

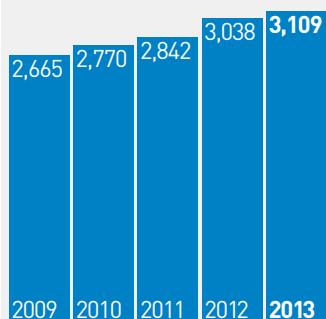
## Bringing technology to life



# 2013 Performance highlights

## Headline revenue £m

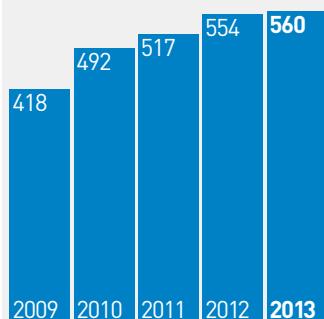
**£3,109m +2%**



Read more on page 28 and note 1

## Headline operating profit £m

**£560m +1%**



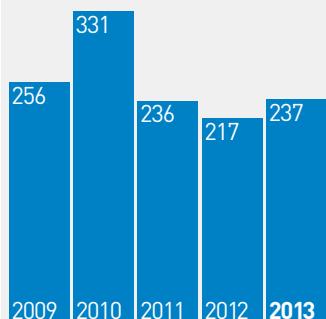
Read more on pages 28, 146 and note 1

## Operational highlights

- Headline revenue 2% higher, driven by John Crane, Smiths Detection and Flex-Tek
- Headline operating profit up 1% – increased investment in growth
- Strong headline operating cash conversion at 98% – with free cash-flow of £237m
- Company-funded investment in new product development up 5% to £112m
- Emerging market revenue up 14%; now representing 16% of Group revenues
- Identified another phase of restructuring in all divisions to fund growth/enhance margins
- Dividend up 4% to 39.5p and special dividend of 30p, reflecting the balance sheet strength

## Free cash-flow £m

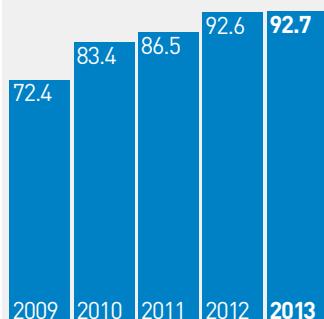
**£237m +9%**



Read more on pages 50, 146 and note 26

## Headline earnings per share Pence

**92.7p +0.1p**



Read more on pages 50, 146 and note 8

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.

## Continuing activities

	2013 £m	2012 £m
Headline revenue	<b>3,109</b>	3,038
Statutory revenue	<b>3,109</b>	3,030
Headline operating profit	<b>560</b>	554
Statutory operating profit	<b>493</b>	407
Headline basic EPS	<b>92.7p</b>	92.6p
Statutory basic EPS	<b>90.7p</b>	65.4p
Free cash-flow	<b>237</b>	217
Dividend	<b>39.5p</b>	38.0p
Special dividend	<b>30.0p</b>	–
Return on capital employed	<b>16.6%</b>	16.5%

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

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### Photographs on the front cover

- 1 David Henry, Global Engineering VP for Platform Product & Manufacturing Engineering, Smiths Interconnect, US
- 2 Liliana Esis, Performance Plus Marketing Co-ordinator, John Crane, Colombia
- 3 Rob Olden, Fabrication Mechanic, Flex-Tek, US
- 4 Rick Martini, Manufacturing Engineer, Flex-Tek, US
- 5 Chae Up Lim, Assembly Supervisor, John Crane, South Korea
- 6 Lee Hiong Chua, Operations Director, Smiths Detection, Malaysia
- 7 Leila Kurevija, Custom Anaesthesia Assembly, Smiths Medical, US

# Bringing technology to life...

We apply leading-edge technology to design, manufacture and deliver innovative, engineered solutions to meet our customers' needs. We do this across a diverse range of applications and end markets, ranging from healthcare, energy and petrochemicals through to threat and contraband detection, telecommunications and equipment manufacture.

A deep understanding of these markets combined with strong customer relationships enables Smiths to apply its leading-edge technologies and deliver engineered solutions to specific client applications. Our products and services are often critical to customer operations, while our proprietary advanced technology and high service levels create competitive advantage.

From seals enabling the efficient, environmentally friendly extraction of oil and gas to high energy cargo scanners protecting ports and borders, and from medication infusion pumps which support safe delivery of medication through to filters enabling next-generation communications networks, we bring technology to life to help to make the world safer, healthier and more productive.

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.

**Employees**  
**23,250**

**Direct operations in over**  
**50 countries**

**2013 Revenue**  
**£3,109m**

**2013 Headline operating profit**  
**£560m**

**Divisions**  
**5**

**Founded in**  
**1851**





**Bringing  
technology  
to life...  
to make  
the world  
safer**



A HI-SCAN 10080 XCT in a testing facility

# Group overview

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## Technologies merge for security first

With passenger numbers steadily growing and stringent security checks still essential, all major airports are under pressure to maximise both traffic flow and threat detection. In response, Smiths Detection has combined some of the most advanced X-ray and 3-D technologies in existence to create a unique airport baggage scanner that delivers unprecedented security and operational efficiency. The revolutionary HI-SCAN 10080 XCT, which has already gained key EU and US technical approvals, screens aircraft hold baggage for explosives and other threats. It was developed with Analogic Corporation, combining Analogic's renowned CT (Computed Tomography) expertise with Smiths Detection's multi-view, X-ray technology. Now undergoing field trials, the high-speed system can screen 1800 bags an hour – more than any comparable system. Its design also allows easy integration into existing baggage-handling configurations.

# Our divisions

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

**They 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.

**2013 Revenue  
£986m**

**2013 Headline operating profit margin  
23.4%**

### Strengths

- Strong proprietary technology with specialist product expertise
- Market leader with c. 30% market share in mechanical seals
- Two-thirds of sales in aftermarket with >95% conversion rate from OEM
- Global network of c. 230 sales and service centres

**Employees  
7,000**

Read more on pages 30-33  
or [www.johncrane.com](http://www.johncrane.com)

## 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.

**2013 Revenue  
£850m**

**2013 Headline operating profit margin  
22.2%**

### Strengths

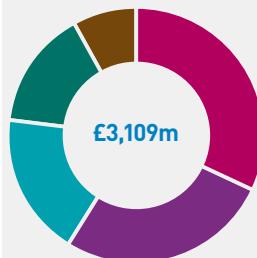
- Strong market positions in niche areas
- Highly recognised and respected brands
- Reputation for high quality and safety
- Differentiated lower risk, short residency, interventional devices
- Innovative pipeline and new product launches
- Extensive global sales network

**Employees  
7,900**

Read more on pages 34-37  
or [www.smiths-medical.com](http://www.smiths-medical.com)

**Divisional revenue**

- John Crane 32%
- Smiths Medical 27%
- Smiths Detection 18%
- Smiths Interconnect 15%
- Flex-Tek 8%



Read more on page 115

**Divisional headline operating profit**

- John Crane 39%
- Smiths Medical 32%
- Smiths Detection 10%
- Smiths Interconnect 12%
- Flex-Tek 7%

Percentage relates to headline operating profit before corporate costs



Read more on page 115



## 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.

**2013 Revenue**  
**£559m**

**2013 Headline operating profit margin**  
**10.4%**

**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. 25% of sales from aftermarket service and growing
- Global sales and service network with strong emerging market presence

**Employees**  
**2,250**

Read more on pages 38-41  
or [www.smithsdetection.com](http://www.smithsdetection.com)

## Smiths Interconnect

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

**2013 Revenue**  
**£461m**

**2013 Headline operating profit margin**  
**14.9%**

**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

**Employees**  
**3,850**

Read more on pages 42-45  
or [www.smithsinterconnect.com](http://www.smithsinterconnect.com)

## Flex-Tek

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

**2013 Revenue**  
**£253m**

**2013 Headline operating profit margin**  
**17.1%**

**Strengths**

- Manufacturer of qualified components for the aerospace industry
- Largest supplier of open coil heating elements worldwide
- >90% share of clothes tumble dryer applications in North America
- Leading manufacturer of flexible gas piping and HVAC ducting for US construction market

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

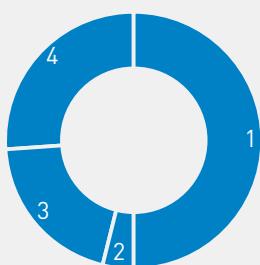
Read more on pages 46-49  
or [www.flextekgroup.com](http://www.flextekgroup.com)

# 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 have an increasing exposure to 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 118

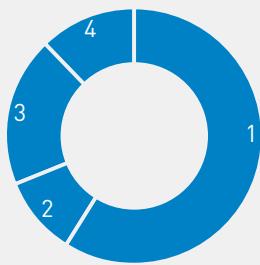
## Group manufacturing and service locations



## Location of assets

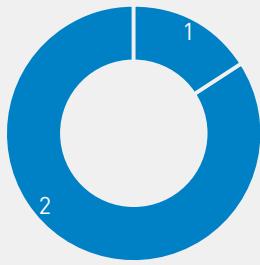
- 1 North America 59%
- 2 United Kingdom 10%
- 3 Europe other 19%
- 4 Rest of World 12%

Analysis excludes cash and cash equivalents



## Revenue from emerging and developed markets

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

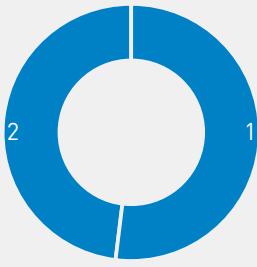


## Smiths Group is investing to expand its emerging market presence

Smiths Group has grown its exposure to high-growth emerging markets through a targeted investment in sales and marketing capabilities. 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 21.5% 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 around £13m in the past two years to build its salesforce and brand presence 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.

### Revenue from equipment sales and aftermarket/consumables

1 Equipment sales 52%  
2 Aftermarket/consumables 48%



### 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 quarter of revenues are from the supply of servicing and spares for their equipment. As a result, Smiths Group generates strong and stable cash-flows.

### Emerging markets revenue up

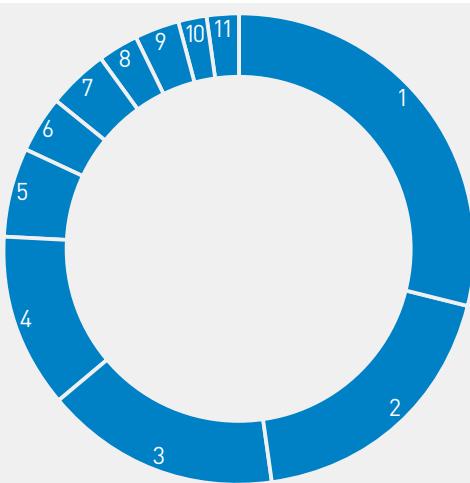
**14%**



### Revenue by end market

1 Healthcare	29%
2 Oil, gas and petrochemical	19%
3 Homeland security	16%
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	2%
11 Household appliances	2%

\*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 direction and allocates capital to manage the portfolio and drive returns. It also fosters a culture of responsibility and accountability wherever we work around the world.

Strategy	Budgeting and planning	Governance	Risk management
Performance monitoring	Information systems	Ethics and compliance	EHS, talent and retention

Capital allocation			
Financing and capital structure	Shareholder returns	Legacy liabilities	Acquisitions and disposals

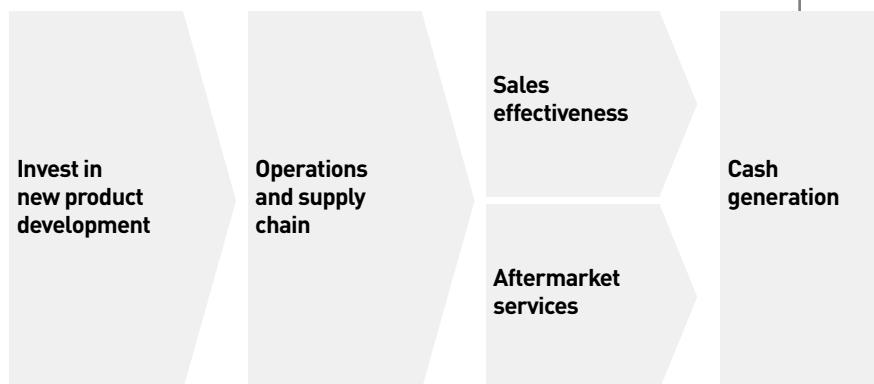
## The divisional business model

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:

- developing products to meet customers' specific needs
- producing those products through low-cost, flexible manufacturing; and
- providing 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.



## Organic investment in business

## The Group's role

### Strategy

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

### Budgeting and planning

Agrees annual Group and divisional budgets.

### Governance

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

### Risk management

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

### Performance monitoring

Reviews and regularly challenges divisional performance.

### 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.

### Capital allocation

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

### Financing and capital structure

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

### Shareholder returns

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

### Legacy liabilities

At the same time, we monitor our portfolio of liabilities, such as our defined benefit pension schemes and legacy product liability issues, so that we minimise their impact on our value creation. These are managed at either Group or divisional level, as appropriate.

### Acquisitions and disposals

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

## The divisional business model

### Customer intimacy and market knowledge

Our businesses consistently refine their knowledge of their markets. This includes knowing the scale of the market and its growth rate, the competitors and their activities, and our potential sources of competitive advantage. This helps us anticipate and respond to developments.

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.

### Invest in new product development

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

We fund the majority of our R&D and we also seek funding from our customers. Our spend is focused more on product development than pure research. In 2013, we invested £121m in R&D, of which £9m was customer funded.

### Operations and supply chain

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.

### Sales effectiveness

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.

### 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.

### Cash generation

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

### Organic investment in business

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 business model in action

A recognised market leader, John Crane is focused on providing customer-specific solutions to energy services customers, from high-quality products through to effective aftermarket services. For instance, its advanced sealing technology has enabled the Marathon Petroleum Galveston Bay Refinery in Texas to meet both emissions requirements and site safety goals.

Customer intimacy  
and market knowledge



Investing in new  
product development



Building a strong supply chain  
and efficient operations



At John Crane we're very proud of our robust research, development and engineering capabilities. More than 700 engineers and technical experts across the world have unmatched technical expertise and market knowledge built up over many decades. Today, we're using that knowledge to leverage our capabilities and target new products and product enhancements driven by the needs of our customers in tackling extremely challenging environments. For instance, within any given refinery, we have the ability to customise solutions to meet our customers' specific needs across all of their rotating equipment, to ensure our products deliver the long-term reliability demanded from us.

**Joe Haas**  
**Vice President Global R&D  
and Engineering, Chicago**

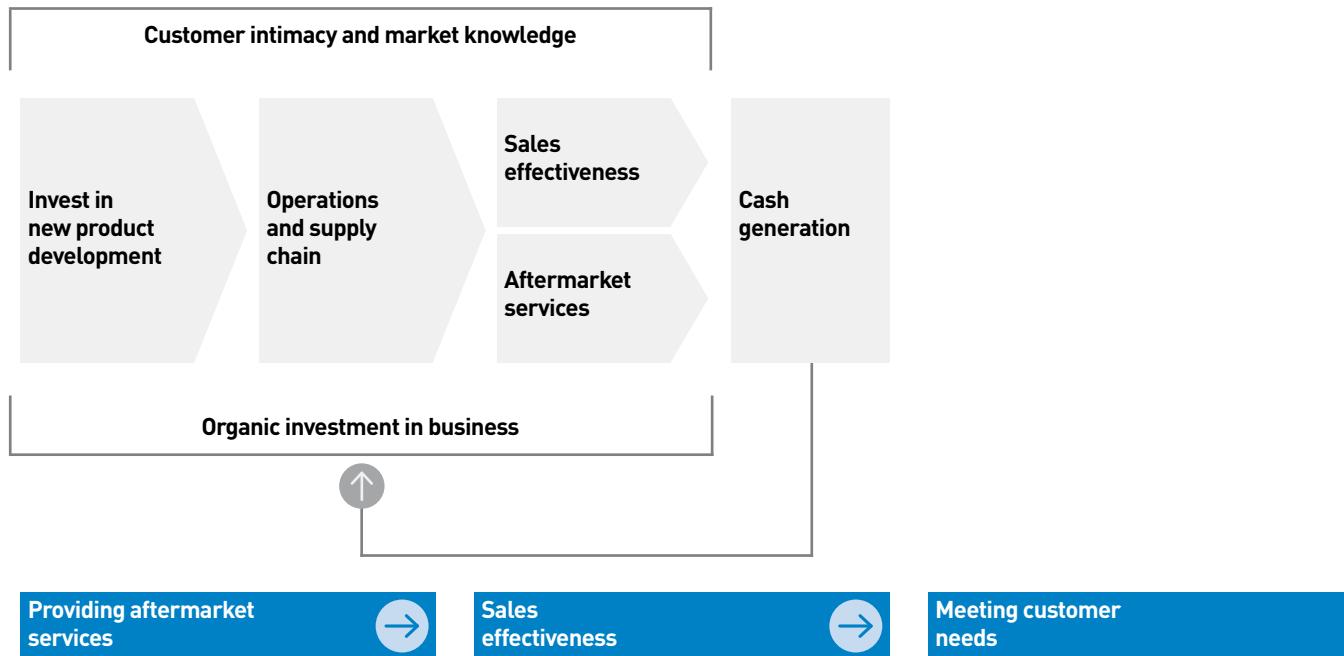
As a product designer, I'm well aware of the need to keep abreast of the constant changes in our markets and technologies. Our New Product Development (NPD) process is designed specifically to meet that challenge. A split seal called the 3740 is just one example. It was recently developed and launched as a result of months of intense research including several customer user meetings. The mechanical seal, split to allow installation without the need to strip down existing equipment, was tested on three of our 75 test rigs. It has extended the operational life of the equipment more than any other product on the market. Its ease of assembly and installation even in our customers' most challenging conditions made it a great success. Even the US Navy has approved use of the seal.

**Jim Wasser**  
**Director of Product Design,  
Global Engineering, Chicago**

Ensuring we have the correct global operations footprint is critical to providing the levels of service our customers expect wherever they are. The advantages of understanding and utilising the breadth of our global operations and supply chain are clear in terms of improving margin. What is not so obvious is how we effectively share this expertise. So we have implemented one global set of operational standards and metrics across all our facilities based on sharing best practices. Our goal is to successfully deliver a quality product the first time, every time, at the optimum cost. We also aim to be the preferred solution to our customers, wherever they are in the world.

**Mark Glennerster**  
**Vice President, Operations,  
America, Chicago**

## The divisional business model



### Providing aftermarket services



### Sales effectiveness



### Meeting customer needs



Our Performance Plus (PP) reliability programmes are designed to replace traditional, individual service agreements with a global approach that focuses on the overall environment our products operate in. This could be system design, operational practices, maintenance and repair practices, or product selection. In doing so we want PP to become integral to the customer's business. Reliability is improved, savings are generated through fewer unplanned outages and maintenance spend is cut. With enhanced reliability comes higher production rates, a drop in emissions, and an improved safety record. Sounds straightforward but a lot of work goes into it!

**Jason Wall**  
Director of Global Business Solutions,  
Houston

John Crane and the Marathon Petroleum Galveston Bay refinery site have both greatly benefited from a sole source, pump seal agreement over the past 12 years. One of our most highly customised gas seals in particular has been the right fit for this customer, whose refinery can process 450,000 barrels per day. The use of our advanced Type-2800XP gas seals used in Marathon's pumps has allowed them to meet current federal emission requirements and achieve the safety goals for their Texas City site. The 2800XP is the only pump seal capable of withstanding pressure greater than 600 psig (pound per square inch gauge) – equivalent to more weight than a fully loaded jumbo jet on a manhole cover.

**Jeff Maluski**  
District Sales Manager,  
US West, Houston

The Marathon Petroleum Galveston Bay refinery and John Crane have worked together for several years in exceeding current emissions-reduction requirements and meeting the safety goals for the refinery. The Type-2800XP sealing technology has enabled the refinery to achieve zero emissions on a VOC application with a sealing pressure of 600 psig.

**Steve Palermo**  
Superintendent, Rotating Equipment Product Group at Marathon Refinery, Texas City, Texas

# 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.

We've delivered progress in tough conditions, with revenue growth and strong cash generation, plus improvements in our corporate responsibility measures and organisational capabilities.

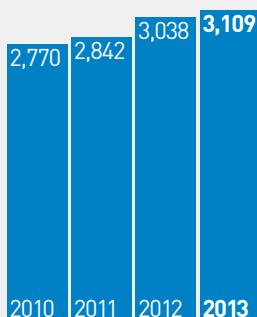
## 1 Driving top-line growth

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 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 2013

Headline revenue £m

**£3,109m**



Headline revenue increased by 2% this year, driven by John Crane, Smiths Detection and Flex-Tek. We raised company-funded R&D by 5% to £112m to drive innovation and completed a number of new product launches across the business.

Revenues from emerging markets grew by 14% to 16% of Group revenues, reflecting our ongoing investment to increase our exposure in these markets.

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 investment in new product development, sales and marketing in high-growth markets and in targeted acquisitions.

Read more on pages 22-25 and in note 1 on page 115



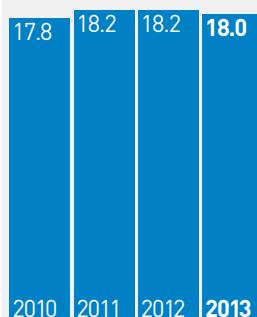
## 2 Enhancing margins through operational efficiencies

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 2013

Headline operating margin %

**18.0%**



Headline operating margin declined by 20 basis points, reflecting reduced profitability in Smiths Medical and Smiths Detection and our continued investment in sales, marketing and new product development.

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 Smiths Detection and a new Group-wide restructuring plan to be launched this year.

Read more on pages 22-25 and in note 1 on page 115

## 3 Transforming Smiths into a world-class organisation

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 2013

#### Leadership

We changed the leadership at John Crane and Smiths Interconnect 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. We have also relaunched our two development programmes for both junior and senior leaders, with almost 90 managers from across the business currently participating.

#### 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 launch our revised HR strategy, further developing our leadership capabilities and technological expertise. We will continue to roll-out e-enabled HR and conduct our third engagement survey.

Read more on pages 20-25, 66-67 and [www.smiths.com/responsibility](http://www.smiths.com/responsibility)



## 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 2013 A range of indicators for safety and environmental impact

**Recordable incident rate per 100 employees (RIR)** 0.54

FY2013 target:  
less than 0.5 per 100 employees  
(established businesses)

Target  
FY2010-FY2015 FY2013 v FY2010

#### Energy

10% reduction Reduced by 19%

#### Greenhouse gas emissions

10% reduction Reduced by 27%

#### Total non-recycled waste

10% reduction Reduced by 21%

#### Water consumption

5% reduction Reduced by 25%

We improved all our environmental metrics in FY2013 and exceeded our FY2015 goals. We improved our RIR over FY2012 in our established businesses from 0.58 to 0.50. Our recently acquired businesses are working to meet our standards, resulting in a published RIR of 0.54.

#### Priorities

We will implement our new sustainability strategy and continue to embed a culture of ethical behaviour across the business.

Read more on pages 62-67 and  
[www.smiths.com/responsibility](http://www.smiths.com/responsibility)

## 5 Generating cash and managing the balance sheet effectively

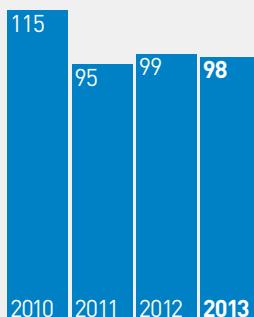
By emphasising working capital management, particularly our debtors and inventories, we are able to convert a high proportion of headline operating profit into cash.

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 2013

#### Cash conversion %

**98%**



Cash generation remained strong, with headline operating cash of £548m resulting in cash conversion of 98%.

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

#### 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, 28-29 and in note 26 on page 143 and page 146

## 6 Allocating capital to maximise returns

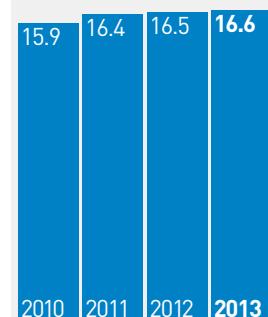
Smiths Group delivers high returns on capital. We achieve this through disciplined capital allocation to the divisions, by enhancing our profitability and through active portfolio management, with a targeted programme of acquisitions and disposals.

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 2013

#### Return on capital employed %

**16.6%**



Return on capital increased by 10 basis points to 16.6%, with improved returns at John Crane, Smiths Interconnect and Flex-Tek offset by declines at Smiths Medical and Smiths Detection as a result of lower profitability.

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 manage our portfolio to create maximum value for shareholders.

Read more on pages 22-25, 28-29, in note 1 on pages 115-118 and page 146

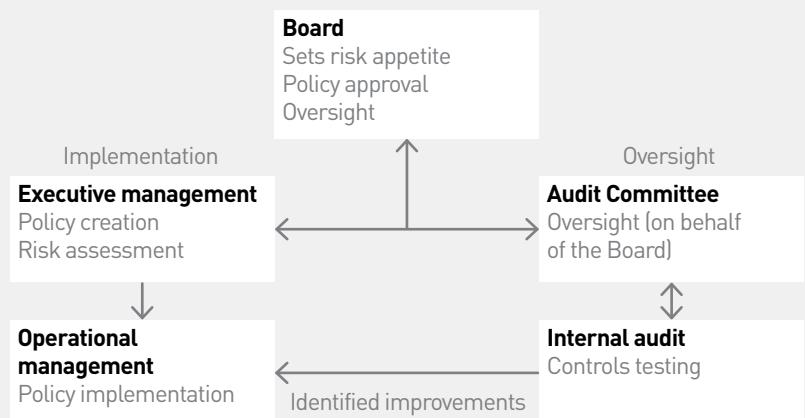
# Securing future returns

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	Transforming Smiths into a world-class organisation	Promoting a culture of responsibility	Generating cash and managing the balance sheet	Allocating capital to maximise returns
Economic outlook	•	•		•	•	
Financial risks	•	•		•	•	
Eurozone break-up	•	•		•	•	
Global supply chain/concentration of manufacturing	•	•				
Government customers	•	•		•		
Information technology	•	•		•		
Acquisitions and disposals	•	•		•	•	
Legislation and regulations	•	•	•	•		
Pension funding				•	•	
Product liability and litigation	•	•		•		
Contractual liabilities	•	•		•		
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 56 to 61



# 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**

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:

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

Read more on pages 8-9 and 30-49



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

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

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

Read more on pages 8-11 and 14-15



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

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

We have invested to improve our systems, with enterprise resource planning 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.

Read more on page 23



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

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.

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

Read more on pages 14-15 and 24-25



## **High returns on capital employed**

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

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

Read more on pages 22-25, 28-29 and 51



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

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

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

Read more on pages 22-25, 28 and in note 26 on page 143 and page 146



# Bringing technology to life...

## to make the world healthier



# Chairman and Chief Executive

Chairman	20
Chief Executive	22



## Improving homecare medication

Homecare is often the preferred option both of patients keen to be treated in familiar surroundings and hospitals under pressure to free beds. However, maintaining the highest standards of clinical care is a major challenge, one that Smiths Medical's CADD-Solis VIP was designed to meet. The portable infusion pump was developed specifically to minimise the risk of medication errors. Used typically for chemotherapy and pain management, the CADD-Solis VIP is the only 'smart' infusion system available for the homecare market. Its error-prevention software alerts operators or interrupts the infusion process when any setting breaches pre-defined limits. Small and lightweight, the CADD-Solis VIP fits into a pouch so patients can keep mobile and maintain their normal lifestyle.

# Chairman's statement

**Smiths Group has again delivered a resilient performance, its broad diversity of markets and geographies providing both scope for business growth and security against adverse trading conditions.**

**Strong results from John Crane and Flex-Tek helped offset poorer trading in Smiths Medical and Smiths Detection as constraints on government budgets and sluggish or zero growth across much of the developed world continued. Margins at Smiths Medical were also affected by the introduction of the US medical device tax and increased growth investment.**

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



The Eurozone has barely emerged from its longest ever recession and the recovery is far from robust. While emerging markets continue to hold out promise, there are rising concerns over how long their impressive growth rates can be sustained. One brighter spot is the United States where the discovery of exploitable deposits of shale gas may turn out to be the most important economic development of recent years. A plentiful supply of cheap, domestic energy could prove enough to revitalise the world's biggest economy. Budget and political wrangles in the US, on the other hand, limit enthusiasm. Against this backdrop, Smiths Group in general has performed soundly, with John Crane in particular delivering impressive revenue and profit growth. However, unresolved issues in contracts hampered Smiths Detection's recovery and the increased investment by Smiths Medical in emerging markets will take time to bear fruit.

