



Celebrating 100 years on the London Stock Exchange



**1851**

Samuel Smith opens his first jewellery shop in south London



**1914**

S. Smith & Sons floats on the London Stock Exchange, only days before the First World War breaks out



**2014**

A world leader in advanced technologies, Smiths today employs more than 23,000 people in over 50 countries

## Smiths founded

Founded in 1851 as a jewellery shop in south London a year after the Great Exhibition, Smiths opened its doors during a period of enormous optimism and huge advances in technology.

Establishing itself as a leader in precision instruments over the following decades, Smiths focus on leading-edge technology has remained constant throughout its history.

## Smiths floats

S. Smith & Sons floats on the London Stock Exchange, days before the outbreak of the First World War.

In the supporting prospectus it was clear that Smiths speedometers and carburettors dominated the domestic car markets.

Already a substantial business, the head office employed over 300 employees.

1851

1904



### The earliest speedometer

Eying the potential of the motor car, Smiths is a pioneer in the development of speedometers and rapidly becomes the market leader



### Smiths opens for business

Samuel Smith opens his first jewellery shop in south London

1912

1913



### Purpose-built headquarters

Speedometer House, Great Portland Street, London, is specially built for Smiths



### Sledge-meter aids South Pole success

A Smiths speedometer is adapted as a sledge-meter for Captain Scott's epic South Pole expedition

1914

# Celebrating 100 years as a listed company



## War effort begins

Adapting to changed circumstances, Smiths devotes the new Cricklewood factory to munitions-related work



## Early sonar technology

A controlling stake in Henry Hughes is acquired as Smiths branches out into early sonar-type technology for air and sea operations

## Everest conquered

Edmund Hillary leads the first successful ascent of Everest using Smiths equipment and wearing a Smiths De Luxe watch

1915

1930

1935

1953

1919

1927

1939

1958



## Clocking up sales

Smiths now produces 80% of speedometers sold in the UK and recruits gifted engineer Robert Lenoir to develop more sophisticated models



## First transatlantic flight

Alcock and Brown make the world's first direct transatlantic flight, from Newfoundland to Ireland, in a plane fitted with Smiths instruments



## Supporting the war effort

Smiths wartime production tally includes: 13 million spark plugs, over 10 million aircraft instruments, 4 million clocks and 1.5 million speedometers and mileage counters



## An embryonic Smiths Medical

Smiths purchases Portland Plastics, a small medical supplies firm, for its plastics and nylons experience for use in aerospace and automobiles. The division would later become Smiths Medical



#### Land speed record attempt

Smiths instruments are on the Bluebird Proteus CN7, in which British racing legend Donald Campbell attempted the world land speed record



#### Aerospace expansion

Acquisition of Lear Siegler companies in the US doubles aerospace sales and positions Smiths for the next decade



#### Changing the face of banking

Smiths develops one of the first chip and PIN ATMs

**1960**

**1967**

**1965**

**1973**

**1987**

**1992**

**2003**



#### TI Group merger

£4.3bn merger with TI Group brings scale in aerospace, plus new business lines including John Crane



#### Making aviation history

A BAC Trident makes the world's first fully automatic landing in civil aviation using Smiths instruments



#### Acquiring IVF pioneers

Smiths acquires H.G. Wallace, which pioneered IVF, culminating in the birth of the world's first test-tube baby in 1978

# Smiths today

2014 marks Smiths Group's centenary as a listed company on the London Stock Exchange.

Smiths has evolved substantially since its foundation in 1851, successfully reinventing itself in line with market opportunities – from clocks and watches, through automotive and aerospace.

Today our portfolio taps into high technology markets with strong long-term growth drivers. We helped shape the modern world through our varied innovations and our products continue to touch the lives of millions of people every day.

2014

2005

2007



## Aerospace divestment

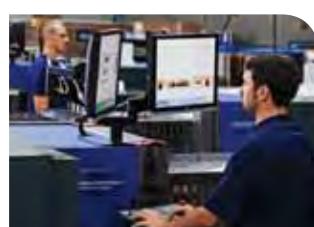
Aerospace is sold to GE for £2.6bn, some 90 years after Smiths first started making aircraft instruments



John Crane



Smiths Medical



Smiths Detection



Smiths Interconnect



## Medical expansion

Acquisition of Medex expands Smiths Medical's expertise in critical care products



Flex-Tek

**Find out more about our history at [www.smiths.com](http://www.smiths.com)**

# Highlights

## Operational highlights:

- Commercial market gains but challenging healthcare and homeland security markets**
- John Crane, Smiths Interconnect and Flex-Tek increased underlying revenue and margins**
- Smiths Medical returned to growth in H2 with improvement in infusion pumps**
- Smiths Detection margins under pressure with tough trading and additional charges**
- Fuel for Growth restructuring process delivered £10m of savings**
- FX translation impact on sales of £157m and operating profit of £27m; transaction hit of £16m**
- Company-funded investment in new product development up 5% to underlying £109m**
- Headline operating cash conversion at 97%; dividend up 2%**

## Continuing activities

	2014 £m	2013 <sup>†</sup> £m
Revenue	<b>2,952</b>	3,109
Headline operating profit	<b>504</b>	560
Statutory operating profit	<b>378</b>	486
Headline basic EPS	<b>81.8p</b>	92.7p
Statutory basic EPS	<b>59.0p</b>	80.1p
Free cash-flow	<b>143</b>	237
Dividend	<b>40.25p</b>	39.5p
Return on capital employed	<b>15.7%</b>	16.6%

Headline profit is before exceptional items, amortisation and impairment of acquired intangible assets, pension charges and financing gains/losses from currency hedging. Free cash-flow and return on capital employed are described in the Financial review.

<sup>†</sup>The statutory figures for 2013 have been restated for IAS 19 (revised 2011)

## Revenue

£m

**£2,952m (5)%**

2014	2,952
2013	3,109
2012	3,038
2011	2,842
2010	2,770

→ Read more on page 25  
and note 1

## Headline operating profit

£m

**£504m (10)%**

2014	504
2013	560
2012	554
2011	517
2010	492

→ Read more on pages 25, 170  
and note 1

## Free cash-flow

£m

**£143m (40)%**

2014	143
2013	237
2012	217
2011	236
2010	331

→ Read more on pages 56, 170  
and note 27

## Headline earnings per share

Pence

**81.8p (10.9)p**

2014	81.8
2013	92.7
2012	92.6
2011	86.5
2010	83.4

→ Read more on pages 56, 170  
and note 6

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

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

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# Bringing technology to life... Making the world safer



Smiths Detection designed and manufactured the first automatic explosives and liquid detection scanner, one of its extensive range of advanced X-ray systems that protect air travellers around the world. Some 75,000 X-ray systems, which can detect and identify threat items in bags, hold luggage and freight, have been deployed in more than 180 countries.

# Strategic report



## Strategic overview

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# Who we are

**Smiths Group is a global technology company listed on the London Stock Exchange. Our vision is to establish Smiths Group as a world-leading engineering business.**

## What we do

We apply leading-edge technology to design, manufacture and deliver innovative solutions that meet our customers' needs.

## Our markets / who we serve

We do this across a wide range of applications and end markets – from healthcare, energy and petrochemicals through to threat and contraband detection, telecommunications and equipment manufacture.

## How we create competitive advantage

Our products and services are often critical to our customers' operations, while our proprietary technology and high service levels help create competitive advantage.

## Our approach

We do this responsibly, through the combined expertise of our people and effective, focused leadership, to deliver value to our customers, shareholders and wider stakeholders.

### Countries with direct operations

**>50**



### Employees worldwide

**23,200**



### Countries our products and services reach

**>200**



### Investment in new product development in 2014

**£117m**



### Safety improvement since 2010 (Recordable incident rate)

**31%**



### Smiths opened its doors for business

**1851**



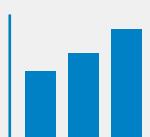
### Revenue in 2014

**£2,952m**



### Headline operating profit in 2014

**£504m**



### Waste reduction since 2010

**25%**



# Bringing technology to life

We bring technology to life to help to make the world safer, healthier and more productive.

We've been at the forefront of technology for over 160 years and our products continue to touch the lives of millions of people every day.



John Crane's seals help extract and transport oil and gas safely at extreme pressures and temperatures



Smiths Medical's safety needles protect healthcare workers from needlestick injuries



Smiths Detection's chemical identifiers help the military and emergency responders identify unknown threats



Smiths Interconnect's microwave products enable next-generation communications networks



Flex-Tek's ultra-lightweight hoses make next-generation airliners more fuel efficient

# Our divisions

**Smiths Group has five divisions: John Crane, Smiths Medical, Smiths Detection, Smiths Interconnect and Flex-Tek.**

**We employ more than 23,000 people in over 50 countries worldwide and are focused on the threat & contraband detection, medical devices, energy, communications and engineered components markets worldwide.**

Our businesses are highly competitive, with strong technology positions, operating in sectors with excellent opportunities for growth. They are united by high-quality brands, a deep understanding of their customers and markets, the ability to engineer products to meet customers' specific needs, expertise in small-batch manufacturing and aftermarket service and an unwavering commitment to operating responsibly.

## John Crane

A leading provider of products and services to global energy services customers. Our solutions help ensure the reliability of mission-critical equipment in challenging operating environments.



Revenue  
2014

**£941m**

Headline operating profit margin  
2014

**24.9%**

Employees

**6,850**

### Strengths

- Strong proprietary technology with expertise in applied engineering
- Market leader in mechanical seals
- Two-thirds of sales in aftermarket
- Global network of c. 230 sales and service centres

## Smiths Medical

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



Revenue  
2014

**£804m**

Headline operating profit margin  
2014

**19.8%**

Employees

**7,850**

### Strengths

- Strong market positions in select clinical areas
- Highly recognised and respected brands
- Reputation for reliable quality and safety
- Differentiated lower risk, short residency, interventional devices
- Innovative pipeline and new product launches
- Extensive global sales network

## Smiths Detection

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



Revenue  
2014

**£512m**

Headline operating profit margin  
2014

**4.8%**

Employees

**2,250**

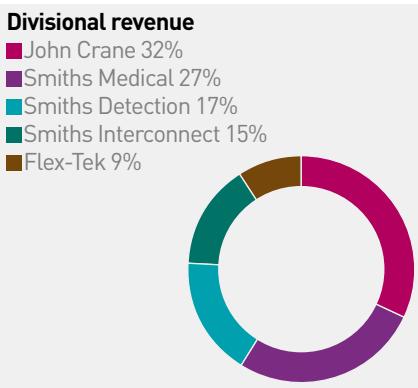
### Strengths

- Market leader with strong global brand
- Operates in regulated markets that require product certification
- Technology leveraged across broad range of markets and applications
- c. 30% of sales from aftermarket service and growing
- Global sales and service network with strong emerging market presence

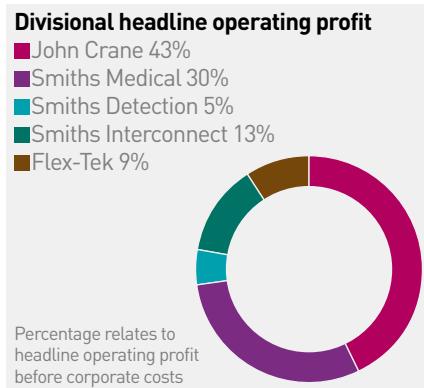
→ Read more on pages 26-31  
or [www.johncrane.com](http://www.johncrane.com)

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

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



→ Read more  
on page 135



→ Read more  
on page 135

## Smiths Interconnect

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



**Revenue**  
2014

**£445m**

**Headline operating profit margin**  
2014

**16.0%**

**Employees**

**4,000**

### Strengths

- Innovative and technically differentiated technologies
- Ultra-high reliability solutions used in demanding applications
- High degree of customer intimacy and product customisation
- Addressing highly regulated markets with strong barriers to entry

## Flex-Tek

A global provider of engineered components that heat and move fluids and gases for the aerospace, medical, industrial, construction and domestic appliance markets.



**Revenue**  
2014

**£250m**

**Headline operating profit margin**  
2014

**18.9%**

**Employees**

**2,000**

### Strengths

- Manufacturer of qualified components for the aerospace industry
- Largest supplier of open coil heating elements worldwide
- Leading manufacturer of flexible gas piping and HVAC ducting for US construction market

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

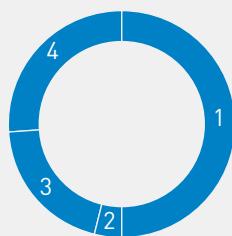
→ Read more on pages 50-55  
or [www.flextekgroup.com](http://www.flextekgroup.com)

## Our geographic reach and end markets

The Group has operations in more than 50 countries, with a network of dealers and distributors in many more. North America accounts for half our revenue and we are investing to grow our presence in high-growth emerging markets. We serve markets that are well positioned to deliver long-term profitable growth, as well as strong and stable cash-flows.

**Group revenue by destination**

- 1 North America 50%
- 2 United Kingdom 4%
- 3 Europe other 20%
- 4 Rest of World 26%



→ Read more in note 1  
on page 138

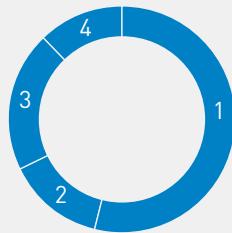
**Group manufacturing and service locations**



**Location of assets**

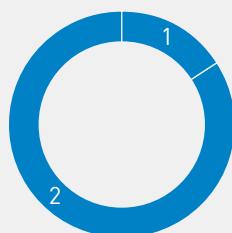
- 1 North America 54%
- 2 United Kingdom 14%
- 3 Europe other 20%
- 4 Rest of World 12%

Analysis excludes cash and cash equivalents



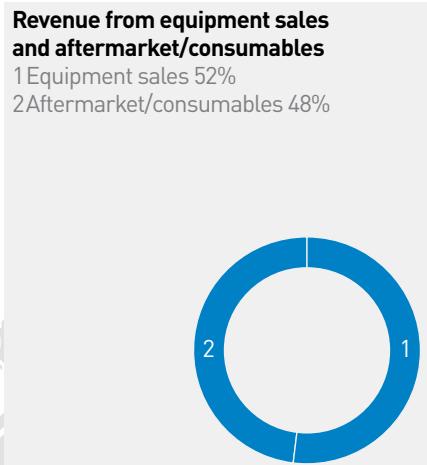
**Revenue from emerging and developed markets**

- 1 High-growth emerging markets 16%
- 2 Developed markets 84%



**Smiths Group is investing to expand its emerging market presence**

Smiths Group has grown its exposure to high-growth emerging markets through a targeted investment in sales and marketing capabilities over the past five years. At 16% of Group revenue, our presence in these markets is not yet where we would like it to be and there are further opportunities to expand our footprint. John Crane has the highest proportion with some 22% of revenue in the emerging markets, building on a long-term presence in countries such as Brazil (over 50 years) and China (around 30 years). Smiths Medical has invested to build its long-term position in these markets. Smiths Interconnect and Smiths Detection have built their coverage through acquisitions over several years. We will continue to seek opportunities to grow our share in these important markets.



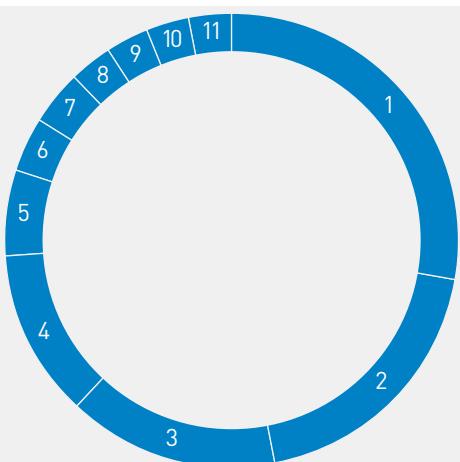
**We have strong and stable cash-flows driven by the high level of revenue from aftermarket service and single-use consumables**

We derive around half our revenue from servicing the aftermarket needs of our customers or supplying single-use consumables that are used as part of everyday processes. For example, almost two-thirds of John Crane's revenues are from the aftermarket servicing of equipment, reflecting a very high capture rate following the original sale to the original equipment manufacturers (OEMs). In Smiths Medical, over 80% of sales are from the supply of single-use consumables that may be used in conjunction with their hardware equipment (such as an infusion pump) or as part of everyday hospital procedures. In Smiths Detection, around a third of revenues are from the supply of servicing and spares for their equipment. As a result, Smiths Group generates strong and stable cash-flows.

**Countries our products and services reach**

**>200**

**Percentage of revenue from emerging markets**  
**16%**



#### Revenue by end market

1 Healthcare	28%
2 Oil, gas and petrochemical	19%
3 Homeland security	15%
4 Industrial	12%*
5 Defence	6%
6 Aerospace, space	4%
7 Chemical and pharma	4%
8 Telecoms	3%
9 Semiconductors, data centres	3%
10 US residential construction	3%
11 Household appliances	3%

\*Industrial includes power generation, alternative energy, mining, test, rail and other general industrial applications

#### Smiths Group benefits from a wide range of end markets

Our businesses are either market leaders in their sectors or are well placed in attractive niches. These typically have scope for long-term profitable growth with strong growth drivers. They include the demand for healthcare from increasing spend in emerging markets and ageing populations in developed markets, the global demand for energy, security threats and challenges, the expansion of wireless communications, the demand for new fuel-efficient aircraft and the need for new homes in the US.

# Our business model

**Smiths Group's business model operates at two levels.**

**The Group manages our portfolio to create value for shareholders, while the five divisions manage their businesses to meet customers' needs and create value for the Group.**

## The Group's role

We have a lean corporate centre, which sets our strategic priorities and allocates capital to manage the portfolio and drive returns. It also co-ordinates strategic initiatives across the divisions and fosters a common culture of responsibility and accountability wherever we work around the world.

The corporate centre focuses on a number of core activities:

### Strategy

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

### Budgeting, planning and reporting

Agrees and reviews annual Group and divisional budgets.

### Governance

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

### Risk management

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

### Performance monitoring

Regularly reviews performance against agreed targets with the divisions.

### Information systems

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

### Ethics and compliance

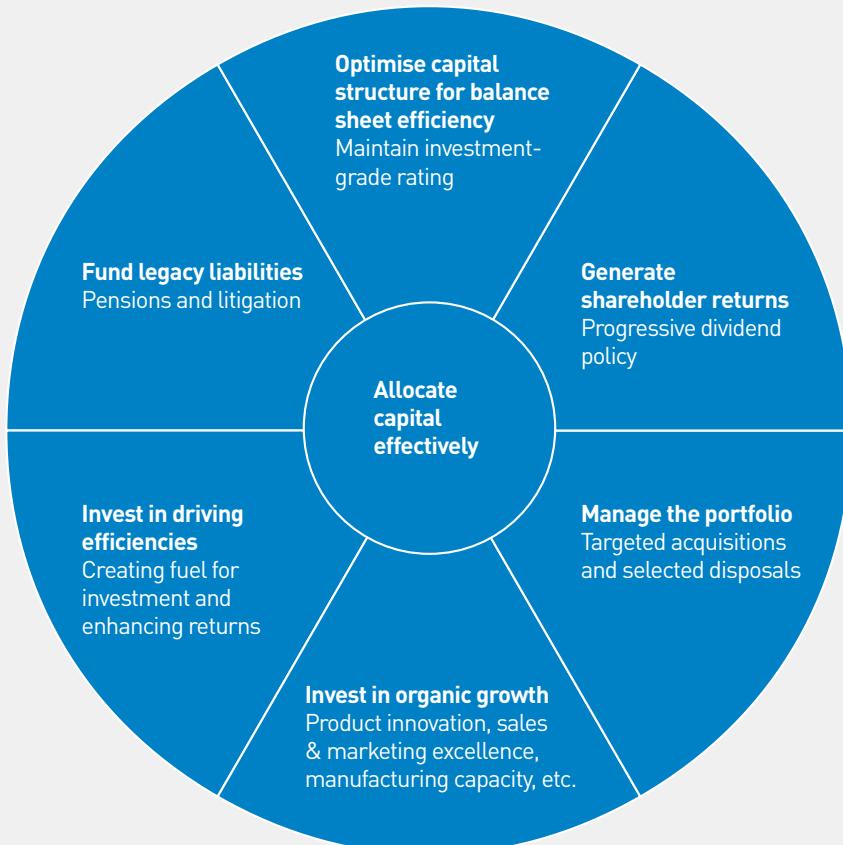
Approves policies and provides oversight to ensure a strong culture of ethical behaviour and compliance.

### EHS, talent and retention

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

### Best practice

Shares best practice in areas such as sales and marketing excellence, quality and innovation.



### Capital allocation

The corporate centre is responsible for the effective allocation of capital across the business. This is important in a multi-industry organisation where our businesses are strongly cash generative and have limited need for fixed capital. We do this through:

- **Securing financing and optimising the Group's capital structure for balance sheet efficiency.** We seek to maintain a strong investment-grade credit rating and net debt/EBITDA gearing at 1.5-2x.
- **Generating shareholder returns through dividend payments and capital returns.** Our focus on cash generation enables us to reinvest in the business to drive growth and to generate attractive shareholder returns. We have a progressive dividend policy, while maintaining 2.5 times cover.
- **Investing in organic growth** through new product development, sales and marketing initiatives and manufacturing capacity.
- **Investing in driving efficiencies** to create the fuel for growth investment and to enhance returns.

- **Funding legacy liabilities**, such as our defined benefit pension schemes and legacy product liability issues, in order to minimise their impact on value creation. These are managed at either Group or divisional level, as appropriate.

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

- **Investing in organic growth** through new product development, sales and marketing initiatives and manufacturing capacity.

- **Investing in driving efficiencies** to create the fuel for growth investment and to enhance returns.

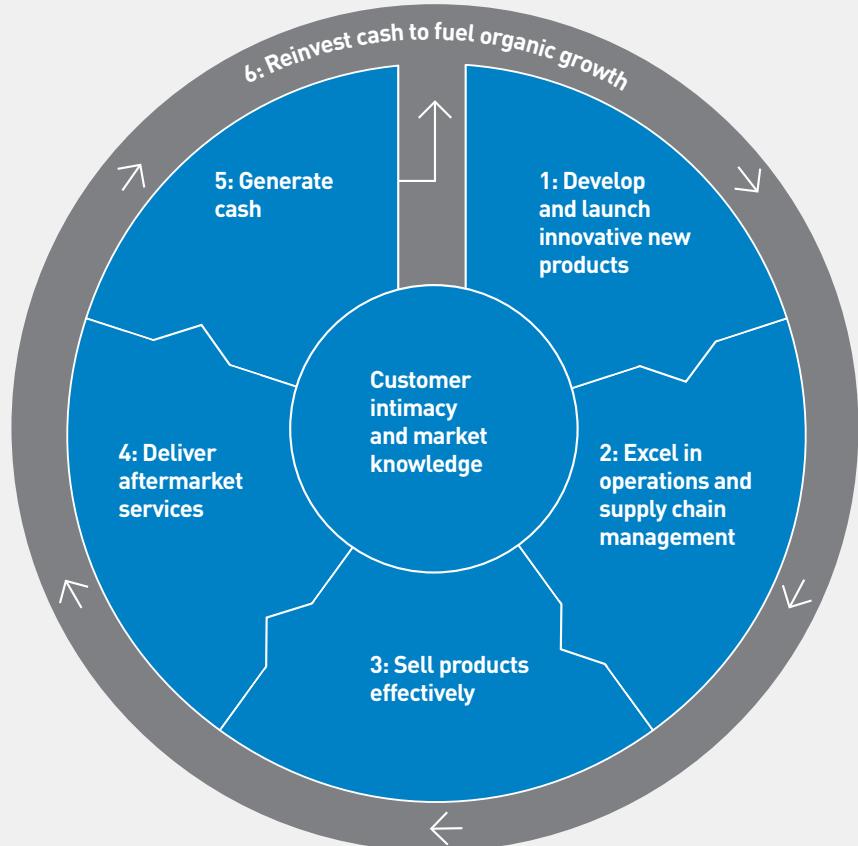
## The divisional business model

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

Our businesses also share a common business model:

- creating sustainable technological differentiation by developing products to meet customers' specific needs
- achieving operational excellence through low-cost, flexible manufacturing; and
- developing strong, lasting customer relationships by providing outstanding aftermarket services.

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



### Create a differentiated market understanding and customer intimacy

Our businesses consistently refine their knowledge of their markets. This includes segmenting those markets, understanding their dynamics, analysing competitors and their activities, identifying opportunities to improve our services and assessing potential sources of competitive advantage. This helps us anticipate and respond to developments.

This deep market knowledge enables us to achieve a high degree of customer intimacy, allowing us to anticipate their specific needs. This in turn helps us to keep our customers for the long term.

### 1: Develop and launch innovative products

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

We fund the majority of our R&D and we also seek funding from our customers. Our spend is focused more on product development than pure research. In 2014, we invested £117m in R&D, of which £8m was customer-funded.

### 2: Excel in operations and supply chain management

The majority of the manufacturing process is in small-batch, low-cost assembly, much of which is made to meet specific customer orders. This makes us capital-light and flexible.

Where appropriate, we have established production facilities in lower-cost countries, such as Mexico, China, India, the Czech Republic, Costa Rica and Tunisia.

### 3: Sell products effectively

We take our products to market through our own sales and marketing teams and a network of dealers and distributors around the world. Our focus on building long-term customer relationships is fundamental to the success of our sales force.

### 4: Develop lasting relationships through outstanding aftermarket services

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

### 5: Generate cash

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

### 6: Re-invest cash to fuel organic growth

Our strong cash-flow enables us to reinvest in the business to drive top-line growth by investing in new product development, optimising our systems and operations and expanding our sales and marketing presence in key growth markets.

This investment enables us to maintain our technology leadership and accelerates sales and margin growth across the business, providing a platform for sustained growth.

# Our strategy and progress

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

## 1: Driving top-line growth

We drive our top-line growth in four ways. First, we invest in new product development – the lifeblood of a technology business such as Smiths. Second, we look to expand our presence where needed, for example in emerging markets such as China, India and Brazil, through investing in sales resources. Third, by improving our sales and marketing effectiveness through sharing tools and best practice. Fourth, we make bolt-on acquisitions to add complementary technologies and increase our exposure to high-growth markets.

### Performance in 2014

Revenue £m

**£2,952m**

2014	2,952
2013	3,109
2012	3,038
2011	2,842
2010	2,770

Revenue was down 5%, but was flat on 2013 excluding currency effects. Gains in our businesses that serve commercial markets were offset by the challenges facing our healthcare and defence-related divisions. We raised company-funded R&D by 5% underlying to £109m to drive innovation and launched a number of new products. Revenues from emerging markets were maintained at 16% of Group sales. Savings from our *Fuel for Growth* programme are providing the fuel for investment in growth initiatives.

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

### Priorities

We aim to accelerate our top-line growth through continued improvement of our market and customer understanding and investment in new product development, sales and marketing in high-growth markets and in targeted acquisitions.

→ Read more on pages 20-25 and in note 1 on page 135

## 2: Enhancing margins through operational excellence

We intend to continue to enhance our attractive margins through further operational improvement, leveraging our scale and IT systems, and focusing on low-cost manufacturing. These operational efficiencies also provide the fuel to invest in growth.

### Performance in 2014

Headline operating margin %

**17.1%**

2014	17.1
2013	18.0
2012	18.2
2011	18.2
2010	17.8

Headline operating profit margin declined by 90 basis points, reflecting reduced profitability at Smiths Medical and Smiths Detection and our continued investment in growth initiatives such as sales excellence.

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

### Priorities

Continue to drive cost savings and operational improvements through the ongoing initiatives at our divisions.

→ Read more on pages 20-25 and in note 1 on page 135

## 3: Developing smarter ways of working and attracting the best talent

Attracting, retaining and developing the right people with the right skills is key to transforming Smiths into a world-class organisation. We are raising the bar in terms of fostering talent through a rigorous focus on succession planning, assessment programmes and personal development. We also look for opportunities to foster smarter ways of working and encourage collaboration.

### Performance in 2014 Leadership

We changed the leadership at Medical and Detection during the year to take both businesses to the next phase of development.

### Talent pipeline

Our focus on succession planning has delivered significant progress in building our talent pipeline, through a more rigorous and consistent approach to talent assessment and the preparation and monitoring of personal development plans. Over 100 managers from across the business are currently on or have been through our refreshed junior and senior leadership development programmes.

### People management

Since 2010 we have transformed our HR function to ensure that we have the appropriate infrastructure in place to support growth.

### Priorities

We will further develop our leadership capabilities and technological expertise across the organisation, and continue to roll-out e-enabled HR. We will continue to address the results of our third MyVoice engagement survey and conduct an interim survey to monitor progress.

→ Read more on pages 20-24, 70-71 and [www.smiths.com/responsibility](http://www.smiths.com/responsibility)

→ See Operational review case studies for our strategy in action

#### 4: Promoting a culture of responsibility

We promote a culture of responsibility throughout Smiths Group. This requires us all to work according to our Code of Business Ethics. We are committed to working in a way that protects the health and safety of employees and minimises the environmental effects of our activities and detrimental effects of our products and services. This delivers real business benefits, while ensuring that we meet our obligations to all our stakeholders.

##### Performance in 2014

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

Recordable incident rate per 100 employees (RIR)	0.50
FY2013-FY2018 Reduction target	FY2014 v FY2013
Energy	15% 1% increase
Greenhouse gas emissions	15% 4% reduction
Total non-recycled waste	15% 5% reduction
Water consumption	10% 1% increase

Whilst our goal is zero harm, we improved our RIR from 0.54 to 0.50. Our environmental performance continued its long-term improvement trend, with good reductions in GHG emissions and non-recycled waste, but minor increases in energy and water usage.

#### Priorities

We will continue to embed a culture of ethical behaviour across the business.

→ Read more on pages 66-71 and [www.smiths.com/responsibility](http://www.smiths.com/responsibility)

#### 5: Generating cash and managing the balance sheet effectively

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.

##### Performance in 2014

###### Cash conversion %

**97%**

2014	97
2013	98
2012	99
2011	95
2010	115

Operating cash generation remained strong, with headline operating cash of £490m, resulting in cash conversion of 97%.

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

#### 6: Allocating capital to maximise returns

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

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

##### Performance in 2014

###### Return on capital employed %

**15.7%**

2014	15.7
2013	16.6
2012	16.5
2011	16.4
2010	15.9

Return on capital employed declined 90 basis points to 15.7%, as a result of reduced profitability in Smiths Medical and Smiths Detection more than offsetting improved profitability in John Crane, Smiths Interconnect and Flex-Tek.

This is headline operating profit divided by monthly average capital employed, expressed as a percentage. Capital employed is total equity, adjusted for goodwill recognised directly in reserves, net post-retirement benefit-related assets and liabilities, litigation provisions relating to exceptional items and net debt. Return on capital for 2010 and 2011 has been restated.

#### Priorities

Continue to focus on cash generation and balance sheet management, so that we have the financial strength to grow the business and generate returns for shareholders.

→ Read more on pages 22-25 and in note 27 on page 169 and page 170

#### Priorities

Continue to manage our portfolio to create maximum value for shareholders.

→ Read more on pages 22-25 and in note 1 on pages 135-138 and page 170

# Driving competitive advantage through innovation

**Innovation is our lifeblood as a technology company. Our long-standing commitment to new product development has underpinned our sustained success and is a key driver of future revenue and margin growth. Company-funded investment in new products was £109m last year, up almost 60% over the past seven years.**

**We completed several new product launches over the past twelve months – below are just a few examples of our commitment to technology leadership.**

## Reducing installation time

Building on the success of its market-leading Type 3740 split seal, John Crane has introduced a larger version ideally suited for large, difficult-to-maintain pumps, mixers and rotating equipment. The unique technology allows the seal to be installed without dismantling the equipment, potentially cutting installation time by more than 50%. Maintenance costs are correspondingly reduced. The targeted market is power facilities, waste water and desalination plants, pulp and paper mills, and mines.



## Real-time monitoring

Smiths Interconnect's next-generation branch circuit monitoring system, JCOMM, allows data centre customers real-time supervision of power to the circuits that drive their servers. This state-of-the-art system enables usage, billing, capacity allocation and overload protection planning. JCOMM's pre-engineered cable system also reduces installation time significantly while its versatility allows configuration for both new data centres and retrofits.



#### Compact threat detection

The HI-SCAN 6040-2is can provide 'airport-quality' screening in a wide range of locations because of its advanced detection features and small footprint. Launched only last year, the X-ray inspection system automatically detects explosives and threat liquids. Its compact size and light weight make it ideal for deployment in the lobbies of secure buildings such as government departments, utility plants, courthouses and jails. It offers dual-view inspection of parcels and hand luggage and can penetrate 35mm of steel.

#### Helping children breathe

**Bivona FlexTend tracheostomy tubes** are specifically designed to improve access when dealing with children. The permanent flexible tube extension on the neck flange helps keep connections away from the neck, chin, and aperture, enhancing patient mobility and comfort. The silicone remains particularly soft and flexible in the trachea and a non-ferrous wire that reinforces the tube has improved visibility in MRI scans. A special coating applied to the surfaces aids tube insertion, removal, cleaning and reinsertion.



#### Special element

Engineers working on a revolutionary home laundry appliance that can rid clothes of wrinkles and odours quickly realised they needed a specialised heating element that was compact, rapid-heating and corrosion-resistant. Building on a long relationship with Whirlpool, which helped develop the Swash device, Flex-Tek adapted its Tutco patented low wattage element to suit. After a spray solution is misted on the garment, the bespoke element supplies a 'rapid thermal drying function' to leave it dry and wrinkle-free in only 10 minutes. Swash, co-designed with Procter & Gamble, was launched into the US market this year.

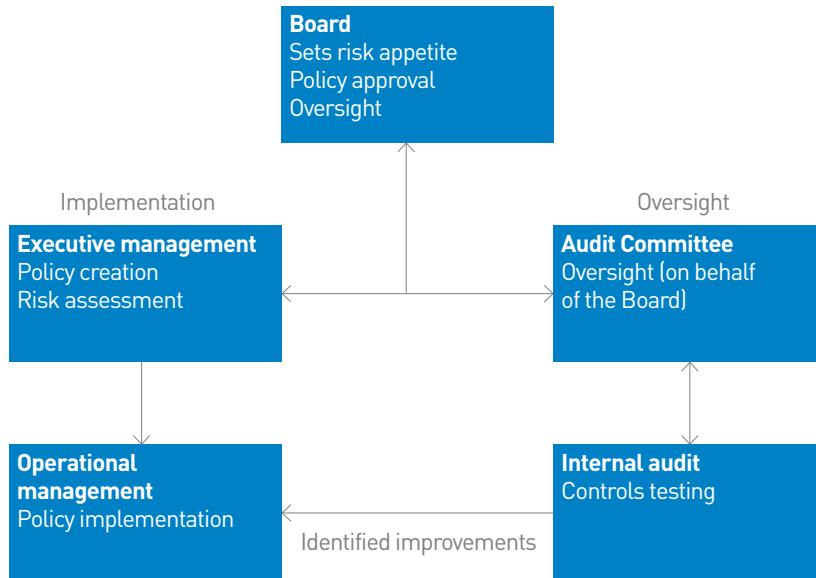
# Securing future returns

In delivering our strategy, it is important that we understand and manage the risks that face us. We achieve this through our embedded risk management approach, combining a top-down strategic view of risks with a bottom-up divisional process.

## Managing risk

### The diagram summarises how we manage risk

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



## The risks to our strategy

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

Risk	Strategy					
	Driving top-line growth	Enhancing margins	Developing smarter ways of working and attracting talent	Promoting a culture of responsibility	Generating cash and managing the balance sheet	Allocating capital to maximise returns
Economic outlook and geo-political environment	■	■			■	■
Financial risks	■	■			■	■
Global supply chain and business/process transformation	■	■				
Government customers	■	■			■	
Information technology	■	■			■	
Acquisitions and disposals	■	■			■	■
Legislation and regulations	■	■		■	■	
Pension funding					■	■
Product liability and litigation	■	■			■	
Programme delivery	■	■			■	
Technology and innovation	■					
Talent and succession planning	■	■	■	■	■	

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

→ Read more on pages 60-65

# The investment case

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

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
<p>Our businesses are either market leaders or are well placed in attractive niches. This allows us to benefit from the long-term growth drivers in their industries. Across our portfolio, these growth drivers include:</p> <ul style="list-style-type: none"><li>• global demand for energy</li><li>• healthcare needs of ageing populations</li><li>• threat of terrorism</li><li>• expansion of wireless communications</li><li>• aerospace demand</li><li>• US residential construction</li></ul>	<p>We stay at the forefront of technology by understanding the needs of our customers and investing in research and development to meet those needs. Our technological strengths give us a competitive advantage and create customer loyalty, enabling us to earn attractive margins.</p> <p>Our businesses often provide significant levels of aftermarket service and essential consumables. This helps us retain customers and provide recurring income as well as insight into customer needs.</p>	<p>Operational efficiencies will drive our margins higher. Our restructuring programme has already delivered significant value, with more to come in the next two years.</p> <p>We have invested to improve our systems, with enterprise resource planning systems installed in Smiths Detection, Smiths Medical and John Crane. Better information enables us to leverage the Group's scale and deliver further savings. Portfolio profitability reviews are also improving operational efficiency.</p>
<p>→ Read more on pages 10-11 and 26-55</p>	<p>→ Read more on pages 10-17</p>	<p>→ Read more on page 23</p>
Opportunity to realise value through portfolio management	High returns on capital employed	Strong cash generation to reinvest in top-line growth and increase dividends
<p>We also assess portfolio management opportunities where we see the potential to create a more focused portfolio through a targeted programme of acquisitions and disposals.</p> <p>We invest in business acquisitions to increase our exposure to attractive and adjacent growing sectors as well as to expand our current businesses.</p>	<p>Our divisions generate attractive margins and tend to specialise in small-batch, low-cost manufacturing. As a result, they have low capital intensity and deliver returns above our weighted average cost of capital.</p> <p>We have opportunities to invest for growth in our businesses to generate attractive incremental returns for our shareholders. We maintain a strong discipline to ensure we make informed investment choices.</p>	<p>Closely managing our working capital enables us to convert most of our operating profit into cash-flow. Improved business data will continue to drive cash generation.</p> <p>Our focus on cash ensures we have the resources needed to reinvest in our businesses through targeted acquisitions, and in organic growth drivers such as product development, and sales and marketing in growth markets. At the same time, it allows us to increase dividend payments to shareholders, while maintaining an efficient balance sheet and meeting the obligations of our legacy liabilities, such as pensions and product liability litigation.</p>
<p>→ Read more on pages 14-15 and 20-21</p>	<p>→ Read more on pages 22-25 and 57</p>	<p>→ Read more on pages 22-25 and 56, and in note 27 on page 169 and on page 170</p>

# Chairman's statement

**Smiths Group has proved its resilience in a challenging trading environment. Its broad diversity of markets and geographies provides both scope for business growth and security against adverse trading conditions.**



**Sir George Buckley**  
**Chairman**

I am honoured and delighted to join Smiths Group as your Chairman, all the more so as we celebrate a remarkable 100 unbroken years on the London Stock Exchange. As an engineer, I have long held the venerable Smiths name in great respect and affection. I well remember the heyday of the British motor industry when handsome Smiths speedometers and gauges were a byword for engineering excellence. Our products may be much changed now and our market reach is global, but the gold standard of excellence established all those years ago remains the same.

The Smiths Group of today is fortunate to have some truly world-class businesses. In a year of familiarisation, I have visited many manufacturing sites that are as good as the best I have seen anywhere. The quality of their advanced technologies and the commitment of our highly skilled engineers have enthralled me. Innovation is – and must always remain – at the heart of our mission as a technology company.

Although it is brought to life in the laboratory or test site, innovation stems from the imagination, talent and industry of our people. It also requires up-front investment and takes time to deliver results. My many site visits and detailed conversations with Smiths colleagues have

left me in no doubt that Smiths boasts people of the right calibre. Of course, as in all businesses, there is always room for improvement and Smiths is no different in that regard. We could most certainly be closer to our customers, helping us commercialise our products more quickly and effectively. We could also improve our manufacturing capability and significantly simplify its footprint. It is far too complex for our needs. These are part of our new mission going forward, along with the most important one: driving faster growth, organic as well as acquisitions. To my mind, the innate capability of a corporation to adapt and reinvent itself is measured in its ability to drive organic growth at higher than market rates. It is also a good forecaster of new, incrementally higher value creation for shareholders. That's good news for everyone. Growth is an 'everyone wins' philosophy.

However, in stressing growth, we should not overlook our impressive success in cutting costs to improve margins, driving better cash generation and enhancing returns. But now we have to take on the really hard part of business life – the need for a step change in innovation and imagination to grow the company faster. This is a theme I will return to several times in this statement.

## A tough trading environment

While a few sectors of the global economy have grown, trading is still tough in many of the end-markets we serve. John Crane and Flex-Tek, which operate across a diverse range of commercial markets, have continued to thrive. In contrast, Smiths Detection and parts of Smiths Interconnect have struggled more lately as government-funded programmes in defence and homeland security are fettered by tough budgetary constraints. Healthcare spending in developed markets has shrunk significantly, squeezed by Obamacare and the new medical device tax in the US and cuts in state-funded health budgets elsewhere around the world. So Smiths Medical is bruised by these changes. Foreign exchange translation has also proved a very significant drag on our figures, as with all UK-based global companies.

Despite these challenges, we are confident in the long-term attractiveness and robustness of our end markets and the ability of our businesses to compete effectively in those markets. Government purchasing is the largest single market in the world and governments are generally a good credit risk. But we must adapt and adjust to these changed competitive circumstances and press ever harder for cost-effective and timely innovative breakthroughs. This is the one way to avoid competing only as commodity players and suffering the price and margin pressure which comes along with that.

## Growth as a value lever

Much can be done to enhance our current and future competitiveness. Greater investment in product innovation is needed to differentiate us from commodity players, expansion in high-growth markets should be accelerated, and more focused sales and marketing efforts will all help us towards that goal. We also have to relentlessly drive efficiency. However, our best incremental value creator is simply organic growth itself – consistent, sustainable, above-peer growth. This is particularly true for our businesses where margins are already relatively high.

If more than 40 years in business has taught me one lesson, it is that a company can neither save nor spend its way into prosperity. If business success can ever be guaranteed, it is only through imagination, innovation and sustained investment in the future. Growth will inexorably gravitate towards the mean market rate unless we

keep relentlessly focused on expanding and reinventing our core markets. As we drive market share we must also seek ways of penetrating new market segments – either geographically or through line extensions. Another way to grow is by moving resources to markets where the average growth rate is higher or – even smarter – by creating entirely new markets. These last options require some courage on the part of leadership as they move us a little outside our comfort zone. Again, our people and to some extent how we organise ourselves, hold the key. Creativity and faith in the power of research, allied to technological excellence, offer by far the best route for converting ideas to profitable, commercial realities.

Under the leadership of our CEO, Philip Bowman, Smiths is already beginning to reposition itself for higher growth. However, change and innovation are so-called diffusion processes and the results are not instantaneous. We can all easily understand that there is a finite time for the invention and development of new products and technology. So this will take time and it will require patience and determination to complete. It also involves some uncertainty since there is no data on the future. It is up to your Board and Smiths senior management to nurture the right environment of encouragement and stimulation tempered by discipline and urgency. In this way, we can truly drive higher long-term value for our shareholders.

### **Operational excellence**

Our growth agenda must be also supported by an equally tireless pursuit of operational excellence. Higher productivity will boost our overall competitive position, a process accelerated by lowering our cost base through a smaller factory footprint, better sourcing and value engineering. In this context, simplicity is the key. Enhanced customer service and quality control should differentiate our competitive offering to help support cost benefits. Another area of operational excellence is working capital efficiency. Fortunately, Smiths businesses are generally good cash converters with relatively low capital intensity. Even so, we will continue to strive to improve the cash characteristics which underpin our ability to invest in organic growth and acquisitions.

### **People and responsibility**

Having the right people with the right skills is the single most important key to the successful implementation of our strategy. The next is relentless execution. Let no-one underestimate the power of able people, coached by inspired leadership, all driving hard towards a believable dream. What always separates the ‘best from the rest’ of corporations is the people they employ and how they inspire and reward them.

We feature in this Annual Report just a few of the employees who have been involved in the cutting edge of new products or important new projects. Our challenge now is to inspire our people with a dream that we can really become a truly world-class engineering business, the very best that Britain has to offer. This will build our employment brand and slowly, but gradually, make us a magnet for the most talented people around. I believe that I can help the Company along that path.

Providing a safe place for our employees to work is a key priority and I am pleased to report that we have made further progress in improving our safety statistics. An impressive outcome given the significant progress the Company has already made in recent years. This has been helped in large part by tracking the leading-edge indicators for the causes of accidents or injuries and dealing with them. On the same theme of responsibility, we also recorded further good progress across a range of environmental and energy consumption measures.

### **Board changes and corporate governance**

The Board has changed since the last report, not least with the retirement of Donald Brydon after nine years as Chairman. His will be a hard act to follow given his considerable contribution to Smiths and the transformation he oversaw including the 2007 sale of Aerospace. My resolve to help grow Smiths is spurred not only by an enduring affection for a great company but also the desire to give something back to Britain after a long career ‘across the pond’. I also welcome Bill Seeger to the Board. A US citizen, Mr Seeger spent nearly 30 years in top finance jobs in American engineering before latterly becoming Group Finance Director of GKN plc. Such a background ideally equips him to succeed David Challen as Chairman of the Audit Committee.

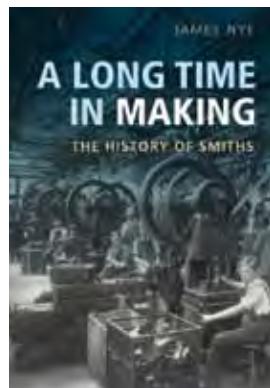
In other governance matters, the 2014 Annual Report is the first to follow standards outlined in the new UK Narrative and Remuneration Reporting regulations. More details can be found in the Corporate governance and Strategic reports.

### **A moment in time**

This, the Annual Report for your 100th AGM, marks another milestone. As a ‘self-exile’ individual but one with strong ties to the UK, I possibly appreciate its historic resonance more than most. Smiths shares were floated in London just two weeks before the start of the First World War, which promptly forced the Exchange to close for six months. Not the most auspicious start. But Smiths had already overcome its fair share of setbacks since its birth as a family clock-maker and jeweller in 1851. This report itself is testament to its success in reinventing itself many times over as technologies came and went. Our fascinating history has now been recorded in a new book, *A Long Time in Making – The History of Smiths*, which will be published by Oxford University Press in October. It will be available at a discount to shareholders via our website.

In closing, rest assured that I already feel at home in a company somehow so quintessentially British while simultaneously very modern and global. I would also like to thank Philip and all the employees for their kind welcome and, much more important, for their sterling efforts in steering Smiths into its second century as a public company.

**Sir George Buckley  
Chairman**



*A Long Time in Making:*  
*The History of Smiths* by  
James Nye will be available  
from October 2014

# Chief Executive's statement

**Our priority is to accelerate medium-term growth and reposition the business through consistent investment in product innovation, sales effectiveness, and expansion in high-growth markets. This investment is funded by our *Fuel for Growth* programme, scheduled to generate £60m of annual savings by 2017 with initiatives underway across all divisions.**



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

## Results summary

Smiths Group made progress, with John Crane, Smiths Interconnect and Flex-Tek all delivering organic revenue growth and headline operating margin improvement. Disappointingly, these advances were offset by Smiths Medical and Smiths Detection as the healthcare and defence/security sectors continued to see challenging market conditions. However, both Smiths Medical and Smiths Interconnect returned to growth in the second half, with growth in Interconnect's commercial markets outpacing pressures on its defence revenues. Profitability at Smiths Detection was affected by working capital adjustments, adverse price/mix, additional programme delivery costs and charges associated with price audits for certain historical supply arrangements. The other significant headwind to the business this year has been foreign exchange, due to the relative strength of sterling, particularly against the US dollar. Adverse foreign exchange translation and transaction impacts totalled £43m, or almost 8% of headline operating profit. As a result, Group revenue and headline operating profit both declined.

Our drive to reposition the Group to accelerate revenue growth continued. This includes investing in product innovation, increasing our presence in high-growth markets, sales and marketing effectiveness, driving a culture of growth across the organisation, and expanding our non-governmental business. Frustratingly, the benefits of this repositioning have been largely obscured by the headwinds we continue to face in healthcare and homeland security. We are part way through a medium-term programme to reposition the business for growth and, while this will take time, this is the right approach to drive future shareholder value. These initiatives will be funded by a relentless focus on operational excellence.

John Crane delivered revenue growth with healthy demand both from first-fit OEM customers and energy aftermarket services. Growth was constrained by declines in upstream energy services. Excluding upstream, overall revenues increased in line with our medium-term guidance. Margins have been boosted by higher volumes and the restructuring benefits which have more than offset cost inflation and investment in growth.

We expect to increase our investment in growth initiatives in the coming year. Smiths Medical saw a return to revenue growth during the second half, albeit against a weak comparator. This followed first half declines caused by weak procedure volumes, price pressure and the impact of a distributor destock in the USA, all of which had an impact on profitability. Medical also had to manage the inevitable disruption caused by the approach last year to acquire the business. As expected, Smiths Detection saw declines in revenues against a strong comparator period, primarily reflecting weaker demand in cargo screening and transportation. Profitability fell as we incurred additional costs on the delivery of existing programmes and with working capital adjustments as we adopted new divisional policies. A new divisional president has taken charge and is focusing on driving operational improvements, as well as addressing the shortcomings in programme delivery. These initiatives to tackle low-margin programmes and other ongoing productivity initiatives are likely to take another year to 18 months. Smiths Interconnect saw a return to revenue growth in the second half, with strong demand from wireless telecom and test and measurement customers. Productivity gains helped enhance margins, despite the lower volumes. Flex-Tek grew revenues with gains in the construction and heating element markets, increasing margins to recent highs as a result of its operational gearing.

## Strategy

Our strategy is to grow shareholder value and transform Smiths into a world-class organisation by:

- Delivering revenue growth through investment in organic drivers, including new product development and expansion in high-growth markets, and through targeted acquisitions;
- Enhancing margins through a relentless drive for operational improvement across all our businesses;
- Developing smarter ways of working and having the best people;
- Promoting a culture of responsibility in everything we do;
- Generating strong operating cash-flows with better balance sheet management; and
- Allocating capital rigorously across the business, through both organic investment and acquisitions & disposals.

We have continued to pursue these objectives and some recent examples are set out below. The area where we see greatest opportunity is revenue growth. This is the key focus for the Group as we continue to reposition the business.

**Engineered for growth – product innovation**

A key driver of future revenue and value growth is product innovation. Our technology leadership stems from our long-standing commitment to new product investment. Company-funded investment in R&D increased 5% at constant currencies to £109m, with increases across most divisions. Customer-funded investment fell to £8m (2013: £9m) as governments reduced funding; this took our total spend to £117m, or 4.0% of revenue (2013: 3.8%). We have completed several important new product launches through this long-term investment.

John Crane was granted a patent for technology that will monitor the condition of a gas seal to improve product performance, extend lifespan and aid emission reduction in operations across the energy sector. Smiths Medical's CADD-Solis PIB (Programmable Intermittent Bolus) pump, launched in the US this year, provides continued growth opportunities, particularly in labour and delivery wards. Another exciting new product is EchoGlo, a catheter specially designed to appear in ultrasound scans to help local anaesthetic procedures. Smiths Detection has unveiled two advanced handheld identifiers that provide quick and accurate field analyses – one for explosives and the other for a range of illicit drugs. Smiths Interconnect is introducing higher density semiconductor test sockets to enable testing of packaged chips to their full limits. Flex-Tek is now marketing a tailor-made hose to exploit the growing market in compressed natural gas as companies seek cheaper alternatives to oil.

#### **Engineered for growth – high-growth markets**

We have continued to invest to expand our presence in emerging markets to improve the Group's growth profile over the medium term. During the year, revenue from emerging markets was maintained, representing about 16% of Group sales. Increases in John Crane and Smiths Interconnect were offset by declines in Smiths Detection and Smiths Medical. We recognise that it takes time to establish a local sales presence through recruitment, training and brand building. In addition, there are also product registration processes in many markets. However, we believe that this is the right strategy for the Group to accelerate its growth profile and generate improved returns in the medium term. In Smiths Interconnect, we saw good growth in Asia in their connector business and secured contracts in data centres in India and Brazil. John Crane continued to build infrastructure in select markets and to invest in local technical service capabilities. For example Tianjin in China is now home to John Crane's third and newest global R&D centre, reflecting our commitment to innovation and new technologies for the global market.

#### **Fuel for Growth – funding the growth initiatives**

We are funding investment in these growth initiatives through our *Fuel for Growth* programme, which is expected to generate £60m of annual savings for reinvestment in sales, marketing and new product development. The programme is expected to cost £120m over a three-year period, which will be treated as an exceptional item. There will also be some accompanying capital expenditure. This restructuring is focusing on three areas: site rationalisation with a particular concentration on manufacturing footprint to support future growth while lowering costs; organisational effectiveness through delayering and broadening management spans of control; and the upgrading of information systems – particularly in John Crane – to improve decision-making and to support the next stage of globalisation. In the year, we incurred costs of £27m across the programme, which delivered savings of £10m in the period. In the coming year, we expect to achieve a cumulative savings run-rate of £20m a year and incur £38m of costs which will be treated as exceptional.

#### **Towards a world-class organisation**

The successful implementation of our strategic initiatives depends on us having the talent in place throughout the organisation. Our processes to foster and retain the necessary skills have been reinforced at all levels across the Group. Jeff McCaulley joined in March to lead Smiths Medical into its next phase of development. Richard Ingram started at Smiths Detection in May and brings valuable experience in delivering complex programmes. We have also increased our focus on driving growth and value through the appointment of Brian Jones as Group Commercial Director and Silvio Bracone as Group Strategy Director. Both roles will strengthen and enhance the co-ordination of the Group's growth initiatives. To drive the growth agenda throughout the organisation, we held a senior management conference in May 2014 – with the top 120 managers across the Group. The theme of the conference was *Engineered for Growth*. Featuring internal and external speakers, we explored how we could operate differently to accelerate revenue growth. As part of this programme, we have identified four specific growth priorities: innovation, driving growth in China, sales excellence and quality improvement. These initiatives are just beginning and we will provide updates in future reports.

#### **Headline earnings per share**

Down 10.9p

**81.8p**

→ Read more on page 56  
and in note 6 on page 141

#### **Dividend per share**

Up 2%

**40.25p**

→ Read more on pages 22-25  
and in note 25 on page 168

#### **Statutory earnings per share**

Down 21.1p

**59.0p**

→ Read more on page 56  
and in note 6 on page 141

#### **Free cash-flow**

**£143m**

→ Read more on page 56  
and in note 27 on page 169

#### **Employees around the world**

In over 50 countries

**23,200**

→ Read more on pages 70-71  
and in note 8 on page 144

## **Chief Executive's statement**

### **Continued**

#### **Promoting responsibility**

We continued to make good progress on our safety and environmental metrics. The recordable incident rate improved again in the year to a new record low.

We have also undertaken several initiatives during the year to promote our Code of Business Ethics. We built on the anti-bribery and corruption course that we launched last year by updating the training on international trade compliance and competition & anti-trust. We also recognise the growing importance of the emerging markets and the challenges of operating in these markets. Following on from the success of the global ethics forum held in Brazil last year, we hosted our third forum in Dubai in October 2013. These events highlight the importance of our Code and enable the Group to share best practice and experiences.

#### **Cash generation and balance sheet**

We experienced another year of good operating cash conversion. Headline operating cash of £490m represented a headline operating cash conversion of 97% (2013: 98%). Free cash-flow was lower as a result of higher exceptional cash costs.

Our balance sheet remains strong. We refinanced our existing revolving credit facility with a US\$800m five-year facility which matures in February 2019 with two one-year extension options.

#### **Dividend**

The Board has a progressive dividend policy for future payouts while maintaining a dividend cover of around 2.5 times over the medium term. This policy will enable us to retain sufficient cash-flow to meet our legacy liabilities and to finance our investment in the drivers of growth. While the medium-term objective is to maintain this dividend cover, we will operate some flexibility in applying the 2.5 times cover to take account of short-term impacts such as foreign exchange. This is in order to underpin progressive returns to shareholders.

The Board has recommended a final dividend of 27.5p per share giving a total for the year of 40.25p, an increase of 2%. The final dividend will be paid on 21 November to shareholders registered at the close of business on 24 October. The ex-dividend date is 23 October.

#### **Outlook**

We remain well placed to benefit from growth in energy demand, the need for new fuel-efficient aircraft, increased US residential construction and investment in wireless networks. We are cautious about sectors such as healthcare and homeland security, which are subject to government funding constraints, although there are signs that the defence market is beginning to stabilise.

Our priority is to drive operational improvements and efficiencies across our business that will fund additional investment in high-growth markets and new product development to accelerate medium-term revenue growth.

Outlook statements for the divisions are provided in the Operational review.

**Philip Bowman**

**Chief Executive**

# Operational review: Group

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

## Revenue

On an underlying basis, revenue was up £2m on last year. However, adverse foreign exchange translation of 5%, or £157m, and the impact of a small disposal in Smiths Interconnect (£2m) resulted in reported revenues of £2,952m, down 5%. The underlying performance, excluding currency translation, was driven primarily by growth in John Crane (up £17m), Flex-Tek (up £8m) and Smiths Interconnect (up £6m), which offset underlying revenue declines in Smiths Detection (£25m) and Smiths Medical (£4m).

## Profit

Headline operating profit at £504m was reduced by £27m from foreign exchange translation and an underlying decline of £29m or 6%. This underlying reduction was the net effect of higher volumes and productivity efforts at John Crane (up £17m), higher volumes at Flex-Tek (up £6m), better volumes and cost savings at Smiths Interconnect (up £5m) more than offset by the impact of foreign exchange transaction, adverse pricing and the impact of the medical device tax at Smiths Medical (down £23m) and working capital adjustments, adverse price/mix, additional programme delivery costs and other provisions at Smiths Detection (down £32m). Corporate centre costs increased by £2m reflecting increased investment in growth initiatives such as sales excellence; a trend which we expect to continue. Headline operating margin declined by 90 basis points to 17.1% (2013: 18.0%) reflecting reduced profitability at Smiths Medical and Smiths Detection.

Operating profit on a statutory basis, after taking account of the items excluded from the headline figures, was £378m (2013: restated £486m). The decline was in large part a result of increased exceptional costs (see note 4). Statutory profit for 2013 has been restated to take account of the reporting requirement of IAS 19 (revised 2011).

The net interest charge on debt decreased slightly to £60m (2013: £62m). The reduction reflects lower interest rates on debt during the year.

The Group's tax rate on headline profit for the period was 27% (2013: 26.5%). Headline earnings per share declined by 10.9p, or 12%, to 81.8p (2013: 92.7p).

On a statutory basis, profit before tax decreased £94m to £302m (2013: restated £396m); it is stated after taking account of increased exceptional costs, a pensions finance charge of £9m (2013: restated charge of £23m) and other items excluded from the headline measure.

## Cash generation

Operating cash generation remained strong with headline operating cash-flow of £490m (2013: £548m), representing 97% (2013: 98%) of headline operating profit (see note 27 to the accounts for a reconciliation of headline operating cash and free cash-flow to statutory cash-flow measures). Looking ahead, we expect cash conversion to be in the range of 85-95%, reflecting our plans for increased capital expenditure to support site restructuring and capacity expansion.

Free cash-flow decreased by £94m to £143m (2013: £237m), reflecting lower operating profit and higher exceptional costs. Free cash-flow is stated after all legacy costs, interest and taxes but before acquisitions and dividends.

On a statutory basis, net cash inflow from continuing operations was £256m (2013: £353m).

Dividends paid in the year on ordinary shares amounted to £275m (2013: £152m) which includes the annual dividend of £157m and the special dividend of £118m, declared with the final results last year.

Net debt at 31 July 2014 was £804m, an increase of £60m from the £744m at 31 July 2013. This increase in net debt reflects the impact of the special dividend paid (£118m) in November 2013 offset by translation gains on foreign currency denominated debt (£70m).

**Company-funded R&D**  
Increased by 5% underlying to

**£109m**

→ Read more on page 56

## Net debt

Up £60m to

**£804m**

→ Read more on pages 56-58 and 128 and in note 18 on pages 157-158

## Annual dividend

Up 2%

**40.25p**

→ Read more on pages 22-24 and in note 25 on page 168

## John Crane





### Expanding in China

A high-growth market with diverse energy needs, China is home to John Crane's third and newest global R&D centre. This year's upgrade of the Tianjin facility near Beijing reflects our commitment to innovation and new technologies for the global market, while strengthening local expertise specifically for the Chinese market.

Close collaboration with top universities and research institutes including nearby Tsinghua University is also key to leveraging Chinese talent and facilities. "Revenue from China has almost doubled in the past five years and this new R&D centre will enhance our offering to local customers – from cost-effective testing and research capabilities to enhanced product design and closer collaboration with state enterprises. It also brings additional confidence and marketing advantage in the region," explained Amrat Parmar, the engineer in charge of the project.

Jiao Yang – Materials Technologist,  
Global R&D, China

## John Crane

**A leading provider of engineered products and services to global energy services customers.**

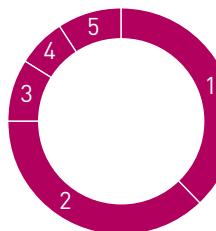
**Our products and services help ensure the reliability of mission-critical equipment in challenging operating environments. In addition to lowering total cost of ownership of equipment, our products reduce emissions and help our customers meet environmental responsibilities. For nearly 100 years, our customers have depended on our global service network and technical excellence.**



**Duncan Gillis**  
President & CEO

### Revenue by sector

**OEM: 38%**  
1 Original equipment manufacture 38%  
**Aftermarket: 62%**  
2 Oil, gas and petrochemical 37%  
3 Chemical and pharmaceutical 9%  
4 Distributors 7%  
5 General industry 9%



### Revenue performance

£m

**£941m (5%)**

2014	941
2013	986
2012	973
2011	894
2010	786

### Contribution to 2014 Group revenue

**32%**

### Contribution to 2014 Group headline operating profit

**43%**

Percentage relates to headline operating profit before corporate costs

### Principal operations regions

John Crane is a global business with a presence in more than 50 countries. We have the largest global service network in the industry with 17 super service centres around the globe supported by more than 230 sales and service centre locations. We have 19 manufacturing sites in 14 countries and global R&D centres in the US and UK.

### Customers

John Crane serves major companies in the energy services sector including production, transmission & storage, refining, power generation, petrochemical, as well as pump and compressor manufacturers. Its main customers include Chevron, BP, China Petroleum, Suncor/Petro Canada, Valero, Petrobras, ExxonMobil, Gazprom, TOTAL, Sabic, PDVSA, Pemex, Saudi Aramco, Shell, Petrom, Sulzer, ITT Goulds, Flowserve, GE Energy, Andritz Hydro, Rolls Royce, Siemens, Mitsubishi, Solar Turbines, Elliot, York, BASF, Weir Group, Bayer, and Dow. No customer is larger than 3% of revenue.

