4.0
Tax services		
– advisory services	**0.5**	0.3
All other services	**0.5**	0.3

Other services relate to one-off projects.

3 Headline profit measures

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

Notes to the accounts
continued

The following items have been excluded from the headline measure:

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

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

	Notes	**Year ended 31 July 2011 £m**	Year ended 31 July 2010 £m
Operating profit		**438.0**	435.9
Exclude			
– exceptional operating items	4	**29.4**	14.4
– amortisation and impairment of acquired intangible assets	12	**49.5**	42.1
Non-headline items in operating profit		**78.9**	56.5
Headline operating profit		**516.9**	492.4
Finance costs		**(44.4)**	(64.6)
Exclude			
– exceptional finance costs	4	**6.1**	7.0
– other financing gains and losses	5	**3.1**	(1.6)
Non-headline items in finance costs		**9.2**	5.4
Headline finance costs		**(35.2)**	(59.2)
Profit before taxation		**397.9**	373.1
Non-headline items in operating profit		**78.9**	56.5
Non-headline items in finance costs		**9.2**	5.4
Headline profit before taxation		**486.0**	435.0
Profit after taxation – continuing operations		**306.1**	294.2
Exclude			
– non-headline items in profit before taxation		**88.1**	61.9
– tax on excluded items	6	**(29.6)**	(25.4)
		58.5	36.5
Headline profit after taxation – continuing operations		**364.6**	330.7

From 1 August 2011 the definition of headline profit will be amended to exclude financing credits and charges relating to retirement benefits. For the year ended 31 July 2011 the retirement benefit credit included in finance costs is £23.3m (2010: £2.3m). The 2011 profit measures under the new definition are:

- Headline finance costs £58.5m (2010: £61.5m),
- Headline profit before taxation £462.7m (2010: £432.7m),
- Headline profit after taxation £340.0m (2010: £325.9m), and
- Headline earnings per share 86.5p (2010: 83.4p) basic and 85.7p (2010: 82.8p) diluted.

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

Notes to the accounts
continued

4 Exceptional items

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

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Operating items		
Restructuring of corporate headquarters and divisional reorganisation	**(15.7)**	(8.2)
Release of diabetes provision	**1.5**	
Gains on changes to post-retirement benefits (note 10)	**10.2**	3.9
Profit on disposal of businesses	**4.4**	3.3
Profit on disposal of property		5.5
Costs of acquisitions	**(1.5)**	(1.3)
Litigation		
– provision for John Crane, Inc. asbestos litigation (note 23)	**(28.3)**	(17.6)
	(29.4)	(14.4)
Financing items		
Exceptional finance costs – adjustment to discounted provision (note 23)	**(6.1)**	(7.0)
	(35.5)	(21.4)

Year ended 31 July 2011

The restructuring of corporate headquarters and divisional reorganisation was announced in 2008, and a second phase of this project was introduced in 2010. The total cost of this restructuring, including redundancy, relocation and consolidation of manufacturing, was considered exceptional by virtue of its size. Costs of £15.7m have been recognised in the year for the project, out of an expected total cost of £62m, of which £52m has been recognised to date.

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

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

The operating charge of £28.3m in respect of John Crane, Inc. asbestos litigation comprises £6.1m in respect of increased provision for adverse legal judgments, £9.3m in respect of increased provision for legal defence costs, £11.9m arising from movements in the discounting and £1.0m in respect of legal fees in connection with litigation against insurers and defence strategy.

Year ended 31 July 2010

On 3 June 2008 the Company announced a number of changes to its corporate centre and divisional organisation. In the year ended 31 July 2010 £8.2m was charged in respect of the restructuring of corporate centre and divisional reorganisation. This cost was reduced by a partial reversal of the impairment loss recognised in 2009.

The UK defined benefit pension schemes were closed with effect from 31 October 2009, and a curtailment gain of £3.6m was recognised. There was also a net gain of £0.3m due to the closure of a small US scheme.

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

Profit on property disposals comprised £5.5m arising from the grant of planning permission in respect of a property sold in the previous year.

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

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

5 Net finance costs

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Interest receivable	**1.8**	3.6
Interest payable		
– bank loans and overdrafts	**(6.6)**	(7.7)
– other loans	**(53.7)**	(57.4)
Interest payable	**(60.3)**	(65.1)
Other financing gains/(losses)		
– fair value gains/(losses) on hedged debt	**3.6**	(2.9)
– fair value (losses)/gains on fair value hedge	**(3.6)**	2.9
– net foreign exchange (losses)/gains	**(3.1)**	1.6
– exceptional finance costs – adjustment to discounted provision	**(6.1)**	(7.0)
Other financing losses	**(9.2)**	(5.4)
Retirement benefits		
– return on plan assets	**198.4**	183.7
– interest cost	**(175.1)**	(181.4)
Retirement benefits	**23.3**	2.3
Net finance costs	**(44.4)**	(64.6)

6 Taxation

	Continuing Year ended 31 July 2011 £m	Continuing Year ended 31 July 2010 £m	**Discontinued Year ended 31 July 2011 £m**	Discontinued Year ended 31 July 2010 £m
The taxation charge for the year comprises				
– current taxation	**67.0**	81.1	**(25.0)**	
– deferred taxation	**24.8**	(2.2)		
Total taxation expense in the income statement	**91.8**	78.9	**(25.0)**	
Current taxation				
– UK corporation tax				
– foreign tax	**67.0**	81.1		
– discontinued tax			**(25.0)**	
	67.0	81.1	**(25.0)**	

Notes to the accounts
continued

Reconciliation of the total tax charge

The tax expense on the profit for the period is different from the standard rate of corporation tax in the UK of 27.3% (2010: 28.0%). The difference is reconciled as follows:

	Continuing Year ended 31 July 2011 £m	Continuing Year ended 31 July 2010 £m	**Discontinued Year ended 31 July 2011 £m**	Discontinued Year ended 31 July 2010 £m
Profit before tax	**397.9**	373.1	**54.0**	16.4
Notional taxation expense at UK rate of 27.3% (2010: 28.0%)	**108.6**	104.5	**14.7**	4.6
Effect of overseas taxation	**15.1**	14.7		
Compliance benefits	**(16.1)**	(15.2)		
Local incentives	**(10.1)**	(16.9)		
Tax effect of other non-headline items	**(5.7)**	(8.2)		
Tax effect of Aerospace sale			**(39.7)**	(4.6)
	91.8	78.9	**(25.0)**	
Comprising				
– taxation on headline profit	**121.4**	104.3		
– tax on non-headline profit/(loss)	**(29.6)**	(25.4)		
– tax on sale of discontinued operations			**(25.0)**	
Total taxation expense in the income statement	**91.8**	78.9	**(25.0)**	

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Tax on items (charged)/credited to equity		
Deferred tax charge/(credit)		
– retirement benefit schemes	**(10.9)**	(12.2)
– share options	**1.8**	(2.4)
	(9.1)	(14.6)

Of the net £10.9m credited to equity for retirement benefits, £11.6m relates to UK schemes. The UK schemes have now closed and this amount represents tax relief on payments that is being set off against previous amounts charged to equity to write off the deferred tax asset.

Notes to the accounts
continued

Deferred taxation

	Excess tax depreciation on fixed assets and goodwill £m	Share-based payment £m	Retirement benefit obligations £m	Capitalised development expenditure £m	Other £m	Total £m
At 31 July 2009	(68.4)	3.9	51.0	(17.6)	129.3	98.2
Credit/(charge) to income statement	22.0	2.8	0.7	(3.8)	(19.5)	2.2
Credit/(charge) to equity		2.4	12.2			14.6
Business combinations	(3.5)					(3.5)
Exchange adjustments	(3.7)		3.2	(1.0)	6.4	4.9
At 31 July 2010	(53.6)	9.1	67.1	(22.4)	116.2	116.4
Deferred tax assets	18.0	9.1	65.2	(2.3)	104.2	194.2
Deferred tax liabilities	(71.6)		1.9	(20.1)	12.0	(77.8)
At 31 July 2010	(53.6)	9.1	67.1	(22.4)	116.2	116.4
Credit/(charge) to income statement	(1.7)	1.5	(22.9)	(5.6)	3.9	(24.8)
Credit/(charge) to equity		(1.8)	10.9			9.1
Business combinations	(1.4)					(1.4)
Exchange adjustments	1.8		(2.4)	1.1	(2.6)	(2.1)
At 31 July 2011	**(54.9)**	**8.8**	**52.7**	**(26.9)**	**117.5**	**97.2**
Deferred tax assets	9.6	8.6	52.0	(5.6)	110.2	174.8
Deferred tax liabilities	(64.5)	0.2	0.7	(21.3)	7.3	(77.6)
At 31 July 2011	**(54.9)**	**8.8**	**52.7**	**(26.9)**	**117.5**	**97.2**

Included in other deferred tax balances above is:

- no deferred tax liability relating to unremitted overseas earnings has been recognised this year (2010: £4.0m) because the Group is in a position to control the timing of other temporary differences and it is probable that such differences will not reverse in the future;
- a deferred tax asset of £26.0m (2010: £31.9m) relating to losses carried forward; and
- a deferred tax asset of £65.0m (2010: £60.3m) relating to provisions where current tax relief is only available as payments are made. Of this asset, £50.6m (£47.4m) relates to the John Crane, Inc. litigation provision. See note 23 for additional information on provisions.

The Group has not recognised deferred tax assets relating to tax losses of £225.4m (2010: £92.4m) and pensions and other long term liabilities of £96.9m (2010: £194.5m) due to uncertainty as to their recoverability.

The expiry date of operating losses carried forward is dependent upon the law of the various territories in which the losses arise. A summary of expiry dates for losses in respect of which restrictions apply is set out below.

Restricted losses

	2011 £m	**Expiry of losses**	2010 £m	Expiry of losses
Territory				
– Americas	**13.3**	**2019-2025**	13.9	2019-2025
– Asia	**3.2**	**2014-2018**	2.5	2014-2017
Total restricted losses	**16.5**		16.4	
Unrestricted losses				
– operating losses	**208.9**	**No expiry**	76.0	No expiry
Total	**225.4**		92.4	

7 Discontinued operations

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

Profit/(loss) on disposal of operation

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Consideration		19.9
Provisions and disposal costs	**54.0**	(3.5)
Pre-tax profit on disposal	**54.0**	16.4
Cash received from disposal of Aerospace operations		19.9
Disposal costs	**(6.2)**	
Net cash (outflow)/inflow on disposal	**(6.2)**	19.9

The profit on disposal in 2011 arises from the resolution and time barring of certain disposal indemnities. The further consideration of £19.9m recognised in 2010 was received following settlement of prior year tax filings.

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

Results from discontinued operations

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Profit on disposal	**54.0**	16.4
Tax credit (note 6)	**25.0**	
Profit for the period	**79.0**	16.4
Earnings per share from discontinued operations – pence		
Basic	**20.2p**	4.2p
Diluted	**20.0p**	4.1p

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

Cash-flows from discontinued operations

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Profit before taxation (including profit on disposal of Aerospace operations)	**54.0**	16.4
Profit on disposal of discontinued operations	**(54.0)**	(16.4)
Net cash inflow from operating activities		

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Investing activities	**(6.2)**	19.9
Net cash (outflow)/inflow from investing activities	**(6.2)**	19.9

8 Dividends

The following dividends were declared and paid in the period:

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Ordinary final dividend of 23.50p for 2010 (2009: 23.50p) paid 19 November 2010	**91.9**	91.6
Ordinary interim dividend of 11.25p for 2011 (2010: 10.5p) paid 21 April 2011	**44.2**	40.9
	136.1	132.5

The final dividend for the year ended 31 July 2011 of 25.0p per share was recommended by the Board on 27 September 2011 and will be paid to shareholders on 25 November 2011, subject to approval by the shareholders. This dividend has not been included as a liability in these accounts and is payable to all shareholders on the register of Members at close of business on 28 October 2011.

9 Earnings per share

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

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Profit attributable to equity shareholders for the year		
– continuing	**304.8**	293.6
– total	**383.8**	310.0
Average number of shares in issue during the year	**391,718,941**	390,034,777

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 395,240,785 (2010: 392,773,151) ordinary shares, being the average number of ordinary shares in issue during the year adjusted by the dilutive effect of employee share schemes. For the year ended 31 July 2011 options over no shares (2010: 1,729,551) were excluded from this calculation because their effect was anti-dilutive for continuing operations.

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

	Year ended 31 July 2011		Year ended 31 July 2010	
	£m	**EPS (p)**	£m	EPS (p)
Profit attributable to equity shareholders of the Parent Company	**304.8**	**77.8**	293.6	75.3
Exclude				
Non-headline items and related tax (note 3)	**58.5**	**14.9**	36.5	9.3
Headline	**363.3**	**92.7**	330.1	84.6
Headline EPS – diluted (p)		**91.9**		84.0

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.

Notes to the accounts
continued

Pension costs are assessed in accordance with the advice of independent, professionally-qualified actuaries. The most recent actuarial valuations of the two principal UK schemes were performed using the Projected Unit Method as at 31 March 2009. The most recent valuations of the six principal US pension and post-retirement healthcare plans were performed at 1 January 2010. These valuations have been updated by independent qualified actuaries in order to assess the liabilities of the schemes as at 31 July 2011. Scheme assets are stated at their market values. Contributions to the schemes are made on the advice of the actuaries.

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

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

The assumptions used are estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily occur in practice. For countries outside the UK and USA these are disclosed as a weighted average.

The mortality assumptions used in the principal UK schemes are based on the SAPS All Birth year tables with relevant scaling factors based on recent actual mortality experience of members within each. They allow for future improvements in life expectancy in line with 80% and 60% of the long cohort for males and females respectively with an annual 1% underpin. The mortality assumptions used in the principal US schemes are based on the most recent mortality study table produced for retired pensioners in the US (RP 2000 table). The table selected allows for future mortality improvements and applies an adjustment for job classification (blue collar versus white collar). The assumptions give the following:

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

The assets in the scheme and the expected rates of return as at 31 July 2011 were:

	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)**
Net pension liability		**(10.8)**		**(149.9)**		**(38.3)**	**(199.0)**
Post-retirement assets		**140.6**					**140.6**
Post-retirement liabilities		**(151.4)**		**(149.9)**		**(38.3)**	**(339.6)**
Net pension liability		**(10.8)**		**(149.9)**		**(38.3)**	**(199.0)**

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

Notes to the accounts
continued

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

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

The scheme assets do not include any of the Group's own financial instruments, nor any property occupied by, nor other assets used by, the Group. The expected rates of return on individual categories of scheme assets are determined by reference to relevant industries. The overall rate of return is calculated by weighting the individual rates in accordance with the anticipated balance in the schemes' investment portfolios.

Amounts recognised in the income statement

	Year ended 31 July 2011				Year ended 31 July 2010			
	Funded defined benefit pension schemes			**Unfunded pension/post-retirement healthcare plans**	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans
	UK £m	**US £m**	**Other £m**	**£m**	UK £m	US £m	Other £m	£m
Amounts (credited)/charged to operating profit								
Current service cost	**0.4**	**0.2**	**2.1**	**0.9**	2.8	0.3	1.6	1.4
Past service (gain)/cost	**(10.2)**	**0.1**				0.1		0.3
Curtailment (gains)/losses		**(0.9)**	**(0.1)**	**0.1**	(3.7)	(0.3)		0.1
Total (credit)/charge	**(9.8)**	**(0.6)**	**2.0**	**1.0**	(0.9)	0.1	1.6	1.8
Amounts (credited)/charged to finance costs								
Expected return on pension scheme assets	**(169.9)**	**(26.0)**	**(2.5)**		(156.4)	(25.0)	(2.3)	
Interest on pension scheme liabilities	**140.1**	**27.2**	**3.2**	**4.6**	144.8	28.8	3.0	4.8
Net return	**(29.8)**	**1.2**	**0.7**	**4.6**	(11.6)	3.8	0.7	4.8
Total (credit)/charge to income statement	**(39.6)**	**0.6**	**2.7**	**5.6**	(12.5)	3.9	2.3	6.6

Notes to the accounts
continued

The UK past service gain of £10.2m in 2011 relates to changes in certain early retirement terms. The curtailment gains in 2010 related to the closure of the UK and US defined benefit schemes. The actual return on scheme assets was a profit of £337.8m (2010: profit of £351.2m).