## **Positioning the Group for growth**

Innovation is at the heart of any technology company and Smiths invested some £112 million in research and development last year. This was channelled particularly towards the design and manufacture of the high-margin products that will spearhead future sales growth. Product launches and milestone developments included:

an X-ray scanner designed especially for cars, key certification for a revolutionary checked baggage scanner, two new safety catheters, a unique non-stick pharmaceutical hose designed for 'high purity' markets; and a fibreglass sucker rod ideal for operations in shale gas fields.

Such technology advances leave Smiths Group well positioned to exploit the opportunities thrown up by a sustained, global economic recovery.

Meanwhile, the world is undergoing profound socio-economic changes magnified by the revolution in global communications. The hegemony once enjoyed by western economies has been steadily eroded by the impressive advances of developing countries. Our task is to rise to the commercial challenges posed by this new world order.

We are intensifying efforts to rebalance our businesses towards the emerging markets that offer greater promise of expansion over the medium to long term. Smiths Medical has bolstered its sales and marketing efforts in Brazil and parts of Asia. Smiths Detection has built a manufacturing plant in Malaysia to serve the Asia Pacific region and a major new service centre has been opened by John Crane in South Korea.

## **Effective capital allocation**

As the custodian of your investment, the Board tries to ensure capital is allocated efficiently across the Group. Management must regularly decide which technologies, products and markets should be funded in the constant pursuit of maximising shareholder value. At the same time, in managing any portfolio of assets, the Board is duty bound to consider whether we are the best owner of each business or if more value could be generated by divestment and redeploying the capital, always subject to market conditions. In addition, pension liabilities inflated by low interest rates, and long-running legal actions around historic product liabilities, curtail our room for manoeuvre.

During the year we received an unsolicited approach for Smiths Medical. After careful consideration, the Board concluded that acceptable terms could not be reached. This decision took full account of the quality and highly cash-generative nature of Smiths Medical, both standalone and as part of the Group as a whole. As previously, the dominant driver of the decision was an assessment of potential value creation for shareholders.

**Headline revenue**

Up to £3,109m

**+2%**Read more on page 28  
and in note 1 on page 115**Headline operating profit**

Up to £560m

**+1%**Read more on page 28 and 50 and in  
note 1 on page 115 and note 3 on page 119**Statutory revenue**

Up to £3,109m

**+3%**Read more on page 28 and  
in note 1 on pages 115-118**Statutory operating profit**

Up to £493m

**+21%**Read more on page 28 and 50 and in  
note 1 on page 115 and note 4 on page 120**Changes to the Board**

Change is the one constant in any healthy business and the Board is no exception. I am therefore delighted that someone of the calibre of Sir George Buckley has agreed to succeed me as Chairman after the Annual General Meeting in November. The Board and Company as a whole will benefit greatly from his solid engineering background, long US experience, and successful track record in running global, multi-industry businesses. His appointment further reinforces the directors' already solid credentials in energy, defence, healthcare, manufacturing, and finance. Although a small Board, it is diverse also in nationalities and gender.

**People and responsibility**

Ultimately, our people and their abilities hold the key to the long-term prosperity of Smiths. In this annual report we feature some of the employees who bring technology to life for our customers. Supporting the efforts of all staff, a more structured and rigorous process to assess and foster talent is now in place throughout the Group. This includes the introduction of specialist career counselling and two specific programmes aimed at early career development and senior leadership roles respectively. Almost 90 managers currently participate in the 'Horizons' or 'Aspire2' programmes.

Promoting a culture of self-responsibility is another priority and it is gratifying to see the improvement in our safety record maintained, with last year's Recordable Incident Rate the lowest in history. Similarly, we have been able to reduce our energy use, greenhouse gas emissions, waste generation and water consumption, all key environmental metrics.

We are equally committed to the ethical values that underpin our business dealings – integrity, honesty, fairness and transparency – and every individual employee is made fully aware of their importance through a range of mandatory information programmes.

My pleasure in welcoming Sir George is, understandably, tinged with personal sadness. It could hardly be otherwise after nine fulfilling years serving you as Chairman of one of the UK's best engineering businesses.

Public companies exist to serve the interests of their customers, and by doing so well and through efficient operation they seek to earn positive returns for their owners. I am pleased that by sticking to these principles we have generated returns around 50% better than those of the FTSE 100 as a whole over the past nine years. Of course, satisfying everyone is impossible. The interests of the owners have become very diverse. In our case we have shareholders who constantly urge

the break-up of the Company and others who urge greater investment through the profit and loss account to generate long-term growth. It is the Board's role to balance these interests carefully and I thank my Board colleagues for the mature and dispassionate way in which they carry out their responsibilities.

Next year we celebrate our 100th anniversary as a listed company. Smiths has evolved a long way from Mr Smith's barrow at Elephant & Castle and I wish Sir George all success in leading Smiths successfully into its second century as a quoted company.

So for the last time, I would like to thank Philip Bowman and all Smiths employees for their substantial efforts during yet another testing year. I also add my own deeply felt appreciation for the friendship and support I have been afforded over almost a decade. It truly has been a privilege to serve you as Chairman.

**Donald Brydon**  
**Chairman**

# Chief Executive's statement

This was a further year of progress for Smiths Group, with organic revenue and profit growth and strong cash generation despite challenging developed market economies and government spending constraints. It was achieved because of our consistent focus on operational improvement and increasing investment in the drivers of future growth. It also reflected gains from five years of reducing our dependence on government contracts and developed markets. Such resilience would have been impossible without this realignment.

**Philip Bowman**  
Chief Executive



The overall performance benefited from our strength and breadth as a diversified engineering company, with our portfolio of leading-edge, technology-driven businesses which serve a wide range of end markets and geographies. Revenue growth in Smiths Detection, John Crane and Flex-Tek offset weaknesses in Smiths Medical and Smiths Interconnect. Headline operating margins improved in John Crane, Flex-Tek and Smiths Interconnect but weakened at Smiths Medical, because of significantly increased investment in growth initiatives and the US medical device tax, and at Smiths Detection due to challenges in contract execution.

John Crane grew revenue despite a cyclical slowdown in some of its end markets, particularly first-fit OEM customers in the turbo-machinery and general industrial areas. However, overall growth rates have shown some recent signs of improvement. Margins increased again to record highs because of better volumes and pricing, more than offsetting cost inflation and investment in growth initiatives. Smiths Medical saw sales decline as weakness in developed markets outweighed growth in emerging markets.

Trading in developed economies deteriorated during the year reflecting hospital capital budget constraints and falling medical procedures weighing on infusion pump and safety sales. It also reflects a strong comparator period which was boosted by the launch of the new Medfusion 4000 infusion pump. Margins also fell with the introduction of the US medical device tax and with significantly increased investment to drive future growth through new product development and expanded sales and marketing capabilities in emerging markets. Smiths Detection saw good revenue growth across most of its market segments, driven by a strong first half. As anticipated, sales growth flattened in the second half against a strong comparator period. Profitability fell, as mentioned above. The performance improvement programme, underway since September 2011, generated cost savings and operational enhancements. Smiths Interconnect revenues fell slightly as growth in connectors was offset by declines in power management and microwave. Productivity gains helped enhance margins, despite the lower volumes. Flex-Tek achieved strong revenue growth across the aerospace and construction markets, pushing margins to recent highs as a result of its operational gearing.

## Strategy

Our strategy is to grow shareholder value 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
- Transforming Smiths into a world-class organisation through smarter ways of working and having the best people
- Promoting a culture of responsibility in everything we do
- Generating strong cash-flows with better balance sheet management
- Allocating capital rigorously across the business through active and disciplined portfolio management and a targeted acquisition strategy.

We have continued to deliver these objectives and some recent examples are set out below. However, we see further opportunities for Smiths Group to improve performance progressively and generate value for shareholders.

**Headline earnings per share**

Up 0.1p

**92.7p**Read more on page 50  
and in note 8 on page 123**Dividend per share**

Up 4%

**39.5p**Read more on pages 24-25  
and in note 7 on page 123**Investing to accelerate revenue growth – new products**

We believe our success and technology leadership stem from our long-standing commitment to new product development and innovation, key drivers of future revenue and margin growth as new products typically command premium margins. We raised company-funded investment in R&D by 5% to £112m. Customer-funded investment fell to £9m (2012: £10m) as government reduced funding; this took our total spend to £121m, or 3.9% of revenue (2012: 3.8%). We have completed several important new product launches through this long-term investment, which has grown more than 60% over the past six years.

Smiths Medical gained FDA clearance for CADD-Solis VIP for the US market. It has already sold successfully in other markets. Smiths Detection launched several new products including the CIP-300, a low-energy X-ray system for scanning cars and light vehicles. Its revolutionary XCT checked baggage screener received certification from both the EU and US authorities during the year. This opens up sales opportunities in most markets around the world, although further field testing is required in the US.

John Crane developed a specialty Fiberod for use in upstream oil production where customers operate at high temperatures. It has also invested in a new infrared spectroscopy system that provides customers with advanced materials analysis for early diagnosis of the root cause of equipment failure. Smiths Interconnect finalised a high-performance microwave filter that prevents mobile phone signals interfering with vital train network communications.

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

We are repositioning the Group to increase our exposure to emerging markets. Revenues to these markets grew 14% and they now represent 16.1% of Group revenues. Greater investment in these high-growth markets is part of our medium-term strategy to improve the growth characteristics of the Group. It takes time to establish a local sales presence through recruitment, training and brand building. In addition, there are often lengthy product registration processes. At Smiths Medical, we have added an additional 230 employees over the past two years to expand our sales force in targeted markets such as China, India and Brazil. At the same time, we have a programme to register a greater proportion of our products in these markets. In John Crane, we opened

a new service centre in Busan, South Korea, another example of our longer-term strategy to strengthen our presence in these high-growth markets.

**Operational improvements to enhance margins and invest in growth**

We are currently evaluating another phase of restructuring opportunities across all divisions. This next phase will concentrate on three areas: site rationalisation with a particular focus 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. We anticipate these plans will generate £50m of annualised savings for reinvestment in sales, marketing and new product development, and will cost around £100m over a three-year period. These will be charged as exceptional items. There will be some accompanying capital expenditure. We expect to provide further details of John Crane's programme at the investor day in December and for the other divisions at the interim results in March 2014.

**Statutory earnings per share**  
Up 39%  
**90.7p**

Read more on page 50  
and in note 8 on page 123

**Free cash-flow**  
From strong cash conversion  
**£237m**

Read more on page 50  
and in note 26 on page 143

**Employees around the world**  
In over 50 countries  
**23,250**

Read more on pages 66-67  
and in note 10 on page 128

In Smiths Detection, the performance improvement initiative has continued to make good progress with a further £9m of savings generated in the year, bringing total savings to date to £24m. We expect to deliver a further £5m of savings next financial year. The total programme is expected to generate £36m of annual savings at a cost of £33m by the end of financial year 2015. This will lower the fixed cost base and enable the business to respond better to variations in demand, while improving customer service.

**Towards a world-class organisation**  
Over the past six years, we have been working towards making Smiths Group a world-class organisation. This is in part about having the right people and processes. We have progressively raised the bar in terms of fostering talent, aided by more rigorous and consistent assessment processes, and greater investment in the preparation and monitoring of personal development plans. During the year, we changed the leadership of John Crane and Smiths Interconnect in order to take both businesses into the next phase of development.

### 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. We built on the success of the global ethics forum held in China last year by hosting our second in Brazil in October 2012.

### Strong cash generation and capital allocation

We experienced another year of strong cash generation. Headline operating cash of £548m represented a headline operating cash conversion of 98% (2012: 99%). This more than offset the impact of pension contributions and dividends, reducing net debt by £47m to £744m. The Group continues to benefit from high cash conversion and a balance sheet that has been considerably strengthened in recent years.

Improving returns on capital by enhancing margins while operating an efficient capital base, remains a key priority. Overall, Group return on capital rose slightly to 16.6%. We achieved improved returns across all divisions except Smiths Medical and Smiths Detection where they declined as a result of lower profitability.

Subject to suitable market conditions, we manage the portfolio of businesses through a combination of acquisitions that satisfy our strategic and financial objectives and disposals that realise additional value for our shareholders. This is undertaken in the context of continuing to manage the legacy issues of the actuarial deficits on the defined benefit pension plans and on-going historical product liability litigation. During the year, we received an unsolicited approach for Smiths Medical, which the Board very carefully considered. After some months of discussion, it proved impossible to reach agreement on acceptable terms. In reaching this conclusion, the Board took into account the quality and potential of Smiths Medical and its highly cash-generative nature, both standalone and in the context of the Group as a whole.

The Board regularly reviews the structure and efficiency of the balance sheet, taking into account the investment needs for organic growth and acquisitions as well as the funding requirements of the legacy issues of pensions and litigation.

Over the past six years, we have consistently increased our investment in organic growth drivers and have invested some £600m in bolt-on acquisitions to add complementary technologies and extend our geographic reach in high-growth markets. Although this investment remains our priority and we continue to actively evaluate potential acquisitions, we have not found opportunities that meet our acquisition and return criteria over the past 18 months. As a result, we have accumulated surplus cash on the balance sheet and net debt/headline EBITDA gearing has fallen to 1.2 times in recent years against our continuing medium-term target of 1.5-2.0 times.

The Group's robust balance sheet and record of strong cash generation is more than adequate to fund our immediate investment needs and other legacy obligations. The Board is therefore recommending a return of cash to shareholders of around £118m, in the form of a special dividend of 30p per share. Looking ahead, we will continue to apply capital discipline to the search for opportunities to invest for future growth while funding our legacy obligations and maintaining strategic flexibility.

### **Dividend**

The Board has a progressive dividend policy while maintaining a dividend cover of around 2.5 times. This policy will enable us to retain sufficient cash-flow to meet our legacy liabilities and finance our investment in the drivers of growth.

The Board has recommended a final dividend of 27.0p per share giving a total for the year of 39.5p, an increase of 4%. The final and special dividends will be paid on 22 November to shareholders registered at the close of business on 25 October. The ex-dividend date is 23 October.

### **Outlook**

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

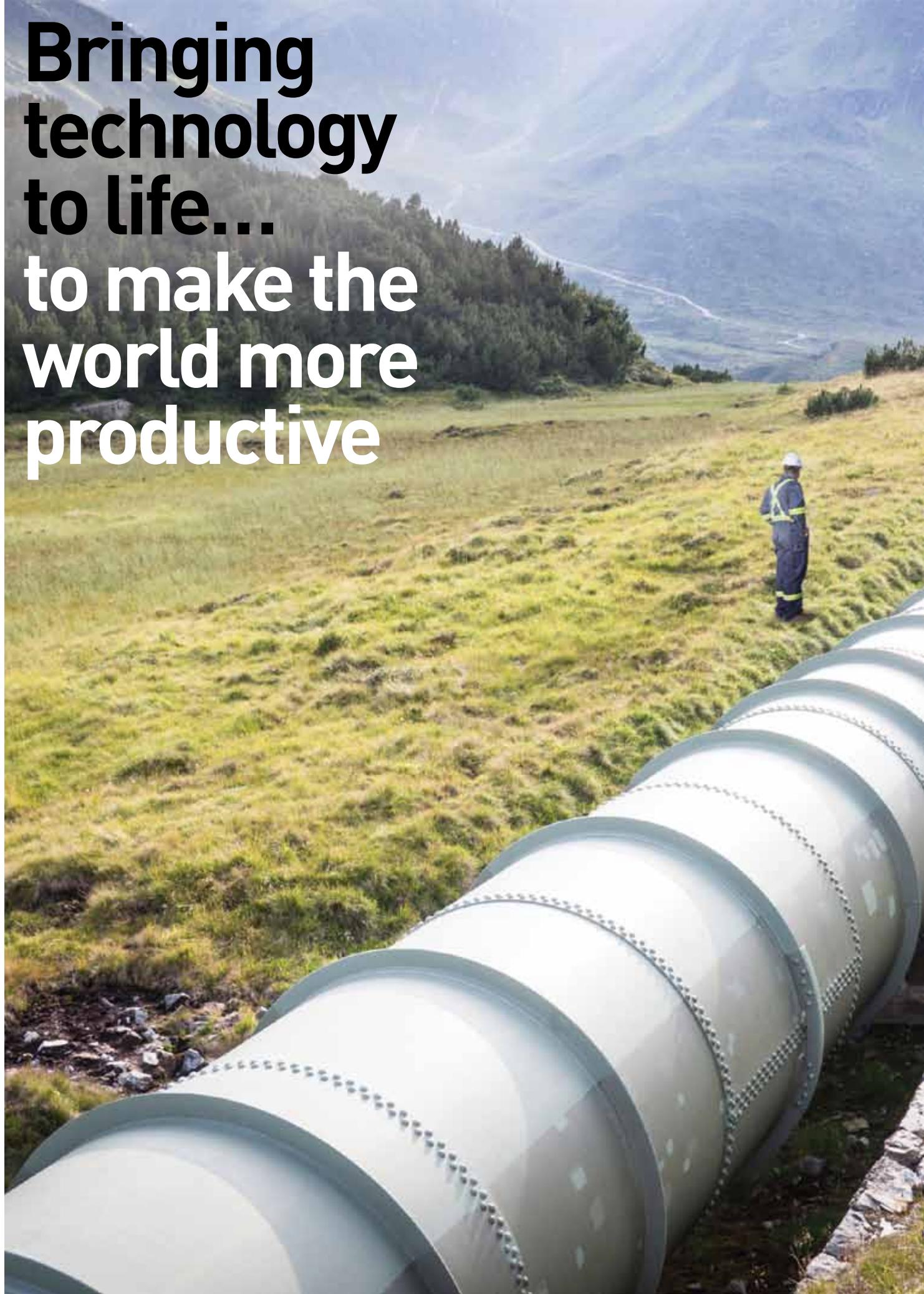
We see significant opportunities to generate value for shareholders although we continue to be cautious about sectors such as defence and healthcare which are subject to government funding constraints. However, we remain well placed to benefit from growth in energy demand, the need for new fuel-efficient aircraft, increased US residential construction and the ever

present need for improved security in an uncertain world. We will continue to focus on investing to grow sales, delivering further operational improvements, while maintaining strong cash conversion and improved returns. Outlook statements for the divisions are provided in the Business review.

We are currently evaluating some new medium-term targets by which our performance can be measured. Absent a major deterioration in economic conditions, we intend to publish these targets in the interim results in March 2014.

**Philip Bowman  
Chief Executive**

**Bringing  
technology  
to life...  
to make the  
world more  
productive**



# Business review

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## Helping power China safely

China's fast-growing demand for energy is such that a third West-East Pipeline from the central Asian gas fields is being built to help fuel what is now the second biggest economy in the world. John Crane will supply a range of specialty equipment – including dry gas seals, filtration systems, bearings and couplings – to ensure the secure, efficient and environmentally safe delivery of natural gas from China's Xinjiang border to the heavily industrialised coastal province of Guangdong. The more than 7,000 km (4,000 mile) pipeline will transport some 30 billion cubic metres of gas each year when it fully opens in 2015.

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# Business review: Group

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

## Company-funded R&D

Increased by 5% to

**£112m**

Read more on page 50



## Net debt

Down £47m to

**£744m**

Read more on pages 50-52 and 108  
and in note 18 on pages 133-134

## Annual dividend

Up 4%

**39.5p**

Read more on pages 24-25 and  
in note 7 on page 123



## Revenue

Headline revenue increased by 2%, or £71m, to £3,109m. The net impact of acquisitions and disposals contributed £15m which more than offset adverse currency translation of £9m. On an underlying basis, excluding currency translation and acquisitions, revenue grew £65m. This increase was driven primarily by strong growth in Smiths Detection (up £40m), John Crane (up £19m) and Flex-Tek (up £18m) which more than offset underlying revenue declines in Smiths Medical (£7m) and Smiths Interconnect (£5m).

## Profit

Headline operating profit rose £6m to £560m. The growth comprises a £4m, or 1%, underlying increase in headline operating profit, a £1m benefit from the net impact of acquisitions and £1m from favourable currency translation. The main drivers of this £4m underlying improvement were a combination of higher volumes, better sales mix and pricing at John Crane (up £22m), higher volumes at Flex-Tek (up £5m), productivity gains at Smiths Interconnect (up £2m) partly offset by higher investment, adverse pricing and the impact of the medical device tax at Smiths Medical (down £15m) and the impact of contract execution challenges at Smiths Detection (down £11m). Corporate centre costs reduced by £1m reflecting lower bonus payments. Headline operating margin declined by 20 basis points to 18.0% (2012: 18.2%) 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 £493m (2012: £407m).

The net interest charge on debt decreased slightly to £62m (2012: £63m) reflecting the higher average levels of cash.

The Group's tax rate on headline profit for the period was 26.5% (2012: 26.5%). Headline earnings per share increased by 0.1p to 92.7p (2012: 92.6p).

On a statutory basis, profit before tax increased £76m to £442m (2012: £366m); it is stated after taking account of the pensions finance credit of £16m (2012: £24m) and other items excluded from the headline measure.

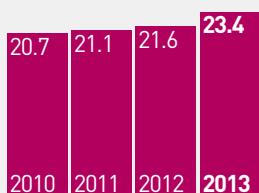
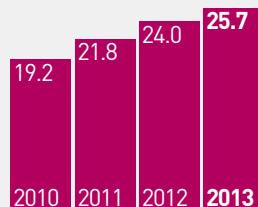
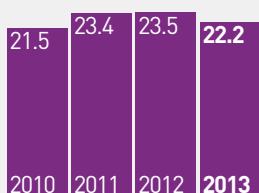
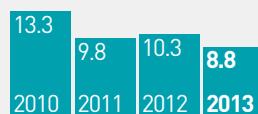
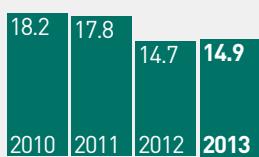
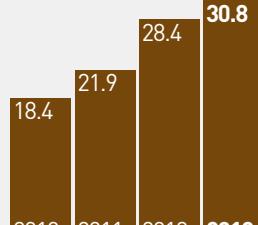
## Cash generation

Operating cash generation remained strong, with headline operating cash of £548m (2012: £549m) representing 98% (2012: 99%) of headline operating profit (see note 26 to the accounts for a reconciliation of headline operating cash and free cash-flow to statutory cash-flow measures). Free cash-flow rose £20m to £237m (2012: £217m). Free cash-flow is stated after interest, tax and pensions financing, but before acquisitions, financing activities and dividends.

On a statutory basis, net cash inflow from continuing operations was £353m (2012: £332m).

Dividends paid in the year on ordinary shares amounted to £152m (2012: £144m).

Net debt at 31 July was £744m, down from £791m at 31 July 2012. The fall in net debt reflects strong cash generation which more than offset outflows from dividends (£152m), pension funding (£78m) and adverse foreign exchange (£41m).

**John Crane****Headline operating profit margin**  
%**Return on capital employed**  
%**Smiths Medical****Headline operating profit margin**  
%**Return on capital employed**  
%**Smiths Detection****Headline operating profit margin**  
%**Return on capital employed**  
%**Smiths Interconnect****Headline operating profit margin**  
%**Return on capital employed**  
%**Flex-Tek****Headline operating profit margin**  
%**Return on capital employed**  
%

## 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



**Contribution to 2013  
Group revenue**

**32%**

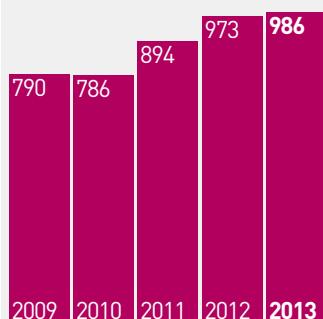
**Contribution to 2013  
Group headline operating profit**

**39%**

Percentage relates to headline operating profit before corporate costs

**Revenue performance  
£m**

**£986m +1%**



**Principal operations regions**

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

**Revenue by sector**

OEM: 37%

1 Original equipment manufacture 37%

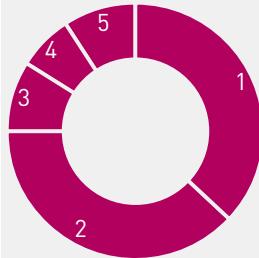
Aftermarket: 63%

2 Oil, gas & petrochemical 38%

3 Chemical & pharmaceutical 9%

4 Distributors 7%

5 General industry 9%



**Revenue by product**

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

**Mechanical seals and systems**

**76%**



**Couplings**

**5%**



**Bearings**

**5%**



**Filtration systems**

**4%**



**Artificial lift**

**10%**



**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, Flowserv, GE Nuovo Pignone, GE Energy and Power, Andritz Hydro, Rolls Royce, Siemens, Mitsubishi, Solar Turbines, Elliot, York, BASF, Weir Group, Bayer, and Dow. No customer is larger than 3% of revenue.

**Competitors**

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

**Suppliers**

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

## 1 Driving top-line growth...

### Performance Plus excellence

With aftermarket revenues comprising 60% of sales, John Crane spares no effort to ensure all its customers benefit from its market-leading, global service network. Testimony to this is the renewal of a five-year Performance Plus reliability contract with Samsung Total Petrochemicals, its biggest end-user customer in South Korea. The agreement covering mechanical seals was reinforced by the relocation of the service centre to a state-of-the-art facility in the southern city of Busan. "Performance Plus focuses on identifying areas for improvement and then designs and implements performance-based solutions tailored to each customer's needs," says BY Yoo, John Crane Sales Director, Korea. "That gives improved plant performance, extended asset life and reduced operating costs."

### 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.



Young Min Ko, Materials Administrator, South Korea

John Crane is a market leader in its traditional product areas – mechanical seals and seal support systems – with a market share of c. 30%. 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 with c. 30% market share in mechanical seals
- Two-thirds of sales in aftermarket with >95% conversion rate from OEM
- 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

	2013 £m	2012 £m	Reported growth	Underlying growth
Revenue	<b>986</b>	973	1%	2%
Headline operating profit	<b>231</b>	210	10%	10%
Headline operating margin	<b>23.4%</b>	21.6%	180 bps	
Statutory operating profit	<b>206</b>	155		
Return on capital employed	<b>25.7%</b>	24.0%	170 bps	

### Key operational highlights

- Expanded installed base in focus markets
- Increased global service network productivity
- Leveraged procurement scale
- Accelerated growth in selected businesses
- Drove lean operating principles into manufacturing

### Performance

John Crane posted solid results with underlying revenue up £19m, or 2%, excluding acquisitions and unfavourable exchange translation. The underlying growth reflects increased revenue in aftermarket and first-fit original equipment, fuelled primarily by the oil & gas and petrochemical sectors. There was a £1m benefit from the acquisition of the business of Turbo Components and Engineering Inc. (TCE) in October 2011. Adverse currency translation of £7m offset the underlying growth and the benefit from acquisitions to leave reported revenue up £13m (1%).

Reported headline operating profit rose £21m, driven by a £22m, or 10%, increase in underlying profit but partially offset by £1m in adverse currency translation. Headline operating margin increased by 180 basis points to 23.4% – a record high for John Crane. The underlying improvement in profitability stems largely from purchasing and productivity initiatives and discretionary spend controls. The margin improved despite continued investment in highly competitive first-fit original equipment projects, and new product development which we believe will position the company for mid-term growth. Return on capital employed improved 170 basis points to 25.7% because of increased profitability and continued careful management of the capital base.

Statutory operating profit at £206m primarily reflects the cost of John Crane, Inc. asbestos litigation of £14m and amortisation of acquired intangible assets of £14m.

Overall aftermarket revenue grew 2% on an underlying basis, stemming mainly from rotating equipment – namely seals, seal support systems, couplings, bearings and filtration – which together represent about 90% of revenue. Continued growth has resulted from strong activity across North America, Asia and the Middle East. Underlying sales in first-fit original equipment rose 2% as customer investment in new capital projects remained cautious.

Revenue from emerging markets, which rose 7%, now represents 21.6% of John Crane sales. Continued investment in infrastructure in these regions will improve service capabilities as well as broaden the company's product range in select markets. Market demands drove the opening of new service centres – one in Busan, South Korea, and a second in Georgia, US. The consolidation of power transmission couplings operations in the US cut operating expenses and improved service levels by combining customer services into one facility.

### Business developments

Our aftermarket revenue was boosted by several renewals and large new contracts for our Performance Plus reliability programmes – in Colombia, Korea, Thailand, the US, Europe, New Zealand and other countries around the world. A major US Gulf Coast refinery renewed a third-generation contract covering more than 3,000 pumps.

Commercial activity continued to expand in our high-growth markets. Multiple first-fit wins were secured for large industry projects including the Petrobras Pre-salt project off the coast of Brazil, and the West-East Asia III Pipeline being built across China. Multiple products from the John Crane portfolio are being used for the West-East III project ranging from gas seals to seal support systems and filters.