### Competitors

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

### Suppliers

John Crane operates a global supply chain, using regional and local partnerships to meet the required service levels. Major suppliers include Morgan Advanced Materials, CoorsTek, Penn United Carbide, Schunk, Metalized Carbon, 3M, Earle M. Jorgensen, BE Group, DuPont and Greene Tweed.

### Revenue by product

A broad portfolio from seals and bearings to couplings and artificial lift equipment

Mechanical seals and systems



**76%**

Couplings



**5%**

Bearings



**5%**

Filtration systems



**5%**

Artificial lift



**9%**

## Markets and trends

Recognised globally across the energy services sector, John Crane provides engineered solutions that drive reliability improvements and sustain the effective operation of customers' rotating equipment and other machinery. The comprehensive product portfolio includes mechanical seals, seal support systems, engineered bearings, power transmission couplings and specialised filtration systems. John Crane also helps maintain and enhance oilfield productivity through the servicing and provision of onshore down-hole 'artificial lift' pumping hardware and systems. This technology is supported by the industry's largest global sales and service network that provides performance-enhancing services utilising expertise developed from decades of technology leadership coupled with proven field experience. Service teams in more than 50 countries maintain and support customers' mission-critical operations throughout the economic lifetime of our products.

Approximately two-thirds of John Crane's sales stem from the aftermarket servicing and support of existing installed equipment, while the remaining one-third are from the design and supply of products to original equipment manufacturers. The business serves a range of process industries including oil and gas, chemical, and power generation.

Demand for John Crane products and services continues to grow, being influenced by a number of factors including the global demand for energy and an increasing desire for national energy independence, and more stringent environmental and safety requirements. John Crane is a market leader in its traditional product areas – mechanical seals and seal support systems. There is opportunity to continue growing market share across all product areas.

John Crane's global network is a key asset which allows for quick-response and effective aftermarket service close to customers' operations. These facilities provide a range of value-added services including repair and refurbishment, root-cause analysis, alignment and condition monitoring; all designed to improve the performance of customers' rotating equipment and to reduce operational downtime. The geographic footprint continues to expand through opening additional service centres in key markets, in support of our growth strategy in selected high-growth markets.

## Strategy

The division's business strategy is focused on sustaining a cycle of growth and productivity. It is built around four core priorities: to expand the installed base, build-out selected growth markets, maximise aftermarket performance and drive continuous productivity. Our company values remain a key element in delivering our strategy: a relentless focus on customer service, improving quality, developing our people, business ethics and safety.

## Competitive strengths

- Strong proprietary technology with expertise in applied engineering
- Market leader in mechanical seals
- Two-thirds of sales in aftermarket
- Global network of c. 230 sales and service centres

## Growth drivers

- Growing demand for energy
- Investment in oil and gas infrastructure
- Expansion in emerging markets
- Developing new products and applications

## Smiths in the making... 1970

John Crane was awarded a patent for spiral groove technology for its pioneering dry gas seals. They eliminate oil contamination of process gas, cut emissions and increase compressor output. The non-contact seals, which maintain a sealing gap of 200<sup>th</sup> of a millimeter between rotating and stationary rings, were the industry standard by the mid-1990s because of low operating cost and high reliability. Now featuring innovations like high-pressure capability and corrosive gas resistance, over 20,000 John Crane dry gas seals operate worldwide.



**1970**

## Operational review

### John Crane

	2014 £m	2013 £m	Reported growth	Underlying growth
Revenue	<b>941</b>	986	(5)%	2%
Headline operating profit	<b>234</b>	231	2%	8%
Headline operating margin	<b>24.9%</b>	23.4%	150 bps	
Statutory operating profit	<b>166</b>	206		
Return on capital employed	<b>26.7%</b>	25.7%	100 bps	

#### Key operational highlights

- Implemented global operating structure
- Expanded installed base in focus markets
- Increased global service network productivity
- Leveraged procurement scale
- Accelerated growth in selected businesses

#### Performance

John Crane delivered strong profit improvement on the back of higher underlying revenues and ongoing productivity initiatives. Reported headline operating profit grew 2% (£3m), driven by an 8% (£17m) underlying increase offset by adverse currency translation of £14m. The order book at the end of the year was at a record high. Headline operating margin increased by 150 basis points to 24.9%, also a record.

The difference between statutory and headline operating profit reflects the cost of John Crane, Inc. asbestos litigation of £49m, amortisation of acquired intangible assets of £12m and restructuring costs of £7m. Return on capital employed improved 100 basis points to 26.7% because of increased profitability.

Underlying revenue grew 2% (£17m), offset by £62m of adverse foreign exchange translation, leaving reported revenue down 5%. The underlying improvement reflects increased revenue in the aftermarket and first-fit rotating equipment business, offset by declining sales in our upstream oil services segment. Excluding this upstream segment, revenues showed a 4% underlying increase.

Overall aftermarket revenues grew 1% on an underlying basis. However, excluding sales from our upstream oil services business, sales grew 4% on the back of strong demand from energy services customers across the Middle East, Latin America and North America. Key renewals and new aftermarket service contracts signed with global customers such as Shell, Chevron, Valero, Colombia-based Ecopetrol Reficar, and Brazil-based Suzano Pulp and Paper, should contribute to steady mid-term growth. Additional wins with BP Rumalia, Petrochina, and Pemex Refinery Pipelines in Mexico contributed to the record order book.

John Crane is benefiting from the reopening of dormant refineries on North America's East Coast to meet growing infrastructure needs, driven by increased production from unconventional sources. Customer investments in shale development have remained steady and are expected to continue so in North America in the near term. In addition, the push to invest in clean fuels is increasing the need to retrofit pipelines. To continue strengthening aftermarket customer support capabilities in the US, a new 'super' service centre opened in Texas to support the oil and gas turbine and compressor markets. In Canada, the expansion of the Edmonton service centre supports the growing demand from the Canadian oil industry.

Our upstream oil services business, reported as part of our aftermarket revenue, experienced a sharp decline this year before showing recent signs of stabilising on a monthly sequential basis. The decline was mainly due to an increasingly competitive US operating environment and severe winter weather in North America.

Underlying sales of first-fit original equipment rose 4%, with demand fuelled by original equipment manufacturers exporting to high-growth regions such as the Middle East. This was illustrated by contract wins for the Zadco oil and gas project and Adco Bab field in the United Arab Emirates, Jizan refinery in Saudi Arabia, and Zubair Oil Field in Iraq. Additionally, China experienced double-digit first-fit revenue growth. Overall, we continue to see customer confidence in the oil and gas pump segment, whereas the power generation turbomachinery segment remains challenging.

Revenue from emerging markets rose 6% and now represents 22% of John Crane sales. Revenue increased 9% year over year in ASEAN countries, 16% in Saudi Arabia, 10% in India, and 6% in China. Market demands in China were behind the opening of a new service centre in Dalian and a second in Chengdu, increasing the number of service centres in the region to eight. Combined with several other investments in our Tianjin, China facility – a new global R&D centre, improvements in the training centre, and increased manufacturing capacity – we have

significantly strengthened customer service capabilities in the region. John Crane also strengthened capabilities in Australia and ASEAN countries, highlighted by a new service centre in Gladstone, Australia, and a new sales and service office in Kuala Lumpur, Malaysia.

Profit growth during the period resulted from both increased underlying revenues and ongoing productivity efforts, some of which are part of our *Fuel for Growth* programme. This programme is expected to deliver £13m of annualised savings by 2017 on an investment of £25m, which will be reported as exceptional. £7m of exceptional items under this programme were incurred during this period.

Reinvestments from the programme are successfully repositioning the business towards growth and value creation. They span several areas: factory and service centre network optimisation, information system infrastructure improvements, and new product innovation. John Crane is also investing in manufacturing capacity to support the strong order book.

#### Research and development

John Crane increased investment in R&D by 13% compared to the prior year, again illustrating its commitment to address future market needs. Our focus remains on developing engineered solutions that address customers' growing processing demands while supporting reduced environmental impact and improved energy efficiency. Operating conditions are ever more challenging as customers face increasingly higher pressure and speed requirements while exploring more difficult environments.

During the period, John Crane launched the Type 3740XL seal, a next-generation, larger mechanical split seal. This new model is used for large, difficult-to-maintain pumps, mixers and rotating equipment. Its split seal technology can reduce costs for customers by potentially cutting installation time by more than 50% in challenging operating environments. John Crane was also awarded a patent for a breakthrough technology that will monitor the condition of a gas seal to improve product performance, extend average product lifespan and aid emission reduction in operations across the energy sector. John Crane was issued 26 new patents in fiscal year 2014 and, in total, has more than 230 patents and patent applications.

To support growth from new product development and generate new product ideas, we have established a Scientific Advisory Board comprising external academics and thought leaders.

## Outlook

John Crane's record high order book is expected to support sales growth from the mid- and downstream segment in the first half of fiscal year 2015. However, we foresee revenue growth below our medium-term operating range in the first half because of the challenging upstream market conditions and some manufacturing constraints. We anticipate these conditions will improve slightly as the year progresses. We expect operating margins for the year to continue to be at the top end of the guidance provided, with further expansion in the near term being limited due to increased investment in growth initiatives.

## Priorities for 2015

- **Expand installed base**
- **Build-out selected growth markets**
- **Maximise aftermarket performance**
- **Drive continuous productivity**

## Medium-term operating ranges

- **Underlying revenue growth: mid-single digits (4-6%)**
- **Headline operating margin: margin expansion to support top quartile margins (22-25%)**

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

**Driving high performance**  
**An unrivalled service programme combined with the largest global support network in the industry has delivered more than a decade of steady growth in John Crane's aftermarket business. Using on-site engineers and technicians, some 170 Performance Plus (PP) contracts have been completed, helping oil, gas and diverse processing companies around the world improve operations and cut costs through bespoke, high-level reliability support. Shell Jurong Island, Valero Energy and Chevron are a few of the leading companies to have benefited recently from PP programmes which are typically rolling five-year contracts.**

"Around two thirds of John Crane's revenues now come from the aftermarket," said Jason Wall, Director of Global Business Solutions. "This is largely down to PP which analyses root cause failures, identifies improvement focal points and implements performance-based solutions. In this way, reliability can be improved by more than 50% because of the dramatic reduction in equipment outages and plant downtime."

Bhalchandra Shinde, Gas Seal Service Engineer, Singapore



## Smiths Medical





**Aiding localised delivery**  
As clinicians move to minimally invasive surgery, Smiths Medical has designed a catheter that allows far greater scope to carry out procedures safely and effectively while delivering local anaesthetic. The EchoGlo, which carries anaesthetic directly to a localised area to numb pain, is made of an air-embedded nylon material that appears as a distinct image during ultrasound scanning. This gives surgeons a vital tool for precise nerve cluster location, clinical effectiveness and constant monitoring while eliminating the need for a general anaesthetic, which invariably carries greater risks.

"The patented technology of EchoGlo means less anaesthesia is required, recovery times are faster, and patients suffer less nausea and post-operative pain," said Jaime LaMontagne, VP of Smiths Medical's Global Product Management, Therapeutics.

Marisa Steele, Global Product Manager, US; Dwight Skinner, Senior Project Manager, US; Tina Greathouse, Product Engineering Manager, US

## Smiths Medical

**A leading supplier of specialty medical devices and consumables for global markets.**

**In medication delivery, our devices help treat patients with acute and chronic disease and relieve pain.**

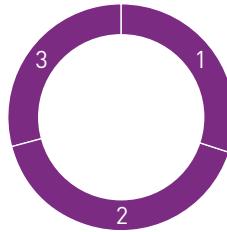
**Our vital care products help reduce hospital-acquired infections, manage patients' airways before, during and after surgery, maintain body temperature and assist reproduction through IVF therapy. Our safety products protect health workers by helping prevent needlestick injuries and reducing cross-infections.**



**Jeff McCaulley**  
President & CEO, Smiths Medical

### Revenue by sector

- 1 Medication delivery 30%
- 2 Vital care 41%
- 3 Safety devices 29%



### Headline revenue performance

£m

**£804m (5%)**

2014	804
2013	850
2012	864
2011	838
2010	858

### Contribution to 2014 Group revenue

**27%**

### Contribution to 2014 Group headline operating profit

**30%**

Percentage relates to headline operating profit before corporate costs

### Principal operations regions

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

### Customers

Three-quarters of our end customers are hospitals, with the remainder comprising the alternate care market such as homecare, clinics and other surgery centres, as well as OEM relationships. We have a direct sales presence in over 20 countries, and distribution arrangements in approximately 100 others.

### Competitors

The competitive landscape for Smiths Medical is complex as we compete with different companies across our product portfolio. Our major competitors include Covidien, Teleflex, B Braun, Becton Dickinson, C R Bard, 3M (Arizant), Hospira and CareFusion. We often compete with a portion of a major competitor's medical business as well as single product line companies trying to enter a particular market. In emerging markets, we compete with both large multinational companies and smaller domestic players.

### Suppliers

Our strategy is to engage suppliers in product innovation, value engineering and a commitment to quality. Our goal is to reduce product and supply chain costs, improve delivery performance and ensure supply continuity plans. The majority of our direct spending is on resins, plastic injection mouldings, and electronics.

### Medication delivery

**30%**



### Vital care

**41%**



### Safety devices

**29%**



## Markets and trends

Despite market challenges, the medical device sector remains attractive, driven by population trends, safety legislation, device interoperability and increasing prosperity – particularly in emerging markets. Procedure growth rates are improving slightly, although they continue to be constrained by reduced healthcare budgets, relatively high unemployment and employer cost shifting. At the same time, pressure continues from the rising costs of healthcare, leading to price deflation, increased regulatory hurdles and health system reforms.

The global market served by Smiths Medical is estimated to be almost £7bn, with further opportunities in target adjacent markets. Smiths Medical has strong design, production and distribution capabilities to seize global opportunities.

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

### Medication delivery

Smiths Medical designs and manufactures drug delivery systems that relieve acute and chronic pain, treat the most at-risk patients in high care units (Medfusion, Graseby), and treat patients with conditions such as cancer, pulmonary hypertension and Parkinson's disease at home (CADD). The global market for medication delivery products in which Smiths Medical competes is estimated to be £1.3bn. We expect continued market growth

through the increasing treatment of chronic conditions, the integration of medication delivery devices with hospital IT systems, and the move to alternate care settings. Our CADD brand is a leader in ambulatory infusion and we have a strong position in the syringe pump market with our Graseby and Medfusion products.

### Vital care

Smiths Medical's products manage patient airways before, during and after surgery (Portex), alleviate breathing difficulties (Portex, Pneupac), help maintain body temperature (Level 1), monitor vital signs such as blood pressure, blood oxygen saturation and heart rate (BCI, Medex), manage pain in acute and chronic care settings (Portex) and assist reproduction through in-vitro fertilisation therapy (Wallace). The vital care market, estimated to be over £2.5bn, has been affected by procedure rate slowdowns, but we expect future growth driven by increasing chronic disease incidence rates, ageing populations and rising healthcare spend in emerging markets.

### Safety

Smiths Medical's safety portfolio protects healthcare workers and patients from the risk of infection and injury through the use of safety enabled devices. Smiths pioneered safety devices including the first safety peripheral intravenous catheter (ProtectIV), and the first port for delivery of chemotherapeutic agents (PORT-A-CATH). Smiths portfolio covers a range of functions including drawing blood samples, administering injections and vaccinations (Jelco), and delivering chemotherapeutic agents for cancer patients (Deltec). The served global market for Smiths related products is estimated to be almost £3bn, and is expected to grow as the focus on safety and reducing the risk of infection

intensifies. Smiths is well positioned to capitalise on the advancement of sharps safety initiatives, including directives in the EU and Brazil designed to protect healthcare workers from needlestick injuries. Our latest innovations in IV catheters – ViaValve, which offers blood control and needlestick injury protection, and IntuitIV, a passive safety catheter – remain well positioned for growth.

### Strategy

Our primary focus is on improving patient outcomes and reducing the total cost of care by helping customers solve their clinical and cost challenges. This drives investment in new product development, manufacturing optimisation, improvements in our supply chain and marketing and distribution models. We are driving growth in selected markets, especially emerging markets. We are well-positioned to take advantage of the ongoing shift in healthcare delivery from hospitals to alternate sites (eg clinics) and home care.

### Competitive strengths

- Strong market positions in select clinical areas
- Highly recognised and respected brands
- Reputation for quality and safety
- Differentiated lower risk, short residency, interventional devices
- Innovative pipeline and new product launches
- Extensive global sales network

### Growth drivers

- Ageing populations
- Safety focus and legislation requirements
- Growing incidence of chronic diseases
- Growth of alternate site care
- Rising healthcare spend in developing markets, offsetting budget constraints in developed markets

## Smiths in the making... 1986

Emergency treatment of massive blood loss was transformed by the launch of Smiths Medical's Level 1 H-500 fluid warmer. Until then doctors treating trauma or medical emergencies were hampered by the limited capacity of fluid warming devices which were vital for raising the temperature of refrigerated blood for immediate transfusion.

Any heating failure and patients could die of hypothermia. By providing a fluid flow rate 10 times the previous speed, Level 1 has saved countless lives and established the brand as the world leader in fluid temperature management.

1986



	2014 £m	2013 £m	Reported growth	Underlying growth
Revenue	<b>804</b>	850	(5)%	(1)%
Headline operating profit	<b>159</b>	189	(16)%	(12)%
Headline operating margin	<b>19.8%</b>	22.2%	(240) bps	
Statutory operating profit	<b>142</b>	179		
Return on capital employed	<b>14.5%</b>	16.6%	(210) bps	

### Key operational highlights

- **Strong medication delivery growth offset safety and vital care declines**
- **Emerging markets down 5% on China infusion and distributor issues**
- **Margins impacted by US medical device tax and price erosion**
- **New product development investment up 5%**

### Performance

Revenue declined 5%, or £46m, representing an underlying fall in revenue of £4m (1%) and adverse currency translation of £42m. First half revenues fell due to tough trading conditions in developed markets, compounded by US distributor destocking, and continued underperformance in emerging markets. Second half revenues increased 3%, albeit against a weak comparator, on sequential improvement in every product franchise and every geographical region. Medication delivery saw especially strong sales. For the year, hardware revenue grew 4%, driven by ambulatory infusion pump sales, which were up 16%. Consumables, which comprise almost 85% of total revenue, were down 2% due to price pressure on peripheral intravenous catheter (PIVC) in developed markets, distributor market pressures and channel destocking in US.

Headline operating profit declined 16% (£30m) and headline operating margin fell 240 basis points to 19.8%. Foreign exchange translation accounted for £7m of the decline while underlying profit fell 12%, or £23m. Underlying profit was hit by price erosion (£9m), foreign exchange transaction impacts (£10m), the incremental effect of US medical device tax (£3m), and non-recurrence of 2013 insurance credits (£6m), partially offset by productivity savings.

The difference between statutory and headline operating profit reflects amortisation of acquired intangible assets of £9m and restructuring costs of £10m.

Return on capital employed fell 210 basis points to 14.5% as a result of the reduced profitability and increased capital expenditure, which included investment in new product development, manufacturing tooling and upgrade of our Oracle ERP system.

We are simplifying our manufacturing footprint and fixed cost base as part of the *Fuel for Growth* restructuring programme, and expect to deliver £23m of savings by the end of FY17. We have incurred costs to date of £10m. In the year, we announced the closure of our Rossendale and Rockland facilities as activities are consolidated in our network. Production started at our newly established Czech facility.

Developed market trading conditions remained soft with sales impacted by price erosion, capital spending constraints, and relatively flat procedure growth rates. Against this backdrop, underlying sales in developed markets grew 3% in the second half to end the year flat following declines in the first half. Infusion sales in these markets showed good growth through strong competitive positioning of ambulatory pumps in the second half. Safety sales were hit in the first half by PIVC share losses, but stabilised in the second half. Marketing initiatives to retain and grow the business gained traction and OEM sales improved in the second half. Vital care sales also stabilised following the 3% decline in the first half, which reflected channel inventory movements particularly in our respiratory products. Second half performance reflects a focus on airway and temperature management service-level improvements. End-user sales performance of our bronchial hygiene distribution arrangement in the US has also been strong.

Emerging market performance declined 5%. China revenues declined 7% as infusion performance held back sales pending the introduction of new products. However, second half sales stabilised as the business refocused on driving growth from other franchises. We saw challenging conditions in many smaller markets with currency controls in Venezuela, slow government payments in South Africa, and the adverse impact on distributor exports from weakening currencies. In India, the transition of business from our former distributor to our onshore India operation was completed in October and direct management of the channel has driven sales growth of 137% in the second half (up 74% for the year). Brazil continued to deliver double digit growth (up 12%) following the salesforce expansion last year.

Medication delivery underlying revenue grew by 7% with continued success of our CADD-Solis pumps and disposables globally, including CADD-Solis PIB and CADD-Solis VIP launched recently in the US. Medfusion pump systems business was robust in the US, with strong second half growth following a soft start.

Vital care underlying revenue ended down 2%, reflecting sluggish procedure volumes and pricing pressures, compounded by distributor destocking in the US. Tracheostomy and assisted reproduction both grew, offset by declines in respiratory, general anaesthesia, temperature management and patient monitoring. Our US respiratory business was particularly hit by channel inventory movements; however, underlying demand for our products remains robust.

Safety devices underlying revenue declined 4% for the year, reflecting an improved second half (down 1%) as marketing activities and pricing actions mitigated first half declines of 7%. In developed markets, competition is increasing in safety devices as customers convert from conventional products, resulting in pricing pressures and share loss.

### Research and development

Investment in new product development remains a priority, growing to 4.8% of revenue (2013: 4.4%) with total R&D spend of £38m (2013: £38m). Continuing our initiative to streamline the organisation, upgrade talent and improve processes in R&D, we have appointed a new Chief Technology Officer. We continue to invest in emerging market R&D and now have an established product development team in Shanghai with particular focus on infusion for the China market. We have also increased our investment in clinical research to deliver evidence of the effectiveness and economic benefit of our products.

Our vitality index, measured as sales from products launched in the last three years, improved to 7% (2013: 5%). This primarily reflects strong sales of ambulatory infusion products during the second half of the year. Launches during the year included Medfusion 3500 v6 (US) and CADD-Solis PIB (US and other markets). Our recently launched ViaValve safety IV catheter (North America) and Jelco IntuitIV safety IV catheter (Europe) are both gaining traction in their respective markets, despite strong price competition. In emerging markets, the broadening of portfolios through registration of existing products is starting to bear fruit, particularly in Brazil and India.

## Outlook

Trading conditions in developed markets are likely to remain challenging in the medium term due to healthcare cost controls and pricing pressures. We expect to see continued robust performance in infusion on the strength of product launches over the past couple of years and strong marketing programmes. Additionally, the introduction of new products to refresh our infusion range in China in 2015 will improve our competitiveness in this important market.

We will drive cost savings through variable and fixed cost productivity initiatives as well as site rationalisation. These cost savings will be largely reinvested in revenue growth drivers.

## Priorities for 2015

- **Build a highly competitive portfolio of products and services through investment in high-impact projects supported by rigorous execution**
- **Improve marketing and sales force impact in both developed markets and emerging markets**

## Medium-term operating ranges

- **Underlying revenue growth: low single digits (0-3%)**
- **Headline operating margin: margin range (20-24%)**

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

**US home infusion benefits**  
Having anticipated rapid growth in the US home infusion market, Smiths Medical is now reaping the benefits from assigning dedicated account managers to work with national agencies on how best to deliver homecare medication. The opportunity arose from a diverse combination of issues: from cost pressures on hospital care and competitor limitations to the positive impact of so-called 'Obamacare'. It presented an ideal opening for Smiths Medical's CADD range of advanced home infusion products.

The result was the conversion of thousands of competitors' pumps to CADD's 'smart' ambulatory devices which meet the demands of today's home healthcare environment," said Cindy Lougheed, Area VP of Alternate Care in the US. The focused approach helped produce record growth in the sector of 35% in FY2014.

Sandi Smith, Senior Global Product Manager, US; Cindy Lougheed, Area Vice President, Alternate Care, US



## Smiths Detection





#### Investing in growth

Greater focus on the aftermarket is paying off for Smiths Detection by not only delivering revenue growth but also improving customer satisfaction and loyalty. The recently opened Training & Service Center for the Americas has provided crucial support for aftermarket maintenance and support services, an increasingly important growth lever which now makes up about 30% of total revenues. "Our investment in this state-of-the-art facility is a good example of our long-term commitment to providing customers the best possible follow-up solutions, training and support," said Brian Bark, Vice President of Global Service. In July 2014 a major four-year logistical support contract was signed to provide training, supplies, parts and services for X-ray and explosives trace systems in around 400 US airports.

John David Johnson, Training Instructor,  
US

## Smiths Detection

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

**Our comprehensive range of detection technologies, including X-ray, trace detection and infra-red spectroscopy help customers in the global transportation, ports and borders, critical infrastructure, military and emergency responder markets.**

### Revenue performance

£m

**£512m (8%)**

2014	512
2013	559
2012	519
2011	510
2010	574

**Contribution to 2014 Group revenue**

**17%**

**Contribution to 2014 Group headline operating profit**

**5%**

Percentage relates to headline operating profit before corporate costs

### Principal operations regions

Our manufacturing centres are concentrated in North America, Germany, France, Malaysia and the UK. We sell to over 180 countries around the world either direct or through third-party distributors.

### Customers

A significant majority of sales are influenced by more than 100 governments and their agencies, including homeland security authorities, customs authorities, emergency responders and the military. These include the US Department of Defense, US Transportation Security Administration (TSA), and the UK Ministry of Defence. All US sales and support activities are controlled under a Special Security Agreement with the US Department of Defense and managed by the operating subsidiary Smiths Detection Inc., to provide independent oversight of the business, its classified contracts and work.

### Competitors

Smiths Detection's exposure to the homeland security and defence sectors brings it into competition with a wide range of companies in each end-use market. Principal competitors include: Morpho (air transportation), Rapiscan (air transportation, ports and borders, critical infrastructure), L-3 Security & Detection Systems (air transportation), Nuctech (ports and borders, critical infrastructure), Astrophysics (critical infrastructure), AS&E (ports and borders), Leidos (air transportation, ports and borders), Chemring (military), Bruker (military, emergency responders), and Thermo Fisher (military, emergency responders).

### Suppliers

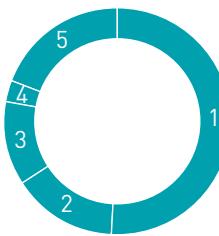
We are achieving increased synergies across manufacturing sites and aligning purchasing activity to ensure that we fully leverage the size of our business. These developments are ongoing and take into account the requirement for local content from some of our major customers, as well as our stringent quality and delivery standards.



**Richard Ingram**  
President, Smiths Detection

### Revenue by sector

- 1 Transportation 51%
- 2 Ports and borders 15%
- 3 Military 12%
- 4 Emergency responders 3%
- 5 Critical infrastructure 19%



#### Transportation

**51%**



#### Ports and borders

**15%**



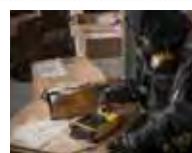
#### Military

**12%**



#### Emergency responders

**3%**



#### Critical infrastructure

**19%**



## Markets and trends

Smiths Detection produces equipment for customers in the air transportation, ports and borders, critical infrastructure, military and emergency responders end-use markets, to help them assure the safety and security of people and critical assets.

Demand for detection equipment is forecast to continue to grow at mid-single digits per annum over the near term, driven by on-going geo-political unrest and the resulting terrorist and criminal threats, but there is considerable variation by geography and end-use market. The growing installed equipment base creates significant opportunities for aftermarket service and support revenues.

Regionally, the Americas remain the principal source of demand but will experience a lower annual growth rate than the Asia Pacific region, where demand levels are expected to match those in the EMEA region within five years, fuelled largely by the requirements of the critical infrastructure and ports & borders sectors. Protection of military forces in Asia Pacific is also expected to become a bigger factor, in response to rising local tensions.

The heavily regulated air transportation sector is the largest market for the division. Rising passenger volumes are resulting in new airport investment, especially in the Middle East and Southeast Asia. This, together with continuing security threats, a strong replacement cycle and globalisation of trade, boosting air freight volumes, is expected to continue to support market growth. There is additional focus on the efficiency and effectiveness of the screening processes based on the analysis of operational data, creating the requirement for integration of aviation information systems with screening equipment.

In the ports and borders market, continuing globalisation of trade combined with increasing regulatory standards will drive the growth in demand for security screening equipment. Powerful technologies are required to address a variety of threats as governments become increasingly concerned about the smuggling of explosives, weapons and radiological materials, while continuing to recognise the strong revenue-generating potential from contraband detection.

The critical infrastructure market is large but fragmented and unregulated. Growth in demand continues at more than 5% as public and private sector organisations seek to provide better protection for their assets and staff. As the market develops, customers are increasingly demanding products tailored to their specific needs: smaller, lighter and considerably cheaper equipment, which can fit into existing buildings and be operated by less well-qualified staff.

Global demand for chemical warfare agent detection equipment and other threat-specific sensors required by the military is forecast to grow steadily. It is driven by governments' need to protect troops, equipment and infrastructure from threats, irrespective of where they are deployed: in theatre; domestically; or held in readiness for rapid deployment. In addition, new equipment must be capable of detecting a wider range of threats whilst becoming smaller, lighter and more sensitive.

Demand in the emergency responder end-use market, the smallest of the five key sectors for Smiths Detection, is driven by customers needing to deploy equipment to detect and identify chemical releases as a consequence of both terrorist and non-terrorist events. The US dominates

demand and has driven much of the innovation in this market but future growth will arise from increased procurement in Asia Pacific, Middle East and other developing economies.

## Strategy

Smiths Detection is focused on leveraging its technology leadership, the engineering integrity of its equipment and its global reach, to exceed the changing expectations of customers. The division's product and technology strategy directly supports its end-use market strategies and will be driven increasingly by greater customer insight, in order to satisfy customers' current and future requirements. Product development priorities remain competitive differentiation and ease of installation, service and up-grade. Better aftermarket penetration to generate revenues, which help to smooth out the traditional volatility of prime contracting, is being successfully achieved.

## Competitive strengths

- **Market leader with strong global brand**
- **Operates in several regulated markets that require product certification**
- **Technologies leveraged across a broad range of markets and applications**
- **c. 30% of sales from aftermarket service and growing**

## Growth drivers

- **Persistent and evolving terror threats**
- **Changing security regulations for cargo and passengers**
- **Equipment replacement cycle – typically 7-10 years**
- **New product and technology innovation benefitting mature markets**
- **Growth of security infrastructure in emerging markets**

## Smiths in the making... 1997

The Detection business was born, almost by accident. Graseby Dynamics, a niche player in chem-bio identification, was a small part of Graseby plc bought by Smiths to expand its medical portfolio. Graseby Dynamics scientists had developed the IMS (Ion Mobility Spectrometry) technology used in chemical agent and trace detectors made by Barringer Instruments. Barringer itself was bought just before the 9/11 terrorist attacks in 2001 and, as security-related demand surged, the subsequent purchase of X-ray scanner specialist Heimann established Smiths Detection as a world leader.

1997



	2014 £m	2013 £m	Reported growth	Underlying growth
Revenue	<b>512</b>	559	(8)%	(5)%
Headline operating profit	<b>25</b>	58	(58)%	(57)%
Headline operating margin	<b>4.8%</b>	10.4%	(560) bps	
Statutory operating profit	<b>23</b>	52		
Return on capital employed	<b>3.9%</b>	8.8%	(490) bps	

### Key operational highlights

- **Revenues declined 5% underlying in tough trading environment**
- **Aftermarket revenues now more than 30% of sales**
- **Radical business improvement programme instigated**

### Performance

Revenue at Smiths Detection declined 5% (or £25m) on an underlying basis against a strong comparator period. Foreign exchange translation had a further £22m impact, reducing reported revenues by £47m to £512m. Customer budgets, notably those of many national governments, remained constrained, resulting in aggressive pricing strategies by many direct competitors.

In a tough trading environment, demand weakened in the transportation, ports and borders, and military markets. There was little compensating growth in the critical infrastructure and emergency responders sectors which remained broadly flat.

In May we announced that, following an assessment of all major contracts and programmes, we had concluded a review of working capital requirements. This review, combined with the adoption of new divisional policies, resulted in an additional charge of £15m for the associated adjustments to inventory and receivables. During the year, we have also incurred additional programme delivery costs of £8m for certain long-running large contracts. We also incurred a charge of £7m in connection with price audits of overhead cost recovery charges associated with certain historical supply agreements. Together, these have resulted in one-off costs in the year of £30m.

Profitability was also affected by volume declines (£8m), adverse price/mix (£8m) and an increase in the level of expensed research and development costs (£8m). Together, these more than offset operational efficiencies (£7m). Foreign exchange transaction losses totalled £4m. In the prior year, we also incurred costs of £19m largely associated with

programme delivery costs, working capital and restructuring. The net impact of these movements was a 57% underlying decline in headline operating profit; margins fell 560 basis points to 4.8%.

The difference between statutory and headline operating profit includes exceptional restructuring costs (£7m), gains on adjustment to deferred consideration (£2m) and profit on disposal of business (£3m). Return on capital declined 490 basis points to 3.9%, reflecting the reduced profitability. Detection's operating environment has undergone major changes in the past five years with contracts becoming more programme-based – often requiring additional services such as infrastructure enabling works and networking. We have been slow to adapt to these changes but we have strengthened the management team to address these shortcomings. Richard Ingram, the new divisional president, has a strong background in programme management and long experience of driving operational improvements and manufacturing efficiencies. We expect that these initiatives to tackle low-margin programmes and other ongoing productivity initiatives will take another year to 18 months to deliver results.

Under *Fuel for Growth*, Smiths Detection started a comprehensive business improvement programme towards the end of the period and has identified a number of priority areas to stabilise and grow the business. It will deliver annual savings of some £14m at an expected total cost of £34m by the end of FY16/17. Costs of £5m were incurred in the year.

A reduction in the number of manufacturing facilities is among the early initiatives to cut costs and restore competitiveness. During 2015, three sites in North America will be closed and their activities consolidated at existing facilities in the US and UK. Production of small X-ray systems at our Malaysia facility will be increased to exploit their existing manufacturing efficiencies.

The focus on price competitiveness has been partly driven by evidence of price deflation in some markets, notably for certain X-ray screening systems. Among our responses, we have implemented a number of value engineering projects, not only to deliver savings in the design and manufacturing processes but also to enhance product appeal in key markets. This will increase sales margins and drive long-term value from the portfolio.

Opportunities presented by higher growth economies are being vigorously pursued, with China becoming a principal focus for 2015, following the appointment of two new distributors. The recent strengthening of local support for Middle East sales is delivering results with new contract wins.

Transportation revenue fell 5% underlying in the face of strong competitive activity in all regions and limited investment in new airports. Major contracts included two orders from the US Transportation Security Administration, totalling almost \$70m, for automatic explosives scanners and a system to identify hazardous liquids in bottles.

An underlying fall in revenues of 16% in the ports and borders market reflected lower contract activity. A review of the product portfolio of high-value cargo X-ray scanners, under the *Fuel for Growth* programme, will simplify the product offering for a large majority of market opportunities.

Critical infrastructure, covering public and commercial buildings and key installations, is both diverse and unregulated. Underlying revenues rose 11%, despite an increasingly competitive environment.

An underlying fall of 10% in military sales continued the trend of a variable annual cycle of activity in a largely contract-driven sector. The overall trend is downwards as pressure on government defence budgets leads to fewer replacement programmes for those long-term projects now coming to an end. However, under the US JCAD program for chemical agent detectors, a further \$20m follow-on production order was received from the Department of Defense.

Across all sectors, aftermarket revenues have delivered underlying growth of 10% and now represent 30% of sales. Planned business improvements will capitalise on the steady income potential of this activity, in order to generate further growth.

## Research and development

Smiths Detection remains committed to investing in the development of its main technologies and new products, to maintain its competitive position, through investment which increasingly will be specifically targeted to support a streamlined product range. Company-funded R&D was £37m or 7.3% of revenue (2013: £36m or 6.5%). This includes £10m of capitalised projects (2013: £16m), which reduced from last year as the mix of projects changed with the completion of developments such as the HI-SCAN 10080 XCT. In addition, customer and government support for R&D totalled £4m in the period (2013: £6m). Looking ahead, we expect to focus our investment more tightly on fewer projects, which will result in lower spend.

Main developments in the period included the launch of a light vehicle scanner for checkpoints and two new portable identifiers, one for illicit drugs and the other to analyse explosive substances.

Following the launch of the HI-SCAN 10080 XCT explosives detection system for hold baggage, after a three-year development programme, the first contracts were received for installation in airports at Santiago, Bremen, and Marrakesh, Morocco.

## Outlook

The order book is at a similar level to last year which is expected deliver flat revenues in the coming year, although we expect a bias to the second half. The trading environment is still challenging: government capital spending remains constrained and pricing is increasingly competitive. Margins should improve against a weak comparator. Pricing pressures are expected to be partially mitigated by the benefits of our recently announced productivity initiatives and as other cost savings bear fruit over the next 12-18 months.

## Priorities for 2015

- **Restore competitiveness in core markets**
- **Streamline product development; targeted R&D investment**
- **Focus on growth markets**
- **Deliver further growth in service revenues**
- **Improve delivery, quality, and responsiveness for greater customer satisfaction**

## Medium-term operating ranges

- **Revenue growth: variable, averaging mid-single digits (4-6%)**
- **Headline operating margin: margin range (14-20%)**

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

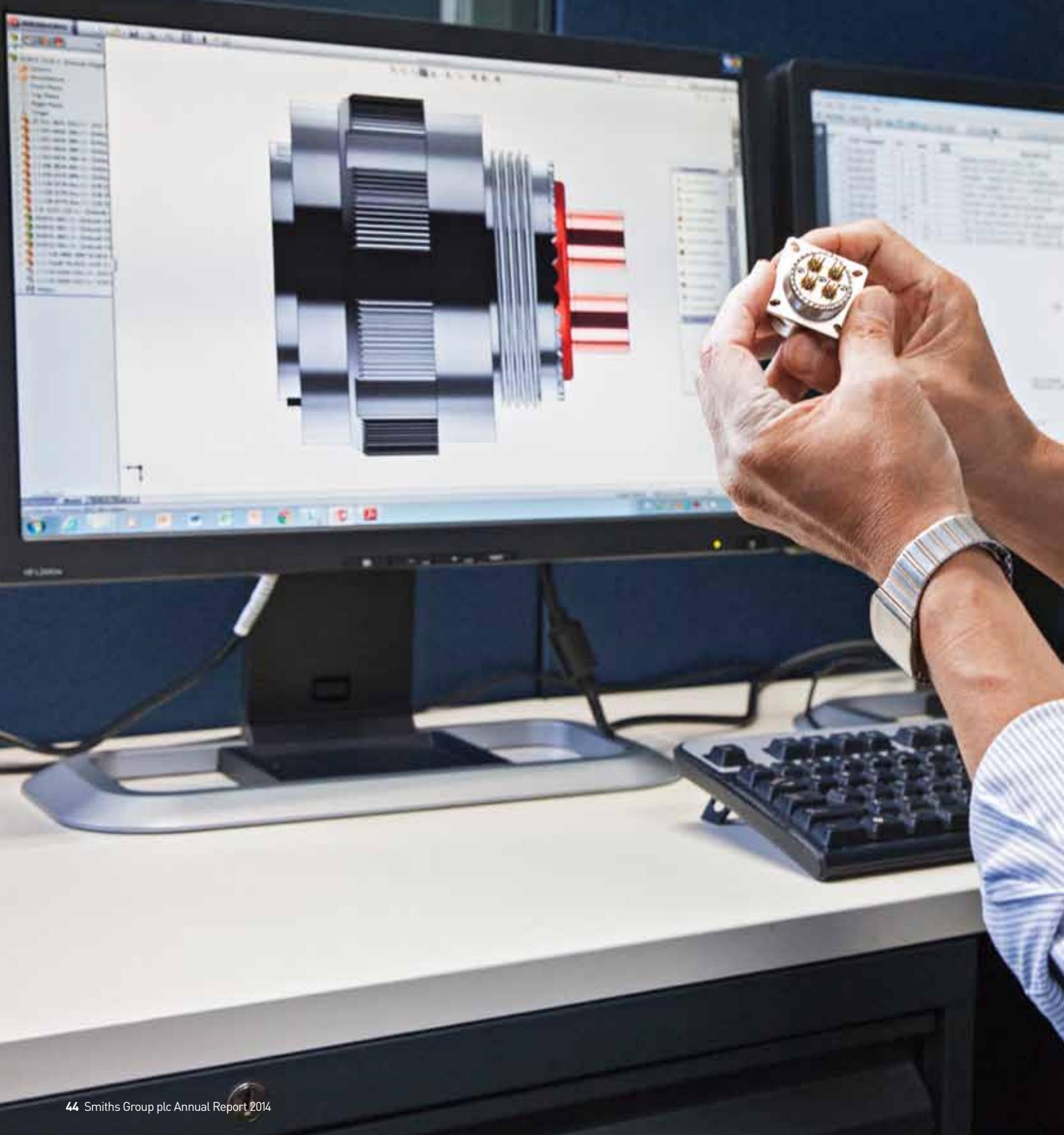
## Delivering value

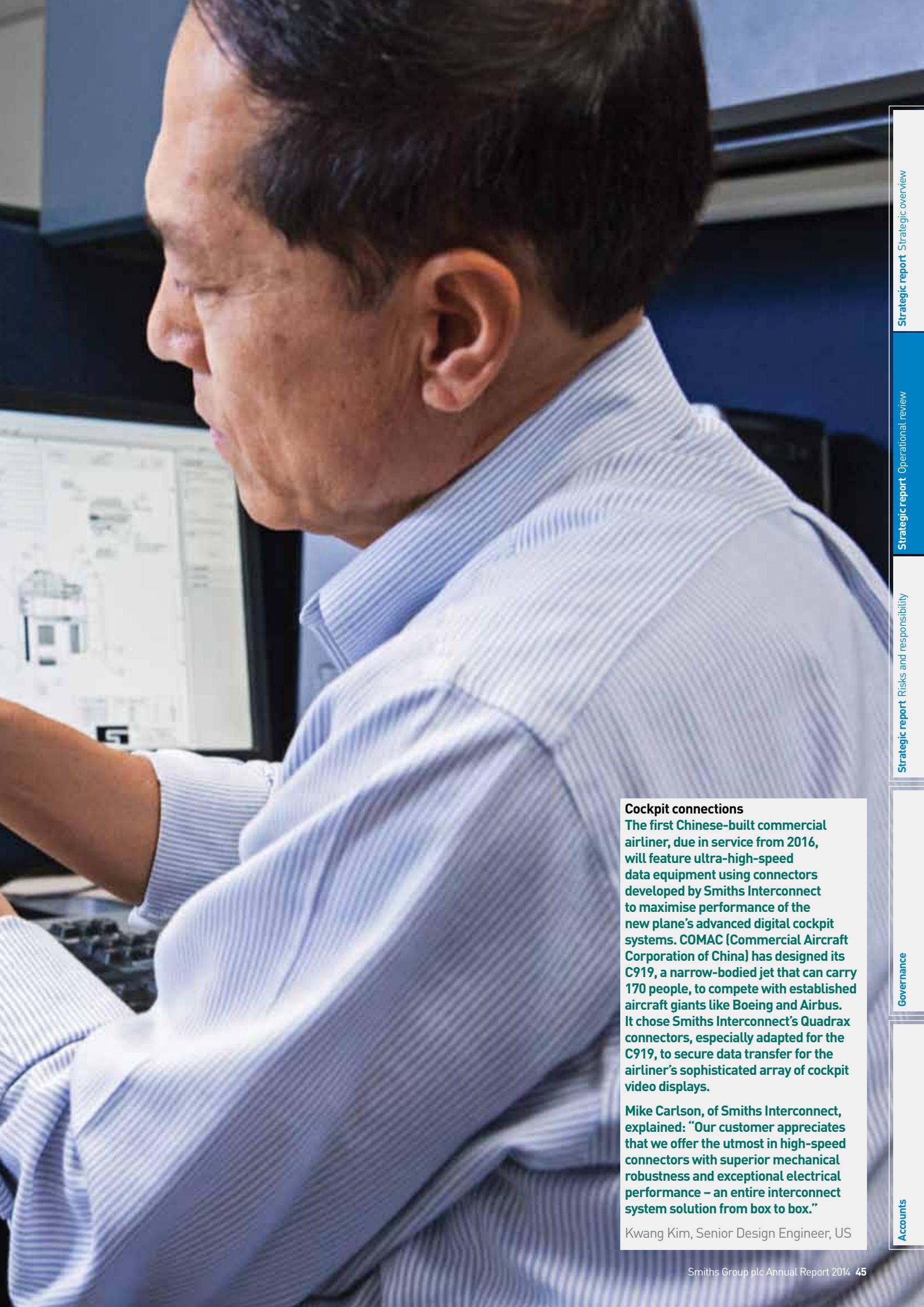
**Smiths Detection is exploring how Value Engineering (VE) can improve its competitiveness in tough global markets. A close review of cost-function relationships in the manufacture of one of its high-energy cargo scanners is helping deliver a product more closely aligned to market requirements, while achieving significant savings. Several sub-systems have been integrated into one section for easier assembly; the range of models on offer is being halved; and the installation time has been cut by two-thirds. "The simplified design and configurations lead to shorter production schedules and lower installation and delivery costs," said Karen Jacques, Head of Value Engineering and Operations Strategy. "This particular example of VE in action has resulted in potential six-figure savings on each scanner."**

Aboubacar Diarra, Assembly Expert,  
France



## Smiths Interconnect





#### Cockpit connections

The first Chinese-built commercial airliner, due in service from 2016, will feature ultra-high-speed data equipment using connectors developed by Smiths Interconnect to maximise performance of the new plane's advanced digital cockpit systems. COMAC (Commercial Aircraft Corporation of China) has designed its C919, a narrow-bodied jet that can carry 170 people, to compete with established aircraft giants like Boeing and Airbus. It chose Smiths Interconnect's QuadraX connectors, especially adapted for the C919, to secure data transfer for the airliner's sophisticated array of cockpit video displays.

Mike Carlson, of Smiths Interconnect, explained: "Our customer appreciates that we offer the utmost in high-speed connectors with superior mechanical robustness and exceptional electrical performance – an entire interconnect system solution from box to box."

Kwang Kim, Senior Design Engineer, US

## Smiths Interconnect

**A recognised leader in technically differentiated electronic components and sub-systems providing signal, power and microwave solutions.**

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

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

### Revenue performance

£m

**£445m (3)%**

2014	445
2013	461
2012	449
2011	379
2010	340

**Contribution to 2014 Group revenue**

**15%**

**Contribution to 2014 Group headline operating profit**

**13%**

Percentage relates to headline operating profit before corporate costs

### Principal operations regions

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

### Customers

Smiths Interconnect supplies to multiple levels of the supply chain and its blue chip customers include prime contractors and service providers, OEMs, system suppliers and sub-system manufacturers. Amongst our largest customers are Raytheon, Finmeccanica, BAE Systems, Boeing, EADS, AAI/Textron, Northrop Grumman, General Dynamics, Lockheed Martin, Row 44, Ericsson, Motorola, AT&T, Verizon, Sprint, China Mobile, Facebook, APC, Foxconn, GE Healthcare, Varian, Qualcomm, NVIDIA and Alstom.

### Competitors

Smiths Interconnect operates in relatively fragmented markets with many small, medium and larger competitors in various product and technology areas. Connector competitors include Amphenol, TE Connectivity, MultiTest (part of Xcerra), Yokowo, Glenair, ODU and Harting. Microwave competes with, amongst others, Anaren, KMW, Dover, CommScope, Cobham, Honeywell and Teledyne. Emerson Network Power, Cyberex (part of ABB), Eaton, Starline (part of Universal Electric), Huber & Suhner, Dehn + Söhne and Phoenix Contact offer competitive power management products.

### Suppliers

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

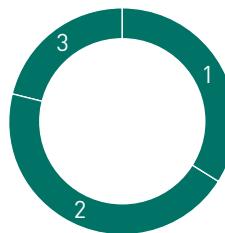


**Roland Carter**

Interim President, Smiths Interconnect

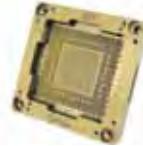
### Revenue by sector

- 1 Connectors 34%
- 2 Microwave 45%
- 3 Power 21%



### Connectors

**34%**



### Microwave

**45%**



### Power

**21%**



## Markets and trends

Smiths Interconnect comprises three technology-focused business units:

**Connectors** provides application-specific, high-reliability electrical interconnect solutions, from highly integrated assemblies to microminiature connectors and spring probe contacts.

**Microwave** provides components, sub-assemblies and systems for defence, aerospace, wireless telecommunications and electronic test applications.

**Power** provides distribution, conditioning, protection and monitoring solutions for data centres, wireless communications and other critical or high-value electrical systems.

Smiths Interconnect addresses a variety of end markets, particularly defence, wireless telecommunications, data centres, test and measurement, and semiconductor test.

Global defence spending is stabilising but likely to remain constrained as western governments maintain tight control of their budgets. Investment is expected to focus on system upgrades rather than new platforms. Critical areas such as intelligence, surveillance and reconnaissance (ISR), improved battle space awareness and force protection are likely to remain priorities. Military applications for Smiths Interconnect technology include unmanned aerial systems (UAS), next-generation ground vehicles, communications systems, radars and electronic warfare systems, surveillance systems and self-protection systems. Our microwave technology, ruggedised connectors and EMP protection solutions are deployed in the most extreme environments, such as enabling sensor and communications systems and protecting military personnel in combat zones.

The commercial aerospace market remains strong, driven by increasing passenger and freight demand particularly in developing regions, and the need to upgrade fleets to more efficient aircraft. Smiths Interconnect provides connector and satellite communications antenna solutions for various aircraft and space applications.

The wireless telecommunications infrastructure market continues to be driven by network improvements and in-building capacity increases to enable higher data rates and bandwidth utilisation. These support the proliferation of mobile communication devices and their data-intensive applications. Smiths Interconnect supplies niche, high-performance microwave components used in cell sites and in-building networks, as well as products and test equipment that help optimise network performance, and protect high-value infrastructure from lightning strikes and power surges.

Data centre demand is mainly influenced by internet traffic growth due to the expansion of web-enabled devices and applications, virtualisation or cloud computing, and by industry-specific regulatory drivers, for example in financial services and healthcare. Co-location data centre providers have grown significantly as companies chose to outsource rather than fund large capital projects. Smiths Interconnect's conditioning, distribution, protection and monitoring solutions ensure power quality is delivered to sensitive IT equipment and enable accurate monitoring and metering, an increasingly important issue as electricity costs increase.

Smiths Interconnect provides connector and cable assembly solutions to semiconductor test and test and measurement applications. The continued proliferation

of electronic devices, high rate of technology refresh, increased functionality and greater connectivity requirements are key drivers for these markets.

## Strategy

Smiths Interconnect is continuing its transition from lower-growth government-funded markets to higher-growth commercial markets. Investment in business development resources has helped identify market opportunities and then meet these with innovative new products. We leverage our strong technology and deep customer relationships facilitated by teams of highly specialised technologists. Diversified end markets provide resilience, and we allocate resources to markets, customers and regions with the most attractive prospects, particularly wireless telecommunications, data centres, test, commercial aerospace, Asia and other emerging geographies. Restructuring and efficiency initiatives, including lean and value engineering, deliver the funds for investment as well as the framework for our people strategy and EHS commitments.

## Competitive strengths

- **Innovative and technically differentiated technologies**
- **Ultra-high reliability solutions used in demanding applications**
- **High degree of customer intimacy and product customisation**
- **Addressing highly regulated markets with strong barriers to entry**

## Growth drivers

- **Proliferation of electronic devices**
- **Demand for greater connectivity**
- **Growth in high data rate applications**
- **Increasing sophistication of customer needs in emerging markets**

## Smiths in the making... 1995

The rights to hyperboloid technology were acquired outright, its revolutionary design ideal for enabling connectors to achieve demanding electrical standards in harsh environments. The tightness of the socket contact is formed by hyperbolically arranged wires encasing a pin when mated. The mesh ensures a robust link suited to functions with high connect-disconnect repetition and zero failure tolerance. Now a crucial component for the medical, defence and commercial aerospace industries, this connector is a cornerstone technology of Smiths Interconnect.



	2014 £m	2013 £m	Reported growth	Underlying growth
Revenue	<b>445</b>	461	[3]%	1%
Headline operating profit	<b>71</b>	69	4%	9%
Headline operating margin	<b>16.0%</b>	14.9%	110 bps	
Statutory operating profit	<b>49</b>	49		
Return on capital employed	<b>13.7%</b>	12.4%	130 bps	

### Key operational highlights

- **Strong H2 performance delivers modest full-year revenue growth**
- **Microwave benefitting from focus on commercial markets**
- **Investment in new products up 5%**
- **Emerging markets sales up 15% underlying, comprising 18% of total**
- **Margins up 110 bps on productivity gains**

### Performance

Reported revenue declined 3%, or £16m, due mainly to a £20m foreign exchange headwind and a minor divestment (£2m). Excluding these, underlying revenue rose 1%, or £6m. Strong performance in the Microwave business in the second half, particularly in commercial markets, offset a modest decline in Connectors. Power was flat.

Reported headline operating profit increased 4%, or £2m despite a foreign exchange hit of £3m. Underlying headline operating profit grew by 9% or £5m.

The difference between statutory and headline operating profit reflects amortisation of acquired intangible assets of £17m and exceptional restructuring costs of £5m.

Margins grew in all three business units contributing to a 110 basis points improvement for the division. Significant benefits came from improvements in productivity, restructuring, increased volumes and procurement savings. Collectively these more than offset pricing pressure and labour inflation, and supported continued reinvestment in growth enablers, particularly new product development and geographic expansion within Connectors.

Return on capital improved by 130 basis points to 13.7%, mostly driven by the increase in profitability.

The Connectors business unit continued to face tough market conditions in Western Europe and the Americas with continued delays and cancellations of major defence projects, particularly the reduced Eurofighter production rate. This led to a decline in underlying revenue of 2%. A focus on commercial markets such as aerospace, medical and semiconductor test provided pockets of growth. Several new products performed well, including an ultra-fine pitch socket for testing semiconductor chips used in gaming and networking applications; a spring probe-based connector for a disposable catheter

application; and a high-speed connector being used on a Chinese commercial aerospace project. Geographically, we continued to build our capabilities in Asia by adding resources and establishing an entity in Singapore to provide local customer service and engineering support. Operationally, Connectors significantly reduced manufacturing in California and the UK as part of the ongoing process of consolidating production capabilities.

In Microwave, a similar but more pronounced story of growth in commercial markets and contraction in defence markets delivered underlying revenue growth of 5%. Lower defence budgets and the US withdrawal from Afghanistan cut demand for some of our products including unmanned aerial vehicle datalinks and ground vehicle self-protection radar systems. After appropriate restructuring measures were taken, our defence businesses have now stabilised. We continue to support several ongoing defence programmes that are less susceptible to budget changes whilst also focusing on redirecting resources to commercial applications and the more strategically important sectors within defence such as ISR (Intelligence, Surveillance, and Reconnaissance). In commercial aerospace sales declined as the primary customer for our current airborne antenna system did not secure any significant new airline orders. However we continue to pursue new opportunities with alternative customers and next-generation product development activities. In wireless telecoms, the combination of new products and healthy demand drove exceptional growth. There was strong global demand for the next-generation version of our PIM (passive intermodulation) test equipment, particularly from US operators to support long-term evolution (LTE) network build-outs. Sales of our Lab-Flex high-performance cable assemblies also increased significantly, with the highest demand in production test applications for wireless devices such as smartphones and tablets.

Underlying revenue in Power was flat as modest growth in the second half offset the first half small decline. US data centre demand slowed as co-location providers cut spending to enable customer demand to catch up with capacity built out in the

previous year, effectively choking the supply chain. However, project wins for our Busway products in international markets such as India and Brazil offset the US softness to provide overall growth in the global data centre market. Furthermore, Power was selected to provide equipment for a large new US government data centre project and there are early signs of an increase in build rates of enterprise data centres. Revenues into the industrial market also increased primarily due to a significant contract for furnace power controllers for LED crystal growth applications. Demand for our power protection products remained weak mainly because changes in our core wireless telecoms market reduced the need for our technology. Consequently, we exited the commoditised Chinese market, restructured our local presence into a low cost manufacturing facility servicing export markets, and we are closing our Bangalore facility. Although military sales of EMP (electromagnetic pulse) protection products also declined in the year, there are signs of a potential uptick as the US Department of Defense appears to be expanding the assets requiring protection to include ground vehicles, aircraft and helicopters. In addition, new potential markets for EMP or GMD (geomagnetic disturbance) protections such as utilities, data centres and financial institutions are under discussion.

### Research and development

Total R&D of £27m increased as a proportion of revenue by 40 basis points to 6.1%. Company-funded R&D of £24m or 5.3% of revenue increased 5% on an underlying basis. New investment was targeted towards higher growth opportunities in commercial markets. Connectors' projects include new technology and products for medical, aerospace and oil and gas applications. In Microwave, the focus has remained on enhancing the features and capabilities of our market-leading PIM test equipment and next-generation airborne satellite communication antenna systems. Recognising the trend towards higher density data centres, Power extended its Busway and static transfer switch product lines with higher power variants and also launched JCOMM, a new branch circuit monitoring system that provides greater functionality, increases safety and reduces installation time.

Customer-funded R&D increased 30% to £3m, with funding for next-generation defence projects including ground-based satellite communications terminals and enhanced visual situational awareness systems for helicopters.

The vitality index, the proportion of revenue from products developed in the last three years, was maintained at over 30%.

## Outlook

The defence market has stabilised but is expected to continue to be challenged by constrained budgets. Sustained growth is expected in commercial markets, particularly semiconductor, wireless telecoms and data centres but at lower rates as certain projects in the second half will not carry over. The drive towards emerging markets, especially Asia, will continue and is likely to support modest overall growth. Investments to support long-term growth are expected to suppress margins, but on an underlying basis margins should remain steady as ongoing and new productivity initiatives are expected to offset pricing and inflationary pressures. Normal seasonality in certain markets and the timing of benefits from investments will again bias performance towards the second half.

## Priorities for 2015

- **Continued focus on commercial market opportunities**
- **International expansion, particularly Asia**
- **Further investment in new product launches targeted at higher growth and nascent segments**
- **Improve cost base through further site rationalisation, quality improvements and value engineering**

## Medium-term operating ranges

- **Underlying growth: low to mid-single digits (3-5%)**
- **Headline operating margin: improving margin trend over the medium term (16-18%)**

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

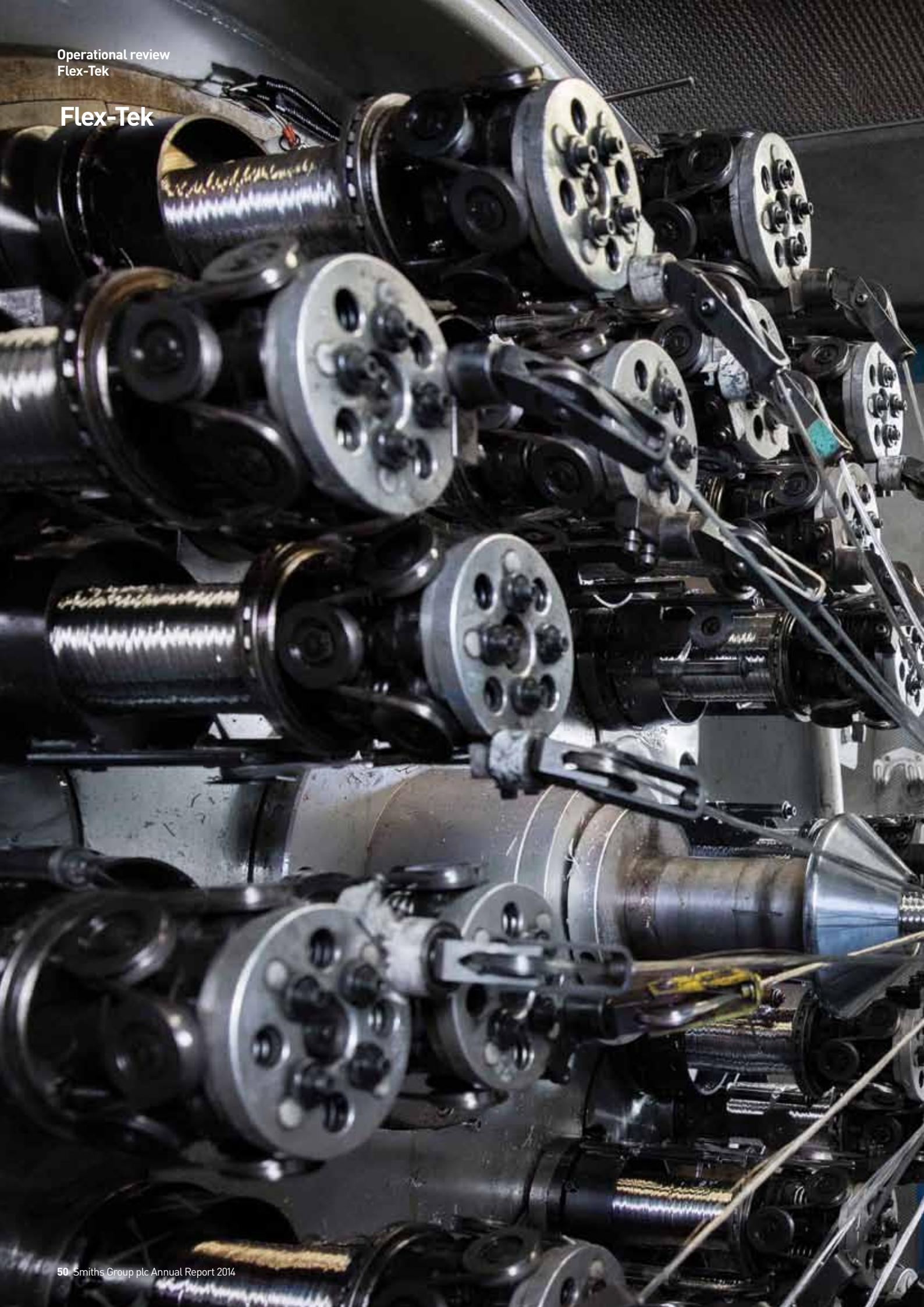
**Testing excellence**  
Feature-rich wireless devices like smartphones, tablets and ‘wearable technology’ are fundamentally changing the way we work, play and communicate. Our apparently insatiable appetite for constant connectivity in turn drives demand for test equipment that should be just as robust and reliable as the products they are trusted to evaluate.