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

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Cost of sales	**0.5**	3.4
Sales and distribution costs	**0.4**	2.6
Administrative expenses	**1.9**	0.5
Exceptional operating items	**(10.2)**	(3.9)
	(7.4)	2.6

Amounts recognised directly in the consolidated statement of comprehensive income

Net actuarial losses of £0.2m (2010: losses of £15.2m) have been reported in the statement of comprehensive income. This includes a loss of £0.5m (2010: gain of £1.3m) in respect of unrecognised assets owing to surplus restriction. Cumulative actuarial losses from 1 August 2004 reported in the statement of comprehensive income are £558.5m (2010: cumulative losses of £558.3m).

Changes in present value of defined benefit obligations

	Year ended 31 July 2011				Year ended 31 July 2010			
	Funded defined benefit pension schemes			**Unfunded pension/post-retirement healthcare plans**	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans
	UK £m	**US £m**	**Other £m**	**£m**	UK £m	US £m	Other £m	£m
At beginning of period	**(2,658.0)**	**(543.4)**	**(57.1)**	**(89.2)**	(2,531.8)	(462.6)	(33.2)	(84.5)
Reclassification of Irish pension scheme					11.6		(11.6)	
Current service cost	**(0.4)**	**(0.2)**	**(2.1)**	**(0.9)**	(2.8)	(0.3)	(1.6)	(1.4)
Interest on obligations	**(140.1)**	**(27.2)**	**(3.2)**	**(4.6)**	(144.8)	(28.8)	(3.0)	(4.8)
Employee contributions			**(0.4)**				(0.4)	
Past service gain/(cost)	**10.2**	**(0.1)**				(0.1)		(0.3)
Actuarial (loss)/gain on liabilities	**(116.6)**	**(22.9)**	**2.7**	**(2.3)**	(126.7)	(46.3)	(6.4)	(4.7)
Curtailment gain/(cost)		**0.9**	**0.1**	**(0.1)**	3.7	0.3		(0.1)
Exchange adjustments		**25.3**	**(2.5)**	**(0.3)**		(29.5)	(2.2)	(1.2)
Benefits paid	**129.2**	**23.8**	**2.3**	**6.7**	132.8	23.9	1.3	7.8
At end of period	**(2,775.7)**	**(543.8)**	**(60.2)**	**(90.7)**	(2,658.0)	(543.4)	(57.1)	(89.2)

Notes to the accounts
continued

Changes in present value of scheme assets

	Year ended 31 July 2011				Year ended 31 July 2010			
	Funded defined benefit pension schemes			**Unfunded pension/post-retirement healthcare plans**	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans
	UK £m	**US £m**	**Other £m**	**£m**	UK £m	US £m	Other £m	£m
At beginning of period	**2,616.3**	**386.6**	**40.2**		2,413.7	334.5	26.9	
Reclassification of Irish pension scheme					(6.7)		6.7	
Expected return on assets	**169.9**	**26.0**	**2.5**		156.4	25.0	2.3	
Actuarial gain/(loss) on scheme assets	**115.8**	**22.6**	**1.0**		150.6	16.9		
Employer contributions	**40.8**	**20.0**	**2.9**	**6.7**	35.1	12.7	3.0	7.8
Employee contributions			**0.4**				0.4	
Exchange adjustments		**(18.6)**	**1.5**			21.4	2.2	
Benefits paid	**(129.2)**	**(23.8)**	**(2.3)**	**(6.7)**	(132.8)	(23.9)	(1.3)	(7.8)
At end of period	**2,813.6**	**412.8**	**46.2**		2,616.3	386.6	40.2	

Cash contributions

Company contributions to the funded defined benefit pension plans for 2011 totalled £63.7m (2010: £50.8m).

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

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

In addition to the funding plans referred to above, the Group agreed to make cash contributions in respect of any future service cost based on actuarial advice. In 2012 the following cash contributions to the Group's principal defined benefit schemes are expected: £36m to SIPS; a conditional £50m to TIGPS; and approximately £20m to the US defined benefit scheme. Including payments to smaller schemes around the world; expected cash payments for 2012 total approximately £110m.

History of schemes

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Balance sheet					
Present value of defined benefit obligation	**(3,470.4)**	(3,347.7)	(3,112.1)	(2,968.9)	(3,132.9)
Fair value of scheme assets	**3,272.6**	3,043.1	2,775.1	2,959.9	3,318.9
Unrecognised asset due to surplus restriction	**(1.2)**	(0.7)	(2.0)	(1.5)	(2.4)
(Deficit)/surplus	**(199.0)**	(305.3)	(339.0)	(10.5)	183.6
Post-retirement assets	**140.6**	80.3	39.2	174.2	333.7
Post-retirement liabilities	**(339.6)**	(385.6)	(378.2)	(184.7)	(150.1)
(Deficit)/surplus	**(199.0)**	(305.3)	(339.0)	(10.5)	183.6

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m	Period ended 31 July 2008 £m	Period ended 5 August 2007 £m
Experience gains/(losses)					
Experience gains/(losses) on scheme liabilities	**(25.5)**	31.5	100.5	(6.4)	(57.6)
Experience gains/(losses) on scheme assets	**139.4**	167.5	(345.4)	(350.0)	95.7
Movement on restricted surplus	**(0.5)**	1.3	(0.5)	0.9	(1.9)

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

Sensitivity

The valuation of post-retirement schemes involves judgements about uncertain future events. Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 July 2011 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions. While each of these sensitivities holds all other assumptions constant, in practice such assumptions rarely change in isolation and the impacts may offset to some extent.

	Profit before tax for year ended 31 July 2011 £m	Increase/ (decrease) in scheme assets £m	(Increase)/ decrease in scheme liabilities £m
Rate of mortality – 1 year increase in life expectancy	(4.0)	25.4	(101.2)
Rate of mortality – 1 year decrease in life expectancy	4.0	(26.1)	102.4
Rate of inflation – 0.25% increase	(4.0)	8.6	(85.6)
Discount rate – 0.25% increase	(0.8)	(10.7)	127.0
Expected return on scheme assets – 0.25% increase	5.8		
Market value of scheme assets – 2.5% increase	4.4	68.7	(0.1)
Healthcare cost trends – 1% increase			(0.1)
Healthcare cost trends – 1% decrease			0.1

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

Investment

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

Defined contribution plans

The Group operates a number of defined contribution plans across many countries. In the UK a defined contribution plan has been offered since the closure of the UK defined benefit pension plans. In the US a 401k defined contribution plan operates. The total expense recognised in the income statement in respect of all these plans was £29.6m (2010: £27.1m).

11 Employees

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Staff costs during the period		
Wages and salaries	**698.4**	686.1
Social security	**82.4**	82.0
Share-based payment (note 30)	**13.8**	11.3
Pension costs (including defined contribution schemes) (note 10)	**32.9**	33.8
	827.5	813.2

The average number of persons employed was:

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

Key management

The key management of the Group 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 76 to 84.

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Key management compensation		
Salaries and short-term employee benefits	**9.2**	10.3
Cost of post-retirement benefits	**0.1**	0.1
Cost of share-based incentive plans	**4.0**	2.4

No member of key management had any material interest 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 2011		Year ended 31 July 2010	
	Number of instruments '000	**Weighted average price**	Number of instruments '000	Weighted average price
CIP	**540**		315	
ESOS	**194**	**£8.81**	220	£8.73
PSP			241	
VSP	**852**		753	
SAYE	**4**	**£6.81**	5	£6.45

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

Related party transactions

The Group has a service contract with a company connected to a member of the Executive Committee. Costs of £0.2m (2010: £0.2m) were incurred in respect of this arrangement.

Notes to the accounts
continued

12 Intangible assets

	Goodwill £m	Development costs £m	Acquired intangibles (see table below) £m	Software, patents and intellectual property £m	Total £m
Cost					
At 1 August 2009	1,266.5	106.2	290.2	116.3	1,779.2
Exchange adjustments	48.7	5.4	13.8	3.0	70.9
Business combinations	64.1		51.5		115.6
Adjustments to prior year business combinations	0.2				0.2
Additions		24.3		7.6	31.9
Disposals		(0.7)		(2.0)	(2.7)
At 31 July 2010	1,379.5	135.2	355.5	124.9	1,995.1
Exchange adjustments	(12.2)	(3.7)	(7.7)	(0.7)	(24.3)
Business combinations	22.4		4.1		26.5
Additions		31.0		10.2	41.2
Disposals				(2.2)	(2.2)
At 31 July 2011	**1,389.7**	**162.5**	**351.9**	**132.2**	**2,036.3**
Amortisation					
At 1 August 2009	92.0	32.4	91.2	63.3	278.9
Exchange adjustments	3.1	2.0	4.2	2.3	11.6
Charge for the year		13.8	42.1	11.7	67.6
Disposals				(1.6)	(1.6)
At 31 July 2010	95.1	48.2	137.5	75.7	356.5
Exchange adjustments	(1.2)	(1.0)	(3.4)	(0.5)	(6.1)
Charge for the year		16.2	44.0	12.1	72.3
Impairment charge			5.5		5.5
Disposals				(2.1)	(2.1)
At 31 July 2011	**93.9**	**63.4**	**183.6**	**85.2**	**426.1**
Net book value at 31 July 2011	**1,295.8**	**99.1**	**168.3**	**47.0**	**1,610.2**
Net book value at 31 July 2010	1,284.4	87.0	218.0	49.2	1,638.6
Net book value at 1 August 2009	1,174.5	73.8	199.0	53.0	1,500.3

Notes to the accounts
continued

In addition to goodwill, the acquired intangible assets comprise:

	Patents, licences and trademarks £m	Technology £m	Customer relationships £m	Total acquired intangibles £m
Cost				
At 1 August 2009	64.3	94.4	131.5	290.2
Exchange adjustments	4.4	5.3	4.1	13.8
Business combinations (note 29)		22.8	28.7	51.5
At 31 July 2010	68.7	122.5	164.3	355.5
Exchange adjustments	(2.1)	(5.1)	(0.5)	(7.7)
Business combinations (note 29)			4.1	4.1
At 31 July 2011	**66.6**	**117.4**	**167.9**	**351.9**
Amortisation				
At 1 August 2009	13.8	32.3	45.1	91.2
Exchange adjustments	0.9	2.0	1.3	4.2
Charge for the year	5.3	11.7	25.1	42.1
At 31 July 2010	20.0	46.0	71.5	137.5
Exchange adjustments	(0.7)	(2.2)	(0.5)	(3.4)
Charge for the year	5.1	13.3	25.6	44.0
Impairment charge	0.8		4.7	5.5
At 31 July 2011	**25.2**	**57.1**	**101.3**	**183.6**
Net book value at 31 July 2011	**41.4**	**60.3**	**66.6**	**168.3**
Net book value at 31 July 2010	48.7	76.5	92.8	218.0
Net book value at 1 August 2009	50.5	62.1	86.4	199.0

Impairment testing

Goodwill

Goodwill is allocated by division as follows:

	2011 £m	**2011 Number of CGUs**	2010 £m	2010 Number of CGUs
Smiths Detection	**406.9**	**1**	372.9	2
John Crane	**132.9**	**6**	130.8	6
Smiths Medical	**497.2**	**1**	512.5	2
Smiths Interconnect	**237.5**	**4**	245.9	4
Flex-Tek	**21.3**	**2**	22.3	2
	1,295.8	**14**	1,284.4	16

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

Goodwill is not amortised but is tested for impairment at least annually. Value in use calculations are used to determine the recoverable amount of goodwill held allocated to each group of cash generating units (CGU). Value in use is calculated as the net present value of the projected risk-adjusted cash-flows of the CGU. These forecast cash-flows are based on the 2012 budget and the three year divisional strategic plan, which have both been approved by the Board.

The key assumptions used in value in use calculations are:

- Sales: projected sales are built up with reference to markets and product categories. They incorporate past performance, historical growth rates and developments in key markets.
- Margins: projected margins reflect historical performance and the impact of all completed projects to improve operational efficiency and leverage scale. The projections do not include the impact of future restructuring projects to which the Group is not yet committed.
- Discount rate: the discount rates have been calculated based on the Group's weighted average cost of capital and risks specific to the CGU being tested. Pre-tax rates of 11.1% to 14.1% (2010: 9.8% to 12.8%) have been used for the impairment testing.
- Long term growth rates: As required by IAS 36, growth rates for the period after the detailed forecasts are based on the long-term GDP projections of the primary market for the CGU. The average growth rate used in the testing was 2.42% (2010: 2.25%). These rates do not reflect the long-term assumption used by the Group for investment planning.

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

	Smiths Medical		Smiths Detection	
	2011	2010 (restated)	**2011**	2010 (restated)
Net book value of goodwill (£m)	**497.2**	512.5	**406.9**	372.9
Discount rate	**11.2%**	11.5%	**11.2%**	11.7%
Period covered by management projections	**5 years**	5 years	**5 years**	5 years
Long-term growth rates	**2.47%**	2.25%	**2.00%**	2.25%

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

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

Other intangible assets

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

Impairment charges of £5.5m have been incurred on intangible assets acquired in two business combinations. Value in use calculations were used to determine the recoverable values of these assets. The impairment charges have arisen because current and forecast profitability is below the levels originally projected.

13 Property, plant and equipment

	Land and buildings £m	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
Cost or valuation				
At 1 August 2009	191.3	454.6	202.9	848.8
Exchange adjustments	8.0	23.5	8.3	39.8
Business combinations		3.4	0.8	4.2
Additions	6.5	26.9	13.6	47.0
Disposals	(18.8)	(14.8)	(15.6)	(49.2)
At 31 July 2010	187.0	493.6	210.0	890.6
Exchange adjustments	(1.8)	(9.0)	1.2	(9.6)
Business combinations		0.2	0.1	0.3
Additions	7.8	26.6	14.9	49.3
Disposals	(2.7)	(15.7)	(16.7)	(35.1)
At 31 July 2011	**190.3**	**495.7**	**209.5**	**895.5**
Depreciation				
At 1 August 2009	79.5	302.7	148.6	530.8
Exchange adjustments	3.8	15.9	6.2	25.9
Charge for the year	7.7	39.1	18.9	65.7
Reversal of impairment	(2.1)			(2.1)
Disposals	(6.4)	(12.7)	(13.3)	(32.4)
At 31 July 2010	82.5	345.0	160.4	587.9
Exchange adjustments	(1.3)	(6.8)	0.7	(7.4)
Charge for the year	7.8	38.9	16.7	63.4
Disposals	(1.9)	(14.4)	(14.9)	(31.2)
At 31 July 2011	**87.1**	**362.7**	**162.9**	**612.7**
Net book value at 31 July 2011	**103.2**	**133.0**	**46.6**	**282.8**
Net book value at 31 July 2010	104.5	148.6	49.6	302.7
Net book value at 1 August 2009	111.8	151.9	54.3	318.0

14 Investments accounted for using the equity method

	31 July 2011 £m	31 July 2010 £m
Investments in associated companies		
At start of period	**13.6**	11.2
Exchange adjustment	**0.8**	0.7
Share of results after tax	**4.3**	1.8
Dividend received	**(0.2)**	(0.1)
At end of period	**18.5**	13.6

The Group's share of the revenue of associates was £23.7m (2010: £22.5m). The total assets of associates are £59.9m (2010: £43.1m) and liabilities are £13.5m (2010: £17.6m). These figures principally represent the performance, assets and liabilities of Cross Match Technologies, Inc., incorporated in the United States. The share of these assets and liabilities attributable to Smiths Group is 35.6% (2010: 35.6%).