In addition, a large first-fit contract was signed in Kazakhstan, reflecting our strong activity in Asia.

In the first half of the year, a global, five-year enterprise framework agreement was signed with Shell for John Crane to supply mechanical seals and seal support systems used in Shell's global operations. In addition, John Crane Production Solutions entered into a four-year contract extension to support OMV Petrom's oil extraction operations across Romania.

Customer investments in shale development projects have remained steady and are expected to continue primarily in the US and Canada in the near-term.

### Research and development

John Crane increased investment in new product development and engineering by 9% this year, highlighting its commitment to developing new products that will address future market needs. This investment now represents some 3.3% of our first-fit original equipment revenues. We intend to raise the investment as a percentage of revenue over the medium term. The company's focus remains on developing engineered solutions that meet customers' growing processing demands while supporting energy efficiency and reduced environmental impact. This includes the development of materials to meet the requirements of today's challenging service conditions. Benefits range from expanded operating performance range and lower energy consumption to extended product life cycles.

As the industry leader in gas seal technology, John Crane remains at the forefront of ultra-high pressure designs capable of meeting the increasing demands of compression equipment and the requirements of emerging markets.



John Vasquez, Sales and Service Engineer, Colombia

Liliana Esis, Performance Plus Marketing Co-ordinator, Colombia

## Outlook

In the first half of the fiscal year 2014, John Crane's order book is expected to support similar revenue growth rates to the same period last year. We anticipate slightly more favourable trading conditions as the year progresses. However, revenue growth will depend on sustained maintenance and repair activity in our rotating equipment end markets as well as performance trends in our John Crane Production Solutions business. We look to maintain margins in the first half of the year similar to the comparator period, through on-going operational productivity improvements, despite continued strategic investments in longer-term growth opportunities. These investments include the expansion of our sales and service network, targeted large projects and increasing our presence in high-growth markets.

## Priorities for 2014

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

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



1

## Driving top-line growth...

### Eliminating 'bad actors'

John Crane has signed a supply and service contract with one of Colombia's main oil transportation companies [midstream] to replace and maintain crucial seals along a crude oil pipeline. The four-year agreement was developed in a joint effort between John Crane and the customer, based on a unique reliability commitment that distinguishes John Crane's customer intimacy strategy, particularly in high-growth markets. The elimination of repeated failures of mechanical elements, known in the industry as 'bad actors', is key to optimising reliability. John Crane's 'Sealing Systems Reliability Programme – SSRP' is designed to allow the customer to focus on increasing operational profitability by pre-empting any problems caused by unplanned outages. Through its Performance Plus contracts, John Crane is now using the SSRP as a model for other supply and service agreements around the world.

## Smiths Medical

**A leading supplier of specialist medical devices, consumables and equipment for global markets.**

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

**Srini Seshadri**  
President, Smiths Medical



**Contribution to 2013  
Group revenue**

**27%**

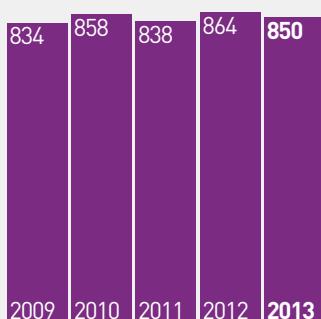
**Contribution to 2013  
Group headline operating profit**

**32%**

Percentage relates to headline operating profit before corporate costs

**Headline revenue performance  
£m**

**£850m (2)%**

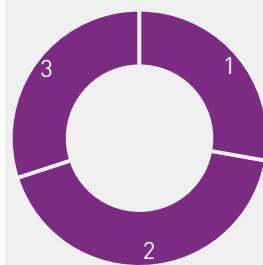


**Principal operating regions**

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

**Revenue by sector**

- 1 Medication delivery 28%
- 2 Vital care 42%
- 3 Safety devices 30%



**Medication delivery**

**28%**



**Vital care**

**42%**



**Safety devices**

**30%**



**Customers**

We estimate that three-quarters of our end customers are hospitals, with the remainder comprising the alternate care market such as homecare, clinics and other surgery centres, 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 broad product portfolio. Our major competitors include Covidien, Teleflex, B Braun, Becton Dickinson, C R Bard, 3M (Arizant), Hospira and CareFusion. We often compete with a small portion of a major competitor's medical business, as well as with smaller, single product line companies trying to gain entrance into a particular market. In emerging markets, we compete with both large multinational companies and smaller domestic players.

**Suppliers**

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

## 1 Driving top-line growth...

### Driving regional growth

Faced with a formidable diversity of market opportunities across Southeast Asia, Smiths Medical challenged its Singapore office to set up the most efficient way of capitalising on the booming regional demand for medical devices and equipment.

The team divided the vast region of some 570 million people into eight markets handled by 27 'channel partners', a low-cost, low-risk strategy that delivered 18% growth this year. "Our structure has greatly helped us improve our relationships with distributors, develop regional product and market knowledge, identify opportunities, and apply effective action plans to increase sales," said Vasanthi Supurmaniyam, regional Sales and Marketing Director.

### Markets and trends

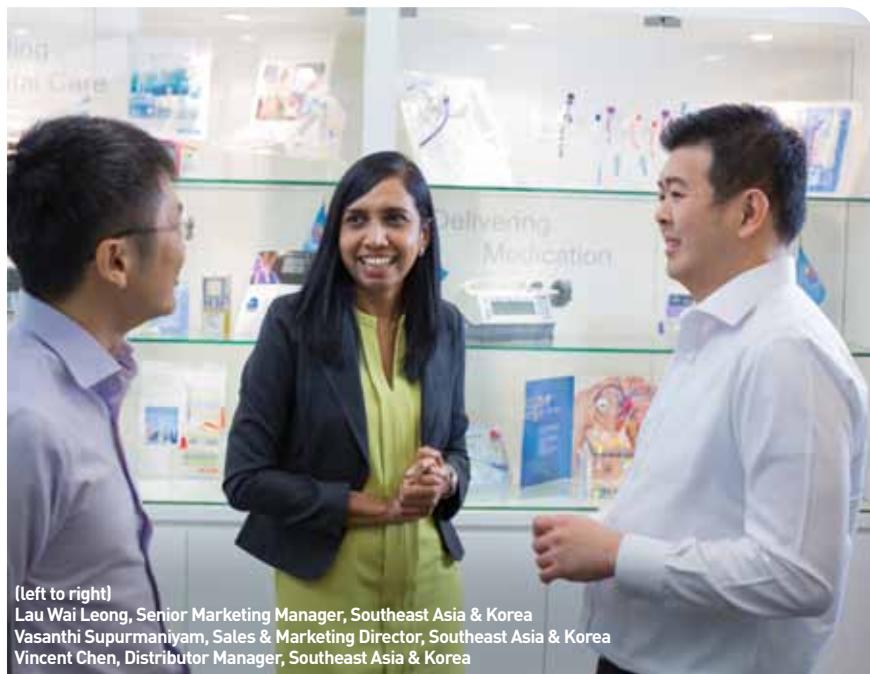
Budgetary restrictions continue to constrain customers' capital spend and increase price pressure in many markets – driven in part by increasing healthcare regulation. Procedure growth rates have stalled or even declined in some countries due to reduced healthcare budgets, high unemployment and employer cost shifting.

Despite market challenges, the medical device sector remains attractive, driven by ageing populations, safety legislation, device interoperability and increasing prosperity – particularly in emerging markets. The global market served by Smiths Medical is estimated to be over £6bn, 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. Its 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, and treat patients with cancer, pulmonary hypertension, Parkinson's disease and other conditions at home. 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



[left to right]

Lau Wai Leong, Senior Marketing Manager, Southeast Asia & Korea  
Vasanthi Supurmaniyam, Sales & Marketing Director, Southeast Asia & Korea  
Vincent Chen, Distributor Manager, Southeast Asia & Korea

brand is a leader in ambulatory infusion, and we have a strong position in the syringe pump market with our Graseby and Medfusion products.

### Vital care

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

### Safety

The vision for Smiths Medical's safety portfolio is to protect healthcare workers and their patients from the risk of infection and injury through the use of safety enabled devices. Smiths heritage of innovation has pioneered safety devices such as the first safety peripheral intravenous catheter (ProtectIV), and the first port for delivery of chemotherapeutic agents (PORT-A-CATH). Devices in this portfolio cover 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 Medical related safety products is estimated to be £2.1bn, and is expected to grow as the focus on safety and reducing the risk of infection intensifies. Smiths Medical is well positioned to capitalise on the advancement of sharps safety initiatives, including directives in the EU and Brazil designed to protect healthcare workers from the risk of needlestick injuries. Our latest innovations in IV catheters are ViaValve, which offers blood control and

needlestick injury protection, and IntuitiIV, a passive safety catheter; both are well positioned for growth.

### Strategy

We are focused on expanding our global scale by driving growth in selected markets and introducing new products and technologies to an increasingly diverse set of healthcare providers, while responding to changes in healthcare, including reimbursement pressures, accountable care requirements, constrained hospital budgets and the shift to non-acute care settings. We have focused on well-defined initiatives that leverage our core strengths: a comprehensive product portfolio; a deep, new product pipeline; established developed market resources; significant emerging market investment; robust manufacturing; a streamlined supply chain base, and a proven ability to drive operational excellence, including our commitment to operating responsibly.

### Competitive strengths

- Strong market positions in niche areas
- Highly recognised and respected brands
- Reputation for high 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

	2013 £m	2012 £m	Reported growth	Underlying growth
Headline revenue	<b>850</b>	864	(2)%	(1)%
Headline operating profit	<b>189</b>	203	(7)%	(7)%
Headline operating margin	<b>22.2%</b>	23.5% (130) bps		
Statutory revenue	<b>850</b>	856	(1) %	
Statutory operating profit	<b>179</b>	180		
Return on capital employed	<b>16.6%</b>	17.6% (100) bps		

### Key operational highlights

- Growth in vital care offset by declines in medication delivery and safety devices
- Emerging markets up 8% – good growth in several key markets
- Margins affected by accelerated investment, US Device Tax and price pressure
- New product development investment up 12%

### Performance

Smiths Medical headline revenue declined 2%, or £14m, reflecting an underlying fall in revenue of £7m (1%) and a currency impact of £7m. The underlying decrease resulted from weaker infusion hardware business, which was affected by hospital capital constraints, and stalled procedure volumes in some major developed markets. Emerging market sales grew 8%, and now represent over 11% of revenue, the increase supported by a broadening of our product sales efforts. Consumables, which comprise almost 85% of our total revenue, were flat. Hardware revenue fell 3%, largely due to lower sales of the wireless Medfusion 4000 syringe pumps, partly offset by ambulatory pumps growth.

Headline operating profit declined 7% (£14m) and headline operating margin fell 130 basis points to 22.2%. Margins were hit by the accelerated investment in a range of growth initiatives (£10m), including sales capabilities in emerging markets and new product development. The impact of the US medical device tax (£4m) and pricing pressure in many markets was also felt. These adverse effects were mitigated to some extent by one-off benefits from insurance receipts (£6m).

Return on capital employed fell 100 basis points to 16.6% as a result of the reduced profitability. The underlying decline in revenue and profitability was a result of difficult trading conditions in the medical devices sector. These stemmed from adverse pricing, capital spending constraints, and stalled procedure growth rates in some countries. The pressures were particularly acute in Europe, given the continued austerity measures and economic uncertainty.

Statutory operating profit at £179m principally reflects amortisation of acquired intangible assets of £11m.

While developed markets remain challenging, increases in access to healthcare and rising spend in emerging markets continue to provide growth opportunities. We have expanded our efforts and presence in these markets to leverage our broad product portfolio, and are beginning to see positive impact from the 230 headcount added during the prior year in selected countries, including China, Brazil, India, and various Southeast Asia and Middle East markets. We continue to see early signs of success with another year of strong revenue growth in the Middle East, Latin America, and Asia Pacific. In China sales of newly registered products grew strongly but overall performance has been restricted by the base infusion business, where we are introducing product range improvements to support accelerated growth.

Underlying revenue from safety devices declined 5%, primarily resulting from pricing pressures and share loss in the US. China and SE Asia saw growth as customers adopt the newly registered safety products. Interest in both safety needle and catheter products remains high in developed markets and is growing in emerging markets. Two safety catheter products were launched during the year to capture global safety opportunities and replace conventional catheter sales in many developed markets. In addition, outside the US, sharps safety sales grew 10%, and vascular access was flat with growth in huber needles offsetting other declines.

The medication delivery business was unable to repeat the strong second half seen in 2012, and full year results declined 2%. However, ambulatory infusion revenue grew well, through the continued success

of our CADD-Solis pumps and dedicated disposable sets, as well as launches of CADD-Solis PIB in Canada and CADD-Solis VIP in the US. Infusion system revenue fell, reflecting hospital capital constraints and deferrals, with spending priorities currently on EMR and IT infrastructure. Medfusion 4000 continues to have a robust order pipeline, and we are well placed to capture further growth as conditions improve.

Vital care underlying revenue was up 3% despite relatively sluggish procedure volumes and pricing pressures in developed countries. Assisted reproduction, general anaesthesia, invasive blood pressure monitoring, tracheostomy and temperature management businesses all grew. Respiratory posted strong growth, driven by the Carefusion distribution agreement for our bronchial hygiene products in the US acute care market. These gains were offset by declines in patient monitoring, veterinary and kitting product lines where we are eliminating low-margin stock-keeping units.

We continue to pursue variable cost productivity initiatives aggressively, though operational resources were also engaged in overcoming short-term external supplier disruption during the year. The contribution to margin expansion has enabled further investment in sales and marketing. We have identified further opportunities for cost savings through a programme of site rationalisation and other operational efficiencies such as variable cost productivity initiatives. We continue to review our manufacturing footprint to support future growth cost effectively. Further details will be provided at the interim results in March 2014.



(left to right)  
Denise Tacy, Customs Specialist, Anaesthesia Circuits, US  
Kim Chaffee, Alternate Care Manager, Anaesthesia Circuits, US  
Beth Youngman, Customs Specialist, Anaesthesia Circuits, US

## Research and development

Investment in new product development remains a priority, increasing 12%. Our total R&D spend of £38m (2012: £34m) comprised 4.4% of revenue (2012: 3.9%). We continued to narrow the number of pipeline projects to ensure adequate investment in the highest impact products. This is raising the rate of project execution and will continue to increase overall R&D effectiveness.

Our vitality index, measured as sales from products launched in the last three years, totalled 5%. The decline since last year was due primarily to the current infusion hardware market conditions. During the year, we launched our CADD-Solis VIP platform in the US market, and our CADD-Solis PIB in Canada. These launches have fuelled significant growth in North America, further strengthening our leadership in the ambulatory pump markets. We received FDA 510(k) clearance for our new ViaValve Safety IV Catheter in North America, and CE clearance for our new Jelco IntuitIV Safety IV Catheter in Europe. Both have now been successfully launched. We have also launched our Bivona Inner Cannula to extend our range of Bivona silicone tracheostomy products. In emerging markets, we have registered many existing portfolio products, including multiple safety product ranges in Brazil, China and India, where we are engaging our customers on the benefits of adopting safety devices.

## Outlook

Developed markets are likely to remain challenging in the short term as healthcare cost controls, unemployment and changes in employer funding of healthcare plans squeeze price and procedure volumes. In the US, the medical device tax is constraining margins, though we will continue to seek to offset the impact, primarily through operational improvements and increased focus on higher margin products. We will pursue ways of driving sales growth through increased investment and new product introductions, coupled with a continued emphasis on customer-facing resources, sales effectiveness and leveraging our broad portfolio through our extensive global network.

### Priorities for 2014

- Drive penetration of our top-selling products across all key franchises
- Emerging market growth, leveraging the infrastructure established over the past 18 months
- Accelerate investment in new product development to support long-term growth
- Fund growth through operational excellence initiatives, by reducing both fixed and variable costs

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

## 2 Enhancing margins...

### Breathing circuits for advanced surgery

The advent of more advanced surgical procedures, often robotics-led, has resulted in major changes in how anaesthesia breathing circuits are configured. These devices, which deliver anaesthetics and air to patients undergoing surgery, must now be able to extend further across the operating theatre. Kim Chaffee, a regional marketing manager at Smiths Medical, explains how its long-established Portex product line adapted to the changing requirements. "The changes in clinical application opened a great opportunity for us to offer a series of longer breathing circuits, up to twice the length currently available as standard. These circuits are faster to make, more cost-effective and profitable than the specialised, customised service which can generate only a small proportion of potential sales."

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

**Mal Maginnis**  
President, Smiths Detection



### Contribution to 2013 Group revenue

**18%**

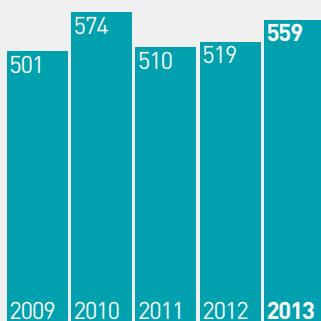
### Contribution to 2013 Group headline operating profit

**10%**

Percentage relates to headline operating profit before corporate costs

### Revenue performance £m

**£559m +8%**

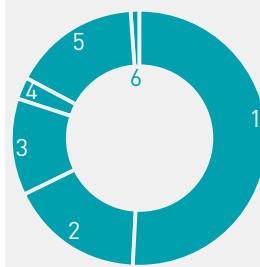


### Principal operations regions

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

### Revenue by sector

- 1 Transportation 51%
- 2 Ports and borders 17%
- 3 Military 12%
- 4 Emergency responders 3%
- 5 Critical infrastructure 16%
- 6 Non-security 1%



#### Transportation 51%



#### Ports and borders 17%



#### Military 12%



#### Emergency responders 3%



#### Critical infrastructure 16%



### Customers

A significant majority of sales are influenced by more than 100 governments and their agencies, including homeland security authorities, customs authorities, emergency responders and the military. These include the US Department of Defense, US Transportation Security Administration (TSA), and the UK Ministry of Defence.

### Competitors

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

### Suppliers

We are actively developing synergies across sites and restructuring our purchasing group to ensure that we fully leverage the size of our business. These developments will be on-going taking into account the demand for local content with some of our major customers as well as our stringent quality and delivery requirements. Our procurement team has now been centralised and our engagement with suppliers is being standardised across all business operations.

## 1 Driving top-line growth...

### Drive-through security screening

Growing market demand for a scanner specialising in screening cars and light trucks has led to the launch of Smiths Detection's CIP-300, a low-energy X-ray system that can reveal hidden explosives, drugs, stowaways and contraband while drivers and passengers remain in the vehicle. The CIP-300 can typically be deployed wherever high-energy equipment is not suitable. A compact footprint and simple configuration offer an affordable and adaptable system that can be applied to a range of operational areas. "This versatile scanner fills an important gap in customer requirements for a 'drive-through' solution," said product manager Joachim Petry.



Left: Marco Dick, Product Management Intern, Germany  
Right: Joachim Petry, Product Manager CXS, Germany

### Markets and trends

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

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

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

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

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

Overall demand in the highly fragmented critical infrastructure market is expected to grow. Governments and other organisations are seeking to protect their assets within current terror threat levels and increasing levels of perceived risk. The highly diverse nature of customers and different forms of threat they face requires application-specific solutions to be developed and the increasing requirement for ease of use by operators to be met.

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

### Strategy

Smiths Detection is focused on leveraging its technology leadership and global reach to exceed the changing demands of our customers. Our main markets hold

excellent long-term growth prospects, but they are evolving and our investment will be channelled rigorously towards the highest-margin products and services. Business focus is increasingly on fewer, more profitable programmes and the rising volume of smaller contracts. Building better customer insight and improved delivery processes will also help boost aftermarket sales and smooth out the traditional volatility of prime contracting. We expect the recurring 'run-rate' business from better aftermarket penetration to comprise some 30% of revenue in the medium term. Rising passenger volumes are driving new airport and infrastructure investment, especially in the emerging markets. In addition, the need for new products to meet ever-evolving security threats, a strong replacement cycle and the globalisation of trade will continue to support healthy market growth.

### Competitive 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. 25% of sales from aftermarket service and growing
- Global sales and service network with strong emerging market presence

### Growth drivers

- Evolving terror threats
- Security regulations on cargo and passengers
- Replacement cycle – typically 7-10 years
- New product launches
- Growth of security infrastructure in emerging markets

	2013 £m	2012 £m	Reported growth	Underlying growth
Revenue	<b>559</b>	519	8%	8%
Headline operating profit	<b>58</b>	69	(16)%	(16)%
Headline operating margin	<b>10.4%</b>	13.3%	(290) bps	
Statutory operating profit	<b>52</b>	84		
Return on capital employed	<b>8.8%</b>	10.3%	(150) bps	

### Key operational highlights

- Revenues up by 8%, driven by strong Transportation and Ports and Borders demand
- Emerging markets sales up 34% – now 20% of overall revenues
- Ramp-up of two new X-ray manufacturing hubs in Asia and USA
- Certification of major new products

### Performance

Revenue at Smiths Detection grew 8% (£40m) on a reported and underlying basis, excluding the impact of currency translation. This growth was driven by strong demand in the transportation, ports and borders and military sectors, which more than offset declines in the critical infrastructure and emergency responders sectors primarily caused by budget uncertainty in the US market.

As announced in July, we identified that the final outcome of three contractual commitments would not meet expectations. They largely involved ports and borders customers where margins are typically lower than average, and the additional costs arose from technical and commercial challenges encountered in contract execution. This, together with additional provisions for the costs associated with certain legal disputes, resulted in a charge of £15m. As a result, headline operating profit fell £11m on both a reported and an underlying basis. Headline operating margins declined 290 basis points to 10.4%. Profitability was also affected by a shift in the timing of certain contracts, reflecting pressures on government spend and delays to airport infrastructure programmes. In addition, there has been an initial under-recovery of overheads at new manufacturing sites.

The fall in profitability resulted in return on capital declining by 150 basis points to 8.8%.

Statutory operating profit includes exceptional restructuring costs (£7m), offset by £2m of acquisition-related gains.

The performance improvement programme delivered £9m of savings and incurred £7m of costs during the year. To date, we have achieved £24m of savings and spent £27m, of which £20m was treated as exceptional. The programme is expected to deliver £36m of annualised savings by the end of fiscal 2015 and cost £33m overall. The X-ray manufacturing plant in Malaysia is now fully operational for mainstream assembly and X-ray generator and detector manufacturing will be added in the coming year. Reduced regional shipping times have already helped to secure significant new orders from Japan and South Korea and allowed the division to bid on tight delivery tenders that were previously uneconomic from Europe.

In Wiesbaden, Germany, our major X-ray production and R&D centre, agreement with the local works council has been reached on the reduction of up to 170 manufacturing employees before the end of 2014. This will lower costs in the coming year. Revenue from aftermarket sales grew in line with overall revenue to remain at 26% of sales. But aftermarket operations, a major focus for long-term revenue, are on track to achieve our target of 30% of revenues in the medium term.

Revenue from emerging markets grew 34%, to represent over 20% of sales. This growth stems from an increased focus on sales force deployment, training, and deeper customer insight. The critical infrastructure market in Russia and the modernisation of Brazil's ports and borders have generated business opportunities.

Transportation revenue grew 17% including airport contracts from customers in Qatar, Spain, New Zealand and Canada. Smiths Detection was selected to equip the new Terminal 2 at Heathrow Airport with advanced X-ray machines to check passengers' hand-baggage, and to

upgrade security checkpoints in other terminals. Investment by most existing airport operators and governments has been curtailed but new airports and terminals are planned, mainly in the Middle East and Asia Pacific.

Underlying revenue in ports and borders grew 18%, helped by major cargo scanner contracts in Azerbaijan and Brazil. Although government spending was generally weak, enquiry levels remain encouragingly high. We are also developing products to identify specific threats in this market and the recently launched next-generation, portable radiation detector and identifier, RadSeeker, was chosen by the Canadian border authorities to enhance national security.

In the military sector, underlying revenue increased by 24%. This reflects a stabilisation of military budgets as defence forces scale back participation in major conflicts. However, follow-on and support contracts continue to be awarded, including the US Army's order for \$7m of chemical detectors towards the end of the period and the UK MoD's £18m contract for biological consumables support.

The critical infrastructure sector saw underlying revenue fall 17%. This market, which includes government buildings, public utilities, prisons, hotels and other strategic sites, has been adversely affected by budget constraints, primarily in the US.

### Research and development

Smiths Detection remains committed to the funded development of its main technologies and new products and systems, to maintain its competitive position. Company-funded R&D was broadly stable at £36m or 6.5% of revenue (2012: £37m or 7.2%). This includes £16m of capitalised projects. Smiths Detection actively seeks customer and government



(left to right)

Lee Hiong Chua, Operations Director, Malaysia

William Lye, Manufacturing Engineering Manager, Malaysia

Izharuddin bin Ahmad Ahpandi, Manufacturing Engineering Manager, Malaysia

support for R&D which totalled £6m in the period (2012: £6m). Total R&D spend was £42m (2012: £43m) or 7.6% of revenue. Main developments included the CIP-300 low-energy X-ray scanner to meet increasing demand for a system to detect explosives, drugs, stowaways and contraband hidden in cars and light motor vehicles. The system allows drivers and passengers to remain in their vehicles during screening. The launch of a Threat Identification Module (TIM) allows airport operators to upgrade existing X-ray systems to comply with the January 2014 EU change to the regulations on transfer passengers carrying liquids on board flights.

The HI-SCAN 10080 XCT has now received certification from the EU authorities and laboratory certification from the US TSA. Bremen Airport saw the first fully operational deployment of the system, a next-generation explosives scanner for hold baggage combining multi-view X-ray technology and three-dimensional computed tomography (CT). The single system provides both greater security and high throughput.

In addition, the eqo millimetre-wave people screener has passed the ECAC (European Civil Aviation Conference) Standard 2 threat detection test.

## Outlook

The current order book is slightly behind the same time last year, against a strong comparator. We also have some major transportation programmes to be delivered in the coming year. Governments continue to look at ways of improving ports and borders operations and tendering activity is high in this market. Performance is still subject to the cycle of capital spending by governments. However, we are well positioned with the launch of several new products and we should benefit from a continued focus on aftermarket revenues. Margins are expected to improve as a result of productivity initiatives and better contract execution.

## Priorities for 2014

- Focus on value-enhancing contracts and programme delivery
- Drive efficiencies of new manufacturing hubs to reduce lead time and costs
- Create local supply chains to maximise regional manufacturing
- Increase run-rate and aftermarket revenues to reduce volatility

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

## 1 Driving top-line growth...

### X-ray production starts in Asia

Smiths Detection's newly opened manufacturing plant in Malaysia has started supplying X-ray baggage scanners to the fast-growing aviation markets of Southeast Asia. Production at the 130,000 square foot site in Johor Bahru is now running at around 100 systems a month. As befits the region it serves, the plant is the first in Smiths Detection to use the Kanban system of 'just-in-time' production, as Operations Director Lee Hiong Chua explains. "Kanban helps us to minimise our inventory and greatly improves the efficiency of our manufacturing schedules. By aligning inventory levels with actual demand, the relationship between us and our customers is kept as close and transparent as possible."

Johor is initially focusing on making systems to screen hand baggage and parcels, followed by larger versions that screen pallets and freight. The advanced aTIX automatic explosives detectors are due to be manufactured at the new site within a year.

## 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.**

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**Mark Reckitt**  
President, Smiths Interconnect



**Contribution to 2013  
Group revenue**

**15%**

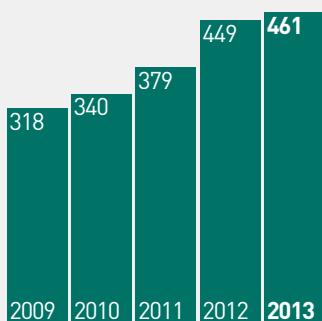
**Contribution to 2013  
Group headline operating profit**

**12%**

Percentage relates to headline operating profit before corporate costs

**Revenue performance  
£m**

**£461m +3%**

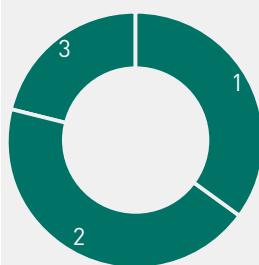


**Principal operations regions**

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

**Revenue by sector**

1 Connectors 35%  
2 Microwave 44%  
3 Power 21%



**Connectors**

**35%**



**Microwave**

**44%**



**Power**

**21%**



**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, Deutsch (part of TE Connectivity), MultiTest (part of Dover), Yokowo, Glenair, ODU and Harting. Microwave competes with, amongst others, Anaren, KMW, Dover, CommScope, Cobham, EMS (part of Honeywell) and Teledyne. Emerson Network Power, Cyberex (part of ABB), Eaton, Starline (part of Universal Electric), Huber & Suhner, Dehn + Söhne and Phoenix Contact offer competitive power management products.