Smiths Interconnect’s suite of Lab-Flex high-performance test cable assemblies meets that challenge in a range of ways. The proprietary designs, which preserve signal strength and boast an extremely high-frequency response, also use stainless steel connectors and solder sleeves. This ensures an exceptionally strong cable-to-connector termination, minimising irregular electrical performance and maximising the physical strength of the connection. “These features, combined with a flexible business model, mean our customers can test millions of wireless devices as quickly as possible and so gain competitive advantage through early delivery to market,” explained Brian DuPell of Smiths Interconnect.

Wendy Calderon, Production Operator,  
Costa Rica



## Flex-Tek





#### Gas transfer savings

As US businesses increasingly switch from oil to cheaper natural gas, a Flex-Tek company has developed an advanced delivery hose for customers with no access to the gas network. Titeflex's Virtual Pipeline Hose can withstand the immense pressure needed for transferring Compressed Natural Gas while its advanced polymer lining helps maintain flexibility in temperatures as low as -100°F. This allows the easy transfer of CNG from cylinder trucks to specialised off-loading stations at major customers such as hospitals, paper mills and asphalt plants. The gas is then decompressed and heated for immediate use, providing savings of up to 40% on energy bills.

"By spotting an opportunity in a promising market for a cleaner and less expensive fuel, we were able to work with customers to develop a hose application that fully matched the market's needs," explained product manager Joe Marinaccio, Titeflex.

Perry Dow, High Pressure Utility Operator, US

## Flex-Tek

**A global provider of engineered components that heat and move fluids and gases for the aerospace, medical, industrial, construction and domestic appliance markets.**

**Our flexible hosing and rigid tubing provide fluid management for fuel and hydraulic applications on commercial and military aircraft, deliver fuel gas and conditioned air in residential and commercial buildings, and provide respiratory care for medical applications. Flex-Tek heating elements and thermal systems improve the performance of a range of devices, from medical and diagnostic equipment to domestic appliances such as clothes tumble dryers and HVAC equipment.**

### Revenue performance

£m

**£250m (1)%**

2014	250
2013	253
2012	233
2011	221
2010	212

**Contribution to 2014  
Group revenue**

**9%**

**Contribution to 2014  
Group headline operating profit**

**9%**

Percentage relates to headline operating profit before corporate costs

### Principal operations regions

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

### Customers

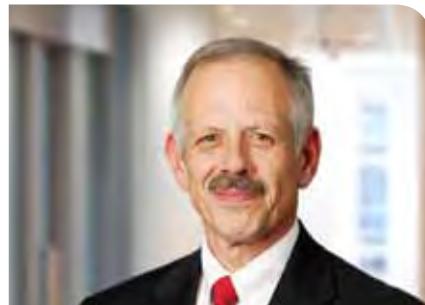
We serve mainly aerospace engine and airframe manufacturers, domestic appliance manufacturers and the US construction industry. Large customers include Boeing, Airbus, Pratt & Whitney, GE Aerospace, Whirlpool, Electrolux, Trane, and Carrier. Our notable distributors in the US construction market include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

### Competitors

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

### Suppliers

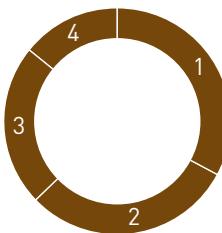
Flex-Tek sources key raw materials from world-class companies including electrical resistance wire from Sandvik, fibreglass insulation from Owens Corning, specialty plastic resins from DuPont and PolyOne, and stainless steel from Allegheny Ludlum. Each of these supply chain partners is chosen based on its ability to provide exceptional quality, service and value.



**Tedd Smith**  
President, Flex-Tek

### Revenue by sector

- 1 Fluid Management 33%
- 2 Construction Products 30%
- 3 Heat Solutions 23%
- 4 Flexible Solutions 14%



### Fluid Management

**33%**



### Construction Products

**30%**



### Heat Solutions

**23%**



### Flexible Solutions

**14%**



## Markets and trends

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

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

### Fluid Management

We are a market-leading manufacturer of specialty high-performance, flexible and rigid tubing assemblies for aerospace, industrial and automotive applications worldwide. Our specialised tubing provides reliable and efficient delivery of hydraulic fluids and jet fuel for both commercial 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.

The strong demand for more fuel-efficient, quieter commercial aircraft has driven the OEM backlog to an all-time high of over 11,000 units – this is equivalent to over eight years of production and represents a key growth driver for the business.

## Heat Solutions

As the world's largest manufacturer of open coil heating elements, our products serve customers that manufacture tumble dryers, HVAC equipment, medical devices, and bespoke applications. Our specialised elements and thermal systems provide consistent temperature controls which improve system efficiency and performance. Revenue growth is driven by the US appliance and housing market demands, along with an increasing number of specialty heating applications in North America and Asia.

## Construction Products

Flex-Tek manufactures market-leading flexible gas piping and HVAC flexible ducting for the US construction market. Our customers are large national wholesale distributors in North America, supplying both plumbing and HVAC tradesmen. The recovering US housing market is driving positive revenue and market share gains.

## Flexible Solutions

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

## Strategy

In Fluid Management we are focused on securing positions on the next-generation airframes and engines in order to support the delivery of the commercial aircraft backlog. Our Construction Products segment is positioned to continue to grow revenue and market share in a recovering US housing market. In Heat Solutions we are expanding our product portfolio and application range through new product development. We are also continuing to seek out strategic bolt-on acquisitions to support business development, through expansion of our product portfolio and market share gains. Quality, safety, environmental impact reductions and people development provide the basis for sustainable growth.

## Competitive strengths

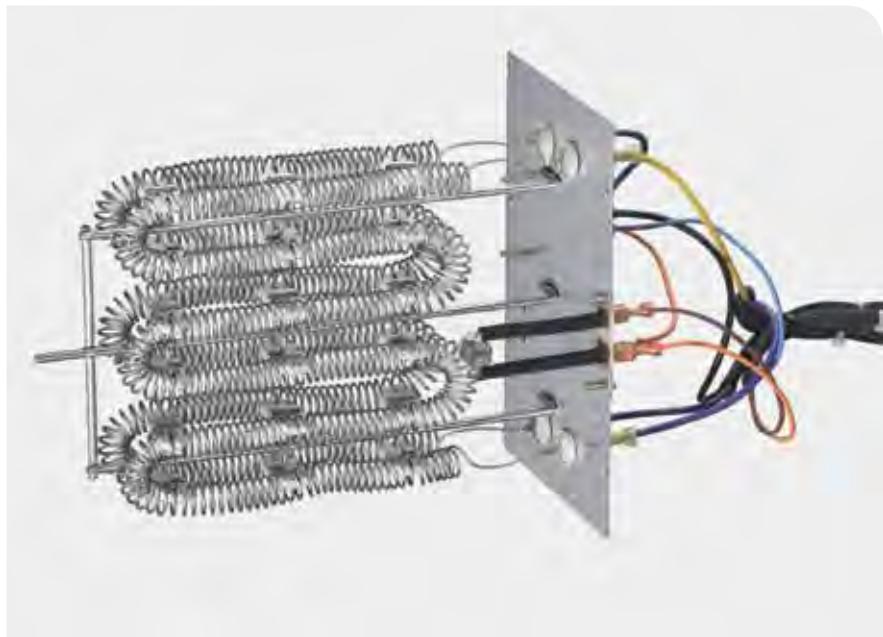
- **Manufacturer of qualified components for the aerospace industry**
- **Largest supplier of open coil heating elements worldwide**
- **Leading manufacturer of flexible gas piping and HVAC ducting for US construction market**

## Growth drivers

- **Leveraged to the improving US residential construction market**
- **Strong backlog for commercial aerospace customers**

## Smiths in the making... 1938

Tutco was founded by the redoubtable Madeline ("Ma") Tuttle as a manufacturer of automobile heating elements. During World War II, it also supplied components for bomb racks on US warplanes to prevent icing at high altitudes. Now central to Flex-Tek's Heating Solutions business, Tutco is the world's largest supplier of open coil heating elements. They are found in countless applications: from refrigeration and HVAC to laboratory and vending equipment. "Tutco is not just about supplying customers. We work as partners to provide engineering solutions to their particular requirements," said Director of Engineering, Brad Campbell.



## Operational review

### Flex-Tek

	2014 £m	2013 £m	Reported growth	Underlying growth
Revenue	<b>250</b>	253	(1)%	3%
Headline operating profit	<b>47</b>	43	9%	14%
Headline operating margin	<b>18.9%</b>	17.1%	180 bps	
Statutory operating profit	<b>37</b>	36		
Return on capital employed	<b>34%</b>	30.8%	320 bps	

#### Key operational highlights

- **Margin improvement from efficiency gains, pricing, and higher volumes**
- **Successfully achieved qualification for tubing on next-generation airframes and engines**
- **Improving ROCE supports continued investment in the business**

#### Performance

Flex-Tek revenues grew 3%, or £8m, on an underlying basis. Reported revenue was affected by £11m of foreign exchange translation which resulted in a decline of 1% to £250m. Continued revenue growth from sales to the reviving US residential construction market and growth of specialty heating elements and flexible hoses formed the basis for the improvement. Fluid Management revenues declined 2% from last year, as demand on new engine platform awards was deferred into next year. This segment also had some exposure to declines in defence spending, and reduced trading in the power generation segment. Headline operating margin rose 180 basis points to 18.9% with increased volumes and positive mix from specialty application solutions. The underlying increase in operating profit of 14% (£6m) stemmed from higher volumes, pricing and the improved sales for bespoke applications.

Return on capital employed rose to 34%, an increase of 320 basis points, on the back of the improved profitability.

The difference between statutory and headline operating profit principally reflects exceptional litigation costs of £10m.

In Fluid Management, the timing of initial shipments to aerospace customers for awards on new platforms versus ramp-downs for existing engine platforms affected this year's revenue, down 2%. Underlying demand remains strong, with major airframe manufacturers Airbus and Boeing and engine manufacturers Pratt & Whitney, GE, and Rolls-Royce placing new orders which have pushed the large commercial jet backlog to record levels. Our sales into automotive fuel and brake applications were up 21% over prior year.

Sales of our flexible gas piping and HVAC ducting to the construction market rose 8%. Revenue growth benefitted from industry consolidation among wholesalers and industry buying groups, as our customers acquired competitors. Increased volumes are expected to improve operational efficiency, while the concentration of buying power will potentially intensify pricing pressure. Our efforts to cross-sell our ducting, flexible gas piping and HVAC heating element product lines to the US distribution market continue to be successful as we gain market share. Our new sales efforts introducing our flexible gas piping into the UK market have met early success, with plans for expansion.

Heat Solutions underlying revenue grew 7% over the prior year, driven by a mix of sales growth in specialty heating elements and flat demand in the appliance sector. Prices for nickel, the primary component in electrical heating elements, remained stable for the year. Improved sales to distributors, via cross-selling efforts with ducting and gas piping, countered lower revenue from OEM HVAC equipment manufacturers. Revenues from our custom heating elements continue to grow and we have increased our R&D investments in new technologies. Sales in China exceeded last year's results by almost 21%.

Underlying revenue at Flexible Solutions was flat, with higher sales for medical hose products in the sleep apnoea market and sales growth in the US industrial market offset by continued market size reduction in floor care. Growth in specialty applications and R&D investment in medical products continue to deliver positive results.

#### Research and development

We are seeing commercial success from our increased R&D investment for approvals on next-generation airplanes and new heating technologies. We continue to seek acquisition opportunities that build on the strength of the businesses and the management team.

In Fluid Management, new product development spending continues to be focused on requirements for the next generation of quieter, more fuel-efficient aircraft, and developments in 3000 psi and 5000 psi hoses are expected to drive future revenues.

We also continue to focus on opportunities to develop specialty heating elements that open up higher margin markets and create scope for additional revenue growth.

#### Outlook

Both the underlying aerospace market demand and increasing output rates of the primary OEMs continue to be positive indications for the Fluid Management business. US residential housing numbers are expected to show modest improvement, although higher interest rates, higher home prices, and stricter lending practices could adversely affect anticipated growth. Improved general economic conditions are expected to benefit the Heat Solutions and Flexible Solutions growth in specialty applications, along with continued economic development in China.

#### Priorities for 2015

- **Increased R&D investment in new products, technologies, and approvals**
- **Well positioned to meet opportunities in the US residential construction market**
- **Expansion of our manufacturing resources to meet global aerospace demand**

#### Medium-term operating ranges

- **Underlying growth: mid-single digits (3-6%)**
- **Headline operating margin: margin range (15-20%)**



#### Successful blend

Flex-Tek has teamed up with two global companies to create a resistance wire alloy designed specifically for clothes dryer elements which rely on high-acceleration heat transfer. Its engineers worked with Swedish materials group Sandvik and Whirlpool, the US home appliance company, to develop the component which, though using 25% less nickel than normal, provides excellent corrosion resistance and heated mechanical strength.

"Aside from its performance and durability, the new wire alloy is attractive to customers because it is less exposed to nickel prices which are normally both high and volatile," said Pat Lollar, Director of Technology at Tutco, the Flex-Tek company behind the breakthrough. The product is due to go to market later this year.

Johnny Allison, R&D Lab Technician, US

# Financial review



**Peter Turner**  
Finance Director

## Revenue

Down 5% to

**£2,952m**

→ Read more on page 25 and in note 1 on page 135-138

## Headline operating profit

Down 10% to

**£504m**

→ Read more on page 25 and in note 1 on page 135 and in note 3 on page 139

## Statutory operating profit

Down 22% to

**£378m**

→ Read more on page 25 and 56 and in note 1 on page 135 and in note 4 on page 140

## Earnings per share

Basic headline earnings per share from continuing activities were 81.8p (2013: 92.7p). This reflects a decline in headline operating profit.

On a statutory basis, the basic earnings per share from continuing activities were 59.0p (2013: restated 80.1p).

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

These items amounted to a charge of £143m compared to a charge of £102m in 2013. They comprised:

- £54m in connection with John Crane, Inc. asbestos litigation (2013: £17m);
- £11m associated with Titeflex Corporation litigation (2013: £8m);
- £29m of exceptional restructuring costs in respect of *Fuel for Growth* and the performance improvement programme in Smiths Detection (2013: £8m);
- £9m for retirement benefit finance charge (2013: restated charge of £23m);
- £6m of legacy retirement benefit administration costs (2013: restated £7m);
- £3m profit on disposal of property and businesses (2013: £6m);
- £1m cost of acquisitions, disposals and aborted transactions (2013: £3m);
- £2m gain on legal settlements and diabetes royalty payments (2013: £1m);
- £2m gain on reassessed contingent consideration provided on acquisitions (2013: £2m); and
- £1m of financing losses (2013: £2m).

During the year to 31 July 2013, in addition to the above, a £4m gain on changes to pensions plans was also excluded from headline performance.

## Cash generation and net debt

Operating cash generation remained strong with headline operating cash-flow of £490m (2013: £548m), representing 97% (2013: 98%) of headline operating profit (see note 27 to the accounts for a reconciliation of headline operating cash and free cash-flow to statutory cash-flow measures). Free cash-flow decreased by £94m to £143m (2013: £237m). Free cash-flow is stated after all legacy costs, interest and taxes but before acquisitions and dividends.

On a statutory basis, net cash inflow from continuing operations was £256m (2013: £353m).

Dividends paid in the year on ordinary shares amounted to £275m (2013: £152m) which includes the annual dividend of £157m and the special dividend of £118m.

Net debt at 31 July was £804m, an increase of £60m from the £744m at 31 July 2013. This increase in net debt reflects the impact of the special dividend paid in November 2013 offset by continued strong cash generation and translation gains on foreign currency-denominated debt of £70m.

## Interest and other financing costs

Interest payable on debt, net of interest earned on cash deposits, was £60m compared with £62m in 2013. This reduction primarily reflects lower interest rates on debt during the year. Interest costs were covered 8.4 times by headline operating profit.

The Group accounts for pensions using IAS 19. As required by this standard, a finance charge of £9m (2013: a charge of £23m restated for IAS 19) is recognised reflecting the unwinding of the discount on the net pension liability.

## Research and development

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

We invested a total of £117m in R&D (2013: £117m), equivalent to 4.0% of revenue (2013: 3.8%). Of that total, £109m was funded by the Company compared with £108m in 2013. However, at constant currencies, company-funded investment increased 5% on an underlying basis. We actively seek funding from customers to support R&D and this amounted to £8m (2013: £9m). Under IFRS, certain development costs are capitalised, and this amounted to £24m in the period (2013: £30m). The gross capitalisation is shown as an intangible asset. Where customers contribute to the costs of development, the contribution is included as deferred income and disclosed within trade and other payables.

## Taxation

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

The headline tax charge for 2014 of £120m (2013: £132m) represented an effective rate of 27% on the headline profit before taxation (2013: 26.5%). On a statutory basis, the tax charge on continuing activities was £67m (2013: £79m).

The Group continues to take advantage of global manufacturing, research and development and other tax incentives, the tax-efficient use of capital and tax compliance management. A rate of between 26% and 27% is expected in the year ending 31 July 2015.

In the 2014 financial year, Smiths Group paid £95m in direct corporate tax and £78m in employer taxes. The Group also collected £197m on behalf of tax authorities from employee taxes and indirect taxes such as VAT. These amounts totalled £370m.

## Return on capital employed

The return on capital employed (ROCE) is calculated over a rolling 12-month period and is the percentage that headline operating profit comprises of monthly average capital employed. Capital employed comprises total equity adjusted for goodwill recognised directly in reserves, post-retirement benefit-related assets and liabilities net of tax, litigation provisions relating to exceptional items net of tax, and net debt. ROCE declined 90 basis points to 15.7% (2013: 16.6%) as a result of reduced profitability in Smiths Medical and Smiths Detection more than offsetting improved profitability in John Crane, Smiths Interconnect and Flex-Tek.

## Retirement benefits

As required by IFRS the balance sheet reflects the net surplus or deficit in retirement benefit plans, taking assets at their market values at 31 July 2014 and evaluating liabilities at period-end AA corporate bond interest rates.

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

another plan. The net pension deficit has reduced to £242m at 31 July 2014 from £254m at 31 July 2013. The deficit reduction reflects the benefit of asset returns and contributions offset by lower discount rates.

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

The retirement benefit position was:

	31 July 2014	31 January 2014	31 July 2013
Funded plans			
UK plans – funding status	<b>99%</b>	99%	99%
US plans – funding status	<b>84%</b>	85%	81%
Other plans – funding status	<b>79%</b>	80%	80%
Deficit			
Funded plans	<b>(135)</b>	(132)	(147)
Unfunded plans	<b>(107)</b>	(104)	(107)
Total deficit	<b>(242)</b>	(236)	(254)
Retirement benefit assets	<b>123</b>	102	121
Retirement benefit liabilities	<b>(365)</b>	(338)	(375)
	<b>(242)</b>	(236)	(254)

In the coming year, cash contributions to all the schemes are expected to total approximately £85m (2014: £88m). In addition, the Group will invest £24m in an escrow account as part of the funding plan agreed with the Smiths Industries Pension Scheme (SIPS).

The approximate pension membership for the three main schemes at around the end of July 2014 is set out in the table below:

Pension scheme members	SIPS	TIGPS	US plans	Total
Deferred active	470	260	3,120	<b>3,850</b>
Deferred	11,400	13,870	6,290	<b>31,560</b>
Pensioners	13,090	17,690	5,600	<b>36,380</b>
<b>Total</b>	<b>24,960</b>	<b>31,820</b>	<b>15,010</b>	<b>71,790</b>

## Exchange rates

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

	31 July 2014	31 July 2013		31 January 2014
Average rates:				
US dollar	<b>1.64</b>	1.57	Dollar weakened 4%	1.61
Euro	<b>1.21</b>	1.20	Euro weakened 1%	1.19
Year-end rates:				
US dollar	<b>1.69</b>	1.52	Dollar weakened 11%	1.65
Euro	<b>1.26</b>	1.14	Euro weakened 11%	1.22

## Financial review

### Continued

#### Goodwill and intangibles

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

Intangible assets arising from business combinations ('acquired intangibles') are assessed at the time of acquisition in accordance with IFRS 3 (Revised) and are amortised over their expected useful life. This amortisation is excluded from the measure of headline profits. When indicators of impairments are identified, the intangible assets are tested and any impairment identified is charged in full. The impairment charge is excluded from the measure of headline profits. Other intangible assets comprise development costs or software which are capitalised as intangible assets as required by IFRS. Amortisation charged on these assets is deducted from headline profits.

#### Accounting policies

The accounts in this report are prepared under International Financial Reporting Standards (IFRS), as adopted by the European Union (EU). The accounting policies used in preparing these accounts are set out on pages 129-134.

#### Significant judgements, key assumptions and estimates

Applying accounting policies requires the use of certain judgements, assumptions and estimates. The most important of these are set out on pages 129-130.

#### Treasury

The Board maintains a Treasury Risk Management Policy which governs the activities of Group Treasury and subsidiary companies and the financial risk profile to be maintained by the Group. A report on treasury activities, financial metrics and compliance with the policy is prepared monthly for the Executive Committee, for every Board meeting and on a semi-annual basis for the Audit Committee.

The Board maintains a treasury control framework within which counterparty risk, financing and debt strategy, interest rate risk and currency translation management are reserved for Group Treasury while cash and currency transaction exposure management are devolved to operating divisions. Centrally directed cash management systems exist globally to manage overall liquid resources efficiently across the divisions. The Group uses financial instruments to raise financing for its global operations, to manage related interest rate and currency financial risk and to hedge transaction risk within subsidiary companies. The Group does not speculate in financial instruments. All financial instruments hedge existing business exposures and all are recognised on the balance sheet.

There are four components of the Treasury Risk Management Policy and within each component a set of financial metrics are set and measured monthly.

#### 1 Credit quality

The Group's strategy is to maintain a solid investment-grade rating to ensure access to the widest possible sources of financing at the right time and to minimise the resulting cost of debt capital. The credit ratings at the end of July 2014 were BBB+ / Baa2 (stable) from Standard & Poor's and Moody's respectively. An essential element of an investment-grade rating is consistent, robust cash-flow metrics. The Group's objective is to maintain a headline operating cash conversion of greater than 90% and net debt/headline EBITDA at less than two times. At 31 July 2014, these measures were 97% (2013: 98%) and 1.36 times (2013: 1.15 times) respectively.

#### 2 Debt and interest rate management

The Group's financing is managed centrally. At 31 July 2014 net debt was £804m (2013: £744m). The core financing for the Group is provided by a US\$800m committed revolving credit facility provided by a group of 10 global banking partners. This facility was renewed during the year at lower costs and the new transaction has a maturity of February 2019 with two one-year uncommitted extension options. The Group remains in full compliance with all covenants within its debt agreements. The Group's risk management objectives are to ensure that over time funding drawn from the bank market is less than 30% of net debt, the average maturity profile of gross debt is at or greater than four years and over 70% of gross debt is at fixed rates. At 31 July 2014, these measures were 13.3% (2013: 0%); 4.5 years (2013: 4.8 years) and 63% (2013: 76%). In May 2014 the \$250m 6.05% fixed rate Notes were partly refinanced using floating rate bank debt and the fixed rate metric is being managed in the short term under the medium-term target of 70%.

There has been no new debt security issuance during the year.

#### 3 Liquidity management

At 31 July 2014, US\$620m of the US\$800m committed bank facility was undrawn. The Group's objective is to ensure that at any time undrawn committed facilities net of overdraft financing are greater than £200m. At 31 July 2014, this measure was £367m (2013: £527m). At 31 July 2014, cash resources were £190m (2013: £394m). The Group aims to ensure that these resources are placed on deposit with highly rated relationship bank counterparties at short-notice availability. Credit exposure to every approved bank is defined by the Treasury Risk Management Policy with counterparty limits established by reference to their Standard & Poor's long-term debt rating and CDS trading levels.

Compliance is measured and reported monthly to the Executive Committee and the Board. At 31 July 2014, 97% (2013: 98%) of cash resources were on deposit with the 10 global relationship banks and of these resources £36m (2013: £74m) was invested with counterparties rated less than A+.

#### 4 Currency management

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

The Group is an international business with the majority of its net assets denominated in foreign currency. It protects its balance sheet and reserves from adverse foreign exchange movements by financing its currency assets in the same currency such that, where the value of net asset exposure is over £30m equivalent, over 50% of those assets are matched with the same currency liability. At 31 July 2014, 45% (2013: 49%) of total foreign currency assets were matched by related currency liabilities.

#### Financial controls

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

The Internal Audit Department reviews all reporting units over a rolling three-year cycle, and its findings are reported to the Audit Committee. All acquisitions are reviewed within 12 months of acquisition, to verify compliance with Group procedures. Further information regarding the Group's procedures to maintain strict controls over all aspects of risk, including financial risk, is set out in Risk management on pages 60-65 and the Corporate governance statement on pages 77-91.

#### Essential contracts

The divisional reviews describe our main customer and supplier relationships and the 'Risks and uncertainties' section outlines the risk management aspects of our contractual arrangements.

Smiths Group has a wide range of suppliers and customers, and while the loss of, or disruption to, certain of these arrangements could temporarily affect the operations of an individual division, none is considered essential.

# Litigation

**Smiths Group is committed to operating within the law in all applicable jurisdictions, and seeks to benefit from the rights and protections afforded by relevant laws. The Group aims to anticipate and meet the changing requirements of the markets it serves, as legal and regulatory reforms impact those markets. It acts to defend and, where appropriate, to assert its legitimate interests.**

## Litigation

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

### John Crane, Inc. litigation

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

→ Read more in note 23  
on pages 165-167

The litigation involves claims for a number of allegedly asbestos-related diseases, with awards, when made, for mesothelioma tending to be larger than those for the other diseases. JCI's ability to defend mesothelioma cases successfully is, therefore, likely to have a significant impact on its annual aggregate adverse judgment and defence costs.

JCI continues to actively monitor the conduct and effect of its current and expected asbestos litigation, including the efficacious presentation of its 'safe product' defence, and intends to resist these asbestos cases based on this defence. Approximately 235,000 claims against JCI have been dismissed before trial over the last 35 years. JCI is currently a defendant in cases involving approximately 80,000 claims. Despite these large numbers of claims, since the inception of litigation JCI has had final judgments against it in 131 cases, and has had to pay awards amounting to approximately US \$149m.

At 31 July 2014, the aggregate provision for JCI asbestos litigation, including for adverse judgments and defence costs, amounted to £204m expressed at the then current exchange rate. In deciding upon the amount of the provision, JCI has relied on independent expert advice from a specialist. Moreover, in establishing this provision no account has been taken of any recoveries from insurers as their nature and timing are subject to pending litigation. Because of the significant uncertainty associated with the future level of asbestos claims and of the costs arising out of the related litigation, there is no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred.

### Titeflex Corporation litigation

Titeflex Corporation, a subsidiary of the Group in the Flex-Tek division, has received a number of claims in recent years from insurance companies seeking recompense on a subrogated basis for the effects of damage allegedly caused by its flexible gas piping products being energised by lightning strikes. It has also received a number of product liability claims relating to this product, some in the form of purported class actions. 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.

At 31 July 2014, provision of £61m has been made for the costs which the Group expects to incur in respect of these claims. Because of the significant uncertainty associated with the future level of claims and of the costs arising out of the related litigation, there is no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred.

# Managing risk in delivering our strategy

**Smiths Group is exposed to a wide range of risks in running its businesses. We regularly review these risks and ensure we have the appropriate processes and policies for managing them.**

## Our approach to risk governance

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

The Board has overall responsibility for our risk management policies and ensuring we have an effective system of internal control. The Group's process for identifying, evaluating and managing significant business risks is reviewed by the Audit Committee and monitored by the Group Internal Audit Department. An outline of this year's review process by the Board and Audit Committee is set out on pages 83 to 89. A description of the Company's internal controls and risk management processes is given in the Corporate Governance statement on pages 83 to 84.

## Our approach to risk management

In delivering our strategy, it is important that we understand and manage the risks that face us. We achieve this through our embedded risk management approach, combining a top-down strategic view of risks with a bottom-up divisional process.

Our top-down approach involves a review of the external and internal environment, and an assessment by the Executive Committee regarding the key risks that face Smiths Group. This review is formalised twice a year. A 'risk owner' is assigned to each risk with the responsibility to monitor the risk and ensure the agreed mitigation actions are completed.

These 'Group-wide' risks are categorised as either:

- Major business challenges
- Risks caused by uncontrollable external factors
- Other risks

A summary of these 'Group-wide' risks is presented for discussion at the July Board meeting. In reviewing the major risks, the Board determines the level of risk which we are prepared to accept in the pursuit of our business goals – this is our risk tolerance. Where the risk impact is greater than that which we are prepared to accept, further mitigation actions are agreed to reduce the potential impact. Where further mitigation actions are not possible or are considered to be cost prohibitive, the risk is closely monitored.

Our bottom-up divisional approach involves the identification, management and monitoring of the material risks in each of our divisions. Each division is required to maintain risk registers and monitor their significant risks on an ongoing basis. Each division attends one Audit Committee a year, to explain and discuss the inherent risks and challenges faced by the division. Additionally, the strategic risks are further debated at the divisional strategy presentations which are made annually to the Group Board. The divisions are also required to provide an update regarding their risk mitigation actions at the Quarterly Business Reviews held with the Chief Executive and Finance Director.

This dual process provides a framework such that the Group's strategic, financial and operational risks are adequately considered and discussed by the Executive Committee and the Board.

There can be no assurance that our approach to risk management will be effective in any particular case. If any of the risks which we identify, or other unforeseen risks, materialise, they could have a significant adverse effect not only on our business and financial condition but also on our reputation and the trading prices and liquidity of our securities. This could lead to a loss for investors of part of or, in a worst case scenario, all of their investment.

## Our Group-wide risks as assessed by the Board

Risks caused by uncontrollable external factors		
Economic outlook and geo-political environment		
Potential impact	Risk and potential impact	Mitigation
<b>Medium</b>  <b>Trend</b> No change 	<p><b>Risk and potential impact</b></p> <p>The Group operates in more than 50 countries and is affected by global economic conditions, particularly in the US and Europe. Our business is also affected by government spending priorities and the willingness of governments to commit substantial resources to homeland security and defence.</p> <p>While current global economic and financial market conditions have stabilised due largely to the impact of quantitative easing, "tapering" or other reduction in such activity may cause increased volatility and uncertainty about inflation, interest rates, exchange rates and investment levels. Equally there is a risk of 'asset bubbles' developing and impacting investor confidence and bank lending. These factors may affect the Group's operational performance and financial condition. Adverse economic and financial market conditions may cause our customers to terminate existing orders, to reduce their purchases, or to be unable to meet their obligations to pay outstanding debts to the Group. These market conditions may also cause our suppliers to be unable to meet their commitments to the Group or to change the credit terms they extend to us.</p> <p>The risk of a Eurozone break-up has reduced over the past twelve months, although there is increasing potential that the UK may leave the EU, which may have policy and economic considerations.</p> <p>Ongoing geo-political unrest in areas such as the Middle East, Ukraine and Russia may also affect the Group's supply chain and customers.</p>	<p><b>Mitigation</b></p> <ul style="list-style-type: none"> <li>• The Group has a diversified portfolio of businesses that mitigates exposure to any one country or sector.</li> <li>• The divisions regularly monitor their order flows and other leading indicators, where available, so that they may respond quickly to deteriorating trading conditions.</li> <li>• In the event of a significant economic downturn, there may be opportunities to identify and implement cost-reduction measures to offset the impact on margins from deteriorating sales.</li> </ul>
Compliance with legislation and regulations		
<b>Potential impact</b> Low to medium  <b>Trend</b> No change 	<p><b>Risk and potential impact</b></p> <p>There is a risk that the Group may not always be in complete compliance with laws, regulations or permits, for example concerning environmental or safety requirements. The Group could be held responsible for liabilities and consequences arising from past or future environmental damage, including potentially significant remedial costs. There can also be no assurance that any provisions for expected environmental liabilities and remediation costs will adequately cover these liabilities or costs.</p> <p>The Group operates in highly regulated sectors. Smiths Detection, Smiths Interconnect and Smiths Medical are particularly subject to regulation, with certain customers, regulators or other enforcement bodies routinely inspecting the Group's practices, processes and premises.</p> <p>Smiths Detection and Smiths Interconnect manufacture security products and components, which are subject to numerous export controls, technology licensing and other government regulations.</p> <p>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.</p> <p>Should a regulator's approval process take a particularly long time, our products may be delayed in getting to market, which could lead to a loss of revenue or benefit a competitor with a similar product. Corruption on the part of a single employee can entail severe consequences for the Group.</p> <p>Failure to comply with certain regulations may result in significant financial penalties, debarment from government contracts and/or reputational damage.</p>	<p><b>Mitigation</b></p> <ul style="list-style-type: none"> <li>• Environmental, health and safety data are reported to the Quarterly Business Reviews, Executive Committee and the Board, along with actions to improve performance over time.</li> <li>• Smiths Medical has dedicated staff who maintain close contact with the US Food and Drug Administration and other key regulators.</li> <li>• All divisions have trade compliance advice and training. This includes training on the Group's Code of Business Ethics and assessments to support compliance.</li> <li>• Divisional and Group General Counsel monitor legislative changes (assisted by Government Relations staff) and report and monitor actions as necessary. This may require modifications to our supply chains and customer arrangements.</li> </ul>

## Managing risk in delivering our strategy

**Continued**

Risks caused by uncontrollable external factors		
Pension funding		
Potential impact High  Trend Reduced slightly 	Risk and potential impact At 31 July 2014, the Group has legacy defined benefit pension plans, with aggregate liabilities of around £4bn on an accounting basis. Changes in discount rates, inflation, asset returns or mortality assumptions could lead to a materially higher deficit. For example, the cost of a buyout on a discontinued basis, and therefore using more conservative assumptions, is likely to be significantly higher than the accounting deficit. In addition, there is a risk that the plan's assets, such as investments in equity and debt securities, will not be sufficient to cover the value of those benefits.  The implications of a higher pension deficit include a direct impact on valuation, credit rating and potential additional funding requirements at subsequent triennial reviews. However, following the 2012 triennial review, cash payments to the principal UK pension schemes remained at the levels agreed in the 2009 review.  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.	Mitigation • All major schemes (US/UK) have been closed to future accrual.  • Agreed funding plans are in place with the major UK schemes following the last triennial reviews. The Group seeks a good working relationship with the trustees through regular update meetings.  • There are plans in place to reduce the mismatch between assets classes and liabilities, as relative outperformance of the assets versus liabilities is achieved, although there is no downside protection in place should this not occur.  • Pension matters are regularly reported to the Board.   Read more in note 9 on pages 145-150
Financial risks (foreign exchange, funding, tax and insurance)		
Potential impact Medium  Trend No change 	Risk and potential impact Foreign exchange: Exchange rate fluctuations have had, and could continue to have, a material impact on the reported results. The Group is exposed to two types of currency risk: transaction and translation. The Group's reported results will fluctuate as average exchange rates change. The Group's reported net assets will fluctuate as the year-end exchange rate changes.  Funding: The Group's ability to refinance its borrowings in the bank or capital markets is dependent on market conditions and the proper functioning of financial markets. The Group may be unable to refinance its debt when due.  Tax: The Group's future profitability, particularly in the US where there are higher rates of corporation tax, may cause the headline tax rate to increase over time. Changes in tax and fiscal regulations and transfer pricing rules in the countries in which we operate could affect the Group, particularly at times when public sector debt is high. Taxation costs could rise and earnings per share could deteriorate, which could affect the Group's market valuation.  Insurance: The Group cannot be certain that it will be able to obtain insurance on acceptable terms or at all. Furthermore, the Group cannot be certain that its insurance will cover losses arising from events or that insurers will not dispute coverage. In addition, even if our coverage is sufficient, the insurance industry is subject to credit risk, particularly in the event of a catastrophe or where an insurer has substantial exposure to a specific risk. If insurance cover is inadequate or does not pay out as expected, the Group could be exposed to an unexpected material cash outflow, which may impact on the Group's liquidity and/or share price.	Mitigation • Foreign exchange: The Group's hedging strategy, whereby larger transactions are hedge accounted, mitigates the risk to profitability to some extent. Net investment hedging of overseas assets of approximately 50% through borrowing in non-sterling currencies mitigates the impact of exchange rate fluctuations on net assets.  • Funding: The Group's debt maturity is staggered so that the refinancing risk is minimised. As at 31 July 2014, US\$620m of an US\$800m committed revolving credit facility was undrawn.  • Tax: The Group's taxation staff co-ordinate tax management to mitigate possible increases in the effective tax rate. Regular reporting to the Board of tax risks and exposures provides good visibility of issues.  • Insurance: Insurance risk is spread across a number of carriers to minimise individual insured risk and counterparty risk.   Read more on page 58

## Business challenges / thematic risks

### Product liability and litigation

<b>Potential impact</b> Medium  <b>Trend</b> No change 	<b>Risk and potential impact</b> <p>In the ordinary course of its business, the Group is subject to litigation such as product liability claims and lawsuits, including potential class actions, alleging that the Group's products have resulted or could result in an unsafe condition or injury. In addition, manufacturing flaws, component failures or design defects could require us to recall products. Many of our products are used in critical applications where the consequences of a failure could be extremely serious and, in some cases, potentially catastrophic.</p> <ul style="list-style-type: none"> <li>Products sold to the aviation, security, healthcare, energy and consumer/domestic industries are particularly critical in nature.</li> <li>Furthermore, over half the Group's sales are in the US, where there is potentially increased litigation risk.</li> </ul> <p>Any liability claim against the Group, with or without merit, could be costly to defend and could increase our insurance premiums.</p> <p>Some claims might not be covered by our insurance policies, either adequately or at all. An adverse event involving one of our products could damage our reputation and reduce market acceptance and demand for all of our products.</p>	<b>Mitigation</b> <ul style="list-style-type: none"> <li>Quality assurance processes are embedded in our manufacturing locations for critical equipment, supporting compliance with industry regulations.</li> <li>A global best practice programme is continuing to enhance product quality processes across the Group. This is sponsored by the Executive Committee and leverages the ongoing work in Smiths Medical and John Crane.</li> <li>The divisions have procedures for dealing with product liability issues and potential product recalls. These procedures are informed by crisis management planning workshops and rehearsals.</li> <li>The Group has insurance cover for certain product liability risks. The US 'Safety Act' provides legislative protection for certain Smiths Detection products in the US; and we support efforts to implement similar legislation in other markets.</li> <li>Any litigation is managed under the supervision of the Group's legal function. We have detailed action plans to manage actual or threatened litigation.</li> </ul>
		 Read more on page 59 and in note 23 on pages 165-167

### Global supply chain and business/process transformation

<b>Potential impact</b> Medium  <b>Trend</b> Slightly higher 	<b>Risk and potential impact</b> <p>The Group's business depends on the availability and timely delivery of raw materials and purchased components, and could be affected by a disruption to its supply chain. In particular, we rely on sole suppliers to provide raw materials or components for some of our products.</p> <p>The Group's manufacturing facilities are exposed to a number of natural catastrophe risks, which, like other external events such as terrorist attacks or a disease pandemic, could have significant adverse consequences. The Group is also affected by the social, economic, regulatory and political conditions in the countries where it operates, which are often unpredictable and outside its control, particularly in developing countries.</p> <p>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.</p> <p>As part of the <i>Fuel for Growth</i> initiative, there are significant restructuring and reorganisation initiatives underway across the Group. These include site rationalisation and consolidation of manufacturing. There is a risk that these initiatives could cause disruption to the business, including manufacturing processes, supply chain, fulfilment of customer demand, and business systems and processes, or lead to industrial action.</p>	<b>Mitigation</b> <ul style="list-style-type: none"> <li>Business continuity and disaster recovery plans are in place and tested for critical locations, to reduce the impact of an event.</li> <li>Single-source supplier risks are identified and, where possible, key materials or components are dual sourced to mitigate the impact of an event.</li> <li>The Group regularly evaluates its key sites for a range of risk factors using externally benchmarked assessments, and takes action to improve these ratings, where appropriate.</li> <li>The Group has business interruption and property damage insurance.</li> <li>Transformation programme and project management is in place in John Crane, Smiths Medical, Smiths Detection and Smiths Interconnect.</li> <li>All transformation projects are approved by the Group Chief Executive and Finance Director. We are experienced in driving change programmes and all projects are subject to ongoing monitoring at Group and divisional levels.</li> </ul>
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## Managing risk in delivering our strategy

**Continued**

<b>Business challenges / thematic risks</b>		
<b>Government customers</b>		
<b>Potential impact</b>  High  <b>Trend</b>  No change	<b>Risk and potential impact</b> <p>We derive a significant proportion of our revenues in mature Western economies and some 35% of the Group's revenues are directly related to government spend. Additionally, a high proportion of our products and services are in some way influenced by government regulation and certification.</p> <p>Smiths Detection, Smiths Medical and Smiths Interconnect frequently tender for government contracts. The timing of contract awards and payments under these contracts may be uncertain and uneven over a given financial year.</p> <p>Any significant disruption or deterioration in relationship with these governments could result in fewer contracts and lower revenues.</p> <p>At a time when government finances are under pressure, these headwinds may lead to slower growth across the business. A decrease in spending by key government customers could materially affect the Group's results and financial condition.</p> <p>Delays in awarding government contracts can affect the Group's sales, margins and cash conversion in a particular reporting period.</p>	<b>Mitigation</b> <ul style="list-style-type: none"> <li>The Group has a diversified portfolio of businesses that mitigates exposure to any one country or sector.</li> <li>Some of our government-related business has a services or consumables component, which can be more resilient during an economic downturn.</li> <li>The Group has a government relations function so that it can inform policy and maintain close relationships with customers.</li> </ul>
<b>Technology and innovation</b>		
<b>Potential impact</b>  Medium  <b>Trend</b>  No change	<b>Risk and potential impact</b> <p>Developing new products and improving existing products is critical to our business and competitors may innovate more effectively. The emergence of a disruptive technology could have an impact on a major cash-flow contributor to the Group over time.</p> <p>The speed of innovation in certain markets may lead to shorter product lifecycles, increasing the need for innovation. Additionally, the entry of new competitors, the consolidation of existing competitors and changed or irrational competitor behaviour could all significantly affect the Group's business.</p> <p>The failure of the Group to develop its products and services, or more effective innovation by a competitor, could have a materially adverse effect on sales growth.</p>	<b>Mitigation</b> <ul style="list-style-type: none"> <li>The Group has a diversified technology portfolio in a range of sectors and geographies.</li> <li>Our continued investment in R&amp;D supports new product and service development. There is an increased focus on new product development processes across the Group.</li> <li>The Group looks to expand the addressable markets of its key businesses by building capabilities in adjacent markets, through organic investment and targeted acquisitions.</li> </ul>
<b>Talent and succession planning</b>		
<b>Potential impact</b>  Medium  <b>Trend</b>  No change	<b>Risk and potential impact</b> <p>The loss of key personnel, or the failure to plan adequately for succession or develop new talent may impact the reputation of the Group, or lead to a disruption in the leadership of the business.</p> <p>Competition for personnel is intense and the Group may not be successful in attracting or retaining qualified personnel, particularly engineering professionals. In addition, certain personnel may be required to receive security clearance and substantial training to work on certain programmes. The loss of key employees, the Group's inability to attract new or adequately trained employees, or a delay in hiring key personnel, could seriously harm the Group's business.</p> <p>Over time, our competitive advantage is defined by the quality of our people – should we fail to attract, develop and retain key talent, in time our competitive advantage will erode, leading to weaker growth potential or returns.</p>	<b>Mitigation</b> <ul style="list-style-type: none"> <li>Each division or function holds talent and succession plan reviews at least annually. These plans are reviewed by the Nomination Committee.</li> <li>Remuneration packages, including variable and long-term elements of the compensation arrangements, are evaluated regularly against market practice.</li> <li>The Chief Executive assesses, on an annual basis, the Top 25 people in the organisation for performance, skills and competencies and presents development and succession plans to the Board.</li> <li>Two leadership development programmes and formal career counselling support the talent pipeline.</li> </ul> <p> Read more on pages 20-24 and 70-71</p>

Business challenges / thematic risks		
Programme delivery		
Potential impact Medium to high  Trend Higher 	Risk and potential impact Failure to deliver, in a timely fashion or at all, the products and services Smiths is obliged to deliver, or any fault in contract execution due to delays or breaches by its suppliers or other counterparties, may lead to higher costs, liquidated damages or other penalties.  Differences between the estimated costs in Smiths medium- and long-term contracts and actual costs may arise from a number of factors including production delays, cost overruns and other items.  Certain of Smiths contracts, particularly those with governments, may include terms that provide for unlimited liabilities on Smiths part or allow the government body or counterparty to terminate unilaterally, reduce or modify the relevant contracts or seek alternative sources of supply at Smiths expense.	Mitigation • Contracts are managed and delivered by programme management teams that regularly review contract risks and take appropriate action. • A new Group-level procedure has been implemented for reviewing and approving high-risk contracts. • Divisional boards review significant contracts. • The diversified nature of the Group mitigates the exposure to any single contract.
Acquisitions and disposals		
Potential impact Low to medium  Trend No change 	Risk and potential impact Targeted acquisitions and selected disposals form part of the Group's growth strategy. The success of our acquisition strategy depends on identifying targets, obtaining authorisations and having the necessary financing. Even if an acquisition is completed, the acquired products and technologies may not be successful or may require significantly greater resources and investment than anticipated.  The Group may not be able to integrate the businesses that it acquires. If integration is unsuccessful, anticipated benefits are not realised or trading by acquired businesses falls below expectations, it may be necessary to impair the carrying value of these assets. In recent years, the Group has disposed of a number of businesses, including its Aerospace operations, where it has given indemnities, warranties and guarantees to counterparties. The Group is also party to a number of contracts relating to formerly owned businesses which it has not yet novated to the purchasers of these businesses.  The Group's return on capital employed may fall if acquisition hurdle rates are not met. The Group's financial performance may suffer from goodwill or other acquisition-related impairment charges. Insufficient allowance for indemnities and warranties given at disposal may affect our financial position.	Mitigation • The Executive Committee and Board review the acquisition pipeline. There are monthly reviews with strategy leads for each division. • We perform comprehensive strategic and financial reviews of all opportunities. Detailed due diligence – including an assessment of the target's talent and competencies – and integration work is undertaken and reviewed in accordance with Group policy. • The Board only authorises acquisitions after completion of due diligence, and approval is subject to meeting the capital allocation and other financial hurdles set by the Board. The Board regularly reviews post-acquisition performance and integration. • On disposals, the Group seeks to minimise its exposure to indemnities and warranties and any that are provided are reviewed on a regular basis.
Information technology and cyber-security		
Potential impact Medium to high  Trend Higher 	Risk and potential impact The Group's information systems, personnel and facilities are subject to security risk. The Group is dependent on information technology systems for both internal and external communications and for the day-to-day management of its operations. The incidence of cyber-security crime is on the rise and some Smiths Group companies operate in sectors where cyber-criminals are active.  Any disruption to the information systems could have significant adverse consequences for the Group's operations or its ability to trade. It could result in the loss of confidential information and intellectual property, which could affect the Group's competitive position and cause reputational damage.	Mitigation • Extensive controls and reviews are undertaken to maintain the integrity and efficiency of IT infrastructure and data. • There are also processes to deal with significant IT security incidents. • A Group-wide information security awareness programme has been launched.

# Corporate responsibility

**Promoting a culture of responsibility, developing smarter ways of working and attracting the best talent, and delivering operational efficiencies to enhance margins form key elements of our six-point business strategy. Behaving ethically, working safely, reducing our environmental impact, attracting and developing our people and contributing to our communities creates long-term value for our shareholders and our wider stakeholders.**

## Our Code of Business Ethics ('the Code')

Our Code of Business Ethics sets out 12 broad principles for how we do business, based on the common values of integrity, honesty, fairness and transparency. It provides the framework for our policies, programmes and procedures for a range of CR issues and is intended to enable our employees to make ethical decisions every time.

### Our Code of Business Ethics

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

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

## Why Corporate responsibility (CR) is important to Smiths

Operating within the Code and implementing our CR objectives enables us to meet our obligations to our stakeholders and delivers real business benefits, creating long-term value for shareholders. It:

- Protects our reputation and ability to grow
- Helps us to win business from customers who value strong CR performance
- Enhances our efficiency
- Enables our people to work productively, in a safe and ethical environment
- Helps us to attract and retain talent, and encourages employees to take pride in working for us
- Reduces the risk of incidents and their associated costs.

Many of our products also benefit the environment and contribute to the safety, health and security of people around the world. For example, Smiths Detection's security scanners play a vital role in helping to prevent terror attacks, while John Crane's seals help its customers to reduce their environmental impacts. You can see examples of these throughout this report.

## CR trends

The business environment is constantly evolving and we recognise that there are a number of environmental, social and regulatory trends that could influence Smiths and the industries in which we operate. These trends include an increased regulatory focus on avoiding bribery and corruption, increased competition for talent, pressure on energy and water use, climate change, materials safety and the ability to recycle waste and products which have reached the end of their useful life.

## Our strategic focus areas

Our Code of Business Ethics provides the framework for the way we do business in support of our business strategy and, more specifically, how we manage many of our CR issues. Within this, we focus on five priority issues: ethics, the environment, health and safety, our people and the communities in which we operate. These priorities are shared across the Group and our divisions are required to implement

and support these strategies and actively manage performance, with regular reporting back to the corporate centre.

## How we manage CR

Strong governance is essential to embedding responsible business practices across the Group. Our Board of directors is ultimately responsible for the stewardship of the business, including the Code. The Board sets the tone for the Group, establishes high ethical standards of behaviour and robust corporate governance and risk management frameworks, defines our strategic and financial objectives, as well as monitoring succession planning.

The Chief Executive and the executive team are responsible for delivering our strategic objectives, upholding the Code, implementing its supporting policies and delivering both our overall business strategy and specific CR strategies. CR issues are typically the top agenda item at Executive Committee and Board meetings and our executive team champion our commitments and strategies within the business, setting and continually reinforcing the 'tone from the top'. Further detail on how CR is managed between the corporate centre and the divisions can be found in 'Our business model' on p12-13.

Within this framework, we have distinct governance and management structures for each of our CR focus areas, reflecting the diverse nature of our activities and decentralised structure.



## Global ethics forum

We held our third global ethics forum in October 2013 in Dubai, UAE. The forum brought together 75 senior executives and managers from around the Group to consider the business and ethical challenges of doing business in the Middle East. The programme included input from subject matter experts and local business leaders, together with a number of case study scenarios. The participants were required to develop action plans to respond to a variety of ethical challenges, which they then discussed with members of the Smiths Group Executive Committee. This event is one of a series of interactive programmes addressing similar issues in many of the developing or emerging markets in which we operate.

## Ethics

Our global Ethics programme is focused on embedding a culture of ethical compliance across Smiths so that our employees do the right things, the right way, every time. Our objective is not only to protect the reputation of our company and to safeguard the investment of our shareholders, but also to protect the interests of every employee by ensuring individual legal and regulatory compliance as well as responsible behaviour.

### 2014 Highlights

- Held our third global ethics forum in Dubai, UAE, to reflect our growing presence in emerging markets
- Expanded training in areas such as anti-bribery and corruption for third parties, international trade compliance, international embargoes and sanctions, and competition and anti-trust
- Expanded Code materials, adding quick reference wallet cards and new translations of Code posters, and enhanced usability of Smiths intranet
- Included ethics questions in our MyVoice global employee engagement survey
- Adopted Supplier Code of Business Ethics, implemented by contractual terms that set the Code as a minimum standard for ethical operations and behaviours

### Governance

Our Ethics and Compliance programme is led by the Code Compliance Council, which acts as the steering committee and reports to the Audit Committee. The Council is responsible for determining priorities, reviewing key issues and making recommendations to the Audit Committee. The Council is supported by the Senior Vice President, Ethics and Compliance, who serves as an adviser and resource on ethical issues and manages responses to all enquiries and allegations, and by legal counsel, who provide compliance support to our businesses.

The Chief Executive and senior management champion the Code, setting and continually reinforcing the 'tone from the top'. The Code is also communicated through a variety of channels and training programmes.

### Reporting concerns and managing specific issues

We encourage employees who have concerns or queries about the Code to raise them with line management, Human Resources, their local in-house legal counsel or our confidential Ethics Alertline. The Alertline answers queries and enables employees to report any concerns or allegations. It is available via email, the internet and toll-free phone numbers in 53 countries. Employees can raise concerns at

any time through call centres operated by a contracted management company, which provides continuous coverage and support in 35 languages. All issues are addressed promptly and referred, as required, to relevant internal or external specialists for investigation. Our non-retaliation policy means that any employee who in good faith reports an act of apparent misconduct or unethical behaviour will not be victimised or treated adversely.

### Strategy and objectives

We embed the Code through communication, training and awareness programmes in order to promote a culture of ethical compliance, as well as developing and enhancing the policies and control processes in place to ensure compliance with laws and regulations across the jurisdictions in which we operate. We continually review and update our policies and business controls to mitigate changing areas of risk. We also review and update our Ethics programme, and systems and procedures for fostering, monitoring and auditing ethical business conduct.

In view of our strategic focus on expanding our presence in emerging markets, we have developed our programme to address the heightened, evolving risks of doing business in these markets. Other focus areas include expanding online training programmes, encouraging open discussion of ethical risks with employees at every level of the organisation, developing additional policies to enhance governance of key areas, and continued collaboration with Internal Audit as part of our risk management and assurance processes.

### Policies and training

We also expand and update training on other key areas of compliance to address evolving global risks. For example, in 2013 we updated and launched our training on international trade compliance and competition & anti-trust to the relevant personnel in several languages. This year we launched an online course on 'Ethics Training for Third Parties' for our agents, distributors and external sales representatives. We also introduced a new Supplier Code of Business Ethics, which is available externally on the Smiths website and provided to all major suppliers. The Supplier Code and our contractual provisions require suppliers to maintain high ethical standards in line with our Supplier Code or their own comparable ethics programme.

We continue to update policies on areas such as international trade sanctions and embargoes, import and customs, and international export compliance. We also undertook a wider review of the Smiths Group policies. With our growing presence in emerging markets, we have also continued to build on our programme

to address the particular challenges associated with operating in these countries. Following the success of our global ethics forums in Shanghai, China in 2011, São Paulo, Brazil in 2012, and Dubai in October 2013, we plan to hold a similar forum in Berlin in June 2015.

### Controls on defence sales

We seek to ensure that all sales and exports of defence equipment are undertaken in accordance with international trade regulations and national government export and approval procedures and regulations, such as the International Traffic in Arms Regulation and the Export Administration Regulations in the US. These laws prohibit export of certain items to specific countries. The Group's policy is to adhere to all relevant government guidelines designed to ensure that products are not incorporated into weapons or other equipment used for the purposes of terrorism or abuse of human rights, with internal controls to ensure compliance with these guidelines.

### Human rights

Smiths seeks to uphold all internationally recognised human rights wherever its operations are located. Within this framework, we do not tolerate the use of child or forced labour at Smiths facilities or those of our suppliers. We take all steps possible to ensure our products are not used to abuse human rights.

### Priorities for 2015

- Hold our fourth global ethics forum in Berlin
- Continue to update our training and compliance programmes in line with changing business needs and regulations, such as expanding international sanctions and embargoes
- Refresh online Code of Ethics training
- Train suppliers on our ethical standards and requirements to support the launch of the new Supplier Code of Business Ethics, including the prohibition of any abuse of human rights.
- Continue to ensure ethics messages are received and understood by all employees worldwide

## Environment, health & safety (EHS)

Promoting a culture of responsibility throughout the Group is part of our business strategy and our Code of Business Ethics. We are committed to achieving excellence in environment, health and safety management and performance and providing effective leadership in the pursuit of injury-free and environmentally responsible workplaces.

## Corporate responsibility

### Continued

#### 2014 Highlights

- **Implemented a new EHS management software system**
- **Re-evaluated our most serious EHS risks and identified additional actions for reduction**
- **Introduced a serious incident metric to help monitor injury severity trends and respond accordingly**
- **Performed a gap analysis of our GHG emissions reporting to further improve completeness and accuracy**

#### EHS governance and management

Our environmental, health and safety (EHS) approach starts with our EHS policy, which was recently updated, and is supported by our EHS strategy, KPIs and goals. Our divisions adapt the Group EHS strategy to reflect their specific impacts and any opportunities to improve their EHS management and performance.

We believe in the power of continuous improvement and use management systems to realise its benefits. In addition, management systems provide detailed risk and issue identification that helps sites to prioritise and focus on the most concerning risks. We require all manufacturing, warehousing and service centre sites with more than 20 employees to implement management systems OHSAS 18001 for occupational health and safety and ISO 14001 for environmental. Sites with 50 or more employees are required to have their EHS management systems externally certified. Of the 98 sites that are required to be externally certified, 96 have completed certification. Including sites that voluntarily certify, 111 sites are externally certified. Sites that have not completed certification have action plans to do so. New acquisitions or expanded operations have two years to obtain certification.

#### EHS strategy

Our EHS strategy is designed to protect our employees, communities, environment, and shareholder value by effectively managing safety and environmental risks. During 2013, we updated our strategic objectives and goals. This strategy development process involved benchmarking against peers and other high-performing companies and evaluating global trends. We identified strategic areas that we will focus on over the next three years, including safety culture, training, risk identification and mitigation and energy management.

The Smiths Group sustainability strategy provides direction for the divisions to manage their sustainability agenda based on evaluation of practical sustainability application and importance to its business. Each division identifies and defines the specific actions for their businesses. Our EHS KPIs are aligned

to the strategy and allow us to assess our progress. Achievement of KPIs is also part of our senior management performance assessment.

#### Environmental targets

In 2013, we set new five-year targets for our environmental metrics. Our targets are to achieve 15% reductions in energy usage, greenhouse gas emissions and waste generation, and a 10% reduction in water usage by FY2018, all normalised to revenue against a baseline of FY2013.

Our greenhouse gas (GHG) emissions calculation methodology closely follows the Greenhouse Gas Protocol and includes emissions from sources under our control. In addition, the inventory consists of Scope 1 (direct GHG emissions from sources owned or controlled by the company) and Scope 2 (GHG emissions from the generation of purchased electricity consumed by the company) emissions. In 2014, an external adviser performed a review of our GHG emissions calculation methodology and prepared a GHG Inventory Management Plan that will be used to further align our emissions calculation methodology with the GHG Protocol. It was concluded that emissions from vehicles, production processes and fugitive sources are small and not material compared to our total GHG emissions. Due to the difficult nature of collecting emission data from these sources and their immateriality, they have been excluded from the inventory totals. The materiality of these sources will be reviewed again in the future.

Over the past four years we have significantly reduced our environmental impact, with 18% energy, 29% GHG, 24% water and 25% non-recycled waste reductions, normalised to revenue. Our environmental performance continued, overall, its long-term improvement trend. We achieved good progress in reducing GHG emissions and non-recycled waste. Minor increases were recorded in energy and water usages due to colder winter temperatures and an increase in sales of products using water in the production process. Less water-intensive production methods are being developed for these products.

#### Performance against environmental targets

	Target FY2013-18	FY2014 progress against FY2013
<b>Energy</b>	15% reduction	<b>1% increase</b>
<b>Greenhouse gas emissions</b>	15% reduction	<b>4% reduction</b>
<b>Total non-recycled waste</b>	15% reduction	<b>5% reduction</b>
<b>Water consumption</b>	10% reduction	<b>1% increase</b>

Reduction targets are compared to the FY2013 baseline year and normalised to revenue consolidated at FY2014 closing exchange rates.

#### Total energy

'000MWh

2014	281
2013	278
2012	279
2011	303
2010	305

#### Total CO<sub>2</sub> emissions

'000 tonnes

2014	99
2013	103
2012	110
2011	121
2010	124

#### Water use

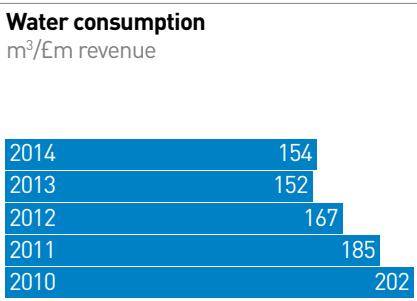
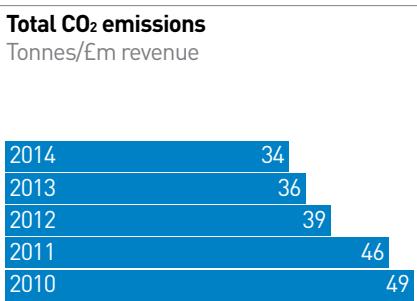
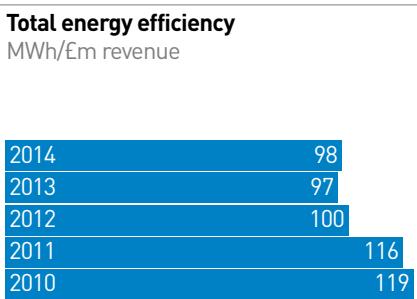
'000m<sup>3</sup>

2014	440
2013	435
2012	465
2011	485
2010	515

#### Total non-recycled waste

'000 tonnes

2014	5.3
2013	5.6
2012	5.5
2011	6.1
2010	6.2



FY2013 metrics have been revised marginally from last year to reflect refinements in monitoring.

## Health and safety management

The Group is committed to working in a way that protects, as far as reasonably practicable, the health and safety of its employees. Our employees recognise this commitment. In our Group-wide engagement surveys, workplace safety continues to be the highest scoring dimension, exceeding the worldwide benchmark for manufacturing industry.

Our Group-wide activities to reduce incidents have focused on leadership and employee safety awareness and involvement and risk reduction. We continue to implement and build on these activities and are monitoring them through our Safety Leading Indicator Activities Programme. We use a safety leading indicator activity score as a KPI for safety, complementing the recordable incident rate (RIR). Sites are required to complete a minimum number of proactive safety activities, which count towards their score.

Annually, we create new leadership and employee training programmes to build on the previous year. Supervisor safety management training was added in FY2014 to improve the safety skills supervisors need for managing a workforce. In FY2015, the activities will be split between common Group-wide and division-specific activities to further target the specific improvement needs of each division.

## Health and safety targets

Our FY2014 safety performance metrics were the Safety Leading Indicator Activity Score, RIR and Lost Time Incident Rate (LTIR). Smiths Group and all divisions completed the required number of safety leading indicator activities, which will support our efforts to improve our safety culture and risk management.

As part of our strategic plan updating and benchmarking in FY2013, we also updated our safety performance targets. The new safety targets increase focus on leading indicator activities designed to reduce the risk of incidents. We will place less emphasis on the lagging indicator Recordable Incident Rate (RIR). However, we will continue to monitor RIR and lost time incident rate and investigate incidents for contributing factors and trends to help focus risk assessments. In FY2014, we developed a new metric to increase our focus on serious incidents and risks. Our ultimate ambition is 'zero harm' to employees. Adopting this further emphasises to employees and other stakeholders how seriously we take our EHS performance.