15 Financial assets

Available for sale financial assets include £29.1m (2010: £25.2m) UK government bonds. This investment forms part of the deficit funding plan agreed with the trustee of one of the principal UK pension schemes. See note 10 for additional details.

16 Inventories

	31 July 2011 £m	31 July 2010 £m
Inventories comprise		
Raw materials and consumables	**145.1**	129.3
Work in progress	**94.7**	72.4
Finished goods	**197.2**	190.5
	437.0	392.2
Less: payments on account	**(4.5)**	(2.2)
	432.5	390.0

The Group consumed £1,332.6m (2010: £1,262.2m) of inventories during the period. £11.3m (2010: £19.0m) was recognised as an expense resulting from the write-down of inventory and £3.0m (2010: £5.6m) was released to the income statement from inventory provisions charged in earlier years but no longer required.

17 Trade and other receivables

	31 July 2011 £m	31 July 2010 £m
Non-current		
Trade receivables	**23.7**	22.8
Prepayments and accrued income	**5.3**	6.0
Other debtors	**4.6**	5.0
	33.6	33.8
Current		
Trade receivables	**564.2**	535.3
Prepayments and accrued income	**32.9**	30.5
Other debtors	**15.7**	13.1
	612.8	578.9

Trade receivables do not carry interest. Management considers that the carrying value of trade and other receivables approximates to the fair value. Trade and other receivables, including prepayments, accrued income and other debtors qualifying as financial instruments are classified as 'loans and receivables'. The maximum credit exposure arising from these financial assets is £606.5m (2010: £575.8m).

Trade receivables are disclosed net of provisions for bad and doubtful debts. The provisions for bad and doubtful debts are based on specific risk assessment and reference to past default experience.

Credit risk is managed separately for each customer and, where appropriate, a credit limit is set for the customer based on previous experience of the customer and third party credit ratings. The Group has no significant concentration of credit risk, with exposure spread over a large number of customers. The largest single customer is the US Federal Government, representing less than 6% (2010: 8%) of Group revenue.

Notes to the accounts
continued

Ageing of trade receivables

	31 July 2011 £m	31 July 2010 £m
Trade receivables which are not impaired and not yet due	**472.4**	447.3
Trade receivables which are not impaired and less than three months overdue	**84.2**	75.7
Trade receivables which are not impaired and more than three months overdue	**28.5**	31.8
Gross value of partially and fully provided debtors	**16.8**	17.9
	601.9	572.7
Provision for bad and doubtful debts	**(14.0)**	(14.6)
Trade receivables	**587.9**	558.1

18 Cash and cash equivalents

	31 July 2011 £m	31 July 2010 £m
Cash at bank and in hand	**232.0**	136.3
Short-term deposits	**29.1**	36.6
Cash and cash equivalents	**261.1**	172.9
Bank overdrafts	**(0.4)**	(0.7)
Net cash and cash equivalents	**260.7**	172.2

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

19 Trade and other payables

	31 July 2011 £m	31 July 2010 £m
Non-current		
Other creditors	**45.1**	27.3
Current		
Trade creditors	**190.3**	151.6
Bills of exchange payable	**0.7**	0.5
Other creditors	**19.4**	35.2
Other taxation and social security costs	**22.5**	21.2
Accruals and deferred income	**221.3**	219.7
	454.2	428.2

Trade and other payables, including accrued expenses and other creditors qualifying as financial instruments, are accounted for at amortised cost and are categorised as other financial liabilities.

20 Borrowings and net debt

This note sets out the calculation of net debt, an important measure in explaining our financing position. The net debt figure includes accrued interest and the fair value adjustments relating to hedge accounting.

	31 July 2011 £m	31 July 2010 £m
Cash and cash equivalents		
Net cash and deposits (note 18)	**261.1**	172.9
Short-term borrowings		
Bank overdrafts	**(0.4)**	(0.7)
Bank and other loans	**(1.2)**	(1.3)
Interest accrual	**(10.1)**	(12.7)
	(11.7)	(14.7)
Long-term borrowings		
$250m 5.45% US$ Private placement 2013	**(158.3)**	(169.1)
$250m 6.05% US$ Guaranteed notes 2014	**(151.4)**	(158.3)
£150m 7.25% Sterling Eurobond 2016	**(149.3)**	(149.1)
€300m 4.125% Eurobond 2017	**(260.2)**	(247.6)
$175m 7.37% US$ Private placement 2018	**(106.4)**	(111.4)
$250m 7.20% US$ Guaranteed notes 2019	**(151.0)**	(158.0)
Bank and other loans	**(1.8)**	(1.5)
	(978.4)	(995.0)
Borrowings	**(990.1)**	(1,009.7)
Net debt	**(729.0)**	(836.8)

Borrowings are accounted for at amortised cost and are categorised as other financial liabilities. See note 21 for a maturity analysis of borrowings. The repayment dates on borrowings repayable after five years range from 2017 to 2019.

Interest of £42.3m (2010: £43.2m) was charged to the consolidated income statement in this period in respect of public bonds.

Movements in net debt

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

Secured loans

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

21 Financial risk management

The Group's international operations and debt financing expose it to financial risks which include the effects of changes in foreign exchange rates, changes in debt market prices, interest rates, credit risks and liquidity risks.

Treasury and risk management policies are set by the Board. The policy sets out specific guidelines to manage foreign exchange risk, interest rate risk, credit risk and the use of financial instruments to manage risk. The instruments and techniques used to manage exposures include foreign currency derivatives, debt and other interest rate derivatives. The central treasury function monitors financial risks and compliance with risk management policies. The management of operational credit risk is discussed in note 17.

(a) Foreign exchange risk

Transactional currency exposure

The Group is exposed to foreign currency risks arising from sales or purchases by businesses in currencies other than their functional currency. It is Group policy that, when the net foreign exchange exposure to known future sales and purchases is material, this exposure is hedged using forward foreign exchange contracts. The net exposure is calculated by adjusting the expected cash-flow for payments or receipts in the same currency linked to the sale or purchase. This policy minimises the risk that the profits generated from the transaction will be affected by foreign exchange movements which occur after the price has been determined.

Hedge accounting documentation and effectiveness testing are only undertaken if it is cost effective.

The following table shows the currency of financial instruments. It excludes loans and derivatives designated as net investment hedges.

	At 31 July 2011				
	Sterling £m	**US$ £m**	**Euro £m**	**Other £m**	**Total £m**
Financial assets and liabilities					
Financial instruments included in trade and other receivables	**35.3**	**290.7**	**144.2**	**136.3**	**606.5**
Financial instruments included in trade and other payables	**(50.3)**	**(141.4)**	**(78.8)**	**(64.6)**	**(335.1)**
Cash and cash equivalents	**55.8**	**58.5**	**32.9**	**113.9**	**261.1**
Borrowings not designated as net investment hedges	**(149.0)**	**(10.8)**	**(3.0)**		**(162.8)**
	(108.2)	**197.0**	**95.3**	**185.6**	**369.7**
Exclude balances held in operations with the same functional currency	**108.5**	**(147.8)**	**(98.4)**	**(183.4)**	**(321.1)**
Exposure arising from intra-group loans		**(93.5)**	**(8.8)**	**8.7**	**(93.6)**
Forward foreign exchange contracts	**(104.4)**	**65.1**	**62.9**	**(23.6)**	
	(104.1)	**20.8**	**51.0**	**(12.7)**	**(45.0)**

	At 31 July 2010				
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Financial assets and liabilities					
Financial instruments included in trade and other receivables	34.5	280.3	138.8	122.2	575.8
Financial instruments included in trade and other payables	(36.3)	(143.1)	(66.2)	(51.1)	(296.7)
Cash and cash equivalents	30.4	30.6	19.0	92.9	172.9
Borrowings not designated as net investment hedges	(151.6)	(11.5)	(2.6)	(0.3)	(166.0)
	(123.0)	156.3	89.0	163.7	286.0
Exclude balances held in operations with the same functional currency	124.7	(103.9)	(87.1)	(159.0)	(225.3)
Exposure arising from intra-group loans		(36.0)	12.8	6.2	(17.0)
Forward foreign exchange contracts	(2.6)	30.0	11.2	(38.6)	
	(0.9)	46.4	25.9	(27.7)	43.7

Notes to the accounts
continued

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

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

	Impact on profit for the year 31 July 2011 £m	**Gain/(loss) recognised in reserves 31 July 2011 £m**	Impact on profit for the year 31 July 2010 £m	Gain/(loss) recognised in reserves 31 July 2010 £m
US dollar	**5.9**	**(3.4)**	1.5	(1.8)
Euro	**(1.8)**	**4.2**	1.0	2.9
Sterling	**0.5**	**1.6**	1.3	1.8

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

Cash-flow hedging

The Group uses foreign currency contracts to hedge future foreign currency sales and purchases. At 31 July 2011 contracts with a nominal value of £217.7m (2010: £292.7m) were designated as hedging instruments. In addition, the Group had outstanding foreign currency contracts with a nominal value of £241.0m (2010: £152.1m) which were being used to manage transactional foreign exchange exposures, but were not accounted for as cash-flow hedges. The fair value of the contracts is disclosed in note 22.

The majority of hedged transactions will be recognised in the income statement in the same period that the cash-flows are expected to occur, with the only differences arising as a result of normal commercial credit terms on sales and purchases. Of the foreign exchange contracts designated as hedging instruments 99.9% are for periods of 12 months or less (2010: 99.6%).

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

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Brought forward cash-flow hedge reserve at start of year	**(0.6)**	1.8
Exchange adjustments	**0.1**	0.2
Gains and losses on effective cash-flow hedges recognised in equity	**0.4**	(2.3)
Amounts removed from the hedge reserve and recognised in the following lines on the income statement		
– revenue	**0.2**	0.1
– cost of sales	**(0.4)**	0.9
– administrative expenses		(1.3)
Carried forward cash-flow hedge reserve at end of year	**(0.3)**	(0.6)

Translational currency exposure

The Group has significant investments in overseas operations, particularly in the United States and Europe. As a result, the sterling value of the Group's balance sheet can be significantly affected by movements in exchange rates. The Group seeks to mitigate the effect of these translational currency exposures by matching the net investment in overseas operations with borrowings denominated in their functional currencies, except where significant adverse interest differentials or other factors would render the cost of such hedging activity uneconomic. This is achieved by borrowing primarily in the relevant currency or in some cases indirectly through the use of forward foreign exchange contracts and cross currency swaps.

Net investment hedges

The table below sets out the currency of loans and swap contracts designated as net investment hedges:

	At 31 July 2011				
	Sterling £m	**US$ £m**	**Euro £m**	**Other £m**	**Total £m**
Loans designated as net investment hedges		**(567.2)**	**(260.1)**		**(827.3)**
Currency swap contracts	**192.6**	**(45.6)**	**(39.2)**	**(107.8)**	
	192.6	**(612.8)**	**(299.3)**	**(107.8)**	**(827.3)**

	At 31 July 2010				
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges		(587.0)	(248.1)		(835.1)
Currency swap contracts	206.7	(32.4)	(39.2)	(135.1)	
	206.7	(619.4)	(287.3)	(135.1)	(835.1)

At 31 July 2011 and 31 July 2010 swap contracts in other currencies hedged the Group's exposure to Australian dollars, Canadian dollars, Japanese yen and Chinese renminbi.

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

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

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Brought forward net investment hedge reserve at start of year	**(128.2)**	(88.9)
Amounts deferred in the period on effective net investment hedges	**7.9**	(39.3)
Carried forward net investment hedge reserve at end of year	**(120.3)**	(128.2)

The fair values of these net investment hedges are subject to exchange rate movements. Based on the hedging instruments in place at the year end, if the specified currencies were to strengthen 10% while all other market rates remained constant, it would have the following effect:

	Loss recognised in hedge reserve 31 July 2011 £m	Loss recognised in hedge reserve 31 July 2010 £m
US dollar	**60.4**	61.8
Euro	**27.6**	26.0

These movements would be fully offset by an opposite movement on the retranslation of the net assets of the overseas subsidiaries. These sensitivities were calculated before adjusting for tax.

(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 2011 98.5% (2010: 91.5%) of the Group's net borrowings were at fixed interest rates, after adjusting for interest rate swaps and the impact of short maturity derivatives designated as net investment hedges.

The weighted average interest rate on borrowings and cross-currency swaps at 31 July 2011, after interest rate swaps, is 5.5% (2010: 5.4%).

Notes to the accounts
continued

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

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

	Cash and cash equivalents 31 July 2011 £m	**Borrowings 31 July 2011 £m**	**Fair value of borrowings 31 July 2011 £m**	Cash and cash equivalents 31 July 2010 £m	Borrowings 31 July 2010 £m	Fair value of borrowings 31 July 2010 £m
Fixed interest (adjusted for interest rate hedging)						
Less than one year		**(1.2)**	**(1.2)**		(1.3)	(1.3)
Between one and five years		**(363.4)**	**(403.6)**		(223.5)	(244.3)
Greater than five years		**(414.2)**	**(463.0)**		(566.9)	(643.7)
Total fixed interest financial assets/(liabilities) (adjusted for interest rate hedging)		**(778.8)**	**(867.8)**		(791.7)	(889.3)
Floating rate interest financial assets/(liabilities)	**243.1**	**(211.3)**	**(211.3)**	156.4	(218.0)	(218.0)
Total interest bearing financial assets/(liabilities)	**243.1**	**(990.1)**	**(1,079.1)**	156.4	(1,009.7)	(1,107.3)
Non-interest bearing assets/(liabilities) in the same category	**18.0**			16.5		
Total	**261.1**	**(990.1)**	**(1,079.1)**	172.9	(1,009.7)	(1,107.3)

Interest rate hedging

The Group has designated US$150.0m interest rate swaps which mature on 28 January 2013 and €120.0m interest rate swaps which mature on 5 May 2017 as fair value hedges on the US Private placement and the Eurobond respectively which mature on the same dates. These positions hedge the risk of variability in the fair value of borrowings arising from fluctuations in base rates.

The fair values of the hedging instruments are disclosed in note 22. The effect of the swaps is to convert £196.3m (2010: £195.3m) debt from fixed rate to floating rate.

Sensitivity of interest charges to interest rate movements

The Group has exposure to sterling, US dollar and euro interest rates. However the Group does not have a significant exposure to interest rate movements for any individual currency. Based on the composition of net debt and foreign exchange rates at 31 July 2011, and taking into consideration all fixed rate borrowings and interest rate swaps in place, a one percentage point (100 basis points) change in average floating interest rates for all three currencies would have a £nil (2010: £0.2m) impact on the Group’s profit before tax.

(c) Financial credit risk

The Group is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, but does not currently expect any counterparties to fail to meet their obligations. Credit risk is mitigated by the Board approved policy of only selecting counterparties with a strong investment grade long-term credit rating for cash deposits and assigning financial limits to individual counterparties. In the normal course of business, the Group operates cash pooling systems, where a legal right of set-off applies.

The maximum credit risk exposure in the event of other parties failing to perform their obligations under financial assets, excluding trade and other receivables and derivatives, totals £292.7m at 31 July 2011 (2010: £199.9m).