**Suppliers**

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

## 1 Driving top-line growth...

### Powering complex data centres

When Mumbai-based GPX, a major data centre provider, faced the task of building a 'future proof' hub able to meet the demand for co-location services, it turned to Smiths Power for a flexible solution for its power needs. Part of Smiths Interconnect, Smiths Power develops systems that deliver ultra-reliable and precisely monitored power performance. Its WaveStar static transfer switches and remote power panels feature intelligent branch circuit monitoring for sophisticated power management that can be readily expanded or modified. "We were able to offer the optimal security and operating conditions crucial for mission-critical equipment and applications used by GPX which constructed the first 'Uptime Certified' Tier IV data centre facility in South Asia," said B Ramakrishnan, Senior Account Manager, Asia, Smiths Power.

### 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 military and aerospace, wireless telecommunications, data centres and semiconductor test.

Considerable pressure remains on defence budgets, given US sequestration and European austerity. While no area is immune, 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.



B Ramakrishnan, Senior Account Manager, Asia, Smiths Power

The commercial aerospace market continues to be 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 is still 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 are expanding 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 solutions to semiconductor test, automated test equipment and circuit-board test applications. The continued proliferation of electronic devices, high rate of technology refresh and increased functionality are key drivers for these markets.

### Strategy

Smiths Interconnect is continuing its transition from lower-growth government-funded markets to higher-growth commercial markets. Recent 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 data centres, semiconductor 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
- Require significant investment in semiconductor and electrical test, data centres, wireless infrastructure and aerospace

	2013 £m	2012 £m	Reported growth	Underlying growth
Revenue	<b>461</b>	449	3%	(1)%
Headline operating profit	<b>69</b>	66	4%	3%
Headline operating margin	<b>14.9%</b>	14.7%	20 bps	
Statutory operating profit	<b>49</b>	34		
Return on capital employed	<b>12.4%</b>	12.3%	10 bps	

### Key operational highlights

- Revenue growth in connectors offset by declines in microwave and power
- Investment in new products up 5%
- Emerging market sales up 5%
- Margins up 20 bps reflecting productivity gains
- Strengthened the divisional and business unit leadership teams and talent

### Performance

Reported revenue rose 3%, or £12m, driven by a £14m contribution from the acquisition of Power Holdings Inc. (PDI) in October 2011 and a £3m benefit from foreign exchange translation. Excluding these, underlying revenue fell 1%, or £5m. Modest growth in the Connectors business unit was offset by declines in Microwave and Power. The former was impacted by government budget cuts and sequestration in the US, which reduced defence spending, and the latter by continued softness in industrial and alternative energy markets.

Reported headline operating profit increased 4%, or £3m. Excluding a £1m benefit from acquisitions and foreign exchange, underlying headline operating profit grew by 3% or £2m. Margins improved 20 basis points on the back of productivity initiatives. A strong margin improvement in Connectors, benefiting from prior and current year cost cutting, was partly offset by a decline in Microwave due to some pricing pressure in commercial markets and the additional investment to create the Microwave business unit. Power margins were flat as efficiency improvements balanced infrastructure investments and the diluted margins of sales in acquired businesses.

Across the division, cost reduction activities focused on further transfer of production to lower cost regions including China, Mexico, Costa Rica and Tunisia; the outsourcing of non-core processes such as plating, moulding and ceramics; and a greater focus on lean and value engineering.

Return on capital improved by 10 basis points to 12.4% reflecting improved profitability.

Statutory operating profit at £49m principally reflects amortisation of acquired intangible assets of £20m.

Smiths Interconnect remained focused on building the leadership teams and talent in its three business units, and supporting the necessary investment in resources and processes to further facilitate the transition from government-funded to commercial markets.

In Connectors, underlying revenue increased 3% despite tough market conditions as defence budgets declined and the climate of austerity persisted in Europe. In addition, the Eurofighter programme, which represents a significant proportion of Connectors revenues, began to slow given the lack of new export orders. The semiconductor test market provided strong growth. A muted overall recovery in market conditions was buoyed by successful launches of new higher density and higher speed products and the continued success of a programme with a major customer. Other positive end markets included medical and commercial aerospace where Connectors focused more resources. Successful new applications included a connector assembly for a new electrophysiology mapping catheter system and the design-in of several products for a new commercial aircraft being developed in Asia. Geographically, the initiative to increase our presence in Asia is gaining traction with the addition of several new sales resources.

After exceptional growth in 2012, Microwave's underlying revenue declined 2% against a strong comparator, but consolidated its position despite significant headwinds. In defence, Microwave's largest end market, we experienced delays in follow-on production awards for several projects, particularly in the second half, although good progress was made on several existing military programmes.

In wireless telecoms, there was continued traction in developing regions as Indian and Chinese network operators started to recognise the benefits of using PIM (passive intermodulation) test equipment. We also significantly increased market share in the US, gaining a key new customer and increasing sales to other operators for our network optimisation products. Sales of the KuStream airborne antenna system weakened in the second half as no new notable airline orders were secured by our major customer. Nonetheless, new opportunities with new products and alternative customers are being progressed. Despite strong competition, we successfully retained a major cable assembly project for the production testing of consumer handheld devices, which generated sufficient demand to match the strong growth achieved in the prior year.

Power revenues increased 10%, on the back of the PDI acquisition. On an underlying basis, revenues declined 6% although the business showed some improvement in the second half, with growth of 7% partially offsetting the 21% first half decline. This turnaround was driven by better sales focus and execution, and strong demand from co-location data centres where the particular customer needs are well aligned with our value proposition of customisation and flexibility. The North American enterprise data centre market remained soft. Other markets such as alternative energy experienced declines on the back of continued weak demand and we are still seeing delays in US military orders for power and electromagnetic pulse protection devices. There are on-going cost-saving initiatives in areas such as value engineering and lean manufacturing to support margins.



(left to right)

Gabriel Guglielmi, VP Business Development & Strategy, Smiths Connectors, US  
David Henry, Global Engineering VP for Platform Product & Manufacturing Engineering, Smiths Connectors, US

## Research and development

Company-funded R&D increased 5% to £24m or 5.2% of revenue (2012: £23m or 5.1% of revenue). In addition, a further £3m in investment was secured for customer-funded projects (2012: £4m). These relate primarily to defence-related projects, which have experienced funding constraints in recent years. Smiths Interconnect continued its strategy to focus resources on high-growth sectors and investment opportunities providing the best risk-adjusted returns with a particular bias to commercial markets. Examples include a new test socket whose insulated metallic housing and unique structure deliver exceptional signal integrity, a new battery bus bar connection for the nascent electric vehicle market, high-frequency radio frequency links for commercial applications, and a new AC surge protection platform range – all aiming to develop innovative technology and address new applications at a competitive cost.

Investment also continued in developing next-generation versions of our market-leading products and technologies, particularly PIM test equipment and airborne antenna systems.

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

## Outlook

Improving trading conditions in some commercial end markets are likely to be offset by more difficult environments elsewhere, such as defence. This is likely to result in relatively modest revenue and profit growth overall, with a bias to the second half. The defence market is expected to remain challenging, although we are comparatively well placed in key technologies and on some long-term programmes. The semiconductor test and data centre markets are expected to become more robust, dependent on macroeconomic conditions and consumer spending patterns. New product launches should help wireless telecoms sales, although they face a tough comparator. Margins should benefit from continuing productivity and pricing initiatives.

## Priorities for 2014

- Strengthen business development capabilities to embed market-led strategies
- Sustained investment in new product launches
- Continued focus on commercial market opportunities and international expansion
- Deliver cost savings through further site rationalisation, lean and value engineering

## 1 Driving top-line growth...

### Da Vinci test socket success

The high-speed semiconductors that drive video graphics, networking devices and ever more sophisticated applications need equally advanced testing systems to ensure their quality and reliability. With that in mind, Smiths Connectors, part of Smiths Interconnect, has launched the Da Vinci test socket which offers unprecedented semiconductor test reliability. The mechanical and bandwidth limitations of traditional plastic spring probe sockets are overcome by the insulated metallic housing and unique structure that enable it to deliver exceptional signal integrity.

Gabriel Guglielmi, VP Business Development & Strategy of Smiths Connectors said: "The Da Vinci socket gives our customers faster test throughput and far greater confidence in the performance of their end-products. Its success with US customers is already delivering sales totalling several million dollars, and is now being replicated in Europe and Asia where marketing drives are underway."



## 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.**

**Tedd Smith**  
President, Flex-Tek



### Contribution to 2013 Group revenue

**8%**

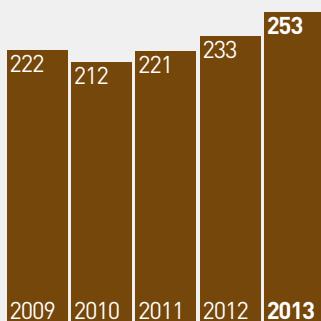
### Contribution to 2013 Group headline operating profit

**7%**

Percentage relates to headline operating profit before corporate costs

### Revenue performance £m

**£253m +9%**

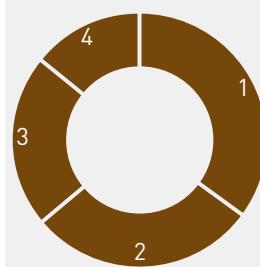


### Principal operations regions

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.

### Revenue by sector

- 1 Fluid Management 35%
- 2 Construction Products 29%
- 3 Heat Solutions 22%
- 4 Flexible Solutions 14%



#### Fluid Management

**35%**



#### Construction Products

**29%**



#### Heat Solutions

**22%**



#### Flexible Solutions

**14%**



### 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.

## 1 Driving top-line growth...

### Customised for high purity market

Combining innovation and traditional expertise, Flex-Tek has used its leadership in flexible hosing to enter a new and potentially attractive market in ultra-clean hoses. It has developed an entirely non-stick version to challenge the domination of silicone hoses in the \$20m 'high purity' market which ranges from pharmaceuticals to fragrance and food and beverage. Senior Engineer Mike Fonfara led the team that created the all-PTFE (Polytetrafluoroethylene) PharmaFlex hose. "Its non-stick qualities give the 100% product flow-through crucial for success in a niche market that cannot allow the tiniest residual contamination. The unique exterior enables it to operate in extreme heat and allows for easy cleaning without compromising the integrity of the hose," Fonfara explained.

### 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 10,000 units – this is equivalent to over seven 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 is largely dictated by household appliance demand in the US, with additional growth driven by specialty applications in the US and Asia.



(left to right)

Mike Fonfara, Senior Engineer, US

Rick Martini, Manufacturing Engineer, US

### Construction Products

Flex-Tek manufactures market-leading flexible gas piping and HVAC flexible ducting for the US construction market. Our customers are large national wholesale distributors in North America, supplying both plumbing and HVAC tradesmen. 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
- >90% share of clothes tumble dryer applications in North America
- 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

	2013 £m	2012 £m	Reported growth	Underlying growth
Revenue	<b>253</b>	233	9%	8%
Headline operating profit	<b>43</b>	38	14%	13%
Headline operating margin	<b>17.1%</b>	16.3%	80 bps	
Statutory operating profit/(loss)	<b>36</b>	(17)		
Return on capital employed	<b>30.8%</b>	28.4%	240 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's reported revenue grew 9%, or £20m, driven by an underlying increase of £18m (8%) and a £2m gain from currency translation. Continued revenue growth in Fluid Management and sales to the reviving US residential construction market formed the basis for the improvement. Heat Solutions and Flexible Solutions revenues were flat to prior year. Headline operating margin rose 80 basis points to 17.1% as a result of the increased volumes and associated operational gearing and positive mix from faster growing aerospace sales. The underlying increase in operating profit of 13% (£5m) stemmed from higher volumes, pricing and the benefits of our cost-saving initiatives.

Return on capital employed rose to 30.8%, an increase of 240 basis points, on the back of the improved profitability.

Statutory operating profit at £36m reflects exceptional litigation costs of £7m. In the prior year, the establishment of a provision of £55m resulted in a statutory operating loss.

In Fluid Management, sales of components to aerospace customers remain strong with an underlying increase of 9% versus prior year. Demand from major airframe manufacturers Airbus and Boeing and engine manufacturers Pratt & Whitney, GE, and Rolls-Royce has increased as new orders have pushed the large commercial jet backlog to record levels. R&D costs have risen as we have incurred qualification expenses in order to position the business for the next generation of quieter, more fuel-efficient aircraft. We also see steady growth in the US automotive market for our tubing in both fuel and brake applications.

Sales of our flexible gas piping and HVAC ducting to the construction market rose 18%. According to the US Census Bureau, the July 2013 seasonally adjusted annual rate of new single family home starts was slightly below 600,000, a 15% increase from July 2012. 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. We have also invested in new sales efforts for our flexible gas piping to be introduced into the UK market.

Heat Solutions underlying revenue was flat to the prior year, comprising a mix of sales growth in specialty heating elements offset by weakness in the residential HVAC and appliance sector, reduced nickel prices, and correspondingly lower surcharges passed along to customers (£1m). The US household appliance market saw 2-3% growth over the prior year due to cautious consumer sentiment. Lower revenue from OEM HVAC equipment manufacturers was offset by sales to the aftermarket distributors via our cross selling efforts with ducting and gas piping. Sales of our custom heating elements continue to grow and we have increased our R&D investments in new technologies.

Underlying revenue at Flexible Solutions was down 2% with higher revenues for medical hose products in the sleep apnoea market and a slight uptick in the US industrial market offset by continued weakness in floor care. Growth in specialty applications and R&D investment in medical products are producing positive results.

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.

**Outlook**

The commercial aerospace market remains positive and we expect this to continue, with a bias to the second half. US residential construction has rebounded from historical lows and we foresee modest steady improvement, although interest rates, higher home prices, and stricter lending practices may dampen anticipated growth. As Heat Solutions and Flexible Solutions move to more bespoke, specialty applications, improved general economic conditions will benefit these businesses.



Chris LeBlanc, Power Bender, US

#### Priorities for 2014

- 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

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



#### 1 Driving top-line growth...

##### Building a platform with Airbus

A regional division of Flex-Tek has won an exclusive, 20-year 'platform' contract with Airbus to supply the new fuel-efficient A350 airliner with lightweight hosing for its engines, landing gear and hydraulic systems. Leveraging an existing, smaller, supply relationship, David Galopin, Technical Director at Titeflex Europe, and his team were able to satisfy a range of new technical requirements specific to the A350. Having already developed the lightweight, high-pressure Kevlar™ hose for Airbus, Titeflex was able to fully meet the A350 requirements. "Advances in our engineering, technology and supply chain, plus a good relationship with Airbus, have allowed us to establish a platform supply contract that we hope to build on over the next 20 years," says Galopin. "This kind of opportunity is rare in the aerospace market." With around 1,000 A350s due to be built, revenues from Titeflex's Kevlar™ high-pressure hosing could total as much as £30m over the life of the programme. "Thanks to this important project, we are now developing new types of hose for other customers," adds Galopin.

# Financial review

**Peter Turner**  
Finance Director



## Headline revenue

Up 2% to

**£3,109m**

Read more on page 28 and in note 1  
on page 115

## Headline operating profit

Up 1% to

**£560m**

Read more on pages 28 and 50 and in note 1  
on page 115 and note 3 on page 119

## Statutory revenue

Up 3% to

**£3,109m**

Read more on page 28 and  
in note 1 on pages 115-118

## Statutory operating profit

Up 21% to

**£493m**

Read more on pages 28 and 50 and in note 1  
on page 115 and note 4 on page 120

## Earnings per share

Basic headline earnings per share from continuing activities were 92.7p (2012: 92.6p). This reflects an increased headline operating profit and lower interest charge which has been mostly offset by the reduction in our share of profit from the associate, Cross Match Technologies, which was sold in July 2012.

On a statutory basis, the basic earnings per share from continuing activities were 90.7p (2012: 65.4p).

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

These items amounted to a charge of £56m compared to a charge of £131m in 2012. They comprised:

- Amortisation and impairment of intangible assets acquired in business combinations of £47m (2012: £62m). The charge relates principally to technology and customer relationships;
- A charge of £17m (2012: £44m) in connection with John Crane, Inc. asbestos litigation;
- A charge of £8m (2012: £55m) associated with Titeflex Corporation litigation following the establishment last year of a 10-year rolling provision in respect of future claims;
- A charge of £8m (2012: £15m) in respect of restructuring, principally relating to a performance improvement programme in Smiths Detection that will conclude in 2015;
- Costs of acquisitions, disposals and aborted transactions of £3m (2012: £2m);
- £5m profit on disposal of property (2012: nil);
- £1m profit on disposal of diabetes intellectual property (2012: £1m);

- £1m profit on disposal of businesses (2012: £31m);

- £2m gain on reassessed contingent consideration provided on acquisitions (2012: £2m);
- £4m gain on changes to pension plans (2012: nil);
- A credit of £16m for retirement benefit income (2012: £24m); and
- A financing loss of £2m (2012: £3m). This represents exchange movements on derivatives and other financing instruments not hedge accounted under IFRS.

During the year to 31 July 2012, in addition to the items above, an £8m charge in relation to a change in the basis of estimating sales rebates in Smiths Medical was also excluded from headline performance.

## Cash generation and net debt

Operating cash generation remained strong with headline operating cash of £548m (2012: £549m), representing 98% (2012: 99%) of headline operating profit [see note 26 to the accounts for a reconciliation of headline operating cash and free cash-flow to statutory cash-flow measures]. Free cash-flow increased £20 to £237m (2012: £217m). Free cash-flow is stated after interest and tax but before acquisitions, financing activities and dividends.

On a statutory basis, net cash inflow from continuing operations was £353m (2012: £332m).

Dividends paid in the year on ordinary shares amounted to £152m (2012: £144m).

Net debt at 31 July was £744m, a reduction from £791m at 31 July 2012. The reduction in net debt reflects strong cash generation that more than offset outflows from dividends (£152m) and pension funding (£78m) and the impact of foreign exchange (£41m).

## Interest and other financing costs

Interest payable on debt, net of interest earned on cash deposits, was £62m compared with £63m in 2012. This reduction reflects the higher average levels of cash. Interest costs were covered 9 times by headline operating profit.

The Group accounts for pensions using IAS 19. As required by this standard, a finance credit is recognised reflecting the expected return on pension scheme assets and a finance charge is recognised reflecting the unwinding of the discount on the future pension liability. The net financing credit was £16m (2012: £24m) and is excluded from our headline measures of profit.

In 2014, we will adopt IAS 19 (Revised) which, *inter alia*, will amend the calculation of this credit. The effect of the amendment on the current year's credit, (which is shown in note 9 to the accounts), will be to reduce statutory pre-tax profit by £46m.

## 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 £121m in R&D (2012: £117m), equivalent to 3.9% of revenue (2012: 3.8%). Of that total, £112m was funded by the Company compared with £107m in 2012, an increase of 5%. We actively seek funding from customers to support R&D and this amounted to £9m (2012: £10m). Under IFRS, certain development costs are capitalised, and this amounted to £30m in the period (2012: £29m). The gross capitalisation is shown as an intangible asset. Where customers contribute to the costs of development, the contribution is included as deferred income and disclosed within trade and other payables.

## Taxation

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

The headline tax charge for 2013 of £132m (2012: £132m) represented an effective rate of 26.5% on the headline profit before taxation (2012: 26.5%). On a statutory basis, the tax charge on continuing activities was £84m (2012: £108m).

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 28% is expected in the year ending 31 July 2014.

In the 2013 financial year, Smiths Group provided £383m in revenue for tax authorities across the world, comprising £95m in corporate tax, £79m in employer taxes and £209m collected through employee taxes and indirect taxes such as VAT.

## 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 increased 10 basis points to 16.6% (2012: 16.5%) as a result of improved profitability across John Crane, Flex-Tek and Smiths Interconnect which was offset by reduced profitability in Smiths Medical as a result of its increased growth investment and in Smiths Detection, reflecting both its trading performance and capital management.

## 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 2013 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 declined to £254m at 31 July 2013 from £620m at 31 July 2012. The deficit

reduction reflects the benefit of asset returns and, for the US, a slight increase in the discount rates upon which the liability is calculated.

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

The retirement benefit position was:

	31July 2013	31 January 2013	31 July 2012
Funded plans			
UK plans – funding status	<b>99%</b>	97%	91%
US plans – funding status	<b>81%</b>	74%	67%
Other plans – funding status	<b>80%</b>	71%	67%
Deficit			
Funded plans	<b>(147)</b>	(276)	(516)
Unfunded plans	<b>(107)</b>	(106)	(104)
Total deficit	<b>(254)</b>	(382)	(620)
Retirement benefit assets	<b>121</b>	83	7
Retirement benefit liabilities	<b>(375)</b>	(465)	(627)
	<b>(254)</b>	(382)	(620)

During the year, as part of the triennial review for the two UK pension schemes, funding plans were agreed with the trustees. In the coming year, cash contributions to the schemes are expected to total approximately £90m (2013: £78m). 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 2013 is set out in the table below:

Pension scheme members	SIPS	TIGPS	US plans	Total
Deferred active	550	280	3,380	<b>4,210</b>
Deferred	11,850	14,400	6,610	<b>32,860</b>
Pensioners	13,050	18,110	5,510	<b>36,670</b>
<b>Total</b>	<b>25,450</b>	<b>32,790</b>	<b>15,500</b>	<b>73,740</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:

	31July 2013	31 July 2012		31 January 2013
Average rates:				
US dollar	<b>1.57</b>	1.58	Dollar strengthened 1%	1.60
Euro	<b>1.20</b>	1.20	Euro – no change	1.24
Year-end rates:				
US dollar	<b>1.52</b>	1.57	Dollar strengthened 3%	1.59
Euro	<b>1.14</b>	1.27	Euro strengthened 10%	1.17

## 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 IFRS3 (Revised) and are amortised over their expected useful life. This amortisation is excluded from the measure of headline profits. When indicators of impairments are identified, the intangible assets are tested and any impairment identified is charged in full. The impairment charge is excluded from the measure of headline profits. Other intangible assets comprise development costs or software which are capitalised as intangible assets as required by IFRS. Amortisation charged on these assets is deducted from headline profits.

#### Accounting policies

The accounts in this report are prepared under International Financial Reporting Standards (IFRS), as adopted by the European Union (EU). The accounting policies used in preparing these accounts are set out on pages 96-101.

#### Significant judgements, key assumptions and estimates

Applying accounting policies requires the use of certain judgements, assumptions and estimates. The most important of these are set out on pages 96-97.

#### Treasury

The Board has a Treasury Risk Management Policy which governs the activities of both Group Treasury and subsidiary companies and the financial risk profile to be maintained by the Group. A monthly report for the Executive Committee and Board and a semi-annual report to the Audit Committee reports on treasury activities, financial metrics and compliance with the policy. The Board maintains a strong 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. Cash pools exist globally to manage liquid resources efficiently across the divisions. The Group uses financial instruments to raise financing for its global operations, to manage related interest rate and currency financial risk and to hedge transaction risk within subsidiary companies. The Group does not speculate in financial instruments. All financial instruments hedge existing business exposures and all are recognised on the balance sheet. There are four components

of the Treasury Risk Management Policy and within each component a series of financial metrics is 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 and to minimise the resulting cost of debt capital. The credit ratings at the end of July 2013 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 2013, these measures were 98% (2012: 99%) and 1.2 times (2012: 1.2 times) respectively.

#### 2 Debt and interest rate management

The Group's financing is managed centrally. At 31 July 2013 net debt was £744m (2012: £791m). The core available financing for the Group is provided by a US\$800m committed revolving credit facility, provided by a group of 10 global banking partners, which matures in December 2015. The Group remains in full compliance with 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 2013, these measures were 0% (2012: 0%); 4.8 years (2012: 3.9 years) and 76% (2012: 75%). In October 2012, a \$400m bond was issued with a 10-year maturity and a fixed coupon of 3.625%.

#### 3 Liquidity management

At 31 July 2013, 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 2013, this measure was £527m (2012: £511m). At 31 July 2013, cash resources were £394m (2012: £206m). 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 2013, 98% (2012: 97%) of cash resources were on deposit with the 10 global relationship banks and of these resources £74m (2012: £13m) was invested with counterparties rated less than A+.

#### 4 Currency management

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

The Group is an international business with the majority of its net assets denominated in foreign currency. It protects its balance sheet and reserves from adverse foreign exchange movements by financing its currency assets in the same currency such that, where the value of net assets is over £30m equivalent, over 50% of those assets are matched with the same currency liability. At 31 July 2013, 49% (2012: 45%) of total foreign currency assets were matched by related currency liabilities.

#### Financial controls

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

The Internal Audit Department reviews all 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, are set out in Risk management on pages 54-58 and the Corporate governance statement on pages 71-79.

#### Essential contracts

The divisional reviews describe our main customer and supplier relationships and the 'Risks and uncertainties' section outlines the risk management aspects of our contractual arrangements. Smiths Group has a wide range of suppliers and customers, and while the loss of, or disruption to, certain of these arrangements could temporarily affect the operations of an individual division, none is considered essential.

# 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 asbestososis, 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 21 on pages 140-141  
and in note 24 on pages 142-143



In recent years, the litigation has focused increasingly on claims for mesothelioma, awards for which, when made, tend to be larger than those for the other diseases. Whilst the number of claims filed against JCI and other defendants has been declining, the proportion of mesothelioma claims has increased, and JCI's ability to defend these cases successfully is likely to have a significant impact on its annual aggregate adverse judgment and defence costs.

JCI continues to actively monitor the conduct and effect of its current and expected asbestos litigation, including the efficacious presentation of its 'safe product' defence, and intends to resist these asbestos cases based on this defence. Approximately 230,000 claims against JCI have been dismissed before trial over the last 34 years. JCI is currently a defendant in cases involving approximately 81,000 claims. Despite these large numbers of claims, JCI has had final judgments against it in only 121 cases, and has had to pay awards amounting to approximately US \$120m.

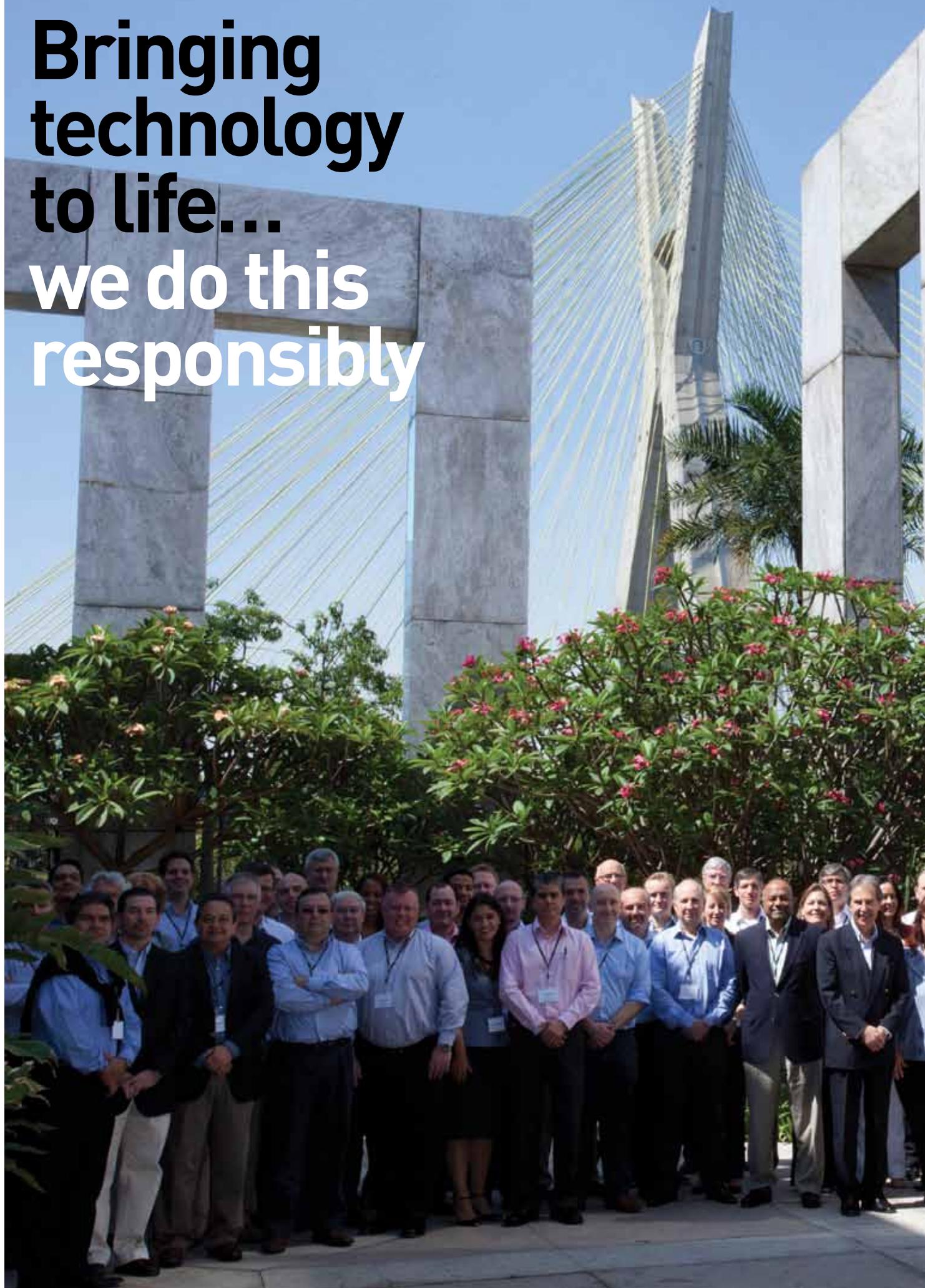
At 31 July 2013, the aggregate provision for JCI asbestos litigation, including for adverse judgments and defence costs, amounted to £210m expressed at the then current exchange rate. In deciding upon the amount of the provision, JCI has relied on expert advice from a specialist in asbestos liability estimation. Moreover, in establishing this provision no account has been taken of any recoveries from insurers as their nature and timing are subject to pending litigation. 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 subrogation claims have been settled on an individual basis without admission of liability.