## Health and safety performance

Since 2004, we have achieved a steady reduction in our RIR, with FY2014 being our safest on record. Whilst our aspiration is zero harm, we improved our RIR from 0.54 to 0.50 with 9% fewer incidents in 2014, meeting our objective to continuously improve.

After years of reductions, our LTIR has been steady at 0.22 for the past two years. This is still well below our FY2008 of 0.54. Over the past ten years, we experienced two occupational fatalities with an employee at a former facility in Sweden in 2003 and a contractor in Costa Rica in 2007.

Security is an important part of protecting our employees and our business. We aim to minimise security risks in order to safeguard our people and physical and intellectual property. Our Group Security Director advises the Executive Committee on current and emerging security risks. The Executive Committee is responsible for setting Group-wide priorities and reviewing our approach and performance. The Group Security Committee oversees progress and shares good practice, while the divisions are responsible for the implementation of division-specific security initiatives. Our Security programme includes Group-wide minimum standards covering physical and procedural security at company sites, business travel security and security awareness.

## Safety performance

	2014 results
<b>Recordable incident rate</b>	<b>0.50</b>
<b>Lost time incident rate</b>	<b>0.22</b>

## Priorities for 2015

- Develop global technical minimum standards to reduce our most serious EHS risks
- Complete the implementation of our new EHS management software system

## Recordable incident rate

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

2014	0.50
2013	0.54
2012	0.60
2011	0.66
2010	0.71

## Lost time incident rate

Where an employee is unable to work the day after an incident (per 100 employees per year)

2014	0.22
2013	0.22
2012	0.21
2011	0.29
2010	0.30

## People

Attracting, retaining and developing the right people with the right skills is central to our ambition of transforming Smiths into a world-class organisation and supporting our growth ambitions.

We believe that people growth is a strong enabler of business growth and we develop our employees' capabilities so they can fulfil their potential and help us to fulfil ours.

## 2014 Highlights

- **Strengthened our talent pipeline through targeted external recruitment and a focus on talent assessment, personal development and succession planning**
- **Rolled out junior and senior leadership development programmes**
- **Conducted our third MyVoice global employee engagement survey**
- **Embedded new HR operating model to support business growth**

## Governance

Over the past four years, we have transformed our HR function to bring world-class people management to Smiths and to leverage our strength and scale. Our new model combines consistent, best practice approaches and programmes in key areas with divisional initiatives that address specific business needs, supported by GlobalView, Smiths first HR information system. The utilisation of an e-enabled model empowers managers and employees to take more responsibility for many aspects of their working lives.

## Strategy and objectives

We have consistently focused on strengthening our leadership capabilities and talent pipeline at both senior and junior levels, improving succession planning, enhancing employee engagement and transforming our HR function to provide a strong platform for growth.

As we work to transform Smiths into a world-class organisation, a talented and determined workforce, united by commercial acumen, an appetite for innovation, strong leadership and a commitment to collaboration and responsibility, will be essential to achieving our ambitions. To support this, we will continue to develop our leadership capabilities throughout the organisation to ensure we have the depth and breadth necessary to support growth; deepen our focus on our technological and engineering expertise in order to drive innovation and maintain our technological leadership; and continue to build employee engagement across the business in response to the global MyVoice survey and ongoing feedback.

## Performance

### Building the talent pipeline and succession planning

Our focus on succession planning has delivered significant progress in building our talent pipeline, through a more rigorous and consistent approach to assessing talent and a greater focus on preparing and monitoring personal development plans. We have also invested significantly in our two leadership development programmes. 'Horizons' fosters emerging talent at junior levels, while 'Aspire2' develops senior leaders. These programmes challenge and engage our employees, build their understanding of the wider Group, increase their exposure to our senior leaders and enhance their core leadership competencies. The programmes will also improve the diversity of candidates, especially in the areas of gender and emerging market backgrounds. Over 100 managers from across the business have been on or are currently participating in these programmes.

We provide a wide variety of learning and training opportunities, ranging from workshops and mentoring to online resources and internal and external training courses. Personal development planning and identification of training and development needs form a key part of our annual performance review process and we are rolling out a new, enhanced toolkit to support this as part of the development of GlobalView.

We constantly challenge ourselves as to whether we have the right skills and competencies to support our growth ambitions and believe this is best achieved through a healthy balance of recruiting the very best external candidates to bring fresh approaches and perspectives, while also strengthening our internal talent pipeline.

### Performance and reward

Managing performance is critical to ensuring our employees fulfil their potential and deliver business results. In a competitive marketplace, we recognise the importance of rewarding employees appropriately and aim to offer compensation and benefits packages that enable us to attract, develop and retain key talent. Our new HR operating model is driving consistent best-in-class approaches to reward across the Group. We encourage our people to share in our success and periodically offer employees in the US and UK opportunities to participate in share plans, aligning their interests more closely with those of shareholders.

## Diversity and inclusion

With operations in more than 50 countries and a strategic focus on innovation and expanding into new geographic markets, having a diverse, engaged workforce that reflects our footprint and brings local knowledge, fresh perspectives and constructive challenge is critical. We aim to provide an inclusive, collaborative culture that values every individual, fosters collaboration, and provides the tools, opportunities and challenges to enable them to fulfil their potential and add value to the business.

At the end of FY2014, 39% of our global workforce and 10% of our senior managers were women. We are committed to increasing the diversity (in its broadest sense) of our workforce, and our two leadership development programmes will help to increase the diversity of candidates for senior positions. Two of our Board directors (22%) were women, slightly below the 25% recommended by the Davies Report as the Board grew with the arrival of Bill Seeger. We hope to address this as Board membership evolves.

### Employees by gender

	Male	Female	Total
Board directors	7	2	<b>9</b>
Senior managers*	229	25	<b>254</b>
Total employees <sup>†</sup>	14,600	9,500	<b>24,100</b>

\*Senior managers are as defined by the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013, which includes employees who have responsibility for planning, directing or controlling the activities of the Group or a strategically significant part of the Group (other than Board members) and/or who are directors of subsidiary undertakings

<sup>†</sup>Full-time equivalents at 31 July 2014

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

All our employees are treated with respect and dignity. Accordingly, any harassment or bullying is unacceptable. The Group respects the right of each employee to join or not to join a trade union or other bona fide employee representative organisation.

## Employee engagement

We recognise that an engaged and motivated workforce is critical to achieving our objectives. Our MyVoice survey is a valuable tool for measuring engagement and providing insight into our employees' motivations and priorities.

We conducted our third survey in 2014 in partnership with Kenexa, a part of IBM and a leading survey provider, to ensure that responses were anonymous and to enable us to conduct the survey in local languages. We achieved a participation rate of 85% and benchmarked results against global norms for the manufacturing industry. We communicated divisional, local and functional results and action plans are in place across the business to address the most significant issues highlighted. During FY2014, we also continued to address the results of the 2012 survey and incorporated any ongoing initiatives in the most recent survey action plans to ensure continuity. We intend to conduct an interim engagement survey in the future based on a significant sample of employees in order to monitor progress.

## Communication

Communication is fundamental to engaging employees. This having been identified as a key theme in the last MyVoice survey, we have implemented a number of initiatives to improve information sharing, facilitate greater collaboration and improve news flow at both Group and divisional levels. These include developing a new intranet platform, more regular updates on performance and key business issues, and providing greater opportunities for feedback and dialogue. This has built on the wide variety of well-established tools and channels used across the Group, including site meetings, team briefings, presentations and newsletters.

In European Union (EU) countries we have workplace information and consultation arrangements at our sites. These link to the Smiths Group European Forum, through which employee representatives from across the EU meet annually to discuss transnational matters with Group executives. Our 2014 Forum was held in the UK and saw 16 representatives from across the Group meet with senior executives to discuss matters such as HR, ethics, market conditions and business strategy and performance. Feedback from the event was extremely positive.

## Acquisition integration

When new businesses are acquired, we implement plans to integrate them into the Group, ensuring that our business ethics, employee development and EHS policies and programmes are well established. We regularly review our processes in these areas, to identify opportunities to improve.



## Priorities for 2015

- Continue to develop leadership capabilities throughout the organisation
- Deepen our focus on technological and engineering expertise
- Continue the roll-out of GlobalView tools to support performance management and development
- Conduct an interim MyVoice engagement survey based on a significant sample of employees to monitor progress

## Communities

Contributing to the communities in which we operate benefits both local people and our business. It helps to drive prosperity in local communities, enhance our profile and reputation, promote employee engagement and attract new employees.

Given the diversity of our business and our decentralised structure, our community relationships and charitable programmes are primarily managed at a local level to allow our businesses to focus on the particular needs of their markets and communities. We also offer some Group-level support to community and charitable organisations, considering charities and organisations that demonstrate how a donation will enhance the well-being of people through improved education, health and welfare or environment.

In FY2014, we made charitable donations of £192,000 as a Group. Our employees also raised money for a wide range of charitable causes through a variety of fund-raising initiatives across the business.

## Horizons development programme

**Our junior leadership development programme, Horizons, aims to build participants' understanding of the wider Group, increase their exposure to senior leadership and enhance their core leadership competencies. Running over 12 months, it mixes theory, business simulations, presentations and psychometric testing with business projects.**

**"The mix of different personalities, cultures and divisions helped me better understand my own leadership style and how to strengthen it. The programme also taught me a lot about Smiths Group and what role I can play in the company in the future. The contacts I made with some outstanding leaders and peers from across the Group continue to help me every day," said participant Louise Branigan, a Commercial Marketing Manager based in the UK. "I feel the Smiths leadership is really supporting me in growing my career."**

**Fellow participant Dharaiv Dalal, a Marketing Manager from India, commented, "Horizons was excellent with the right balance of business management and personal development, through public speaking and group work. The exposure to different functions and divisions provided a great platform for developing my understanding of the Group."**

## Strategic report

The Strategic report was approved by the Board on 16 September 2014.

By order of the Board

**Peter Turner  
Finance Director**

# Bringing technology to life... Making the world healthier



Since 2007 Smiths Medical's Portex epidural catheters have assisted in managing pain for more than 17 million patients in over 100 countries. Commonly used during childbirth, the catheter carries painkilling drugs directly into the nerves around the spine in the small of the patient's back to provide safe and highly effective regional anaesthesia.



## Governance

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

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# Board of directors



## Sir George Buckley

### Chairman

Aged 67, Sir George Buckley joined the Board on 1 August 2013 as a non-executive director and Deputy Chairman and succeeded Donald Brydon as Chairman on Donald's planned retirement at the close of the AGM on 19 November 2013. A citizen of both the UK and US, Sir George has a PhD in Electrical Engineering.

#### Strengths and experience

Sir George retired in 2012 as Chairman and CEO of 3M, the US-based global technology company and Dow Jones 30 component, after a long and successful business career spent mainly in the United States. He was previously Chairman and CEO of Brunswick Corporation and Chief Technology Officer at Emerson Electric Company. Sir George's expertise in engineering and innovation, combined with his extensive experience of multi-industry businesses that operate in global markets, are of huge benefit to Smiths.

#### Committee membership

- Nomination Committee
- Remuneration Committee

#### External appointments

- Chairman of Ownership Capital
- Chairman of Arle Capital
- Non-executive director of Hitachi, Ltd.
- Non-executive director of PepsiCo
- Non-executive director of Stanley Black & Decker, Inc.



## Philip Bowman

### Chief Executive

Aged 61, Philip Bowman is Australian with an MA in Natural Sciences. He has extensive experience of leadership at major international public companies and was appointed Chief Executive of Smiths Group in 2007.

#### Strengths and experience

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

#### External appointments

- Senior Independent Director and Chairman of the Audit Committee of Burberry Group plc
- Non-executive director of Better Capital PCC Limited
- Chairman of The Miller Group (UK) Limited and Chairman of its Remuneration Committee and a member of its Audit Committee



## Peter Turner

### Finance Director

Aged 44, Peter Turner is British with a BA in Natural Science – Chemistry. He qualified as a Chartered Accountant whilst working for PricewaterhouseCoopers. He became Finance Director of Smiths Group in 2010.

#### Strengths and experience

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



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

Aged 67, Bruno Angelici is French with an MBA (Kellogg School of Management) and Business and Law degrees from Reims. He was appointed to the Board in 2010.

**Strengths and experience**

Bruno's career includes senior management roles in pharmaceutical and medical device companies. Bruno retired from AstraZeneca in 2010 as Executive Vice President, International after a 20-year career. He was responsible for Europe, Japan, Asia Pacific, Latin America, Middle East and Africa and originally joined as President of ICI Pharma France. Prior to this, he was at Baxter, a US-based global supplier of medical devices. He has extensive international experience, including in the US, and brings a deep understanding to the Group of the medical device and pharmaceutical industries.

**Committee memberships**

- Audit Committee
- Nomination Committee
- Remuneration Committee

**External appointments**

- Member of the Global Advisory Board of Takeda Pharmaceutical Company Ltd, Japan
- Non-executive director and member of the Nomination Committee of Novo Nordisk A/S, a Danish healthcare company
- Member of the Supervisory Board and the Audit Committee of Wolters Kluwer nv, a Dutch-based information services and publishing company
- Chairman and a member of the Nomination and Remuneration Committees of Vectura Group plc, a specialty pharmaceutical company



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

Aged 71, David Challen CBE was appointed to the Board in 2004. He is British with a BA in Mathematics, a BSc in Natural Science – Physics and an MBA from Harvard.

**Strengths and experience**

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

**Committee membership**

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

**External appointments**

- Deputy Chairman of the Takeover Panel
- Member of the Financial Reporting Council's advisory group of audit committee chairmen



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

Aged 53, Tanya Fratto was appointed to the Board in 2012. An American, she is a qualified electrical engineer with a BSc in Electrical Engineering.

**Strengths and experience**

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

**Committee membership**

- Audit Committee
- Nomination Committee
- Remuneration Committee

**External appointments**

- Non-executive director and member of the Remuneration Committee of Boart Longyear Ltd, an Australian-listed, US-based mining products and services company
- Non-executive director and member of the Audit Committee of Advanced Drainage Systems, Inc., a US-listed water management and drainage company

## Board of directors

### Continued



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

Aged 63, Anne Quinn was appointed to the Board in 2009. She is from New Zealand and has a BCom and MSc in Management Science.

#### Strengths and experience

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

#### Committee memberships

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

#### External appointments

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



#### Bill Seeger Non-executive director

Aged 62, Bill Seeger was appointed to the Board in May 2014 as Chairman-elect of the Audit Committee. He is a US citizen with a BA in Economics and an MBA, both from UCLA (University of California, Los Angeles).

#### Strengths and experience

Bill joined GKN plc, the global engineering company, in 2003 as Senior Vice-President and Chief Financial Officer of Aerospace. In 2007 he became a member of the Executive Committee as President and Chief Executive Propulsion Systems and Special Products before being appointed to the Board as Group Finance Director the same year. He retired from GKN in August 2014. Bill previously held a number of senior finance posts during a 28-year career with TRW, the US-based automotive components group. His long career in finance in the engineering sector and in-depth knowledge of global markets, contracting and strategy execution will greatly benefit Smiths.

#### Committee memberships

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



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

Aged 67, Sir Kevin Tebbit was appointed to the Board in June 2006. Sir Kevin is British and has a BA in History.

#### Strengths and experience

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

#### Committee memberships

- Audit Committee
- Nomination Committee
- Remuneration Committee

#### External appointments

- Senior Adviser to URS Corporation and to Hewlett Packard
- Senior Associate Fellow at Royal United Services Institute
- Visiting Professor at King's College, London
- Member of the Advisory Board of the Imperial College Institute for Security, Science and Technology

#### Board balance and diversity

The Smiths Group Board increased from eight members to nine members in 2013/14, with the addition of Bill Seeger. The charts below illustrate as at 31 July 2014 the diversity of the Board in relation to tenure, gender and nationality.

#### Nationality

Five nationalities are represented on the Board (United Kingdom, France, Australia, United States and New Zealand), although the international experience of Board members is much wider than this.



United Kingdom France Australia United States New Zealand

#### Executive balance

- 1 Executive
- 2 Non-executive

The Board has two executive directors, the Chief Executive and Finance Director. The majority of the Board are independent non-executives, who bring a wealth of skills and experience to Smiths.

1	22%
2	78%

#### Gender balance

- 1 Female
- 2 Male

There are two women on the Board, Anne Quinn and Tanya Fratto.

1	22%
2	78%

#### Board tenure

- 1 From 0 to 2 years
- 2 From 3 to 6 years
- 3 From 7 to 10 years

Further details on the tenure of each director are shown on pages 74 to 76.

1	33%
2	45%
3	22%

# Corporate governance statement

## Chairman's introduction



### Sir George Buckley

I have highlighted in my Chairman's statement the importance of excellence in many areas of the Company's activities, such as innovation, manufacturing, and customer service. That commitment to excellence is no less important when it comes to governance.

I am honoured to be the Chairman of Smiths Group in its 100th year as a listed company. I am committed to ensuring that the Board provides the effective leadership which Smiths requires, as a diversified technology company operating in the complex global environment of the 21st century, and which its shareholders rightfully expect.

The Smiths Board comprises nine people, with diverse backgrounds, skills and experience, who share a collective responsibility for the long-term success of the Company. As Chairman, I lead the Board and strive to ensure that I and my colleagues on the Board provide support and constructive challenge to the executive team, whether it be in formal Board meetings or in less formal discussions with Philip and members of his team.

As referred to in my Chairman's statement, I am very pleased to report the addition of Bill Seeger to the Board. Bill not only brings us relevant and recent financial skills and expertise, having spent the last seven years as Group Finance Director of GKN plc, but he also joins me and Tanya Fratto in providing valuable US commercial perspectives, further strengthening the international outlook and experience of the Board.

Bill has been engaged in an extremely thorough induction programme, visiting several sites in each of the Company's five divisions, as well as the Company's headquarters in London, and spending time with members of both the Corporate and divisional management teams and other colleagues. Having recently completed my own extensive induction programme at Smiths, I am acutely aware of how valuable it is to engage with the Company's employees on their home turf, share their enthusiasm for Smiths products and skills and learn about their challenges.

As part of understanding the business, our effectiveness as a Board is also dependent on each of the directors absorbing and understanding large amounts of information. I am pleased to report that the executive team take great care with the quality of the information provided to the Board and its Committees, whether as part of formal meeting packs or by way of updates or additional information at other times. I have instituted an additional reporting and scrutiny process at Board meetings whereby each division provides an Annual Operating Review to the Board. This supplements the existing divisional reporting processes to the Board and the Audit Committee and allows the Board to give increased focus to each division individually.

One of the innovations which my predecessor, Donald Brydon, instituted was to set annual objectives for the Board each year. I believe this is a useful discipline and, at the final Board meeting of the year in July, the Board considered its performance against those objectives and agreed to set new objectives for this year. Of course, the Board also carries out comprehensive and rigorous annual reviews of its own performance, the performance of its committees and the individual performance of its members. For the financial year 2013/14, this is an externally facilitated review, as further set out in the Corporate governance statement below.

This year is the first year that the Company is subject to the new requirements in the UK Corporate Governance Code which includes the provision that the directors state in the annual report and accounts that they consider that the report:

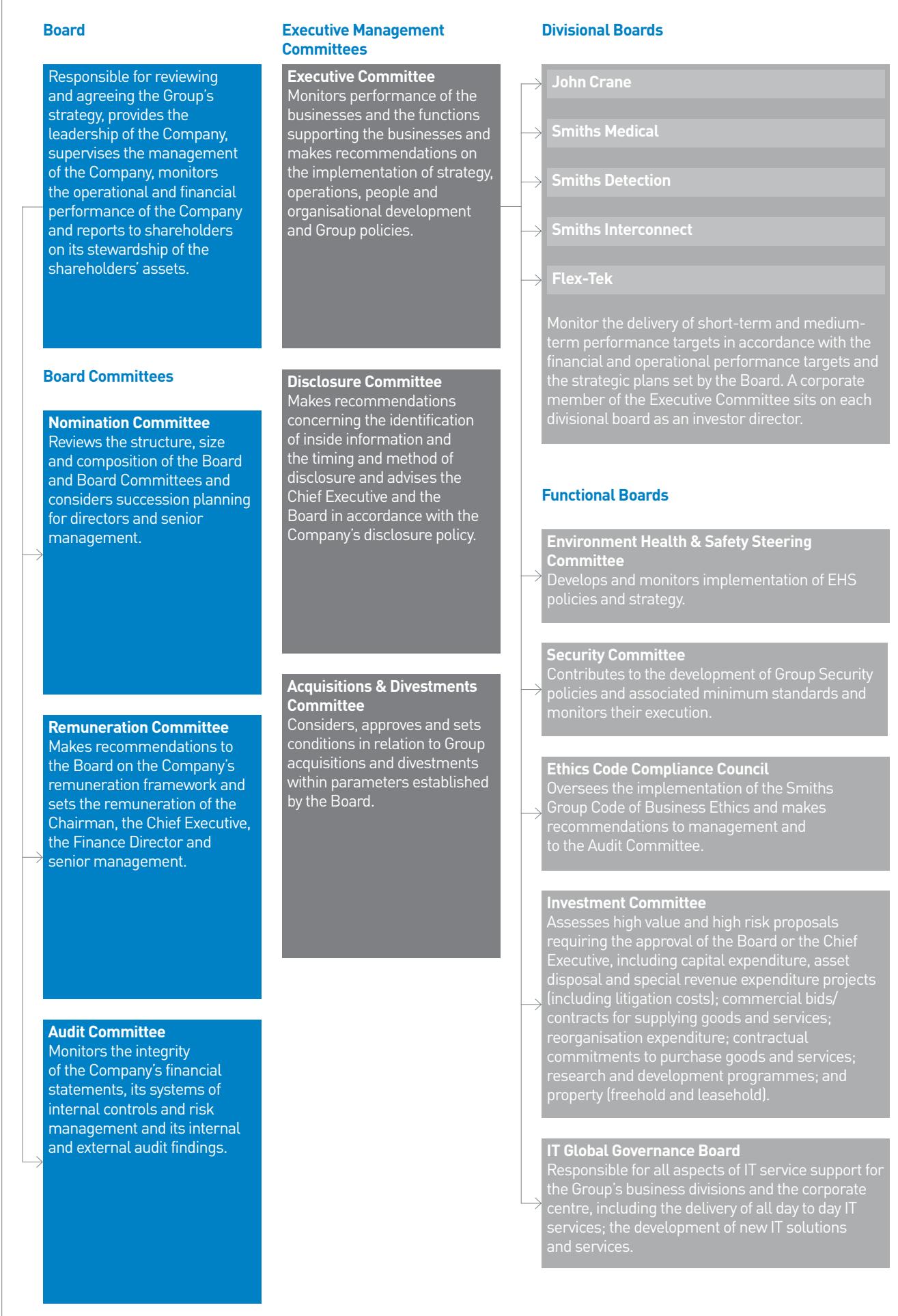
"taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's performance, business model and strategy". (paragraph C.3.4 of the Code)

It is also the first year that the Company is subject to the new Remuneration Reporting Regulations and to the narrative reporting changes which require the Company to prepare a strategic report and make a number of new disclosures.

The Audit Committee and the Board have discussed these topics and considered, with the executive team, how best to ensure good corporate reporting, which is clear and concise, whilst also containing all the information required by shareholders. It is always a tricky balancing act to provide all the information which regulation requires, whilst also producing a report which is useful to our diverse shareholder community. We will, of course, seek to continue to improve our reporting, as part of our commitment to maintaining a dialogue with our shareholders and other stakeholders, but I hope that you find this year's Annual Report informative and helpful.

**Sir George Buckley**  
**Chairman**

## Governance structure



## Compliance with the UK Corporate Governance Code

Throughout the period 1 August 2013 to 31 July 2014 the Company has been in full compliance with the September 2012 edition of the UK Corporate Governance Code (the 'Code'), published by the Financial Reporting Council and available on its website (<https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx>) except that:

- 1) The Company has not put the external audit contract out to tender for more than ten years. The requirement in paragraph C.3.7 of the Code to put the external audit contract out to tender at least every ten years applies to the Company for the first time this year, as it was not included in the version of the Code that applied last year. It was the view of the Audit Committee and the Board that it would not be advisable to re-tender the audit contract in a year in which a new Chairman of the Company and a new Chairman-elect of the Audit Committee were recruited. Taking into account the requirements in the Code, the final proposals of the Competition & Market Authority's investigation into statutory audit services, and the Department for Business, Innovation & Skills proposals to implement the EU's June 2014 Audit Directive and Regulation, the Audit Committee will keep the issue of audit firm rotation under annual review.
- 2) The value of any fees received by executive directors in respect of external non-executive directorships is not disclosed in the Directors' remuneration report, as this is not considered relevant to the Company. (The Company intends to continue to explain rather than comply with the Code in this limited area.)

## Disclosure & Transparency Rule 7

This Corporate Governance statement is a section of the Group directors' report and is incorporated therein by reference.

This statement complies with sub-sections 2.1; 2.2(1); 2.3(1); 2.5; 2.7; and 2.10 of Rule 7 of the UK Listing Authority Disclosure & Transparency Rules. The information required to be disclosed by sub-section 2.6 of Rule 7 is shown in the Group directors' report on pages 111 and 112 and is incorporated in this Corporate governance statement by reference.

## Directors

### The Board

As at 15 September 2014, the Board comprises Sir George Buckley (Chairman), Mr Philip Bowman (Chief Executive), Mr Peter Turner (Finance Director) and six independent non-executive directors: Mr David Challen (Senior Independent Director), Mr Bruno Angelici, Ms Tanya Fratto, Ms Anne Quinn, Mr Bill Seeger and Sir Kevin Tebbit. Mr Donald Brydon retired from the Board at the end of the Annual General Meeting on 19 November 2013 and Sir George succeeded him as Chairman. Biographies of the current directors, giving details of their experience and other main commitments, are set out on pages 74 to 76. 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 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, and holds additional meetings to consider the strategy of each of the divisions and the strategy of the Company. The Board exercises control by determining matters specifically reserved to it in a formal schedule which only the Board may change: these matters include the acquisition or divestment of significant companies or businesses, the issue of shares, significant contractual commitments, the review of the effectiveness of risk management processes and major capital expenditure. Further meetings are arranged as necessary to deal with urgent items.

The Board sets the Company's values and standards, including the Company's Code of Business Ethics which is referred to on pages 66 and 67.

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

The Chairman meets the non-executive directors without the executive directors present at least twice a year. The Senior Independent Director meets the other non-executive directors without the Chairman present at least annually and is available to provide support to the Chairman and to serve as an intermediary for the other directors, if required.

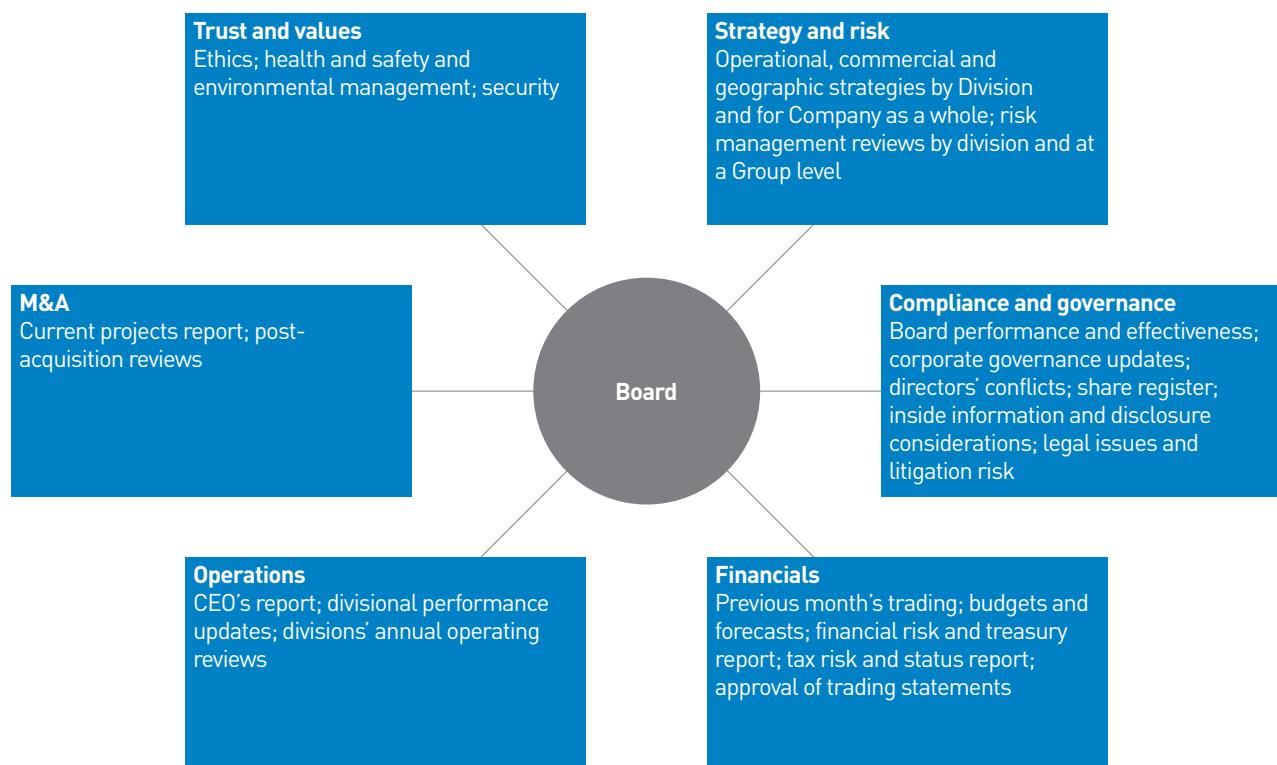
Directors and officers of the Company and its subsidiaries have the benefit of a directors' and officers' liability insurance policy.



### Board visit to Smiths Medical, St Paul, US

**As part of its programme of visits to the Group's businesses, the Board visited the head office and manufacturing facilities of Smiths Medical in St Paul, Minnesota, US, in May 2014. The visit included updates on strategy and performance from senior management, a tour of the facility and the opportunity to meet employees.**

**Board activities**



**Trust and values**

The Board sets the tone for the Company's culture of compliance with high ethical standards and with all the laws and regulations that apply to its businesses. The Board supported the holding of an Ethics Conference in Dubai in October 2013 which addressed the ethical risks arising from operations in multiple jurisdictions, with particular focus on the Middle East. The Board also participated in the online refresher training for the Code of Business Ethics which was rolled out to all employees throughout the Group who had not recently completed the training.

**Strategy and risk**

The Board holds a number of dedicated strategy sessions each year, focusing on long-term targets and initiatives to improve the growth, efficiency and capability of each division and of the Company. The information and proposals which are provided to the Board are underpinned by a number of workstreams amongst the executive teams in each division and on a Group-wide basis. This year initiatives included the establishment of a cross-divisional working group on additive manufacturing (also known as 3D printing), in order to share experience and resources. The Board saw at first hand the exciting developments in this fast-moving area when the Directors visited the 3D printing facility at the Smiths Medical site in

St Paul, USA in July. The Chairman also spoke on the theme of "engineered for growth" at the Group's senior management conference in Miami in May which was attended by over one hundred managers from across the Group.

In addition to the regular divisional risk reviews presented to the Audit Committee, at least once a year the Board reviews risks at a Group level. In July this year the Group-wide risk report that was presented to the Board included analyses of risks faced by the Company in the areas of contractual liabilities; exposure to developing markets; and business and process transformation and the measures in place to mitigate these risks. A report on cyber-risk is submitted to each scheduled Board meeting.

**Compliance and governance**

The Board receives regular corporate governance updates on relevant issues, including amendments to the Listing Rules and the UK Corporate Governance Code and developments in regulatory and legal regimes and sanctions.

**Financials**

The Board considers the Group's trading performance and financial risk at each meeting. In September 2013, the Board recommended the payment of a special dividend at the same time as the payment of the final dividend, in November 2013, subject to shareholder approval at the 2013 AGM. In January 2014, the Board

approved the refinancing of its existing US\$800m bank facility, which was due to mature in December 2015. The new US\$800m committed revolving credit facility will mature in February 2019, with two one-year extension options.

**Operations**

The Board regularly monitors the optimal operating structure of the Group, including consideration of the interaction between the role of the Corporate Centre (operating under the Board's direction and subject to the Board's reserved powers) and the divisions. This year there has been a particular focus on the resources and optimum structure required, at both a divisional and Group level, to achieve growth. The new post of Group Commercial Director was created in May 2014 to leverage growth potential across all five divisions and lead initiatives on sales and marketing effectiveness and expansion into key developing markets.

**M&A**

The Board considers a report on potential changes to the Group's portfolio of assets at each meeting and additional meetings of the Board are convened, as necessary, to discuss significant acquisition and divestment proposals.

## Board meetings

The table below shows the number of board meetings held during the financial year ended 31 July 2014 and, opposite each director's name, the number of meetings they were eligible to attend and the number actually attended.

	Board meetings	
	Eligible to attend*	Attended*
D.H. Brydon (Chairman to 19 Nov 2013)	4	4
Sir George Buckley (Deputy Chairman to 19 Nov 2013 and Chairman thereafter)	10	10
P. Bowman	10	10
P.A. Turner	10	10
B.F.J. Angelici	10	10
D.J. Challen	10	10
T.D. Fratto	10	10
A.C. Quinn	10	10
W.C. Seeger (appointed 12 May 2014)	2	2
Sir Kevin Tebbit	10	10

\*includes one occasion where matters were conducted by written resolution approved by all members of the Board

## Board visits

The Board regards attendance at meetings as only one measure of directors' contributions to the Company. In addition to formal Board meetings, the directors attend other meetings and make site visits during the year. For example, as part of his induction, Sir George visited a large number of the Company's sites in the USA and Europe and met employees and management in all five divisions. Bill Seeger has also completed various site visits as part of his induction programme which will be completed by the end of October 2014.

In January 2014 the Board visited the John Crane facility in Singapore; participated in the formal opening ceremony of the new Detection facility in Johor Bahru, Malaysia; and visited the Flex-Tek facility, also in Johor Bahru. The Board spent time with each of the local management teams. In May 2014 the Board visited the head office and manufacturing facilities of Smiths Medical in St Paul, Minnesota, USA and in July 2014, the Board visited the Interconnect manufacturing facility of EMC/RF Labs (part of the Microwave business) in Stuart, Florida, USA.

## 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.

### Key roles and responsibilities

#### Chairman

##### **The Chairman's responsibilities include:**

- Leadership of the Board
- Setting the agenda and tone for the Board
- Promoting high standards of integrity and corporate governance
- Ensuring the effectiveness of the Board

#### Chief Executive

##### **The Chief Executive's responsibilities include:**

- Ensuring implementation of the strategic and financial objectives approved by the Board
- Providing leadership on all executive management matters affecting the Company
- Chairing the Executive Committee
- Ensuring the proper management of the Company's diverse stakeholder relationships (including with shareholders, employees and customers)

#### Senior Independent Director

##### **The Senior Independent Director's responsibilities include:**

- Acting as a sounding board for the Chairman
- Acting as an intermediary for the directors where necessary
- Being available to shareholders if they have concerns which cannot be resolved through the Chairman or executive management
- Conducting an annual review of the Chairman's performance

#### Company Secretary

##### **The Company Secretary's responsibilities include:**

- Ensuring that all Board and Board Committee meetings are properly held
- Assisting the Chairman and the Chief Executive in ensuring that the directors are provided with all relevant information
- Organising new directors' induction and ongoing training requirements
- Maintaining the Group's governance and listing rule compliance framework

## **Corporate governance statement**

### **Continued**

#### **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 making. Throughout the financial year at least half the Board, excluding the Chairman, has comprised independent non-executive directors.

In deciding the chairmanship and membership of the Board Committees, the need to refresh membership of the Committees is taken into account. The table on page 82 indicates the service, to 31 July 2014, of each of the directors. Each of the non-executive directors is considered to be independent and Sir George was considered independent at the time of his appointment as Chairman. In the light of the length of David Challen's tenure on the Board, the Board and its committees have rigorously reviewed David Challen's position as a non-executive director and his committee memberships, taking into consideration his performance, judgements and character. The Board is completely satisfied that Mr Challen continues to be an independent director and should remain in the role of Senior Independent Director.

#### **Appointments to the Board**

The Nomination Committee has a formal, rigorous and transparent procedure for the appointment of new directors, which are made on merit and against objective criteria, having due regard for the benefits of diversity, including gender. This procedure was followed in the appointment of Sir George Buckley as an independent non-executive director and Deputy Chairman on 1 August 2013 and the appointment of Bill Seeger as a non-executive director on 12 May 2014. Further information in relation to the recruitment of Bill Seeger is described in the Nomination Committee report on page 90.

The Board is satisfied that the directors are able to allocate sufficient time to their responsibilities relating to the Company. During the year, the Board considered the other engagements and proposed engagements of the directors as part of the Directors' conflicts of interest procedure as further described below.

#### **Information and professional development**

The Board is provided with detailed information up to a week in advance on matters to be considered at its meetings and non-executive directors have ready access to the executive directors and other senior corporate staff. Non-executive directors are also provided with information and updates between meetings. Regular site visits are arranged and non-executive directors are encouraged to visit sites independently. During site visits, briefings are arranged and the directors are free to discuss aspects of the business with employees at all levels.

Newly appointed directors undergo an induction programme to ensure that they have the necessary knowledge and understanding of the Company and its activities. They undertake briefing sessions on corporate governance, strategy, stakeholder issues, finance and risk management and HR, as well as meetings and site visits to business locations. Each director's individual experience and background is taken into account in developing a programme tailored to his or her own requirements. Bill Seeger was well versed in the obligations of UK-listed companies by virtue of his recent experience as the Finance Director of GKN plc, so the focus of his induction has been on getting to know the Smiths products, businesses and people. He has visited more than ten US Smiths sites and, by the time he completes his induction, will have visited at least another five sites in Europe.

The Chairman consults with the directors on their respective training and development requirements. The suitability of external courses is kept under review by the Company Secretary who is charged with facilitating the induction of new directors and with assisting in the ongoing training and development of all directors.

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

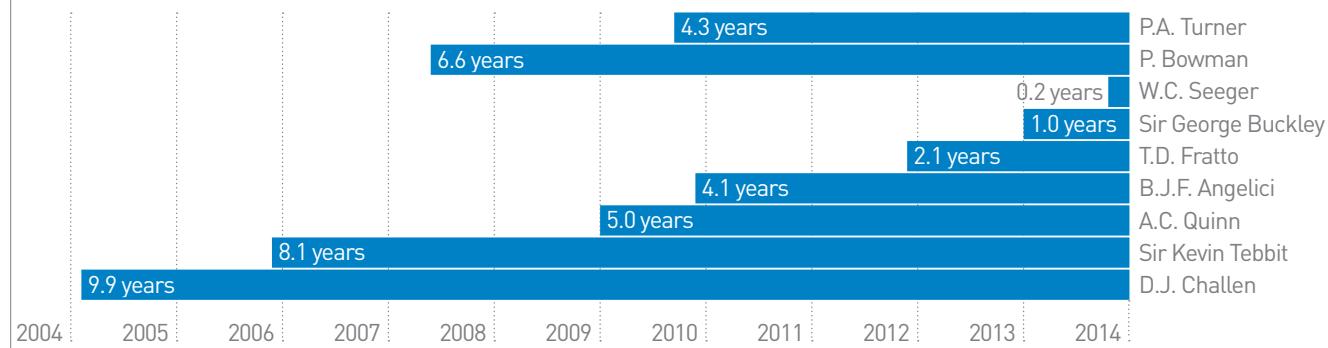
#### **Conflicts of interest**

Under the 2006 Act a director must avoid a situation where he or she has, or could 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. Article 76(5) of the Company's articles provides that the directors can authorise potential conflicts of interest.

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 formally reviewing conflicts disclosed, and authorisations given (including such conditions as the Board may determine in each case), is repeated twice a year. 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.

#### **Tenure of the Board**

The Board and Nomination Committee regularly review the mix of skills and experience on the Board. The chart illustrates the good balance of longer-standing Board members and more recent appointments, providing both continuity and fresh perspectives.



## 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 2013, the Board evaluation was conducted by the Company Secretary using internally administered questionnaires. The questionnaire required each of the directors to consider the performance of the Board and each of the main Board committees against a number of criteria, including effectiveness of leadership, efficiency of meetings, time and focus given to particular areas, information issues, corporate governance standards and the extent to which the objectives set by the Board had been met. The Board evaluation completed in respect of the year ended 31 July 2013 identified a number of key strengths of the Board or its functions and activities, including focused and productive Board meetings; the high-quality materials provided at Board meetings; a very effective Audit Committee; the orderly process to secure the outgoing Chairman's succession, ably supported by the Nomination Committee; and a well-managed corporate governance programme.

Following on from the review, the Board noted a number of points which it considered could enhance its performance, including creating more opportunities for the non-executive directors to visit the divisions, improving the monitoring of business performance by reference to competitors and spending more time on succession planning. The Board also set itself a series of written objectives for the year ended 31 July 2014, including to:

- continue to seek and test opportunities for portfolio rationalisation;
- better monitor how innovation is driving growth in new product sales;
- encourage a culture where learnings from past mistakes prevent repetition; and
- ensure a successful transition to a new Chairman.

The Board noted the additional work during the year in linking innovation to revenue growth; the renewed emphasis on inorganic growth and portfolio rationalisation (subject to market conditions); and the increased candour and transparency in relation to the sharing of 'lessons learned' in a number of areas.

The Board evaluation for the year ended 31 July 2014 is in progress and is being facilitated by Ms Sheena Crane, an external consultant. The Company has no other connections with Ms Crane. The results of the evaluation will be presented to the Board in November 2014 and will be used to inform further the Board's approach and its objectives.

The current directorships in listed companies and other significant commitments of the Chairman and the non-executive directors are shown on pages 74 to 76. During the year, Bruno Angelici was appointed as Chairman of Vectura Group Limited; Advanced Drainage Systems, Inc., on whose board Tanya Fratto sits, successfully conducted an initial public offering; David Challen retired from his positions at Citigroup and Anglo American; and Sir Kevin Tebbit relinquished the chairmanship of the Industry Advisory Group to the UKTI Defence and Security Organisation. 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 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. The Chairman has confirmed that, following

the performance reviews undertaken in 2013, the performance of each of the directors standing for re-election at this year's AGM continues to be effective and that they each continue to demonstrate commitment to their respective roles and dedicate the time necessary to perform their duties.

## Remuneration

Information regarding the Remuneration Committee is set out on page 91 and the Directors' remuneration report is on pages 92 to 109.

## Accountability and audit

### Financial reporting

The Board is required to present a fair, balanced and understandable assessment of the Company's position and prospects in the Annual Report and in interim and other public reports. The directors are required to explain in the Annual Report the basis on which the Company both generates and preserves value over the longer term and its strategy for delivering the Company's objectives. The Board is satisfied that it has met these obligations in this Annual Report. A summary of the directors' responsibilities for the financial statements is set out on page 118. The 'going concern' statement required by the Code is set out in the Group directors' report on page 111.

## 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 2014.

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

The Company's internal control is based on assessment of risk and a framework of control procedures to manage risks and to monitor compliance with procedures. The procedures for accountability and control are outlined below.

The Company's internal control systems are designed to meet the Company's particular needs and the risks to which it is exposed and, by their nature, can provide only reasonable, not absolute, assurance against material loss to the Company or material misstatement in the financial accounts.

The Group has an embedded process for the identification, evaluation and management of significant business risks. The process is reviewed through the Audit Committee and monitored by the Group Internal Audit Department. The Company has during the year identified and evaluated the key risks 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.

## Corporate governance statement

### Continued

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

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

#### Audit Committee and Auditors

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

#### Relations with shareholders

##### Dialogue with shareholders

The Chief Executive, the Finance Director and the Director, Investor Relations communicate with institutional investors through analysts' briefings and extensive investor roadshows in the UK, US and continental Europe, as well as timely Stock Exchange announcements, meetings with management and site visits (as shown in the table below). Members of the Board, and in particular non-executive directors, are kept informed of investors' views,

in the main through distribution of analysts' and brokers' briefings. At least twice a year a report is made to the Board on the number and types of meetings between the Company and institutional shareholders. The Board is confident that this process enables the non-executive directors to maintain a balanced understanding of the views and concerns of major shareholders. In 2014, Sir George Buckley met with many of the Group's largest shareholders as part of his induction. More broadly, the Chairman, the Senior Independent Director and the other non-executive directors are available to meet shareholders on request.

#### Constructive use of the Annual General Meeting

All directors normally attend the Company's AGM and shareholders are invited to ask questions during the meeting and to meet directors after the formal proceedings have ended. It is intended that there shall be a poll vote on each resolution at the 2014 AGM. The audited, final results of the poll votes will be released to the London Stock Exchange and published on the Company's website, [www.smiths.com](http://www.smiths.com), as soon as is practicable after the conclusion of the AGM.

All the directors, including the Chairmen of the Audit, Nomination and Remuneration Committees, were available at the 2013 AGM to answer shareholders' questions. The notice of the AGM and related papers were sent to shareholders at least 20 working days before the meeting.

#### Board Committees

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

#### Investor relations activities timeline 2013-2014

	Roadshows	Presentations
July 2014	Switzerland	
May 2014	UK, Sweden	
April 2014	UK, US, Germany, France	
March 2014	UK	Interim results
January 2014	UK (Chairman roadshow)	
December 2013	Private client brokers	John Crane Capital Markets Day, Dubai
November 2013	Japan, Hong Kong, Singapore, France, Private client brokers	AGM
October 2013	UK, US, Canada, Germany, Private client brokers	
September 2013	UK	Annual results

**During financial year 2013/14, senior management and the investor relations team had contact with over 300 analysts and investors.**

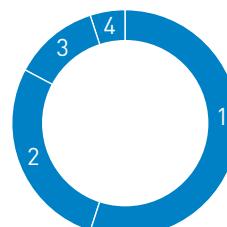
#### Contact with investors/analysts

1 United Kingdom 55%

2 US and Canada 28%

3 Rest of Europe 12%

4 Rest of World 5%



**John Crane Capital Markets Day, Dubai**  
In December 2013, we held a capital markets day at our John Crane business in Dubai. The programme included presentations on the division's strategy, business model, markets and growth opportunities, as well as a tour of the facility. Investors and analysts were also taken on an airside tour of Detection's operations at Dubai International Airport.



## Audit Committee



**David Challen, CBE**  
**Chairman of the Audit Committee**

### Introduction from the Chairman of the Audit Committee

The financial year ended 31 July 2014 is the first year that the 2012 edition of the UK Corporate Governance Code (the 'Code') has applied to the Company. The Audit Committee has considered guidance from the Financial Reporting Council and other sources on the changes introduced by the Code, including the revisions to the role of audit committees. We have implemented the necessary amendments both to our terms of reference and processes and to the reports we receive, in order to ensure the Committee has been able to monitor effectively the Company's compliance with the Code. The Committee has also carefully considered the tenure of PwC as the Company's external auditor and has taken into account guidance on the audit tendering process issued by various sources, including the Institutional Investor Committee. Details of the work performed by the Committee over the year are outlined in the new, expanded Committee report below.

Upon joining the Board, Bill Seeger also joined the Committee and he will succeed me as Chairman after this year's AGM. He has extensive experience in the finance functions of major industrial companies, most recently as the Group Finance Director of GKN plc, and so is ideally suited to take over the Chairmanship of this Committee.

Throughout the year we have enjoyed excellent relationships with the external auditors, Internal Audit and the Group's management. We appreciate the contribution they have all made to the effective operation of the Committee. In a group with the scale, diversity and geographical spread of Smiths Group, issues relating to internal financial and other risk controls, codes of conduct and ethical standards arise from time to time for review by the Committee. We are satisfied that the Group has systems in place to identify such issues promptly and that management has the appropriate processes and resources available to address them effectively.

### Committee membership

The members of the Committee during the 2013/14 financial year were:

	Audit Committee	
	Appointed/ Last re-appointed	
D.J. Challen (Chairman)	21 September 2013	
B.F.J. Angelici	1 July 2013	
T.D. Fratto	1 July 2012	
A.C. Quinn	1 August 2012	
W.C Seeger	12 May 2014	
Sir Kevin Tebbit	12 July 2012	

All members served on the Committee throughout the year except Bill Seeger, who was appointed as a member of the Committee and as its Chairman-elect on his appointment to the Board on 12 May 2014. It is expected that Mr Seeger will take over Chairmanship of the Committee after the AGM on 19 November 2014.

All members of the Committee are independent non-executive directors and, in the view of the Board, have recent and relevant financial and accounting experience, gained from their respective business activities in international businesses. In particular, David Challen has held a number of senior finance roles in investment banking and advisory roles in City financial institutions, including membership of the Financial Reporting Council's advisory group of audit committee chairmen. Bill Seeger has retired this year from the position of Group Finance Director of GKN plc which post he had held for over six years. Further details of the qualifications and experience of the members of the Committee are contained in the biographies of the directors in pages 74 to 76.

There have been no changes to the membership of the Committee since the financial year-end.

### Meetings and attendance

The Committee met three times during the 2013/14 financial year, with the meetings timed to coincide with the financial reporting and audit cycles of the Company – the approval of the Annual Report in September; the approval of the half-year report in March; and the presentation of the pre-year end 'early warnings' report from PwC in July. The Committee has agreed to a meeting schedule over the next two financial years that will align with expected future key financial reporting and audit cycle events.

The attendance record of the members of the Committee was:

	Audit Committee	
	Eligible to attend	Attended
D.J. Challen (Chairman)	3	3
B.F.J. Angelici	3	3
T.D. Fratto	3	3
A.C. Quinn	3	3
W.C Seeger (appointed 12 May 2014)	1	1
Sir Kevin Tebbit	3	3

→ More information can be found at [www.smiths.com](http://www.smiths.com)

In order to maintain effective communications between all relevant parties, the following were frequent attendees at the meetings:

- the Group Chairman;
- the Group Finance Director;
- the Group Financial Controller;
- the Company Secretary;
- the Director of Internal Audit;
- the Group Director of Tax and Treasury; and
- the Group audit partners of the external auditor, PricewaterhouseCoopers LLP ('PwC').

Annual presentations on risk management were given to the Committee by the divisional president of each of the five divisions; and the head of Business Information Services ('BIS' – the Group's IT function). The Senior Vice-President & General Counsel – Ethics & Compliance reported on the implementation of the Business Ethics Programme; the work of the Company's Code Compliance Council; and the investigations into allegations of non-compliance with the Ethics Code, including issues raised through the Group's whistle-blowing procedures.

## **Corporate governance statement**

### **Continued**

At the conclusion of the meetings, the representatives of the external auditor were given the opportunity to discuss matters without executive management being present. The Director of Internal Audit, the Senior Vice-President & General Counsel – Ethics & Compliance and the external auditors have direct access to the Chairman and the members of the Committee should he or they wish to raise any concerns outside formal Committee meetings.

The members of the Committee also had the opportunity to meet separately at the end of each meeting to discuss any relevant matters in the absence of all the invitees.

The members of the Committee receive briefing notes from the Company and from PwC on all relevant developments in company law; governance standards; and international and domestic financial accounting practices and regulations. Mr Seeger is undergoing a tailored induction process following his appointment as a director of the Company and a member of the Committee.

All the members of the Committee attended the Annual General Meeting of the Company in November 2013 (apart from Mr Seeger, who was not in post at the time).

Outside of the formal meetings schedule, the Chairman of the Audit committee has met separately with senior management of the Company, the representatives of PwC and the Director of Internal Audit to discuss the Company's governance.

#### **Role and responsibilities**

The primary role of the Audit Committee is to ensure the integrity of the financial reporting and audit processes and the maintenance of sound internal control and risk management systems. This includes responsibility for monitoring and reviewing:

- the integrity of the Group's financial statements; the significant reporting issues and judgements contained therein; and the reports of the external and internal auditors thereon;
- the basis for the Group's going concern statements;
- financial announcements released by the Company and any reports or returns made by the Group to financial regulators;
- the appropriateness of the Group's relationship with the external auditors, including auditor independence and objectivity; auditor compliance with relevant ethical and professional standards and guidance; audit fees; and provision of non-audit services;
- the terms of engagement of the external auditor;
- the scope of the annual external audit plan and the quality and experience of the external audit team assigned to its execution;
- the reports of the external auditor, including any major issues or reservations and significant accounting and audit judgements arising therein;
- the effectiveness of the external audit process, making recommendations to the Board on the appointment or re-appointment or the removal of the external auditors;
- the remit and effectiveness of the internal audit function and the appropriateness of the resources available thereto;
- the effectiveness of the Group's policies on internal control and risk management systems in the evaluation and management of significant business risk;
- statements on the assessment and management of risks and on internal controls;
- the Group's implementation of the Company's Code of Business Ethics and Business Ethics Programme, including the Group's arrangements for its employees to raise any issues of concern and the process for the investigation and resolution of any such issues; and
- the Group's procedures for detecting fraud and systems and controls for preventing bribery.

The Chairman of the Audit committee reports formally to the full Board on the activities of the Committee after each Committee meeting.

Written terms of reference that define the Committee's authority and responsibility are available on our website at [www.smiths.com](http://www.smiths.com).

#### **Financial reporting**

During the financial year, the Committee:

- considered information presented by management on key matters of accounting judgements and policies, adopted in respect of the Company's 2013 Annual Report and 2014 half-year report, and relevant changes to accounting standards and agreed their appropriateness;
- discussed with PwC the firm's audit reports and noted the key accounting matters and significant judgements highlighted by PwC in respect of each set of financial statements;
- reviewed documentation prepared to support the statement on internal control in the 2013 Annual Report, and was satisfied that the Company was operating an effective system of internal controls to manage risk;
- reviewed documentation prepared to support the going concern judgement in the 2013 Annual Report, and concluded that the accounts had been properly prepared on a going concern basis;
- examined key points of disclosure and presentation to ensure the adequacy, clarity and completeness of the 2013 Annual Report and 2014 half-year report and the announcement of the annual results, including the treatment of some items as non-headline;
- has reported to the Board its views on significant financial reporting issues and judgements applied to the 2013 Annual Report, the 2014 half-year report and the associated information releases (including matters communicated to the Committee by the external auditors); the business review and corporate governance statements in the 2013 Annual report; and
- considered and approved management proposals to introduce the changes necessary to ensure full compliance in the Company's 2014 Annual Report with the requirements of the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013; the 2012 edition of the UK Corporate Governance Code (the 'Code'); and The Large & Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 (the 'new regulations').

Subsequent to the end of the financial year, the Committee has also reviewed and reported to the Board on the reports and information supplied by management and by PwC on the judgements and policies adopted for the 2014 Annual Report; the content of that document; approved the statement on internal controls and the going concern statement; and the content of the announcement of the financial results for 2013/14.

#### **Narrative reporting**

This Annual Report is the first time that the 2012 edition of the UK Corporate Governance Code has applied to the Company. At the request of the Board, the Audit Committee reviewed the full content of the draft Annual Report and advised the Board that, taken as a whole, the Committee considered the report to be fair, balanced and understandable and that shareholders had been provided with the information necessary properly to assess the Company's performance, business models and strategies over the 2013/14 financial year.

## External audit

In relation to the activities of the external auditor, during the financial year, the Committee:

- considered PwC's audit reports on the 2013 Annual Report and the 2014 half year report and its 'Early Warning' report on the 2013/14 audit;
- monitored PwC's execution of the audit plan for 2013/14;
- discussed all major issues identified by PwC during the course of the audit, including the key accounting and audit judgements taken by management;
- agreed materiality levels with PwC and accepted the low-level, uncorrected misstatements identified in the audit;
- reviewed and approved PwC's audit plan and terms of engagement for 2014, noting that both the statutory audit report and the Audit Committee report in the Corporate Governance section of the 2014 Annual Report would need to be expanded to comply with the requirements of the new regulations for the first time;
- reviewed the non-audit fees payable to PwC and found them to have been incurred in accordance with the policy on the provision of non-audit services;
- conducted the annual review of the independence and objectivity of PwC and was satisfied that PwC's behaviour had been professional in both respects;
- determined that PwC remained effective in its role as external auditor; and
- recommended to the Board that PwC be proposed for re-appointment as external auditor at the 2013 AGM for a further year.

Subsequent to the financial year-end, the Committee has considered the same items in respect of the 2014 Annual Report and recommended that PwC be proposed for re-appointment at the 2014 AGM.

In preparation for the expiry of Martin Hodgson's five-year tenure as Group audit engagement leader and statutory auditor, at the conclusion of the 2014 audit, the Committee met with and approved the appointment of Andy Kemp as his successor. He has shadowed the 2014 Group audit and has taken over as Group audit engagement leader following the signing of the 2014 audit report.

## External audit plan

PwC presented its Group Audit Plan for the financial year ending 31 July 2014. The Committee discussed with PwC its risk matrix and the factors affecting the various audit risk assessments; the proposed audit scope, taking into consideration statutory audit requirements, financially significant components and significant risk components and central programme testing; materiality levels; the testing of IT controls within the ERP environments in Detection, John Crane and Medical; and the impact of changes in governance regulations and professional standards. The Committee considered the resources proposed by PwC, including the qualities, seniorities and experience of the audit team members, to be consistent with the scope of the audit. Due to the rotation of the Group engagement leader at the end of the audit, it was agreed that his successor would shadow him during the audit. It was noted that the Audit Plan had been discussed and co-ordinated with Internal Audit and that 88% of Group revenue would be covered by the combination of the audit scope and local statutory audits. The fee structure and terms of engagement, which had been agreed with Smiths management, and PwC's assessment of its independence were considered appropriate for the work proposed and were approved.

## Non-audit services

In order to safeguard auditor independence, the Committee has monitored compliance with the Group policy on the appointment of external auditors. Non-audit services are divided into three categories in relation to the incumbent external auditor:

- Pre-approved (but subject to the Group Finance Director's approval for projects likely to exceed £10,000) – where the threat to auditor objectivity and independence is considered low, such as regulatory compliance work; tax advisory work; and low-level acquisition work;
- Permitted (but subject to the approval of the Audit Committee for projects over £10,000 and competitive tendering for projects over £100,000) – such as larger acquisitions; corporate reorganisation; tax structuring; and IT risk and security;
- Not permitted – such as book keeping; financial system design; actuarial services; management functions; and internal audit.

The Committee is satisfied that the non-audit work performed by PwC during the financial year had been properly assessed and authorised in accordance with the Group policy.

## External auditor independence

The Committee is responsible for the development, implementation and monitoring of the Company's policies on external audit which are designed to maintain the objectivity and independence of the external auditors. These policies also regulate the appointment by the Group of former employees of PwC and set out the approach to be taken when using the external auditors for non-audit work.

External auditors are not permitted to provide services which could result in:

- the external auditor auditing its own firm's work;
- the external auditor making management decisions for the Group;
- a mutuality of interests being created; or
- the external auditor being put in the role of advocate for the Group.

The Committee's review of the independence of the external auditors included:

- examining written confirmation from PwC that they remained independent and objective within the context of applicable professional standards;
- considering the tenure of the audit engagement partner, who is required to rotate every five years in line with ethical standards (and has so rotated following the conclusion of the 2014 audit);
- monitoring the ratio between the fees for audit work and non-audit services; and
- checking that management confirmed compliance with the Group's policies on the employment of former employees of PwC and the use of PwC for non-audit work.

As a result of this review, the Committee concluded that PwC remained appropriately independent in the role of external auditors.

Details of the fees paid to PwC in 2013/14 can be found in note 2 to the 2013 Annual Report. Non-audit fees incurred during 2013/14 amounted to £0.8m which related principally to tax, consulting and IT services. Non-audit fees as a percentage of audit fees totalled 17%. All such activities remained within the policy approved by the Board.

## **Corporate governance statement**

### **Continued**

#### **External auditor effectiveness and reappointment**

The Committee's review of the performance of PwC and the effectiveness of the external audit process included consideration of the views and opinions of the executive directors and senior management on PwC's effectiveness in a number of areas including independence and objectivity, audit strategy and planning, conduct and communication, audit findings and feedback, and expertise and resourcing.

The Committee also considered the results of the survey conducted by PwC's independent client perspective team on the 2012/13 Group audit and the review meetings between PwC's independent senior partner and the Company's Chief Executive, Finance Director and Chairman of the Audit Committee. The results were positive and confirmed that both PwC and its audit process were appropriate and effective and that the relationships between the audit teams and the Company's businesses were strengthening. The Committee recognised the challenges in ensuring consistency in the audit process across the whole Group and the need to continue to improve communication at local and divisional levels.

The Committee received and considered the Independence Letters, sent by PwC in September 2013 in respect of its 2012/13 audit and September 2014 in respect of the 2013/14 audit, and concurred with PwC's opinion that it had complied with all relevant regulatory and professional requirements and that the firm's objectivity had not been compromised.

The Committee reviewed the findings in the Financial Reporting Council's 2013/14 Audit Quality Inspection report on PwC and satisfied itself that the quality of the work exhibited by the firm and its commitment to improvements were of a sufficiently high standard.

PwC has been the Company's external auditor since its formation in 1998, although a predecessor organisation of PwC has held office as sole auditor from 1997. In determining whether to recommend PwC for reappointment as auditors in 2014, the Committee took into consideration the following factors:

- the length of PwC's appointment and the guidance on the new audit firm rotation proposals;
- the results of the effectiveness review detailed above;
- the qualities and experience of the new audit partner (following the rotation of the previous audit partner whose five-year term expired at the completion of the 2013/14 audit), and
- the appointment of two new non-executive directors, Sir George Buckley who took over as Chairman of the Company in November 2013, and Bill Seeger, appointed as a non-executive director and as Chairman-elect of the Audit Committee in May 2014.

Taking these elements into account, the Committee concluded (a) that it would not be advisable to put the auditor appointment out to competitive tender at this stage and (b) that it was appropriate to recommend to the Board that the reappointment of PwC as the Company's auditors for a further year be proposed to shareholders.

Taking into account the requirements in the Code and the consultation phases of both the Competition & Market Authority's investigation into statutory audit services and the Department for Business, Innovation & Skills proposals to implement the EU's June 2014 Audit Directive and Regulation, the Committee will keep the issue of audit firm rotation under regular review.

There are no contractual obligations that acted to restrict the Group's choice of external auditors.

#### **Internal control and risk management**

In fulfilling its responsibilities, the Committee:

- reported to the Board on its evaluation of the Group's risk assurance framework and embedded risk management processes, based on consideration of the Group's control environment and ERP systems and on fraud risk; the audits undertaken by Internal Audit; and the risk management reports presented by and discussed with each of the divisions and BIS;
- reviewed management's plans to mitigate and remedy the failings and weaknesses in the Company's internal financial and risk controls that were identified by PwC and Internal Audit and has monitored their effectiveness; and
- considered and approved the Committee Chairman's responses to the UK Cyber Security Health Check issued by the UK Government to all FTSE 350 companies.