	31 July 2011 £m	31 July 2010 £m
Cash at banks with at least a AA- credit rating	**236.6**	120.9
Cash at banks with a A+ credit rating	**21.1**	47.4
Cash at other banks	**3.4**	4.7
UK government bonds with a AAA credit rating (note 15)	**29.1**	25.2
Other investments	**2.5**	1.7
	292.7	199.9

At 31 July 2011 the maximum exposure with a single bank for deposits and cash is £57.1m (2010: £41.6m), whilst the maximum mark to market exposure for derivatives is £5.3m (2010: £6.8m). These banks have AA- and AA credit rating, respectively (2010: AA and AA).

(d) Liquidity risk

Borrowing facilities

The Board policy specifies the maintenance of unused committed credit facilities of at least £200m at all times to ensure it has sufficient available funds for operations and planned development. On 14 December 2010 the £660m Revolving Credit Facility 2012 was refinanced with a new US$800m multi-currency revolving credit facility. The new facility, which matures in December 2015, is undrawn. At the balance sheet date the Group had the following undrawn credit facilities:

	31 July 2011 £m	31 July 2010 £m
Expiring within one year		
Expiring between one and two years		660.0
Expiring after two years	**486.8**	
	486.8	660.0

Cash deposits

As at 31 July 2011, £29.1m (2010: £36.6m) of cash and cash equivalents was on deposit with various banks of which £4.5m (2010: £20.8m) was on deposit in the UK.

Gross contractual cash-flows for borrowings

	Borrowings (Note 20) 31 July 2011 £m	Fair value adjustments 31 July 2011 £m	Contractual interest payments 31 July 2011 £m	Total contractual cash-flows 31 July 2011 £m	Borrowings (Note 20) 31 July 2010 £m	Fair value adjustments 31 July 2010 £m	Contractual interest payments 31 July 2010 £m	Total contractual cash-flows 31 July 2010 £m
Less than one year	**(11.7)**	**(1.1)**	**(46.9)**	**(59.7)**	(14.7)	1.3	(47.9)	(61.3)
Between one and two years	**(159.2)**	**6.2**	**(54.0)**	**(207.0)**	(1.0)		(59.2)	(60.2)
Between two and three years	**(152.3)**	**(0.7)**	**(49.8)**	**(202.8)**	(169.6)	9.8	(54.9)	(214.7)
Between three and four years			**(40.5)**	**(40.5)**	(158.3)	(1.0)	(50.5)	(209.8)
Between four and five years	**(149.3)**	**(0.7)**	**(40.5)**	**(190.5)**			(40.8)	(40.8)
Greater than five years	**(517.6)**	**(3.6)**	**(59.4)**	**(580.6)**	(666.1)	(4.0)	(102.0)	(772.1)
Total	**(990.1)**	**0.1**	**(291.1)**	**(1,281.1)**	(1,009.7)	6.1	(355.3)	(1,358.9)

The figures presented in the borrowings column include the non-cash adjustments which are highlighted in the adjacent column. The contractual interest reported for borrowings is before the effect of interest rate swaps.

Gross contractual cash-flows for derivative financial instruments

	Receipts 31 July 2011 £m	**Payments 31 July 2011 £m**	**Net cash-flow 31 July 2011 £m**	Receipts 31 July 2010 £m	Payments 31 July 2010 £m	Net cash-flow 31 July 2010 £m
Assets						
Less than one year	**182.3**	**(166.6)**	**15.7**	375.2	(354.0)	21.2
Greater than one year	**102.4**	**(92.5)**	**9.9**	78.7	(60.7)	18.0
Liabilities						
Less than one year	**351.3**	**(359.5)**	**(8.2)**	362.5	(377.8)	(15.3)
Greater than one year	**26.8**	**(27.0)**	**(0.2)**	30.2	(31.3)	(1.1)
Total	**662.8**	**(645.6)**	**17.2**	846.6	(823.8)	22.8

This table presents the undiscounted future contractual cash-flows for all derivative financial instruments. For this disclosure, cash-flows in foreign currencies are translated using the spot rates at the balance sheet date. The fair values of these financial instruments are presented in note 22.

Gross contractual cash-flows for other financial liabilities

The contractual cash-flows for financial liabilities included in trade and other payables are: £309.9m (2010: £284.5m) due in less than one year, £20.9m (2010: £8.2m) due between one and five years and £4.3m (2010: £4.0m) due after more than five years.

22 Financial derivatives

The tables below set out the nominal amount and fair value of derivative contracts held by the Group, identifying the derivative contracts which qualify for hedge accounting treatment:

	At 31 July 2011			
	Contract or underlying nominal amount	**Fair value**		
	£m	**Assets £m**	**Liabilities £m**	**Net £m**
Foreign exchange contracts (cash-flow hedges)	**217.7**	**3.2**	**(4.5)**	**(1.3)**
Foreign exchange contracts (not hedge accounted)	**241.0**	**1.6**	**(2.6)**	**(1.0)**
Total foreign exchange contracts	**458.7**	**4.8**	**(7.1)**	**(2.3)**
Currency swaps (net investment hedges)	**192.6**	**1.9**	**(2.3)**	**(0.4)**
Interest rate swaps (fair value hedges)	**196.3**	**5.4**	**(1.0)**	**4.4**
Total financial derivatives	**847.6**	**12.1**	**(10.4)**	**1.7**
Balance sheet entries				
Non-current		**6.4**	**(1.5)**	**4.9**
Current		**5.7**	**(8.9)**	**(3.2)**
Total financial derivatives		**12.1**	**(10.4)**	**1.7**

Notes to the accounts
continued

	At 31 July 2010			
	Contract or underlying nominal amount	Fair value		
	£m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	292.7	5.2	(7.0)	(1.8)
Foreign exchange contracts (not hedge accounted)	152.1	1.2	(2.3)	(1.1)
Total foreign exchange contracts	444.8	6.4	(9.3)	(2.9)
Currency swaps (net investment hedges)	206.7	4.9	(0.8)	4.1
Currency swaps (not hedge accounted)	180.7	6.7	(5.6)	1.1
Total currency swap contracts	387.4	11.6	(6.4)	5.2
Interest rate swaps (fair value hedges)	195.3	8.3	(0.3)	8.0
Total financial derivatives	1,027.5	26.3	(16.0)	10.3
Balance sheet entries				
Non-current		10.8	(1.1)	9.7
Current		15.5	(14.9)	0.6
Total financial derivatives		26.3	(16.0)	10.3

Currency swaps not hedge accounted

These contracts comprise derivatives which were previously part of the net investment hedging programme and matching contracts to eliminate this exposure. There is no further net exposure arising from these contracts.

Accounting for other derivative contracts

Any foreign exchange contracts which are not formally designated as hedges and tested are classified as 'held for trading' and not hedge accounted.

Fair value hierarchy

All derivatives values are calculated using level 2 valuation methodologies.

23 Provisions for liabilities and charges

	Warranty provision and product liability £m	Reorganisation £m	Property £m	Disposal £m	John Crane, Inc. litigation £m	Other litigation £m	**Total £m**
At 31 July 2010	37.5	11.4	4.7	56.2	175.7	15.7	301.2
Exchange adjustments	0.5	(0.2)			(8.3)	(0.4)	(8.4)
Provision charged	22.9	4.8	0.8		27.3	5.0	60.8
Provision released	(5.8)	(2.0)	(0.8)	(43.8)		(2.1)	(54.5)
Unwind of provision discount					6.1		6.1
Utilisation	(17.5)	(6.2)	(1.3)	(8.5)	(19.1)	(3.8)	(56.4)
At 31 July 2011	**37.6**	**7.8**	**3.4**	**3.9**	**181.7**	**14.4**	**248.8**

Analysed as:

	31 July 2011 £m	31 July 2010 £m
Current liabilities	**74.7**	70.4
Non-current liabilities	**174.1**	230.8
	248.8	301.2

Warranty provision and product liability

Warranties over the Group's products typically cover periods of between one and three years. Provision is made for the likely cost of after-sales support based on the recent past experience of individual businesses.

Reorganisation

The restructuring of corporate and divisional headquarters was announced on 3 June 2008, and a second phase of this project was introduced in 2010. At 31 July 2011 there is a provision of £4.7m (2010: £8.6m) relating to the two phases of this project.

Reorganisation provisions include £1.8m (2010: £2.8m) costs relating to restructuring supply arrangements following the automotive seals disposal. These costs are expected to be spread over the next two years.

Disposal

The disposal provision relates to warranties and other obligations in respect of the disposal of the Marine Systems and Aerospace businesses.

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

Litigation

John Crane, Inc.

John Crane, Inc. ("JCI") is one of many co-defendants in numerous lawsuits pending in the United States in which plaintiffs are claiming damages arising from alleged exposure to, or use of, products previously manufactured which contained asbestos. Until 2006, the awards, the related interest and all material defence costs were met directly by insurers. In 2007, JCI secured the commutation of certain insurance policies in respect of product liability. While JCI has excess liability insurance, the availability of such insurance and scope of the cover are currently the subject of litigation in the United States. An adverse judgment at first instance from the Circuit Court of Cook County, Illinois is currently under appeal. Pending the outcome of that litigation, JCI has begun to meet defence costs directly. Provision is made in respect of the expected costs of defending known and predicted future claims and of adverse judgments in relation thereto, to the extent that such costs can be reliably estimated. No account has been taken of recoveries from insurers as their nature and timing are not yet sufficiently certain to permit recognition as an asset for these purposes.

The JCI products generally referred to in these cases consist of industrial sealing product, primarily packing and gaskets. The asbestos was encapsulated within these products in such a manner that causes JCI to believe, based on tests conducted on its behalf, that the products were safe. JCI ceased manufacturing products containing asbestos in 1985.

JCI continues to actively monitor the conduct and effect of its current and expected asbestos litigation, including the most efficacious presentation of its 'safe product' defence, and intends to continue to resist these asbestos claims based upon this defence. Approximately 202,000 claims against JCI have been dismissed before trial over the last 32 years. JCI is currently a defendant in cases involving approximately 101,000 claims. Despite the large number of claims brought against JCI, it has had final judgments against it, after appeals, in only 107 cases over the period, and has had to pay awards amounting to approximately US$103m. JCI has also incurred significant additional defence costs and, whilst the number of claims being filed against JCI and other defendants has been declining, the proportion of mesothelioma claims has increased, and JCI's ability to defend these cases successfully is likely to have a significant impact on its annual aggregate adverse judgment and defence costs.

The assumptions made in assessing the appropriate level of provision include:

- The period over which the expenditure can be reliably estimated.
- The future trend of legal costs.
- The rate of future claims filed.
- The rate of successful resolution of claims.
- The average amount of judgments awarded.

The provision is based on past history and allows for decreasing levels of new claims based on published tables of asbestos incidence projections and is determined using asbestos valuation experts, Bates White LLC. In the current period the method used to calculate the expected costs of defending claims has been conformed to the approach used to calculate the expected cost of adverse judgments following the appointment of Bates White LLC to value both elements of JCI's exposure. The projections use a 10 year time horizon (see note 26), compared to time horizons of up to 16 years used in previous estimates, on the basis that Bates White LLC consider that there is substantial uncertainty in the asbestos litigation environment so probable expenditures are not reasonably estimable beyond this time horizon. The Income Statement charge arising from movements in discounting (see note 4) incorporates the impact of the change in the time frame of the projections. The movement in the gross provision reflects the higher expected annual defence costs offset by the change in the time horizon.

However, because of the significant uncertainty associated with the future level of asbestos claims and of the costs arising out of related litigation, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred and, as a result, the provision may be subject to potentially material revision from time to time if new information becomes available as a result of future events.

The provision in respect of JCI is a discounted pre-tax provision using discount rates, being the risk-free rate on US debt instruments for the appropriate period. The deferred tax asset related to this provision is shown within the deferred tax balance (note 6). Set out below is the gross, discounted and post-tax information relating to this provision:

	31 July 2011 £m	31 July 2010 £m
Gross provision	**203.1**	214.5
Discount	**(21.4)**	(38.8)
Discounted pre-tax provision	**181.7**	175.7
Deferred tax	**(50.6)**	(47.4)
Discounted post-tax provision	**131.1**	128.3

Other litigation

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

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

24 Share capital

	Number of shares	Issued capital £m	Consideration £m
Ordinary shares of 37.5p each			
At 31 July 2010	390,728,043	146.5	
Exercise of share options	1,622,360	0.6	14.4
Total share capital at 31 July 2011	**392,350,403**	**147.1**	

At 31 July 2011 all of the issued share capital was in free issue. All issued shares are fully paid.

25 Reserves

Retained earnings include the value of Smiths Group plc shares held by the Smiths Industries Employee Benefit Trust. In the year the Company issued nil (2010: 558,754) shares to the Trust, and the Trust purchased 700,892 (2010: nil shares) in the market. At 31 July 2011 the Trust held 855 (2010: 32,858) ordinary shares with a market value of £0.0m (2010: £0.4m).

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

Capital management

Capital employed comprises total equity adjusted for goodwill recognised directly in reserves, net post-retirement benefit assets and liabilities and net debt. The efficiency of the allocation of the capital to the divisions is monitored through the headline return on capital employed (ROCE). This ratio is calculated over a rolling 12-month period and is the percentage that headline operating profit comprises of monthly average capital employed. The ROCE was 17.0% (2010: 16.6%).

The capital structure is based on the directors' judgement of the balance required to maintain flexibility while achieving an efficient cost of capital. The Group has a target gearing, calculated on a market value basis, of approximately 20%. At the balance sheet date the Group had gearing of 15% (2010: 19%).

As part of its capital management the Group strategy is to maintain a solid investment grade credit rating to ensure access to the widest possible sources of financing and to minimise the resulting cost of capital. At 31 July 2011 the Group had a credit rating of BBB+/Baa2 (2010: BBB+/Baa2 – negative outlook) with Standard & Poor's and Moody's respectively. The credit rating is managed through the following cash-flow targets: headline operating cash conversion of greater than 80% and a ratio of net debt to headline EBITDA of less than two. For the year ended 31 July 2011 these measures were 95% (2010: 115%) and 1.2 (2010: 1.4).

The Board aims for dividend cover of around 2.5 times, to ensure that the Group retains sufficient cash to finance investment in growth.

Hedge reserve

	31 July 2011 £m	31 July 2010 £m
The hedge reserve on the balance sheet comprises		
– cash-flow hedge reserve	**(0.3)**	(0.6)
– net investment hedge reserve	**(120.3)**	(128.2)
	(120.6)	(128.8)

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

26 Contingent liabilities and commitments

John Crane, Inc.

As stated in note 23, John Crane, Inc. ("JCI") is involved in numerous lawsuits pending in the United States in which plaintiffs are claiming damages arising from exposure to, or use of, products containing asbestos. The JCI products generally referred to in these cases are ones in which the asbestos fibres were encapsulated in such a manner that, according to tests conducted on behalf of JCI, the products were safe. JCI ceased manufacturing products containing asbestos in 1985.

Provision has been made for future defence costs and the cost of adverse judgments expected to occur. The Group anticipates that asbestos litigation will continue beyond the period covered by this provision; however, because of the uncertainty surrounding the outcome of litigation beyond this period, the costs cannot be reliably estimated.

Other contingent liabilities and commitments

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

At 31 July 2011, contingent liabilities, comprising bonds and guarantees arising in the normal course of business, amounted to £137.8m (2010: £143.5m), including pension commitments of £43.1m (2010: £40.6m).

From time to time the Group co-operates with relevant authorities in investigating business conduct issues. The Group is not aware of any issues which are expected to generate material financial exposures.