At 31 July 2013, provision of £66m 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.

**Bringing  
technology  
to life...  
we do this  
responsibly**



# Risk and responsibility

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## Global ethics

We held our second global ethics forum in December 2012 in São Paulo, Brazil. The forum brought together 60 senior executives and managers from around the Group to consider the business and ethical challenges of doing business in Latin America. 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.

# 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 81 to 82. A description of the Company's internal controls and risk management processes is given in the Corporate Governance statement on pages 79 to 80.

## 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 appetite. 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 on-going 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

##### Potential impact

High



##### Trend

No change



##### Risk and potential impact

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.

Current global economic and financial market conditions, and the potential for a significant and prolonged global recession, may materially and adversely affect the Group's operational performance and financial condition. A recession may also materially affect our customers, suppliers and other parties with which we do business. Adverse economic and financial market conditions may cause our customers to terminate existing orders, to reduce their purchases from the Group, or to be unable to meet their obligations to pay outstanding 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.

##### Mitigation

- The Group has a diversified portfolio of businesses that mitigates exposure to any one country or sector.
- The divisions regularly monitor their order flows and other leading indicators, where available, so that they may respond quickly to deteriorating trading conditions.
- 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.

## Risks caused by uncontrollable external factors

### Eurozone break-up

#### Potential impact

Medium



#### Trend

Reduced



#### Risk and potential impact

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

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

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

The risk has reduced slightly over the last 12 months as we have collected some long overdue debts in Spain and repatriated the capital.

#### Mitigation

- The diversified portfolio mitigates exposure to any single country or currency. We also have robust processes to monitor overdue debts.
- We have net investment hedging of c. 50% of our overseas currency exposure and assets.
- We have identified further divisional risk mitigation actions should the risk occur.

### Compliance with legislation and regulations

#### Potential impact

Low to Medium



#### Trend

No change



#### Risk and potential impact

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.

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

Smiths Detection and Smiths Interconnect manufacture security products and components, which are subject to numerous export controls, technology licensing and other government regulations.

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

Should a regulator's approval process take a particularly long time, our products may be delayed in getting to market, which could lead to a loss of revenue or benefit a competitor with a similar product. Corruption on the part of a single employee can entail severe consequences for the Group.

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

#### Mitigation

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

## 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 2013, 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 124-127



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

##### Potential impact

Medium



##### Trend

Slightly higher



##### 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.

The risk has increased slightly since last year, in particular, tax and exchange rate risk. However, funding risk is lower in the light of the bond issue in October 2012.

##### 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 2013, we had an undrawn revolving credit facility of \$800m.
- Tax: The Group's taxation staff co-ordinate tax management to mitigate possible increases in the effective tax rate. Regular reporting to the Board of tax risks and exposures provides good visibility of issues.
- Insurance: Insurance risk is spread across a number of carriers to minimise individual insured risk and counterparty risk.

Read more on page 52



## Business challenges / thematic risks

### Product liability and litigation

#### Potential impact

Medium



#### Trend

No change



#### Risk and potential impact

In the ordinary course of its business, the Group is subject to litigation such as product liability claims and lawsuits, including potential class actions, alleging that the Group's products have resulted or could result in an unsafe condition or injury. In addition, manufacturing flaws, component failures or design defects could require us to recall products. Many of our products are used in critical applications where the consequences of a failure could be extremely serious and, in some cases, potentially catastrophic.

- Products sold to the aviation, security, healthcare, energy and consumer/domestic industries are particularly critical in nature.
- Furthermore, over half the Group's sales are in the US, where there is potentially increased litigation risk.

Any liability claim against the Group, with or without merit, could be costly to defend and could increase our insurance premiums.

Some claims might not be covered by our insurance policies, either adequately or at all. An adverse event involving one of our products could damage our reputation and reduce market acceptance and demand for all of our products.

#### Mitigation

- Quality assurance processes are embedded in our manufacturing locations for critical equipment, supporting compliance with industry regulations.
- 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 on-going work in Smiths Medical and John Crane.
- The divisions have procedures for dealing with product liability issues and potential product recalls. These procedures are informed by crisis management planning workshops and rehearsals.
- The Group has insurance cover for certain product liability risks. The US 'Safety Act' provides legislative protection for certain Smiths Detection products in the US; and we support efforts to implement similar legislation in other markets.
- Any litigation is managed under the supervision of the Group's legal function. We have detailed action plans to manage actual or threatened litigation.

Read more on page 53 and in note 21 on pages 140-141



### Global supply chain/concentration of manufacturing

#### Potential impact

Medium



#### Trend

No change



#### Risk and potential impact

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

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

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.

#### Mitigation

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

## Managing risk in delivering our strategy

**Continued**

### Business challenges / thematic risks

#### Government customers

##### Potential impact

High



##### Trend

No change



##### Risk and potential impact

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.

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

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

At a time when government finances are under pressure, these headwinds may lead to slower growth across the business. A decrease in spending by key government customers could materially affect the Group's results and financial condition. Delays in awarding government contracts can affect the Group's sales, margins and cash conversion in a particular reporting period.

##### Mitigation

- The Group has a diversified portfolio of businesses that mitigates exposure to any one country or sector.
- Some of our government-related business has a services or consumables component, which can be more resilient during an economic downturn.
- The Group has a government relations function so that it can inform policy and maintain close relationships with customers.

#### Technology and innovation

##### Potential impact

Medium



##### Trend

No change



##### Risk and potential impact

Developing new products and improving existing products is critical to our business and competitors may innovate more effectively. The emergence of a disruptive technology could have an impact on a major cash-flow contributor to the Group over time.

The speed of innovation in certain markets may lead to shorter product lifecycles, increasing the need for innovation. Additionally, the entry of new competitors, the consolidation of existing competitors and changed or irrational competitor behaviour could all significantly affect the Group's business.

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.

##### Mitigation

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

#### Talent and succession planning

##### Potential impact

Medium



##### Trend

No change



##### Risk and potential impact

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.

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.

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.

##### Mitigation

- Each division or function holds talent and succession plan reviews at least annually. These plans are reviewed by the Nomination Committee.
- Remuneration packages, including variable and long-term elements of the compensation arrangements, are evaluated regularly against market practice.
- The Chief Executive has assessed and continues to assess the Top 25 people in the organisation for performance, skills and competencies and presents development and succession plans to the Board.

Read more on pages 20-26 and 66-67



## Business challenges / thematic risks

### Contractual liabilities

#### 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.
- 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

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

The Group may not be able to integrate the businesses that it acquires. If integration is unsuccessful, anticipated benefits are not realised or trading by acquired businesses falls below expectations, it may be necessary to impair the carrying value of these assets. In recent years, the Group has disposed of a number of businesses, including its Aerospace operations, where it has given indemnities, warranties and guarantees to counterparties. The Group is also party to a number of contracts relating to formerly owned businesses which it has not yet novated to the purchasers of these businesses.

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

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

### 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, transforming Smiths into a world-class organisation 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 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 and materials safety.

## 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 p10.

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.

## 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.

### 2013 Highlights

- Held our second global ethics forum in São Paulo, Brazil, to reflect our growing presence in emerging markets
- Updated training in areas such as anti-bribery and corruption, international trade compliance and competition and anti-trust
- Expanded Code materials, adding seven new translations and enhancing usability of intranet portal

## 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 functions so we can investigate them. 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, 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.

Similarly, in 2013 as part of a wider review of the Smiths Group policies, we updated policies on international trade sanction and embargoes, import and customs, and international export compliance. 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 first global ethics forum in Shanghai, China in 2011, we held our second forum in São Paulo, Brazil in 2012 and the next one is scheduled for Dubai in October 2013.

### Controls on defence sales

All sales and exports of defence equipment are undertaken in accordance with international trade regulations and national government export and approval procedures and regulations, such as the

International Traffic in Arms Regulation and the Export Administration Regulations in the USA. These laws prohibit export of certain items to specific countries. The Group adheres to all relevant government guidelines designed to ensure that products are not incorporated into weapons or other equipment used for the purposes of terrorism or abuse of human rights, with internal controls to ensure compliance with these guidelines.

## 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.

### 2013 Highlights

- Updated our EHS and Energy & Greenhouse policies
- Completed an EHS benchmarking study to peers and high-performing companies
- Updated our multi-year EHS and sustainability strategy and targets
- Implemented Company-wide environmental awareness training

## 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 94 sites that are required to be externally certified,

## Corporate responsibility

### Continued

92 have completed certification. Sites that have not completed certification have action plans to do so. New acquisitions or expanded operations have two years to obtain certification.

#### Future priorities

- Review the use of materiality assessments for identifying key issues
- Re-evaluate our most serious EHS risks by performing Group and division-level risk assessments
- Introduce a serious incident metric to help monitor injury severity trends and respond accordingly

#### EHS strategy

Our EHS strategy is designed to protect our employees, communities, environment, and shareholder value through effective management of safety, and environmental risks. During 2013, we developed our next set of strategic objectives and corresponding goals. The recent strategy development process involved benchmarking to peer and high-performing companies and evaluating global trends. We identified strategic areas that we will focus on during 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 using processes such as materiality assessments. Each division identifies and defines the specific actions for their businesses. Sustainability strategic improvement areas include product stewardship, supply chain corporate responsibility and value chain environmental impacts.

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 2010, we set new five-year targets for our environmental metrics and added an energy reduction target. Our targets were to achieve 10% reductions in energy usage, greenhouse gas emissions and waste generation, and a 5% reduction in water usage by FY2015, all normalised to revenue against a baseline of FY2010. Also in 2010, we adopted a new reporting policy for our environmental metrics, which expanded the number of sites required to report environmental performance to the Group. These reporting changes provide us with a more comprehensive view of our environmental impact. The environmental metrics for FY2010 were therefore slightly higher than FY2009, due to the inclusion of data from more of our business.

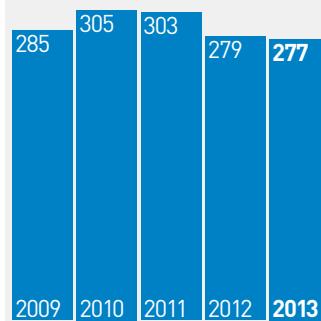
The current targets established in FY2010 were scheduled to be achieved by FY2015. However, we had over-achieved against these targets by the end of FY2013. We therefore revised our environmental targets as part of the benchmarking and updating of our EHS strategy in FY2013. The new targets require the following reductions over FY2013 performance by the end of FY2018, normalised to revenue:

- Energy: 15% reduction
- Greenhouse gas emissions: 15% reduction
- Waste (non-recycled): 15%
- Water: 10%

Our environmental performance through FY2013 continued to be very favourable compared to our baseline year of FY2010. We achieved significant reductions in all metrics, and exceeded our FY2015 goals.

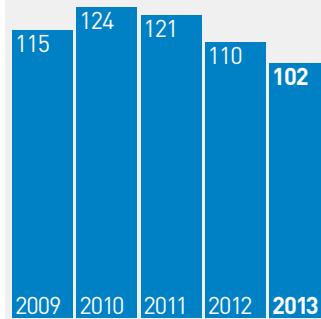
#### Total energy

'000MWh



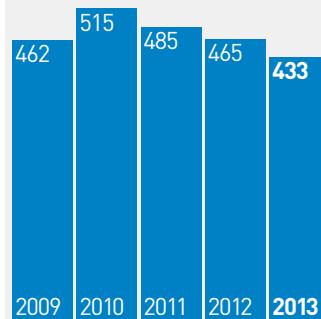
#### Total CO<sub>2</sub> emissions

'000 tonnes



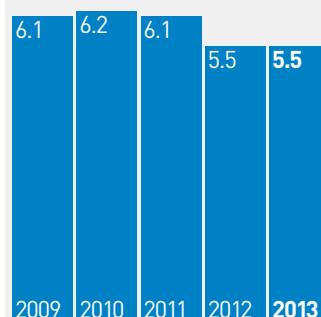
#### Water use

'000m<sup>3</sup>



#### Total non-recycled waste

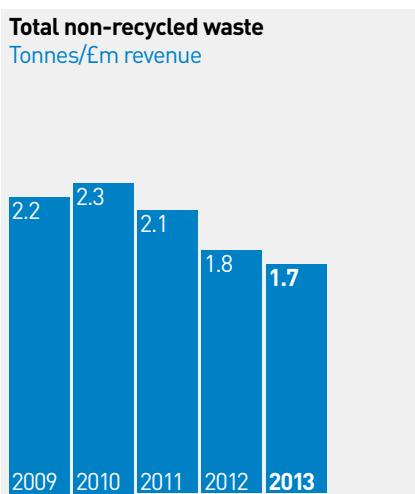
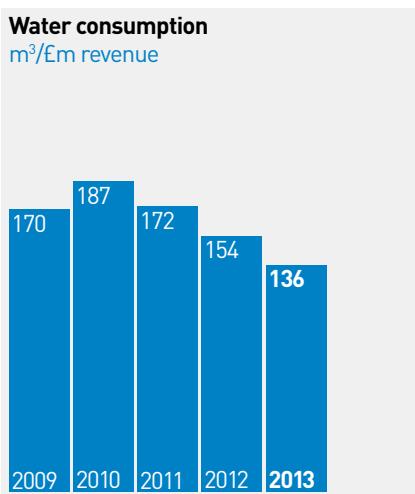
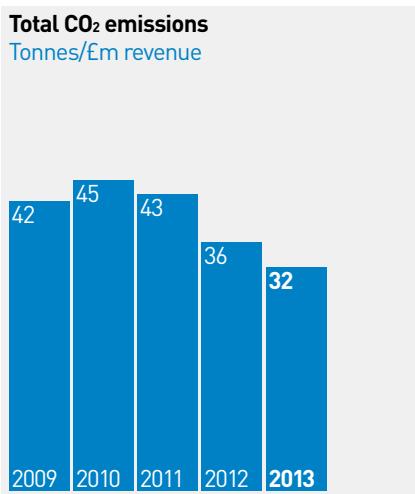
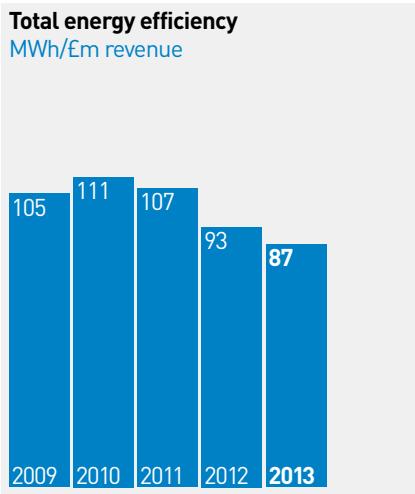
'000 tonnes



#### Performance against environmental targets

	Target FY2010-15	2013 progress against FY2010
<b>Energy</b>	10% reduction	<b>19% reduction</b>
<b>Greenhouse gas emissions</b>	10% reduction	<b>27% reduction</b>
<b>Total non-recycled waste</b>	10% reduction	<b>21% reduction</b>
<b>Water consumption</b>	5% reduction	<b>25% reduction</b>

Reduction targets are compared to the FY2010 baseline year and normalised to revenue consolidated at FY2013 closing exchange rates.



## Performance against safety targets

	FY2013 target	2013 results
<b>Recordable incident rate</b>	Better than 0.5 per 100 employees	<b>0.54*</b>
<b>Lost time incident rate</b>	No target	<b>0.22</b>

\*0.50 excluding business acquired within the last two years

### 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 was 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. We continue to implement and build on these activities and are monitoring them through our Safety Leading Indicator Activities Programme. In FY2012, we added 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. An employee safety risk assessments activity was added in FY2013 to increase employee identification and perception of risks. Supervisor safety management training will be added in FY2014 to improve supervisor safety skills required for managing a workforce.

### Health and safety targets

Our FY2013 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 safety leading indicator activities that contribute to reduction in 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 will evaluate a new metric to further aid in focusing on serious incidents and risks. However, our aim will be 'zero harm' to employees: this is our ultimate ambition and adopting it will further emphasise to our employees and other stakeholders the serious intent we have for EHS in the Company.

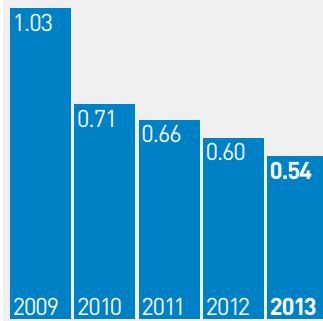
### Health and safety performance

Since 2004, we have achieved a steady reduction in our RIR, with FY2013 being our safest on record. In keeping with our continuous improvement commitment, in FY2010 we established a three-year RIR goal of 0.50, to be achieved by July 2013. We improved our RIR over last year for our established businesses, with an RIR reduction from 0.58 to 0.50, meeting our goal. Our recently acquired businesses are working to meet our operations and performance standards resulting in our published RIR of 0.54, which is still our best on record and lower than our FY2012 RIR of 0.60.

After years of reductions in our LTIR, we had a slight increase in FY2013 from 0.21 to 0.22. Since FY2008, our LTIR has dropped from 0.54 to 0.22 in FY2013.

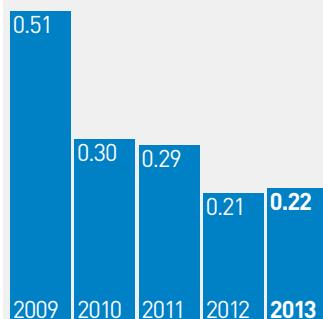
### Recordable incident rate

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



### Lost time incident rate

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



## Corporate responsibility

### Continued

#### People

Attracting, retaining and developing the right people with the right skillset 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.

#### 2013 Highlights

- Strengthened our talent pipeline through focus on talent assessment, personal development and succession planning.
- Rolled out junior and senior leadership development programmes
- Continued to address results of 2012 MyVoice global employee engagement survey
- Implemented new HR operating model to support business growth

#### Governance

Since 2010 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

Over the past three years, we have 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. In FY2014, we will launch a revised HR strategy, to build the enablers for growth between now and 2020. A core part of this will be repositioning the business with a clear Employee Value Proposition, which reflects our multi-industry career offering and the global careers we can offer for the very best

people. We will also 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.

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.

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 re-training, if needed, for people who have become disabled), career development and promotion on the basis of their aptitudes and abilities. We endeavour to find appropriate alternative jobs for those who are unable to continue in their existing job because of disability.

All 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 second survey in 2012 in partnership with Kenexa, a leading survey provider. We achieved a participation rate of more than 91%, up from 85% in 2011. Results were benchmarked against global norms for the manufacturing industry and we have communicated divisional, local and functional results. In 2013 we continued to address the results of our 2012 survey, implementing action plans across the business to address the most significant issues highlighted. We will repeat the survey in 2014 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 2013 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 2014

- Launch revised HR strategy
- 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 our third MyVoice engagement survey

## 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 organizations that demonstrate how a donation will enhance the well-being of people through improved education, health and welfare or environment.

In FY2013, we made charitable donations of £453,000 as a Group. This included £303,000 to The Great Ormond Street Hospital in London by Smiths Medical for sponsorship of the Professor of Anaesthesia and Critical Care and the Portex Anaesthesia, Intensive Care and Respiratory Unit. Our employees also raised money for a wide range of charitable causes through a variety of fund-raising initiatives across the business.

**Bringing  
technology  
to life...  
with effective,  
focused  
leadership**



## Governance

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### Board visit to John Crane, Chicago

As part of the 2013 programme of visits to the Group's businesses, the Board visited the new John Crane headquarters in Chicago and nearby manufacturing facility in Morton Grove. The visit included a tour of the recently improved facility, the opportunity to meet employees involved in specialist production areas, and updates on business strategy and performance from senior management.

Group overview

Chairman and Chief Executive

Business review

Risks and responsibility

Governance

Accounts

# Board of directors

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



Aged 68, Donald Brydon is British and has a BSc in Mathematical Science. He started his career in investment management and has chaired a number of major companies. He became Chairman of Smiths Group in 2004. Donald will retire from the Board and as Chairman of the Company after the Annual General Meeting ("AGM") on 19 November 2013.

#### Strengths and experience

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

#### Committee membership

- Chairman of the Nomination Committee
- Remuneration Committee

#### External appointments

- Chairman of Royal Mail Group plc and Chairman of its Nominations committee
- Chairman of Sage Group plc
- Chairman of the Medical Research Council

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



Aged 66, Sir George Buckley joined the Board on 1 August 2013 as a non-executive director and Deputy Chairman and will succeed 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.

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



Aged 66, Bruno Angelici is French with an MBA (Kellogg School of Management) and Business and Law degrees from Reims. He was appointed to the Board of Smiths Group in 2010.

#### Strengths and experience

Bruno's career includes senior management roles in pharmaceutical and medical device companies. Bruno retired from AstraZeneca in 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

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



Aged 60, Philip Bowman is Australian with a MA in Natural Sciences. He has extensive experience of leadership at major international public companies and was appointed Chief Executive of Smiths Group in 2007.

**Strengths and experience**

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

**External appointments**

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

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



Aged 43, Peter Turner is British with a BA in Natural Science – Chemistry. He qualified as a Chartered Accountant whilst working for PricewaterhouseCoopers. He became Finance Director of Smiths Group in 2010.

**Strengths and experience**

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

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



Aged 70, David Challen CBE was appointed to the Board in 2004. He is British with a BA in Mathematics, a BSc in Natural Science – Physics and an MBA from Harvard.

**Strengths and experience**

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

**Committee membership**

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

**External appointments**

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

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



Aged 52, Tanya Fratto was appointed to the Board in 2012. An American, she is a qualified electrical engineer with a BSc in Electrical Engineering.

**Strengths and experience**

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

**Committee membership**

- Audit Committee
- Nomination Committee
- Remuneration Committee

**External appointments**

- Non-executive director of Boart Longyear Ltd, an Australian-listed, US-based mining products and services company
- Non-executive director of Advanced Drainage Systems, Inc., a US-based private company

## Board of directors

Continued

### Anne Quinn, CBE Non-executive director



Aged 62, Anne Quinn was appointed to the Board in 2009. She is from New Zealand and has a BCom and MSc in Management Science.

#### Strengths and experience

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

#### Committee memberships

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

#### External appointments

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

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



Aged 66, Sir Kevin Tebbit was appointed to the Board in June 2006. Sir Kevin is British and has a BA in History.

#### Strengths and experience

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

#### Committee memberships

- Audit Committee
- Nomination Committee
- Remuneration Committee

#### External appointments

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

## Board balance and diversity

The Smiths Group Board comprised eight members throughout FY2013 and currently has nine members, with the addition of Sir George Buckley. The charts below illustrate as at 31st July 2013 the diversity of the Board in relation to tenure, gender and nationality.

### Executive balance

- a Executive
- b 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.



### Nationality

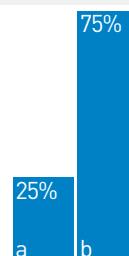


Five nationalities are represented on the Board, although the international experience of Board members is much wider than this.

### Gender balance

- a Female
- b Male

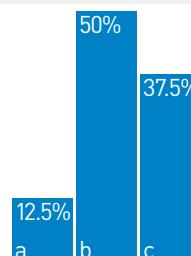
There are two women on the Board, Anne Quinn and Tanya Fratto.



### Board tenure

- a From 0-2 years
- b From 3-6 years
- c From 7-10 years

Further details on the tenure of each director are shown on pages 70-72.



# Corporate governance statement

## Chairman's introduction

**Donald Brydon, CBE**



The Board of the Company is committed to ensuring that it provides effective leadership and promotes uncompromising ethical standards. One of the ways in which the Board achieves this is by requiring that good governance principles and practices are adhered to throughout the Company. The Board determined that the following is a helpful summary of its role:

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

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

It also involves the creation of a sensitive interface for the views of shareholders and other stakeholders to be given appropriate consideration when reaching these judgements.

The executive team is required to provide such information to the Board as the Board needs to enable it to exercise its judgement over these matters.

There is a very fine distinction between the approval of processes and their definition. Wherever possible it is the role of the Board to approve process rather than initiate or define it. Only exceptionally would the Board intervene to initiate or define.

The Board also sets the tone for the Company. The way in which it conducts itself, its attitude to ethical matters, its definitions of success and the assessment of appropriate risk all define the atmosphere within which the executive team works.

Good corporate governance is not about adhering to codes of practice (although adherence may constitute a part of the evidence of good governance) but rather about the exercise of a mindset to do what is right.

One of the challenges facing any Board is the way in which the non-executive and the executive directors interact. It is clear that they each have the same legal responsibility but it is generally unrealistic to expect executive directors to speak individually with the same freedom as the non-executive directors. Equally, executive directors who just 'toe the executive line' in contradiction to their own views may not be effectively contributing to good governance. A well-functioning Board needs to find the right balance between hearing the collective executive view and being aware of the natural internal tensions in an executive team.

One of the consequences of both increasing the watchdog role of the Board and finding this balance between individuality and team behaviour is driving more and more Boards to have fewer and fewer executive directors. In our circumstances as a holding company for a number of businesses, the reduced Board size works effectively and an appropriate balance is struck. Notwithstanding the tensions created by many external expectations, which may be wholly or in part unrealistic, a successful board should, ideally, be composed of a group of respected, experienced, like-minded but diverse people who coalesce around a common purpose of promoting the long-term success of the Company, provide a unified vision of the definitions of success and appropriate risk, endeavour to support management (i.e. those who honestly criticise at times but encourage all the time) and who create confidence in all stakeholders in the integrity of the business.

A board meeting should feel like a meeting at which everyone is participating to solve problems together. Above all, all participants should be able to say after a board meeting that value has been added as a result of the meeting taking place. This added value will come in many forms: challenge, advice, clarity, imagination, support, sharing of problems, or creating strategic intent. The list is not exhaustive.

Board membership is for 365 days of the year. Board responsibilities do not start and end with formal meetings. Board members, on the Company's and their own initiative, should endeavour to engage outside of meetings to bring their experience to the assistance of the executive team whenever possible.

Above all there should be a sense of value added from the engagement of the board members in all their interaction with the Company, formal or otherwise."

To enhance its performance and effectiveness, each year since 2011 the Board has set itself explicit objectives – separate from objectives set for the Company and for the Chief Executive, following the outcome of the respective Board appraisal process for the prior year. In relation to the objectives for the year ended 31 July 2013, the Board has regularly monitored its performance against these and has found this process adds value.

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

## Corporate governance statement

**Continued**

### Governance structure

#### Board

Responsible for setting the Group's strategy, provides the leadership of the Company, supervises the management of the Company, monitors the operational and financial performance of the Company, and reports to shareholders on its stewardship of the shareholders' assets.

### Board Committees

#### Nominations Committee

Reviews the structure, size and composition of the Board and Board Committees and considers succession planning for directors and senior management.

#### Remuneration Committee

Makes recommendations to the Board on the Company's remuneration framework and sets the remuneration of the Chairman, the Chief Executive, the Finance Director and senior management.

#### Audit Committee

Monitors the integrity of the Company's financial statements, its systems of internal controls and risk management and its internal and external audit findings.



### Executive Management Committees

#### Executive Committee

Monitors performance of the businesses and the functions supporting the businesses, and makes recommendations on the implementation of strategy, operations, people and organisational development and Group policies.