The Board has reserved to itself responsibility for reviewing the effectiveness of the identification and management of risk at the Group level. Each division also presents an analysis of its own business strategic risks to the Board on an annual basis.

Further information on the Group's systems of internal control and risk management is given on pages 83 and 84.

#### **Internal audit**

During the financial year the Committee:

- received progress reports on the execution of the 2013/14 Internal Audit Plan (which comprised 61 site audits; audits of the five divisional headquarters; and three programme management reviews);
- discussed the recommendations made by the internal auditors;
- reviewed the progress being made by management in reducing the numbers of aged outstanding recommendations;
- reviewed the effectiveness of Internal Audit as a part of the Company's risk management process, including its use of KPMG as an external contractor to provide additional facilities and capabilities in certain overseas audit visits;
- considered the remit of Internal Audit, its budget and resources and its outsourcing to KPMG; and
- approved the 2014/15 Internal Audit Plan (59 site visits and six programme management audits), including the proposed audit scope, approach, coverage and allocation of resources.

#### **Treasury and tax**

During the financial year, the Committee reviewed the report of the Treasury department of the Group on financial risk and treasury management, noting the Group's borrowing position and debt capacity. The efficacy of the new framework for setting banking counterparty limits, approved in July 2013, which involves the use of both S&P ratings and CDS levels, was duly monitored.

The Committee also received status reports on tax risk from the Group's tax department, noting the assessments of compliance, tax audit risk, tax provisions and international tax rates.

#### **Ethics**

During the financial year, the Committee reviewed the annual report on the Ethics programme, including the progress made in improving and extending the training programmes available for the Company's Code of Business Ethics and the further dissemination of the programmes to the Company's smaller and more remote locations. The expansion of the Code to include third parties and business partners was duly noted. The report included details of the investigations into allegations of non-compliance with the Ethics Code and 'whistleblowing' events, including bribery and corruption investigations. The Committee commended the reduction in the number of substantiated complaints that were being reported.

## Constitution and membership

During the year the Committee considered and approved changes to its terms of reference to reflect the changes contained in the new Code.

The Committee has also reviewed rigorously the performance of David Challen as a member and as Chairman of the Committee, in accordance with the Committee's decision last year to review Mr Challen's membership annually, following the completion of his third three-year term in office in September 2013. The Committee, with Mr Challen excluded from voting, determined to recommend to the Nomination Committee and the Board of directors that Mr Challen be reappointed as a member of the Committee from the expiry of his current term until the earlier of a year from the expiry date of his current term and the date on which he ceases to be a director of the Company and as Chairman from the expiry of his current term until the earlier of a year from the expiry date of his current term and the date on which he ceases to be a director of the Company or the date he steps down from the Chairmanship of the Committee.

## Performance evaluation

An annual evaluation of the performance of the Committee is conducted as part of the annual evaluation of the performance of the Board.

In respect of the year ended 31 July 2013 the Board evaluation was conducted by the Company Secretary using internally administered questionnaires. The evaluation considered the balance of skills, experience, independence and knowledge of the Company on the Board and its diversity (in the widest sense) and other factors relevant to its effectiveness. The questionnaire required each of the directors to consider the performance of the Board and each of the main Board committees against a number of criteria. In the case of the Audit Committee evaluation, those criteria included effectiveness of the leadership provided by the Chairman, clarity of the definition of the role and scope of the Committee; adequacy of the schedule of meetings; efficiency of meetings, the ability of the Committee to carry out a comprehensive review of the integrity of the Annual Report; and the adequacy of the assessment of the effectiveness of the external auditors. On a scale of 1 to 7, the assessment criteria relating to the Committee were scored between 6.7 and 7.0.

## Significant judgements and issues

An important responsibility of the Audit Committee is to review and agree the most significant management judgements and issues. To satisfy this responsibility, the Committee requests a written formal update from the Finance Director and Director of Tax and Treasury twice a year and requires regular reports from the external auditors at each committee meeting. The Committee carefully considers the content of these reports and the most significant issues and areas of judgement raised. The key areas of judgement in the year were as follows:

### Revenue recognition

The Committee reviewed the key judgements on revenue recognition. Attention was given to large, multi-faceted and non-standard contracts in Smiths Detection and to contracts where 'point of completion' accounting was used in Smiths Detection and Smiths Interconnect. Following their review, the Committee concluded that the revenue judgements made were appropriate.

## Impairment

The Committee considered the Group's carrying value of intangible assets and the assumptions used to justify the carrying value. Particular attention was given to the carrying value of goodwill for Smiths Interconnect Power and Smiths Detection following the underperformance of these businesses in 2013/14, as well as capitalised development assets for Smiths Medical and Smiths Detection. The Committee also reviewed the 'fair value less costs to sell' for Smiths Detection and Smiths Interconnect Power. The Committee agreed that the projected future cash flows from these businesses and assets supported the carrying value and the disclosures contained in the financial statements appropriately reflect the sensitivity of the judgements made. Details of impairment testing and sensitivities are included in note 12 of the financial statements.

## Working capital

The Committee considered the key judgements within working capital and considered the harmonisation of provisioning policy in Smiths Detection following a full review of working capital in the year. The Committee determined that the judgments made were appropriate to justify the working capital provision levels at 31 July 2014.

## Provisions for liabilities and charges

The Committee continued to monitor carefully the expert assessments of the financial exposure of the Group to the John Crane, Inc. asbestos litigation and to the Titeflex, Inc. CSST claims. The treatment of potential liabilities and the assumptions made in calculating the provisions were reviewed and determined fairly to reflect the position at 31 July 2014. Further details of the assumptions used are included in note 23 of the financial statements.

## Deferred taxation

The Committee assessed the appropriateness of the Group's assumptions and judgements in relation to the estimates of the assets and liabilities to be recognised in income and deferred tax. Particular focus was given to deferred tax assets relating to the John Crane, Inc. asbestos provision, the Titeflex CSST provision and Smiths Detection. In reviewing projected profit streams the Committee was satisfied that the relevant entities will generate sufficient future profits to utilise these assets. Further details on movements in tax balances are set out in note 7 of the financial statements.

## Post-retirement benefits

The Committee reviewed and agreed the methods, assumptions and benchmarks used by the actuaries to calculate the position of the UK and US schemes at 31 July 2014. The Committee agreed the treatment and the corresponding disclosures on this matter and noted that a reliable estimate will be made by the scheme trustees in 2014/15. More detail on post-retirement benefits is contained in note 9 of the financial statements.

## Advice

The Committee has independent access to the services of Internal Audit and to the external auditors and may obtain outside professional advice, at the expense of the Company, as it sees fit, in the performance of its duties.

## Nomination Committee



**Sir George Buckley**  
**Chairman of the Nomination Committee**

### Introduction from the Chairman of the Nomination Committee

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

In July 2014 the Nomination Committee carried out a detailed review of leadership talent across the Group, facilitated by the Group HR director, the Group Director of Leadership and Talent and the Group Director of Reward. The review focused on succession planning, especially in the context of the number of changes in the Executive Committee in the last year, and the action needed to improve the bench strength. It also noted the improvements made in the talent development architecture to drive a more focused and consistent approach to developing our leadership capability. The Committee also reviewed a number of initiatives now in place to support our growth strategy, including increased focus on engineering talent through the introduction of an Engineering Council, the integrated approach to management training and the launch of the new global performance review system.

### Membership

During the financial year the members of the Committee were: Mr Brydon [Chairman of the Committee up to his retirement from the Board and the Committee on 19 November 2013], Sir George Buckley (appointed as a member of the Committee on 1 August 2013 and Chairman of the Committee from Mr Brydon's retirement), Mr Angelici, Mr Challen, Ms Fratto, Ms Quinn and Sir Kevin Tebbit. Mr Seeger joined the Committee on his appointment to the Board on 12 May 2014. The Committee leads the process for identifying and makes recommendations to the Board regarding candidates for appointment as directors of the Company and as Company Secretary (and their removal or retirement), giving full consideration to succession planning and the leadership needs of the Group. It also makes recommendations to the Board on the composition of the Nomination Committee and the composition and chairmanship of the Audit and Remuneration Committees. It reviews regularly the structure, size and composition of the Board, including the balance of skills, knowledge and experience and the independence of the non-executive directors, and makes recommendations to the Board with regard to any changes.

In October 2013 the Nomination Committee resolved to seek an additional member of the Board to succeed David Challen as Chairman of the Audit Committee in due course. The Nomination Committee appointed Egon Zehnder ('EZ') to handle the search. The Nomination Committee worked with EZ to produce a detailed specification for the role including the capabilities and attributes which were either required or desirable. These included the benefits to the Board of diversity in its widest sense (gender, nationality, age, experience, and background) and the particular skills which would benefit Smiths as a multi-industry company operating in a global market. After an extensive search and interview process, which involved nearly every member of the Board, the Nomination Committee was pleased to recommend to the Board the appointment of Bill Seeger as a non-executive director and as Chairman-elect of the Audit Committee. Mr Seeger was also appointed as a member of the Nomination and Remuneration Committees.

The Chairman and the rest of the Board continue to support Lord Davies' aspiration for female board representation, but this presents a particular challenge for a small board. The appointment of Bill Seeger has meant that the proportion of women on the Board has fallen below 25%.

The Nomination Committee and the Board remain committed to ensuring diversity is included within the remit for appointments at all levels in the Company, but does not think it is appropriate to set specific Group-wide targets or objectives at this stage. At the talent management and succession planning review presented to the Nomination Committee in July 2014, the Committee was provided with data and analysis on the diversity of the workforce as a whole, and details of a number of initiatives to support inclusion and diversity. Further information on diversity is provided in the Strategic report on page 70.

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

The Committee has access to such information and advice both from within the Group and externally, at the cost of the Company, as it deems necessary. This may include the appointment of external search consultants, where appropriate. The Committee reviews annually its terms of reference and effectiveness and recommends to the Board any changes required as a result of such review. The annual review of the Committee's terms of reference was conducted in July 2014.

### Meeting attendance

	Nomination Committee	
	Eligible to attend	Attended
D.H. Brydon (Chairman to 19 Nov 2013)	1	1
Sir George Buckley (Chairman from 19 Nov 2013)	3	3
B.F.J. Angelici	3	3
D.J. Challen	3	3
T.D. Fratto	3	3
A.C. Quinn	3	3
W.C. Seeger	1	1
Sir Kevin Tebbit	3	3

More information can be found at  
[www.smiths.com](http://www.smiths.com)

## Remuneration Committee



**Anne Quinn, CBE**  
**Chair of the Remuneration Committee**

### Introduction from the Chair of the Remuneration Committee

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

### Meeting attendance

	Remuneration Committee	
	Eligible to attend	Attended
A.C. Quinn (Chair)	3	3
D.H. Brydon (retired 19 Nov 2013)	1	1
Sir George Buckley (appointed 1 Aug 2013)	3	3
B.F.J. Angelici	3	3
D.J. Challen	3	3
T.D. Fratto	3	3
W.C. Seeger (appointed 12 May 2014)	1	1
Sir Kevin Tebbit	3	3

→ More information can be found at  
[www.smiths.com](http://www.smiths.com)

### Membership

The members of the Committee during the financial year were Ms Quinn (Chair of the Committee), Mr Angelici, Mr Brydon, Mr Challen, Ms Fratto and Sir Kevin Tebbit. Sir George Buckley joined the Committee on his appointment to the Board on 1 August 2013 and Mr Seeger joined following his appointment to the Board on 12 May 2014. Mr Brydon ceased to be a member of the Committee on his retirement from the Board on 19 November 2013.

### Responsibilities and activities

The Committee's responsibilities and main activities are described in the Directors' remuneration report on page 100. The Committee reviews its terms of reference and effectiveness annually and recommends to the Board any changes required as a result of such review. The annual review of the Committee's Terms of Reference was conducted in July 2014.

# Directors' remuneration report

## Remuneration Committee



**Anne Quinn, CBE**  
**Chair of the Remuneration Committee**

### Annual Statement

On behalf of the Board, I am pleased to present the report of the Remuneration Committee for the year to 31 July 2014. In line with the new reporting regulations that came into effect in October 2013, this report is split into three parts:

- this Annual Statement;
- a Policy Report, which presents the Group's forward-looking Directors' remuneration policy; and
- an Annual Report on Remuneration, which details how our remuneration policy was implemented during the year to 31 July 2014 and how we intend to apply the policy in the year to 31 July 2015.

The Policy Report will be put to a binding shareholder vote at the AGM on 18 November 2014, while the Annual Report on Remuneration is subject to an advisory vote. The Remuneration Committee hopes you find the new layout to be clear and transparent and that we can count on your support at the AGM for our Directors' remuneration policy and its implementation during the year.

As highlighted by the Chairman and Chief Executive in their annual statements on pages 20 to 24 of this Annual Report, the Group's markets remained challenging in the year to 31 July 2014. In this difficult economic climate, the Group has seen broadly flat headline revenue and a 12% decrease in headline EPS. Cash conversion remains strong (97% in the last financial year) and ROCE (15.7% in the last financial year) remains well ahead of the Group's weighted average cost of capital. A significant part of this headline revenue and EPS outcome was a direct result of the impact of currency movements over the year. Against this backdrop, annual bonus pay-outs are between threshold and target, and the TSR and EPS elements of 2011 LTIP awards lapsed in full following the end of the performance period on 31 July 2014. The Group's cash conversion, however, warranted the partial payout of that element of the bonus and LTIP, and the matching award under the CIP vested reflecting our sustained ROCE performance. The Committee recognises the importance of close alignment of remuneration with Group performance, and we consider the incentive outcomes for this year (further details of which are disclosed in this year's Annual Report on Remuneration) to demonstrate this link appropriately.

During the year, the Committee reviewed the existing executive remuneration framework and concluded that it continues to reinforce our objective of incentivising long-term value creation through the four key drivers of revenue growth, operating margin, cash conversion and ROCE. Therefore, the remuneration policy which we set out in this Report (and which will be put to a binding shareholder vote) remains unchanged from last year. In line with the salary increases awarded across the broader employee population, the Committee agreed to award salary increases of c.2.5% to each of the Chief Executive and Finance Director for the year commencing 1 August 2014.

In the coming year, the Committee will be reviewing the effectiveness of its long-term incentives in attracting, motivating and retaining our key talent. Following the conclusion of this review, we will consult shareholders on any substantive changes to the long-term incentive arrangements for executive directors and seek relevant approvals, as appropriate.

On behalf of the Board, I would like to thank shareholders for their continued support.

**Anne Quinn, CBE**  
**Chair of the Remuneration Committee**

The Directors' remuneration report is presented to shareholders by the Board. The report complies with Regulation 11 and Schedule 8 of the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008 (the 'Regulations'). As required by the Regulations, the Remuneration policy report will be put to a binding shareholder vote at the Annual General Meeting on 18 November 2014. The Annual report on remuneration (pages 101 to 109) will be put to a separate, advisory vote at the same Meeting. The Committee also continues to comply fully with the provisions of the UK Corporate Governance Code relating to directors' remuneration, except as disclosed in the Corporate governance statement on page 79.

### **Remuneration policy report**

This section of the report sets out the remuneration policy for executive directors and non-executive directors, and will be subject to a binding vote at the 2014 AGM. If approved at the AGM, the policy will come into effect on that date. The policy will be put to shareholders again no later than the 2017 Annual General Meeting.

### **Future remuneration policy for the executive directors**

The future remuneration policy for the executive directors at Smiths is summarised in the table below:

<b>Base salary</b>			
<b>Element and link to strategy</b> To attract, motivate and retain executive directors with the required skills and expertise to deliver the Group's objectives.	<b>Operation</b> Salaries are reviewed (but not necessarily increased) annually and benchmarked against comparable roles at other FTSE100 companies of similar market capitalisation, revenues and complexity. The review also takes into account individual performance and experience, the relative performance of the Company and the remuneration policy operated across the Company as a whole.  Salary increases are typically effective 1 August.	<b>Opportunity</b> Base salaries are adjusted according to the outcome of the annual review and will be disclosed in the Annual Report on Remuneration.  Salary increases for the executive directors will normally be in line with those awarded to Smiths wider employee population. Where increases are awarded in excess of this, for example if there is a material change in the responsibility, size or complexity of the role, or a significant change in the market competitiveness of salary, the Committee will provide the rationale in the relevant year's Annual Report on Remuneration.	<b>Performance measures</b> Not applicable.
<b>Pension</b>			
<b>Element and link to strategy</b> Enables executive directors to save for their retirement in a cost-efficient manner.	<b>Operation</b> Executives may choose either to participate in the Company's defined contribution pension plan or to receive a pension allowance in lieu thereof (and thus arrange their own pension provision).  Pension allowances are reviewed periodically to ensure market competitiveness.  Salary is the only element of remuneration that is taken into account when determining pension contributions or allowances.	<b>Opportunity</b> Pension allowances are set at a level that the Committee considers appropriate having regard to prevailing market practice at other FTSE 100 companies of similar market capitalisation, revenues and complexity.  Pension allowances are currently 42% and 25% of annual base salary for the Chief Executive and Finance Director respectively.  Our future policy is that new executive director external appointments are eligible for a pension allowance, which is market competitive, payable in cash.	<b>Performance measures</b> Not applicable.

<b>Annual bonus</b>			
<b>Element and link to strategy</b> Incentivises short-term cash management and profit growth, as well as annually defined non-financial goals.	<b>Operation</b> Annual bonus payments are determined based upon performance against measures and targets set by the Committee at the start of each financial year.  After the end of the financial year, to the extent that the performance criteria have been met, 50% of the earned annual bonus is paid in cash. The remaining 50% is deferred into shares under the Co-Investment Plan and released after a further period of three years, subject to continued employment only.  The Committee may use its discretion to adjust payout of the annual bonus to executive directors, within the range of the minimum to maximum opportunity. Such discretion will only be used where the Committee believes that performance against the prescribed targets does not accurately reflect the Company's underlying performance.	<b>Opportunity</b> The maximum annual bonus opportunity for executive directors is 180% of salary. The annual bonus opportunities for the year under review and the coming year are disclosed in the Annual Report on Remuneration.  The Committee's practice has been to apply a limit of 180% for the Chief Executive and 150% (i.e. below the policy maximum) for the Finance Director.  Under the financial element of the annual bonus, threshold performance must be exceeded before any annual bonus becomes payable. The % payout then increases according to the level of achievement against targets.	<b>Performance measures</b> Based on a combination of financial and non-financial performance measures linked to short-term objectives. Financial performance will account for no less than 70% of the bonus opportunity and may include, but is not limited to, profit and cash measures.
<b>Co-Investment Plan (CIP)</b>			
<b>Element and link to strategy</b> Helps to align short- and long-term remuneration and incentivises effective allocation of capital to maximise returns.	<b>Operation</b> The conditional shares into which 50% of annual bonus is deferred (see 'Annual bonus' above) are eligible for a match based on the achievement of stretching performance conditions over a three-year performance period. To the extent warranted by performance, matching shares vest following the announcement of results for the last financial year of the performance period, unless otherwise specified in the Plan rules.  Dividends accrue and are paid in cash at the end of the vesting period, on matching shares that vest.  The Committee may use its discretion to adjust the calculation of the performance measure of the CIP. Such discretion will only be used where the Committee believes that performance against the prescribed targets does not accurately reflect the Company's underlying performance.	<b>Opportunity</b> Maximum opportunity: <ul style="list-style-type: none"><li>• Two matching shares per deferred share</li></ul> Threshold opportunity: <ul style="list-style-type: none"><li>• One matching share per deferred share</li></ul> For performance between threshold and maximum, one matching share per deferred share vests.	<b>Performance measures</b> Average ROCE compared to the weighted average cost of capital over the three-year performance period.

## Long-Term Investment Plan (LTIP)

Element and link to strategy	Operation	Opportunity	Performance measures
Incentivises long-term value creation for shareholders, sustainable profit growth and effective management of the balance sheet.	<p><b>Operation</b></p> <p>Awards of conditional shares are granted annually and vest after a three-year performance period, subject to the achievement of performance targets set by the Committee at the start of each cycle.</p> <p>To the extent that the performance targets are not met over the performance period, awards will lapse. No retesting of awards under any performance condition is permitted.</p> <p>Dividends accrue and are paid in cash at the end of the vesting period, on shares that vest.</p> <p>Awards are also subject to clawback in case of misconduct or material misstatement in the published results of the Group.</p> <p>The Committee may use its discretion to adjust payout of the LTIP to executive directors, within the limits of the Plan rules. Such discretion will only be used where the Committee believes that performance against the prescribed targets does not accurately reflect the Company's underlying performance.</p>	<p><b>Opportunity</b></p> <p>The maximum LTIP award opportunity for executive directors is 300% of salary. LTIP award sizes for the year under review and the coming year are disclosed in the Annual Report on Remuneration.</p> <p>At threshold performance 25% of the award vests, increasing on a straight-line basis to 100% for achieving stretch targets.</p>	<p><b>Performance measures</b></p> <p>Based on a combination of earnings per share, total shareholder return and cash targets over the three-year performance period. To ensure continued alignment with the Company's strategic priorities, the Committee may, at its discretion, vary the measures and weightings from time to time, or apply different performance measures (but will consult shareholders before doing so).</p>

## Benefits

Element and link to strategy	Operation	Opportunity	Performance measures
To provide market-competitive benefits to executive directors.	<p><b>Operation</b></p> <p>Benefits comprise car allowance, life assurance and private healthcare insurance, and other such benefits as the Committee may from time to time determine are appropriate. These include, but are not limited to, relocation allowances if an executive director is recruited from outside the UK, as well as any other future benefits made available either to all employees globally or all employees in the region in which the executive director is employed.</p>	<p><b>Opportunity</b></p> <p>Benefits vary by role and individual circumstances.</p> <p>Benefits in respect of the year under review are disclosed in the Annual Report on Remuneration.</p> <p>It is not anticipated that the costs of benefits provided will increase significantly in the financial years over which this policy will apply, although the Committee retains discretion to approve a higher cost in exceptional circumstances (eg to facilitate recruitment, relocation, expatriation, etc.) or in circumstances where factors outside the Group's control have changed materially (eg market increases in insurance costs).</p>	<p><b>Performance measures</b></p> <p>Not applicable.</p>

## Directors' remuneration report

**Continued**

<b>Sharesave</b>		
<b>Element and link to strategy</b> Encourages ownership of shares in the Company and alignment with shareholder interests.	<b>Operation</b> All UK employees (including executive directors) may save up to a maximum monthly savings limit (as determined by UK legislation, or other such lower limit as the Committee may determine at its discretion) for three or five years. At the end of the savings period, participants may use their savings to exercise options to acquire shares, which may be granted at a discount of up to 20% to the market price on grant. The Company intends to introduce all-employee share schemes to non-UK countries on a basis consistent with local laws and market practice.	<b>Performance measures</b> Not applicable.
<b>Shareholding guidelines</b>		
<b>Element and link to strategy</b> Encourages ownership of shares in the company and alignment with shareholder interests.	<b>Operation</b> Executive directors must build a minimum shareholding within five years of appointment to the Board. For the Chief Executive this is set at two times gross annual salary and for other executive directors it is set at one and a half times annual salary. 50% of any net vested share awards (after sales to meet tax liabilities) must be retained until the minimum shareholding requirements are met.	<b>Performance measures</b> Not applicable.

### Existing grants or entitlements

It is the Company's intention to honour all pre-existing commitments at the date of this report and to honour all future obligations entered into, consistent with the approved remuneration policy. In the case of internal promotion to the Board, the Committee intends to honour any pre-existing commitments made prior to becoming a member of the Board, including where these differ from the approved remuneration policy.

### Performance measure selection and approach to target setting

Annual bonus measures are selected to reflect the Company's short-term financial and non-financial priorities. At its discretion, the Committee may vary these measures at the start of each financial year to maintain close alignment between executive incentives and the annual business plan.

The combination of measures used in the long-term incentives reinforces Smiths current strategy to create value through four key drivers: revenue growth, operating margin (which the Committee continues to advocate is best represented by EPS), cash conversion and ROCE (currently incentivised by the CIP). Relative TSR (excluding financial services companies) is a widely used measure amongst FTSE 100 companies. This balance between both internal and external performance and between absolute and relative performance is considered to be important by the Committee.

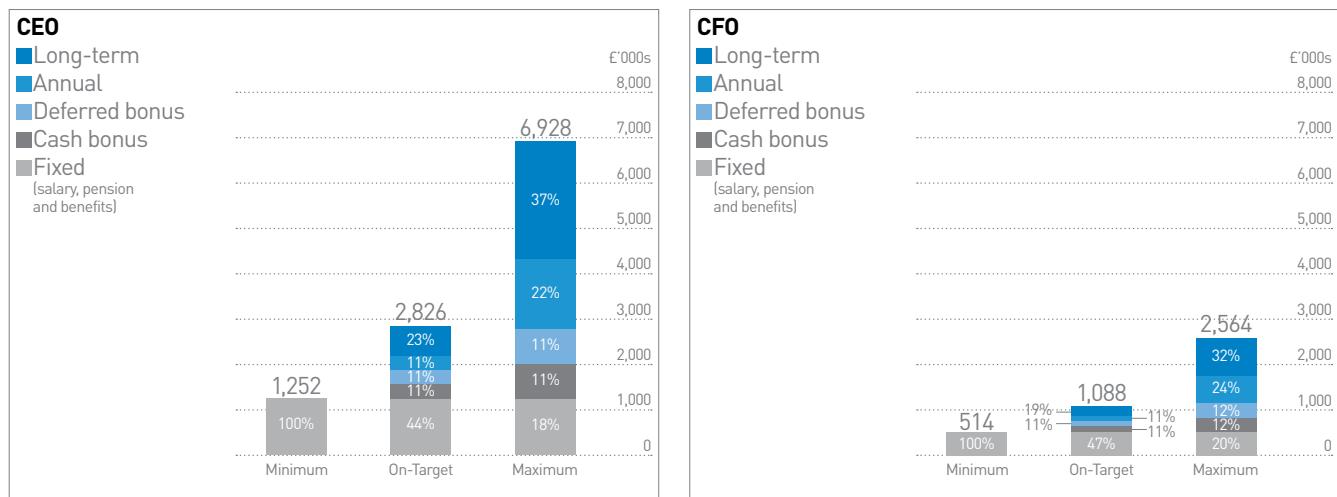
Annual bonus, CIP and LTIP targets are reviewed annually, and take into account the Company's strategic plan, analyst forecasts for Smiths and its sector comparators and external expectations for Smiths key markets. The Remuneration Committee sets targets that it considers to be challenging but attainable and aligned to the Company's business objectives over the short term, as reflected in the annual business plan, and longer term, consistent with the strategic plan. On top of aligning strategy with incentives, targets are designed to ensure that participants are aligned with the interests of shareholders.

### Difference in policy between executive director and other employees

There is no difference in the reward policy for executive directors and other senior employees and the Company does not currently operate any incentive plans in which only executive directors participate. The Remuneration Committee reviews each year the all-employee pay and incentive trends and takes these into account in setting executive director pay levels. The principles of remuneration packages being market related, performance sensitive and driven by business needs are applied at all levels and geographies in the Group.

## Pay scenarios

The graphs below provide estimates of the potential future reward opportunity for executive directors, and the potential mix between the different elements of remuneration under three different performance scenarios; 'Minimum', 'On-Target' and 'Maximum'.



Potential opportunities illustrated above are based on the policy which will apply in the 2014/15 financial year, applied to the base salary in force at 1 August 2014. For the annual bonus, the amounts illustrated are those potentially receivable in respect of performance for 2014/15. It should be noted that any awards granted under the CIP and LTIP in a year do not normally vest until the third anniversary of the date of grant. This illustration is intended to provide further information to shareholders on the relationship between executive pay and performance. Please note, however, that actual pay delivered will further be influenced by changes in factors such as share price appreciation and the value of dividends paid. The following assumptions have been made in compiling the above charts:

CEO			
Base salary	Annual base salary		
Pension	Company pension allowance		
Other benefits	Taxable value of annual benefits provided		
<b>Cash bonus</b>	'Minimum' 0% of salary (Minimum)	'On-Target' 36% of salary (Target)	'Maximum' 90% of salary (Maximum)
<b>Deferred bonus</b>	'Minimum' 0% of salary	'On-Target' 36% of salary (Target)	'Maximum' 90% of salary (Maximum)
<b>CIP</b>	'Minimum' 0 x match (Minimum)	'On-Target' 1 x match (Threshold)	'Maximum' 2 x match (Maximum)
<b>LTIP</b>	'Minimum' 0% of salary (Minimum)	'On-Target' 75% of salary (Threshold)	'Maximum' 300% of salary (Maximum)

CFO			
Base salary	Annual base salary		
Pension	Company pension allowance		
Other benefits	Taxable value of annual benefits provided		
<b>Cash bonus</b>	'Minimum' 0% of salary (Minimum)	'On-Target' 30% of salary (Target)	'Maximum' 75% of salary (Maximum)
<b>Deferred bonus</b>	'Minimum' 0% of salary	'On-Target' 30% of salary (Target)	'Maximum' 75% of salary (Maximum)
<b>CIP</b>	'Minimum' 0 x match (Minimum)	'On-Target' 1 x match (Threshold)	'Maximum' 2 x match (Maximum)
<b>LTIP</b>	'Minimum' 0% of salary (Minimum)	'On-Target' 50% of salary (Threshold)	'Maximum' 200% of salary (Maximum)

## Directors' remuneration report

**Continued**

### Chairman and non-executive directors

The policy for the remuneration of Chairman and non-executive directors at Smiths is summarised in the table below:

<b>Annual fee</b>				
<b>Element and link to strategy</b> To attract, motivate and retain non-executive directors with the required skills and expertise.	<b>Operation</b> Fees are paid in cash and are reviewed annually (but not necessarily increased) to ensure they compare appropriately to fees payable at companies of similar size and complexity to Smiths.  Additional fees are paid to the chairs of the Remuneration, Nomination and Audit Committees and to the Senior Independent Director to reflect the additional time commitment of these roles.  The additional fee paid to the Chairman of the Board is determined by the Committee, absent the Chairman, while the fees for all non-executive directors are agreed by the executive directors.	<b>Opportunity</b> Fees are adjusted according to the outcome of the annual reviews. The basic fee for non-executive directors is subject to the maximum aggregate annual fee of £750,000, as approved by shareholders in 2006 in the Company's Articles of Association.  Fee levels for the year under review and for the current year are disclosed in the Annual Report on Remuneration.	<b>Performance measures</b> Not applicable.	
<b>Other</b>				
				The Chairman and non-executive directors are not eligible for benefits. The Chairman and the non-executive directors are not eligible for bonuses or participation in share schemes or any pension provision. They are paid an attendance allowance for each overseas meeting attended in addition to the annual fee and are reimbursed for actual expenses incurred (transportation, hotels etc).

### Approach to recruitment remuneration

#### External appointments

The Remuneration Committee approves the remuneration of each executive director on their appointment. In setting the remuneration during the recruitment of external appointments, the Committee will apply the following policy:

<b>External appointments</b>	
<b>Pay element</b>	<b>Policy on recruitment</b>
<b>Salary</b>	Salary on recruitment is determined based on the same principles as the annual salary review, as outlined in the policy table.
<b>Pension</b>	As described in the policy table.
<b>Benefits</b>	As described in the policy table.
<b>Annual bonus</b>	As described in the policy table and typically pro-rated for proportion of year served.  Maximum annual award opportunity: 180% of salary*.
<b>CIP</b>	Eligible for match, as described in the policy table (only after bonus is first earned).  Maximum match: 180% of salary.
<b>LTIP</b>	May be considered for an award under the LTIP on similar terms to other executives.  Maximum annual award opportunity: 300% of salary.
<b>Other</b>	The Remuneration Committee may make an award in recognition of incentive arrangements forfeited on leaving a previous employer. Any such award will take account of relevant factors including the fair value of awards forfeited, any performance conditions attached, the likelihood of those conditions being met and the proportion of the vesting period remaining. For the purposes of making such awards, but for no other reason, the Committee may avail itself of Listing Rule 9.4.2R. The Remuneration Committee may also make payments to cover reasonable expenses in recruitment and relocation, and any other miscellaneous expenses including but not limited to housing, tax and immigration support.

\*Annual bonus maximum shown is prior to mandatory 50% deferral

## Internal promotions

In cases of appointing a new executive director by way of internal promotion, the policy will be consistent with that for external appointees, as detailed above. Any commitments made prior to an individual's promotion will continue to be honoured even if they would not otherwise be consistent with the policy prevailing when the commitment is fulfilled, although the Company may, where appropriate, seek to revise an individual's existing service contract on promotion to ensure it aligns with other executive directors and prevailing market best practice.

Disclosure on the remuneration structure of any new executive director (external or internal), including details of any exceptional payments, will be disclosed in the RNS notification made at the time of appointment and in the Annual Report on Remuneration for the year in which the recruitment occurred.

## Non-executive directors

In recruiting a new non-executive director, the Committee will use the policy as set out in the table on page 98.

## Service contracts

The Company's policy is that executive directors are normally employed on terms which include a one-year rolling period of notice and provision for the payment of a predetermined sum in the event of termination of employment in certain circumstances (but excluding circumstances where the Company is entitled to dismiss without compensation). In addition to payment of basic salary, pension allowance and benefits in respect of the unexpired portion of the one-year notice period, the predetermined sum would include annual bonus and share awards only in respect of the period they have served, payable following the relevant performance year-end and subject to the normal performance conditions. Existing service contracts are available for viewing at the Company's Registered Office.

### Mr Bowman

Mr Bowman is employed under a service contract with the Company dated 15 November 2007 and effective from 10 December 2007. It may be terminated by 12 months' notice given by the Company or six months' notice given by Mr Bowman. The Company may elect to terminate the contract by making a payment in lieu of notice equal to 150% of Mr Bowman's basic salary, other than for cause, this being a genuine pre-estimate of Mr Bowman's entitlement in respect of the unserved notice period, to cover:

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

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

### Mr Turner

Mr Turner is employed under a service contract with the Company dated 23 March 2010 and effective from 19 April 2010. It provides for a rolling one-year notice period given by the Company or six months' notice given by Mr Turner. In the event of termination by the Company (other than for cause), the Board is required to consider what sum should be payable as compensation to Mr Turner. In doing so, the Board shall take into account a number of specific matters, including Mr Turner's personal circumstances, the financial performance of Smiths Group, applicable corporate governance best practice, the likelihood of Mr Turner obtaining alternative employment, and various other matters relating to Mr Turner's financial loss. The amount of compensation, as so determined, will not be less than 12 months' basic salary.

## Chairman and non-executive directors

The Chairman and the non-executive directors serve the Company under letters of appointment and do not have contracts of service or contracts for services. Except where appointed at a general meeting, directors stand for election by shareholders at the first Annual General Meeting (AGM) following appointment. Although the articles of association only require directors to stand for re-election at every third AGM (or such earlier AGM as the Board may determine) thereafter (under Article 49), the Board has resolved that all directors who are willing to continue in office will stand for re-election by the shareholders each year at the AGM. Either party can terminate the appointment on one month's written notice and no compensation is payable in the event of an appointment being terminated early.

Non-executive director	Date of appointment	Expiry of current term	Date of election/last re-election
B.F.J. Angelici	1 July 2010	2014	19 November 2013
Sir G. Buckley	1 August 2013	2014	19 November 2013
D.J. Challen	21 September 2004	2014	19 November 2013
T.D. Fratto	1 July 2012	2015	19 November 2013
W. Seeger	12 May 2014	2017	
A.C. Quinn	1 August 2009	2014	19 November 2013
K.R. Tebbit	14 June 2006	2014	19 November 2013

## **Directors' remuneration report**

### **Continued**

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

For those individuals regarded as 'bad leavers' (eg voluntary resignation or dismissals for cause), annual bonus awards are forfeited and matching awards under the CIP and outstanding awards under the LTIP automatically lapse. A good leaver will typically remain eligible for a pro-rated annual bonus award to be paid after the end of the financial year and will also continue to be eligible to receive a pro-rated number of matching shares under the CIP – subject to the normal performance criteria – provided the individual holds the relevant proportion of their invested shares until the end of the original three-year performance period.

LTIP awards will typically vest at the normal vesting date for good leavers to the extent that the TSR, EPS and cash conversion performance conditions are met, but will normally be pro-rated on the basis of actual service within the performance period. In cases of death or disability, individuals are automatically deemed to be good leavers under the plan rules of the LTIP and CIP. All other good leavers will be defined at the discretion of the Committee on a case-by-case basis. LTIP awards automatically lapse for those not regarded as good leavers.

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

#### **External appointments**

Subject to the overriding requirements of the Company, the Committee allows executive directors to accept external appointments where it considers that such appointments will contribute to the director's breadth of knowledge and experience. Directors are permitted to retain fees associated with such appointments.

#### **Consideration of employment conditions**

The Committee always takes into account pay and employment conditions elsewhere in the Company. We do not consult directly with employees regarding executive director pay. Each year the Committee is provided with information on pay trends and ratios of the wider employee population across the Group.

#### **Consideration of shareholder views**

The Committee has actively consulted with major shareholders whenever there have been changes to the remuneration policy in a manner that is receptive and respectful of shareholder views.

#### **Annual report on remuneration**

This section of the remuneration report details how our Policy was implemented in the year ended 31 July 2014.

#### **Committee members and meeting attendance in 2013/14**

The members of the Committee and their attendance at meetings held during the year are set out in the Corporate governance statement on page 91.

Sir George Buckley is absent when his own remuneration as Chairman of the Company is under consideration. The Chief Executive attends meetings of the Committee by invitation but he is not involved in the determination of his own remuneration.

#### **Advisers to the Committee**

During the year, the Committee received material assistance and advice from the Chief Executive, the HR Director (who is also Secretary to the Committee), the Group Director of Reward, Kepler Associates (the Committee's appointed independent remuneration adviser) and Freshfields Bruckhaus Deringer LLP.

The Company paid a total annual fee of £56,218 to Kepler Associates in relation to remuneration advice to the Remuneration Committee during the year. Fees were determined on the basis of time and expenses. During FY2014, Kepler provided the Remuneration Committee with benchmarking analysis of executive and non-executive directors' pay, information on market trends, drafting support for this and last year's Directors' remuneration report, and other relevant assistance on determining directors' remuneration. Kepler was reappointed by the Remuneration Committee via competitive tender in 2013. Kepler is a founding member, and signatory, of the Remuneration Consultants Group. Kepler does not provide any other material services to the Group, and the Committee is therefore satisfied that the advice provided by Kepler is objective and independent. Freshfields Bruckhaus Deringer LLP was appointed by the Company to advise the Group on various legal matters during the year.

#### **Main activities during the year**

During the year under review, the Committee's main activities included:

- consideration of market trends and pay levels for executive directors and the Chairman;
- review of all senior executive salary and bonus payments;
- target setting for both the Annual Incentive Plan and Long-Term Incentive Plan;
- performance review of the executive directors against the targets for the financial year; and
- other activities included consideration of the effectiveness of the incentive arrangements.

#### **Summary of shareholder advisory vote on 2012/13 Directors' remuneration report**

The resulting voting outcome for last year's Directors' remuneration report was as follows:

Votes for	% of votes cast for	Votes against	% of votes cast against	Total votes cast	Votes withheld (abstentions)
273,188,230	96.2%	10,892,101	3.8%	284,080,331	10,992,522

## Directors' single figure of annual remuneration (auditable)

### Executive directors

	Salary / fees		Benefits <sup>5</sup>		Annual bonus <sup>6</sup>		Long-term incentives <sup>7</sup>		Payments in lieu of pension contribution		Other <sup>8</sup>		Total	
	2014 £000	2013 £000	2014 £000	2013 £000	2014 £000	2013 £000	2014 £000	2013 £000	2014 £000	2013 £000	2014 £000	2013 £000	2014 £000	2013 £000
P. Bowman	<b>840</b>	820	<b>31</b>	39	<b>643</b>	583	<b>2,094</b>	2,078	<b>353</b>	344	<b>6</b>	0	<b>3,967</b>	3,864
P. A. Turner	<b>400</b>	400	<b>1</b>	1	<b>223</b>	241	<b>721</b>	325	<b>100</b>	100	<b>0</b>	0	<b>1,445</b>	1,067

### Chairman and non-executive directors

	Salary / fees		Benefits <sup>5</sup>		Annual bonus <sup>6</sup>		Long-term incentives <sup>7</sup>		Payments in lieu of pension contribution		Other <sup>8</sup>		Total	
	2014 £000	2013 £000	2014 £000	2013 £000	2014 £000	2013 £000	2014 £000	2013 £000	2014 £000	2013 £000	2014 £000	2013 £000	2014 £000	2013 £000
Sir G. Buckley <sup>1</sup>	<b>340</b>		<b>0</b>								<b>40</b>		<b>380</b>	
D.H. Brydon <sup>2</sup>	<b>95</b>	315	<b>16</b>	33									<b>111</b>	348
D.J. Challen <sup>3</sup>	<b>79</b>		<b>75</b>										<b>79</b>	75
K.R. Tebbit	<b>63</b>		<b>60</b>										<b>63</b>	60
A.C. Quinn <sup>4</sup>	<b>79</b>		<b>75</b>										<b>79</b>	75
B.F.J. Angelici	<b>63</b>		<b>60</b>								<b>8</b>	13	<b>71</b>	73
T.D. Fratto	<b>63</b>		<b>60</b>								<b>22</b>	40	<b>85</b>	100
W.C. Seeger <sup>4</sup>	<b>14</b>												<b>14</b>	

<sup>1</sup>Sir George Buckley's fees comprised his non-executive director's fee; an additional fee for being Deputy Chairman from his appointment to 19 November 2013; an additional fee for being Chairman from 19 November to 31 July 2014; and his additional fee for the Chairmanship of the Nomination Committee from 19 November 2013.

<sup>2</sup>Mr Brydon's fees comprised his non-executive director's fee; his additional fee for being Chairman; and his additional fee for the Chairmanship of the Nomination Committee – all up to his retirement on 19 November 2013.

<sup>3</sup>Mr Challen waived his right to the fee payable to the Senior Independent Director but he did receive the fee paid for his Chairmanship of the Audit Committee, in addition to his non-executive director's fee.

<sup>4</sup>Ms Quinn's fees comprised her non-executive director's fee and her additional fee for Chairing the Remuneration Committee. Mr Seeger's fees for 2014 are for a part year, covering the period from his appointment on 12 May 2014 until the end of the financial year on 31 July 2014.

<sup>5</sup>Benefits include car allowance, life assurance and private healthcare insurance.

<sup>6</sup>In accordance with the rules of the CIP set out in the remuneration policy table on page 94, Mr Bowman and Mr Turner each deferred 50% of their net bonus earned into Smiths shares. The total bonus paid during the year, including deferral, is captured under 'annual bonus' above.

<sup>7</sup>Figure for 2014 has been valued using the three-month average share price to 31 July 2014 (1293p) and includes the projected payouts from the 2011 CIP and 2011 LTIP awards. Figure for 2013 has been trued up (compared to last year's figure) to reflect the vest-date share price on 19 September 2013 of £14.06.

<sup>8</sup>Other includes amounts received from the Company's Share Save Scheme for the Chief Executive and reimbursed travel-related expenses for the Chairman and non-executive directors.

**Directors' remuneration report**  
**Continued**

**Incentive outcomes for 2013/14**

**2013/14 annual bonus outcome**

The table below summarises the structure of the 2013/14 annual bonus, our performance and the resulting annual bonus payouts:

Measure	Weighting	Performance level	Earned bonus		
			(% of max. bonus)	(% salary)	£000
Group EPS	50%	Below threshold	0%	0%	
Mr Bowman		Below threshold	0%	0%	0
Mr Turner		Below threshold	0%	0%	0
Cash conversion	20%	Between target and maximum	70%		
Mr Bowman		Between target and maximum	70%	25.2%	212
Mr Turner		Between target and maximum	70%	21.0%	84
Personal objectives	30%	Challenging personal objectives are derived from the Company's annual and strategic plans. For 2013/14, these targets included revenue growth, cash generation, and improvements in our corporate responsibility measures and organisational capabilities.			
Mr Bowman		Between target and maximum	95.0%	51.3%	431
Mr Turner		Between target and maximum	77.0%	34.7%	139
<b>Total</b>					
Mr Bowman			42.5%	76.5%	643
Mr Turner			37.1%	55.7%	223

2014 targets are not disclosed in this report as they are considered commercially sensitive by the Board, given the close link between performance targets and Smiths longer-term strategy. In addition, the Committee believes disclosing targets would put Smiths at a competitive disadvantage to its international and privately-held competitors, which are not subject to similar disclosure requirements. The Committee will disclose targets at such a time as they will no longer be deemed to affect the commerciality of Smiths Group.

## 2011 CIP outcome

Included in the 'Long-term incentives' column of the executive director annual remuneration table above, is the outcome of CIP awards granted in 2011. Matching awards granted under the CIP in 2011 were subject to the following performance condition:

Measure	Weighting	Performance period	Vesting schedule		Actual performance	
			ROCE performance	% match	ROCE	% match
Group ROCE	100%	1 August 2011 to 31 July 2014	< WACC+1% p.a.	0%	> WACC+3% p.a	200%
			WACC+1% p.a.	100%		
			WACC+1% to 3% p.a.	100%		
			≥ WACC+3% p.a.	200%		

2011 CIP	Interests held	Vesting %	Interests vesting	Date of vesting	Market price <sup>1</sup>	Value £000
Mr Bowman	95,377	100%	95,377	Sept 2014	1293p	1,233
Mr Turner	33,781	100%	33,781	Sept 2014	1293p	437

<sup>1</sup> Based on the average share price over the three months to 31 July 2014 of 1293p

The CIP values carried in the 2014 long-term incentive element of the single figure table also include dividend equivalents of £153,938 (Mr Bowman) and £54,523 (Mr Turner) in respect of the vested 2011 CIP shares.

## 2011 LTIP outcome

Also included in the 'Long-term incentives' column of the executive director annual remuneration table above, is the outcome of the LTIP awards granted in 2011, details of which are summarised in the table below:

Measure	Weighting	Performance period	Vesting schedule		Actual performance	
			Performance	% vesting	Outturn	% vesting
Group EPS growth	50%	1 August 2011 to 31 July 2014	< 6% p.a.	0%	< 6% p.a.	0%
			6% p.a.	12.5%		
			≥ 14% p.a.	50.0%		
			Straight-line vesting between these points			
Total Shareholder Return rank vs. FTSE 100 companies (excluding financial services)	30%	1 August 2011 to 31 July 2014	Below median	0%	Below median	0%
			Median	7.5%		
			Upper quartile or above	30.0%		
			Straight-line vesting between these points			
Average cash conversion	20%	1 August 2011 to 31 July 2014	< 85%	0%	98%	18%
			85%	5.0%		
			≥ 100%	20.0%		
			Straight-line vesting between these points			
<b>Total</b>						18%

2011 LTIP	Interests held	Vesting %	Interests vesting	Date of vesting	Market price <sup>1</sup>	Value £000
Mr Bowman	275,321	18%	49,558	Sept 2014	1293p	641
Mr Turner	89,535	18%	16,116	Sept 2014	1293p	208

<sup>1</sup> Based on the average share price over the three months to 31 July 2014 of 1293p

The 2011 LTIP values carried in the single figure table also include dividend equivalents of £66,219 (Mr Bowman) and £21,534 (Mr Turner) in respect of the vested LTIP shares.

**Directors' remuneration report**  
**Continued**

**Scheme interests awarded in 2013/14 (auditable)**

**2013 LTIP**

During the year ended 31 July 2014, the executive directors were awarded conditional share awards under the LTIP, details of which are summarised in the table below:

Executive	Form of award	Date of grant	Number of shares awarded	Award price <sup>1</sup>	Face value		
					£'000	% of salary	Date of vesting
Mr Bowman	Conditional shares	19 Sept 2013	178,470	£14.12	2,520	300%	19 Sept 2016
Mr Turner	Conditional shares	19 Sept 2013	56,657	£14.12	800	200%	19 Sept 2016

<sup>1</sup>The closing price on 18 September 2013

The performance conditions attached to these 2013 LTIP awards are as follows:

Measure	Weighting	Performance period	Vesting schedule	
			Performance	% vesting
Group EPS growth	50%	1 August 2013 to 31 July 2016	< 4% p.a.	0%
			4% p.a.	12.5%
			≥ 12% p.a.	50.0%
Straight-line vesting between these points				
Total Shareholder Return rank vs. FTSE 100 companies (excluding financial services)	30%	1 August 2013 to 31 July 2016	Below median	0%
			Median	7.5%
			Upper quartile or above	30.0%
Straight-line vesting between these points				
Average cash conversion	20%	1 August 2013 to 31 July 2016	< 85%	0%
			85%	5.0%
			≥ 100%	20.0%
Straight-line vesting between these points				

**2013 CIP**

During the year ended 31 July 2014, the executive directors were also awarded conditional matching share awards under the CIP, set with reference to the annual bonus outcome for the year ended 31 July 2013. Details of these awards are summarised below:

Executive	Form of award	Date of grant	Number of shares awarded	Award price <sup>1</sup>	Face value		
					£'000	% of salary	Date of vesting
Mr Bowman	Conditional shares	26 Sept 2013	41,913	£13.91	583	69%	19 Sept 2016
Mr Turner	Conditional shares	26 Sept 2013	17,296	£13.91	241	60%	19 Sept 2016

<sup>1</sup>The closing price on 25 September 2013.

2013 CIP matching shares vest after three years, subject to the achievement of the following ROCE performance targets:

Measure	Weighting	Performance period	Vesting schedule	
			ROCE performance	% match
Group ROCE	100%	1 August 2013 to 31 July 2016	< WACC+1% p.a.	0%
			WACC+1% p.a.	100%
			WACC+1% to 3% p.a.	100%
			≥ WACC+3% p.a.	200%

## Percentage change in remuneration from 2012/13 to 2013/14

	Salary	Benefits	Bonus
CEO remuneration	2.4%	[20.5)%	10.2%
Average of all employees	2.6%	0%	15.6%

All employees is defined as the global senior management population of approximately 50 individuals who are eligible to participate in the same incentive arrangements (AIP, CIP and LTIP) as the Chief Executive,

### Relative importance of spend on pay

The table below shows shareholder distributions (ie dividends and share buybacks) and total employee pay expenditure for the financial years ended 31 July 2013 and 31 July 2014, and the percentage change.

	2014 <sup>1</sup> £m	2013 £m	Change
Shareholder distributions	<b>275.0</b>	152.4	80.4%
Employee costs	<b>845.5</b>	892.1	[5.2)%

<sup>1</sup>The increase in shareholder distributions in 2014 reflects the payment of a special dividend.

### Payments to past directors (auditable)

No payments were made to past directors in the year.

### Payments for loss of office (auditable)

No directors left office during the year.

### TSR performance

The following graph shows the Company's total shareholder return (TSR) performance over the past five years compared to the FTSE 100 Index. The FTSE 100 Index, of which the Company has been a member throughout the period, has been selected to reflect the TSR performance of other leading UK-listed companies. The values of hypothetical £100 investments in the FTSE 100 Index and Smiths Group plc shares were £186.27 and £214.73 respectively.



### CEO remuneration for the last five years

Year	2010	2011	2012	2013	2014
CEO total remuneration £000	3,399	4,776	5,026	3,865	<b>3,967</b>
Annual bonus outcome (% max)	95%	64%	79%	39%	<b>43%</b>
CIP outcome (% max)	n/a	100%	100%	100%	<b>100%</b>
2007 PSP outcome (% max) <sup>1</sup>	46%	33%	n/a	n/a	<b>n/a</b>
2011 LTIP outcome (% max)					<b>18%</b>

<sup>1</sup>The 2007 PSP outcome shown for 2010 represents the outcome under the EPS element of that award only (2/3 of the award). The 2007 PSP outcome shown for 2011 represents the outcome under the TSR element of that award (1/3 of the award) as TSR performance was measured over a three-year period commencing on the date of the grant.

Note: VSP outcome as a percentage of maximum is not shown in table above as award opportunity was uncapped. Awards received are included in the CEO total remuneration table above and the values are: £1,453,000 for 2011 (150,694 shares at a price of 964p); £1,899,000 for 2012 (175,193 shares at a price of 1084p); and £364,000 for 2013 at (25,885 shares at a price of 1406p).

## Directors' remuneration report

Continued

### Statement of implementation of remuneration policy in 2014/15

#### Base salary and benefits

Salaries are reviewed (but not necessarily increased) annually and benchmarked against comparable roles at other FTSE 100 companies of similar market capitalisation, revenues and complexity. Having considered a number of important factors including individuals' performance and experience, the relative performance of the Company and the remuneration policy within the Company, the Committee determined to award a salary increase of 2.4% to the Chief Executive and of 2.5% to the Finance Director for 2014/15, in line with the average salary increase awarded across the Group (2.6%). The historical progression of executive director salary over the past five years is summarised in the table below:

Executive director	Salary last reviewed	2010/11	2011/12	2012/13	2013/14	2014/15
P. Bowman	15 July 2014	£800,000	£820,000	£820,000	£840,000	£860,000
P.A. Turner	15 July 2014	£400,000	£400,000	£400,000	£400,000	£410,000

#### Pension and benefits

There are no changes in pension contribution rates or benefit provision for 2014/15.

#### Annual bonus

The annual bonus, including the maximum award opportunity, performance measures and their weightings, will remain unchanged for 2014/15. Specific targets cannot be disclosed at this time due to the commercially sensitive nature of these objectives, but they will be disclosed at such a time as the Committee deems them to no longer affect the commerciality of the Company.

#### Co-Investment Plan (CIP)

The 2014 CIP (based on the deferral of 50% of earned 2013/14 annual bonuses) will continue to operate as in 2013/14. Matching share awards will vest in full if ROCE exceeds WACC by an average margin of at least 3% a year; a 1-for-1 matching share award vests if ROCE is between WACC+1% and WACC+3% p.a.

#### Long-Term Incentive Plan

The LTIP is a conventional share plan under which an award over a capped number of shares will vest if demanding performance conditions are met. LTIP awards of conditional shares are granted to selected senior executives (including the executive directors) with face values of up to 300% of salary. Under the LTIP, the normal annual grants are 300% of salary for the Chief Executive and 200% of salary for the Finance Director.

LTIP awards to be granted to executive directors in 2014/15 (at the normal annual grant levels disclosed above) will vest on the achievement of the following performance conditions:

Performance measure	Weighting	Threshold performance target	Maximum performance target (full vesting of element)
3-year EPS growth	50%	4% p.a.	12% p.a.
3-year TSR rank vs. the FTSE 100 companies (excluding financial services companies)	30%	Median	Upper quartile
3-year average annual cash conversion	20%	85%	100%

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

## Non-executive director fees

NED fees for 2014/15 are as follows:

NED base fee	£64,575 (2.5% increase from 2013/14)
Additional fee payable to the Chairman of the Board	£328,425 (2.5% increase from 2013/14)
Additional fee payable to the Senior Independent Director	£17,000 (£1,000 increase from 2013/14)
Additional fees for Audit, Nomination and Remuneration Committee Chairs	£17,000 (£1,000 increase from 2013/14)
Attendance allowance for meetings outside the NED's home continent	£3,000 per meeting (introduced for 2014/15)

## Share ownership guidelines

It is the Committee's policy that executive directors should, over time, acquire a shareholding with a value equal to at least two years' base salary for the Chief Executive and one and a half years' gross salary for the Finance Director. Executive directors are required to retain at least 50% of any net vested share awards (after sales to meet tax liabilities) until those guidelines are achieved. There is no shareholding policy for non-executive directors.

## Directors' shareholdings (auditable)

The table below shows the shareholding of each executive director against their respective shareholding requirement as at 31 July 2014.

	Shareholding requirement (% 2013/14 salary)	Shares owned outright	Shares subject to performance	Performance tested but unvested shares	Shares subject to CIP deferral	Save As You Earn (SAYE)	Current shareholding (% 2013/14 salary)	Guideline met
P. Bowman	200%	518,675	925,722	0	62,015	4,568	787%	Yes
P.A. Turner	150%	56,879	307,019	0	22,019	0	181%	Yes
B. F. J. Angelici		2,000						
G. Buckley		0						
D. J. Challen		1,333						
T. D. Fratto		1,500						
A. C. Quinn		1,024						
W. C. Seeger		2,500						
K. R. Tebbit		1,000						

The only change in the interests of the directors and their connected persons between 31 July 2014 and the date of this report relates to the maturity of Mr Bowman's 2009 SAYE (2,750 share options) award on 1 August 2014 increasing Mr Bowman's 'shares owned outright' number to 521,425 and reducing his SAYE number to 1,818.

## Share scheme dilution limits

The Company complies with the guidelines laid down by the Association of British Insurers. These restrict the issue of new shares under all the Company's share schemes in any 10-year period to 10% of the issued ordinary share capital and under the Company's discretionary schemes to 5% in any 10-year period. As at 31 July 2014, the headroom available under these limits was 6.61% and 2.21%, respectively.

## Auditable part

The directors' single figure of annual remuneration and accompanying notes on page 101; the scheme interests awarded in 2013/14 and accompanying notes on page 104; the directors' shareholdings on page 107 and the directors' share options and long-term plans table on pages 108 to 109 have been audited.

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

**A.C. Quinn**

16 September 2014

## Directors' remuneration report

**Continued**

### Directors' share options and long-term share plans (Auditable)

Director and Plans	Options and awards held on 31 July 2014		Options and awards held on 31 July 2013		Option and award data					Awards vested 2013/14		
	Number	Number	Performance test	Exercise price	Grant date	Vesting date*	Expiry date**	Exercise/vesting date	Number	Exercise price	Market price at date of grant#	Market price at date of exercise##
<b>P. Bowman</b>												
LTIP	137,661	137,661	A	n/a	16/12/11	Sep 2014	Sep 2014					
	82,596	82,596	B	n/a	16/12/11	Sep 2014	Sep 2014					
	55,064	55,064	C	n/a	16/12/11	Sep 2014	Sep 2014					
	113,469	113,469	A	n/a	19/10/12	Oct 2015	Oct 2015					
	68,081	68,081	B	n/a	19/10/12	Oct 2015	Oct 2015					
	45,387	45,387	C	n/a	19/10/12	Oct 2015	Oct 2015					
	89,235	0	A	n/a	19/09/13	Oct 2016	Oct 2016					
	53,541	0	B	n/a	19/09/13	Oct 2016	Oct 2016					
	35,694	0	C	n/a	19/09/13	Oct 2016	Oct 2016					
CIP	0	112,169	D	n/a	05/10/10			19/09/13	112,169	n/a	1240.00p	1417.48p
	95,377	95,377	D	n/a	24/10/11	Oct 2014	Oct 2014					
	107,704	107,704	D	n/a	19/10/12	Oct 2015	Oct 2015					
	41,913	0	D	n/a	26/09/13	Oct 2016	Oct 2016					
SAYE	2,750†	2,750		569.00p	21/05/09	01/08/14	01/02/15					
	1,818	0		990.00p	14/05/14	01/08/17	01/02/18					

### P.A. Turner

Director and Plans	VSP awards held on 31 July 2014		VSP awards held on 31 July 2013		Award data					Awards vested 2013/14		
	Shares per £5m surplus value	Shares per £5m surplus value	Performance test		Grant date	Vesting date*		Vesting date	Number of shares vested	Market price at date of grant#	Market price at date of exercise##	
<b>P. Bowman</b>												
VSP 2010	0	240 ♦	E		17/12/10							
	0	560	F		17/12/10	Sep 2013		19/09/13	25,885	n/a	1235.00p	1417.48p
<b>P.A. Turner</b>												
VSP 2010	0	96 ♦	E		17/12/10							
	0	224	F		17/12/10	Sep 2013		19/09/13	10,354	n/a	1235.00p	1417.48p

### Value sharing plans

Director and Plans	VSP awards held on 31 July 2014		VSP awards held on 31 July 2013		Award data					Awards vested 2013/14		
	Shares per £5m surplus value	Shares per £5m surplus value	Performance test		Grant date	Vesting date*		Vesting date	Number of shares vested	Market price at date of grant#	Market price at date of exercise##	
<b>P. Bowman</b>												
VSP 2010	0	240 ♦	E		17/12/10							
	0	560	F		17/12/10	Sep 2013		19/09/13	25,885	n/a	1235.00p	1417.48p
<b>P.A. Turner</b>												
VSP 2010	0	96 ♦	E		17/12/10							
	0	224	F		17/12/10	Sep 2013		19/09/13	10,354	n/a	1235.00p	1417.48p

**Key**

LTIP The Smiths Group Long-Term Incentive Plan

CIP The Smiths Group Co-Investment Plan

SAYE The Smiths Group Sharesave Scheme

VSP 2010 The Smiths Group 2010 Value Sharing Plan

\* The vesting dates shown above in respect of awards made under LTIP and CIP are subject to the relevant performance test(s) being passed.

\*\* The expiry dates shown above apply in normal circumstances. No expiry date is shown if the option or award was exercised or vested or lapsed prior to 16 September 2014

# Mid-market closing price of a Smiths share on the business day preceding the date of grant. The exercise price of an option under the SAYE is set at 20% less than the mid-market closing price of a Smiths share on the business day immediately preceding the day on which employees are invited to participate in the grant.

## Actual sale price on date of option exercise or vesting of award.

† SAYE option exercised in full on 1 August 2014, following the maturity of the Sharesave savings contract

◊ Awards which lapsed during the period 1 August 2013 to 31 July 2014.

**Performance tests**

A LTIP Earnings Per Share (EPS) growth test

B LTIP Total Shareholder Return (TSR) rank test

C LTIP Cash Conversion test

D CIP Return on Capital Employed (ROCE) test

E Surplus Shareholder Value – VSP 2010 TSR test

F Surplus Internal Value – VSP 2010 PBT test

- There are no performance criteria for SAYE.

**Notes**

The high and low market prices of the ordinary shares during the period 1 August 2013 to 31 July 2014 were 1211p and 1535p respectively.

The mid-market closing price on 31 July 2013 was 1385p and on 31 July 2014 was 1275p.

The mid-market closing prices of a Smiths share on the dates of awards made to directors in the 2013/14 financial year were 1406p (19 September 2013 for the LTIP Awards) and 1404p (26 September 2013 for the CIP Awards).

The option over 4,568 shares granted to and held by directors under SAYE at 31 July 2014 was granted at an exercise price below the market price of a Smiths Group share on 15 September 2014 (1360p). The SAYE option granted on 21 May 2009 vested and was exercised in full on 1 August 2014.

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

No other director held any options over the Company's shares during the period 1 August 2013 to 31 July 2014.

Other than the SAYE option which was excised on 1 August 2014, no options or awards have been granted to or exercised by directors or have lapsed during the period 1 August to 16 September 2014.

At 31 July 2014 the trustee of the Employee Share Trust held 855 shares (none of the directors had an interest in these shares at 31 July 2014). The market value of the shares held by the trustee on 31 July 2014 was £10,901 and dividends of approximately £596 were waived in the year in respect of the shares held by the trustee during the year.