27 Operating lease commitments – minimum lease payments

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

	31 July 2011		31 July 2010	
	Land and buildings £m	**Other £m**	Land and buildings £m	Other £m
Payments due				
– not later than one year	**30.4**	**9.1**	27.3	9.0
– later than one year and not later than five years	**64.1**	**8.8**	63.7	10.7
– later than five years	**22.7**	**0.1**	27.7	0.1
	117.2	**18.0**	118.7	19.8

28 Cash-flow

Cash-flow from operating activities

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Operating profit – continuing	**438.0**	435.9
Amortisation of intangible assets	**72.3**	67.6
Impairment of intangible assets	**5.5**	
Profit on disposal of property, plant and equipment	**(0.7)**	(3.1)
Profit on disposal of business	**(4.4)**	(3.3)
Depreciation of property, plant and equipment	**63.4**	65.7
Impairment of property, plant and equipment		(2.1)
Share-based payment expense	**13.8**	10.3
Retirement benefits	**(77.6)**	(56.1)
(Increase)/decrease in inventories	**(46.7)**	46.1
Increase in trade and other receivables	**(33.1)**	(16.5)
Increase in trade and other payables	**43.7**	27.0
Increase/(decrease) in provisions	**5.2**	(21.8)
Cash generated from operations	**479.4**	549.7
Interest	**(66.8)**	(52.8)
Tax paid	**(90.9)**	(86.4)
Net cash inflow from operating activities	**321.7**	410.5

Smiths Group cash-flow measures

The Group uses two non-statutory cash-flow measures to monitor performance: headline operating cash-flow and free cash-flow. Headline operating cash-flow is net cash inflow from headline operating activities less capital expenditure. See note 3 for a description of headline profit measures. Free cash-flow is cash-flow after interest and tax but before acquisitions, financing activities and dividends. The tables below reconcile these two measures to statutory cash-flow measures.

Headline operating cash-flow

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Net cash inflow from operating activities	**321.7**	410.5
Exclude:		
Interest	**66.8**	52.8
Tax paid	**90.9**	86.4
Cash outflow in respect of exceptional operating items	**34.8**	45.7
Pension deficit payments	**60.1**	44.7
Include:		
Expenditure on capitalised development, other intangible assets and property, plant and equipment	**(90.1)**	(78.9)
Disposals of property, plant and equipment in the ordinary course of business	**4.5**	3.6
Headline operating cash-flow	**488.7**	564.8

Notes to the accounts
continued

Free cash-flow

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Net cash inflow from operating activities	**321.7**	410.5
Expenditure on capitalised development, other intangible assets and property, plant and equipment	**(90.1)**	(78.9)
Disposals of property, plant and equipment	**4.5**	24.8
Investment in financial assets relating to pensions financing		(25.0)
Free cash-flow	**236.1**	331.4
Investment in other financial assets	**(0.3)**	(0.3)
Acquisition of businesses	**(18.5)**	(132.7)
Disposal of Aerospace	**(6.2)**	19.9
Disposal of businesses	**3.9**	1.1
Net cash-flow used in financing activities	**(129.2)**	(66.1)
Net increase in cash and cash equivalents	**85.8**	153.3

29 Acquisitions

During the period ended 31 July 2011, the Group acquired the detection sales, distribution and servicing business of Veecon IPA Gastchnik Limited (August 2010) and the entire issued share capital of SDBR Comercio De Equipamentos De Seguanca LTDA (May 2011) on behalf of Smiths Detection. The acquired businesses are the Indian and Brazilian distributors for Smiths Detection, and this will continue to be their principal business activity. The acquisitions give Smiths Detection direct control over sales of its products in two major fast-growing economies.

The consideration for these acquisitions comprises:

- cash of £12.0m;
- fixed deferred consideration of which £1.5m is outstanding at 31 July 2011. This is due to be paid over the next two years;
- contingent consideration based on the sales the acquired businesses achieve over the next five years. This consideration is denominated in US dollars. The fair value of $14.7m at acquisition has been calculated using probability weighted forecasts of potential future sales by target customers and market sectors. The maximum potential contingent consideration payable is $23.0m; and
- non-equity shares in one of the new subsidiaries, which were valued at £3.5m on acquisition.

From the date of acquisition to 31 July 2011, the acquisitions contributed £15.1m to revenue, £1.6m to headline profit before taxation and £0.1m to profit before taxation. If Smiths had acquired the businesses at the beginning of the financial period, the acquisitions would have contributed £19.4m to revenue and £1.7m to headline profit before taxation.

The intangible assets recognised comprise £4.1m in respect of customer relationships, orders and contractual non-compete arrangements with the vendors. The assets recognised include the current value of the maintenance contracts acquired. Goodwill represents the value of future growth opportunities in these markets. The goodwill recognised is not expected to be deductible for tax purposes.

The values set out below are provisional pending finalisation of the fair values attributable and working capital adjustments, and will be finalised in the year ending 31 July 2012.

	Acquisitions		
	Book value £m	Fair value adjustments £m	Provisional fair value £m
Intangible assets		4.1	**4.1**
Property, plant and equipment	0.3		**0.3**
Current assets	0.9		**0.9**
Non-current liabilities	—	(1.4)	**(1.4)**
Net assets acquired	1.2	2.7	**3.9**
Goodwill on current year acquisitions			**22.4**
Total consideration			**26.3**
Cash paid during the period – current year acquisitions			**12.0**
Deferred consideration – current year acquisitions			**10.8**
Other financial instruments – current year acquisitions			**3.5**
Total consideration			**26.3**

30 Employee share schemes

The Group operates share schemes and plans for the benefit of employees. The nature of the principal schemes and plans, including general conditions, is set out below:

2008 Value Sharing Plan (2008 VSP)

The VSP is a long-term incentive plan approved by the shareholders in July 2008 rewarding executives for value creation at Group and Divisional levels. Corporate participants will be rewarded under the VSP for value creation at a Group level, whereas the executives with divisional responsibilities will be rewarded for value creation within the division for which they are responsible. For the Group scheme, one-third of the award will depend on the growth in Smiths' TSR over and above the median for the companies comprising the FTSE 100 (excluding financial services companies) and the remaining two-thirds of each award will be determined by the growth in internal value in excess of fixed rate. The growth in internal value is calculated as follows: adjusted profit before tax ('PBT') times the ratio of PBT to market capitalisation determined at the date of grant plus net equity cash-flows to shareholders. The divisional awards will depend on meeting an internal value growth target set for the division in which the participant works. The performance conditions are measured over three-year and four-year periods commencing with the financial year 2008/09. For the Group scheme, the growth in internal value is tested against a hurdle rate of 9.5% a year.

2010 Value Sharing Plan (2010 VSP)

The 2010 VSP is a long-term incentive plan approved by the shareholders at the Annual General Meeting on 16 November 2010 rewarding executives for value creation at Group and Divisional levels. The awards have the same structure and calculation methods as the 2008 VSP. The performance conditions are measured over a three-year period commencing with the financial year 2010/11, and the Group scheme hurdle rate is 8.5% a year.

Smiths Group Co-Investment Plan (CIP)

Under the CIP, as introduced in October 2005, the executive directors and senior executives are able, if invited, to use their after tax bonus or 25% of their basic salary after tax, whichever is the greater, to invest in the Company's shares at the prevailing market price. At the end of a three year period, if the executive is still in office and provided the performance test is passed, matching shares will be awarded in respect of any invested shares retained for that period. The number of matching shares to be awarded is determined by the Remuneration Committee at the end of the year in which the bonus is earned by reference to annual bonus, and other corporate financial criteria. The maximum award will not exceed the value, before tax, of the bonus or salary invested in shares by the executive. Vesting of matching shares will occur and the matching shares will be released at the end of the three year period if the Group's Return on Capital Employed ('ROCE') over the Performance Period exceeds the Group's weighted average cost of capital ('WACC') over the Performance Period by an average margin of at least 1% per annum.

In July 2008 the CIP was amended. From 2009 participants have been required to invest 50% of their post tax bonus in purchased shares. The performance conditions have been expanded to include an enhanced performance condition of ROCE exceeding WACC by an average margin of 3% per annum. If the enhanced performance condition is met, two matching shares will be issued for every purchased share.

	CIP	Long term incentive plans	Other share schemes	Total	Weighted average price for option plans £
Ordinary shares under option ('000)					
1 August 2009	990	3,339	9,020	13,349	£5.83
Granted	412		248	660	£3.32
Update of estimates		(241)		(241)	£0.00
Exercised	(430)	(130)	(1,643)	(2,203)	£6.18
Lapsed	(95)	(1,198)	(1,193)	(2,486)	£5.53
31 July 2010	877	1,770	6,432	9,079	£6.15
Granted	730	785	123	1,638	£0.78
Update of estimates		122		122	£0.00
Exercised	(216)	(517)	(1,744)	(2,477)	£6.28
Lapsed	(51)	(303)	(373)	(727)	£6.46
31 July 2011	**1,340**	**1,857**	**4,438**	**7,635**	**£5.37**

Options were exercised on an irregular basis during the period. The average closing share price over the financial year was 1,240.24p (2010: 1,000.61p). There has been no change to the effective option price of any of the outstanding options during the period.

Range of exercise prices	Total shares under option ('000)	Weighted average remaining contractual life (months)	**Options exercisable at 31 July 2011 ('000)**	Options exercisable at 31 July 2010 ('000)	**Exercisable weighted average exercise price for options exercisable at 31 July 2011**
£0.00 – £2.00	3,197	18			**£ 0.00**
£2.01 – £6.00	532	27	**2**	2	**£ 5.69**
£6.01 – £10.00	2,786	40	**2,106**	1,667	**£ 8.19**
£10.01 – £14.00	1,120	73	**907**	51	**£10.97**

For the purposes of valuing options to arrive at the share-based payment charge, the Binomial option pricing model has been used for most schemes and the Monte Carlo method is used for schemes with total shareholder return performance targets. The key assumptions used in the models for 2011 and 2010 are volatility of 30% (2010: 30%) and dividend yield of 3.33% (2010: 3.75%). Assumptions on expected volatility and expected option term have been made on the basis of historical data, for the period corresponding with the vesting period of the option. These generated a weighted average fair value for CIP of £12.40 (2010: £9.45) and VSP of £13.86 (2010: £11.21). The fair value disclosed for the CIP award treats the two matching shares as separate options.

Included within staff costs is an expense arising from share-based payment transactions of £13.8m (2010: £11.3m), of which £13.8m (2010: £10.3m) relates to equity-settled share-based payment.

At 31 July 2011 the creditor relating to cash-settled schemes is £0.6m (2010: £0.9m).

31 Events after the balance sheet date

On 2 September 2011 Smiths Interconnect agreed to purchase Power Holdings Inc. a leading designer and manufacturer of specialist power distribution, conditioning and monitoring systems. The purchase price of $235m will be subject to post closing adjustments with respect to working capital at completion. The acquisition is subject to regulatory approval.

On 17 August 2011 John Crane agreed to purchase the business and assets of Turbo Components and Engineering Inc. ("TCE") which services, repairs and builds replacement bearings and seals used in critical rotating equipment. The purchase price of $20m will be subject to post closing adjustments. TCE has gross assets of approximately $3.2m and expected sales of $10m for the current calendar year. This acquisition is subject to regulatory approval.

Independent auditors' report to the members of Smiths Group plc

We have audited the Group financial statements of Smiths Group plc for the year ended 31 July 2010 which comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated balance sheet, the consolidated statement of changes in equity, the consolidated cash-flow statement, the accounting policies and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Respective responsibilities of directors and auditors

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

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion the Group financial statements:

- give a true and fair view of the state of the Group's affairs as at 31 July 2010 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

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

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

Under the Listing Rules we are required to review:

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

Other matter

We have reported separately on the parent company financial statements of Smiths Group plc for the year ended 31 July 2010 and on the information in the Directors' remuneration report that is described as having been audited.

Martin Hodgson (Senior Statutory Auditor)

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

28 September 2010

Notes

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

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

Consolidated income statement

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

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

Consolidated statement of comprehensive income

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

Consolidated balance sheet

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

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

Philip Bowman	**Peter Turner**
Chief Executive	**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 2009		452.5	242.3	251.3	(87.1)	859.0	3.8	862.8
Profit for the year				310.0		310.0	0.6	310.6
Other comprehensive income								
Exchange gains				80.4	0.2	80.6	0.8	81.4
Actuarial losses on retirement benefits net of tax				(3.0)		(3.0)		(3.0)
Fair value gains/(losses)				0.2	(41.9)	(41.7)		(41.7)
Total comprehensive income for the year				387.6	(41.7)	345.9	1.4	347.3
Transactions relating to ownership interests								
Exercises of share options		9.1		0.6		9.7		9.7
Taxation recognised on share-based payment	6			2.4		2.4		2.4
Purchase of own shares		0.2		(0.2)				
Dividends								
– equity shareholders	8			(132.5)		(132.5)		(132.5)
– non-controlling interest							(0.2)	(0.2)
Share-based payment	30			10.3		10.3		10.3
At 31 July 2010		**461.8**	**242.3**	**519.5**	**(128.8)**	**1,094.8**	**5.0**	**1,099.8**

	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 2008		449.1	242.3	253.7	(29.2)	915.9	2.3	918.2
Profit for the year				269.5		269.5	0.5	270.0
Other comprehensive income								
Exchange gains				187.9	0.3	188.2	1.0	189.2
Actuarial losses on retirement benefits net of tax				(335.6)		(335.6)		(335.6)
Fair value losses					(58.2)	(58.2)		(58.2)
Total comprehensive income for the year				121.8	(57.9)	63.9	1.5	65.4
Transactions relating to ownership interest								
Exercises of share options		1.5		2.6		4.1		4.1
Taxation recognised on share-based payment	6			(4.0)		(4.0)		(4.0)
Purchase of own shares		0.2		(0.2)				
Conversion of B shares		1.7				1.7		1.7
Dividends paid to equity shareholders	8			(132.0)		(132.0)		(132.0)
Share-based payment	30			9.4		9.4		9.4
At 31 July 2009		**452.5**	**242.3**	**251.3**	**(87.1)**	**859.0**	**3.8**	**862.8**

Consolidated cash-flow statement

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

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

Accounting policies

Basis of preparation

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

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

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

Significant judgements, key assumptions and estimates

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

Revenue recognition

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

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

Impairment

Goodwill is tested at least annually for impairment in accordance with the accounting policy for goodwill set out below. The recoverable amounts of cash generating units are determined based on value in use calculations.

Accounting policies
continued

These calculations require the use of estimates including projected future cash-flows and other future events. See note 12 for details of the critical assumptions made and disclosures on the sensitivity of the impairment testing to these key assumptions.

Provisions for liabilities and charges

The consolidated financial statements include a provision for litigation of £191.4m (2009: £185.4m).

As previously reported, John Crane, Inc., a subsidiary of the Group, is currently one of many co-defendants in litigation relating to products previously manufactured which contained asbestos. Provision has been made for the future defence costs which the Group is expected to incur and the expected costs of future adverse judgments against John Crane, Inc. However, because of the significant uncertainty associated with the future level of asbestos claims and of the costs arising out of the related litigation, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred and, as a result, the provision may be subject to potentially material revisions from time to time if new information becomes available as a result of future events. John Crane, Inc. takes account of the advice of an expert in asbestos liability estimation in quantifying the expected costs of future adverse judgments. See note 23 for details.

Retirement benefits

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

Taxation

The Group has recognised deferred tax assets relating to UK losses of £117m (2009: £111m). The recognition of assets pertaining to these losses involves judgement by management as to the likelihood of realisation of these deferred tax assets and this is based on a number of factors, which seek to assess the expectation that the benefit of deferred tax assets will be realised, including appropriate taxable temporary timing differences and it has been concluded that there are sufficient taxable profits in future periods to support recognition.

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

Accounting policies

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.

Accounting policies
continued

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

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

Revenue

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

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

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

Long-term funded contracts

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

Employee benefits

Pension obligations and post-retirement benefits

The Group has both defined benefit and defined contribution plans.