#### Disclosure Committee

Takes decisions concerning the identification of inside information and the timing and method of disclosure, and advises the Chief Executive and the Board in accordance with the Company's disclosure policy.

#### Acquisitions & Disposals Committee

Considers, approves and sets conditions in relation to Group acquisitions and divestments within parameters established by the Board.



### Divisional Boards

### Functional Boards

John Crane	Smiths Medical	Smiths Detection	Smiths Interconnect	Flex-Tek	Environment Health & Safety Steering Committee	Security Committee	Ethics Code Compliance Council
Monitors the delivery of short-term and medium-term performance targets in accordance with the financial and operational performance targets and the strategic plans set by the Board. A corporate member of the Executive Committee sits on each divisional board as an investor director.	Develops and monitors implementation of EHS policies and strategy.	Contributes to the development of Group Security policies and associated minimum standards and monitors their execution.	Oversees the implementation of the Smiths Group Code of Business Ethics and makes recommendations to management and to the Audit Committee.				

## Compliance with the UK Corporate Governance Code

Throughout the period 1 August 2012 to 31 July 2013 the Company has been in full compliance with the UK Corporate Governance Code (the 'Code'), published by the Financial Reporting Council and available on its website [www.frc.org.uk](http://www.frc.org.uk), except that the value of any fees received by executive directors in respect of external non-executive directorships is not disclosed in the Directors' remuneration report, as this is not considered relevant to the Company. The Company intends to continue to explain rather than comply with the Code in this limited area.

## Disclosure & Transparency Rule 7

This statement complies with sub-sections 2.1; 2.2(1); 2.3(1); 2.5; 2.7; and 2.10 of Rule 7 of the UK Listing Authority Disclosure & Transparency Rules. The information required to be disclosed by sub-section 2.6 of Rule 7 is shown in the Group directors' report on pages 97 and 98 and is incorporated in this Corporate governance statement by reference.

## Directors

### The Board

As at 17 September 2013, the Board comprises Mr Brydon (Chairman), Mr Bowman (Chief Executive), Mr Turner (Finance Director) and six independent non-executive directors: Sir George Buckley (Deputy Chairman), Mr Challen (Senior Independent Director), Mr Angelici, Ms Fratto, Ms Quinn and Sir Kevin Tebbit. Mr Brydon will retire from the Board at the end of the Annual General Meeting to be held on 19 November 2013 and Sir George Buckley will be appointed as Chairman to succeed him. Biographies of these directors, giving details of their experience and other main commitments, are set out on pages 70 to 72. 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 regular 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 and has adopted a Code of Business Ethics which is referred to on page 62.

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 John Crane, Chicago**

## Corporate governance statement

Continued

### Board activities

#### Trust and values

Ethics, health and safety and environmental management; security

#### Strategy and risk

Operational, commercial and geographic strategies by Division and for Company as a whole; risk management reviews

#### Compliance and governance

Board performance and effectiveness; corporate governance updates; directors' conflicts; share register; inside information and disclosure considerations; legal issues and litigation risk

#### Financials

Previous month's trading; budgets and forecasts; financial risk and treasury report; tax risk and status report; approval of trading statements

#### Operations

CEO's report, operating business performance updates

#### M&A

Current projects report; post-acquisition reviews

#### 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. In January, the Board considered the anti-corruption measures in place across the Group particularly in the light of the UK Bribery Act and its focus on a company having 'adequate procedures' to prevent bribery. The Board supported the holding of an Ethics Conference in São Paulo in December 2012, focused on Latin America and attended by corporate and divisional managers, to address the ethical risks arising from operations in multiple jurisdictions. In September, the Board discussed the results of the MyVoice survey completed by over 90% of all employees throughout the Group, designed to strengthen employee engagement, communication and trust. Later in the year, the Board was also updated on the ongoing work on Human Resources strategy and the challenges of attracting the best talent in a global marketplace.

#### 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 work-streams amongst the executive teams in each division. This year initiatives included the holding of an innovation workshop in October at which a number of draft principles, key enablers and individual actions covering the most important aspects of innovation process and capability were formulated. A cross-divisional strategy workshop was also held in October which concentrated on competitor effectiveness, commercial prioritisation, marketing and pricing.

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 an analysis of the cyber security risks faced by the Company and the measures in place to mitigate these.

#### Compliance and governance

The Board receives regular corporate governance updates on relevant issues. This year in March the Board approved an update of the Company's Disclosure Policy and Procedures Manual to help ensure that the Company's policies and procedures are in line with the increasingly stringent obligations which apply in relation to inside information and disclosure. The Board also approved revisions to the Company's Share Dealing Policy to reflect recent guidance.

#### Financials

The Board considers the Group's trading performance and financial risk at each meeting. During the year, it also reviews and approves the budget and periodic forecasts. In September, the Board approved the issue of a US\$400m bond.

#### 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 is an area which the Executive Committee also considered in detail during the year, including at a four day off-site meeting in June. One of the areas identified during the year for greater synergy was procurement. A new Group Head of Procurement to lead the Smiths Group Procurement Council was appointed in June.

#### 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 acquisitions and divestments. This year, the Company received an unsolicited approach for the Medical division which the Board considered as part of its duty to shareholders to determine whether the Company remains the best owner of its businesses. After careful assessment, the Board concluded that acceptable terms could not be reached.

## Board meetings

The table below shows the number of board meetings held during the financial year ended 31 July 2013 and, opposite each director's name, the number of meetings they were eligible to attend and the number actually attended. A number of meetings were held at short notice during the year to deal with urgent matters. By their nature, it is not always possible to achieve full attendance at short-notice meetings, since directors may have pre-existing commitments which they are unable to change. Where an individual director was unable to attend a meeting convened at short notice, he or she provided input to the Chairman separately in advance of the meeting, which was duly represented at the meeting and the director concerned received feedback after the meeting from either the Chairman or the Company Secretary.

	Board meetings	
	Eligible to attend	Attended
D.H. Brydon (Chairman)	12	12
P. Bowman	12	12
P.A. Turner	12	12
B.F.J. Angelici	12	12
D.J. Challen	12	12
T.D. Fratto	12	12
A.C. Quinn	12	12
K.R. Tebbit	12	11

## 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 her induction process which began at the end of last financial year and continued in the first quarter of this financial year, Ms Fratto visited a number of the Company's sites in the USA and Europe and met employees and management in all five divisions.

In May 2013 the Board visited the new John Crane headquarters in Chicago and the nearby John Crane manufacturing facility in Morton Grove. The Board was shown the recent improvements to the facility and met employees involved in each of the specialist production areas within the plant. The directors also spent time with the John Crane senior management team and received an update on business performance, strategy and a number of commercial and business improvement initiatives.

## 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 Company's diverse stakeholder relationships [including with shareholders, employees and customers] are properly managed

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

In deciding the chairmanship and membership of the Board Committees, the need to refresh membership of the Committees is taken into account. The table below indicates the service, to 31 July 2013, of each of the directors. All the non-executive directors are considered to be independent and Mr Brydon was considered independent at the time of his appointment as Chairman.

#### 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. Further information in relation to the Chairman's succession and the recruitment of Sir George are described in the Nomination Committee report below.

The Board is satisfied that the directors are able to allocate sufficient time to their responsibilities relating to the Company. The Board considered during the year other appointments and proposed appointments 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 several days in advance on matters to be considered at its meetings and non-executive directors have ready access to the executive directors and other senior corporate staff. 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.

#### 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, ensuring a healthy blend of experience and fresh perspectives.



Newly appointed directors undergo an induction programme to ensure that they have the necessary knowledge and understanding of the Company and its activities. They undertake briefing sessions on corporate governance, strategy, stakeholder issues, finance and risk management and HR, as well as meetings and site visits to business locations. Each director's individual experience and background is taken into account in developing a programme tailored to his or her own requirements.

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

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

#### Conflicts of interest

Under the Companies Act 2006 (the '2006 Act') a director must avoid a situation where he or she has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the company's interests. The requirement is very broad, and could apply, for example, if a director becomes a director of another company or a trustee of another organisation. The 2006 Act allows directors of public companies to authorise conflicts and potential conflicts where appropriate and where the articles of association contain a provision to this effect, as the Company's Articles do.

The Board has put procedures in place for directors to report any potential or actual conflicts to the other members of the Board for their authorisation where appropriate. Each director is aware of the requirement to seek approval of the Board for any new conflict situations, as they may arise. The process of 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.

## Performance evaluation

The Board undertakes a formal and rigorous annual evaluation of its own performance and that of its Committees and each director. The Board evaluation completed in respect of the year ended 31 July 2012 identified a number of key strengths of the Board or its functions and activities, including focused, efficient and collaborative Board meetings; good leadership from the Chairman; useful reporting against a demanding set of Board objectives; appropriate balance of skills and expertise among Board members; thorough but not oppressive corporate governance framework.

Following on from the review the Board noted a number of points which it considered could enhance its performance and set itself a series of written objectives for the year ended 31 July 2013.

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

Objective	2013 Performance
Improve understanding of the cross-business initiatives and how they can contribute to Group value	The Board received updates on cross-business working groups (for example, New Product Introduction and Quality) and considered the impact of these and other areas of shared interest (such as potential new materials or increased cyber-security risk) as part of divisional strategy reviews to the Board and the divisional risk reviews to the Audit Committee
Manage Chairman succession	The formal process of recruitment for a successor to the Chairman commenced in December 2012 and completed in June 2013 with the announcement of the appointment of Sir George Buckley
Deepen understanding of the top 30 executives following the 2011/12 review	The Nominations Committee (on which all the non-executive directors sit) received a detailed presentation on talent management and succession planning in May 2013. In addition, the members of the Board received presentations from different representatives of senior management at Board meetings throughout the year, and met with senior executives in less formal settings during Board visits and before and after Board and Committee meetings.

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, including effectiveness of leadership, efficiency of meetings, time and focus given to particular areas, information issues, corporate governance standards and the extent to which the objectives set by the Board had been met. It also looked at how well the Board works together as a unit and the performance of each individual director against a number of criteria. The results of the evaluation are used to inform the Board's approach going forward.

The directorships in listed companies and other significant commitments of the Chairman and the non-executive directors are shown on pages 70 to 72. 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.

### Remuneration

Information regarding the Remuneration Committee is set out on page 83 and the Directors' remuneration report is on pages 84 to 85.

## Accountability and audit

### Financial reporting

The Board is required to present a balanced and understandable assessment of the Company's position and prospects in the Annual Report and in interim and other public reports. The Board is satisfied that it has met this obligation. A summary of the directors' responsibilities for the financial statements is set out on page 102.

The 'going concern' statement required by the Code is set out in the Group directors' report on page 97.

### 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 2013. The Financial Reporting Council's report 'Internal Control: Revised Guidance for Directors on the Combined Code (October 2005)' provides guidance.

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

## Corporate governance statement

### Continued

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

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

The Group has an embedded process for the identification, evaluation and management of significant business risks. The process is reviewed through the Audit Committee and monitored by the Group Internal Audit Department. The Company has during the year identified and evaluated the key risks and has ensured that effective controls and procedures are in place to manage these risks.

In the highly regulated environment of the industries in which the Company operates, procedures are codified in detailed operating procedures manuals and are reinforced by training programmes. These are designed to ensure compliance not only with the regulatory requirements but also with general principles of business integrity.

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

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

### Investor relations activities timeline 2012-2013

	Roadshows	Presentations
June 2013	US	
May 2013	Germany	
April 2013	UK, US, Canada, Norway, Sweden, Netherlands	
March 2013	UK	Interim results
December 2012	Private client brokers	
November 2012	Germany, Switzerland, France, Private client brokers	AGM
October 2012	UK, US, Canada	
September 2012	UK	Annual results

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

### Audit Committee and Auditors

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

### Relations with shareholders

#### Dialogue with shareholders

The Chief Executive, the Finance Director and the Director, Investor Relations communicate with institutional investors through analysts' briefings and extensive investor roadshows in the UK, US and continental Europe, as well as timely Stock Exchange announcements, meetings with management and site visits (as shown in the table below). Members of the Board, and in particular non-executive directors, are kept informed of investors' views, in the main through distribution of analysts' and brokers' briefings. At least twice a year a report is made to the Board on the number and types of meetings between the Company and institutional shareholders. The Chairman, the Senior Independent Director and the other non-executive directors are available to meet shareholders on request.

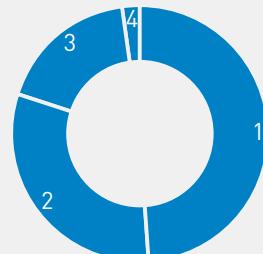
#### Constructive use of the Annual General Meeting

All directors normally attend the Company's AGM and shareholders are invited to ask questions during the meeting and to meet directors after the formal proceedings have ended. It is intended that there shall be a poll vote on each resolution at the 2013 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 2012 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.

### Contact with investors/analysts

- 1 United Kingdom 49%
- 2 US and Canada 31%
- 3 Rest of Europe 18%
- 4 Rest of World 2%



## Board Committees

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

### Audit Committee

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



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

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

As agreed by the Board last financial year, the Audit Committee focused on monitoring operational risks whilst the Board carried out the review of strategic Group-level risk. The Committee has carefully reviewed annual risk presentations from each of the five divisions and from BIS (Business Information Services, the Company's IT function). In order to be satisfied that risk management is fully embedded in the thinking and planning of the management teams of each of the divisions and of BIS, the Committee has challenged the divisional general managers and BIS to show that they have properly identified all the significant risks to their business, how these have changed since the previous review and the measures and contingency plans which have been put in place to manage them satisfactorily.

The Committee has monitored the activities of the Company in promoting and policing its Business Ethics Programme. The Committee has reviewed the treatment of allegations of unethical and non-compliant behaviour that are dealt with by the Company's Code Compliance Council. The level of allegations received and their materiality are considered to be low in the context of the size and scope of the Company.

### Meeting attendance

	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
K.R. 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 Mr Challen (Chairman of the Committee), Mr Angelici, Ms Fratto, Ms Quinn and Sir Kevin Tebbit.

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

### Responsibilities and activities

The Committee meets at least three times a year to monitor the integrity of the Company's financial statements and the effectiveness of the external audit process, corporate governance issues and, in particular, the implementation of the Company's Code of Business Ethics and the arrangements for employees to raise confidentially (and anonymously, if they so choose) concerns about possible wrongdoing in financial reporting and other matters. It is responsible for ensuring that an appropriate relationship between the Company and the external auditors is maintained, including reviewing non-audit services and fees and implementing the Company's audit partner rotation policy. The Committee has primary responsibility for making recommendations to the Board on the appointment, reappointment and removal of the external auditors.

The Committee also reviews annually the Group's systems of internal control; the processes for monitoring and evaluating the risks facing the Group; and the effectiveness of the internal audit function: it is responsible for approving the appointment and removal of the Director, Internal Audit. The Committee reviews annually its terms of reference and its effectiveness and recommends to the Board any changes required as a result of such review.

The annual review of the Committee's terms of reference was conducted in July 2013 and addressed the changes necessary, at this stage, to reflect the revisions to reporting requirements under the UK Corporate Governance Code that have been proposed by the Financial Reporting Council and the Department for Business, Innovation and Skills and will apply, in their final form, to the Company's 2013/14 financial year.

In the year to 31 July 2013, the Audit Committee discharged its responsibilities by reviewing:

- the Group's financial statements and interim results statement prior to Board approval and the external auditors' detailed reports thereon;
- the audit fee and non-audit fees payable to the Group's external auditors;
- the external auditors' effectiveness and plan for the audit of the Group's 2012/13 accounts, which included confirmations of auditor independence and the proposed audit fee, and approving the terms of engagement for the audit;
- an annual report on the Group's systems of internal control and their effectiveness, reporting to the Board on the results of the review and receiving regular updates on key risk areas of financial control;
- the risks associated with major business programmes; and
- the internal audit function's terms of reference, its 2012/13 work programme and regular reports on the key issues arising from its work during the year.

## Corporate governance statement

### Continued

The Committee's reviews paid particular attention to those areas of financial reporting where specific risks or significant estimates and judgements had been involved. These included judgements in the application of the revenue recognition policy, the assessment of provisions in respect of litigation, the assumptions underpinning the assessment of the pension deficit, the assumptions in respect of impairment testing of goodwill and other intangible assets and the recoverability of deferred tax assets.

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

No-one other than the members of the Committee is entitled to be present at meetings. However, the Chairman; Chief Executive; Finance Director; Group Financial Controller; Director, Tax and Treasury; Director, Internal Audit; and external auditors are normally invited to attend. Others may be invited to attend by the Committee. The papers for and minutes of each Committee meeting are sent to all directors. At least once a year, there is an opportunity for the external auditors, the Director, Internal Audit and the Senior Vice President & General Counsel – Ethics & Compliance to discuss matters with the Committee without any executive management being present. The Director, Internal Audit, the Senior Vice President & General Counsel – Ethics & Compliance and the external auditors have direct access to the Chairman of the Committee outside formal Committee meetings.

The Committee reviews the nature and extent of non-audit services provided by the external auditors in order to ensure that objectivity and independence are maintained. Under the audit independence policy, approved by the Committee, certain non-audit services may not be provided by the external auditors, certain services, not exceeding £10,000 in fees, require the approval of the Finance Director and all other services require the approval of the Chairman of the Committee. Where the cost of the services is expected to exceed £100,000, the engagement will normally be subject to competitive tender. The external auditors have in place processes to ensure that their independence is maintained including safeguards to ensure that where they provide non-audit services, their independence is not threatened. The external auditors have written to the Audit Committee confirming that, in their opinion, they are independent and the Audit Committee concurs with that view.

## Nomination Committee

**Donald Brydon, CBE**  
**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 May 2013 the Nomination Committee carried out a detailed review of leadership talent across the Group, facilitated by the Group HR director and the Group Director of Leadership and Talent. The review included an assessment of talent across the top 100 leaders of the business and the current strengths and weaknesses within the Company's leadership succession plan. Particular focus was given to recent actions to improve the talent pipeline, including the introduction of internal assessment and development programmes at senior and early career stages and other performance management initiatives.

During the year the Nomination Committee met several times to review progress and make recommendations to the Board in relation to the recruitment of my successor as Chairman. Mr Challen chaired these meetings and ensured that all Board members were kept up to date with developments, and had regular opportunities to provide their input.

## Meeting attendance

	Nomination Committee	
	Eligible to attend	Attended
D.H. Brydon (Chairman, save as noted below)	4	4
B.F.J. Angelici	4	3
D.J. Challen (Chairman, when Company Chairman's succession under discussion)	4	4
T.D. Fratto	4	4
A.C. Quinn	4	4
K.R. Tebbit	4	4

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



## Membership

During the financial year the members of the Committee were: Mr Brydon (Chairman of the Committee), Mr Angelici, Mr Challen, Ms Fratto, Ms Quinn and Sir Kevin Tebbit. As stated above, during the year Mr Challen, as Senior Independent Director, chaired the meetings, or parts of meetings, relating to the Chairman's succession.

## Responsibilities and activities

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 December 2012 the Senior Independent Director led a process to select a search firm to handle the Chairman's succession brief. This involved meetings with four search agencies, with the Group HR Director and the Company Secretary also in attendance. Following this process, Egon Zehnder International ("EZI") was selected.

The Nomination Committee worked with EZI to produce a detailed specification for the Chairman role, including the capabilities, attributes and time commitment which were either required or desirable. These included the benefits to the Board of diversity in its widest sense (gender, nationality, age, experience, 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 every member of the Board, the Nomination Committee was pleased to recommend to the Board the appointment of Sir George Buckley as a non-executive director and as Deputy Chairman, to succeed Mr Brydon as Chairman after the AGM in November. Sir George was also appointed as a member of the Nomination and Remuneration Committees, and as Chairman elect of the Nomination Committee to succeed Mr Brydon after his retirement from the Board.

In the Company's 2011 and 2012 Annual Reports, the Chairman explained that the Board supports Lord Davies' aspiration for female board representation, but this presented a particular challenge for a small board. Notwithstanding the challenge, following the recruitment of Ms Fratto in 2012, Board diversity has improved with women comprising a quarter of the Board and five nationalities being represented on the Board. The Chairman also explained that the proportion of women executives in senior positions in the Company was a reflection of the masculine nature of the engineering industry globally and this remains an ongoing issue.

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 to the Nomination Committee in May, 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.

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 2013.

## 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	3	2
B.F.J. Angelici	3	3
D.J. Challen	3	3
T.D. Fratto	3	3
K.R. 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.

### Responsibilities and activities

The Committee's responsibilities and terms of reference are described in the Directors' remuneration report on page 84. 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 2013.

# Directors' remuneration report

## Remuneration Committee

Anne Quinn, CBE  
Chair of the  
Remuneration Committee



### Introduction

On behalf of the Board, I am pleased to present the report of the Remuneration Committee for the year to 31 July 2013.

Shareholders will be aware of the Group's solid and sustainable growth in profits and EPS over the previous three years, which resulted in a payout under the three-year element of the 2008 Group Value Sharing Plan (VSP), which vested in October 2012.

In a challenging economic climate, the Group has seen a 2% underlying increase in headline revenue, flat headline EPS growth, and strong cash conversion in the last financial year. The annual bonuses for FY2013 reflect this level of financial performance and the personal performance of the executive directors. In line with prevailing market practice, half of the annual bonus awarded to executive directors is delivered in Smiths shares which are deferred for three years. If return on capital employed (ROCE) targets are achieved over the following three-year period, the deferred shares will be matched up to 2:1.

We engaged with shareholders during the year and specifically on the changes that were introduced for FY2013, which were an increase to the maximum bonus opportunity for the Finance Director to a level of 150% of salary and a change to the EPS targets in the Long-Term Incentive Plan from 6-14% p.a. to 4-12% p.a.

Following a review of the Group's executive remuneration framework and its application to executive directors in particular, the Committee remains satisfied that the existing arrangements align appropriately with the Group's strategy, and as a result there are no structural changes for the new financial year. The focus continues to be on creating value through the four key drivers of revenue growth, operating margin, cash conversion and ROCE with the important underpin of shareholders' longer-term interests.

It was agreed to award the Chief Executive only his second salary increase during his six-year tenure. The increase of 2.4% is in line with the increases being awarded elsewhere in the Group. There is no change in the salary level of the Finance Director.

The Committee welcomes the feedback of our shareholders and we hope that you will support the policies and practices detailed in this report.

**Anne Quinn, CBE**  
**Chair of the Remuneration Committee**

The Directors' remuneration report is presented to shareholders by the Board. The report complies with Regulation 11 and Schedule 8 of the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008 (the Regulations). So far as practicable, the format of the report also seeks to pre-comply with the new BIS regulations that will first apply to our 2014 remuneration report. An advisory resolution will be put to shareholders at the Annual General Meeting on 19 November 2013 inviting them to approve this report.

### The Remuneration Committee

Responsibilities of the Committee include:

- The Group's framework of executive total remuneration
- Individual total remuneration packages for executive directors and other executive committee members

- Annual Incentive Plan performance and payments for the financial year ended 31 July 2013
- Principles, structure and performance targets of the Annual Incentive Plan for the financial year ending 31 July 2014
- Structure, awards, performance targets and levels of achievement for the Long-Term Incentive Plans currently in place
- The remuneration of the Chairman

The Committee always reviews and takes into account pay and employment conditions in all parts of the Group and operates within agreed terms of reference which are available for inspection on the website. The Company continues to comply fully with the provisions of the UK Corporate Governance Code relating to directors' remuneration throughout the financial year except as is disclosed in the Corporate governance statement on page 75.

### FY2013 Committee members and meeting attendance

	Attendance
Anne Quinn (Chair of the Committee)	3/3
Bruno Angelici	3/3
Donald Brydon	2/3
David Challen	3/3
Kevin Tebbit	3/3
Tanya Fratto	3/3

Each member's attendance at meetings held during the year is also set out in the Corporate governance statement on page 83.

Mr Brydon is absent when his own remuneration as Chairman of the Company is under consideration. The Chief Executive attends meetings of the Committee by invitation but he is not involved in the determination of his own remuneration.

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 £55,180 to Kepler Associates in relation to remuneration advice to the Remuneration Committee during the year. Kepler does not provide any other material services to the Group. Freshfields Bruckhaus Deringer LLP were appointed by the Company to advise the Group on various legal matters during the year. Kepler Associates are signatories to the Code of Conduct for Remuneration Consultants.

### Remuneration policy

The Committee applies a remuneration policy which is driven by the following objectives:

- aligning the interests of executives with those of shareholders;
- focusing on the key business objectives of growth, margin improvement, cash conversion and capital discipline;
- creating a close link between remuneration and performance over both the short and long term;
- ensuring market competitive levels of total remuneration that attract and retain the highest calibre executives.

### Elements of remuneration

The remuneration of executive directors and senior executives balances fixed, variable, short-term and long-term remuneration, and is reviewed each year on a total remuneration basis to ensure that executives continue to be appropriately incentivised to achieve the Group's objectives.

## Executive directors

The main elements of remuneration for executive directors in 2012/13 are summarised in the table below:

Element and link to strategy	Operation	Opportunity	Performance measures
<b>Base salary</b>			
To attract, motivate and retain directors with the required skills and expertise	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. The review also takes into account individual performance and experience, the relative performance of the Company and the remuneration policy within the Company	Base salaries are adjusted according to the outcome of the annual review and will be disclosed in the Annual report on remuneration section of the remuneration report  Salary increases are typically effective 1 August	Not applicable
<b>Pension</b>			
Enables executive directors to save for their retirement, by choosing either to participate in the company pension plan or to receive a pension allowance and thus arrange their own pension provision	Pension allowances are reviewed periodically to ensure market competitiveness	Pension allowances are set at a level that the Committee considers appropriate having regard to market practice at other FTSE 100 companies of similar market capitalisation, revenues and complexity	Not applicable
<b>Annual bonus</b>			
Incentivises short-term operational, financial and personal performance	Annual bonus payments are determined based upon performance against targets set at the beginning of each year	Chief Executive: up to 180% of salary  Finance Director: up to 150% of salary	50% earnings per share 20% cash 30% personal
<b>Co-Investment Plan (CIP)</b>			
Helps to align short- and long-term remuneration	Mandatory investment of 50% of any net bonus earned in Smiths shares	Up to two matching shares per deferred share for maximum performance  One matching share per deferred share for threshold performance	Average ROCE compared to the weighted average cost of capital over the three-year performance period
<b>Long-Term Investment Plan (LTIP)</b>			
Incentivises long-term value creation for shareholders	Awards of conditional shares granted annually and vest, subject to performance, after a three-year period  Dividends accrue and are paid in cash at the end of the vesting period, on shares that vest  The awards are subject to clawback in particular circumstances	Chief Executive: up to 300% of salary  Finance Director: up to 200% of salary  At threshold performance 25% of the award vests	50% earnings per share 30% total shareholder return 20% cash
<b>Benefits</b>			
To provide market-competitive benefits	Benefits comprise car allowance, life assurance and private healthcare insurance	Benefit provision is set based on the level of the role	Not applicable
<b>Sharesave</b>			
Encourages ownership of shares in the company and alignment with shareholder interests	Participants can save a fixed sum of up to a maximum under UK legislation of £250 a month for three or five years and may use the sum generated by their savings contracts to exercise options to acquire shares which are usually granted at a 20% discount to the market price		Not applicable

## Directors' remuneration report

Continued

### Chairman and non-executive directors

The main elements of remuneration for the Chairman and non-executive directors in 2012/13 are summarised in the table below:

Element and link to strategy	Operation	Opportunity	Performance measures
<b>Annual fee</b>			
To attract, motivate and retain directors with the required skills and expertise	The base fee and additional fees for chairing Board Committees are paid in cash and are reviewed annually to ensure they compare appropriately to fees payable at companies of similar size and complexity as Smiths. The annual review does not necessarily result in an increase to fee levels.	Fees are adjusted according to the outcome of the annual review	Not applicable
<b>Other</b>			
		The Chairman is provided with the use of a company car. The 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	

### 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.

### Performance measure selection

The combination of measures used in the LTIP 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 provides strong alignment with shareholders and the FTSE 100 Index (excluding financial services companies) continues to be considered a relevant and robust indicator of the relative value created by Smiths management for its shareholders. This balance between both internal and external performance and between absolute and relative performance is considered to be important by the Committee.

### Performance target setting

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.

### 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.

### Service contracts

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

#### Mr Bowman

Mr Bowman is employed under a service contract with the Company dated 15 November 2007 and effective from 10 December 2007. It may be terminated by 12 months' notice given by the Company or six months' notice given by Mr Bowman. The Company may elect to terminate the contract by making a payment in lieu of notice equal to 150% of Mr Bowman's basic salary, this being a genuine pre-estimate of Mr Bowman's entitlement in respect of the unserved notice period, to cover:

1. salary;
2. annual pension contribution by the Company (42% of base salary);
3. the annual cost to the Company of providing all other benefits to which Mr Bowman is entitled under his contract, but excluding bonus.