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

Smiths ROCE over the performance period for the 2010 CIP awards (1 August 2010 to 31 July 2013) exceeded the Company's weighted average costs of capital (WACC) over the period by more than 3% p.a. and accordingly, the 2010 CIP Awards vested in full. The notional gross dividends accrued in respect of the performance period amounted to £122.51 per share. This amount, after deduction of income tax and national insurance contributions, was paid in cash in respect of each share that vested.

Over the three-year period from 1 August 2010 to 31 July 2013, Smiths TSR did not result in the vesting of any shares under that element of the VSP award. Under the earnings element of the 2010 Group VSP, performance was measured in terms of absolute growth in adjusted headline profit times a multiple plus net equity cash-flows to shareholders. Smiths performance over the period generated £231m of surplus value above the 8.5% p.a. hurdle rate, which resulted in 25,885 shares vesting to the Chief Executive and 10,354 shares vesting to the Finance Director (the only directors to have participated in the VSP).

# Group directors' report

## Results and dividends

The results for the financial year ended 31 July 2014 are set out in the Consolidated income statement. Revenues for the year amounted to £2,952m (2013: £3,109m). The profit for the year after taxation amounted to £234.7m (2013: £316.6m).

An interim dividend of 12.75p per ordinary share of 37.5p was paid on 25 April 2014. The directors recommend for payment on 21 November 2014 a final cash dividend of 27.5p on each ordinary share of 37.5p, making a total dividend of 40.25p for the financial year.

## Directors

Messrs B.F.J. Angelici, P. Bowman, D.J. Challen, CBE and P.A. Turner; Ms T.D. Fratto; Ms A.C. Quinn, CBE; and Sir Kevin Tebbit, KCB, CMG all served as directors of the Company throughout the year. Mr D.H. Brydon, CBE retired from the board and as Chairman on 19 November 2013. Sir George Buckley was appointed as a non-executive director and as Deputy Chairman on 1 August 2013 and succeeded Mr Brydon as Chairman on 19 November 2013. Mr W.C. Seeger was appointed as a non-executive director on 12 May 2014.

## Reappointment of directors

In accordance with the UK Corporate Governance Code, all the directors, except for Mr Seeger, will retire voluntarily from office at the AGM and will seek re-election. Mr Seeger will retire at the AGM under Article 49 of the Company's Articles of Association, following his appointment during the year, and will seek election. Separate resolutions to re-elect or elect each of them as a director of the Company will be proposed at the AGM. Biographical details of all the directors are set out on pages 74 to 76.

## Directors' remuneration report and policy

The Directors' remuneration report and the proposed Directors' remuneration policy are on pages 92 to 109.

Ordinary resolutions to approve the report and to adopt the policy will be put to shareholders at the AGM.

## Directors' interests in contracts

Details of the executive directors' service contracts are disclosed in the service contracts section of the Directors' remuneration report on page 99. Details of the interests of the executive directors in the Company's share option schemes and plans are shown in the Directors' remuneration report on pages 108 and 109.

Qualifying third-party indemnity provisions (as defined by section 234 of the Companies Act 2006 (the '2006 Act')) have remained in force for the directors during the financial year ended 31 July 2014 and, at the date of this report, are in force for the benefit of the current directors in relation to certain losses and liabilities which they may incur (or may have incurred) to third parties in the course of their professional duties for the Company.

Apart from the exceptions referred to above, no director had an interest in any significant contract to which the Company or its subsidiaries was a party during the year.

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

On 2 August 2013 the Company announced that discussions about the possible sale of the Medical division had been terminated.

On 20 February 2014 the Company completed the refinancing of its existing US\$800m bank facility, which had been due to mature in December 2015. The new US\$800m committed revolving credit facility will mature in February 2019, with two one-year extension options.

On 21 July 2014 the Company celebrated the centenary of the first listing of its shares on the London Stock Exchange.

## Post balance sheet events

There have been no post-balance sheet events.

## Political donations

The Group made contributions to non-EU political parties totalling US\$42,600 (£25,000) during the year. The political contributions were made on a bi-partisan basis in the US, in accordance with US state and federal election laws, in order to raise awareness and to promote the interests of the Company. The Group has a number of key manufacturing sites and approximately 8,300 employees in the US.

## Interests in voting rights

As at 31 July 2014 the Company had been notified, pursuant to the FCA's Disclosure & Transparency Rules, of notifiable voting rights in its issued share capital or had received disclosures pursuant to the 2006 Act of shareholding interests in excess of three percent of its share capital, as follows:

	Number of shares	Percentage of issued ordinary share capital*	Date of notification or disclosure
Ameriprise Financial / Threadneedle Asset Management	Not disclosed	>5.0%	13/06/2014
BlackRock Investment Management (UK) Ltd	16.4m	4.2%	30/07/2012
Harris Associates LP	20.2m	5.1%	15/05/2013
M&G Investment	17.4m	4.4%	29/08/2012
Massachusetts Financial Services Company	18.5m	4.7%	31/08/2012

During the period 1 August to 15 September 2014 the Company has received the following notifications or disclosures:

	Number of shares	Percentage of issued ordinary share capital*	Date of notification or disclosure
Ameriprise Financial / Threadneedle Asset Management	19.9m	5.0%	10/09/2014
BlackRock Investment Management (UK) Ltd	20.0m	5.1%	14/08/2014
Harris Associates LP	29.3m	7.4%	15/08/2014
M&G Investment	15.7m	4.0%	15/08/2014
Massachusetts Financial Services Company	17.1m	4.1%	11/08/2014

\*Percentage of ordinary share capital in issue on 31 July 2014.

Note: The Disclosure & Transparency Rules oblige shareholders to notify to a company when interests in the voting rights of that company's shares exceed or fall below 3% of the company's issued share capital and every whole percentage point above 3%. Where the voting rights in shares are managed by an investment manager under certain defined schemes, the manager is obliged to notify a company when its interests in the voting rights in the shares it manages under such schemes exceed or fall below 5% or 10% of the company's issued share capital.

The interests of the directors, their families and any connected persons in the issued share capital of the Company are shown in the Directors' remuneration report on page 107.

## Corporate responsibility

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

Further information on environmental, employee and health and safety matters, including key performance indicators, is contained in the Corporate responsibility summary on pages 66 to 71. The full Corporate responsibility report is available online at [www.smiths.com/responsibility](http://www.smiths.com/responsibility).

## Corporate governance statement

The Corporate governance statement is on pages 74 to 91 and is incorporated in this Directors' report by reference. PricewaterhouseCoopers LLP has reviewed the Company's statements as to compliance with the UK Corporate Governance Code, to the extent required by the UK Listing Authority Listing Rules. The results of its review are set out in the Independent auditors' report on pages 119 to 123.

## Strategic report

The statements and reviews on pages 6 to 71 comprise the Group Strategic report which contains certain information, outlined below, that is incorporated into this Directors' report by reference:

- an indication of the Group's likely future business developments;
- an indication of the Group's research and development activities;
- information on the Company's policies for the employment of disabled persons and employee involvement; and
- the Group's disclosures regarding greenhouse gas emissions.

## Branches

The Company does not operate through any branches. Some Group subsidiary companies have established branch operations outside the UK.

## Financial instruments

The financial risk management objectives and policies of the Group; the policy for hedging each major type of forecasted transaction for which hedge accounting is used; and the exposure of the Group to foreign exchange risk, interest rate risk, price risk, financial credit risk, liquidity risk and cash-flow risk is outlined in note 19 of the Group accounts.

## Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic report on pages 6 to 71. The financial position of the Company, its cash-flows, liquidity position and borrowing facilities are described in the Financial review on pages 56 to 58. In addition, the notes to the accounts include the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk.

At 31 July 2014 the Group had available cash and short-term deposit resources of £189m and US\$620 million undrawn of the committed revolving credit facility of US\$800m which is due to mature in February 2019 (unless otherwise extended or reviewed). Whilst these facilities have certain financial covenants they are not expected to prevent full utilisation of the facilities if required. This, together with the maturity profile of debt, provides confidence that the Group has sufficient financial resources for the foreseeable future. As a consequence, the directors believe that the Company is well placed to manage its business. In coming to this conclusion, the directors have taken account of the Group's risk management process, described on pages 60 to 65, and have paid particular attention to the financial and pension funding risks and their mitigation (see page 62).

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

## Share capital and control

As at 31 July 2014, the Company's issued share capital was £147,921,051 and comprised 394,456,135 ordinary shares of 37.5p each nominal value (ordinary shares). The ordinary shares are listed on the London Stock Exchange. The Company has an American Depository Receipt ('ADR') programme for which J.P. Morgan acts as Depositary and transfer agent. One ADR equates to one Smiths Group ordinary share which trade as a level 1 ADR over-the-counter programme under the ticker symbol SMGZY. At the year-end, 5,672,747 ordinary shares were held by the nominee of the programme depositary in respect of the same number of ADRs in issue at that time.

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

There are no restrictions on transfer or limitations on the holding of any class of shares and no requirements for prior approval of any transfers. None of the shares carries any special rights with regard to control of the Company. There are no restrictions on the voting rights attaching to the ordinary shares (other than a 48 hour cut-off for the casting of proxy votes prior to a general meeting). There are no arrangements of which the directors are aware under which financial rights are held by a person other than the holder of the shares and no known agreements relating to or restrictions on share transfers or voting rights.

Shares acquired through Company share schemes and plans rank pari passu with the shares in issue and have no special rights. The Company operates an employee benefit trust, with an independent trustee, to hold shares pending employees becoming entitled to them under the Company's share schemes and plans. On 31 July 2014 the trust held 855 ordinary shares in the Company. The trust waives all but 0.1p per share of each dividend entitlement on its holding and abstains from voting the shares at general meetings.

The table on page 110 sets out the notifications, received by the Company pursuant to the FCA's Disclosure & Transparency Rules and the 2006 Act, as at 31 July 2014 and any changes thereto up to 15 September 2014, from persons with significant direct or indirect holdings in the Company's share capital.

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

## **Group directors' report**

### **Continued**

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

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

If there is a change in control of the Company, the terms of Mr Bowman's service contract require that all available discretions will be exercised under the Company's share schemes and in default the Company must indemnify Mr Bowman for the value of any awards that do not vest on the change in control.

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

#### **Purchase of shares**

No shares were either purchased or acquired or charged or disposed of by the Company during the financial year ended 31 July 2014.

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

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

Electronic copies of the Annual Report 2014 and the Notice of AGM will be posted on the Company's website, [www.smiths.com](http://www.smiths.com). The Company's announcements to the Stock Exchange and press releases are available online through the website. Shareholding details and practical help on share transfers and changes of address can be found at [www.shareview.co.uk](http://www.shareview.co.uk).

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

#### **Annual General Meeting ('AGM')**

The 2014 AGM will be held at on Tuesday 18 November 2014 at 10:30 am. The Notice of the AGM will be published on the Company's website, [www.smiths.com](http://www.smiths.com), on or around 13 October 2014.

#### **Approval of the directors' remuneration policy**

At the AGM shareholders will be asked to approve the directors' remuneration policy, as shown on pages 93 to 100, which gives details of the remuneration policy being proposed by the Remuneration Committee for the executive directors, the Chairman and the non-executive directors. Under new regulations which now form part of the Companies Act 2006, the remuneration policy must be put to a binding shareholder vote at least once every three years. Shareholders will be invited to approve the directors' remuneration policy (2014) at the AGM. If so approved, the policy will take effect at the conclusion of the meeting. Once effective, all future payments to directors, past and present, must comply with the terms of the policy, unless specifically approved by shareholders in general meeting.

#### **Authority to issue shares**

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

The authority in the first part of the Allotment Resolution will allow the directors to allot new shares in the Company or to grant rights to subscribe for or convert any security into shares in the Company up to a nominal value which is equivalent to approximately one-third of the total issued ordinary share capital of the Company as at the latest practical date prior to the publication of the Notice of AGM.

The authority in the second part of the Allotment Resolution will allow the directors to allot new shares or to grant rights to subscribe for or convert any security into shares in the Company only in connection with a rights issue up to a nominal value which is equivalent to approximately one-third of the total issued ordinary share capital of the Company as at the latest practical date prior to the publication of the Notice of AGM. This is in line with corporate governance guidelines. The Board has undertaken to seek the re-election of each director annually by the shareholders, whether or not this authority were to be used.

At 15 September 2014, the Company did not hold any shares in treasury.

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

If the resolution is passed the authority will expire on the earlier of 31 January 2016 and the end of the next AGM, due to be held in 2015.

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

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

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

- a) in connection with a pre-emptive offer; and/or
- b) otherwise up to a nominal value equivalent to 5% of the total issued ordinary share capital of the Company as at the latest practical date prior to the publication of the Notice of AGM, in each case without the shares first being offered to existing shareholders in proportion to their existing holdings.

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

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

During the financial year ended 31 July 2014, the following ordinary shares in the Company were issued:

- 637,625 ordinary shares of 37.5p pursuant to the terms of the Company's shareholder-approved share option schemes and share plans.

#### **Authority to purchase shares**

At the AGM the Company will seek to renew the authority, granted at the last AGM to the directors, to purchase the Company's ordinary shares in the market.

The effect of the resolution is to renew the authority granted to the Company to purchase its own ordinary shares until the next AGM (due to be held in 2015) or 31 January 2016 whichever is the earlier. This authority is limited to 10% of the ordinary shares in issue as at the latest practical date prior to the publication of the Notice of AGM and the Company's exercise of this authority is subject to the stated upper and lower limits on the price payable, which reflect the requirements of the Listing Rules.

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

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

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

#### **Political donations**

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

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

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

#### **Auditors**

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

#### **Notice period for extraordinary general meetings**

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

Before the coming into force of the Shareholders' Rights Regulations on 3 August 2009, the Company was able to call general meetings other than an AGM on 14 clear days' notice without obtaining such shareholder approval. In order to preserve this ability, such approval is sought at the AGM. Any exercise of this power by the Company will be conducted in accordance with any relevant corporate governance guidelines applicable at the time. In particular, the shorter notice period will only be used where flexibility is merited by the business of the meeting and is thought to be to the advantage of shareholders as a whole. The approval will be effective until the Company's next AGM, when it is intended that a similar resolution will be proposed.

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

#### **Employee share purchase plan for US employees**

An ordinary resolution will be proposed at the AGM to adopt an all-employee, savings-based, share purchase plan for the employees of our US subsidiary companies. Full details of the proposed scheme are included with the Notice of AGM.

**Group directors' report**  
**Continued**

**Disclosure table pursuant to Listing Rule LR9.8.4C**

Listing Rule	Information to be included	Disclosure
9.8.4(1)	Interest capitalised by the Group	£2.0m interest was capitalised as part of the costs of development projects
9.8.4(2)	Unaudited financial information (LR9.2.18)	The supplementary US dollar financial statements on pages 171 to 175. The Group financial record 2010-2014 on page 170
9.8.4(4)	Long-term incentive scheme only involving a director (LR9.4.3)	None
9.8.4(5)	Directors' waivers of emoluments	None
9.8.4(6)	Directors' waivers of future emoluments	None
9.8.4(7)	Non pro-rata allotments for cash (issuer)	Shares have been issued and allotted pursuant to the exercise of options awarded under shareholder-approved schemes
9.8.4(8)	Non pro-rata allotments for cash (major subsidiaries)	None
9.8.4(9)	Listed company is a subsidiary of another company	Not applicable
9.8.4(10)	Contracts of significance involving a director	None
9.8.4(11)	Contracts of significance involving a controlling shareholder	Not applicable
9.8.4(12)	Waivers of dividends	Waiver by Greenwood Nominees Limited 581722 a/c (per pro the Smiths Industries Employee Share Trust) of all but 0.1p per share per dividend (855 shares); and full waiver of all dividends by Reuter File Limited (2 shares)
9.8.4(13)	Waivers of future dividends	See above
9.8.4(14)	Agreement with a controlling shareholder LR9.2.2AR(2)(a)	Not applicable

**Additional information pursuant to LR9.8.6**

Listing Rule	Information to be included	Disclosure
9.8.6(1)	Directors' (and their connected persons') interests in Smiths shares at year-end and at not more than one month prior to date of the Notice of AGM	See page 107 above
9.8.6(2)	Interests in Smiths shares disclosed under DTR5 at year-end and not more than one month prior to date of the Notice of AGM	See page 110 above
9.8.6(3)	The going concern statement	See page 111 above
9.8.6(4)(a)	Amount of the authority to purchase own shares available at year-end	Authority available in full at year-end
9.8.6(4)(b)	Off-market purchases of own shares during the year	None
9.8.6(4)(c)	Off-market purchases of own shares post year-end	None
9.8.6(4)(d)	Non pro-rata sales of treasury shares during the year	None
9.8.6(5)	Compliance with the Main Principles of the UK Corporate Governance Code	See the Corporate governance statement on page 79
9.8.6(6)(b)	Details of non-compliance with UK Corporate Governance Code	See the Corporate governance statement on page 79
9.8.6(7)	Re directors proposed for re-election: the unexpired term of any director's service contract and a statement about directors with no service contracts	Details of the executive directors' service contracts are given in the Directors' remuneration report on page 99. The Chairman and the non-executive directors serve under letters of appointment see page 99

## **Electronic proxy voting**

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

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

Shareholders who will not be able to attend the AGM on 18 November 2014 in person are encouraged to vote their shares by appointing a proxy and issuing voting instructions (either electronically or by completing and returning their proxy cards). Electronic and paper proxy appointments and voting instructions must be received by the Company's Registrar not later than 48 hours before the AGM in order to be valid.

## **Registrar**

The address and contact details of Equiniti Limited, the Company's Registrar, are listed on the inside back cover of this report. Individual shareholders' access to their personal shareholder information is available online, through the [www.shareview.co.uk](http://www.shareview.co.uk) website. The UK shareholder helpline telephone number is 0871 384 2943. (Note: calls to this number are charged at 8p per minute plus network extras. Helpline services are available from 08:30 to 17:30, Monday to Friday (including UK Bank Holidays).) The international shareholder helpline telephone number is +44 (0) 121 415 7047.

## **Important information**

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

## **Disclosure of information to the auditors**

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

## **Recommendation**

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

By Order of the Board

**Sarah Cameron**

**Secretary**

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

16 September 2014

# Bringing technology to life... Making the world more productive



John Crane's seals, filters and bearings help extract and transport oil and gas safely and efficiently to provide the energy that powers our everyday lives. Its global network of service centres ensures that its energy services customers, from production and transmission to storage and refining, can rely on the most comprehensive technical support even in the harshest operating environments.

# Accounts

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

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# Statement of directors' responsibilities

The directors are responsible for preparing the Annual Report and the Group and Parent Company financial statements in accordance with applicable law and regulations.

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

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

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's and the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and the Company and enable them to ensure that the accounts and the Directors' remuneration report comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

## **Directors' responsibility statement**

The directors consider that the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy.

Each of the directors (who are listed in the Group directors' report) confirms that to the best of his or her knowledge:

- the Group's financial statements have been prepared in accordance with IFRS as adopted by the European Union and give a true and fair view of the Group's assets, liabilities and financial position as at 31 July 2014 and of its profit for the financial year then ended; and
- the Group directors' report and Strategic report include a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties that the Group faces.

**Philip Bowman**  
**Chief Executive**  
16 September 2014

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

# Independent auditors' report to the members of Smiths Group plc

## Report on the Group financial statements

### Our opinion

In our opinion, Smiths Group plc's Group financial statements (the "financial statements"),:

- give a true and fair view of the state of the Group's affairs as at 31 July 2014 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (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.

### What we have audited

Smiths Group plc's financial statements comprise:

- the consolidated income statement and the consolidated statement of comprehensive income for the year end 31 July 2014;
- the consolidated balance sheet as at 31 July 2014;
- the consolidated statement of changes in equity for the year then ended;
- the consolidated cash-flow statement for the year then ended; and
- the accounting policies and notes to the financial statements, which include other explanatory information.

Certain required disclosures have been presented elsewhere in the Annual Report, rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and IFRSs as adopted by the European Union.

### Our audit approach

#### Overview

Materiality	<ul style="list-style-type: none"><li>• Overall Group materiality: £18 million which represents 3.5% of headline operating profit.</li></ul>
Audit scope	<ul style="list-style-type: none"><li>• We conducted audit work in 15 countries covering 43 reporting units.</li><li>• Our audit scope addressed 72% of the Group's revenues and 73% of the Group's headline operating profit.</li></ul>
Areas of focus	<ul style="list-style-type: none"><li>• Revenue recognition, existence and cut off, together with long term contract accounting in the Smiths Detection and Smiths Interconnect Divisions.</li><li>• Working capital and associated provisions within the Smiths Detection Division.</li><li>• Goodwill and intangible asset impairment assessments, particularly in the Smiths Detection and Smiths Interconnect Divisions.</li><li>• Product litigation provisions for asbestos in John Crane, Inc. and flexible gas piping product in Titeflex Corporation, a subsidiary of the Flex-Tek Division.</li><li>• Taxation provisions and the recognition of deferred tax assets.</li><li>• Defined benefit pension plan net assets and liabilities.</li></ul>

#### The scope of our audit and our areas of focus

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)").

We designed our audit by determining materiality and assessing the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. In all of our audits, we also address the risk of management override of internal controls, including evaluating whether there was evidence of bias by the directors that may represent a risk of material misstatement due to fraud.

The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are identified as "Areas of focus" in the table below together with an explanation of how we tailored our audit to address these specific areas. Each of the areas of focus below are also referred to in the Audit committee report on page 89 and in the Accounting policies on pages 129 to 130. This is not a complete list of all risks or areas of focus identified by our audit.

**Revenue recognition, existence and cut off, together with long term contract accounting in the Smiths Detection and Smiths Interconnect Divisions**

**Area of focus**

We focused on revenue recognition for all divisions in the final accounting period to check that revenue was recorded in the correct period.

In the Smiths Detection and Smiths Interconnect divisions we focused on long term contract accounting. The recognition of revenue is largely dependent on the terms of the underlying contract with the customer, including achieving milestones within those contracts. As these contracts are usually long term in nature, sometimes spanning a number of reporting periods, changes in conditions and circumstances over time can result in variations to the original contract terms, including cost overruns which require further negotiation and settlements resulting in the need for mark down provisions.

**How our audit addressed the area of focus**

For all the divisions we assessed whether the Group's revenue recognition policies complied with IFRSs as adopted by the EU, and tested the implementation of those policies. Specifically we considered whether revenue was recognised based on the transfer of the risks and rewards of ownership to the customer and the accounting period in which services were rendered by testing a sample of revenue items to contract and shipping documents, with a specific focus on transactions which occurred near 31 July 2014.

Where appropriate we evaluated the relevant IT systems and tested the operating effectiveness of the internal controls over the recording of revenue in the correct period.

We also tested journal entries posted to revenue accounts to identify any unusual or irregular items, and the reconciliations between the revenue systems used by the Group and its financial ledgers.

In the case of the Smiths Detection and Smiths Interconnect divisions, for a sample of contracts, we read extracts of the relevant customer agreements and tested the accounting for contractual milestones against the analysis of the contract position that management maintains. This testing included evaluating customer acceptance of the work done to establish whether contractual milestones had been achieved, assessing the impact of any ongoing disputes, and assessing the reasonableness of the directors' estimates of costs to complete the contract.

**Working capital and associated provisions within the Smiths Detection Division**

**Area of focus**

Refer also to notes 14, 15 and 16 (pages 155-156).

We focused on this area because inventory provisions include subjective estimates and are influenced by assumptions concerning future revenue, and the Group also has material amounts of trade receivables that are overdue and not impaired (as disclosed in note 15 to the financial statements).

We focused in particular on the Smiths Detection division given its financial performance together with the inherent judgements associated with large programmes and complex contractual terms. The key associated risks were recoverability of billed and unbilled trade receivables and the valuation of work in progress and inventory. Management's related provisions are subjective and are influenced by assumptions concerning future selling prices and the level of sales activity.

**How the scope of our audit addressed the area of focus**

We evaluated the directors' forecasted sales for each significant category of slow moving inventory by comparing them to historical sales and orders for future sales.

We compared the historical provision for bad debts to the actual amounts written off, to determine whether the directors' estimation techniques were reasonable and considered the adequacy of provisions for bad debts for significant customers at subsidiary level, taking into account future sales forecasts and specific credit risk assessments for each customer.

In addition, we performed the procedures documented above for revenue recognition in relation to the key long term revenue contracts.

**Goodwill and intangible asset impairment assessments, particularly in the Smiths Detection and Smiths Interconnect Divisions**

**Area of focus**

Refer also to note 12 (pages 153-154).

The Group holds significant amounts of goodwill, acquired intangibles and development costs on the balance sheet, as detailed in note 11 to the financial statements. The risk is that these balances are overstated.

We focused on the estimated values in use of the Smiths Interconnect Power cash generating unit, which has a net book value of goodwill of £114.0m, and the Smiths Detection division, which has a net book value of goodwill of £368.6m, given their financial performance in the year. Smiths Interconnect Power's value in use exceeds its carrying value by £7.8m and Smiths Detection's value in use exceeds its carrying value by £165m.

**How the scope of our audit addressed the area of focus**

We evaluated the directors' future cash flow forecasts, and the process by which they were drawn up, including testing the underlying calculations and comparing them to the latest Board approved divisional budgets. We challenged:

- the directors' key assumptions for long term growth rates in the forecasts by comparing them to historical results, economic and industry forecasts; and
- the discount rate by assessing the cost of capital for the Group

For the Smiths Interconnect Power cash generating unit and Smiths Detection division, we evaluated the reasonableness of the Directors' forecast performance by performing a sensitivity analysis around the key drivers of the cash flow forecasts, in particular:

- the current order book;
- the proportion of recent tenders which have been successful; and
- independent projections of the expected growth of key markets.

We also reviewed the director's assessment of the fair value less costs of disposal.

Having ascertained the extent of change in the assumptions that either individually or collectively would be required for the goodwill to be impaired, we considered the likelihood of such a movement in those key assumptions and the disclosures on sensitivity analyses set out in note 12.

## Product litigation provisions for asbestos in John Crane, Inc. and flexible gas piping product in Titeflex Corporation, a subsidiary of the Flex-Tek Division

### Area of focus

[Refer also to note 23 \(page 165-167\).](#)

John Crane, Inc., a US based subsidiary of the Group, is currently one of many co-defendants in litigation relating to products previously manufactured which contained asbestos. As described in note 23 to the financial statements, a provision of £204.1m 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.

Titeflex Corporation, another US based subsidiary of the Group, 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. It has also received a number of product liability claims regarding this product, some in the form of purported class actions. As described in note 23 to the financial statements, a provision of £61.1m has been made for the costs which the Group is expected to incur in respect of these claims.

We focused on these areas because there is significant judgement involved in the assumptions used to estimate the provisions, in particular those relating to the US litigation environment such as the future level of claims and the cost of defence. As a result the provision may be subject to potentially material revisions from time to time.

### How the scope of our audit addressed the area of focus

In John Crane Inc. we used our own specialist knowledge to challenge management's assumptions underlying the adverse judgement and defence cost provisions. This included a review of the model maintained by management's valuation expert, in addition to testing the mathematical accuracy of the underlying calculations and the input data.

At Titeflex Corporation we challenged management's underlying assumptions supporting their provision. This included an evaluation of the valuation model, in addition to testing the mathematical accuracy of the underlying calculations and the input data such as the average amount of settlements, the number of future settlements and the period over which expenditure can be reasonably estimated.

We also discussed these matters with the Company's internal legal counsel, obtained letters from external counsel and evaluated the appropriateness of the disclosures made in the Group financial statements.

## Taxation provisions and the recognition of deferred tax assets

### Area of focus

[Refer also to note 7 \(pages 142-143\).](#)

The Group has recognised £185m deferred tax assets on the balance sheet, the recognition of which involves judgement by management as to the likelihood of the realisation of these deferred tax assets, which is based on a number of factors including whether there will be sufficient taxable profits in future periods to support recognition.

The Group has recognised provisions against uncertain tax positions, the valuation of which is a highly judgemental area. The Group has a wide geographic footprint and is subject to tax laws in a number of jurisdictions.

### How the scope of our audit addressed the area of focus

We evaluated the directors' assessment as to whether there will be sufficient taxable profits in future periods to support the recognition of deferred tax assets by comparing the directors' forecasts of future profits to historical results, and evaluating the assumptions used in those forecasts.

We discussed with management the known uncertain tax positions and read communications from taxation authorities to identify uncertain tax positions.

We assessed the adequacy of the director's taxation provisions by considering factors such as whether the matter represents a permanent or temporary difference, and whether the provision addresses possible penalties and interest.

## Defined benefit pension plan net assets and liabilities

### Area of focus

[Refer also to note 9 \(pages 145-150\).](#)

The Group has defined benefit pension plans with net post-retirement assets of £122.6m and net post-retirement liabilities of £364.3m, which are significant in the context of the overall balance sheet of the Group.

The valuation of the pension liabilities requires significant levels of judgement and technical expertise in choosing appropriate assumptions. Unfavourable changes in a number of the key assumptions (including salary increases, inflation, discount rates and mortality) can have a material impact on the calculation of the liability. There is also some judgement in the measurement of fair value of pension assets.

The recognition of post-retirement plan net assets for accounting purposes is dependent on the rights of the employers to recover the surplus at the end of the life of the scheme.

### How the scope of our audit addressed the area of focus

We evaluated the directors' assessment of the assumptions they made in relation to the valuations of the liabilities and assets in the pension plans and the assumptions around salary increases and mortality rates to national and industry averages.

We also focussed on the valuations of pension plan liabilities and the pension assets as follows:

- We agreed the discount and inflation rates used in the valuation of the pension liability to our internally developed benchmarks.
- We obtained third party confirmations on ownership and valuation of pension assets.
- Where new census data is available in the year we have tested the controls at the scheme administrators to assess whether this data is accurate. Where there is no new census data in the year we have assessed the roll forward assumptions used by the actuaries.

## How we approached the audit scope

In identifying these areas of focus and in ensuring that we performed enough work to be able to give an opinion on the financial statements as a whole, we took into account: the geographic structure of the Group; the accounting processes and controls; and the industries in which the Group operates, and tailored the scope of our audit accordingly.

The Group is organised into five divisions: John Crane, Smiths Medical, Smiths Detection, Smiths Interconnect and Flex-Tek and is a consolidation of over 250 units.

In establishing the overall approach to the Group audit, we determined the type of work that needed to be performed at the reporting units by us, as the Group engagement team, or component auditors within PwC UK and from other PwC network firms operating under our instruction. Where the work was performed by component auditors, we determined the level of involvement we needed to have in the audit work at those reporting units to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the Group financial statements as a whole.

## **Independent auditors' report to the members of Smiths Group plc**

### **Continued**

The Group's operating reporting units vary significantly in size and we identified 28 reporting units that, in our view, required an audit of their complete financial information, due to their size or risk characteristics. Specific audit procedures over certain balances and transactions were performed at a further 15 reporting units, to give appropriate coverage of all material balances at both divisional and Group levels. We conducted work in 15 countries and the Group engagement team visited multiple reporting sites in the North America and Europe. Together, the reporting units subject to audit procedures were responsible for 72% of the Group's revenues and 73% of the Group's headline operating profit.

Further specific audit procedures over central functions and areas of significant judgement, including taxation, goodwill, treasury, post-retirement benefits and material litigation, were performed at the local headquarters of each of the divisions and at the Group's Head Office.

#### **Materiality**

The scope of our audit is influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

<b>Overall Group materiality</b>	£18 million (2013: £20 million)
<b>How we determined it</b>	3.5% of "headline operating profit". Headline operating profit is operating profit adjusted for exceptional items, amortisation and impairment of acquired intangible assets, net pensions finance credit and financing gains/losses from currency hedging. We have also considered the other items of income and expense included within statutory profit before tax to ensure the materiality determined was reasonable.
<b>Rationale for benchmark applied</b>	We applied this benchmark because, in our view, this is the metric against which the performance of the Group is most commonly measured.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £0.5m (2013: £0.5m) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

#### **Going concern**

Under the Listing Rules we are required to review the directors' statement, set out on page 111, in relation to going concern. We have nothing to report having performed our review.

As noted in the directors' statement, the directors have concluded that it is appropriate to prepare the financial statements using the going concern basis of accounting. The going concern basis presumes that the Group has adequate resources to remain in operation, and that the directors intend it to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the directors' use of the going concern basis is appropriate.

However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Group's ability to continue as a going concern.

#### **Other required reporting**

##### **Consistency of other information**

##### **Companies Act 2006 opinion**

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

##### **ISAs (UK & Ireland) reporting**

Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

Information in the Annual Report is:		
<ul style="list-style-type: none"><li>• materially inconsistent with the information in the audited financial statements; or</li><li>• apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or</li><li>• is otherwise misleading.</li></ul>	We have no exceptions to report arising from this responsibility.	
The statement given by the directors on page 118, in accordance with Code Provision C.1.1, that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's performance, business model and strategy is materially inconsistent with our knowledge of the Group acquired in the course of performing our audit.	We have no exceptions to report arising from this responsibility.	
The section of the Annual Report on page 89 as required by Code Provision C.3.8, describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.	We have no exceptions to report arising from this responsibility.	

##### **Adequacy of information and explanations received**

Under the Companies Act 2006 we are required to report to you if, in our opinion, we have not received all the information and explanations we require for our audit. We have no exceptions to report arising from this responsibility.

## Directors' remuneration

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. We have no exceptions to report arising from this responsibility.

## Corporate governance statement

Under the Listing Rules we are required to review the part of the Corporate Governance Statement relating to the parent company's compliance with nine provisions of the UK Corporate Governance Code ("the Code"). We have nothing to report having performed our review.

## Responsibilities for the financial statements and the audit

### Our responsibilities and those of the Directors

As explained more fully in the Statement of directors' responsibilities, set out on page 118, 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 ISAs (UK & 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.

## What an audit of financial statements involves

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.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

## Other matter

We have reported separately on the parent company financial statements of Smiths Group plc for the year ended 31 July 2014 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

16 September 2014

(a) The maintenance and integrity of the Smiths website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

(b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

# Consolidated income statement

	Notes	Year ended 31 July 2014	Year ended 31 July 2013 (restated)
		£m	£m
<b>Continuing operations</b>			
Revenue	1	<b>2,951.6</b>	3,108.6
Cost of sales		<b>(1,625.5)</b>	(1,694.0)
Gross profit		<b>1,326.1</b>	1,414.6
Sales and distribution costs		<b>(398.3)</b>	(425.6)
Administrative expenses		<b>(550.2)</b>	(502.5)
<b>Operating profit</b>	2	<b>377.6</b>	486.5
Comprising			
– headline operating profit	3	<b>504.4</b>	559.7
– exceptional items, amortisation of acquired intangibles	3	<b>(126.8)</b>	(73.2)
		<b>377.6</b>	486.5
Interest receivable		<b>2.6</b>	2.6
Interest payable		<b>(62.4)</b>	(64.3)
Other financing losses		<b>(7.4)</b>	(6.1)
Net finance charges – retirement benefits	9	<b>(8.4)</b>	(23.0)
Finance costs	5	<b>(75.6)</b>	(90.8)
<b>Profit before taxation</b>		<b>302.0</b>	395.7
Comprising			
– headline profit before taxation	3	<b>444.6</b>	498.0
– exceptional items, amortisation of acquired intangibles and other financing gains and losses	3	<b>(142.6)</b>	(102.3)
		<b>302.0</b>	395.7
Taxation	7	<b>(67.4)</b>	(79.1)
<b>Profit after taxation – continuing operations</b>		<b>234.6</b>	316.6
Profit – discontinued operations		<b>0.1</b>	
<b>Profit for the year</b>		<b>234.7</b>	316.6
Attributable to			
Smiths Group shareholders		<b>232.8</b>	315.0
Non-controlling interests		<b>1.9</b>	1.6
		<b>234.7</b>	316.6
<b>Earnings per share</b>	6		
Basic		<b>59.0p</b>	80.1p
Diluted		<b>58.4p</b>	79.3p

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 135 to 169, which form an integral part of the consolidated accounts.

# Consolidated statement of comprehensive income

	Notes	£m	Year ended 31 July 2014	Year ended 31 July 2013 (restated) £m
Profit for the period			<b>234.7</b>	316.6
<b>Other comprehensive income</b>				
Actuarial (losses)/gains on retirement benefits	9	<b>(76.9)</b>	326.6	
Taxation recognised on actuarial movements	7	<b>5.8</b>	[39.0]	
<b>Other comprehensive income and expenditure which will not be reclassified to the consolidated income statement</b>			<b>(71.1)</b>	287.6
Other comprehensive income which will be, or has been, reclassified				
Exchange gains/(losses)		<b>(257.2)</b>	99.8	
Fair value gains/(losses)				
– on available for sale financial assets		<b>2.8</b>	0.1	
– deferred in the period on cash-flow and net investment hedges		<b>118.7</b>	(44.7)	
– reclassified to income statement		<b>(2.4)</b>	(4.3)	
Taxation recognised on fair value gains and losses		<b>0.1</b>	(1.0)	
<b>Total other comprehensive income</b>			<b>(209.1)</b>	337.5
<b>Total comprehensive income</b>			<b>25.6</b>	654.1
Attributable to				
Smiths Group shareholders		<b>24.9</b>	654.2	
Non-controlling interests		<b>0.7</b>	[0.1]	
		<b>25.6</b>	654.1	

# Consolidated balance sheet

	Notes	31 July 2014 £m	31 July 2013 £m
<b>Non-current assets</b>			
Intangible assets	11	<b>1,543.6</b>	1,746.0
Property, plant and equipment	13	<b>258.4</b>	280.0
Financial assets – other investments	17	<b>116.9</b>	86.1
Retirement benefit assets	9	<b>122.6</b>	121.7
Deferred tax assets	7	<b>185.0</b>	185.4
Trade and other receivables	15	<b>35.0</b>	34.1
Financial derivatives	20	<b>9.2</b>	6.4
		<b>2,270.7</b>	2,459.7
<b>Current assets</b>			
Inventories	14	<b>427.3</b>	475.6
Current tax receivable		<b>33.8</b>	33.4
Trade and other receivables	15	<b>634.8</b>	695.5
Cash and cash equivalents	18	<b>190.2</b>	393.8
Financial derivatives	20	<b>7.7</b>	8.1
		<b>1,293.8</b>	1,606.4
<b>Total assets</b>		<b>3,564.5</b>	4,066.1
<b>Non-current liabilities</b>			
Financial liabilities			
- borrowings	18	<b>(981.9)</b>	(951.1)
- financial derivatives	20	<b>(4.3)</b>	(11.0)
Provisions for liabilities and charges	23	<b>(245.3)</b>	(258.1)
Retirement benefit obligations	9	<b>(364.3)</b>	(375.3)
Deferred tax liabilities	7	<b>(57.9)</b>	(73.1)
Trade and other payables	16	<b>(27.6)</b>	(31.0)
		<b>(1,681.3)</b>	(1,699.6)
<b>Current liabilities</b>			
Financial liabilities			
- borrowings	18	<b>(12.5)</b>	(187.1)
- financial derivatives	20	<b>(4.6)</b>	(5.8)
Provisions for liabilities and charges	23	<b>(81.9)</b>	(78.1)
Trade and other payables	16	<b>(464.1)</b>	(521.8)
Current tax payable		<b>(74.7)</b>	(80.1)
		<b>(637.8)</b>	(872.9)
<b>Total liabilities</b>		<b>(2,319.1)</b>	(2,572.5)
<b>Net assets</b>		<b>1,245.4</b>	1,493.6
<b>Shareholders' equity</b>			
Share capital	24	<b>147.9</b>	147.7
Share premium account		<b>346.4</b>	340.8
Capital redemption reserve		<b>5.8</b>	5.8
Revaluation reserve		<b>1.7</b>	1.7
Merger reserve		<b>234.8</b>	234.8
Retained earnings	26	<b>558.5</b>	929.2
Hedge reserve	26	<b>(57.7)</b>	(174.0)
Total shareholders' equity		<b>1,237.4</b>	1,486.0
Non-controlling interest equity		<b>8.0</b>	7.6
<b>Total equity</b>		<b>1,245.4</b>	1,493.6

The accounts on pages 124 to 169 were approved by the Board of Directors on 16 September 2014 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 2013		488.5	242.3	929.2	(174.0)	1,486.0	7.6	1,493.6
Profit for the year				232.8		232.8	1.9	234.7
Other comprehensive income								
Actuarial gains on retirement benefits and related tax				(71.1)		(71.1)		(71.1)
Exchange gains/(losses)				(256.0)		(256.0)	(1.2)	(257.2)
Fair value gains/(losses) and related tax				2.9	116.3	119.2		119.2
<b>Total comprehensive income for the year</b>				(91.4)	116.3	24.9	0.7	25.6
Transactions relating to ownership interests								
Exercises of share options	24	5.8				5.8		5.8
Taxation recognised on share options	7			(0.7)		(0.7)		(0.7)
Purchase of own shares	26			(12.8)		(12.8)		(12.8)
Dividends								
- equity shareholders	25			(275.0)		(275.0)		(275.0)
- non-controlling interest							(0.3)	(0.3)
Share-based payment	10			9.2		9.2		9.2
<b>At 31 July 2014</b>		<b>494.3</b>	<b>242.3</b>	<b>558.5</b>	<b>(57.7)</b>	<b>1,237.4</b>	<b>8.0</b>	<b>1,245.4</b>

	Notes	Share capital and share premium £m	Other reserves £m	Retained earnings £m	Hedge reserve £m	Equity shareholders' funds £m	Non-controlling interest £m	Total equity £m
At 31 July 2012		479.2	242.3	376.1	(124.8)	972.8	8.0	980.8
Profit for the year (restated)				315.0		315.0	1.6	316.6
Other comprehensive income								
Actuarial losses on retirement benefits and related tax (restated)				287.6		287.6		287.6
Exchange (losses)/gains				101.7	(0.2)	101.5	(1.7)	99.8
Fair value gains/(losses) and related tax				(0.9)	(49.0)	(49.9)		(49.9)
<b>Total comprehensive income for the year</b>				703.4	(49.2)	654.2	(0.1)	654.1
Transactions relating to ownership interests								
Exercises of share options	24	9.3				9.3		9.3
Taxation recognised on share options	7			1.0		1.0		1.0
Purchase of own shares	26			(11.0)		(11.0)		(11.0)
Dividends								
- equity shareholders	25			(152.4)		(152.4)		(152.4)
- non-controlling interest							(0.3)	(0.3)
Share-based payment	10			12.1		12.1		12.1
<b>At 31 July 2013</b>		<b>488.5</b>	<b>242.3</b>	<b>929.2</b>	<b>(174.0)</b>	<b>1,486.0</b>	<b>7.6</b>	<b>1,493.6</b>

# Consolidated cash-flow statement

	Notes	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
<b>Net cash inflow from operating activities</b>	27	<b>256.2</b>	353.4
<b>Cash-flows from investing activities</b>			
Expenditure on capitalised development		(22.6)	(28.4)
Expenditure on other intangible assets		(17.5)	(11.1)
Purchases of property, plant and equipment	13	(53.9)	(56.5)
Disposals of property, plant and equipment		4.7	3.9
Investment in financial assets		(27.3)	(24.3)
Acquisition of businesses		(1.3)	(0.5)
Disposals of businesses		3.2	0.3
<b>Net cash-flow used in investing activities</b>		<b>(114.7)</b>	(116.6)
<b>Cash-flows from financing activities</b>			
Proceeds from exercise of share options	24	5.8	9.3
Purchase of own shares		(12.8)	(11.0)
Dividends paid to equity shareholders	25	(275.0)	(152.4)
Dividends paid to non-controlling interests		(0.3)	(0.3)
Cash inflow/(outflow) from matured derivative financial instruments		10.9	(0.4)
Increase in new borrowings		138.0	247.2
Reduction and repayment of borrowings		(179.6)	(159.1)
<b>Net cash-flow used in financing activities</b>		<b>(313.0)</b>	(66.7)
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>(171.5)</b>	170.1
Cash and cash equivalents at beginning of year		386.5	203.7
Exchange differences		(25.9)	12.7
<b>Cash and cash equivalents at end of year</b>	18	<b>189.1</b>	386.5
Cash and cash equivalents at end of year comprise			
- cash at bank and in hand		115.1	164.2
- short-term deposits		75.1	229.6
- bank overdrafts		(1.1)	(7.3)
		<b>189.1</b>	386.5
Included in cash and cash equivalents per the balance sheet		<b>190.2</b>	393.8
Included in overdrafts per the balance sheet		(1.1)	(7.3)
		<b>189.1</b>	386.5
<b>Reconciliation of net cash-flow to movement in net debt</b>			
	Notes	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>(171.5)</b>	170.1
Net decrease/(increase) in borrowings resulting from cash-flows		41.6	(88.1)
<b>Movement in net debt resulting from cash-flows</b>		<b>(129.9)</b>	82.0
Capitalisation, interest accruals and unwind of capitalisation fees		2.6	(3.8)
Movement from fair value hedging		(2.8)	9.7
Exchange differences		70.3	(40.9)
<b>Movement in net debt in the year</b>	18	<b>(59.8)</b>	47.0
Net debt at start of year		(744.4)	(791.4)
<b>Net debt at end of year</b>	18	<b>(804.2)</b>	(744.4)

# 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, on a going concern basis and under the historical cost convention modified to include revaluation of certain financial instruments, share options and pension assets and liabilities, held at fair value as described below.

The accounting policies adopted are consistent with those of the previous financial year except for the adoption of:

- 'IAS 19 (Revised 2011): Employee benefits'. The consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and related notes have been restated to reflect the recognition requirements of this standard;
- 'IAS 28: Investments in Associates and Joint Ventures' which has not led to any changes in reported figures or disclosures;
- Amendments to IFRS 7 'Disclosures – Offsetting financial assets and financial liabilities' requiring additional disclosures on netting;
- 'IFRS 10: Consolidated financial statements' which has not led to any changes in reported figures or disclosures;
- 'IFRS 11: Joint Arrangements' which has not led to any changes in reported figures or disclosures;
- 'IFRS 12: Disclosure of Interests in Other Entities' which has not led to any changes in reported figures or disclosures; and
- 'IFRS 13: Fair value measurement' which has increased the disclosure on valuation methods.

## 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 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 £28.7m (2013: £53.0m) has been recognised in the period in respect of contracts in progress at the period end with a total expected value of £112.7m (2013: £149.7m). A 5% reduction in the proportion of the contract activity recognised in the current period would have reduced operating profit by an estimated £0.1m (2013: £0.5m) for Smiths Detection and £0.1m (2013: £0.3m) for Smiths Interconnect.

In addition to contracts accounted for on a percentage of completion basis, Smiths Detection also has long-term contractual arrangements for the sale of goods and services. Margins achieved on these contracts can reflect the impact of commercial decisions made in different economic circumstances. In addition, contract delivery is subject to commercial and technical risks which can affect the outcome of the contract.

Smiths Medical has rebate arrangements in place with some distributors in respect of sales to end customers where sales prices have been negotiated by Smiths Medical. Rebates are estimated based on the level of discount derived from sales data from distributors, 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 2014 was £19.1m (2013: £17.0m).

### Taxation

The Group has recognised deferred tax assets of £21.3m (2013: £28.1m) relating to losses and £91.6m (2013: £85.6m) 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 7.

### 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 9.

At 31 July 2014 there is a retirement benefit asset of £122.6m (2013: £121.7m) 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 buyouts would cost significantly more than the present value of the scheme liabilities calculated in accordance with IAS 19: Employee benefits.

### Working capital provisions

For inventory and receivables, if the carrying value is higher than the expected recoverable value, the Group makes provisions writing down the assets to their recoverable value. The recoverable value of inventory is estimated using historical selling prices, sales activity and customer contracts. The recoverable value of receivables is considered individually for each customer and incorporates past experience and progress with collecting receivables.

At 31 July 2014 the carrying value of inventory incorporates provisions of £76.4m (2013: £74.4m). The inventory turn rate of 3.8 (2013: 3.6) varies across the five divisions. Smiths Detection has the slowest inventory utilisation with a turn rate of 3.1 (2013: 2.4). See note 14 for additional information about inventory.

At 31 July 2014 the gross value of receivables partly provided for or more than three months overdue was £45.8m (2013: £53.4m) and there were provisions of £17.5m (2013: £17.8m) against these receivables which were carried at a net value of £28.3m (2013: £35.6m). See note 15 for disclosures on credit risk and ageing of trade receivables.

## **Accounting policies**

### **Continued**

#### **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, including the sales and margin volatility in Smiths Detection and Smiths Interconnect and disclosures on the sensitivity of the impairment testing to these key assumptions, including details of the changes in assumptions which would be required to trigger an impairment in Smiths Detection or Smiths Interconnect Power.

#### **Provisions for liabilities and charges**

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 of £204.1m (2013: £210.0m) 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. Whilst published incidence curves can be used to estimate the likely future pattern of asbestos related disease, John Crane, Inc.'s claims experience is significantly impacted by other factors which influence the US litigation environment. These can include: changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels; and legislative and procedural changes in both the state and federal court systems. Therefore, 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. John Crane, Inc. takes account of the advice of an expert in asbestos liability estimation in quantifying the expected costs.

As previously reported, 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. It has also received a number of product liability claims regarding this product, some in the form of purported class actions. 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. Provision of £61.1m (2013: £65.6m) has been made for the costs which the Group is expected to incur in respect of these claims. However, because of the significant uncertainty associated with the future level of 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.

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.

All provisions may be subject to potentially material revisions from time to time if new information becomes available as a result of future events. See note 23 for details of the assumptions and disclosures on the sensitivity of the provision calculations.

#### **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.

For the convenience of users, supplementary primary financial statements translated into US dollars have been presented after the Group financial record. Assets and liabilities have been translated into US dollars at the exchange rate at the date of that balance sheet and income, expenses and cash-flows are translated at average exchange rates for the period.

## Revenue

Revenue is measured at the fair value of the consideration received, net of trade discounts (including distributor rebates) 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 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.

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 and disposals;
- spend on the integration of significant acquisitions and other major restructuring programmes;
- significant goodwill or other asset impairments;
- income and expenditure relating to material litigation in respect of products no longer in production; and
- other particularly significant or unusual items.

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

## **Accounting policies**

### **Continued**

#### **Taxation**

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

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

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

Deferred tax liabilities and assets are not discounted.

#### **Discontinued operations**

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

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

#### **Intangible assets**

##### **Goodwill**

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

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

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

##### **Research and development**

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

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

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

##### **Intangible assets acquired in business combinations**

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

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

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

##### **Software, patents and intellectual property**

The estimated useful lives are as follows:

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

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

##### **Property, plant and equipment**

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

Land is not depreciated. Depreciation is provided on other assets estimated to write off the depreciable amount of relevant assets by equal annual instalments over their estimated useful lives. In general, the rates used are: Freehold and long leasehold buildings – 2%; Short leasehold property – over the period of the lease; Plant, machinery, etc. – 10% to 20%; Fixtures, fittings, tools and other equipment – 10% to 33%.

The cost of any assets which are expected to take a substantial period of time to complete and 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.

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 remeasurements are included in the income statement. No depreciation is charged on assets and businesses classified as held for sale.

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

## Cash and cash equivalents

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

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

## Financial assets

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

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

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

Financial assets are derecognised when the right to receive cash-flows from the assets has expired, or has been transferred, and the Company has transferred substantially all of the risks and rewards of ownership. When securities classified as available for sale are sold or impaired, the accumulated fair value adjustments previously taken to reserves are included in the income statement.

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

## Financial liabilities

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

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

## **Accounting policies**

### **Continued**

#### **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.

See note 21 for information on the methods the Group uses to estimate the fair values of its financial instruments.

#### **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 will affect future annual reports and accounts.

- 'IFRS 9: Financial instruments'
- 'IFRS 15: Revenue from contracts with customers'
- Amendment to 'IAS 36: Impairment of assets' on recoverable amount disclosures.

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.

#### **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 177 to 185.

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

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

# Notes to the accounts

## 1 Segment information

### Analysis by operating segment

The Group is organised into five divisions: John Crane, Smiths Medical, Smiths Detection, Smiths Interconnect and Flex-Tek. These divisions design and manufacture the following products:

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

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

Intersegment sales and transfers are charged at arm's length prices.

	Year ended 31 July 2014						
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £m
Revenue	941.0	803.7	512.3	445.2	249.4		2,951.6
Divisional headline operating profit	234.1	159.5	24.7	71.2	47.1		536.6
Corporate headline operating costs						(32.2)	(32.2)
<b>Headline operating profit/(loss)</b>	<b>234.1</b>	<b>159.5</b>	<b>24.7</b>	<b>71.2</b>	<b>47.1</b>	<b>(32.2)</b>	<b>504.4</b>
Exceptional operating items (note 4)	(55.5)	(8.5)	(1.3)	(5.0)	(10.1)	(1.2)	(81.6)
Legacy retirement benefits	(0.1)	(0.1)	(0.1)		(0.1)	(6.1)	(6.5)
Amortisation and impairment of acquired intangible assets	(12.2)	(8.9)	(0.3)	(17.1)	(0.2)		(38.7)
<b>Operating profit/(loss)</b>	<b>166.3</b>	<b>142.0</b>	<b>23.0</b>	<b>49.1</b>	<b>36.7</b>	<b>(39.5)</b>	<b>377.6</b>
Exceptional finance costs – adjustment to discounted provision (note 4)		(4.7)				(1.3)	
Net finance costs – other							(6.0) (69.6)
<b>Profit before taxation</b>							<b>302.0</b>

	Year ended 31 July 2013						
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £m
Revenue	985.7	850.4	559.0	460.6	252.9		3,108.6
Divisional headline operating profit	230.5	189.1	58.0	68.8	43.2		589.6
Corporate headline operating costs						(29.9)	(29.9)
<b>Headline operating profit/(loss)</b>	<b>230.5</b>	<b>189.1</b>	<b>58.0</b>	<b>68.8</b>	<b>43.2</b>	<b>(29.9)</b>	<b>559.7</b>
Exceptional operating items (note 4)	(10.8)	1.2	(4.9)	(0.2)	(7.0)	1.8	(19.9)
Legacy retirement benefits (restated)						(6.7)	(6.7)
Amortisation and impairment of acquired intangible assets	(14.2)	(11.4)	(1.1)	(19.7)	(0.2)		(46.6)
<b>Operating profit/(loss) (restated)</b>	<b>205.5</b>	<b>178.9</b>	<b>52.0</b>	<b>48.9</b>	<b>36.0</b>	<b>(34.8)</b>	<b>486.5</b>
Exceptional finance costs – adjustment to discounted provision (note 4)		(3.3)				(0.9)	
Net finance costs – other (restated)							(4.2) (86.6)
<b>Profit before taxation (restated)</b>							<b>395.7</b>

## 1 Segment information continued

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

	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Year ended 31 July 2014
Depreciation	<b>13.7</b>	<b>15.6</b>	<b>5.1</b>	<b>7.3</b>	<b>3.1</b>	<b>1.3</b>	<b>46.1</b>
Amortisation of capitalised development		<b>12.1</b>	<b>9.1</b>	<b>0.1</b>			<b>21.3</b>
Amortisation of software, patents and intellectual property	<b>2.6</b>	<b>2.1</b>	<b>3.6</b>	<b>0.7</b>	<b>0.1</b>	<b>3.9</b>	<b>13.0</b>
Amortisation of acquired intangibles						<b>38.7</b>	<b>38.7</b>
Share-based payment	<b>2.3</b>	<b>1.1</b>	<b>0.4</b>	<b>0.6</b>	<b>1.2</b>	<b>4.3</b>	<b>9.9</b>

	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Year ended 31 July 2013
Depreciation	14.4	19.1	6.6	7.5	3.3	1.4	52.3
Amortisation of capitalised development		12.6	8.7				21.3
Amortisation of software, patents and intellectual property	2.6	3.2	3.4	0.8		3.2	13.2
Amortisation of acquired intangibles						46.6	46.6
Share-based payment	1.7	1.7	0.7	0.6	2.0	6.1	12.8

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

The capital expenditure for each division is:

	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
<b>Capital expenditure year ended 31 July 2014</b>	<b>18.0</b>	<b>43.7</b>	<b>13.9</b>	<b>11.0</b>	<b>3.4</b>	<b>5.1</b>	<b>95.1</b>
Capital expenditure year ended 31 July 2013	17.3	39.8	22.4	9.7	2.6	5.7	97.5

The reconciling items comprise corporate capital expenditure through Smiths Business Information Services on IT equipment and software.

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

	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Total £m	31 July 2014
Property, plant, equipment, development projects and other intangibles	91.3	159.6	96.8	39.0	18.8	405.5	
Working capital assets	<b>349.7</b>	<b>227.6</b>	<b>274.6</b>	<b>161.4</b>	<b>73.6</b>	<b>1,086.9</b>	
<b>Operating assets</b>	<b>441.0</b>	<b>387.2</b>	<b>371.4</b>	<b>200.4</b>	<b>92.4</b>	<b>1,492.4</b>	
Derivatives, tax and retirement benefit assets							358.3
Goodwill and acquired intangibles							1,381.2
Corporate assets							142.4
Cash							190.2
<b>Total assets</b>							<b>3,564.5</b>
Working capital liabilities	(143.6)	(96.8)	(165.8)	(70.2)	(25.7)	(502.1)	
Corporate and non-headline liabilities							(316.7)
Derivatives, tax and retirement benefit liabilities							(505.9)
Borrowings							(994.4)
<b>Total liabilities</b>							<b>(2,319.1)</b>
Average divisional capital employed	<b>875.7</b>	<b>1,100.1</b>	<b>631.9</b>	<b>518.5</b>	<b>138.5</b>	<b>3,264.7</b>	
Average corporate capital employed							(47.3)
<b>Average total capital employed</b>							<b>3,217.4</b>

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

Capital employed is a non-statutory measure of invested resources. It comprises statutory net assets adjusted to add goodwill recognised directly in reserves in respect of subsidiaries acquired before 1 August 1998 of £815.2m (2013: £815.2m) and eliminate post-retirement benefit related assets and liabilities and litigation provisions relating to exceptional items, both net of related tax, and net debt.

## 1 Segment information continued

	31 July 2013					
	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	100.8	163.8	108.7	36.7	20.4	430.4
Working capital assets	363.0	245.2	343.1	159.5	78.1	1,188.9
<b>Operating assets</b>	<b>463.8</b>	<b>409.0</b>	<b>451.8</b>	<b>196.2</b>	<b>98.5</b>	<b>1,619.3</b>
Derivatives, tax and retirement benefit assets						355.0
Goodwill and acquired intangibles						1,576.9
Corporate assets						121.1
Cash						393.8
<b>Total assets</b>						<b>4,066.1</b>
Working capital liabilities	(166.8)	(96.8)	(202.0)	(69.5)	(28.5)	(563.6)
Corporate and non-headline liabilities						(325.4)
Derivatives, tax and retirement benefit liabilities						(545.3)
Borrowings						(1,138.2)
<b>Total liabilities</b>						<b>(2,572.5)</b>
Average divisional capital employed	897.9	1,141.4	657.4	554.4	140.2	3,391.3
Average corporate capital employed						[29.6]
<b>Average total capital employed</b>						<b>3,361.7</b>

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

### Analysis of revenue

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

	Original equipment manufacture			Aftermarket		Total £m
	£m	Oil, gas and petrochemical £m	Chemical and pharmaceutical £m	Distributors £m	General industry £m	
<b>John Crane</b>						
<b>Revenue year ended 31 July 2014</b>	<b>360.1</b>	<b>350.4</b>	<b>80.6</b>	<b>67.8</b>	<b>82.1</b>	<b>941.0</b>
Revenue year ended 31 July 2013	363.5	379.8	84.3	71.2	86.9	985.7
<b>Smiths Medical</b>						
<b>Revenue year ended 31 July 2014</b>		<b>241.4</b>	<b>327.5</b>	<b>234.8</b>	<b>803.7</b>	
Revenue year ended 31 July 2013		237.7	354.5	258.2		850.4
<b>Smiths Detection</b>						
<b>Revenue year ended 31 July 2014</b>	<b>263.5</b>	<b>78.1</b>	<b>60.1</b>	<b>14.1</b>	<b>95.6</b>	<b>512.3</b>
Revenue year ended 31 July 2013	286.2	95.7	69.3	13.7	91.3	559.0
<b>Smiths Interconnect</b>						
<b>Revenue year ended 31 July 2014</b>						
Revenue year ended 31 July 2013						
<b>Flex-Tek</b>						
<b>Revenue year ended 31 July 2014</b>	<b>82.7</b>	<b>34.2</b>	<b>57.2</b>	<b>75.3</b>	<b>249.4</b>	
Revenue year ended 31 July 2013	87.8	35.7	56.1	73.3		252.9

## 1 Segment information continued

### Analysis of revenue continued

The Group's statutory revenue is analysed as follows:

	<b>Year ended 31 July 2014 £m</b>	Year ended 31 July 2013 £m
Sale of goods	<b>2,682.4</b>	2,855.5
Services	<b>239.4</b>	213.5
Contracts	<b>29.8</b>	39.6
	<b>2,951.6</b>	3,108.6

### Analysis by geographical areas

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

	Revenue		Intangible assets and property plant and equipment	
	<b>Year ended 31 July 2014 £m</b>	Year ended 31 July 2013 £m	<b>31 July 2014 £m</b>	31 July 2013 £m
United Kingdom	<b>119.0</b>	128.8	<b>132.5</b>	140.9
Germany	<b>148.1</b>	155.7	<b>303.6</b>	334.6
France	<b>87.9</b>	93.5	<b>18.7</b>	20.2
Other European	<b>340.1</b>	356.8	<b>66.7</b>	78.0
United States of America	<b>1,318.7</b>	1,398.1	<b>1,131.9</b>	1,278.3
Canada	<b>120.9</b>	122.3	<b>14.3</b>	12.6
Mexico	<b>31.9</b>	33.1	<b>9.0</b>	10.4
Japan	<b>105.9</b>	114.3	<b>15.6</b>	18.4
China	<b>112.8</b>	99.1	<b>53.3</b>	60.3
Rest of the World	<b>566.3</b>	606.9	<b>56.4</b>	72.3
	<b>2,951.6</b>	3,108.6	<b>1,802.0</b>	2,026.0

## 2 Operating profit is stated after charging

	<b>Year ended 31 July 2014 £m</b>	Year ended 31 July 2013 (restated) £m
Research and development expense	<b>84.8</b>	77.9
Operating leases		
- land and buildings	<b>28.6</b>	30.4
- other	<b>9.8</b>	10.8

Research and development expense has been restated to eliminate John Crane's engineering costs of £4.7m for customer-specific product modifications, following a review that determined that this work was not providing a significant contribution to new product development.