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

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

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

Share-based compensation

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

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

Accounting policies
continued

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

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

Exceptional items

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

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

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

Discontinued operations

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

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

Assets and businesses held for sale

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

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

Intangible assets

Goodwill

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

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

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

Research and development

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

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

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

Intangible assets acquired in business combinations

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

The estimated useful lives are as follows:

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

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

Property, plant and equipment

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

Land is not depreciated. Depreciation is provided on other assets estimated to write off the depreciable amount of relevant assets by equal annual instalments over their estimated useful lives. In general, the rates used are: Freehold and long leasehold buildings – 2%; Short leasehold property – over the period of the lease; Plant, machinery, etc. – 10% to 20%; Fixtures, fittings, tools and other equipment – 10% to 33%.

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

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

Leases

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

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in, first-out (FIFO) method. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). The cost of items of inventory which take a substantial period of time to complete includes attributable borrowing costs for all items whose production began after 1 August 2009. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

Trade and other receivables

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

Accounting policies
continued

Cash and cash equivalents

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

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

Provisions

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

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

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

Taxation

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

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

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

Deferred tax liabilities and assets are not discounted.

Financial assets

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

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

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

Accounting policies
continued

Financial assets are derecognised when the right to receive cash-flows from the assets has expired, or has been transferred, and the Company has transferred substantially all of the risks and rewards of ownership. When securities classified as available for sale are sold or impaired, the accumulated fair value adjustments previously taken to reserves are included in the income statement.

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

Financial liabilities

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

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

Derivative financial instruments and hedging activities

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

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

Fair value hedge

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

Cash-flow hedge

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

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

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

Net investment hedge

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

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

Accounting policies
continued

Fair value of financial assets and liabilities

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

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

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

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

- cash, trade receivables and payables and floating rate borrowings – the carrying value is a good approximation of the fair value;
- government bonds – quoted market prices (level 1);
- fixed rate borrowings – quoted market prices of equivalent instruments (level 2); and
- forward exchange contracts, currency swaps, interest rate instruments and embedded derivatives – net present value of the future cash-flows, calculated using market data at the balance sheet date (principally exchange rates and yield curves) (level 2).

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

Financial guarantees

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

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

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

Dividends

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

Recent accounting developments

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

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

Accounting policies
continued

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

Parent company

The accounts of the parent company, Smiths Group plc, have been prepared in accordance with UK GAAP. The Company accounts are presented in separate financial statements on pages 129 to 137.

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

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

Notes to the accounts

1 Segment information

Analysis by operating segment

The Group is organised into five divisions: Smiths Detection, John Crane, Smiths Medical, Smiths Interconnect and Flex-Tek. These divisions design and manufacture the following products:

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

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

Intersegment sales and transfers are charged at arm's length prices.

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

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

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

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

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

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

The capital expenditure for each division is:

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

Notes to the accounts
continued

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

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

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

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

	31 July 2009					
	Smiths Detection £m	John Crane £m	Smiths Medical £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Property, plant, equipment, development projects and other intangibles	101.9	101.0	180.9	30.0	26.6	440.4
Investments in associates	11.2					11.2
Working capital assets	300.2	266.2	262.3	96.3	58.9	983.9
Operating assets	413.3	367.2	443.2	126.3	85.5	1,435.5
Derivatives, tax and retirement benefit assets						258.5
Goodwill and acquired intangibles						1,373.5
Corporate assets						16.8
Cash						91.7
Total assets						3,176.0
Working capital liabilities	(141.5)	(115.7)	(100.0)	(47.2)	(25.8)	(430.2)
Corporate and non-headline liabilities						(298.4)
Derivatives, tax and retirement benefit liabilities						(608.0)
Borrowings						(976.6)
Total liabilities						(2,313.2)
Average divisional capital employed	667.0	700.4	1,276.6	301.2	131.3	3,076.5
Average corporate capital employed						(226.2)
Average total capital employed						2,850.3

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

Notes to the accounts
continued

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

Analysis of revenue

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

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

	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 2010	**287.5**	**298.6**	**69.4**	**52.0**	**78.6**	**786.1**
Revenue year ended 31 July 2009	295.6	296.1	71.8	48.6	77.7	789.8

Smiths Medical	Medication delivery £m	Vital care £m	Safety devices £m	Total £m
Revenue year ended 31 July 2010	**235.0**	**351.8**	**270.8**	**857.6**
Revenue year ended 31 July 2009	237.3	335.2	261.0	833.5

Smiths Interconnect	Telecom £m	Military and Aerospace £m	Rail, Medical Automation, Test £m	Total £m
Revenue year ended 31 July 2010	**91.1**	**170.2**	**78.6**	**339.9**
Revenue year ended 31 July 2009	95.9	154.8	67.4	318.1

Flex-Tek	Aerospace £m	Flexible Solutions £m	Heat Solutions £m	Total £m
Revenue year ended 31 July 2010	**51.0**	**49.4**	**111.5**	**211.9**
Revenue year ended 31 July 2009	59.7	49.0	113.6	222.3

The Group's statutory revenue is analysed as follows:

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Sale of goods	**2,535.4**	2,460.9
Contracts	**71.8**	67.4
Services	**162.4**	136.3
	2,769.6	2,664.6

Analysis by geographical areas

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

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

2 Operating profit is stated after charging

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Research and development expense	**69.2**	66.7
Operating leases		
– land and buildings	**24.4**	21.7
– other	**10.2**	9.4

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £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**	3.4
– other services pursuant to legislation	**0.1**	0.1
	4.0	4.0
Tax services		
– advisory services	**0.3**	0.2
All other services	**0.3**	0.3

Other services relate to one-off projects.

3 Headline profit measures

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

The following items have been excluded from the headline measure:

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

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

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

4 Exceptional items

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

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

Year ended 31 July 2010

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

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

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

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

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

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

Year ended 31 July 2009

On 3 June 2008 the Company announced a number of changes to its corporate centre and divisional organisation. The total cost of this restructuring, including redundancy, relocation and consolidation of manufacturing, was considered exceptional by virtue of its size. In the year ended 31 July 2009 £23.7m was charged in respect of this restructuring, including an impairment charge of £3.1m in respect of affected properties.

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

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

5 Net finance costs

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

Notes to the accounts
continued

6 Taxation

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

Reconciliation of the total tax charge

The tax expense on the profit for the period is different from the standard rate of corporation tax in the UK of 28% (2009: 28%). The difference is reconciled as follows:

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

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

Notes to the accounts
continued

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 2008	(64.3)	12.2	(10.5)	(12.0)	106.5	31.9
Credit/(charge) to income statement	8.0	(4.3)	(35.8)	(4.0)	6.7	(29.4)
Credit/(charge) to equity		(4.0)	94.3			90.3
Other	(4.1)					(4.1)
Exchange adjustments	(8.0)		3.0	(1.6)	16.1	9.5
At 31 July 2009	(68.4)	3.9	51.0	(17.6)	129.3	98.2
Deferred tax assets	(4.9)	3.9	50.6	(8.9)	124.0	164.7
Deferred tax liabilities	(63.5)		0.4	(8.7)	5.3	(66.5)
At 31 July 2009	(68.4)	3.9	51.0	(17.6)	129.3	98.2
Credit/(charge) to income statement	22.0	2.8	0.7	(3.8)	(19.5)	2.2
Credit/(charge) to equity		2.4	12.2			14.6
Business combinations	(3.5)					(3.5)
Exchange adjustments	(3.7)		3.2	(1.0)	6.4	4.9
At 31 July 2010	**(53.6)**	**9.1**	**67.1**	**(22.4)**	**116.2**	**116.4**
Deferred tax assets	18.0	9.1	65.2	(2.3)	104.2	194.2
Deferred tax liabilities	(71.6)		1.9	(20.1)	12.0	(77.8)
At 31 July 2010	**(53.6)**	**9.1**	**67.1**	**(22.4)**	**116.2**	**116.4**

Included in Other above is a deferred tax liability of £4.0m (2009: £4.0m) relating to unremitted overseas earnings. No additional tax liabilities have been recognised because the Group is in a position to control the timing of other temporary differences and it is probable that such differences will not reverse in the future. Other deferred tax also includes the tax benefits of losses carried forward amounting to £31.9m (2009: £31.3m).

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

The expiry date of operating losses carried forward is dependent upon the law of the various territories in which the losses arise. A summary of expiry dates for losses in respect of which restrictions apply is set out below.

Restricted losses

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

7 Discontinued operations

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

Notes to the accounts
continued

Profit/(loss) on disposal of operation

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

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

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

Results from discontinued operations

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

Cash-flows from discontinued operations

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

	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Investing activities	**19.9**	(1.9)
Net cash inflow/(outflow) from investing activities	**19.9**	(1.9)

8 Dividends

The following dividends were declared and paid in the period:

	Year ended 31 July 2010 £m	**Year ended 31 July 2009 £m**
Ordinary final dividend of 23.50p for 2009 (2008: 23.50p) paid 20 November 2009	**91.6**	91.1
Ordinary interim dividend of 10.5p for 2010 (2009: 10.5p) paid 23 April 2010	**40.9**	40.9
	132.5	132.0

The final dividend for the year ended 31 July 2010 of 23.5p per share was declared by the Board on 28 September 2010 and will be paid to shareholders on 19 November 2010, subject to approval by the shareholders. This dividend has not been included as a liability in these accounts and is payable to all shareholders on the register of Members at close of business on 22 October 2010.

9 Earnings per share

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

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

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 392,773,151 (2009: 392,591,613) ordinary shares, being the average number of ordinary shares in issue during the year adjusted by the dilutive effect of employee share schemes. For the year ended 31 July 2010 options over 1,729,551 (2009: 5,017,907) shares were excluded from this calculation because their effect was anti-dilutive for continuing operations.

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

	Year ended 31 July 2010		Year ended 31 July 2009	
	£m	**EPS (p)**	£m	EPS (p)
Profit attributable to equity shareholders of the Parent Company	**293.6**	**75.3**	275.4	70.8
Exclude				
Non-headline items and related tax (note 3)	**36.5**	**9.3**	6.0	1.6
Headline	**330.1**	**84.6**	281.4	72.4
Headline EPS – diluted (p)		**84.0**		71.7

10 Post-retirement benefits

Smiths operates a number of defined benefit plans throughout the world. The principal schemes are in the United Kingdom and in the United States and assets are held in separate trustee-administered funds. These schemes are closed, and no further benefits are being accrued. The Group also provides defined contribution plans for its UK and US employees.

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

Pension costs are assessed in accordance with the advice of independent, professionally-qualified actuaries. The most recent actuarial valuations of the two principal UK schemes were performed using the Projected Unit Method as at 31 March 2009. The most recent valuations of the six principal US pension and post-retirement healthcare plans were performed at 1 January 2008. These valuations have been updated by independent qualified actuaries in order to assess the liabilities of the schemes as at 31 July 2010. Scheme assets are stated at their market values. Contributions to the schemes are made on the advice of the actuaries with the objective that the benefits be fully funded during the scheme members' average working lives.

Notes to the accounts
continued

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

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

The assumptions used are estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily occur in practice. For countries outside the UK and USA these are disclosed as a weighted average.

The mortality assumptions used in the principal UK schemes are based on the SAPS All Birth year tables with relevant scaling factors based on recent actual mortality experience of members within each. They allow for future improvements in life expectancy in line with 80% and 60% of the long cohort for males and females respectively with an annual 1% underpin. The mortality assumptions used in the principal US schemes are based on the most recent mortality study table produced for retired pensioners in the US (RP 2000 table). The table selected allows for future mortality improvements and applies an adjustment for job classification (blue collar versus white collar). The assumptions give the following:

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

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

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

	2009						
	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	8.2%	1,113.1	8.8%	198.6	9.3%	7.8	1,319.5
Government bonds	4.5%	242.5	4.3%	68.5	4.6%	3.5	314.5
Corporate bonds	5.9%	267.1	6.0%	44.2	7.7%	2.5	313.8
Insured liabilities	5.9%	490.1	6.0%	1.8	n/a		491.9
Property	7.2%	137.8	n/a		2.9%	0.2	138.0
Other	5.0%	163.1	3.0%	21.4	5.0%	12.9	197.4
Total market value		2,413.7		334.5		26.9	2,775.1
Present value of funded scheme liabilities		(2,531.8)		(462.6)		(33.2)	(3,027.6)
Deficit		(118.1)		(128.1)		(6.3)	(252.5)
Unfunded pension plans		(36.0)		(4.9)		(18.7)	(59.6)
Post-retirement healthcare		(6.2)		(18.0)		(0.7)	(24.9)
Present value of unfunded obligations		(42.2)		(22.9)		(19.4)	(84.5)
Unrecognised asset due to surplus restriction						(2.0)	(2.0)
Net pension liability		(160.3)		(151.0)		(27.7)	(339.0)
Post-retirement assets		39.2					39.2
Post-retirement liabilities		(199.5)		(151.0)		(27.7)	(378.2)
Net pension liability		(160.3)		(151.0)		(27.7)	(339.0)

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

Notes to the accounts
continued

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

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

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

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

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

Amounts recognised directly in the consolidated statement of comprehensive income

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

Changes in present value of defined benefit obligations

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

Notes to the accounts
continued

Changes in present value of scheme assets

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

Cash contributions

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

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

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

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

History of schemes

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

Notes to the accounts
continued

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

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

Sensitivity

Valuation of post-retirement schemes involves judgements about uncertain future events. Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 July 2010 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions. While each of these sensitivities holds all other assumptions constant, in practice such assumptions rarely change in isolation and the impacts may offset to some extent.

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

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

Defined contribution plans

The Group operates a number of defined contribution plans. The total expense recognised in the income statement in respect of these plans was £27.1m (2009: £15.6m).

11 Employees

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

The average number of persons employed was:

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

Key management

The key management of the Group comprises Smiths Group plc Board directors and Executive Committee members. Their aggregate compensation is shown below. Details of directors' remuneration are contained in the report of the Remuneration Committee on pages 73 to 81.