In this event, the contract provides that Mr Bowman's bonus entitlement for the financial year in which termination occurs and for the unserved notice period will be the subject of a separate, good faith discussion between Mr Bowman and the Chairman; the contract also specifies that Mr Bowman would in this case be treated as a "good leaver" for the purposes of relevant share plans. In certain constructive dismissal events, Mr Bowman is entitled to resign and be treated in the manner set out above.

#### Mr Turner

Mr Turner is employed under a service contract with the Company dated 23 March 2010 and effective from 19 April 2010. It provides for a rolling one-year notice period given by the Company or six months' notice given by Mr Turner. In the event of termination by the Company (other than for cause), the Board is required to consider what sum should be payable as compensation to Mr Turner. In doing so, the Board shall take into account a number of specific matters, including Mr Turner's personal circumstances, the financial performance of Smiths Group, applicable corporate governance best practice, the likelihood of Mr Turner obtaining alternative employment, and various other matters relating to Mr Turner's financial loss. The amount of compensation, as so determined, will not be less than 12 months' basic salary.

## Chairman and non-executive directors

The Chairman and the non-executive directors serve the Company under letters of appointment and do not have contracts of service or contracts for services. Except where appointed at a general meeting, directors stand for election by shareholders at the first Annual General Meeting (AGM) following appointment and then stand for re-election at every third AGM (or such earlier AGM as the Board may determine) thereafter (under Article 49). The Board has resolved that all directors who are willing to continue in office will stand for re-election by the shareholders each year at the AGM. Either party can terminate the appointment on one month's written notice and no compensation is payable in the event of an appointment being terminated early. The dates of their original appointment are as follows:

Non-executive director	Date of appointment	*Expiry of current term	Date of election/last re-election
B.F.J. Angelici	1 July 2010	2013	20 November 2012
D.H. Brydon	19 April 2004	2013	20 November 2012
D.J. Challen	21 September 2004	2013	20 November 2012
T.D. Fratto	1 July 2012	2015	20 November 2012
A.C. Quinn	1 August 2009	2013	20 November 2012
K.R. Tebbit	14 June 2006	2013	20 November 2012

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

## Leaving and change-of-control provisions

For those individuals regarded as 'bad leavers' (e.g. 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 – if the individual holds a pro-rated 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. 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 invested 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.

## Approach to recruitment remuneration

The Remuneration Committee approves the remuneration of each executive director on their appointment. In setting remuneration on recruitment, the Committee will apply the following policy:

Pay element	Policy on recruitment	Maximum
Salary	Salary on recruitment is determined based on the same principles as the annual salary review, as outlined in the policy table	–
Pension	As described in the policy table	–
Benefits	As described in the policy table and may include, but not limited to, car, medical insurance and life assurance	–
Annual bonus	As described in the policy table and typically pro-rated for proportion of year served	180%* of salary
CIP	As described in the policy table	180%** of salary
LTIP	May be considered for an award under the LTIP on similar terms to other executives	300% of salary
Other	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 performance conditions, the likelihood of those conditions being met and the proportion of the vesting period remaining. The Remuneration Committee may make payments to cover reasonable expenses in recruitment and relocation, and any other miscellaneous expenses such as housing, tax and immigration support.	–

\*Annual bonus maximum shown is prior to mandatory deferral

\*\*Maximum CIP shown assumes maximum bonus is earned in the first year of employment, and maximum performance over the performance period covering the following three years, i.e. warranting a maximum 2-for-1 match

## Directors' remuneration report

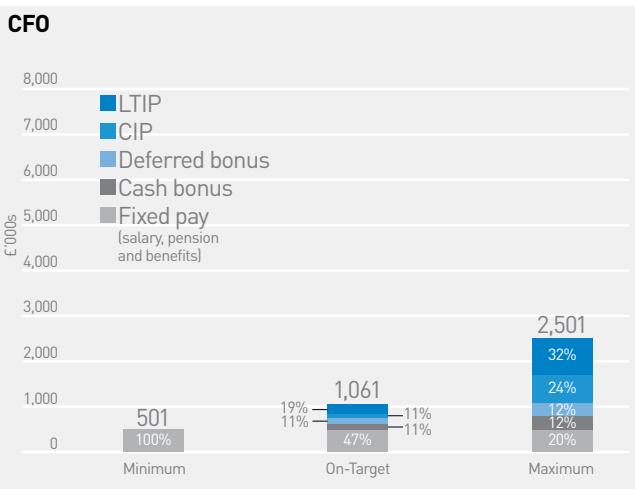
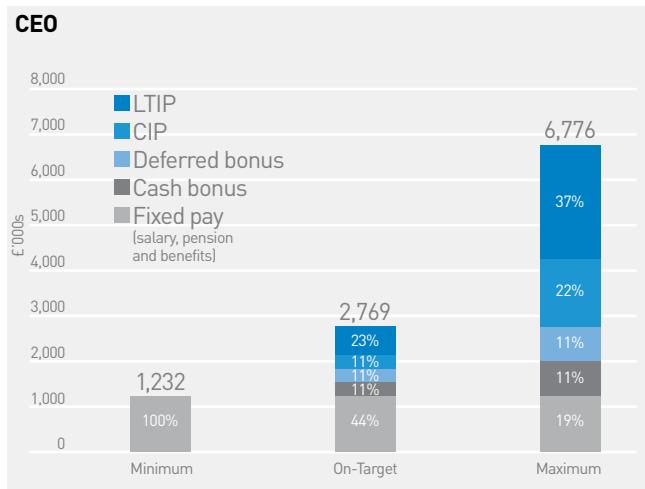
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### External appointments

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.

### 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 financial year, applied to the base salary in force at 1 August 2013. For the annual bonus, the amounts illustrated are those potentially receivable in respect of performance for 2014. 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 the Company's share price and the value of dividends paid. The following assumptions have been made in compiling the above charts:

CEO			
Component	'Minimum'	'On-Target'	'Maximum'
Base salary	Annual base salary		
Pension	Company pension contribution		
Other benefits	Taxable value of annual benefits provided		
Cash bonus	0% of salary (Minimum)	36% of salary (Target)	90% of salary (Maximum)
Deferred bonus	0% of salary	36% of salary (Target)	90% of salary (Maximum)
CIP	0 x match (Minimum)	1 x match (Threshold)	2 x match (Maximum)
LTIP	0% of salary (Minimum)	75% of salary (Threshold)	300% of salary (Maximum)

CFO			
Component	'Minimum'	'On-Target'	'Maximum'
Base salary	Annual base salary		
Pension	Company pension contribution		
Other benefits	Taxable value of annual benefits provided		
Cash bonus	0% of salary (Minimum)	30% of salary (Target)	75% of salary (Maximum)
Deferred bonus	0% of salary	30% of salary (Target)	75% of salary (Maximum)
CIP	0 x match (Minimum)	1 x match (Threshold)	2 x match (Maximum)
LTIP	0% of salary (Minimum)	50% of salary (Threshold)	200% of salary (Maximum)

### Consideration of employment conditions

The Committee always takes into account pay and employment conditions elsewhere in the Company.

### 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.

### Summary of shareholder advisory vote on 2012 Directors' remuneration report

The resulting voting outcome for last year's Directors' remuneration report was as follows:

For: 82.79%

Against: 8.45%

Abstentions 8.76%

## Annual report on remuneration

### Executive director annual remuneration

	Salary		Pension		Benefits**		Annual bonus***		Long-term incentives		Total	
	2013 £000	2012 £000	2013 £000	2012 £000	2013 £000	2012 £000	2013 £000	2012 £000	2013* £000	2012 £000	2013 £000	2012 £000
P. Bowman	<b>820</b>	820	<b>344</b>	344	<b>39</b>	39	<b>583</b>	1,168	<b>1,977</b>	2,655	<b>3,763</b>	5,026
P. A. Turner	<b>400</b>	400	<b>100</b>	100	<b>1</b>	1	<b>241</b>	390	<b>309</b>	—	<b>1,051</b>	891

\*Valued using the three-month average share price to 31 July 2013 (13.32p).

\*\*Benefits include car allowance, life assurance and private healthcare insurance.

\*\*\*In accordance with the rules of the CIP set out in the Remuneration Policy table on page 85, Mr Bowman and Mr Turner each deferred 50% of their net bonus earned into Smiths shares.

### Incentive outcomes for 2012/13

The table below summarises the structure of the 2012/13 annual bonus plan and the awards receivable for performance in 2012/13.

#### 2012/13 annual bonus outcome

Executive director	Group EPS		Cash conversion		Personal objectives		Total (% of salary)	
	Maximum	Actual	Maximum	Actual	Maximum	Actual	Maximum	Actual
P. Bowman	90%	0.0%	36%	25.2%	54%	45.9%	180%	71.1%
P.A. Turner	75%	0.0%	30%	21.0%	45%	39.2%	150%	60.2%

Mr Bowman and Mr Turner are set a number of challenging personal objectives derived from the Company's annual and strategic plans. These targets include revenue growth, cash generation, and improvements in our corporate responsibility measures and organisational capabilities.

#### 2010 CIP outcome

Included in the Executive director annual remuneration table above, is the outcome that awards will vest in full as ROCE exceeded WACC by an average margin of at least 3% a year over the performance period. The CIP values shown in the 2013 long-term incentive element above are £1,631,408 for Mr Bowman and £171,098 for Mr Turner. These figures include 112,169 shares (Mr Bowman) and 11,764 shares (Mr Turner) received in respect of the 2010 CIP. The value of these shares is based on the average share price over the three months to 31 July 2013 of 1332p. The figure also includes dividend equivalents of £137,418 (Mr Bowman) and £14,412 (Mr Turner) in respect of the vested CIP shares.

#### 2008 VSP (four-year element) outcome

The outcome was that 175,193 shares vested to Mr Bowman on 18 October 2012. These are valued in the Executive director annual remuneration table above at a share price of 1084p, which was the closing price on the date of exercise.

#### 2010 VSP outcome

The outcome is that 25,885 share will vest to Mr Bowman and 10,354 shares will vest to Mr Turner. These are valued in the Executive director annual remuneration table above at a share price of 1332p, which was the average share price over the three months to 31 July 2013.

### Chairman and non-executive director annual remuneration

	Annual fee		Committee Chairman fee		Benefits		Total fees	
	2013 £000	2012 £000	2013 £000	2012 £000	2013 £000	2012 £000	2013 £000	2012 £000
D.H. Brydon	<b>315</b>	305	—	—	<b>33</b>	32	<b>348</b>	337
D.J. Challen <sup>1</sup>	<b>60</b>	54	<b>15</b>	15	—	—	<b>75</b>	69
S.J. Chambers <sup>2</sup>	—	49	—	14	—	—	—	63
K.R. Tebbit	<b>60</b>	54	—	—	—	—	<b>60</b>	54
A.C. Quinn	<b>60</b>	54	<b>15</b>	1	—	—	<b>75</b>	55
B.F.J. Angelici	<b>60</b>	54	—	—	—	—	<b>60</b>	54
T.D. Fratto <sup>3</sup>	<b>60</b>	5	—	—	—	—	<b>60</b>	5

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

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

3 Tanya Fratto's fees for 2012 are for a part year, covering the period from her appointment on 1 July 2012 until the end of the financial year on 31 July 2012.

## Directors' remuneration report

Continued

### 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 £144 and £154 respectively.

### Total shareholder return



### CEO pay for the last five years

Year	2009	2010	2011	2012	2013
CEO total remuneration £000	1,778	3,399	4,776	5,026	<b>3,763</b>
Annual bonus outcome [% max]	42%	95%	64%	79%	<b>39%</b>
CIP outcome [% max]	n/a	n/a	100%	100%	<b>100%</b>
2007 PSP outcome [% max] <sup>1</sup>	n/a	46%	33%	n/a	<b>n/a</b>

1 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 £345,000 for 2013 at (25,885 shares at a price of 1332p).

### Scheme interests awarded in 2012/13

The CIP and LTIP awards granted in 2012/13 are itemised in the table on page 94.

### Payments to past directors

No payments were made to past directors in the year.

### Payments for loss of office

No directors left office during the year.

### 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 year's 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

The table below shows the shareholding of each executive Director against their respective shareholding requirement as at 31 July 2013.

	Shareholding requirement (% 2012/13 salary)	Shares owned outright	Shares subject to performance	Performance tested but unvested shares	Shares subject to CIP deferral	Current shareholding (% 2012/13 salary)	Guideline met?
P. Bowman	200%	435,197	817,508	0	79,119	735%	Yes
P.A. Turner	150%	40,870	244,830	0	20,599	142%	No

### Relative importance of spend on pay

The table below show shareholder distributions (i.e. dividends and share buybacks) and total employee pay expenditure for the financial years ended 31 July 2012 and 31 July 2013, and the percentage change.

	2013 £m	2012 £m	% change
Shareholder distributions	<b>152.4</b>	144.1	5.8%
Employee costs	<b>892.1</b>	871.6	2.4%

## Annual report on remuneration

### 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 such as; the individual performance and experience, the relative performance of the Company and the remuneration policy within the Company, the Committee determined that the salary of the Chief Executive would increase by 2.4% for 2013/14 and that the salary of the Finance Director for 2013/14 would remain unchanged as shown in the table below:

Executive director	Salary last reviewed	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
P. Bowman	16 July 2013	£800,000	£800,000	£800,000	£820,000	£820,000	£840,000
P.A. Turner	16 July 2013	n/a	£400,000	£400,000	£400,000	£400,000	£400,000

Benefits for Mr Bowman include a car allowance and health insurance. Mr Turner receives health insurance but does not receive a car allowance.

### Annual bonus

Executive directors are eligible to participate in an annual bonus plan based on a combination of corporate financial goals (Group EPS and cash conversion) and the achievement of personal objectives. The maximum annual bonus opportunity for the Chief Executive is 180% of salary and for the Finance Director is 150% of salary. The table below summarises the structure of the 2013/14 annual bonus plan and the awards receivable for performance in 2013/14.

Executive director	Group EPS Maximum	Cash conversion Maximum	Personal Objectives Maximum	Total Maximum
P. Bowman	90%	36%	54%	180%
P.A. Turner	75%	30%	45%	150%

### Co-Investment Plan (CIP)

Under the rules of the CIP, there is a mandatory investment of 50% of any net earned annual bonus in Smiths shares for selected senior executives (including executive directors). Invested amounts can earn a 2-for-1 matching share award after three years (based on the pre-tax amount of deferred bonus), subject to continued employment in the Group and the Company's average return on capital employed (ROCE) over the performance period exceeding the Company's weighted average cost of capital (WACC), which the Committee regards as appropriately reflecting the operating efficiency of the Company.

Prior to the start of each award cycle, the Committee reviews the targets required for any matching shares to vest to ensure they remain appropriately stretching. For CIP awards granted in 2013, matching share awards vest in full if ROCE exceeds WACC by an average margin of at least 3% a year; a 1-for-1 matching share award vests if ROCE is between WACC+1% and WACC+3% p.a. Dividends accrue on matching shares that vest.

### 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.

Awards made in 2012/13 are disclosed on page 94. LTIP awards to be granted to executive directors in 2013/14 will vest on the achievement of the following performance conditions:

Performance measure	Weighting	Threshold performance target (25% vesting of element)	Maximum performance target (full vesting of element)
3-year EPS growth	50%	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.

To the extent that the performance targets are not met over the three-year performance period, awards will lapse. No retesting of awards under either performance condition is permitted.

Dividends accrue and are paid in cash at the end of the vesting period, on shares that vest.

In addition, LTIP awards are subject to clawback in the event of a material mis-statement in the published results of the Group, or in the event of misconduct on the part of the participant.

## Directors' remuneration report

Continued

### Sharesave Scheme

The Smiths Group Sharesave Scheme is open to all UK employees with at least 12 months' service. Participants can save a fixed sum of up to a maximum under UK legislation of £250 a month for three or five years and may use the sum generated by their savings contracts to exercise options to acquire shares which are usually granted at a 20% discount to the market price.

### Share 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 2013, the headroom available under these limits was 5.8% and 1.7%, respectively (excluding the conditional share awards granted under the 2010 VSP).

### Pension

No director accrues pension entitlements under a defined benefit scheme. The Company operates pension supplement arrangements for executive directors. The Company pays a monthly salary supplement to Mr Bowman (worth 42% of salary per annum), and to Mr Turner (worth 25% of salary per annum). These supplements are approved by the Committee and enable them to make their own pension provision.

### Non-executive director fees

The Board of Directors, excluding Remuneration Committee members, is responsible for recommending the remuneration of the non-executive directors with the exception of the Chairman, whose remuneration is determined by the Remuneration Committee. The fees payable to the non-executive directors were increased with effect from 1 August 2012 to £60,000 but no change was made to the fees for the Senior Independent Director and Committee Chairs, which remain at £15,000 per annum.

### Remuneration

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

	2013 £000	2012 £000
Fees, salaries and benefits	<b>1,938</b>	1,897
Performance-related bonuses	<b>824</b>	1,558
Aggregate gain from exercise of share options and vesting of share awards	<b>2,608</b>	2,144
Payments in lieu of pension contribution	<b>444</b>	444
	<b>5,814</b>	6,043

The emoluments of the directors are set out below:

	Fees/salary 2012 £000	Benefits 2013 £000	Bonus 2013 £000	Payments in lieu of pension contribution 2013 £000	Total emoluments	
					2013 £000	2012 £000
<b>Chairman</b>						
D.H. Brydon	305	<b>315</b>	<b>33</b>		<b>348</b>	337
<b>Chief Executive</b>						
P. Bowman	820	<b>820</b>	<b>39</b>	<b>583</b>	<b>344</b>	<b>1,786</b>
<b>Executive director</b>						
P.A. Turner	400	<b>400</b>	<b>1</b>	<b>241</b>	<b>100</b>	<b>742</b>
<b>Non-executive directors</b>						
D.J. Challen	69	<b>75</b>			<b>75</b>	69
S.J. Chambers <sup>1</sup>	63	—			—	63
K.R. Tebbit	54	<b>60</b>			<b>60</b>	54
A.C. Quinn	55	<b>75</b>			<b>75</b>	55
B.F.J. Angelici	54	<b>60</b>			<b>60</b>	54
T.D. Fratto <sup>2</sup>	5	<b>60</b>			<b>60</b>	5
Total	1,825	<b>1,865</b>	<b>73</b>	<b>824</b>	<b>444</b>	<b>3,206</b>
						3899

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

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

## Directors' interests in the Company's shares

	Ordinary shares of 37.5p each 31 July 2013	Ordinary shares of 37.5p each 31 July 2012
B.F.J. Angelici	2,000	2,000
D.H. Brydon	8,000	8,000
P. Bowman	<b>435,197</b>	293,997
D.J. Challen	1,333	1,333
T.D. Fratto	1,500	1,500
A.C. Quinn	1,024	1,024
K. R. Tebbit	1,000	1,000
P.A. Turner	<b>40,870</b>	22,790

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

The Company has not been notified of any changes to the holdings of the current directors, their families and any connected persons between 1 August and 17 September 2013, being the last practicable date before publication of the remuneration report.

### Auditable part

The directors' remuneration tables and accompanying notes on page 92; the directors' pensions allowances and accompanying notes on page 92; and the directors' share options and awards table on page 94 have been audited.

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

**A.C. Quinn**

17 September 2013

## Directors' remuneration report

**Continued**

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

Director and Plans	Options and awards held on 31 July 2013		Options and awards held on 31 July 2012		Option and award data					Awards vested 2012/13		
	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	Oct 2014	Oct 2014					
	82,596	82,596	B	n/a	16/12/11	Oct 2014	Oct 2014					
	55,064	55,064	C	n/a	16/12/11	Oct 2014	Oct 2014					
	113,469	0	A	n/a	19/10/12	Oct 2015	Oct 2015					
	68,081	0	B	n/a	19/10/12	Oct 2015	Oct 2015					
	45,387	0	C	n/a	19/10/12	Oct 2015	Oct 2015					
CIP	0	62,919	D	n/a	15/10/09	Oct 2012	Oct 2012	18/10/12	62,919	n/a	962.50p	1064.43p
	112,169	112,169	D	n/a	05/10/10	Oct 2013	Oct 2013					
	95,377	95,377	D	n/a	24/10/11	Oct 2014	Oct 2014					
	107,704	0	D	n/a	19/10/12	Oct 2015	Oct 2015					
SAYE	2,750	2,750	-	569.00p	21/05/09	01/08/14	01/02/15					
<b>P.A. Turner</b>												
LTIP	44,768	44,768	A	n/a	16/12/11	Oct 2014	Oct 2014					
	26,860	26,860	B	n/a	16/12/11	Oct 2014	Oct 2014					
	17,907	17,907	C	n/a	16/12/11	Oct 2014	Oct 2014					
	36,900	0	A	n/a	19/10/12	Oct 2015	Oct 2015					
	22,140	0	B	n/a	19/10/12	Oct 2015	Oct 2015					
	14,760	0	C	n/a	19/10/12	Oct 2015	Oct 2015					
CIP	11,764	11,764	D	n/a	05/10/10	Oct 2013	Oct 2013					
	33,781	33,781	D	n/a	24/10/11	Oct 2014	Oct 2014					
	35,950	0	D	n/a	19/10/12	Oct 2015	Oct 2015					

### Value sharing plans

Director and Plans	VSP awards held on 31 July 2013		VSP awards held on 31 July 2012		Award data					Awards vested 2012/13		
	Shares per £5m surplus value	Shares per £5m surplus value	Performance test	Exercise price	Grant date	Vesting date*	Expiry date	Exercise/vesting date	Number	Exercise price	Market price at date of grant#	Market price at date of exercise##
<b>P. Bowman</b>												
VSP 2008	0	417	E	n/a	28/07/08			18/10/12	0			
	0	833	F	n/a	28/07/08			18/10/12	175,193	n/a	1060.00p	1064.43p
VSP 2010	240	240	G	n/a	17/12/10	Oct 2013	Oct 2013					
	560	560	H	n/a	17/12/10	Oct 2013	Oct 2013					
<b>P.A. Turner</b>												
VSP 2010	96	96	G	n/a	17/12/10	Oct 2013	Oct 2013					
	224	224	H	n/a	17/12/10	Oct 2013	Oct 2013					

### Key

LTIP The Smiths Group Long-Term Incentive Plan

CIP The Smiths Group Co-Investment Plan

SAYE The Smiths Group Sharesave Scheme

VSP 2008 The Smiths Group Value Sharing Plan

VSP 2010 The Smiths Group 2010 Value Sharing Plan

\* The vesting dates shown above in respect of awards made under LTIP, CIP and VSP 2010 are subject to the relevant performance test(s) being passed.

\*\* The expiry dates shown above apply in normal circumstances. No expiry date is shown if the option or award was exercised or vested or lapsed prior to 17 September 2013

# 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.

### Performance tests

- A LTIP Earnings Per Share (EPS) growth test
- B LTIP Total Shareholder Return (TSR) rank test
- C LTIP Cash Conversion test
- D CIP Return on Capital Employed (ROCE) test
- E Surplus Shareholder Value – VSP 2008 TSR Test
- F Surplus Internal Value – VSP 2008 PBT Test
- G Surplus Shareholder Value – VSP 2010 TSR Test
- H Surplus Internal Value – VSP 2010 PBT Test
- There are no performance criteria for SAYE.

All the relevant performance targets can be found in the 2011 and 2012 Annual Reports.

### Notes

The high and low market prices of the ordinary shares during the period 1 August 2012 to 31 July 2013 were 1010p and 1456p respectively.

The mid-market closing price on 31 July 2012 was 1067p and on 31 July 2013 was 1385p.

The mid-market closing prices of a Smiths share on the dates of awards made to directors in the 2012/13 financial year was 1076p (for the CIP Awards and the LTIP Awards).

The option over 2,750 shares granted to and held by directors under SAYE at 31 July 2013 was granted at an exercise price below the market price of a Smiths Group share on 16 September 2013 (1373p).

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

No options or awards held by any director lapsed during the period 1 August 2012 to 31 July 2013.

No other Director held any options over the Company's shares during the period 1 August 2012 to 31 July 2013.

No options or awards have been granted to or exercised by directors or have lapsed during the period 1 August to 17 September 2013.

At 31 July 2013 the trustee of the Employee Share Trust held 855 shares (none of the directors had an interest in these shares at 31 July 2013). The market value of the shares held by the trustee on 31 July 2013 was £11,842 and dividends of approximately £330 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.

In relation to the 2008 Group VSP, over the four-year period from 1 August 2008 to 31 July 2012, Smiths TSR did not result in the vesting of any shares under that element of the award. Under the four-year Earnings Element of the 2008 Group VSP, performance is measured in terms of absolute growth in Adjusted Headline Profit times a multiple, plus net equity cash-flows to shareholders. During the year, the Earnings Element was adjusted to reflect additional payments that were made to further reduce the pension deficit during the performance period. Smiths performance resulted in £1,052m of value created above the 9.5% p.a. hurdle rate resulting in 175,193 shares vesting to the Chief Executive on 18 October 2012. Under the four-year portion of the 2008 Group VSP, therefore, the total number of shares vesting to the Chief Executive was 175,193.

Smiths' ROCE over the performance period for the 2009 CIP awards (1 August 2009 to 31 July 2012) exceeded the Company's weighted average costs of capital (WACC) over the period by more than 3% p.a. Accordingly the 2009 CIP Awards vested in full. The notional gross dividends accrued in respect of the performance period amounted to 117.23 per share. This amount, after deduction of income tax and national insurance contributions, was paid in cash in respect of each share that vested.

# Group directors' report

## Principal activities

The principal activities of the Company and its subsidiaries (the Group) are and, during the year ended 31 July 2013, were the development, manufacture, sale and support of:

- detection technologies, including x-ray, trace detection, infra-red and gamma ray spectroscopy and millimetre-wave, that detect and identify explosives, narcotics, weapons, chemical agents, biohazards, nuclear and radioactive materials and contraband;
- engineered products and services for the major process industries, including oil and gas, power generation, chemical, pharmaceutical, pulp and paper and mining sectors;
- medical devices and consumables for medication delivery; vital care; and the safety of healthworkers and patients;
- technically differentiated electronic components and subsystems providing signal, power and microwave solutions for the global data centre, wireless telecommunications, aerospace, defence, space, medical, rail, test and industrial markets; and
- engineered components including ducting, hose assemblies and heating elements that move and heat fluids and gases for the aerospace, medical, industrial, construction and domestic appliance markets.

The main manufacturing operations are in the UK, the Americas, Continental Europe and China.

## Business review and model / future strategy and development / research and development

The statements and reviews on pages 8 to 72 comprise the Group business review and are incorporated by reference, forming part of this Directors' report. This is a review of the development and performance of the business of the Group, including the financial performance during the financial year ended 31 July 2013; key performance indicators; and the principal risks and uncertainties facing the Group. It also includes an explanation of the basis on which the Group generates or preserves value over the longer term and the strategy for delivering the objectives of the Group and information on likely future developments and activities in the field of research and development. The cautionary statement set out on the inside front cover of this Annual Report forms part of this Annual Report and is incorporated by reference into the Business review.

## Results and dividends

The results for the financial year ended 31 July 2013 are set out in the Consolidated income statement. Revenues for the year amounted to £3,109m (2012: £3,030m). The profit for the year after taxation amounted to £358.2m (2012: £258.2m).

An interim dividend of 12.5p per ordinary share of 37.5p was paid on 26 April 2013. The directors recommend for payment on 22 November 2013 a final cash dividend of 27p on each ordinary share of 37.5p, making a total ordinary dividend of 39.5p for the financial year. In addition, the directors recommend for payment on 22 November 2013 a special cash dividend of 30p per ordinary share. The ex-dividend date and the record date for both dividends will be 23 October and 25 October 2013, respectively.

The retained profit of £358.2m was transferred to Reserves.

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

On 15 October 2012 the Company announced that it had closed a US\$400m dollar-denominated bond offering (the "Notes") following its launch on 5 October 2012. The Notes have a 10-year maturity and were priced at a fixed coupon of 3.625%.

On 31 May 2013 the Company confirmed that it had received a preliminary approach for the Medical division.

On 17 June 2013 the Company announced the appointment of Sir George Buckley as its Chairman, effective from the close of its Annual General Meeting on 19 November 2013. He will succeed Donald Brydon whose planned retirement was announced at the AGM in 2012. Sir George joined the Smiths Board on 1 August 2013 as a non-executive director and Deputy Chairman and a member of the Nomination and Remuneration committees.