	<b>Year ended 31 July 2014 £m</b>	Year ended 31 July 2013 (restated) £m
Audit services		
Fees payable to the Company's auditors for the audit the company's annual financial statements	<b>2.3</b>	2.0
Fees payable to the Company's auditors and its associates for other services		
- the audit of the Company's subsidiaries	<b>2.4</b>	2.4
	<b>4.7</b>	4.4
Tax services		
- advisory services	<b>0.2</b>	0.1
- compliance services	<b>0.1</b>	0.1
Other assurance services relating to corporate transactions		
All other services	<b>0.5</b>	0.1

Other services relate to one-off IT and consulting projects.

The split of fees payable in respect of audit services has been restated to separately reflect the nature of fees payable for subsidiary statutory audits.

### 3 Headline profit measures

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

The following items have been excluded from the headline measure:

- exceptional items, including income and expenditure relating to material litigation in respect of products no longer in production;
- amortisation and impairment of intangible assets acquired in a business combination – the charge is a non-cash item, and the directors believe that it should be added back to give a clearer picture of underlying performance;
- other financing gains and losses, which represent the potentially volatile gains and losses on derivatives and other financial instruments which do not fall to be hedge accounted under IAS 39; and
- scheme administration costs, financing credits and charges relating to retirement benefits.

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

	Notes	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
<b>Operating profit (2013 restated)</b>		<b>377.6</b>	486.5
Exclude			
– exceptional operating items	4	<b>81.6</b>	19.9
– legacy retirement benefits (restated)	9	<b>6.5</b>	6.7
– amortisation and impairment of acquired intangible assets	11	<b>38.7</b>	46.6
Non-headline items in operating profit		<b>126.8</b>	73.2
<b>Headline operating profit</b>		<b>504.4</b>	559.7
<b>Finance costs (2013 restated)</b>		<b>(75.6)</b>	[90.8]
Exclude			
– exceptional finance costs	4	<b>6.0</b>	4.2
– other financing gains and losses		<b>1.4</b>	1.9
– other financing costs retirement benefits (restated)	5,9	<b>8.4</b>	23.0
Non-headline items in finance costs		<b>15.8</b>	29.1
<b>Headline finance costs</b>		<b>(59.8)</b>	[61.7]
<b>Profit before taxation (2013 restated)</b>		<b>302.0</b>	395.7
Non-headline items in operating profit		<b>126.8</b>	73.2
Non-headline items in finance costs		<b>15.8</b>	29.1
<b>Headline profit before taxation</b>		<b>444.6</b>	498.0
<b>Profit after taxation – continuing operations (2013 restated)</b>		<b>234.6</b>	316.6
Exclude			
– non-headline items in profit before taxation		<b>142.6</b>	102.3
– tax on excluded items	7	<b>(52.6)</b>	[52.9]
		<b>90.0</b>	49.4
<b>Headline profit after taxation – continuing operations</b>		<b>324.6</b>	366.0

#### Headline earnings before interest, tax, depreciation and amortisation

Headline EBITDA, calculated as follows, is used to calculate one of Smiths cash-flow targets, see note 26 for details.

	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
<b>Headline operating profit</b>	<b>504.4</b>	559.7
Exclude:		
Depreciation	<b>46.1</b>	52.3
Amortisation of development costs	<b>21.3</b>	21.3
Amortisation of software, patents and intellectual property	<b>13.0</b>	13.2
<b>Headline EBITDA</b>	<b>584.8</b>	646.5

## 4 Exceptional items

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

	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
<b>Operating items</b>		
Restructuring programmes	<b>(28.8)</b>	(7.8)
Sale of intellectual property relating to diabetes	<b>1.1</b>	1.2
Resolution of legacy litigation	<b>0.6</b>	
Gains on changes to post-retirement benefits (note 9)		3.5
Profit on disposal of businesses and property	<b>3.0</b>	5.9
Adjustment to contingent consideration provided on acquisitions	<b>2.6</b>	1.4
Costs of acquisitions, disposals and aborted transactions	<b>(1.3)</b>	(3.0)
Litigation		
- provision for Titeflex Corporation claims (note 23)	<b>(10.0)</b>	(6.8)
- provision for John Crane, Inc. asbestos litigation (note 23)	<b>(48.8)</b>	(14.3)
	<b>(81.6)</b>	(19.9)
<b>Financing items</b>		
Exceptional finance costs – adjustment to discounted provisions		
- provision for Titeflex Corporation claims (note 23)	<b>(1.3)</b>	(0.9)
- provision for John Crane, Inc. asbestos litigation (note 23)	<b>(4.7)</b>	(3.3)
	<b>(87.6)</b>	(24.1)

### Year ended 31 July 2014

Restructuring costs include the final charge of £2.6m in respect of the Smiths Detection improvement programme and £25.9m in respect of Fuel for Growth. These programmes, which involve redundancy, relocation and consolidation of manufacturing, are considered exceptional by virtue of their size.

Profit on disposal of businesses includes the expiry of certain warranties on the disposal of Cross Match Technologies, Inc., which has generated an additional profit of £2.5m. Profits on disposal of business and property have been combined this year, because there are no individually material disposals.

A charge of £10.0m has been made by Titeflex Corporation. This reflects costs (which are not expected to recur) associated with one anomalous case which was settled during the year together with the estimated cost of future claims including those from insurance companies seeking recompense for damage allegedly caused by lightning strike, net of gains of £0.1m relating to changes in discounting.

The operating charge in respect of John Crane, Inc. litigation comprises £49.6m in respect of increased provision for adverse judgments and legal defence costs, £1.4m in respect of legal fees in connection with litigation against insurers, less £2.2m arising from changes in US risk free rates. The increase in the provision reflects two large historical judgments which were settled in the year.

The sale of intellectual property and resolution of legacy litigation have been reported as exceptional items because the earlier transactions relating to the same items were reported as exceptional items. The litigation provisions for Titeflex Corporation and John Crane, Inc., and the commutation of insurance policies received by John Crane, Inc., were reported as exceptional in the year of recognition. Consequently, the ongoing adjustments to these provisions are reported as exceptional items.

### Year ended 31 July 2013

Restructuring costs included £6.9m in respect of the improvement programme in Smiths Detection announced in September 2011. This programme, which involves redundancy, relocation, and consolidation of manufacturing, was considered exceptional by virtue of its size.

Gains on changes to post-retirement benefits comprised a settlement gain of £2.2m on the closure of a defined benefit pension scheme which was net of professional costs of £0.8m, and a past service gain of £2.1m on a scheme which has been closed to future accruals.

The agreement of the Cross Match Technologies, Inc. closing balance sheet and tax position generated a £0.6m additional profit on disposal of businesses. The profit on disposal of property arose from the sale of two sites which were formerly occupied by businesses which are no longer owned by Smiths.

Professional fees of £3m were incurred in relation to potential acquisitions and disposals.

A charge of £6.8m was made by Titeflex Corporation in respect of changes to the estimated cost of future claims including those from insurance companies seeking recompense for damage allegedly caused by lightning strike, net of gains of £2.6m relating to changes in discounting.

The operating charge in respect of John Crane, Inc. litigation comprised £22.6m in respect of increased provision for adverse judgments and legal defence costs, £0.5m in respect of legal fees in connection with litigation against insurers, less £8.8m arising from the increase in US risk free rates.

## 5 Net finance costs

	Year ended 31 July 2014	Year ended 31 July 2013 (restated)
	£m	£m
<b>Interest receivable</b>	<b>2.6</b>	2.6
Interest payable		
– bank loans and overdrafts, including associated fees	(7.4)	(7.4)
– other loans	(55.0)	(56.9)
<b>Interest payable</b>	<b>(62.4)</b>	(64.3)
Other financing gains/(losses)		
– fair value gains/(losses) on hedged debt	(2.8)	9.7
– fair value (losses)/gains on fair value hedge	2.8	(9.7)
– net foreign exchange (losses)/gains	(1.4)	(1.9)
– exceptional finance costs – adjustment to discounted provisions	(6.0)	(4.2)
<b>Other financing losses</b>	<b>(7.4)</b>	(6.1)
<b>Net interest expense on retirement benefit obligations</b>	<b>(8.4)</b>	(23.0)
<b>Net finance costs</b>	<b>(75.6)</b>	(90.8)

## 6 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 2014	Year ended 31 July 2013 (restated)
	£m	£m
Profit attributable to equity shareholders for the year		
– continuing	232.7	315.0
– total	232.8	315.0
Average number of shares in issue during the year	<b>394,296,986</b>	393,323,206

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 398,399,449 (2013: 397,467,678) 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 2014 no options (2013: no options) 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 2014		Year ended 31 July 2013 (restated)	
	£m	EPS (p)	£m	EPS (p)
Profit attributable to equity shareholders of the Parent Company	<b>232.7</b>	<b>59.0</b>	315.0	80.1
Exclude				
Non-headline items and related tax (note 3)	<b>90.0</b>	<b>22.8</b>	49.4	12.6
Headline	<b>322.7</b>	<b>81.8</b>	364.4	92.7
Statutory earnings per share – diluted (p)		<b>58.4</b>	79.3	
Headline earnings per share – diluted (p)		<b>81.0</b>	91.7	

## 7 Taxation

The Group's approach to taxation is set out in the Financial review. This note only provides information about corporate income taxes under IFRS. Smiths companies operate in over 50 countries across the world. They pay and collect many different taxes in addition to corporate income taxes including: payroll taxes; value added and sales taxes; property taxes; product-specific taxes and environmental taxes. The costs associated with these other taxes are included in profit before tax.

	<b>Year ended 31 July 2014</b>	Year ended 31 July 2013 (restated)
	<b>£m</b>	£m
The taxation charge in the consolidated income statement for the year comprises		
- current income tax charge	<b>93.0</b>	86.7
- current tax adjustments in respect of prior periods	<b>(3.7)</b>	8.1
Current taxation	<b>89.3</b>	94.8
- deferred taxation	<b>(21.9)</b>	(15.7)
<b>Total taxation expense in the consolidated income statement</b>	<b>67.4</b>	79.1

### Reconciliation of the tax charge

The tax expense on the profit for the year for continuing operations is different from the standard rate of corporation tax in the UK of 22.3% (2013: 23.7%). The difference is reconciled as follows:

	<b>Year ended 31 July 2014</b>	Year ended 31 July 2013 (restated)
	<b>£m</b>	£m
<b>Profit before taxation – continuing operations</b>	<b>302.0</b>	395.7
Notional taxation expense at UK rate of 22.3% (2013: 23.7%)	<b>67.4</b>	93.7
Different tax rates on non-UK profits and losses	<b>6.8</b>	2.3
Non-deductible expenses, tax credits and non-taxable income	<b>(6.1)</b>	(2.8)
Adjustments to unrecognised deferred tax	<b>5.3</b>	(15.5)
Non-taxable profit on disposal of businesses	<b>0.4</b>	(0.6)
Prior year true-up	<b>(6.4)</b>	2.0
	<b>67.4</b>	79.1
Comprising		
- taxation on headline profit	<b>120.0</b>	132.0
- tax on non-headline loss	<b>(52.6)</b>	(52.9)
<b>Taxation expense in the consolidated income statement</b>	<b>67.4</b>	79.1

The head office of Smiths Group is domiciled in the UK, so the tax charge has been reconciled to UK tax rates. In recent years, Smiths has made substantial payments to its UK defined benefit pension plans which generated significant UK tax losses.

	<b>Year ended 31 July 2014</b>	Year ended 31 July 2013 (restated)
	<b>£m</b>	£m
<b>Tax on items charged/(credited) to equity</b>		
Deferred tax charge/(credit)		
- retirement benefit schemes	<b>(5.8)</b>	39.0
- cash-flow hedges	<b>(0.1)</b>	1.0
- share options	<b>0.7</b>	(1.0)
	<b>(5.2)</b>	39.0

The net retirement benefit credit to equity includes £1.1m (2013: £4.2m) 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.

## 7 Taxation 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 2012	(75.4)	4.2	92.8	(33.7)	145.9	133.8
Credit/(charge) to income statement (restated)	(6.3)	1.5	(3.3)	(2.2)	26.0	15.7
Credit/(charge) to equity (restated)		1.0	(39.0)		(1.0)	(39.0)
Exchange adjustments	(2.6)		1.8	(1.3)	3.9	1.8
At 31 July 2013	(84.3)	6.7	52.3	(37.2)	174.8	112.3
Deferred tax assets	[20.2]	6.6	49.6	[10.0]	159.4	185.4
Deferred tax liabilities	[64.1]	0.1	2.7	[27.2]	15.4	[73.1]
At 31 July 2013	(84.3)	6.7	52.3	(37.2)	174.8	112.3
Credit/(charge) to income statement	3.6	[1.2]	[8.9]	[0.2]	28.6	21.9
Credit/(charge) to equity		[0.7]	5.8		0.1	5.2
Exchange adjustments	8.5	[0.1]	[5.3]	4.1	(19.5)	(12.3)
<b>At 31 July 2014</b>	<b>(72.2)</b>	<b>4.7</b>	<b>43.9</b>	<b>(33.3)</b>	<b>184.0</b>	<b>127.1</b>
Deferred tax assets	[18.9]	4.7	43.8	[8.9]	164.3	185.0
Deferred tax liabilities	[53.3]		0.1	[24.4]	19.7	[57.9]
<b>At 31 July 2014</b>	<b>(72.2)</b>	<b>4.7</b>	<b>43.9</b>	<b>(33.3)</b>	<b>184.0</b>	<b>127.1</b>

Included in other deferred tax balances above are:

- a deferred tax asset of £21.3m (2013: £28.1m) relating to losses carried forward. The decrease mainly relates to additional non-recognition provisions. The Group has recognised deferred tax on the basis that operations show a consistent pattern of improving results and the Group has implemented plans to support continuing improvements or the losses relate to specific, identified non-recurring events;
- a deferred tax asset of £117.3m (2013: £99.0m) relating to provisions where current tax relief is only available as payments are made. Of this asset, £68.4m (2013: £60.7m) relates to the John Crane, Inc. litigation provision, and £23.2m (2013: £24.9m) relates to Titeflex Corporation. See note 23 for additional information on provisions; and
- a deferred tax asset of £17.6m (2013: £22.2m) relating to inventory where current tax relief is only available when the inventory is sold.

The Group has not recognised deferred tax assets relating to tax losses of £470.2m (2013: £392.9m) and pensions and other long-term liabilities of £244.7m (2013: £284.5m) due to uncertainty as to their recoverability. This includes £83.3m (2013: £71.5m) relating to the UK pension deficit.

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 deferred tax has not been recognised is set out below.

### Restricted losses

	2014 £m	Expiry of losses	2013 £m	Expiry of losses
Territory				
- Americas	<b>31.5</b>	<b>2016-2034</b>	15.6	2016-2033
- Asia	<b>5.6</b>	<b>2016-2021</b>	3.9	2016-2020
Total restricted losses	<b>37.1</b>		19.5	
Unrestricted losses				
- operating losses	<b>433.1</b>	<b>No expiry</b>	373.4	No expiry
<b>Total</b>	<b>470.2</b>		392.9	

## 8 Employees

	<b>Year ended 31 July 2014 £m</b>	Year ended 31 July 2013 £m
<b>Staff costs during the period</b>		
Wages and salaries	<b>717.5</b>	756.3
Social security	<b>85.8</b>	89.2
Share-based payment (note 10)	<b>9.9</b>	12.8
Pension costs (including defined contribution schemes) (note 9)	<b>32.3</b>	33.8
	<b>845.5</b>	892.1

The average number of persons employed was:

	<b>Year ended 31 July 2014</b>	Year ended 31 July 2013
John Crane	<b>6,850</b>	7,000
Smiths Medical	<b>7,850</b>	7,900
Smiths Detection	<b>2,250</b>	2,250
Smiths Interconnect	<b>4,000</b>	3,850
Flex-Tek	<b>2,000</b>	2,000
Smiths Business Information Services	<b>200</b>	200
Corporate	<b>50</b>	50
	<b>23,200</b>	23,250

Smiths Business Information Services directly employs people working in its operations. All the costs of IT infrastructure and support, including these employment costs, are reflected in reported divisional operating profit.

### 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 92 to 109.

	<b>Year ended 31 July 2014 £m</b>	Year ended 31 July 2013 £m
<b>Key management compensation</b>		
Salaries and short-term employee benefits	<b>9.0</b>	8.5
Cost of post-retirement benefits	<b>0.1</b>	0.1
Cost of share-based incentive plans	<b>3.4</b>	4.5

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:

	<b>Year ended 31 July 2014</b>		Year ended 31 July 2013	
	<b>Number of instruments '000</b>	<b>Weighted average price</b>	Number of instruments '000	Weighted average price
CIP	<b>706</b>		834	
ESOS	<b>31</b>	<b>£10.12</b>	126	£8.71
VSP			78	
LTIP	<b>1,629</b>		1,251	
SAYE	<b>10</b>	<b>£8.57</b>	5	£7.28

### Related party transactions

There are no related party transactions in the year ended 31 July 2014.

In 2013 the Group had a service contract with a company connected to a member of the Executive Committee. Costs of £0.2m were incurred in respect of this arrangement.

## 9 Post-retirement benefits

Smiths provides post-retirement benefits to employees in a number of countries. This includes defined benefit and defined contribution plans and, mainly in the United Kingdom (UK) and United States of America (US), post-retirement healthcare.

### 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 consolidated income statement in respect of all these plans was £30.0m (2013: £29.9m).

### Defined benefit and post-retirement healthcare plans

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.

For all schemes, pension costs are assessed in accordance with the advice of independent, professionally qualified actuaries. These valuations have been updated by independent qualified actuaries in order to assess the liabilities of the schemes as at 31 July 2014. Scheme assets are stated at their market values. Contributions to the schemes are made on the advice of the actuaries.

#### The changes in the present value of the net pension liability in the period were:

	Year ended 31 July 2014	Year ended 31 July 2013 (restated)
	£m	£m
At beginning of period	<b>(253.6)</b>	[620.2]
Exchange adjustment	<b>18.3</b>	[8.1]
Current service cost	<b>(2.6)</b>	[4.1]
Scheme administration costs	<b>(6.5)</b>	[6.7]
Past service cost, curtailments, settlements	<b>0.1</b>	4.3
Finance charges – retirement benefits	<b>(8.4)</b>	[23.0]
Contributions by employer	<b>87.9</b>	77.5
Actuarial (loss)/gain	<b>(76.9)</b>	326.6
Movement in surplus restriction		0.1
<b>Net retirement benefit liability</b>	<b>(241.7)</b>	[253.6]

### UK pension schemes

Smiths funded UK pension schemes are subject to a statutory funding objective, as set out in UK pension legislation. Scheme trustees need to obtain regular actuarial valuations to assess the scheme against this funding objective. The trustees and sponsoring companies need to agree funding plans to improve the position of a scheme, when it is below the acceptable funding level.

The UK Pensions Regulator has extensive powers to protect the benefits of members, promote good administration and reduce the risk of situations arising which may require compensation to be paid from the Pension Protection Fund. These powers include imposing a schedule of contributions or the calculation of the technical provisions, where a trustee and company fail to agree appropriate calculations.

#### Smiths Industries Pension Scheme ("SIPS")

This scheme was closed to future accrual effective 1 November 2009. SIPS provides index-linked pension benefits based on final earnings at date of closure. SIPS is governed by a corporate trustee (SI Trustee Limited, a wholly owned subsidiary of Smiths Group plc). The board of trustee directors comprises five company-nominated trustees and four member-nominated trustees, with an independent chairman selected by Smiths Group plc. Trustee Directors are responsible for the management, administration, funding and investment strategy of the scheme.

The most recent actuarial valuation of this scheme was performed using the Projected Unit Method as at 31 March 2012, and the next funding valuation is required no later than 31 March 2015. Under the current funding plan for SIPS Smiths pays cash contributions of £3m a month until October 2019. In addition, Smiths invests £2m a month in index-linked gilts held in an escrow account. The escrow account remains an asset of the Group until 2020, see note 17. At that time, the assets in escrow will be 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 funding valuation.

SIPS are reviewing member records to prepare for the implementation of Guaranteed Minimum Pensions equalisation in respect of members contracted out of the State Earnings Related Pensions Scheme prior to 6 April 1997 and implement any outstanding Barber equalisation. It is not yet possible to reliably quantify the impact of either of these adjustments.

The duration of the SIPS liabilities is around 23 years (2013: 22 years) for active deferred members, 23 years (2013: 24 years) for deferred members and 11 years (2013: 12 years) for pensioners and dependants.

#### TI Group Pension Scheme ("TIGPS")

This scheme was closed to future accrual effective 1 November 2009. TIGPS provides index-linked pension benefits based on final earnings at the date of closure. TIGPS is governed by a corporate trustee (TI Pension Trustee Limited, an independent company). The board of trustee directors comprises five company-nominated trustees and four member-nominated trustees, with an independent trustee director selected by the Trustee. The Trustee is responsible for the management, administration, funding and investment strategy of the scheme.

The most recent actuarial valuation of this scheme was performed using the Projected Unit Method as at 5 April 2012, and the next funding valuation is required no later than 5 April 2015. Under the current funding plan for TIGPS Smiths pays cash contributions of £16m a year until April 2016.

Under the governing documentation of the TIGPS, any future surplus would be returnable to Smiths Group plc by refund, assuming gradual settlement of the liabilities over the lifetime of the scheme. If TIGPS was wound up while it had members, the scheme would need to buy out the benefits of all members. The buyouts would cost significantly more than the present value of the scheme liabilities calculated in accordance with IAS 19 (revised).

## 9 Post-retirement benefits continued

### Defined benefit and post-retirement healthcare plans continued

#### UK pension schemes continued

##### TI Group Pension Scheme ("TIGPS") continued

TIGPS is compliant with all identified requirements of Barber equalisation. TIGPS will implement Guaranteed Minimum Pensions equalisation in respect of members contracted out of the State Earnings Related Pensions Scheme prior to 6 April 1997, once the government has completed its consultations and confirmed an approach. It is not yet possible to reliably quantify the impact of this adjustment.

The duration of the TIGPS liabilities is around 23 years (2013: 23 years) for active deferred members, 20 years (2013: 21 years) for deferred members and 10 years (2013: 10 years) for pensioners and dependants.

#### US pension plans

The most recent valuations of the six principal US pension and post-retirement healthcare plans were performed at 1 January 2014.

The pension plans were closed with effect from 30 April 2009 and benefits were calculated as at that date and are not revalued. Governance of the US pension plans is managed by a Settlor Committee appointed by Smiths Group Services Corp. The US pension plans are offering deferred members a one-off option to elect to cash out their retirement entitlements rather than receive a pension at retirement. Lump sum payments of \$145m were made in August 2014, with further payments of approximately \$5m expected in September 2014 for applications where data review or corrections were required. This programme will generate a settlement gain that will be reported in the 31 January 2015 Interim report. The final settlement gain will not be confirmed until the September payment has been finalised, but it is expected to be approximately \$20m.

The duration of the liabilities for the largest US plan is around 18 years (2013: 17 years) for active deferred members, 19 years (2013: 19 years) for deferred members and 9 years (2013: 9 years) for pensioners and dependants.

#### Risk management

The pensions schemes are exposed to risks that:

- investment returns are below expectations, leaving the scheme with insufficient assets in future to pay all its pension obligations;
- members and dependants live longer than expected, increasing the value of the pensions the scheme has to pay;
- inflation rates are higher than expected, so amounts payable under indexed-linked pensions are higher than expected; and
- increased contributions may be required to meet regulatory funding targets if lower interest rates increase the current value of liabilities.

These risks are managed separately for each pension scheme. However Smiths has adopted a common approach of closing defined benefit schemes to cap members' entitlements and supporting trustees in adopting investment strategies which match assets to future obligations, after allowing for the funding position of the scheme.

TIGPS with a mature member profile, and a strong funding position, has been able to progress its matching strategy to the point where 53% of liabilities are covered by matching annuities, eliminating investment return, longevity, inflation and funding risks. In September 2013, the Trustees of the TIGPS invested a further £160m in annuities matched with specific liabilities of the Scheme.

From August 2014, SIPS have adjusted the scheme investment strategy. The scheme has invested in diversified growth funds and introduced a synthetic equity mandate with BlackRock, using exchange-traded futures, which are derivative contracts entered into for a fixed term, to invest in global equity markets. If equity markets rise, the value of the synthetic equity mandate will increase, whilst if equity markets fall, the value of the synthetic equity mandate will fall. At future year-ends the value of the mandate could be positive or negative depending upon movement in the global equity markets. The risk and return characteristics of synthetic equities are similar to physical equities.

#### The principal assumptions used in updating the valuations are set out below:

	2014 UK	2014 US	2014 Other	2013 UK	2013 US	2013 Other
Rate of increase in salaries	<b>n/a</b>	<b>n/a</b>	<b>2.6%</b>	n/a	n/a	2.7%
Rate of increase for active deferred members	<b>4.2%</b>	<b>n/a</b>	<b>n/a</b>	4.3%	n/a	n/a
Rate of increase in pensions in payment	<b>3.3%</b>	<b>n/a</b>	<b>0.9%</b>	3.4%	n/a	0.9%
Rate of increase in deferred pensions	<b>3.3%</b>	<b>n/a</b>	<b>0.1%</b>	3.4%	n/a	1.0%
Discount rate	<b>4.0%</b>	<b>4.4%</b>	<b>3.8%</b>	4.4%	4.8%	4.0%
Inflation rate	<b>3.3%</b>	<b>n/a</b>	<b>1.6%</b>	3.4%	n/a	1.7%
Healthcare cost increases	<b>4.3%</b>	<b>n/a</b>	<b>2.3%</b>	5.0%	n/a	2.6%

The assumptions used in calculating the costs and obligations of the Group's defined benefit pension plans are set by Smiths after consultation with independent professionally qualified actuaries. 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 assumptions are disclosed as a weighted average.

#### Discount rate assumptions

The UK schemes use a discount rate based on the yield on the iBOXX over 15-year AA-rated corporate bond index, adjusted to better reflect the shape of the yield curve considering the Aon Hewitt GBP Select AA curve. For the USA, the discount rate referenced Moody's Aa annualised yield, the Citigroup High Grade Index, the Merrill Lynch 15+ years High Quality Index and the Towers Watson cash-flow matching models.

## 9 Post-retirement benefits continued

### Defined benefit and post-retirement healthcare plans continued

#### Risk management continued

##### Mortality assumptions

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 2013 CMI projections, blended to a long-term rate of 1.25%. The mortality assumptions used in the principal US schemes are based on the RP 2000 table projected to 2025. 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 schemes				US schemes			
	Male 31 July 2014	Female 31 July 2014	Male 31 July 2013	Female 31 July 2013	Male 31 July 2014	Female 31 July 2014	Male 31 July 2013	Female 31 July 2013
Member who retires next year at age 65	<b>23</b>	<b>25</b>	23	25	<b>20</b>	<b>21</b>	20	21
Member, currently 45, when they retire in 20 years' time	<b>25</b>	<b>27</b>	25	27	<b>20</b>	<b>21</b>	20	21

#### Sensitivity

Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 July 2014 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 2014 £m	Increase/(decrease) in scheme assets £m	(Increase)/decrease in scheme liabilities £m	Profit before tax for year ended 31 July 2013 £m	Increase/(decrease) in scheme assets £m	(Increase)/decrease in scheme liabilities £m
Rate of mortality – 1 year increase in life expectancy	<b>(3.4)</b>	<b>44.5</b>	<b>(130.8)</b>	(4.1)	32.8	(123.3)
Rate of mortality – 1 year decrease in life expectancy	<b>3.6</b>	<b>(45.2)</b>	<b>132.7</b>	4.0	(32.8)	124.0
Rate of inflation – 0.25% increase	<b>(2.9)</b>	<b>12.5</b>	<b>(86.9)</b>	(3.3)	11.0	(85.6)
Discount rate – 0.25% increase	<b>4.9</b>	<b>(19.6)</b>	<b>141.2</b>	(5.6)	(16.2)	139.8
Market value of scheme assets – 2.5% increase	<b>2.9</b>	<b>73.2</b>		3.3	74.6	

The effect on profit before tax reflects the impact of current service cost and net interest cost.

The value of the scheme assets is affected by changes in mortality rates, inflation and discounting because they affect the carrying value of the insurance assets.

#### Retirement benefit plan assets

	31 July 2014 £m				31 July 2013 £m			
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
Cash and cash equivalents								
- Cash	<b>592.9</b>		<b>0.4</b>	<b>593.3</b>	34.2			34.2
- Liquidity funds	<b>42.7</b>	<b>60.5</b>		<b>103.2</b>	183.5			183.5
Equities								
- UK funds	<b>178.4</b>		<b>3.5</b>	<b>181.9</b>	768.0		3.6	771.6
- North American funds	<b>156.7</b>	<b>136.6</b>	<b>1.6</b>	<b>294.9</b>	319.6	240.9	1.9	562.4
- Other regions and global funds	<b>269.0</b>	<b>56.7</b>	<b>13.9</b>	<b>339.6</b>	530.7	70.3	13.9	614.9
Government bonds								
- index-linked bonds	<b>657.5</b>			<b>657.5</b>	145.2			145.2
- fixed-interest bonds	<b>92.1</b>	<b>64.9</b>	<b>10.9</b>	<b>167.9</b>	42.0	29.1	11.2	82.3
Corporate bonds	<b>266.9</b>	<b>181.2</b>	<b>2.3</b>	<b>450.4</b>	274.2	158.9	2.3	435.4
Insured liabilities	<b>811.4</b>		<b>0.4</b>	<b>811.8</b>	672.1		0.5	672.6
Property								
- UK property	<b>181.2</b>			<b>181.2</b>	176.4			176.4
- other property							0.5	0.5
Other	<b>0.7</b>		<b>17.2</b>	<b>17.9</b>		2.0	15.2	17.2
<b>Total market value</b>	<b>3,249.5</b>	<b>499.9</b>	<b>50.5</b>	<b>3,799.9</b>	3,145.9	501.2	49.1	3,696.2

SIPS was in the process of implementing a change to its investment strategy at 31 July 2014, so the UK schemes cash includes £326m which was reinvested in diversified growth funds shortly after the year end. The balance of the cash held by SIPS will be retained within the scheme to meet calls on the equity strategy.

Liquidity funds, equities and bonds are valued using quoted market prices in active markets. Insured liabilities comprise annuity policies matching the scheme obligation to identified groups of pensioners. These assets are valued at the actuarial valuation of the corresponding liability, reflecting this matching relationship. Property is valued by specialists applying recognised property valuation methods incorporating current market data on rental yields and transaction prices.

The scheme assets do not include any property occupied by, or other assets used by, the Group. The only financial instruments of the Group included in scheme assets are ordinary equity shares in Smiths Group plc held in broad-based equity investment funds.

## 9 Post-retirement benefits continued

### Defined benefit and post-retirement healthcare plans continued

#### Present value of funded scheme liabilities and assets for the main UK and US schemes

	31 July 2014 £m			31 July 2013 £m		
	SIPS	TIGPS	US schemes	SIPS	TIGPS	US schemes
Present value of funded scheme liabilities						
- Active deferred members	(71.4)	(73.6)	(96.3)	(85.7)	(71.5)	(108.6)
- Deferred members	(713.8)	(589.2)	(221.5)	(702.9)	(557.3)	(221.2)
- Pensioners	(999.3)	(810.1)	(277.3)	(925.8)	(800.2)	(290.7)
Present value of funded scheme liabilities	(1,784.5)	(1,472.9)	(595.1)	(1,714.4)	(1,429.0)	(620.5)
Market value of scheme assets	1,639.1	1,594.3	499.9	1,580.9	1,549.4	501.2
<b>Surplus/(deficit)</b>	<b>(145.4)</b>	<b>121.4</b>	<b>(95.2)</b>	<b>(133.5)</b>	<b>120.4</b>	<b>(119.3)</b>

#### Net retirement benefit obligations

	31 July 2014 £m				31 July 2013 £m			
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
Market value of scheme assets	3,249.5	499.9	50.5	3,799.9	3,145.9	501.2	49.1	3,696.2
Present value of funded scheme liabilities	(3,275.3)	(595.1)	(64.1)	(3,934.5)	(3,160.6)	(620.5)	(61.5)	(3,842.6)
<b>Surplus/(deficit)</b>	<b>(25.8)</b>	<b>(95.2)</b>	<b>(13.6)</b>	<b>(134.6)</b>	<b>(14.7)</b>	<b>(119.3)</b>	<b>(12.4)</b>	<b>(146.4)</b>
Unfunded pension plans	(49.9)	(6.0)	(32.9)	(88.8)	(48.3)	(6.5)	(31.3)	(86.1)
Post-retirement healthcare	(7.6)	(9.7)	(1.0)	(18.3)	(8.5)	(11.6)	(1.0)	(21.1)
Present value of unfunded obligations	(57.5)	(15.7)	(33.9)	(107.1)	(56.8)	(18.1)	(32.3)	(107.2)
<b>Net pension liability</b>	<b>(83.3)</b>	<b>(110.9)</b>	<b>(47.5)</b>	<b>(241.7)</b>	<b>(71.5)</b>	<b>(137.4)</b>	<b>(44.7)</b>	<b>(253.6)</b>
Post-retirement assets	121.4	1.2	122.6	120.6		1.1		121.7
Post-retirement liabilities	(204.7)	(110.9)	(48.7)	(364.3)	(192.1)	(137.4)	(45.8)	(375.3)
<b>Net pension liability</b>	<b>(83.3)</b>	<b>(110.9)</b>	<b>(47.5)</b>	<b>(241.7)</b>	<b>(71.5)</b>	<b>(137.4)</b>	<b>(44.7)</b>	<b>(253.6)</b>

Where any individual scheme shows a recoverable surplus under IAS 19, this is disclosed on the balance sheet as a retirement benefit asset. The IAS 19 surplus of any one scheme is not available to fund the IAS 19 deficit of another scheme. The retirement benefit asset disclosed arises from the rights of the employers to recover the surplus at the end of the life of the scheme.

#### Amounts recognised in the consolidated income statement (2013 restated)

	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
<b>Amounts (credited)/charged to operating profit</b>		
Current service cost	2.6	4.1
Past service (gain)/cost	(0.1)	(2.1)
Settlement (gain)/loss		(2.2)
Scheme administration costs	6.5	6.7
	9.0	6.5
<b>The operating cost is charged/(credited) as follows:</b>		
Cost of sales	0.5	1.0
Sales and distribution costs	0.9	1.2
Administrative expenses	7.6	8.6
Exceptional operating items		(4.3)
	9.0	6.5
<b>Amounts charged to finance costs</b>		
Net interest cost	8.4	23.0

## 9 Post-retirement benefits continued

### Defined benefit and post-retirement healthcare plans continued

Amounts recognised directly in the consolidated statement of comprehensive income (2013 restated)

	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
<b>Actuarial gains/(losses)</b>		
Difference between interest credit and return on assets	<b>97.1</b>	321.5
Experience gains and losses on scheme liabilities	<b>5.8</b>	(3.1)
Actuarial gains/(losses) arising from changes in demographic assumptions	<b>30.6</b>	(16.1)
Actuarial gains/(losses) arising from changes in financial assumptions	<b>(210.4)</b>	24.2
Movements in surplus restriction		0.1
	<b>(76.9)</b>	326.6

### Changes in present value of funded scheme assets (2013 restated)

	31 July 2014 £m				31 July 2013 £m			
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
At beginning of period	<b>3,145.9</b>	<b>501.2</b>	<b>49.1</b>	<b>3,696.2</b>	2,844.9	458.1	44.6	3,347.6
Interest on assets	<b>136.6</b>	<b>22.4</b>	<b>2.1</b>	<b>161.1</b>	115.2	17.0	1.8	134.0
Actuarial gain on scheme assets	<b>58.5</b>	<b>32.4</b>	<b>6.2</b>	<b>97.1</b>	278.7	32.5	10.4	321.6
Employer contributions	<b>53.4</b>	<b>25.3</b>	<b>2.9</b>	<b>81.6</b>	53.5	7.7	9.8	71.0
Employee contributions			<b>0.2</b>	<b>0.2</b>			0.2	0.2
Assets distributed on settlement								(16.8)
Scheme administration costs	<b>(4.2)</b>	<b>(2.1)</b>	<b>(0.2)</b>	<b>(6.5)</b>	(4.5)	(2.2)		(6.7)
Exchange adjustments		<b>(52.1)</b>	<b>(7.1)</b>	<b>(59.2)</b>		15.7	1.4	17.1
Benefits paid	<b>(140.7)</b>	<b>(27.2)</b>	<b>(2.7)</b>	<b>(170.6)</b>	(141.9)	(27.6)	(2.3)	(171.8)
<b>At end of period</b>	<b>3,249.5</b>	<b>499.9</b>	<b>50.5</b>	<b>3,799.9</b>	3,145.9	501.2	49.1	3,696.2

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

	31 July 2014 £m				31 July 2013 £m			
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
At beginning of period	<b>(3,160.6)</b>	<b>(620.5)</b>	<b>(61.5)</b>	<b>(3,842.6)</b>	(3,116.7)	(680.6)	(66.3)	(3,863.6)
Current service cost	<b>(0.3)</b>		<b>(1.0)</b>	<b>(1.3)</b>	(0.3)		(2.1)	(2.4)
Interest on obligations	<b>(136.1)</b>	<b>(26.9)</b>	<b>(2.5)</b>	<b>(165.5)</b>	(125.0)	(25.4)	(2.7)	(153.1)
Employee contributions			<b>(0.2)</b>	<b>(0.2)</b>			(0.2)	(0.2)
Past service gain/(cost)			<b>0.1</b>	<b>0.1</b>			2.1	2.1
Actuarial (loss)/gain on liabilities	<b>(119.0)</b>	<b>(38.8)</b>	<b>(10.2)</b>	<b>(168.0)</b>	(60.5)	77.5	(11.3)	5.7
Liabilities extinguished on settlement							19.0	19.0
Curtailment gain/(cost)								
Exchange adjustments		<b>63.9</b>	<b>8.5</b>	<b>72.4</b>		(19.6)	(2.3)	(21.9)
Benefits paid	<b>140.7</b>	<b>27.2</b>	<b>2.7</b>	<b>170.6</b>	141.9	27.6	2.3	171.8
<b>At end of period</b>	<b>(3,275.3)</b>	<b>(595.1)</b>	<b>(64.1)</b>	<b>(3,934.5)</b>	(3,160.6)	(620.5)	(61.5)	(3,842.6)

### Changes in present value of unfunded defined benefit pensions and post-retirement healthcare plans

	Assets		Obligations	
	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
At beginning of period			<b>(107.2)</b>	(104.1)
Current service cost			<b>(1.3)</b>	(1.7)
Interest on obligations			<b>(4.0)</b>	(3.9)
Actuarial (loss)/gain			<b>(6.0)</b>	(0.7)
Employer contributions	<b>6.3</b>	6.5		
Exchange adjustments			<b>5.1</b>	(3.3)
Benefits paid	<b>(6.3)</b>	(6.5)	<b>6.3</b>	6.5
<b>At end of period</b>			<b>(107.1)</b>	(107.2)

## 9 Post-retirement benefits continued

### Defined benefit and post-retirement healthcare plans continued

#### Cash contributions

Company contributions to the funded defined benefit pension plans for 2014 totalled £81.6m (2013: £71.0m).

In 2015 the following cash contributions to the Group's principal defined benefit schemes are expected: £36.4m to SIPS; £16.6m to TIGPS; and approximately £31.5m to other plans, including the US defined benefit scheme. Expected cash payments for 2015 total £84.5m. In addition, £24m will be invested in UK government bonds held in escrow, in accordance with the funding plan for SIPS.

#### Adopting IAS 19 (Revised 2011) has had the following impact on reported results

	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
Additional charge to operating profit	(6.5)	(6.7)
Increased finance charges	(48.7)	(39.4)
Impact on profit before tax	(55.2)	(46.1)
Change to actuarial gains and losses recognised	55.2	46.1

## 10 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 growth of headline EPS adjusted to exclude tax; 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 operating 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 operating 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 three-year performance period, awards will lapse. There is no re-testing of the performance conditions.

#### 2010 Value Sharing Plan (2010 VSP)

The 2010 VSP is a long-term incentive plan approved by the shareholders at the Annual General Meeting on 16 November 2010, rewarding executives for value creation at Group and divisional levels. Corporate participants were rewarded under the VSP for value creation at a Group level, whereas the executives with divisional responsibilities were rewarded for value creation within the division for which they are responsible. For the Group scheme, one-third of the award depended 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 was determined by the growth in internal value in excess of fixed rate. The growth in internal value was 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 depended on meeting an internal value growth target set for the division in which the participant worked. 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.

## 10 Employee share schemes continued

	CIP	Long-term incentive plans	Other share schemes	Total	Weighted average price for option plans £
Ordinary shares under option ('000)					
1 August 2012	1,708	2,299	3,475	7,482	£4.10
Granted	707	1,020	149	1,876	£0.80
Update of estimates		[64]		(64)	£0.00
Exercised	(306)	(721)	(1,224)	(2,251)	£4.60
Lapsed	(235)	(167)	(314)	(716)	£4.15
31 July 2013	1,874	2,367	2,086	6,327	£2.98
Granted	412	927	398	1,737	£2.27
Update of estimates		6		6	£0.00
Exercised	(546)	(349)	(657)	(1,552)	£3.87
Lapsed	(172)	(256)	(83)	(511)	£1.49
<b>31 July 2014</b>	<b>1,568</b>	<b>2,695</b>	<b>1,744</b>	<b>6,007</b>	<b>£2.67</b>

Options were exercised on an irregular basis during the period. The average closing share price over the financial year was 1,353.95p (2013: 1,195.79p). 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 2014 ('000)	Options exercisable at 31 July 2013 ('000)	Exercisable weighted average exercise price for options exercisable at 31 July 2014
£0.00 – £2.00	4,263	9			£0.00
£2.01 – £6.00	164	9	23		£5.69
£6.01 – £10.00	1,093	30	463	1,071	£8.85
£10.01 – £14.00	487	34	289	532	£10.96

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 2014 and 2013 are volatility of 25% (2013: 25% to 27%) and dividend yield of 3.75% (2013: 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 £14.04 (2013: £10.84), Group long-term incentive plans of £12.26 (2013: £9.18) and divisional long-term incentive plans of £14.12 (2013: £10.84). 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 £9.9m (2013: £12.8m), of which £9.2m (2013: £12.1m) relates to equity-settled share-based payment.

At 31 July 2014 the payable relating to cash-settled schemes is £0.2m (2013: £0.5m).

## 11 Intangible assets

	Goodwill £m	Development costs £m	Acquired intangibles (see table below) £m	Software, patents and intellectual property £m	Total £m
<b>Cost</b>					
At 1 August 2012	1,488.1	181.3	413.6	143.4	2,226.4
Exchange adjustments	69.2	7.7	16.6	2.6	96.1
Additions		29.9		11.1	41.0
Disposals	(4.0)	(1.5)		(1.4)	(6.9)
At 31 July 2013	1,553.3	217.4	430.2	155.7	2,356.6
Exchange adjustments	(156.3)	(21.7)	(43.2)	(8.2)	(229.4)
Business combinations	1.0		0.3		1.3
Additions		24.6		17.5	42.1
Disposals	(2.7)	(4.4)	(1.7)	(1.1)	(9.9)
<b>At 31 July 2014</b>	<b>1,395.3</b>	<b>215.9</b>	<b>385.6</b>	<b>163.9</b>	<b>2,160.7</b>
<b>Amortisation</b>					
At 1 August 2012	93.7	70.6	249.1	95.9	509.3
Exchange adjustments	4.9	3.1	12.3	2.4	22.7
Charge for the year		21.3	46.6	13.2	81.1
Disposals		(1.5)		(1.0)	(2.5)
At 31 July 2013	98.6	93.5	308.0	110.5	610.6
Exchange adjustments	(9.2)	(9.8)	(32.0)	(6.9)	(57.9)
Charge for the year		21.3	38.7	13.0	73.0
Disposals	(2.7)	(3.3)	(1.7)	(0.9)	(8.6)
<b>At 31 July 2014</b>	<b>86.7</b>	<b>101.7</b>	<b>313.0</b>	<b>115.7</b>	<b>617.1</b>
<b>Net book value at 31 July 2014</b>	<b>1,308.6</b>	<b>114.2</b>	<b>72.6</b>	<b>48.2</b>	<b>1,543.6</b>
Net book value at 31 July 2013	1,454.7	123.9	122.2	45.2	1,746.0
Net book value at 1 August 2012	1,394.4	110.7	164.5	47.5	1,717.1

In addition to goodwill, the acquired intangible assets comprise:

	Patents, licences and trademarks £m	Technology £m	Customer relationships £m	Total acquired intangibles £m
<b>Cost</b>				
At 1 August 2012	73.4	139.0	201.2	413.6
Exchange adjustments	1.8	4.8	10.0	16.6
At 1 August 2013	75.2	143.8	211.2	430.2
Exchange adjustments	(7.5)	(14.5)	(21.2)	(43.2)
Business combinations	0.2		0.1	0.3
Disposals		(1.7)		(1.7)
<b>At 31 July 2014</b>	<b>67.9</b>	<b>127.6</b>	<b>190.1</b>	<b>385.6</b>
<b>Amortisation</b>				
At 1 August 2012	33.2	77.9	138.0	249.1
Exchange adjustments	1.0	3.2	8.1	12.3
Charge for the year	5.8	16.5	24.3	46.6
At 31 July 2013	40.0	97.6	170.4	308.0
Exchange adjustments	(4.1)	(10.2)	(17.7)	(32.0)
Charge for the year	5.3	15.1	18.3	38.7
Disposals		(1.7)		(1.7)
<b>At 31 July 2014</b>	<b>41.2</b>	<b>100.8</b>	<b>171.0</b>	<b>313.0</b>
<b>Net book value at 31 July 2014</b>	<b>26.7</b>	<b>26.8</b>	<b>19.1</b>	<b>72.6</b>
Net book value at 31 July 2013	35.2	46.2	40.8	122.2
Net book value at 1 August 2012	40.2	61.1	63.2	164.5

## 12 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 2015 budget and the four-year divisional strategic plan, which have both been approved by the Board.

Goodwill is allocated by division as follows:

	2014 £m	2014 Number of CGUs	2013 £m	2013 Number of CGUs
John Crane	<b>121.3</b>	<b>4</b>	142.7	4
Smiths Medical	<b>480.6</b>	<b>1</b>	529.5	1
Smiths Detection	<b>368.6</b>	<b>1</b>	407.8	1
Smiths Interconnect	<b>316.7</b>	<b>3</b>	351.6	3
Flex-Tek	<b>21.4</b>	<b>2</b>	23.1	2
	<b>1,308.6</b>	<b>11</b>	1,454.7	11

As required by IAS 36, the allocation of goodwill to CGUs for John Crane has been revised following a reorganisation of the division into a new structure. If goodwill had been tested using the previous allocation, it would not have triggered any impairments.

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. The discount rates disclosed incorporate risk adjustments where the projected sales and margins are affected by significant delivery risks. Pre-tax rates of 10.7% to 13.6% (2013: 10.9% to 14.9%) 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 2.03% (2013: 2.13%). 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:

	Year ended 31 July 2014				
	Smiths Medical	Smiths Detection	Smiths Interconnect		
			Microwave	Connectors	Power
Net book value of goodwill (£m)	<b>480.6</b>	<b>368.6</b>	<b>124.1</b>	<b>78.6</b>	<b>114.0</b>
Discount rate	10.7%	12.5%	13.6%	13.2%	11.4%
Period covered by management projections	5 years	5 years	5 years	5 years	5 years
Long-term growth rates	2.0%	2.3%	1.0%	1.5%	2.5%

	Year ended 31 July 2013				
	Smiths Medical	Smiths Detection	Smiths Interconnect		
			Microwave	Connectors	Power
Net book value of goodwill (£m)	529.5	407.8	137.3	87.4	126.9
Discount rate	10.9%	14.9%	13.2%	13.8%	13.3%
Period covered by management projections	5 years	5 years	5 years	5 years	5 years
Long-term growth rates	2.1%	1.6%	2.8%	2.5%	2.4%

The discount rates used for testing Smiths Interconnect Connectors and Smiths Interconnect Power for the year ended 31 July 2014 are lower than previous years because higher risk adjustments have been made to the cash-flow projections, requiring a corresponding reduction in the risk adjustment incorporated in the discount rate.

The remaining balance of the goodwill represents smaller individual amounts which have been allocated to smaller CGUs.

## 12 Impairment testing continued

### Goodwill continued

#### Sensitivity analysis

##### Smiths Detection

Smiths Detection's value in use exceeds its carrying value by £165m. Sensitivity analysis performed around the base case assumptions has indicated that for Smiths Detection, the following changes in assumptions (in isolation), would cause the value in use to fall below the carrying value:

	Year ended 31 July 2014 Change required to trigger impairment
Forecast operating cash-flow	<b>30% reduction</b>
Discount rate	<b>300 basis points higher</b>
Long-term growth rates	<b>690 basis points lower</b>

Sales assumptions for Smiths Detection are based on:

- the current order book and tenders in progress, including airport, cargo scanning and military opportunities;
- expected market growth rates. Market growth drivers considered include
  - passenger numbers for air transportation;
  - global trade for cargo screening;
  - increased regulatory standards to detect a wider range of substances at lower threat mass; and
  - expected rate of replacement for units initially installed following 11 September 2001.
- expected rate of adoption of new products and technologies, including HI-SCAN 10080 XCT for baggage handling systems, HI-SCAN 6040-2is for critical infrastructure and Ace-ID for trace; and
- forecast servicing of the installed product base.

Margin projections for Smiths Detection are based on historical margins, projected margins on tenders in progress and the current fixed cost base.

Smiths Detection is currently implementing a significant performance improvement programme, see note 4. As required by IAS 36, the benefit of future restructuring has been eliminated from the projections used for impairment testing. However, this required material changes to the projections approved by the Board. As a result, the directors also reviewed the fair value less costs to sell for the division when considering the results of the impairment testing. This additional work also indicated that the Smiths Detection goodwill was not impaired.

#### Smiths Interconnect Power

Smiths Interconnect Power's value in use exceeds its carrying value by £7.8m (2013: £7.8m). Sensitivity analysis performed around the base case assumptions has indicated that for Smiths Interconnect Power, the following changes in assumptions (in isolation), would cause the value in use to fall below the carrying value:

	Year ended 31 July 2014 Change required to trigger impairment	Year ended 31 July 2013 Change required to trigger impairment
Forecast operating cash-flow	<b>6% reduction</b>	4% reduction
Discount rate	<b>40 basis points higher</b>	50 basis points higher
Long-term growth rates	<b>70 basis points lower</b>	90 basis points lower

Sales assumptions for Smiths Interconnect Power are based on:

- the current order book;
- proportion of recent tenders which have been successful; and
- independent projections of the expected growth of the data centre market in North America.

Margin projections for Smiths Interconnect Power are based on current variable costs and production capacity, and the expected costs of increasing capacity to support higher levels of sales.

The directors also reviewed the fair value less costs to sell for the division when considering the results of the impairment testing, which also supported the conclusion that the Smiths Interconnect Power goodwill was not impaired.

#### Other CGUs

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

#### Other intangible assets

The Group has no indefinite life intangible assets other than goodwill. During the year impairment tests were carried out for development projects which have not yet started to be amortised and acquired intangibles where there were indications of impairment. Value in use calculations were used to determine the recoverable values of these assets.

No impairment charges have been incurred (2013: £nil).

## 13 Property, plant and equipment

	Land and buildings £m	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
<b>Cost or valuation</b>				
At 1 August 2012	192.7	516.0	213.7	922.4
Exchange adjustments	7.4	20.0	8.0	35.4
Additions	7.8	33.0	15.7	56.5
Disposals	(8.3)	(15.1)	(7.8)	(31.2)
At 31 July 2013	199.6	553.9	229.6	983.1
Exchange adjustments	(20.0)	(58.0)	(23.0)	(101.0)
Additions	5.8	33.6	14.5	53.9
Disposals	(1.1)	(10.0)	(8.7)	(19.8)
<b>At 31 July 2014</b>	<b>184.3</b>	<b>519.5</b>	<b>212.4</b>	<b>916.2</b>
<b>Depreciation</b>				
At 1 August 2012	92.7	389.6	169.6	651.9
Exchange adjustments	3.4	15.1	6.7	25.2
Charge for the year	7.5	29.3	15.5	52.3
Disposals	(5.3)	(14.3)	(6.7)	(26.3)
At 31 July 2013	98.3	419.7	185.1	703.1
Exchange adjustments	(10.0)	(44.6)	(18.8)	(73.4)
Charge for the year	7.2	26.8	12.1	46.1
Disposals	(0.9)	(8.9)	(8.2)	(18.0)
<b>At 31 July 2014</b>	<b>94.6</b>	<b>393.0</b>	<b>170.2</b>	<b>657.8</b>
<b>Net book value at 31 July 2014</b>	<b>89.7</b>	<b>126.5</b>	<b>42.2</b>	<b>258.4</b>
Net book value at 31 July 2013	101.3	134.2	44.5	280.0
Net book value at 1 August 2012	100.0	126.4	44.1	270.5

## 14 Inventories

	31 July 2014 £m	31 July 2013 £m
<b>Inventories comprise</b>		
Raw materials and consumables	142.9	155.5
Work in progress	93.9	110.2
Finished goods	194.3	227.3
Less: payments on account	431.1 (3.8)	493.0 (17.4)
	<b>427.3</b>	475.6

The Group consumed £1,325.9m (2013: £1,408.7m) of inventories during the period. £21.4m (2013: £12.3m) was recognised as an expense resulting from the write-down of inventory and £4.1m (2013: £4.8m) was released to the consolidated income statement from inventory provisions charged in earlier years but no longer required.

**Notes to the accounts**  
**Continued**

## 15 Trade and other receivables

	31 July 2014 £m	31 July 2013 £m
<b>Non-current</b>		
Trade receivables	<b>25.8</b>	23.6
Accrued income	<b>3.6</b>	4.9
Prepayments	<b>0.7</b>	0.7
Other receivables	<b>4.9</b>	4.9
	<b>35.0</b>	34.1
<b>Current</b>		
Trade receivables	<b>577.8</b>	628.2
Accrued income	<b>17.6</b>	37.8
Prepayments	<b>12.8</b>	12.6
Other receivables	<b>26.6</b>	16.9
	<b>634.8</b>	695.5

Accrued income and prepayments have been separately disclosed following a review of the nature and liquidity of the balances.

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 receivables qualifying as financial instruments are classified as 'loans and receivables'. The maximum credit exposure arising from these financial assets is £624.4m (2013: £677.2m).

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% (2013: 4%) of Group revenue.

### Ageing of trade receivables

	31 July 2014 £m	31 July 2013 £m
Trade receivables which are not impaired and not yet due	<b>482.8</b>	516.7
Trade receivables which are not impaired and less than three months overdue	<b>92.5</b>	99.5
Trade receivables which are not impaired and more than three months overdue	<b>25.5</b>	30.9
Gross value of partially and fully provided receivables	<b>20.3</b>	22.5
	<b>621.1</b>	669.6
Provision for bad and doubtful debts	<b>(17.5)</b>	(17.8)
<b>Trade receivables</b>	<b>603.6</b>	651.8

## 16 Trade and other payables

	31 July 2014 £m	31 July 2013 £m
<b>Non-current</b>		
Other payables	<b>27.6</b>	31.0
<b>Current</b>		
Trade payables	<b>198.0</b>	213.5
Bills of exchange payable	<b>0.4</b>	2.7
Other payables	<b>8.2</b>	10.7
Other taxation and social security costs	<b>21.9</b>	23.0
Accruals	<b>192.4</b>	219.2
Deferred income	<b>43.2</b>	52.7
	<b>464.1</b>	521.8

Accruals and deferred income have been separately disclosed following a review of the nature and liquidity of the balances.

Trade and other payables, including accrued expenses and other payables qualifying as financial instruments, are accounted for at amortised cost and are categorised as other financial liabilities.

## 17 Financial assets

Available for sale financial assets include £111.1m (2013: £83.0m) 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 9 for additional details.

The Group also invests in early stage businesses that are developing or commercialising related technology. In the current year £0.2m (2013: £0.3m) was invested in detection technologies and £3.1m (2013: £nil) in interconnect technologies.

## 18 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 2014 £m	31 July 2013 £m
<b>Cash and cash equivalents</b>		
Net cash and deposits	<b>190.2</b>	393.8
<b>Short-term borrowings</b>		
Bank overdrafts	(1.1)	(7.3)
\$250m 6.05% US\$ Guaranteed notes 2014		(164.5)
Bank and other loans	(0.9)	(1.2)
Interest accrual	(10.5)	(14.1)
	<b>(12.5)</b>	(187.1)
<b>Long-term borrowings</b>		
£150m 7.25% Sterling Eurobond 2016	(149.7)	(149.6)
€300m 4.125% Eurobond 2017	(242.6)	(267.5)
\$175m 7.37% US\$ Private placement 2018	(103.6)	(115.3)
Revolving Credit Facility 2019	(106.6)	
\$250m 7.20% US\$ Guaranteed notes 2019	(147.4)	(163.8)
\$400m 3.625% US\$ Guaranteed notes 2022	(230.7)	(253.4)
Bank and other loans	(1.3)	(1.5)
	<b>(981.9)</b>	(951.1)
<b>Borrowings</b>	<b>(994.4)</b>	(1,138.2)
<b>Net debt</b>	<b>(804.2)</b>	(744.4)

On 14 May 2014 Smiths Group plc repaid the maturing 6.05% US\$ Guaranteed notes 2014.

Borrowings are accounted for at amortised cost and are categorised as other financial liabilities. See note 19 for a maturity analysis of borrowings. The borrowings repayable after five years are repayable in 2022.

Interest of £48.2m (2013: £49.7m) was charged to the consolidated income statement in this period in respect of public bonds.

### Net cash and cash equivalents

	31 July 2014 £m	31 July 2013 £m
Cash at bank and in hand	115.1	164.2
Short-term deposits	75.1	229.6
Cash and cash equivalents	<b>190.2</b>	393.8
Bank overdrafts	(1.1)	(7.3)
<b>Net cash and cash equivalents</b>	<b>189.1</b>	386.5

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

### Netting

Cash and overdraft balances in interest compensation cash pooling systems are reported gross on the balance sheet. The cash pooling agreements incorporate a legally enforceable right of net settlement. However there is no intention to settle the balances net, so these arrangements do not qualify for net presentation.

	Assets 31 July 2014 £m	Liabilities 31 July 2014 £m	Assets 31 July 2013 £m	Liabilities 31 July 2013 £m
Gross amount recognised	<b>59.3</b>		71.8	(6.4)
Related assets and liabilities subject to master netting agreements			(6.4)	6.4
<b>Net exposure</b>	<b>59.3</b>		65.4	

The balances held in zero balancing cash pooling arrangements are not included in this disclosure, since these arrangements have daily settlement of balances.

## 18 Borrowings and net debt continued

### Movements in net debt

	Net cash and cash equivalents £m	Other short-term borrowing £m	Long-term borrowings £m	Net debt £m
At 31 July 2013	386.5	(179.8)	(951.1)	(744.4)
Foreign exchange gains and losses	(25.9)	15.8	80.4	70.3
Net cash outflow	(171.5)			(171.5)
Repayment of borrowings		150.1	29.5	179.6
Drawdown of borrowings			(138.0)	(138.0)
Capitalisation, interest accruals and unwind of capitalised fees		3.3	(0.7)	2.6
Fair value movement from interest rate hedging		0.1	(2.9)	(2.8)
Change in maturity analysis		(0.9)	0.9	
<b>At 31 July 2014</b>	<b>189.1</b>	<b>(11.4)</b>	<b>(981.9)</b>	<b>(804.2)</b>

### Secured loans

Loans amounting to £2.3m (2013: £2.7m) were secured on plant and equipment with a book value of £2.3m (2013: £2.5m).

## 19 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 15.

### (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 2014				
	Sterling £m	US\$ £m	Euro £m	Other £m	Total £m
<b>Financial assets and liabilities</b>					
Financial instruments included in trade and other receivables	33.7	322.4	115.3	153.0	624.4
Financial instruments included in trade and other payables	(36.4)	(171.0)	(68.7)	(60.7)	(336.8)
Cash and cash equivalents	23.8	76.9	27.0	62.5	190.2
Borrowings not designated as net investment hedges	(149.6)	(10.4)	(3.5)		(163.5)
	(128.5)	217.9	70.1	154.8	314.3
Exclude balances held in operations with the same functional currency	127.9	(167.3)	(71.3)	(141.2)	(251.9)
Exposure arising from intra-group loans		(37.2)		(2.9)	(40.1)
Forward foreign exchange contracts	(87.1)	29.4	30.8	26.9	
	(87.7)	42.8	29.6	37.6	22.3

## 19 Financial risk management continued

	At 31 July 2013				
	Sterling £m	US\$ £m	Euro £m	Other £m	Total £m
<b>Financial assets and liabilities</b>					
Financial instruments included in trade and other receivables	34.8	349.0	145.2	148.2	677.2
Financial instruments included in trade and other payables	(34.0)	(191.0)	(82.6)	(70.9)	(378.5)
Cash and cash equivalents	129.5	142.7	34.5	87.1	393.8
Borrowings not designated as net investment hedges	(149.9)	(13.8)	(9.6)	(0.4)	(173.7)
	(19.6)	286.9	87.5	164.0	518.8
Exclude balances held in operations with the same functional currency	19.1	(168.3)	(87.8)	(163.5)	(400.5)
Exposure arising from intra-group loans		(61.6)		4.3	(57.3)
Forward foreign exchange contracts	(1.0)	(75.6)	76.6		
	(1.5)	(18.6)	76.3	4.8	61.0

Financial instruments included in trade and other receivables comprise trade receivables, accrued income and other receivables which qualify as financial instruments. Similarly, financial instruments included in trade and other payables comprise trade payables, accrued expenses and other payables 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 2014 £m	Gain/(loss) recognised in reserves 31 July 2014 £m	Impact on profit for the year 31 July 2013 £m	Gain/(loss) recognised in reserves 31 July 2013 £m
US dollar	3.8	(0.6)	2.9	(1.7)
Euro	(1.3)	0.1	5.3	2.0
Sterling	3.9	1.1	(0.6)	0.9

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 2014 contracts with a nominal value of £200.9m (2013: £234.0m) were designated as hedging instruments. In addition, the Group had outstanding foreign currency contracts with a nominal value of £237.1m (2013: £87.5m) 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 20.

The majority of hedged transactions will be recognised in the consolidated 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 100% are for periods of 12 months or less (2013: 99.9%).

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

	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
Brought forward cash-flow hedge reserve at start of year	1.8	(4.7)
Exchange adjustments		(0.2)
Gains/(losses) on effective cash-flow hedges recognised in equity	0.8	11.0
Amounts removed from the hedge reserve and recognised in the following lines on the income statement		
- revenue	(4.2)	(3.8)
- cost of sales	1.8	(0.5)
<b>Carried forward cash-flow hedge reserve at end of year</b>	<b>0.2</b>	<b>1.8</b>

## 19 Financial risk management continued

### Translational currency exposure

The Group has significant investments in overseas operations, particularly in the United States and Europe. As a result, the sterling value of the Group's balance sheet can be significantly affected by movements in exchange rates. The Group seeks to mitigate the effect of these translational currency exposures by matching the net investment in overseas operations with borrowings denominated in their functional currencies, except where significant adverse interest differentials or other factors would render the cost of such hedging activity uneconomic. This is achieved by borrowing primarily in the relevant currency or in some cases indirectly through the use of forward foreign exchange contracts and cross-currency swaps.