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

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

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

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

Related party transactions

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

Notes to the accounts
continued

12 Intangible assets

	Goodwill £m	Development costs £m	Acquired intangibles (see table on next page) £m	Software, patents and intellectual property £m	Total £m
Cost					
At 1 August 2008	1,071.8	73.5	212.8	94.3	1,452.4
Exchange adjustments	145.1	10.2	32.4	6.2	193.9
Business combinations	50.3		45.0		95.3
Adjustments to prior year business combinations	(0.7)				(0.7)
Additions		22.5		17.4	39.9
Disposals				(1.6)	(1.6)
At 31 July 2009	1,266.5	106.2	290.2	116.3	1,779.2
Exchange adjustments	48.7	5.4	13.8	3.0	70.9
Business combinations	64.1		51.5		115.6
Adjustments to prior year business combinations	0.2				0.2
Additions		24.3		7.6	31.9
Disposals		(0.7)		(2.0)	(2.7)
At 31 July 2010	**1,379.5**	**135.2**	**355.5**	**124.9**	**1,995.1**
Amortisation					
At 1 August 2008	82.1	18.8	50.6	47.7	199.2
Exchange adjustments	9.9	2.6	6.0	7.4	25.9
Charge for the year		10.8	34.6	9.8	55.2
Adjustments to prior year business combinations		0.2			0.2
Disposals				(1.6)	(1.6)
At 31 July 2009	92.0	32.4	91.2	63.3	278.9
Exchange adjustments	3.1	2.0	4.2	2.3	11.6
Charge for the year		13.8	42.1	11.7	67.6
Disposals				(1.6)	(1.6)
At 31 July 2010	**95.1**	**48.2**	**137.5**	**75.7**	**356.5**
Net book value at 31 July 2010	**1,284.4**	**87.0**	**218.0**	**49.2**	**1,638.6**
Net book value at 31 July 2009	1,174.5	73.8	199.0	53.0	1,500.3
Net book value at 1 August 2008	989.7	54.7	162.2	46.6	1,253.2

In addition to goodwill, the acquired intangible assets comprise:

	Patents, licences and trademarks £m	Technology £m	Customer relationships £m	Total acquired intangibles £m
Cost				
At 1 August 2008	53.3	77.1	82.4	212.8
Exchange adjustments	9.1	13.5	9.8	32.4
Business combinations (note 28)	1.9	3.8	39.3	45.0
At 31 July 2009	64.3	94.4	131.5	290.2
Exchange adjustments	4.4	5.3	4.1	13.8
Business combinations (note 28)		22.8	28.7	51.5
At 31 July 2010	**68.7**	**122.5**	**164.3**	**355.5**
Amortisation				
At 1 August 2008	8.5	19.2	22.9	50.6
Exchange adjustments	0.4	2.5	3.1	6.0
Charge for the year	4.9	10.6	19.1	34.6
At 31 July 2009	13.8	32.3	45.1	91.2
Exchange adjustments	0.9	2.0	1.3	4.2
Charge for the year	5.3	11.7	25.1	42.1
At 31 July 2010	**20.0**	**46.0**	**71.5**	**137.5**
Net book value at 31 July 2010	**48.7**	**76.5**	**92.8**	**218.0**
Net book value at 31 July 2009	50.5	62.1	86.4	199.0
Net book value at 1 August 2008	44.8	57.9	59.5	162.2

Significant cash generating units

Goodwill is not amortised but is tested for impairment at least annually. Value in use calculations are used to determine the recoverable amount of goodwill held within each cash generating unit (CGU). Value in use is calculated as the net present value of the projected risk-adjusted post-tax cash-flows of the CGU, applying a discount rate based on the Group's post-tax weighted average cost of capital adjusted where appropriate for risks specific to the CGU. This approximates to applying a pre-tax discount rate to pre-tax cash-flows. These forecast cash-flows are based on approved budgets and represent a best estimate of future performance.

The assumptions used in the discounted cash-flow forecasts incorporate past performance, historical growth rates and margins achievable in our key markets. The assumptions used in the impairment testing of significant CGUs are as follows:

	Smiths Medical Critical Care		Smiths Detection Civil	
	2010	2009	**2010**	2009
Net book value of goodwill (£m)	**398.3**	374.3	**311.5**	316.0
Discount rate	**8.0%**	8.0%	**8.5%**	8.0%
Period covered by management projections	**5 years**	5 years	**5 years**	5 years
Growth rates	**2.25%**	2.25%	**2.25%**	2.25%
Other key assumptions	– future sales prices and volumes – operating margins – cost structure and productivity			

The first five years of the cash-flow forecasts are based on our annual planning and strategic planning processes. The growth rates used to estimate future performance beyond this period do not exceed the long-term average growth rates for the underlying markets and do not reflect long-term planning assumptions used by the Group for investment planning.

Sales projections are made with reference to specific customer relationships and product lines.

Sensitivity analysis performed around the base case assumptions has indicated that no reasonable changes in key assumptions would cause the carrying amount of the Smiths Medical Critical Care and Smiths Detection Civil CGUs to exceed their respective recoverable amounts.

The balance of the goodwill represents smaller individual amounts which have been allocated to specific operating companies and smaller CGUs. These amounts are tested for impairment at this level. Sensitivity analysis was also performed for these CGUs, and no reasonable changes in the key assumptions would have caused an impairment.

Notes to the accounts
continued

13 Property, plant and equipment

	Land and buildings £m	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
Cost or valuation				
At 1 August 2008	171.4	389.9	189.2	750.5
Exchange adjustments	18.2	48.4	20.5	87.1
Reclassification	1.3	5.3	(6.6)	
Business combinations	0.5	8.3	0.2	9.0
Additions	9.4	30.1	17.9	57.4
Disposals	(9.5)	(27.4)	(18.3)	(55.2)
At 31 July 2009	191.3	454.6	202.9	848.8
Exchange adjustments	8.0	23.5	8.3	39.8
Business combinations		3.4	0.8	4.2
Additions	6.5	26.9	13.6	47.0
Disposals	(18.8)	(14.8)	(15.6)	(49.2)
At 31 July 2010	**187.0**	**493.6**	**210.0**	**890.6**
Depreciation				
At 1 August 2008	60.7	258.5	135.0	454.2
Exchange adjustments	10.0	29.9	14.7	54.6
Reclassification	0.7	4.6	(5.3)	
Charge for the year	7.2	34.9	20.1	62.2
Impairment charge	3.1	0.7		3.8
Disposals	(2.2)	(25.9)	(15.9)	(44.0)
At 31 July 2009	79.5	302.7	148.6	530.8
Exchange adjustments	3.8	15.9	6.2	25.9
Charge for the year	7.7	39.1	18.9	65.7
Reversal of impairment (note 4)	(2.1)			(2.1)
Disposals	(6.4)	(12.7)	(13.3)	(32.4)
At 31 July 2010	**82.5**	**345.0**	**160.4**	**587.9**
Net book value at 31 July 2010	**104.5**	**148.6**	**49.6**	**302.7**
Net book value at 31 July 2009	111.8	151.9	54.3	318.0
Net book value at 1 August 2008	110.7	131.4	54.2	296.3

14 Investments accounted for using the equity method

	2010 £m	2009 £m
Investments in associated companies		
At start of period	**11.2**	9.1
Exchange adjustment	**0.7**	1.7
Share of results after tax	**1.8**	0.4
Dividend received	**(0.1)**	
At end of period	**13.6**	11.2

The Group's share of the revenue of associates was £22.5m (2009: £19.3m). The total assets of associates are £43.1m (2009: £49.0m) and liabilities are £17.6m (2009: £16.8m). These figures principally represent the performance, assets and liabilities of Cross Match Technologies, Inc., incorporated in the United States. The share of these assets and liabilities attributable to Smiths Group is 35.6% (2009: 34%).

15 Financial assets

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

16 Inventories

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

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

17 Trade and other receivables

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

Trade receivables do not carry interest. Management considers that the carrying value of trade and other receivables approximates the fair value. Trade and other receivables, including prepayments, accrued income and other debtors qualifying as financial instruments are classified as 'loans and receivables'. The maximum credit exposure arising from these financial assets is £575.8m (2009: £533.3m).

Trade receivables are disclosed net of a provision for bad and doubtful debts. The provision for bad and doubtful debts is based on specific risk assessment and reference to past default experience.

Credit risk is managed separately for each customer and, where appropriate, a credit limit is set for the customer based on previous experience of the customer and third party credit ratings. The Group has no significant concentration of credit risk, with exposure spread over a large number of customers. The largest single customer is the US Federal Government, representing less than 8% (2009: 8%) of Group revenue.

Ageing of trade receivables

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

18 Cash and cash equivalents

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

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

19 Trade and other payables

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

Trade and other payables, including accrued expenses and other creditors qualifying as financial instruments, are accounted for at amortised cost and are categorised as other financial liabilities.

20 Borrowings and net debt

This note sets out the calculation of net debt, an important measure in explaining our financing position. The net debt figure includes accrued interest and the fair value adjustments relating to hedge accounting.

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

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

Interest of £43.2m (2009: £27.7m) was charged to the consolidated income statement in this period in respect of public bonds.

Cash and overdraft balances in interest compensation cash pooling systems are reported gross on the balance sheet. This gross up increased cash and overdrafts by £0.2m at 31 July 2010 (2009: £44.0m).

Movements in net debt

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

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

Secured loans

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

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

21 Financial risk management

The Group's international operations and debt financing expose it to financial risks which include the effects of changes in foreign exchange rates, changes in debt market prices, interest rates, credit risks and liquidity risks.

Treasury and risk management policies are set by the Board. The policy sets out specific guidelines to manage foreign exchange risk, interest rate risk, credit risk and the use of financial instruments to manage risk. The instruments and techniques used to manage exposures include foreign currency derivatives, debt and other interest rate derivatives. The central treasury function monitors financial risks and compliance with risk management policies. The management of operational credit risk is discussed in note 17.

(a) Foreign exchange risk

Transactional currency exposure

The Group is exposed to foreign currency risks arising from sales or purchases by businesses in currencies other than their functional currency. It is Group policy that, when the net foreign exchange exposure to known future sales and purchases is material, this exposure is hedged using forward foreign exchange contracts. The net exposure is calculated by adjusting the expected cash-flow for payments or receipts in the same currency linked to the sale or purchase. This policy minimises the risk that the profits generated from the transaction will be affected by foreign exchange movements which occur after the price has been determined.

Hedge accounting documentation and effectiveness testing are only undertaken if it is cost effective.

The following table shows the currency of financial instruments. It excludes loans and derivatives designated as net investment hedges.

	At 31 July 2010				
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Financial assets and liabilities					
Financial instruments included in trade and other receivables	**34.5**	**280.3**	**138.8**	**122.2**	**575.8**
Financial instruments included in trade and other payables	**(36.3)**	**(143.1)**	**(66.2)**	**(51.1)**	**(296.7)**
Cash and cash equivalents	**30.4**	**30.6**	**19.0**	**92.9**	**172.9**
Borrowings not designated as net investment hedges	**(151.6)**	**(11.5)**	**(2.6)**	**(0.3)**	**(166.0)**
	(123.0)	**156.3**	**89.0**	**163.7**	**286.0**
Exclude balances held in operations with the same functional currency	**124.7**	**(103.9)**	**(87.1)**	**(159.0)**	**(225.3)**
Exposure arising from intra-group loans		**(36.0)**	**12.8**	**6.2**	**(17.0)**
Forward foreign exchange contracts	**(2.6)**	**30.0**	**11.2**	**(38.6)**	
	(0.9)	**46.4**	**25.9**	**(27.7)**	**43.7**

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

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

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

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

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

Cash-flow hedging

The Group uses foreign currency contracts to hedge future foreign currency sales and purchases. At 31 July 2010 contracts with a nominal value of £292.7m (2009: £310.7m) were designated as hedging instruments. In addition, the Group had outstanding foreign currency contracts with a nominal value of £152.1m (2009: £121.7m) which were being used to manage transactional foreign exchange exposures, but were not accounted for as cash-flow hedges. The fair value of the contracts is disclosed in note 22.

The majority of hedged transactions will be recognised in the income statement in the same period that the cash-flows are expected to occur, with the only differences arising as a result of normal commercial credit terms on sales and purchases. Of the foreign exchange contracts designated as hedging instruments 99.6% are for periods of 12 months or less (2009: 99%).

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

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

Notes to the accounts
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 2010				
	Sterling £m	**US$ £m**	**Euro £m**	**Other £m**	**Total £m**
Loans designated as net investment hedges		**(587.0)**	**(248.1)**		**(835.1)**
Currency swap contracts	**206.7**	**(32.4)**	**(39.2)**	**(135.1)**	
	206.7	**(619.4)**	**(287.3)**	**(135.1)**	**(835.1)**

	At 31 July 2009				
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges		(551.3)		(36.9)	(588.2)
Cross-currency swap contracts		59.9	(59.9)		
Currency swap contracts	380.8	(92.6)	(207.4)	(80.8)	
	380.8	(584.0)	(267.3)	(117.7)	(588.2)

At 31 July 2010 swap contracts hedged the Group's exposure to Australian dollars, Canadian dollars, Japanese yen and Chinese renminbi (2009: Japanese yen and Chinese renminbi). At 31 July 2009 currency loans in other currencies hedged the Group's exposure to Canadian dollars and Australian dollars.

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

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

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

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 2010 £m	Loss recognised in hedge reserve 31 July 2009 £m
US dollar	**61.8**	70.8
Euro	**26.0**	10.7

These movements would be fully offset by an opposite movement on the retranslation of the net assets of the overseas subsidiaries. These sensitivities were calculated before adjusting for tax.

(b) Interest rate risk

The Group operates an interest rate policy designed to optimise interest cost and reduce volatility in reported earnings. The Group's current policy is to require interest rates to be fixed for 60% to 100% of the level of net debt. This is achieved primarily through fixed rate borrowings, and also through the use of interest rate swaps. At 31 July 2010 91.5% (2009: 73.9%) of the Group's net borrowings were at fixed interest rates, after adjusting for interest rate swaps and the impact of short maturity derivatives designated as net investment hedges.

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

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

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

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

Interest rate hedging

The Group has designated US$150.0m interest rate swaps which mature on 28 January 2013 and €120.0m interest rate swaps which mature on 5 May 2017 as fair value hedges on the US private placement and the Eurobond respectively which mature on the same dates. These positions hedge the risk of variability in the fair value of borrowings arising from fluctuations in base rates.

The fair values of the hedging instruments are disclosed in note 22. The effect of the swaps is to convert £195.3m (2009: £149.7m) debt from fixed rate to floating rate.

Sensitivity of interest charges to interest rate movements

The Group has exposure to sterling, US dollar and euro interest rates. However the Group does not have a significant exposure to interest rate movements for any individual currency. Based on the composition of net debt and foreign exchange rates at 31 July 2010, and taking into consideration all fixed rate borrowings and interest rate swaps in place, a one percentage point (100 basis points) change in average floating interest rates for all three currencies would have a £0.2m (2009: £2.2m) impact on the Group's profit before tax.

(c) Financial credit risk

The Group is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, but does not currently expect any counterparties to fail to meet their obligations. Credit risk is mitigated by the Board approved policy of only selecting counterparties with a strong investment grade long-term credit rating for cash deposits and assigning financial limits to individual counterparties. In the normal course of business, the Group operates notional cash pooling systems, where a legal right of set-off applies.

The maximum credit risk exposure in the event of other parties failing to perform their obligations under financial assets, excluding trade and other receivables and derivatives, totals £199.9m at 31 July 2010 (2009: £99.5m).

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

At 31 July 2010 the maximum exposure with a single bank for deposits and cash is £41.6m (2009: £24.1m), whilst the maximum mark to market exposure for derivatives is £6.8m (2009: £6.4m). These exposures were with the same bank, which has a AA credit rating.

(d) Liquidity risk

Borrowing facilities

The Board policy specifies the maintenance of unused committed credit facilities of at least £200m at all times to ensure it has sufficient available funds for operations and planned development. The principal £660m revolving credit facility matures in June 2012. At the balance sheet date the Group had the following undrawn credit facilities:

	2010 £m	2009 £m
Expiring within one year		
Expiring between one and two years	**660.0**	
Expiring after two years		622.8
	660.0	622.8

Cash deposits

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

Gross contractual cash-flows for borrowings

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

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

This table presents the undiscounted future contractual cash-flows for all derivative financial instruments. For this disclosure, cash-flows in foreign currencies are translated using the spot rates at the balance sheet date. The fair values of these financial instruments are presented in note 22.

Gross contractual cash-flows for other financial liabilities

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

22 Financial derivatives

The tables below set out the nominal amount and fair value of derivative contracts held by the Group, identifying the derivative contracts which qualify for hedge accounting treatment:

	At 31 July 2010			
	Contract or underlying nominal amount	**Fair value**		
	£m	**Assets £m**	**Liabilities £m**	**Net £m**
Foreign exchange contracts (cash-flow hedges)	**292.7**	**5.2**	**(7.0)**	**(1.8)**
Foreign exchange contracts (not hedge accounted)	**152.1**	**1.2**	**(2.3)**	**(1.1)**
Total foreign exchange contracts	**444.8**	**6.4**	**(9.3)**	**(2.9)**
Currency swaps (net investment hedges)	**206.7**	**4.9**	**(0.8)**	**4.1**
Currency swaps (not hedge accounted)	**180.7**	**6.7**	**(5.6)**	**1.1**
Total currency swap contracts	**387.4**	**11.6**	**(6.4)**	**5.2**
Interest rate swaps (fair value hedges)	**195.3**	**8.3**	**(0.3)**	**8.0**
Total financial derivatives	**1,027.5**	**26.3**	**(16.0)**	**10.3**
Balance sheet entries				
Non-current		**10.8**	**(1.1)**	**9.7**
Current		**15.5**	**(14.9)**	**0.6**
Total financial derivatives		**26.3**	**(16.0)**	**10.3**

Notes to the accounts
continued

	At 31 July 2009			
	Contract or underlying nominal amount	Fair value		
	£m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	310.7	10.2	(7.8)	2.4
Foreign exchange contracts (not hedge accounted)	121.7	2.3	(2.3)	
Total foreign exchange contracts	432.4	12.5	(10.1)	2.4
Currency swaps (net investment hedges)	470.6	32.6	(2.4)	30.2
Currency swaps (not hedge accounted)	436.7	3.3	(31.9)	(28.6)
Total currency swap contracts	907.3	35.9	(34.3)	1.6
Cross-currency swaps (net investment and fair value hedges)	59.9		(1.2)	(1.2)
Interest rate swaps (fair value hedges)	89.8	6.2		6.2
Total financial derivatives	1,489.4	54.6	(45.6)	9.0
Balance sheet entries				
Non-current		13.9	(6.7)	7.2
Current		40.7	(38.9)	1.8
Total financial derivatives		54.6	(45.6)	9.0

Currency swaps not hedge accounted

These contracts comprise derivatives which were previously part of the net investment hedging programme and matching contracts to eliminate this exposure. There is no further net exposure arising from these contracts.

Accounting for other derivative contracts

Any foreign exchange contracts which are not formally designated as hedges and tested are classified as 'held for trading' and not hedge accounted.

Fair value hierarchy

All derivatives values are calculated using level 2 valuation methodologies.

23 Provisions for liabilities and charges

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

Analysed as:

	2010 £m	2009 £m
Current liabilities	**70.4**	77.2
Non-current liabilities	**230.8**	226.5
	301.2	303.7

Warranty provision and product liability

Warranties over the Group's products typically cover periods of between one and three years. Provision is made for the likely cost of after-sales support based on the recent past experience of individual businesses.

Reorganisation

On 3 June 2008 the Company announced a number of changes to its corporate centre and divisional headquarters. The total cost of this restructuring, including redundancy, relocation and consolidation of manufacturing, is expected to amount to approximately £45m over the period to 2010, of which £5.4m has been charged in the current year.

Reorganisation provisions include £2.8m (2009: £4.8m) costs relating to restructuring supply arrangements following the automotive seals disposal. These costs are expected to be spread over the next six years.

Disposal

The disposal provision relates to warranties and other obligations in respect of the disposal of the Marine Systems and Aerospace businesses.

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

Litigation

John Crane, Inc.

John Crane, Inc. ("JCI") is one of many co-defendants in numerous lawsuits pending in the United States in which plaintiffs are claiming damages arising from alleged exposure to, or use of, products previously manufactured which contained asbestos. Until 2006, the awards, the related interest and all material defence costs were met directly by insurers. In 2007, JCI secured the commutation of certain insurance policies in respect of product liability. While JCI has excess liability insurance, the availability of such insurance and scope of the cover are currently the subject of litigation in the United States. An adverse judgment at first instance from the Circuit Court of Cook County, Illinois is currently under appeal. Pending the outcome of that litigation, JCI has begun to meet defence costs directly. Provision is made in respect of the expected costs of defending known and predicted future claims and of adverse judgments in relation thereto, to the extent that such costs can be reliably estimated. No account has been taken of recoveries from insurers as their nature and timing are not yet sufficiently certain to permit recognition as an asset for these purposes.

The JCI products generally referred to in these cases consist of industrial sealing product, primarily packing and gaskets. The asbestos was encapsulated within these products in such a manner that causes JCI to believe, based on tests conducted on its behalf, that the products were safe. JCI ceased manufacturing products containing asbestos in 1985.

JCI is actively monitoring the conduct and effect of its current and expected asbestos litigation, including the most efficacious presentation of its 'safe product' defence, and intends to continue to resist all asbestos claims based upon this defence. Approximately 184,000 claims against JCI have been dismissed before trial over the last 31 years. JCI is currently a defendant in cases involving approximately 116,000 claims. Despite the large number of claims brought against JCI, it has had final judgments against it, after appeals, in only 100 cases over the period, and has had to pay awards amounting to approximately US$95m. JCI has also incurred significant additional defence costs and, whilst the number of claims being filed against JCI and other defendants has been declining, the proportion of mesothelioma claims has increased, and JCI's ability to defend these cases is likely to have a significant impact on its annual aggregate adverse judgment and defence costs.

The assumptions made in assessing the appropriate level of provision include:

- The periods over which the expenditure can be reliably estimated. Projections used range between 10 and 17 years.
- The future trend of legal costs, allowing for 3% cost inflation.

- The rate of future claims filed.
- The rate of successful resolution of claims.
- The average amount of judgments awarded.

The provision is based on past history and allows for decreasing costs based on published tables of asbestos incidence projections. However, because of the significant uncertainty associated with the future level of asbestos claims and of the costs arising out of related litigation, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred and, as a result, the provision may be subject to potentially material revision from time to time if new information becomes available as a result of future events.

The provision in respect of JCI is a discounted pre-tax provision using discount rates, being the risk-free rate on US debt instruments for the appropriate period. The deferred tax asset related to this provision is shown within the deferred tax balance (note 6). Set out below is the gross, discounted and post-tax information relating to this provision:

	2010 £m	**2009 £m**
Gross provision	214.5	213.3
Discount	(38.8)	(46.7)
Discounted pre-tax provision	175.7	166.6
Deferred tax	(47.4)	(45.0)
Discounted post-tax provision	128.3	121.6

Other litigation

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

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

24 Operating lease commitments – minimum lease payments

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

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

25 Contingent liabilities and commitments

John Crane, Inc.

As stated in note 23, John Crane, Inc. (“JCI”) is involved in numerous law suits pending in the United States in which plaintiffs are claiming damages arising from exposure to, or use of, products containing asbestos. The JCI products generally referred to in these cases are ones in which the asbestos fibres were encapsulated in such a manner that, according to tests conducted on behalf of JCI, the products were safe. JCI ceased manufacturing products containing asbestos in 1985.

Provision has been made for the cost of adverse judgments expected to occur. The Group anticipates that asbestos litigation will continue beyond the period covered by this provision; however, because of the uncertainty surrounding the outcome of litigation beyond this period, the cost of adverse judgments cannot be reliably estimated.

Other contingent liabilities and commitments

In the ordinary course of its business, the Group is subject to litigation such as product liability claims, employee disputes and other kinds of lawsuits, and faces different types of legal issues in different jurisdictions. The high level of activity in the US, for example, exposes the Group to the likelihood of various types of litigation commonplace in that country, such as ‘mass tort’ and ‘class action’ litigation, and legal challenges to the scope and validity of patents. These types of proceedings (or the threat of them) are also used to create pressure to encourage negotiated settlement of disputes. Any claim brought against the Group (with or without merit), could be costly to defend. These matters are inherently difficult to quantify. In appropriate cases a provision is recognised based on best estimates and management 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 2010, contingent liabilities, comprising bonds and guarantees arising in the normal course of business, amounted to £143.5m (2009: £202.1m), including pension commitments of £40.6m (2009: £116.1m). At 31 July 2009 the Parent Company had two letters of credit to support the Group’s pension plans, one for £100.0m and one for £50.0m, which were both partially utilised. Following the agreement of ten year funding plans with the Trustees of its two major UK pension schemes the first letter of credit has been cancelled, leaving only the £50.0m facility.

The Group is currently co-operating with the relevant authorities in investigating certain business conduct issues. Based on the work completed to date, these are not expected to give rise to any material financial exposure.

26 Share capital

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

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

27 Reserves

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

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

Capital management

The capital structure is based on the directors’ judgement of the balance required to maintain flexibility while achieving an efficient cost of capital. The Group has a target gearing, calculated on a market value basis, of approximately 20%. At the balance sheet date the Group had gearing of 19% (2009: 26%).

Notes to the accounts
continued

As part of this process the Group maintains its target of a solid investment grade credit rating by monitoring the factors utilised by ratings agencies and evaluating the impact of potential distributions and future funding requirements. At 31 July 2010 the Group had a credit rating of BBB+/Baa2 – negative outlook (2009: BBB+/Baa2 – negative outlook) with Standard & Poor's and Moody's respectively.

Hedge reserve

	2010 £m	2009 £m
The hedge reserve on the balance sheet comprises		
– cash-flow hedge reserve	**(0.6)**	1.8
– net investment hedge reserve	**(128.2)**	(88.9)
	(128.8)	(87.1)

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

28 Cash-flow from operating activities

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

29 Acquisitions

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

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

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

Notes to the accounts
continued

The intangible assets recognised comprise £22.8m in respect of technology and £28.7m in respect of customer relationships and orders. Goodwill represents the value of synergies arising from the acquisitions and future growth opportunities. The goodwill recognised is not expected to be deductible for tax purposes. The adjustments to current assets and liabilities relate to valuation adjustments and are provisional, based on management's best estimates.

The values set out below are provisional pending finalisation of the fair values attributable, and will be finalised in the year ending 31 July 2011. Goodwill and other net assets in respect of prior year acquisitions, as previously reported, have been adjusted as a result of finalising their attributable fair values and changes in the estimated value of contingent considerations. Accordingly, goodwill has increased by £0.2m.

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

30 Employee share schemes

The Group operates share schemes and plans for the benefit of employees. The nature of the principal schemes and plans, including general conditions, is set out below:

Smiths Group Performance Share Plan (PSP)

The PSP was introduced in 2004 and replaced the 95 ESOS for executive directors and senior executives. Conditional awards of up to 1.5 times salary (and exceptionally three times salary) were granted annually. The awards are released following the third anniversary of the date of grant to the extent the PSP's performance tests have been met. One-third of the award is subject to a total shareholder return ('TSR') target relative to other FTSE 100 companies (excluding financial companies and investment trusts). For full vesting, the company's TSR must be at or above the 75th percentile over the three year performance period. 25% of the award will vest if the company's TSR is at median. Awards will vest on a straight-line pro-rata basis between median and 75th percentile. The remaining two-thirds of the award is subject to an earnings per share ('EPS') growth target (measured before exceptional items). Full vesting will occur if the compound annual growth in EPS is equivalent to 12% per annum. 25% vesting will occur if the compound annual growth in EPS is equivalent to 5% per annum, with vesting on a straight-line basis between 5% and 12%. The PSP has been replaced by the VSP, and the final award under the PSP will be released in December 2010.

Notes to the accounts
continued

Value Sharing Plan (VSP)

The VSP is a long-term incentive plan approved by the shareholders in July 2008 rewarding executives for value creation at Group and Divisional levels over three-year and four-year periods commencing with the financial year 2008/09. Corporate participants will be rewarded under the VSP for value creation at a Group level, whereas the executives with divisional responsibilities will be rewarded for value creation within the division for which they are responsible. For the Group scheme, one-third of the award will depend on the growth in Smiths' TSR over and above the median for the companies comprising the FTSE 100 (excluding financial services companies) and the remaining two-thirds of each award will be determined by the growth in internal value in excess of 9.5% a year. The growth in internal value is calculated as follows: adjusted profit before tax ('PBT') times the ratio of PBT to market capitalisation determined at the date of grant plus net equity cash-flows to shareholders. The divisional awards will depend on meeting an internal value growth target set for the division in which the participant works.

The participants in the VSP will not be eligible for awards under the Performance Share Plan in 2008/09 or 2009/10.

Smiths Group Co-Investment Plan (CIP)

Under the CIP, as introduced in October 2005, the executive directors and senior executives are able, if invited, to use their after tax bonus or 25% of their basic salary after tax, whichever is the greater, to invest in the Company's shares at the prevailing market price. At the end of a three year period, if the executive is still in office and provided the performance test is passed, matching shares will be awarded in respect of any invested shares retained for that period. The number of matching shares to be awarded is determined by the Remuneration Committee at the end of the year in which the bonus is earned by reference to annual bonus, and other corporate financial criteria. The maximum award will not exceed the value, before tax, of the bonus or salary invested in shares by the executive. Vesting of matching shares will occur and the matching shares will be released at the end of the three year period if the Group's Return on Capital Employed ('ROCE') over the Performance Period exceeds the Group's weighted average cost of capital ('WACC') over the Performance Period by an average margin of at least 1% per annum.

In July 2008 the CIP was amended. From 2009 participants have been required to invest 50% of their post tax bonus in purchased shares. The performance conditions have been expanded to include an enhanced performance condition of ROCE exceeding WACC by an average margin of 3% per annum. If the enhanced performance condition is met, two matching shares will be issued for every purchased share.

	CIP	PSP and VSP	Other share schemes	Total	Weighted average price for option plans £
Ordinary shares under option ('000)					
1 August 2008	1,407	2,661	10,148	14,216	£6.23
Granted	305	1,604	647	2,556	£1.45
Exercised	(675)	(683)	(584)	(1,942)	£2.18
Lapsed	(47)	(243)	(1,191)	(1,481)	£6.75
31 July 2009	990	3,339	9,020	13,349	£5.83
Granted	412		248	660	£3.32
Update of estimates		(241)		(241)	£0.00
Exercised	(430)	(130)	(1,643)	(2,203)	£6.18
Lapsed	(95)	(1,198)	(1,193)	(2,486)	£5.53
31 July 2010	**877**	**1,770**	**6,432**	**9,079**	**£6.15**

Notes to the accounts
continued

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

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

For the purposes of valuing options to arrive at the share-based payment charge, the Binomial option pricing model has been used for most schemes and the Monte Carlo method is used for schemes with total shareholder return performance targets. The key assumptions used in the models for 2010 and 2009 are volatility of 30% (2009: 23%) and dividend yield of 3.75% (2009: 3.75%). Assumptions on expected volatility and expected option term have been made on the basis of historical data, for the period corresponding with the vesting period of the option. These generated a weighted average fair value for CIP of £18.89 (2009: £6.96) and VSP/PSP of £11.21 (2009: £11.01).

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

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

REGISTERED OFFICE OF THE ISSUER

Smiths Group plc
Cardinal Place
80 Victoria Street
London SW1E 5JL
England

REGISTERED OFFICE OF THE GUARANTOR

Smiths Group International Holdings Limited
Cardinal Place
80 Victoria Street
London SW1E 5JL
England

LEGAL ADVISERS TO THE ISSUER AND THE GUARANTOR

as to US and English law

Linklaters LLP
One Silk Street
London EC2Y 8HQ
England

JOINT BOOKRUNNERS

Barclays Capital Inc.
745 Seventh Avenue
New York, NY 10019
United States

J.P. Morgan Securities LLC
383 Madison Avenue
New York, NY 10179
United States

Morgan Stanley & Co. LLC
1585 Broadway
New York, NY 10036
United States

Mitsubishi UFJ Securities (USA), Inc.
1633 Broadway, 29th Floor
New York, NY 10019
United States

LEGAL ADVISERS TO THE INITIAL PURCHASERS

as to US law

Davis Polk & Wardwell London LLP
99 Gresham Street
London EC2V 7NG
England

INDEPENDENT AUDITORS OF THE ISSUER AND THE GUARANTOR

PricewaterhouseCoopers LLP
1 Embankment Place
London WC2N 6RH
England

FISCAL AGENT, PAYING AGENT AND TRANSFER AGENT

Citibank, N.A.
Citigroup Centre
Canada Square
Canary Wharf
London E14 5LB
England

REGISTRAR

Citigroup Global Markets Deutschland AG
Reuterweg 16
60323, Frankfurt
Germany

Printed by RR Donnelley 412103