### Net investment hedges

The table below sets out the currency of loans and swap contracts designated as net investment hedges:

	At 31 July 2014				
	Sterling £m	US\$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges		(588.3)	(242.6)		(830.9)
Currency swap contracts	184.4	(44.6)	(49.7)	(90.1)	
	184.4	(632.9)	(292.3)	(90.1)	(830.9)

	At 31 July 2013				
	Sterling £m	US\$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges		(697.0)	(267.5)		(964.5)
Currency swap contracts	197.1	(56.2)	(52.4)	(88.5)	
	197.1	(753.2)	(319.9)	(88.5)	(964.5)

At 31 July 2014 swap contracts in other currencies hedged the Group's exposure to Canadian dollars, Japanese yen and Chinese renminbi (31 July 2013: Canadian dollars, Japanese yen and Chinese renminbi).

Of the contracts designated as net investment hedges, 58% (2013: 55%) are current and the balance matures over the next two years (2013: 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 2014 £m	Year ended 31 July 2013 £m
Brought forward net investment hedge reserve at start of year	(175.8)	(120.1)
Amounts deferred in the period on effective net investment hedges	117.9	(55.7)
<b>Carried forward net investment hedge reserve at end of year</b>	<b>(57.9)</b>	<b>(175.8)</b>

The fair values of these net investment hedges are subject to exchange rate movements. Based on the hedging instruments in place at the year end, if the specified currencies were to strengthen 10% while all other market rates remained constant, it would have the following effect:

	Loss recognised in hedge reserve 31 July 2014 £m	Loss recognised in hedge reserve 31 July 2013 £m
US dollar	63.7	76.2
Euro	28.7	29.2

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 70% of the level of gross debt. This is achieved primarily through fixed rate borrowings, and also through the use of interest rate swaps. At 31 July 2014 63% (2013: 76%) of the Group's gross borrowings were at fixed interest rates, after adjusting for interest rate swaps and the impact of short maturity derivatives designated as net investment hedges. In May 2014 the \$250m 6.05% fixed rate Notes were partly refinanced using floating rate bank debt and the fixed rate metric is being managed in the short term under the medium term target of 70%. The Group monitors its fixed rate risk profile against both gross and net debt. For medium-term planning, it now focuses on gross debt to eliminate the fluctuations of variable cash levels over the cycle.

The weighted average interest rate on borrowings and cross-currency swaps at 31 July 2014, after interest rate swaps, is 4.5% (2013: 5.2%).

## 19 Financial risk management 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, with the borrowings adjusted for the impact of interest rate hedging. 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 2014 £m	Cash and cash equivalents 31 July 2014 £m	Borrowings 31 July 2014 £m	Fair value of borrowings 31 July 2014 £m	Available for sale investments 31 July 2013 £m	Cash and cash equivalents 31 July 2013 £m	Borrowings 31 July 2013 £m	Fair value of borrowings 31 July 2013 £m
<b>Fixed interest</b>								
Less than one year				(0.9)			(165.7)	(170.9)
Between one and five years				(544.2)			(423.3)	(483.7)
Greater than five years	<b>111.1</b>		<b>(146.4)</b>	<b>(142.4)</b>	83.0		(327.3)	(349.0)
Total fixed interest financial assets/(liabilities)	<b>111.1</b>		<b>(691.5)</b>	<b>(762.5)</b>	83.0		(916.3)	(1,003.6)
Floating rate interest financial assets/(liabilities)		<b>168.9</b>	<b>(302.9)</b>	<b>(302.9)</b>		339.8	(221.9)	(221.9)
Total interest-bearing financial assets/(liabilities)	<b>111.1</b>	<b>168.9</b>	<b>(994.4)</b>	<b>(1,065.4)</b>	83.0	339.8	(1,138.2)	(1,225.5)
Non-interest-bearing assets/(liabilities) in the same category	<b>5.8</b>	<b>21.3</b>			3.1	54.0		
<b>Total</b>	<b>116.9</b>	<b>190.2</b>	<b>(994.4)</b>	<b>(1,065.4)</b>	86.1	393.8	(1,138.2)	(1,225.5)

### Interest rate hedging

At 31 July 2014 the Group has designated US\$150.0m interest rate swaps which mature on 12 October 2022 and €120.0m interest rate swaps which mature on 5 May 2017 as fair value hedges on the US\$ 2022 Guaranteed notes and the € 2017 Eurobond respectively which mature on the same dates. At 31 July 2013 the same hedging arrangements were in place. 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 20. The effect of the swaps is to convert £184.0m (2013: £203.8m) 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 2014, 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 £0.7m (2013: £0.4m) impact on the Group's profit before tax.

Based on the investments held at 31 July 2014 a one percentage point (100 basis points) increase in sterling interest rates would reduce the carrying value of investments by £15.0m (2013: £11.8m), 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 placing cash deposits with highly rated relationship bank counterparties within counterparty limits established by reference to their Standard & Poor's long-term debt rating. 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 £307.1m at 31 July 2014 (2013: £479.9m).

	31 July 2014 £m	31 July 2013 £m
UK government bonds with at least a AA credit rating (note 17)	<b>111.1</b>	83.0
Cash at banks with at least a AA- credit rating	<b>111.0</b>	230.2
Cash at banks with a A+ credit rating	<b>43.2</b>	89.6
Cash at other banks	<b>36.0</b>	74.0
Other investments	<b>5.8</b>	3.1
<b>Total</b>	<b>307.1</b>	479.9

At 31 July 2014 the maximum exposure with a single bank for deposits and cash is £59.7m (2013: £121.8m), whilst the maximum mark to market exposure for derivatives is £2.6m (2013: £3.1m). These banks have AA- and A credit rating, respectively (2013: AA- and A).

## 19 Financial risk management continued

### (d) Liquidity risk

#### Borrowing facilities

The Board policy specifies the maintenance of unused committed credit facilities of at least £200m at all times to ensure it has sufficient available funds for operations and planned development, which is provided by a multi-currency revolving credit facility.

On 19 February 2014 Smiths completed the refinancing of its existing \$800m Revolving Credit Facility which was due to mature in December 2015. The new \$800m Revolving Credit Facility matures in February 2019 with two uncommitted extension options. At the balance sheet date the Group had the following undrawn credit facilities:

	31 July 2014 £m	31 July 2013 £m
Expiring within one year		
Expiring between one and two years		
Expiring after two years	<b>367.2</b>	527.1
	<b>367.2</b>	527.1

#### Cash deposits

As at 31 July 2014, £75.1m (2013: £229.6m) of cash and cash equivalents was on deposit with various banks of which £4.0m (2013: £167.1m) was on deposit in the UK.

#### Gross contractual cash-flows for borrowings

	Borrowings (Note 18) 31 July 2014 £m	Fair value adjustments 31 July 2014 £m	Contractual interest payments 31 July 2014 £m	Total contractual cash-flows 31 July 2014 £m	Borrowings (Note 18) 31 July 2013 £m	Fair value adjustments 31 July 2013 £m	Contractual interest payments 31 July 2013 £m	Total contractual cash-flows 31 July 2013 £m	
Less than one year	(12.5)		(36.2)	(48.7)	(187.1)		(0.2)	(51.2)	(238.5)
Between one and two years	(150.4)	(0.3)	(47.6)	(198.3)	(0.9)		(51.7)	(52.6)	
Between two and three years	(243.2)	4.8	(36.7)	(275.1)	(150.1)		(51.6)	(202.1)	
Between three and four years	(103.6)		(26.9)	(130.5)	(267.5)		5.1	(40.7)	(303.1)
Between four and five years	(254.0)	(0.7)	(19.2)	(273.9)	(115.3)		(0.1)	(29.9)	(145.3)
Greater than five years	(230.7)	(6.2)	(30.1)	(267.0)	(417.3)		(11.0)	(54.9)	(483.2)
<b>Total</b>	<b>(994.4)</b>	<b>(2.4)</b>	<b>(196.7)</b>	<b>(1,193.5)</b>	(1,138.2)		(6.6)	(280.0)	(1,424.8)

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 2014 £m	Payments 31 July 2014 £m	Net cash-flow 31 July 2014 £m	Receipts 31 July 2013 £m	Payments 31 July 2013 £m	Net cash-flow 31 July 2013 £m
<b>Assets</b>						
Less than one year	256.5	(247.2)	9.3	214.2	(204.2)	10.0
Greater than one year	81.4	(73.2)	8.2	12.0	(5.3)	6.7
<b>Liabilities</b>						
Less than one year	222.2	(225.4)	(3.2)	171.9	(176.6)	(4.7)
Greater than one year	25.3	(15.5)	9.8	102.3	(93.8)	8.5
<b>Total</b>	<b>585.4</b>	<b>(561.3)</b>	<b>24.1</b>	500.4	(479.9)	20.5

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 20.

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

The contractual cash-flows for financial liabilities included in trade and other payables are: £323.4m (2013: £360.8m) due in less than one year, £8.7m (2013: £12.6m) due between one and five years and £4.7m (2013: £5.1m) due after more than five years.

## 20 Derivative financial instruments

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 2014			
	Contract or underlying nominal amount		Fair value	
	£m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	200.9	2.3	(2.7)	(0.4)
Foreign exchange contracts (not hedge accounted)	237.1	1.4	(1.4)	
Total foreign exchange contracts	438.0	3.7	(4.1)	(0.4)
Currency swaps (net investment hedges)	213.8	7.5	(0.6)	6.9
Interest rate swaps (fair value hedges)	184.0	5.7	(4.2)	1.5
<b>Total financial derivatives</b>	<b>835.8</b>	<b>16.9</b>	<b>(8.9)</b>	<b>8.0</b>
Balance sheet entries				
Non-current		9.2	(4.3)	4.9
Current		7.7	(4.6)	3.1
<b>Total financial derivatives</b>		<b>16.9</b>	<b>(8.9)</b>	<b>8.0</b>

	At 31 July 2013			
	Contract or underlying nominal amount		Fair value	
	£m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	234.0	5.0	(2.3)	2.7
Foreign exchange contracts (not hedge accounted)	87.5	1.1	(1.4)	(0.3)
Total foreign exchange contracts	321.5	6.1	(3.7)	2.4
Currency swaps (net investment hedges)	197.1	2.0	(5.4)	(3.4)
Interest rate swaps (fair value hedges)	203.8	6.4	(7.7)	(1.3)
<b>Total financial derivatives</b>	<b>722.4</b>	<b>14.5</b>	<b>(16.8)</b>	<b>(2.3)</b>
Balance sheet entries				
Non-current		6.4	(11.0)	(4.6)
Current		8.1	(5.8)	2.3
<b>Total financial derivatives</b>		<b>14.5</b>	<b>(16.8)</b>	<b>(2.3)</b>

### Currency swaps not hedge accounted

These contracts comprise derivatives which were previously part of the net investment hedging programme and matching contracts to eliminate this exposure. There is no further net exposure arising from these contracts.

### Accounting for other derivative contracts

Any foreign exchange contracts which are not formally designated as hedges and tested are classified as 'held for trading' and not hedge accounted.

### Netting

International Swaps and Derivatives Association (ISDA) master netting agreements are in place with derivative counterparties except for contracts traded on a dedicated international electronic trading platform used for operational foreign exchange hedging. Under these agreements if a credit event occurs, all outstanding transactions under the ISDA are terminated and only a single net amount per counterparty is payable in settlement of all transactions. The ISDA agreements do not meet the criteria for offsetting, since the offsetting is enforceable only if specific events occur in the future, and there is no intention to settle the contracts on a net basis.

	Assets 31 July 2014 £m	Liabilities 31 July 2014 £m	Assets 31 July 2013 £m	Liabilities 31 July 2013 £m
Gross value of assets and liabilities	16.9	(8.9)	14.5	(16.8)
Related assets and liabilities subject to master netting agreements	(3.8)	3.8	(5.7)	5.7
<b>Net exposure</b>	<b>13.1</b>	<b>(5.1)</b>	<b>8.8</b>	<b>(11.1)</b>

## 21 Fair value of financial instruments

	Notes	Carrying value 31 July 2014 £m	Fair value 31 July 2014 £m	Carrying value 31 July 2013 £m	Fair value 31 July 2013 £m
<b>Level 1 valuations</b>					
Financial assets – other investments	17	<b>111.1</b>	<b>111.1</b>	83.0	83.0
<b>Level 2 valuations</b>					
Financial derivatives – assets	20	<b>16.9</b>	<b>16.9</b>	14.5	14.5
Borrowings	18	<b>(994.4)</b>	<b>(1,065.4)</b>	(1,138.2)	(1,225.5)
Financial derivatives – liabilities	20	<b>(8.9)</b>	<b>(8.9)</b>	(16.8)	(16.8)
<b>Level 3 valuations</b>					
Financial assets – other investments		<b>5.8</b>	<b>5.8</b>	3.1	3.1

Investments with level 1 valuations comprise quoted government bonds.

Derivatives, including forward exchange contracts, currency swaps, interest rate instruments, and embedded derivatives, are valued at the net present value of the future cash-flows calculated using market data at the balance sheet date (principally exchange rates and yield curves).

Borrowings are valued at the net present value of the future cash-flows using credit spreads and yield curves derived from market data. 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.

Cash, trade receivables and trade payables are excluded from this table because carrying value is a reasonable approximation to fair value for all these assets and liabilities.

## 22 Commitments

### Operating lease commitments – minimum lease payments

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

	31 July 2014		31 July 2013	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Payments due				
- not later than one year	<b>28.5</b>	<b>7.2</b>	32.3	8.2
- later than one year and not later than five years	<b>55.9</b>	<b>8.0</b>	69.0	8.8
- later than five years	<b>8.4</b>		12.6	
	<b>92.8</b>	<b>15.2</b>	113.9	17.0

### Other commitments

At 31 July 2014, commitments, comprising bonds and guarantees arising in the normal course of business, amounted to £152.8m (2013: £166.0m), including pension commitments of £50.8m (2013: £52.1m).

## 23 Provisions and contingent liabilities

	Trading £m	Exceptional and legacy			Total £m
		John Crane, Inc. litigation £m	Titeflex Corporation litigation £m	Other £m	
At 31 July 2013	40.7	210.0	65.6	19.9	336.2
Exchange adjustments	(4.2)	(21.7)	(6.7)	(1.3)	(33.9)
Provision charged	34.5	47.4	14.1	6.5	102.5
Provision released	(5.9)		(4.1)	(0.7)	(10.7)
Unwind of provision discount		4.7	1.3		6.0
Utilisation	(21.9)	(36.3)	(9.1)	(5.6)	(72.9)
<b>At 31 July 2014</b>	<b>43.2</b>	<b>204.1</b>	<b>61.1</b>	<b>18.8</b>	<b>327.2</b>
Current liabilities	31.7	25.5	13.5	11.2	81.9
Non-current liabilities	11.5	178.6	47.6	7.6	245.3
<b>At 31 July 2014</b>	<b>43.2</b>	<b>204.1</b>	<b>61.1</b>	<b>18.8</b>	<b>327.2</b>

The John Crane, Inc. and Titeflex Corporation litigation provisions are the only provisions which are discounted.

### Trading

#### Warranty provision and product liability

At 31 July 2014 there are warranty and product liability provisions of £35.3m (2013: £40.0m). 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.

#### Commercial disputes and litigation in respect of ongoing business activities

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. Trading provisions include £7.0m in connection with ongoing price audits of overhead cost recovery charges associated with certain historical supply arrangements.

### Contingent liabilities

In the ordinary course of its business, the Group is subject to commercial disputes and litigation such as government price audits, 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.

The Group operates in some markets where the risk of unethical or corrupt behaviour is material and has procedures, including an employee 'Ethics Alertline', to help it identify potential issues. Such procedures will, from time to time, give rise to internal investigations, sometimes conducted with external support, to ensure that Smiths Group properly understands risks and concerns and can take steps both to manage immediate issues and to improve its practices and procedures for the future. From time to time the Group also 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.

### Exceptional and legacy

#### 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. Pending the outcome of that litigation, JCI has met 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.

## 23 Provisions and contingent liabilities continued

### Exceptional and legacy continued

#### John Crane, Inc. continued

##### John Crane, Inc. litigation provision

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 235,000 claims (2013: 230,000 claims) against JCI have been dismissed before trial over the last 35 years. JCI is currently a defendant in cases involving approximately 80,000 claims (2013: 81,000 claims). Despite the large number of claims brought against JCI, since the inception of the litigation it has had final judgments against it, after appeals, in 131 cases (2013: 121 cases) over the period, and has had to pay awards amounting to approximately US\$149m (2013: US\$120m). JCI has also incurred significant additional defence costs. The litigation involves claims for a number of allegedly asbestos related diseases, with awards, when made, for mesothelioma tending to be larger than those for the other diseases JCI's ability to defend mesothelioma cases successfully is, therefore, likely to have a significant impact on its annual aggregate adverse judgment and defence costs.

The provision is based on past history and published tables of asbestos incidence projections and is determined using asbestos valuation experts, Bates White LLC. Whilst published incidence curves can be used to estimate the likely future pattern of asbestos related disease, John Crane, Inc.'s claims experience is significantly impacted by other factors which influence the US litigation environment. These can include: changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels; and legislative and procedural changes in both the state and federal court systems. 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.

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 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 7]. Set out below is the gross, discounted and post-tax information relating to this provision:

	31 July 2014 £m	31 July 2013 £m
Gross provision	<b>226.8</b>	232.8
Discount	<b>(22.7)</b>	(22.8)
Discounted pre-tax provision	<b>204.1</b>	210.0
Deferred tax	<b>(68.4)</b>	(60.7)
Discounted post-tax provision	<b>135.7</b>	149.3

##### John Crane, Inc. litigation provision sensitivities

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.

Statistical analysis of the provision indicates that there is a 50% probability that the total future spend will fall between £212m and £239m (2013: between £221m and £240m), compared to the gross provision value of £226.8m (2013: £232.8m).

##### John Crane, Inc. contingent liabilities

Provision has been made for future defence costs and the cost of adverse judgments expected to occur. JCI's claims experience is significantly impacted by other factors which influence the US litigation environment. These can include: changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels; and legislative and procedural changes in both the state and federal court systems. As a result, whilst the Group anticipates that asbestos litigation will continue beyond the period covered by the provision, the uncertainty surrounding the US litigation environment beyond this point is such that the costs cannot be reliably estimated.

##### 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. It has also received a number of product liability claims regarding this product, some in the form of purported class actions. 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. Equivalent third-party products in the US marketplace face similar challenges.

## 23 Provisions and contingent liabilities continued

### Exceptional and legacy continued

#### Titeflex Corporation continued

##### Titeflex Corporation litigation provision

The continuing progress of claims and the pattern of settlement, together with the recent market place activity, 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 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.

The provision of £61.1m (2013: £65.6m) 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 7).

	31 July 2014 £m	31 July 2013 £m
Gross provision	<b>67.5</b>	72.3
Discount	<b>(6.4)</b>	(6.7)
Discounted pre-tax provision	<b>61.1</b>	65.6
Deferred tax	<b>(23.2)</b>	(24.9)
Discounted post-tax provision	<b>37.9</b>	40.7

##### Titeflex Corporation litigation provision sensitivities

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.

##### Titeflex Corporation contingent liabilities

The Group anticipates that litigation might continue beyond the period covered by the provision. However, the uncertainty surrounding the US litigation environment beyond this point (which reflects factors such as changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels; and legislative and procedural changes in both the state and federal court systems) is such that the costs cannot be reliably estimated.

##### Other exceptional and legacy

Legacy provisions comprise provisions relating to former business activities and properties no longer used by Smiths. Exceptional provisions comprise all provisions which were disclosed as exceptional items when they were charged to the consolidated income statement.

These provisions cover exceptional reorganisation, vacant properties, disposal indemnities and litigation in respect of old products and discontinued business activities.

##### Reorganisation and property

At 31 July 2014 provisions of £5.7m relate to Fuel for Growth, £6.5m relate to onerous leases and dilapidations provisions, and £1.4m relate to actual and potential environmental issues for sites which are no longer occupied by Smiths operations.

The fuel for growth provisions are expected to be spent in 2015.

At 31 July 2013, there was a provision of £10.7m relating to the performance improvement programme in Smiths Detection.

##### Disposal

Other provisions include disposal provisions of £3.4m (2013: £3.6m) relating 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.

## 24 Share capital

	Number of shares	Issued capital £m	Consideration £m
<b>Ordinary shares of 37.5p each</b>			
At 31 July 2012	392,725,943	147.3	
Exercise of share options	1,092,567	0.4	9.3
At 31 July 2013	393,818,510	147.7	
Exercise of share options	637,625	0.2	5.8
<b>Total share capital at 31 July 2014</b>	<b>394,456,135</b>	<b>147.9</b>	

At 31 July 2014 all of the issued share capital was in free issue. All issued shares are fully paid.

## 25 Dividends

The following dividends were declared and paid in the period:

	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
Ordinary final dividend of 27.00p for 2013 [2012: 26.25p] paid 22 November 2013	<b>106.4</b>	103.2
Special dividend of 30.00p for 2013 paid 22 November 2013	<b>118.3</b>	
Ordinary interim dividend of 12.75p for 2014 [2013: 12.50p] paid 25 April 2014	<b>50.3</b>	49.2
	<b>275.0</b>	152.4

The final dividend for the year ended 31 July 2014 of 27.5p per share was recommended by the Board on 16 September 2014 and will be paid to shareholders on 21 November 2014, 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 24 October 2014.

## 26 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 [2013: nil] shares to the Trust, and the Trust purchased 895,489 shares [2013: 1,027,540 shares] in the market. At 31 July 2014 the Trust held 855 [2013: 855] ordinary shares.

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 related assets and liabilities, net litigation provisions relating to exceptional items and net debt. 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 15.7% [2013: 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% [2013: 13%].

In November 2013 the Group returned £118.3m to shareholders in the form of a special dividend of 30.0p per share. This has brought the ratio of net debt to headline EBITDA of 1.4 [2013: 1.2] close to the medium term target of 1.5 to 2.0. The Group's robust balance sheet and record of strong cash generation is more than able to fund the immediate investment needs and other legacy obligations.

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 2014 the Group had a credit rating of BBB+/Baa2 [2013: 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 2014 these measures were 97% [2013: 98%] and 1.4 [2013: 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 and to meet its legacy liabilities.

### Hedge reserve

	31 July 2014 £m	31 July 2013 £m
The hedge reserve on the balance sheet comprises		
- cash-flow hedge reserve	<b>0.2</b>	1.8
- net investment hedge reserve	<b>(57.9)</b>	(175.8)
	<b>(57.7)</b>	(174.0)

See transactional currency exposure risk management disclosures in note 19 for additional details of cash-flow hedges, and translational currency exposure risk management disclosure also in note 19 for additional details of net investment hedges.

## 27 Cash-flow

### Cash-flow from operating activities

	Year ended 31 July 2014 £m	Year ended 31 July 2013 [restated] £m
Operating profit – continuing	<b>377.6</b>	486.5
Amortisation of intangible assets	<b>73.0</b>	81.1
Loss/(profit) on disposal of property, plant and equipment	<b>2.6</b>	(4.3)
Profit on disposal of business	<b>(2.8)</b>	(0.9)
Depreciation of property, plant and equipment	<b>46.1</b>	52.3
Share-based payment expense	<b>9.2</b>	12.1
Retirement benefits	<b>(78.9)</b>	(71.0)
Decrease/(increase) in inventories	<b>3.8</b>	(20.3)
Increase in trade and other receivables	<b>(13.1)</b>	(30.3)
Increase/(decrease) in trade and other payables	<b>(8.6)</b>	31.8
Increase/(decrease) in provisions	<b>18.9</b>	(9.9)
Cash generated from operations	<b>427.8</b>	527.1
Interest	<b>(76.2)</b>	(59.6)
Tax paid	<b>(95.4)</b>	(114.1)
<b>Net cash inflow from operating activities</b>	<b>256.2</b>	353.4

### 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 2014 £m	Year ended 31 July 2013 £m
<b>Net cash inflow from operating activities</b>	<b>256.2</b>	353.4
Exclude:		
Interest	<b>76.2</b>	59.6
Tax paid	<b>95.4</b>	114.1
Cash outflow in respect of exceptional operating items	<b>73.0</b>	43.9
Pension deficit payments	<b>82.2</b>	71.4
Include:		
Expenditure on capitalised development, other intangible assets and property, plant and equipment	<b>(94.0)</b>	(96.0)
Disposals of property, plant and equipment in the ordinary course of business	<b>0.6</b>	1.5
<b>Headline operating cash-flow</b>	<b>489.6</b>	547.9

#### Free cash-flow

	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m
Net cash inflow from operating activities	<b>256.2</b>	353.4
Expenditure on capitalised development, other intangible assets and property, plant and equipment	<b>(94.0)</b>	(96.0)
Disposals of property, plant and equipment	<b>4.7</b>	3.9
Investment in financial assets relating to pensions financing	<b>(24.0)</b>	(24.0)
<b>Free cash-flow</b>	<b>142.9</b>	237.3
Investment in other financial assets	<b>(3.3)</b>	(0.3)
Acquisition of businesses	<b>(1.3)</b>	(0.5)
Disposal of businesses	<b>3.2</b>	0.3
Net cash-flow used in financing activities	<b>(313.0)</b>	(66.7)
<b>Net (decrease)/increase in cash and cash equivalents</b>	<b>(171.5)</b>	170.1

# Unaudited Group financial record 2010-2014

	<b>Year ended 31 July 2014 £m</b>	<b>Year ended 31 July 2013 £m</b>	<b>Year ended 31 July 2012 £m</b>	<b>Year ended 31 July 2011 £m</b>	<b>Year ended 31 July 2010 £m</b>
<b>Revenue</b>	<b>2,951.6</b>	3,108.6	3,030.1	2,842.0	2,769.6
<b>Headline operating profit</b>	<b>504.4</b>	559.7	553.7	516.9	492.4
Amortisation of acquired intangible assets	(38.7)	(46.6)	(61.6)	(49.5)	(42.1)
Exceptional items	(81.6)	(19.9)	(85.5)	(29.4)	(14.4)
Legacy retirement benefits (2013 restated)*	(6.5)	(6.7)			
<b>Operating profit (2013 restated)*</b>	<b>377.6</b>	486.5	406.6	438.0	435.9
Net finance costs (2013 restated)*	(75.6)	(90.8)	(46.4)	(44.4)	(64.6)
Share of post-tax profits of associated companies			5.7	4.3	1.8
<b>Profit before taxation (2013 restated)*</b>	<b>302.0</b>	395.7	365.9	397.9	373.1
Taxation (2013 restated)*	(67.4)	(79.1)	(107.6)	(91.8)	(78.9)
<b>Profit after taxation – continuing operations (2013 restated)*</b>	<b>234.6</b>	316.6	258.3	306.1	294.2
<b>Profit/(loss) after taxation – discontinued operations</b>	<b>0.1</b>		[0.1]	79.0	16.4
<b>Shareholders' equity</b>	<b>1,237.4</b>	1,486.0	972.8	1,373.5	1,094.8
Represented by					
- intangible assets	<b>1,543.6</b>	1,746.0	1,717.1	1,610.2	1,638.6
- property, plant & equipment and investments	<b>375.3</b>	366.1	331.4	332.9	343.3
- net current assets/provisions/retirement benefit liabilities	<b>122.7</b>	118.3	(284.3)	159.4	(50.3)
Net borrowings	<b>(804.2)</b>	(744.4)	(791.4)	(729.0)	(836.8)
<b>Funds employed</b>	<b>1,237.4</b>	1,486.0	972.8	1,373.5	1,094.8
<b>Ratios</b>					
Headline operating profit: turnover (%)	<b>17.1</b>	18.0	18.2	18.2	17.8
Headline effective tax rate (%)	<b>27.0</b>	26.5	26.5	26.5	24.7
Return on capital employed (%)	<b>15.7</b>	16.6	16.5	16.4	15.9
Return on shareholders' funds (%)	<b>14.9</b>	17.8	18.3	17.7	18.4
<b>Cash-flow</b>					
Headline operating cash	<b>489.6</b>	547.9	548.6	488.7	564.8
Headline operating cash conversion (%)	<b>97</b>	98	99	95	115
Free cash-flow (before acquisitions and dividends, after capital expenditure)	<b>142.9</b>	237.3	217.0	236.1	331.3
Free cash-flow per share (p)	<b>36.2</b>	60.3	55.3	60.4	84.9
<b>Earnings per share</b>					
Headline earnings per share (p)	<b>81.8</b>	92.7	92.6	86.5	83.4
<b>Dividends</b>					
Pence per share	<b>40.25</b>	39.50	38.00	36.25	34.00
Special dividend		30.00			
Headline dividend cover	<b>2.0</b>	2.3	2.4	2.4	2.5
<b>Number of employees (000s)</b>					
United Kingdom	<b>1.8</b>	1.9	1.9	2.0	2.0
Overseas	<b>21.4</b>	21.4	21.3	20.9	21.6
	<b>23.2</b>	23.3	23.2	22.9	23.6

\*The years ending 2012, 2011 and 2010 have not been restated for the adoption of IAS 19 (revised 2011). As a result, the statutory operating profit is higher, since it does not include administration costs for retirement benefit schemes, and statutory finance costs are lower, since they benefit from higher interest credits on pension assets. There is no impact on figures reporting on a headline basis.

# Unaudited supplementary consolidated income statement – US dollar translation

	Year ended 31 July 2014	Year ended 31 July 2013 (restated)
	\$m	\$m
<b>Continuing operations</b>		
Revenue	<b>4,849</b>	4,866
Cost of sales	<b>(2,671)</b>	(2,652)
Gross profit	<b>2,178</b>	2,214
Sales and distribution costs	<b>(654)</b>	(666)
Administrative expenses	<b>(904)</b>	(786)
<b>Operating profit</b>	<b>620</b>	762
Comprising		
– headline operating profit	<b>828</b>	876
– exceptional items, amortisation of acquired intangibles	<b>(208)</b>	(114)
	<b>620</b>	762
Interest receivable	4	4
Interest payable	(102)	(101)
Other financing losses	(12)	(9)
Net finance charges – retirement benefits	(14)	(36)
Finance costs	(124)	(142)
<b>Profit before taxation</b>	<b>496</b>	620
Comprising		
– headline profit before taxation	<b>730</b>	780
– exceptional items, amortisation of acquired intangibles and other financing gains and losses	<b>(234)</b>	(160)
	<b>496</b>	620
Taxation	(111)	(124)
<b>Profit after taxation – continuing operations</b>	<b>385</b>	496
Profit – discontinued operations		
<b>Profit for the year</b>	<b>385</b>	496
Attributable to		
Smiths Group shareholders	<b>382</b>	493
Non-controlling interests	<b>3</b>	3
	<b>385</b>	496
<b>Earnings per share</b>		
Basic	<b>96.9c</b>	125.4c
Diluted	<b>95.9c</b>	124.1c

Assets and liabilities have been translated into US dollars at the exchange rate at the date of that balance sheet and income, expenses and cash-flows are translated at average exchange rates for the period. This reflects the accounting approach that Smiths Group plc would use if the Group moved to reporting in US dollars without making any changes to its Group structure or financing arrangements.

# Unaudited supplementary consolidated statement of comprehensive income – US dollar translation

	Year ended 31 July 2014	Year ended 31 July 2013 (restated)
	\$m	\$m
Profit for the period	<b>385</b>	496
<b>Other comprehensive income</b>		
Actuarial (losses)/gains on retirement benefits	<b>(126)</b>	511
Taxation recognised on actuarial movements	<b>10</b>	(61)
<b>Other comprehensive income and expenditure which will not be reclassified to the consolidated income statement</b>		
Other comprehensive income which will be, or has been, reclassified	<b>(116)</b>	450
Exchange gains/(losses)	<b>(179)</b>	84
Fair value gains/(losses)		
– on available for sale financial assets	5	
– deferred in the period on cash-flow and net investment hedges	<b>195</b>	(70)
– reclassified to income statement	<b>(4)</b>	(7)
Taxation recognised on fair value gains and losses		(2)
<b>Total other comprehensive income</b>	<b>(99)</b>	455
<b>Total comprehensive income</b>	<b>286</b>	951
Attributable to		
Smiths Group shareholders	<b>284</b>	952
Non-controlling interests	<b>2</b>	(1)
	<b>286</b>	951

# Unaudited supplementary consolidated balance sheet – US dollar translation

	31 July 2014 \$m	31 July 2013 \$m
<b>Non-current assets</b>		
Intangible assets	2,606	2,650
Property, plant and equipment	436	425
Financial assets – other investments	197	131
Retirement benefit assets	207	185
Deferred tax assets	312	281
Trade and other receivables	59	52
Financial derivatives	16	10
	<b>3,833</b>	3,734
<b>Current assets</b>		
Inventories	722	722
Current tax receivable	57	51
Trade and other receivables	1,072	1,055
Cash and cash equivalents	321	598
Financial derivatives	13	12
	<b>2,185</b>	2,438
<b>Total assets</b>	<b>6,018</b>	6,172
<b>Non-current liabilities</b>		
Financial liabilities		
– borrowings	(1,658)	(1,443)
– financial derivatives	(7)	(17)
Provisions for liabilities and charges	(414)	(392)
Retirement benefit obligations	(615)	(570)
Deferred tax liabilities	(98)	(111)
Trade and other payables	(46)	(47)
	<b>(2,838)</b>	(2,580)
<b>Current liabilities</b>		
Financial liabilities		
– borrowings	(21)	(284)
– financial derivatives	(8)	(9)
Provisions for liabilities and charges	(138)	(118)
Trade and other payables	(783)	(792)
Current tax payable	(126)	(122)
	<b>(1,076)</b>	(1,325)
<b>Total liabilities</b>	<b>(3,914)</b>	(3,905)
<b>Net assets</b>	<b>2,104</b>	2,267
<b>Shareholders' equity</b>		
Share capital	250	224
Share premium account	585	517
Capital redemption reserve	10	9
Revaluation reserve	3	3
Merger reserve	396	356
Retained earnings	943	1,410
Hedge reserve	(97)	(264)
Total shareholders' equity	<b>2,090</b>	2,255
Non-controlling interest equity	14	12
<b>Total equity</b>	<b>2,104</b>	2,267

# Unaudited supplementary consolidated statement of changes in equity – US dollar translation

	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
<b>At 31 July 2013</b>	<b>741</b>	<b>368</b>	<b>1,410</b>	<b>(264)</b>	<b>2,255</b>	<b>12</b>	<b>2,267</b>
Profit for the year			382		382	3	385
Other comprehensive income							
Actuarial gains on retirement benefits and related tax			(116)		(116)		(116)
Exchange gains/(losses)	84	41	(279)	(24)	(178)	(1)	(179)
Fair value gains/(losses) and related tax			5	191	196		196
<b>Total comprehensive income for the year</b>	<b>84</b>	<b>41</b>	<b>(8)</b>	<b>167</b>	<b>284</b>	<b>2</b>	<b>286</b>
Transactions relating to ownership interests							
Exercises of share options		10			10		10
Taxation recognised on share options			(1)		(1)		(1)
Purchase of own shares			(21)		(21)		(21)
Dividends							
– equity shareholders			(452)		(452)		(452)
– non-controlling interest							
Share-based payment			15		15		15
<b>At 31 July 2014</b>	<b>835</b>	<b>409</b>	<b>943</b>	<b>(97)</b>	<b>2,090</b>	<b>14</b>	<b>2,104</b>

	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
<b>At 31 July 2012</b>	<b>750</b>	<b>380</b>	<b>589</b>	<b>(195)</b>	<b>1,524</b>	<b>13</b>	<b>1,537</b>
Profit for the year			493		493	3	496
Other comprehensive income							
Actuarial losses on retirement benefits and related tax			450		450		450
Exchange (losses)/gains	(24)	(12)	116	8	88	(4)	84
Fair value gains/(losses) and related tax			(2)	(77)	(79)		(79)
<b>Total comprehensive income for the year</b>	<b>(24)</b>	<b>(12)</b>	<b>1,057</b>	<b>(69)</b>	<b>952</b>	<b>(1)</b>	<b>951</b>
Transactions relating to ownership interests							
Exercises of share options		15			15		15
Taxation recognised on share options			1		1		1
Purchase of own shares			(17)		(17)		(17)
Dividends							
– equity shareholders			(239)		(239)		(239)
– non-controlling interest							
Share-based payment			19		19		19
<b>At 31 July 2013</b>	<b>741</b>	<b>368</b>	<b>1,410</b>	<b>(264)</b>	<b>2,255</b>	<b>12</b>	<b>2,267</b>

# Unaudited supplementary consolidated cash-flow statement – US dollar translation

	Year ended 31 July 2014 \$m	Year ended 31 July 2013 \$m
<b>Net cash inflow from operating activities</b>	<b>421</b>	553
<b>Cash-flows from investing activities</b>		
Expenditure on capitalised development	(37)	(45)
Expenditure on other intangible assets	(29)	(17)
Purchases of property, plant and equipment	(89)	(88)
Disposals of property, plant and equipment	8	6
Investment in financial assets	(45)	(38)
Acquisition of businesses	(2)	(1)
Disposals of businesses	5	
<b>Net cash-flow used in investing activities</b>	<b>(189)</b>	(183)
<b>Cash-flows from financing activities</b>		
Proceeds from exercise of share options	10	15
Purchase of own shares	(21)	(17)
Dividends paid to equity shareholders	(452)	(239)
Dividends paid to non-controlling interests		
Cash inflow/(outflow) from matured derivative financial instruments	18	(1)
Increase in new borrowings	227	387
Reduction and repayment of borrowings	(295)	(249)
<b>Net cash-flow used in financing activities</b>	<b>(513)</b>	(104)
<b>Net (decrease)/increase in cash and cash equivalents</b>	<b>(281)</b>	266
Cash and cash equivalents at beginning of year	587	319
Exchange differences	13	2
<b>Cash and cash equivalents at end of year</b>	<b>319</b>	587
Cash and cash equivalents at end of year comprise		
– cash at bank and in hand	194	249
– short-term deposits	127	349
– bank overdrafts	(2)	(11)
	<b>319</b>	587
Included in cash and cash equivalents per the balance sheet	321	598
Included in overdrafts per the balance sheet	(2)	(11)
	<b>319</b>	587
<b>Reconciliation of net cash-flow to movement in net debt</b>		
	Year ended 31 July 2014 \$m	Year ended 31 July 2013 \$m
<b>Net (decrease)/increase in cash and cash equivalents</b>	<b>(281)</b>	266
Net decrease/(increase) in borrowings resulting from cash-flows	68	(138)
<b>Movement in net debt resulting from cash-flows</b>	<b>(213)</b>	128
Capitalisation, interest accruals and unwind of capitalisation fees	4	(6)
Movement from fair value hedging	(5)	15
Exchange differences	(15)	(26)
<b>Movement in net debt in the year</b>	<b>(229)</b>	111
Net debt at start of year	(1,129)	(1,240)
<b>Net debt at end of year</b>	<b>(1,358)</b>	(1,129)

# Independent auditors' report to the members of Smiths Group plc

We have audited the Parent Company financial statements of Smiths Group plc for the year ended 31 July 2014 which comprise the Company balance sheet, the accounting policies and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

## **Respective responsibilities of directors and auditors**

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

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

## **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

## **Opinion on financial statements**

In our opinion the Parent Company financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 July 2014;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

## **Opinion on other matters prescribed by the Companies Act 2006**

In our opinion:

- the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Group Directors' report for the financial year for which the Parent Company financial statements are prepared is consistent with the Parent Company financial statements.

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

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements and the part of the Directors' remuneration report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

## **Other matter**

We have reported separately on the Group financial statements of Smiths Group plc for the year ended 31 July 2014.

### **Martin Hodgson**

#### **[Senior Statutory Auditor]**

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

16 September 2014

### **Notes**

(a) The maintenance and integrity of the Smiths Group plc website is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

(b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

# Company balance sheet

	Notes	31 July 2014 £m	31 July 2013 £m
<b>Fixed assets</b>			
Tangible assets	2	<b>0.6</b>	1.5
Investments and advances	3	<b>3,495.2</b>	3,884.4
Available for sale financial assets	4	<b>111.1</b>	83.0
		<b>3,606.9</b>	3,968.9
<b>Current assets</b>			
Debtors			
- amounts falling due within one year	5	<b>58.0</b>	56.2
Cash at bank and on deposit		<b>16.8</b>	172.9
Financial derivatives			
- amounts falling due within one year		<b>4.7</b>	2.3
- amounts falling due after more than one year		<b>9.2</b>	6.4
		<b>88.7</b>	237.8
Creditors: amounts falling due within one year	6	<b>(57.9)</b>	(254.3)
<b>Net current assets/(liabilities)</b>		<b>30.8</b>	[16.5]
<b>Total assets less current liabilities</b>		<b>3,637.7</b>	3,952.4
Creditors: amounts falling due after more than one year	6	<b>(980.6)</b>	(949.6)
Provisions for liabilities and charges	7	<b>(2.5)</b>	[2.3]
Financial derivatives		<b>(4.3)</b>	[11.0]
<b>Net assets excluding pension liabilities</b>		<b>2,650.3</b>	2,989.5
Retirement benefit liabilities	8	<b>(202.4)</b>	(189.6)
<b>Net assets including pension liabilities</b>		<b>2,447.9</b>	2,799.9
<b>Capital and reserves</b>			
Called up share capital	9	<b>147.9</b>	147.7
Share premium account	10	<b>346.4</b>	340.8
Capital redemption reserve	10	<b>5.8</b>	5.8
Other reserves	10	<b>180.5</b>	180.5
Profit and loss account	10	<b>1,767.3</b>	2,125.1
<b>Shareholders' equity</b>		<b>2,447.9</b>	2,799.9

The accounts on pages 177 to 185 were approved by the Board of Directors on 16 September 2014 and were signed on its behalf by:

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

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

# Company accounting policies

## Basis of preparation

The accounts have been prepared in accordance with the Companies Act 2006 and all applicable accounting standards in the United Kingdom (UK GAAP).

These accounts have been prepared on a going concern basis and under the historical cost convention modified to include revaluation of certain financial instruments, share options and pension assets and liabilities held at fair value.

As permitted by Section 408(3) of the Companies Act 2006, the Company's entity profit and loss account and statement of total recognised gains and losses have not been presented. As permitted by Section 408(2) information about the Company's employee numbers and costs is not presented.

The Company has taken advantage of the exemption in 'FRS 8: Related Party Disclosures' not to disclose transactions with other wholly owned members of the Smiths Group.

## Foreign currencies

Foreign currency transactions are recorded at the exchange rate ruling on the date of transaction. Foreign exchange gains and losses resulting from the settlement of such transactions, and from the retranslation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies, are recognised in the profit and loss account.

## Operating leases

Payments made under operating leases are charged to the profit and loss account as incurred over the term of the lease.

Where a leasehold property is vacant, or sub-let under terms such that the rental income is insufficient to meet all outgoings, provision is made for the anticipated future shortfall up to termination of the lease.

## Tangible fixed assets

Depreciation is provided at rates estimated to write off the relevant assets by equal annual amounts over their expected useful lives. In general, the rates used are: Freehold and long leasehold buildings – 2%; Short leasehold property – over the period of the lease; Plant, machinery, etc. – 10% to 20%; Fixtures, fittings, tools and other equipment – 10% to 33%.

## Fixed asset investments

The Company's investments in shares in Group companies are stated at cost less provision for impairment. Any impairment is charged to the profit and loss account as it arises.

## Financial instruments

The policies disclosed in the Group accounting policies on pages 129 to 134 for recognition, measurement and presentation of financial instruments are applied in the Company accounts.

Where there are no differences between the disclosures required for the Group and the Company in respect of a class of financial instruments, an appropriate cross-reference is made to the Group accounts.

## Taxation

Deferred tax is recognised in respect of timing differences that have originated but not reversed as at the balance sheet date.

Timing differences are differences between the Company's taxable profits and its results as disclosed in the accounts, arising from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the accounts.

Deferred tax is not recognised on any fixed assets that have been revalued unless there is a binding agreement to sell the asset.

## Provisions

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

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

## Post-retirement benefits

The Company has both defined benefit and defined contribution plans.

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

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

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

## Share-based payment

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

The fair value of the shares or share options granted is recognised over the vesting period to reflect the value of the employee services received. The charge relating to grants to employees of the Company is recognised as an expense in the profit and loss account and the charge for grants to employees of other group companies is recognised as an investment in the relevant subsidiary.

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

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

## Dividends

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

# Notes to the Company accounts

## 1 Audit fee

The audit fee for the parent company was £0.1m (2013: £0.1m).

## 2 Property, plant and equipment

	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
<b>Cost or valuation</b>			
<b>At 31 July 2013 and 31 July 2014</b>	<b>6.6</b>	<b>0.3</b>	<b>6.9</b>
<b>Depreciation</b>			
At 31 July 2013	5.3	0.1	5.4
Charge for the period	0.8	0.1	0.9
<b>At 31 July 2014</b>	<b>6.1</b>	<b>0.2</b>	<b>6.3</b>
<b>Net book value at 31 July 2014</b>			
Net book value at 31 July 2013	0.5	0.1	0.6
	1.3	0.2	1.5

## 3 Investments and advances

	Shares at cost £m	Due from subsidiaries £m	Due to subsidiaries £m	Total £m
<b>Cost or valuation</b>				
At 31 July 2013	2,391.4	1,824.7	(308.8)	3,907.3
Exchange adjustments		(110.4)		(110.4)
Contribution through share options	4.6			4.6
Increases in advances due from/(due to) subsidiaries		205.1	(488.5)	(283.4)
<b>At 31 July 2014</b>	<b>2,396.0</b>	<b>1,919.4</b>	<b>(797.3)</b>	<b>3,518.1</b>
<b>Provision for impairment</b>				
At 31 July 2013 and 31 July 2014	22.0	0.9		22.9
<b>Net book value at 31 July 2014</b>				<b>2,374.0</b>
Net book value at 31 July 2013	2,369.4	1,823.8	(308.8)	3,884.4

Loans due to subsidiaries are only offset against loans due from subsidiaries to the extent that there is a legal right of set off and an intention to settle the balances net. The Company has large offsetting loan balances because it uses loans to reduce its foreign currency exposures and separately monitor net cash generated from trading activities.

The Company's subsidiaries are largely held according to business lines by the following holding companies, which are incorporated in England:

Smiths Group International Holdings Limited

Smiths Detection Group Limited

John Crane Group Limited

Smiths Medical Group Limited

Smiths Interconnect Group Limited

## 3 Investments and advances continued

The principal subsidiaries and their countries of incorporation are:

### England

Smiths Detection – Watford Ltd  
Smiths Medical International Limited  
John Crane UK Limited

### Europe

Smiths Heimann SAS (France)  
Smiths Heimann GmbH (Germany)  
Smiths Medical France SA (France)  
Smiths Medical Deutschland GmbH (Germany)  
John Crane Italia SpA (Italy)

### Other

Smiths Detection (Asia-Pacific) Pte Ltd (Singapore)  
Smiths Medical Japan Limited (Japan)  
John Crane Middle East FZE (UAE)

### United States

Smiths Detection, Inc.  
Smiths Medical ASD, Inc.  
John Crane, Inc.  
Titeflex Corporation  
Flexible Technologies, Inc.  
Tutco, Inc.  
Hypertronics Corporation  
Transtector Systems, Inc.  
Interconnect Devices, Inc.  
Power Distribution, Inc.  
JC Production Solutions, Inc.

Of the companies above, Smiths Group International Holdings Limited is 100% owned directly by the Company. The others are 100% owned through intermediate holding companies. Shareholdings are of ordinary shares or common stock. All subsidiaries operate in their country of incorporation.

The Company has taken advantage of the exemption under Section 410 (2) of the Companies Act 2006 by providing information only in relation to subsidiary undertakings whose results or financial position, in the opinion of the directors, principally affected the financial statements.

## 4 Available for sale financial assets

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

## 5 Debtors

	31 July 2014 £m	31 July 2013 £m
<b>Amounts falling due within one year</b>		
Amounts owed by subsidiaries	<b>53.5</b>	52.2
Other debtors	<b>4.5</b>	4.0
	<b>58.0</b>	56.2

## 6 Creditors

	31 July 2014 £m	31 July 2013 £m
<b>Amounts falling due within one year</b>		
Term loans	164.5	
Amounts owed to subsidiaries	<b>33.9</b>	61.5
Other creditors	<b>16.2</b>	19.7
Other taxation and social security costs	<b>0.3</b>	0.4
Accruals and deferred income	<b>7.5</b>	8.2
	<b>57.9</b>	254.3

## 6 Creditors continued

	31 July 2014 £m	31 July 2013 £m
<b>Amounts falling due after more than one year</b>		
Term loans	<b>980.6</b>	949.6
	<b>980.6</b>	949.6

### Term loans

The currency and coupons for the term loans are disclosed in note 18 of the Group accounts.

	31 July 2014 £m	31 July 2013 £m
Less than one year		164.5
Between one and two years	<b>149.7</b>	
Between two and three years	<b>242.6</b>	149.6
Between three and four years	<b>103.6</b>	267.5
Between four and five years	<b>254.0</b>	115.3
Greater than five years	<b>230.7</b>	417.2
Smiths Group plc term loans	<b>980.6</b>	1,114.1

See the liquidity risk disclosures in note 19 in the Group accounts for information on the cash and borrowing facilities available to the Group. The Company can borrow an additional \$620m under the US\$800m multi-currency revolving credit facility, which matures in February 2019.

## 7 Provisions for liabilities and charges

	At 31 July 2013 £m	Charged against profit £m	Utilisation £m	At 31 July 2014 £m
Disposals	2.3	0.3	(0.1)	<b>2.5</b>
	2.3	0.3	(0.1)	<b>2.5</b>

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

## 8 Post-retirement benefits

The Company operates three defined benefit plans in the UK. The largest of them is a funded scheme with assets held in a separate trustee-administered fund. The Company is the sole employer in that scheme and, accordingly, accounts for it as a defined benefit pension plan, in accordance with FRS 17. The UK defined benefit pension schemes were closed with effect from 31 October 2009.

Pension costs are assessed in accordance with the advice of independent, professionally qualified actuaries. The most recent actuarial valuation of the funded scheme was performed using the Projected Unit Method as at 31 March 2012. This valuation has been updated by independent qualified actuaries in order to assess the liabilities of the scheme as at 31 July 2014. Scheme assets are stated at their market values. Contributions to the schemes are made on the advice of the actuaries.

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

	31 July 2014	31 July 2013
Rate of increase in salaries	<b>n/a</b>	n/a
Rate of increase for active deferred members	<b>4.2%</b>	4.3%
Rate of increase in pensions in payment	<b>3.3%</b>	3.4%
Rate of increase in deferred pensions	<b>3.3%</b>	3.4%
Discount rate	<b>4.0%</b>	4.4%
Inflation rate	<b>3.3%</b>	3.4%
Healthcare cost increases	<b>4.3%</b>	5.0%

The assumptions used are estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily occur in practice.

The mortality assumptions used are based on the recent actual mortality experience of members. The assumptions are based on the new SAPS All Birth year tables with relevant scaling factors based on the experience of the schemes. The assumption also allows for future improvements in life expectancy in line with the 2013 CMI projections blended to a long-term rate of 1.25%. The assumptions give the following:

	31 July 2014		31 July 2013	
	Male	Female	Male	Female
Member who retires next year at age 65	<b>23</b>	<b>25</b>	23	25
Member, currently 45, when they retire in 20 years' time	<b>25</b>	<b>27</b>	25	27

## 8 Post-retirement benefits continued

The assets in the scheme and the expected rates of return as at 31 July 2014 were:

	31 July 2014 Long-term rate of return	Value £m	31 July 2013 Long-term rate of return	Value £m
Equities	<b>7.3%</b>	<b>23.5</b>	7.2%	903.6
Government bonds	<b>3.2%</b>	<b>508.5</b>	3.3%	5.4
Corporate bonds	<b>4.0%</b>	<b>266.5</b>	4.4%	273.7
Insured liabilities	<b>4.0%</b>	<b>30.9</b>	4.4%	30.1
Property	<b>6.9%</b>	<b>180.8</b>	6.8%	176.0
Cash and money market funds	<b>3.2%</b>	<b>628.9</b>	3.4%	192.1
Total market value		<b>1,639.1</b>		1,580.9
Present value of funded pension scheme liabilities		<b>(1,784.5)</b>		(1,714.4)
Deficit		<b>(145.4)</b>		(133.5)
Unfunded pension plans		<b>(49.9)</b>		(48.3)
Post-retirement healthcare		<b>(7.1)</b>		(7.8)
<b>Net retirement benefit liability</b>		<b>(202.4)</b>		(189.6)

The scheme assets do not include any of the Group's own financial instruments, nor any property occupied by, nor other assets used by, the Group. The expected rates of return on individual categories of scheme assets are determined by reference to relevant industries. The overall rate of return is calculated by weighting the individual rates in accordance with the anticipated balance in the scheme's investment portfolios.

### History of experience gains and losses

	31 July 2014 £m	31 July 2013 £m	31 July 2012 £m	31 July 2011 £m	31 July 2010 £m
Fair value of scheme assets	<b>1,639.1</b>	1,580.9	1,412.9	1,438.9	1,325.6
Present value of pension and post-retirement healthcare obligations	<b>(1,841.5)</b>	(1,770.5)	(1,743.1)	(1,587.6)	(1,489.9)
Net retirement benefit liability	<b>(202.4)</b>	(189.6)	(330.2)	(148.7)	(164.3)
Actual return less expected return on pension scheme assets		126.6	(87.5)	45.6	84.2
As a percentage of scheme assets	<b>(0%)</b>	8%	(6%)	3%	6%
Experience gains and losses arising on the scheme liabilities	<b>11.4</b>	(4.8)	78.9	(15.5)	7.1
As a percentage of present value scheme liabilities	<b>1%</b>	0%	5%	(1%)	0%

### Changes in present value of scheme assets and defined benefit obligations

	Assets 31 July 2014 £m	Assets 31 July 2013 £m	Obligations 31 July 2014 £m	Obligations 31 July 2013 £m
At beginning of the period	<b>1,580.9</b>	1,412.9	<b>(1,770.5)</b>	(1,743.1)
Service cost			<b>(0.1)</b>	0.5
Expected return on assets	<b>93.7</b>	76.6		
Interest on obligations			<b>(76.3)</b>	(70.0)
Actuarial gain/(loss)			<b>126.6</b>	(69.2)
Contributions by employer	<b>39.1</b>	39.3		
Benefits paid	<b>(74.6)</b>	(74.5)	<b>74.6</b>	74.5
<b>At end of the period</b>	<b>1,639.1</b>	1,580.9	<b>(1,841.5)</b>	(1,770.5)

## 8 Post-retirement benefits continued

### Cash contributions

Following completion of the 2012 triennial valuations for the principal UK schemes, agreement has been reached with the trustees that the current contributions will continue as follows:

- Cash contributions to SIPS of £36m a year until October 2019.
- In connection with SIPS, an on-going investment of £24m a year in index-linked gilts held in an escrow account. The escrow account remains an asset of the Group until 2020. At that time the assets in escrow will be allocated subject to the funding position of SIPS. In addition, the escrow account may revert to the Group, should there be a surplus at an intervening triennial review.

Contributions to the scheme are made on the advice of the scheme actuaries.

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

	One percentage point increase £m	One percentage point decrease £m
Effect on the aggregate of service cost and interest cost		
Effect on defined benefit obligations	0.2	(0.2)

## 9 Share capital

	Number of shares	Issued capital £m	Consideration £m
<b>Ordinary shares of 37.5p each</b>			
At 31 July 2013	393,818,510	147.7	
Exercise of share options	637,625	0.2	5.8
<b>Total share capital at 31 July 2014</b>	<b>394,456,135</b>	<b>147.9</b>	

At 31 July 2014 all of the issued share capital was in free issue. All issued shares are fully paid.

	31 July 2014	31 July 2013
Number of ordinary shares issuable under outstanding options	<b>1,678,684</b>	1,973,719

	Year issued	Number of shares	Subscription prices	Dates normally exercisable
Smiths Sharesave Scheme	2007	9,749	868.00p	2010/2014
	2008	2,601	724.00p	2011/2015
	2009	163,862	569.00p	2012/2016
	2010	27,366	894.00p	2013/2017
	2011	69,411	1035.00p	2014/2018
	2012	220,104	811.00p	2015/2019
	2013	133,850	1008.00p	2016/2020
	2014	395,933	990.00p	2017/2021
Smiths Industries Executive Share Option Schemes	2004	67,161	774.00p	2007/2014
	2005	135,352	901.00p	2008/2015
	2006	201,000	896.50p	2009/2016
	2007	252,295	1,097.00p	2010/2017

## 10 Share premium account and reserves

	Share premium £m	Capital redemption reserve £m	Other reserves £m	Profit and loss account £m
At 31 July 2013	340.8	5.8	180.5	2,125.1
Exercise of share options	5.6			
Purchase of own shares				(12.8)
Loss for the period				(13.8)
Dividends paid to equity shareholders				(275.0)
Actuarial loss on retirement benefits				(69.2)
Fair value gains on available for sale financial assets				3.1
Share-based payment				9.9
<b>At 31 July 2014</b>	<b>346.4</b>	<b>5.8</b>	<b>180.5</b>	<b>1,767.3</b>

The retained earnings include the purchase of Smiths Group plc shares by the Smiths Industries Employee Benefit Trust, and the issue of these shares upon the exercise of share options. The consideration paid was £12.8m (2013: £11.0m) and £nil (2013: £nil) was received as a result of the issue of shares. At 31 July 2014 the Trust held 855 (2013: 855) ordinary shares.

The Company's profit and loss reserve of £1,767.3m includes £895.7m (2013: £895.7m) not available for distribution as dividend.

During the year, the Company received £5.8m (2013: £9.3m) on the issue of shares in respect of the exercise of options awarded under various share option schemes.

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

## 11 Deferred tax

The Company is part of a UK tax group including all its UK-based subsidiaries. At 31 July 2011 the Company recognised UK tax assets relating to revenue losses brought forward of £27.8m, and other timing differences of £4.0m. The value of these assets is reviewed regularly and is dependent on the ability to recover them against forecast UK taxable profits of the tax group. Having considered the impact of the increased pension deficit on the outlook for the UK tax base, the Company decided to derecognise the tax assets at 31 July 2012 because it is no longer probable that they will be recovered.

At 31 July 2014 the Company has unrecognised deferred tax assets of £91.2m (2013: £90.0m) relating to:

- retirement benefit obligations £39.2m (2013: £36.5m)
- losses carried forward £48.4m (2013: £49.9m);
- share-based payments £1.8m (2013: £2.0m); and
- other timing differences £1.8m (2013: £1.6m).

These tax allowances remain available to the Company and can be utilised should the UK tax base improve.

## 12 Contingent liabilities

The Company has provided guarantees and arranged letter of credit facilities to support the Group's pension plans. The current amount outstanding under letters of credit is £50.9m (2013: £52.1m).

The Company has guaranteed the US\$800m revolving credit facility available to a subsidiary.

## 13 Post balance sheet event

The directors propose a final dividend of 27.5p per share (totalling approximately £108.5m) for the year ended 31 July 2014. The dividend will be submitted for formal approval at the Annual General Meeting to be held on 18 November 2014.

In accordance with FRS 21, these financial statements do not reflect this dividend payable, which will be accounted for in shareholders' equity as an appropriation of retained earnings in the year ending 31 July 2015. During the year ended 31 July 2014, a final dividend of 27.00p per share (totalling £106.4m) and a special dividend of 30.00p per share (totalling £118.3m) were paid in respect of the dividends declared for the year ended 31 July 2013.

# Financial calendar

	2014
Preliminary announcement of results for 2013/14	17 September
Ordinary shares final dividend ex-dividend date	22 October
Ordinary shares final dividend record date	24 October
Annual General Meeting	18 November
Ordinary shares final dividend payment date	21 November

	2015
2014/15 interim results announced	18 March (provisional)
Ordinary shares interim dividend ex-dividend date	26 March (provisional)
Ordinary shares interim dividend record date	27 March (provisional)
Ordinary shares interim dividend payment date	24 April (provisional)
Smiths Group financial year end	31 July
Preliminary announcement of results for 2014/15	23 September (provisional)
Ordinary shares final dividend ex-dividend date	22 October (provisional)
Ordinary shares final dividend record date	23 October (provisional)
Annual General Meeting	17 November (provisional)
Ordinary shares final dividend payment date	20 November (provisional)

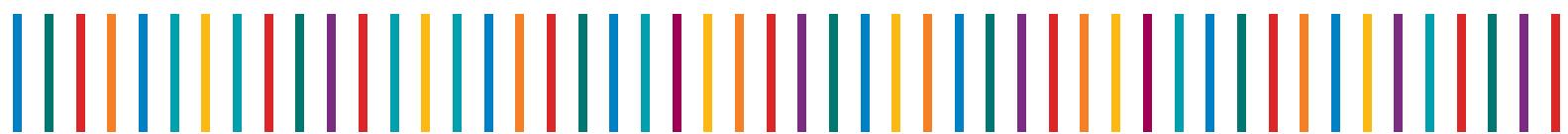
The market value of an ordinary share of the Company on 31 March 1982 for the purposes of capital gains tax was 136.875p (taking into account the sub-division of 50p shares into 25p shares on 14 January 1985 and the subdivision and consolidation of 25p shares into 37.5p shares on 18 June 2007).

The 2014 Annual General Meeting will be held at the Northcliffe House Auditorium of the law firm, Freshfields Bruckhaus Deringer, 26-28 Tudor Street, London EC4Y 0BQ on Tuesday 18 November 2014 at 10:30am.

**Registered Office**  
 Smiths Group plc  
 2nd Floor  
 Cardinal Place  
 80 Victoria Street  
 London SW1E 5JL, UK  
 T +44 (0)20 7808 5500  
 F +44 (0)20 7808 5544  
[www.smiths.com](http://www.smiths.com)  
 Incorporated in England  
 No. 137013

**Registrars**  
 Equiniti Limited  
 Aspect House  
 Spencer Road  
 Lancing  
 West Sussex BN99 6DA, UK  
 T 0871 384 2943  
 (United Kingdom)  
 Calls to this number are charged  
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 T +44 (0)121 415 7047  
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**Smiths Group plc**  
**Cardinal Place**  
**80 Victoria Street**  
**London SW1E 5JL, UK**  
**T +44 (0)20 7808 5500**  
**F +44 (0)20 7808 5544**  
**[www.smiths.com](http://www.smiths.com)**