On 31 July 2013 the Company sold land at New North Road, Hainault for £5.8m.

## Post balance sheet events

On 2 August 2013 the Company announced that discussions about the possible sale of the Medical division had been terminated.

## Charitable and political donations

During the financial year the Group made donations of £453,000 for charitable purposes. This comprised payments totalling £303,000 to the Institute of Child Health at the Great Ormond Street Hospital, in sponsorship of the Smiths Medical Professor of Anaesthesia and Critical Care and the Portex Anaesthesia, Intensive Care and Respiratory Unit; £18,000 to UK charities in the health and education fields; and other donations made by the Company and its businesses worldwide. The Group supports charities working in the areas of health; education and well-being; and the environment. The Group made contributions to non-EU political parties totalling £18,500 during the year. The political contributions were made on a bi-partisan basis in the US, in accordance with US federal and state 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 8,500 employees in the US.

## Directors

Messrs B.F.J. Angelici, P. Bowman, D.H. Brydon, CBE, D.J. Challen, CBE and P.A. Turner; Ms T.D. Fratto; Ms A.C. Quinn, CBE; and Sir Kevin Tebbit, KCB, CMG all served as directors of the Company throughout the year. Sir George Buckley was appointed as a non-executive director and as Deputy Chairman on 1 August 2013.

## Reappointment of directors

In accordance with the UK Corporate Governance Code, all the directors, except for Mr Brydon and Sir George Buckley, will retire voluntarily from office at the AGM and will seek re-election. Mr Brydon will leave the Company at the end of the AGM and so will not stand for re-election. Sir George Buckley will retire from the Board at the AGM, in accordance with Article 49 of the Company's Articles of Association, following his appointment during the year, and, being eligible, will seek election. Separate resolutions to re-elect or elect each of them, apart from Mr Brydon, as a director of the Company will be proposed at the AGM. Biographical details of all the directors are set out on pages 70 to 72.

## Directors' remuneration report

The Directors' remuneration report is on pages 84 to 95.

An ordinary resolution to approve the report will be put to shareholders at the AGM.

## Directors' interests in contracts

Details of the executive directors' service contracts are as disclosed in the service contracts section of the Directors' remuneration report on page 86. 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 94 and 95.

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 2013 and, at the date of this report, are in force for the benefit of the current directors in relation to certain losses and liabilities which they may incur [or may have incurred] to third parties in the course of their professional duties for the Company.

Apart from the exceptions referred to above, no director had an interest in any contract to which the Company or its subsidiaries was a party during the year.

## Interests in voting rights

As at 31 July 2013 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 interests in its share capital, as follows:

	Number of shares	Percentage of issued ordinary share capital*
BlackRock, Inc.	16.4m	4.2%
Ameriprise Financial / Threadneedle Asset Management	18.3m	4.6%
M&G Investment	17.4m	4.4%
Massachusetts Financial Services Company	18.5m	4.7%
Harris Associates LP	20.2m	5.1%

\*Percentage of ordinary share capital in issue on 31 July 2013.

The Company has not been notified of any other changes to the notifiable voting rights in its shares during the period 1 August to 16 September 2013.

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 93.

## Corporate governance statement

The Corporate governance statement is on pages 73 to 83 and is incorporated in this Directors' report by reference. PricewaterhouseCoopers LLP has reviewed the Company's statements as to compliance with the UK Corporate Governance Code, to the extent required by the UK Listing Authority Listing Rules. The results of its review are set out in the Independent auditors' report on page 103.

## Financial instruments

The financial risk management objectives and policies of the Group; the policy for hedging each major type of forecasted transaction for which hedge accounting is used; and the exposure of the Group to foreign exchange risk, interest rate risk, financial credit risk and liquidity risk are 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 Business review on pages 28 to 53. The financial position of the Company, its cash-flows, liquidity position and borrowing facilities are described in the Financial review on pages 50 to 52. In addition, the notes to the accounts include the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk.

At 31 July 2013 the Group had available cash and short-term deposit resources of £394m and undrawn committed borrowing facilities of US\$800m which are due to expire in 2015 [unless otherwise extended or reviewed]. Whilst these facilities have certain financial covenants they are not expected to prevent full utilisation of the facilities if required. This, together with the maturity profile of debt, provides confidence that the Group has sufficient financial resources for the foreseeable future. As a consequence, the directors believe that the Company is well placed to manage its business despite the current uncertain economic environment which increases risk and uncertainties (see pages 56 to 61). In coming to this conclusion, the directors have taken account of the Group's risk management process, described on pages 79 to 82, and have paid particular attention to the financial and pension funding risks and their mitigation (see page 58).

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

## Policy on payment of creditors

The Company's policy and practice is to pay creditors (including suppliers) promptly in accordance with agreed terms of business. The average time taken to pay an invoice was 33 days (2012: 41) for the parent Company and 45 days (2012: 41) for the Group as a whole.

## Share capital and control

As at 31 July 2013, the Company's issued share capital was £147,681,941 and comprised 393,818,510 ordinary shares of 37.5p each nominal value [ordinary shares]. The ordinary shares are listed on the London Stock Exchange.

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

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

Shares acquired through Company share schemes and plans rank pari passu with the shares in issue and have no special rights. The Company operates an employee benefit trust, with an independent trustee, to hold shares pending employees becoming entitled to them under the Company's share schemes and plans. On 31 July 2013 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.

## **Group directors' report**

### **Continued**

The table on page 97 sets out the notifications, received by the Company pursuant to the FCA's Disclosure & Transparency Rules and the 2006 Act, as at 31 July 2013 and any changes thereto up to 16 September 2013, 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. Changes to the Articles of Association must be approved by the shareholders in accordance with the legislation in force from time to time.

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

The Company has in place credit facility agreements under which a change in control would trigger prepayment clauses and has bonds in issue the terms of which would allow bondholders to exercise put options and require the Company to buy back the bonds at their principal amount plus interest if a rating downgrade occurs at the same time as a change of control takes effect. The Company's share schemes and plans contain clauses which may cause options and awards to vest on a change in control, in some cases subject to the satisfaction of performance conditions at that time. The Company is not party to any other significant agreements that would take effect, alter or terminate upon a change of control following a takeover.

If there is a change in control of the Company, the terms of Mr Bowman's service contract require that all available discretions will be exercised under the Company's share schemes and in default the Company must indemnify Mr Bowman for the value of any awards that do not vest on the change in control.

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

### **Purchase of shares**

No shares were purchased by the Company during the financial year ended 31 July 2013.

### **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 62 to 67. The full Corporate responsibility report is available online at [www.smiths.com/responsibility](http://www.smiths.com/responsibility).

### **Annual General Meeting ('AGM')**

The 2013 AGM will be held on Tuesday 19 November 2013 at 9:30am at the Northcliffe House Auditorium of the law firm, Freshfields Bruckhaus Deringer, 26-28 Tudor Street, London EC4Y 0BQ. The Notice of the AGM will be published on the Company's website, [www.smiths.com](http://www.smiths.com), on or around 14 October 2013.

### **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 16 September 2013, 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 2015 and the end of the next AGM, due to be held in 2014.

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 2013, the following ordinary shares in the Company were issued:

- 1,092,567 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 2014) or 31 January 2015 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.

**Special dividend**

The Group's robust balance sheet and record of strong cash generation is more than able to fund immediate investment needs and other legacy issues. The Board is proposing a resolution for the return of £118m of cash to shareholders in the form of a special dividend of 30 pence per ordinary share. The special dividend would be in addition to the recommended final ordinary dividend of 27 pence per ordinary share. The approval of this resolution is not dependant on the approval of the final dividend resolution, nor vice versa. Subject to the passing of this resolution at the AGM, the special dividend will be paid to shareholders who are on the register of members at close of business on 25 October 2013. The payment date will be 22 November 2013.

**Disclosure of information to the auditors**

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

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

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

Electronic copies of the Annual Report 2013 and the Notice of AGM will be posted on the Company's website, [www.smiths.com](http://www.smiths.com). The Company's announcements to the Stock Exchange and press releases are available online through the website. Shareholding details and practical help on share transfers and changes of address can be found at [www.shareview.co.uk](http://www.shareview.co.uk).

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

**Electronic proxy voting**

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

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

Shareholders who will not be able to attend the AGM on 19 November 2013 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.

**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

17 September 2013

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# Statement of directors' responsibilities

Company law requires the directors to prepare accounts for each financial year. Under company law the directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for that period. In preparing these accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether the consolidated accounts comply with International Financial Reporting Standards ("IFRS"), and the Parent Company accounts comply with applicable UK Accounting Standards, subject to any material departures disclosed and explained in the accounts;
- prepare the accounts on the going concern basis unless it is inappropriate to presume that the Group and the Company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group'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.

In accordance with the Disclosure and Transparency Rules of the UK Listing Authority, each of the directors (who are listed in the Group directors' report) confirms that to the best of his or her knowledge:

- the Group's financial statements have been prepared in accordance with IFRS as adopted by the European Union and give a true and fair view of the Group's assets, liabilities and financial position as at 31 July 2013 and of its profit for the financial year then ended; and
- the Group directors' report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties that the Group faces.

**Philip Bowman**  
**Chief Executive**  
17 September 2013

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

# Independent auditors' report to the members of Smiths Group plc

We have audited the Group financial statements of Smiths Group plc for the year ended 31 July 2013 which comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated balance sheet, the consolidated statement of changes in equity, the consolidated cash-flow statement, the accounting policies and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

## Respective responsibilities of directors and auditors

As explained more fully in the Statement of Directors' responsibilities, the Directors are responsible for the preparation of the Group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the Group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

## Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

## Opinion on financial statements

In our opinion the Group financial statements:

- give a true and fair view of the state of the Group's affairs as at 31 July 2013 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

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

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

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

We have nothing to report in respect of the following:

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

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

Under the Listing Rules we are required to review:

- the Directors' statement in relation to going concern;
- the part of the Corporate governance statement relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review; and
- certain elements of the report to shareholders by the Board on Directors' remuneration.

## Other matter

We have reported separately on the Parent Company financial statements of Smiths Group plc for the year ended 31 July 2013 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

17 September 2013

## Notes

(a) The maintenance and integrity of the Smiths Group plc website is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Group financial statements since they were initially presented on the website.

(b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

# Consolidated income statement

	Notes	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
<b>Continuing operations</b>			
Revenue	1	<b>3,108.6</b>	3,030.1
Cost of sales		<b>(1,694.0)</b>	(1,645.9)
Gross profit		<b>1,414.6</b>	1,384.2
Sales and distribution costs		<b>(425.6)</b>	(411.9)
Administrative expenses		<b>(496.7)</b>	(596.5)
Profit on disposal of businesses	4	<b>0.9</b>	30.8
<b>Operating profit</b>	2	<b>493.2</b>	406.6
Comprising			
– headline operating profit	3	<b>559.7</b>	553.7
– exceptional items, amortisation of acquired intangibles	3	<b>(66.5)</b>	(147.1)
		<b>493.2</b>	406.6
Interest receivable		<b>2.6</b>	2.2
Interest payable		<b>(64.3)</b>	(64.8)
Other financing losses		<b>(6.1)</b>	(7.3)
Other finance income – retirement benefits		<b>16.4</b>	23.5
Finance costs	5	<b>(51.4)</b>	(46.4)
Share of post-tax profits of associated companies	13		5.7
<b>Profit before taxation</b>		<b>441.8</b>	365.9
Comprising			
– headline profit before taxation	3	<b>498.0</b>	496.8
– exceptional items, amortisation of acquired intangibles and other financing gains and losses	3	<b>(56.2)</b>	(130.9)
		<b>441.8</b>	365.9
Taxation	6	<b>(83.6)</b>	(107.6)
<b>Profit after taxation – continuing operations</b>		<b>358.2</b>	258.3
Loss – discontinued operations			(0.1)
<b>Profit for the year</b>		<b>358.2</b>	258.2
Attributable to			
Smiths Group shareholders		<b>356.6</b>	256.6
Non-controlling interests		<b>1.6</b>	1.6
		<b>358.2</b>	258.2
<b>Earnings per share</b>			
Basic	8	<b>90.7p</b>	65.4p
Basic – continuing operations		<b>90.7p</b>	65.4p
Diluted		<b>89.7p</b>	64.9p
Diluted – continuing operations		<b>89.7p</b>	64.9p

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 115 to 145, which form an integral part of the consolidated accounts.

# Consolidated statement of comprehensive income

	Notes	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Profit for the period		<b>358.2</b>	258.2
<b>Other comprehensive income</b>			
Actuarial gains/(losses) on retirement benefits	9	<b>280.5</b>	(559.0)
Taxation recognised on actuarial movements	6	<b>(34.5)</b>	52.4
<b>Other comprehensive income which will not be reclassified to the consolidated income statement</b>		<b>246.0</b>	(506.6)
Other comprehensive income which will be, or has been, reclassified			
Exchange gains/(losses)		<b>99.8</b>	(9.9)
Cumulative exchange gains recycled on disposals			(4.9)
Fair value gains/(losses)			
– on available for sale financial assets		<b>0.1</b>	4.4
– deferred in the period on cash-flow and net investment hedges		<b>(44.7)</b>	(10.7)
– reclassified to income statement		<b>(4.3)</b>	6.4
Taxation recognised on fair value gains and losses		<b>(1.0)</b>	1.5
<b>Total other comprehensive income</b>		<b>295.9</b>	(519.8)
<b>Total comprehensive income</b>		<b>654.1</b>	[261.6]
Attributable to			
Smiths Group shareholders		<b>654.2</b>	[263.5]
Non-controlling interests		<b>(0.1)</b>	1.9
		<b>654.1</b>	[261.6]

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Chairman and Chief Executive

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# Consolidated balance sheet

	Notes	31 July 2013 £m	31 July 2012 £m
<b>Non-current assets</b>			
Intangible assets	11	<b>1,746.0</b>	1,717.1
Property, plant and equipment	12	<b>280.0</b>	270.5
Financial assets – other investments	14	<b>86.1</b>	60.9
Retirement benefit assets	9	<b>121.7</b>	7.2
Deferred tax assets	6	<b>185.4</b>	203.3
Trade and other receivables	16	<b>34.1</b>	37.4
Financial derivatives	20	<b>6.4</b>	7.2
		<b>2,459.7</b>	2,303.6
<b>Current assets</b>			
Inventories	15	<b>475.6</b>	438.5
Current tax receivable		<b>33.4</b>	15.3
Trade and other receivables	16	<b>695.5</b>	634.4
Cash and cash equivalents	18	<b>393.8</b>	205.6
Financial derivatives	20	<b>8.1</b>	7.9
		<b>1,606.4</b>	1,301.7
<b>Total assets</b>		<b>4,066.1</b>	3,605.3
<b>Non-current liabilities</b>			
Financial liabilities			
– borrowings	18	<b>(951.1)</b>	(821.7)
– financial derivatives	20	<b>(11.0)</b>	(1.1)
Provisions for liabilities and charges	21	<b>(258.1)</b>	(254.4)
Retirement benefit obligations	9	<b>(375.3)</b>	(627.4)
Deferred tax liabilities	6	<b>(73.1)</b>	(69.5)
Trade and other payables	17	<b>(31.0)</b>	(37.5)
		<b>(1,699.6)</b>	(1,811.6)
<b>Current liabilities</b>			
Financial liabilities			
– borrowings	18	<b>(187.1)</b>	(175.3)
– financial derivatives	20	<b>(5.8)</b>	(10.6)
Provisions for liabilities and charges	21	<b>(78.1)</b>	(77.3)
Trade and other payables	17	<b>(521.8)</b>	(468.2)
Current tax payable		<b>(80.1)</b>	(81.5)
		<b>(872.9)</b>	(812.9)
<b>Total liabilities</b>		<b>(2,572.5)</b>	(2,624.5)
<b>Net assets</b>		<b>1,493.6</b>	980.8
<b>Shareholders' equity</b>			
Share capital	22	<b>147.7</b>	147.3
Share premium account		<b>340.8</b>	331.9
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	23	<b>929.2</b>	376.1
Hedge reserve	23	<b>(174.0)</b>	(124.8)
Total shareholders' equity		<b>1,486.0</b>	972.8
Non-controlling interest equity		<b>7.6</b>	8.0
<b>Total equity</b>		<b>1,493.6</b>	980.8

The accounts on pages 104 to 145 were approved by the Board of Directors on 17 September 2013 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 2012		479.2	242.3	376.1	(124.8)	972.8	8.0	980.8
Profit for the year				356.6		356.6	1.6	358.2
Other comprehensive income								
Actuarial gains on retirement benefits and related tax				246.0		246.0		246.0
Exchange gains/(losses)				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	22	9.3				9.3		9.3
Taxation recognised on share options	6			1.0		1.0		1.0
Purchase of own shares	23			(11.0)		(11.0)		(11.0)
Dividends								
- equity shareholders	7			(152.4)		(152.4)		(152.4)
- non-controlling interest							(0.3)	(0.3)
Share-based payment	27			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>

	Notes	Share capital and share premium £m	Other reserves £m	Retained earnings £m	Hedge reserve £m	Equity shareholders' funds £m	Non-controlling interest £m	Total equity £m
At 31 July 2011		476.2	242.3	775.6	(120.6)	1,373.5	6.4	1,379.9
Profit for the year				256.6		256.6	1.6	258.2
Other comprehensive income								
Actuarial losses on retirement benefits and related tax				(506.6)		(506.6)		(506.6)
Exchange (losses)/gains				(15.2)	0.1	(15.1)	0.3	(14.8)
Fair value gains/(losses) and related tax				5.9	(4.3)	1.6		1.6
<b>Total comprehensive income for the year</b>				(259.3)	(4.2)	(263.5)	1.9	(261.6)
Transactions relating to ownership interests								
Exercises of share options	22	3.0				3.0		3.0
Taxation recognised on share options	6			(0.8)		(0.8)		(0.8)
Purchase of own shares	23			(9.7)		(9.7)		(9.7)
Dividends								
- equity shareholders	7			(144.1)		(144.1)		(144.1)
- non-controlling interest							(0.3)	(0.3)
Share-based payment	27			14.4		14.4		14.4
<b>At 31 July 2012</b>		<b>479.2</b>	<b>242.3</b>	<b>376.1</b>	<b>(124.8)</b>	<b>972.8</b>	<b>8.0</b>	<b>980.8</b>

# Consolidated cash-flow statement

	Notes	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
<b>Net cash inflow from operating activities</b>	26	<b>353.4</b>	331.5
<b>Cash-flows from investing activities</b>			
Expenditure on capitalised development		(28.4)	(27.6)
Expenditure on other intangible assets		(11.1)	(13.5)
Purchases of property, plant and equipment	12	(56.5)	(50.1)
Disposals of property, plant and equipment		3.9	0.7
Investment in financial assets		(24.3)	(24.3)
Acquisition of businesses		(0.5)	(167.5)
Disposals of businesses		0.3	47.3
<b>Net cash-flow used in investing activities</b>		<b>(116.6)</b>	(235.0)
<b>Cash-flows from financing activities</b>			
Proceeds from exercise of share options	22	9.3	3.0
Purchase of own shares		(11.0)	(9.7)
Dividends paid to equity shareholders	7	(152.4)	(144.1)
Dividends paid to non-controlling interests		(0.3)	(0.3)
Cash outflow from matured derivative financial instruments		(0.4)	(1.7)
Increase in new borrowings		247.2	174.8
Reduction and repayment of borrowings		(159.1)	(173.5)
<b>Net cash-flow used in financing activities</b>		<b>(66.7)</b>	(151.5)
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>170.1</b>	(55.0)
Cash and cash equivalents at beginning of year		<b>203.7</b>	260.7
Exchange gain/(loss)		<b>12.7</b>	(2.0)
<b>Cash and cash equivalents at end of year</b>	18	<b>386.5</b>	203.7
Cash and cash equivalents at end of year comprise			
- cash at bank and in hand		<b>164.2</b>	130.8
- short-term deposits		<b>229.6</b>	74.8
- bank overdrafts		<b>(7.3)</b>	(1.9)
		<b>386.5</b>	203.7
Included in cash and cash equivalents per the balance sheet		<b>393.8</b>	205.6
Included in overdrafts per the balance sheet		<b>(7.3)</b>	(1.9)
		<b>386.5</b>	203.7
<b>Reconciliation of net cash-flow to movement in net debt</b>			
	Notes	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>170.1</b>	(55.0)
Net (increase)/decrease in borrowings resulting from cash-flows		<b>(88.1)</b>	(1.3)
<b>Movement in net debt resulting from cash-flows</b>		<b>82.0</b>	(56.3)
Capitalisation, interest accruals and unwind of capitalisation fees		<b>(3.8)</b>	(0.5)
Movement from fair value hedging		<b>9.7</b>	(4.2)
Exchange differences		<b>(40.9)</b>	(1.4)
<b>Movement in net debt in the year</b>	18	<b>47.0</b>	(62.4)
Net debt at start of year		<b>(791.4)</b>	(729.0)
<b>Net debt at end of year</b>	18	<b>(744.4)</b>	(791.4)

# 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 'Amendment to IAS 1: Presentation of Financial Statements – Presentation of items of other comprehensive income'. Adopting this new accounting requirement has changed the layout of the consolidated statement of comprehensive income.

## 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 £53.0m (31 July 2012: £34.5m) has been recognised in the period in respect of contracts in progress at the period end with a total expected value of £149.7m (31 July 2012: £172.2m). A 5% reduction in the proportion of the contract activity recognised in the current year would have reduced operating profit by an estimated £0.5m (31 July 2012: £0.1m) for Smiths Detection and £0.3m (31 July 2012: £0.6m) 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 Detection recognised revenue of £244.5m for goods and services this year in respect of contracts which were signed before the start of the year.

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 2013 was £17.0m (31 July 2012: £18.8m).

### 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 11 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 required to trigger an impairment in Smiths Interconnect Power Management.

### 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 £210.0m (31 July 2012: £213.1m) 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. 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. As a result, the provision may be subject to potentially material revisions from time to time if new information becomes available as a result of future events. John Crane, Inc. takes account of the advice of an expert in asbestos liability estimation in quantifying the expected costs.

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 £65.6m (31 July 2012: £61.8m) 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. As a result the provision may be subject to potentially material revisions if new information becomes available.

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

## **Accounting policies**

### **Continued**

#### **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 2013 there is a retirement benefit asset of £121.7m (2012: £7.2m) which arises from the rights of the employers to recover the surplus at the end of the life of the scheme. If the pension schemes were wound up while they still had members, the schemes would need to buy out the benefits of all members. The buy outs would cost significantly more than the present value of the scheme liabilities calculated in accordance with IAS 19: Employee benefits.

#### **Taxation**

The Group has recognised deferred tax assets of £28.1m (2012: £16.1m) relating to losses and £85.6m (2012: £74.1m) relating to the John Crane, Inc. and Titeflex Corporation litigation provisions. The recognition of assets pertaining to these items involves judgement by management as to the likelihood of realisation of these deferred tax assets and this is based on a number of factors, which seek to assess the expectation that the benefit of these assets will be realised, including appropriate taxable temporary timing differences and it has been concluded that there are sufficient taxable profits in future periods to support recognition. Further detail on the Group's deferred taxation position is included in note 6.

## **Accounting policies**

### **Basis of consolidation**

The consolidated accounts incorporate the financial statements of Smiths Group plc ("the Company") and its subsidiary undertakings, together with the Group's share of the results of its associates.

Subsidiaries are all entities over which the Company has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which this power is transferred to the Company to the date that control ceases.

Associates are entities over which the Group has significant influence but does not control, generally accompanied by a share of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method.

### **Foreign currencies**

The Company's presentational currency is sterling. The results and financial position of all subsidiaries and associates that have a functional currency different from sterling are translated into sterling as follows:

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

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

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

### **Revenue**

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

#### **Sale of goods**

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

#### **Services**

Revenue from services is recognised in accounting periods in which the services are rendered, by reference to completion of the specific transaction, assessed on the basis of the actual service provided as a proportion of the total services to be provided. Depending on the nature of the contract, revenue will be recognised on the basis of the proportion of the contract term completed, the proportion of the contract costs incurred or the specific services provided to date.

#### **Construction contracts**

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

Where the outcome of a construction contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date. The Group uses the 'percentage of completion method' to determine the appropriate amount to recognise in a given period. The assessment of the stage of completion is dependent on the nature of the contract, but will generally be based on the estimated proportion of the total contract costs which have been incurred to date. If a contract is expected to be loss-making, a provision is recognised for the entire loss.

## **Employee benefits**

### **Share-based compensation**

The Group operates a number of equity-settled and cash-settled share-based compensation plans.

The fair value of the shares or share options granted is recognised as an expense over the vesting period to reflect the value of the employee services received. The fair value of options granted, excluding the impact of any non-market vesting conditions, is calculated using established option pricing models, principally binomial models. The probability of meeting non-market vesting conditions, which include profitability targets, is used to estimate the number of share options which are likely to vest.

For cash-settled share-based payment, a liability is recognised based on the fair value of the payment earned by the balance sheet date. For equity-settled share-based payment, the corresponding credit is recognised directly in reserves.

### **Pension obligations and post-retirement benefits**

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

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

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

### **Leases**

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

### **Exceptional items**

Items which are material either because of their size or their nature, and material items which are non-recurring, are presented within their relevant consolidated income statement category, but highlighted through separate disclosure. The separate reporting of exceptional items helps provide a better picture of the Company's underlying performance. Items which are included within the exceptional category include:

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

### **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.

## **Accounting policies**

### **Continued**

#### **Intangible assets**

##### **Goodwill**

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the identifiable net assets of the acquired subsidiary at the date of acquisition.

Goodwill arising from acquisitions of subsidiaries after 1 August 1998 is included in intangible assets, tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold. Goodwill arising from acquisitions of subsidiaries before 1 August 1998 was set against reserves in the year of acquisition.

Goodwill is tested for impairment at least annually. Any impairment is recognised immediately in the income statement. Subsequent reversals of impairment losses for goodwill are not recognised.

##### **Research and development**

Expenditure on research and development is charged to the income statement in the year in which it is incurred with the exception of:

- amounts recoverable from third parties; and
- expenditure incurred in respect of the development of major new products where the outcome of those projects is assessed as being reasonably certain as regards viability and technical feasibility. Such expenditure is capitalised and amortised straight line over the estimated period of sale for each product, commencing in the year that sales of the product are first made.

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

#### **Intangible assets acquired in business combinations**

The identifiable net assets acquired as a result of a business combination may include intangible assets other than goodwill.

Any such intangible assets are amortised straight line over their expected useful lives as follows:

Patents, licences and trademarks	up to 20 years
Technology	up to 12 years
Customer relationships	up to 7 years

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

#### **Software, patents and intellectual property**

The estimated useful lives are as follows:

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

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

#### **Property, plant and equipment**

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

Land is not depreciated. Depreciation is provided on other assets estimated to write off the depreciable amount of relevant assets by equal annual instalments over their estimated useful lives. In general, the rates used are: Freehold and long leasehold buildings – 2%; Short leasehold property – over the period of the lease; Plant, machinery, etc. – 10% to 20%; Fixtures, fittings, tools and other equipment – 10% to 33%.

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

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

#### **Inventories**

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in, first-out (FIFO) method. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). The cost of items of inventory which take a substantial period of time to complete includes attributable borrowing costs for all items whose production began after 1 August 2009. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

#### **Trade and other receivables**

Trade receivables are initially recognised at fair value and subsequently measured at amortised cost, less any appropriate provision for estimated irrecoverable amounts. A provision is established for irrecoverable amounts when there is objective evidence that amounts due under the original payment terms will not be collected.

## Provisions

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

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.

## 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.

## **Accounting policies**

### **Continued**

#### **Cash-flow hedge**

The effective portions of changes in the fair values of derivatives that are designated and qualify as cash-flow hedges are recognised in equity. The gain or loss relating to any ineffective portion is recognised immediately in the income statement.

Amounts accumulated in the hedge reserve are recycled in the income statement in the periods when the hedged items will affect profit or loss (for instance when the forecast sale that is hedged takes place). If a forecast transaction that is hedged results in the recognition of a non-financial asset (for example, inventory) or a liability, the gains and losses previously deferred in the hedge reserve are transferred from the reserve and included in the initial measurement of the cost of the asset or liability.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in the hedge reserve at that time remains in the reserve and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in other comprehensive income is immediately transferred to the income statement.

#### **Fair value of financial assets and liabilities**

The fair values of financial assets and financial liabilities are the amounts at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

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

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

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

- cash, trade receivables and payables and floating rate borrowings – the carrying value is a good approximation of the fair value;
- government bonds – quoted market prices (level 1);
- fixed rate borrowings – quoted market prices of equivalent instruments (level 2); and
- forward exchange contracts, currency swaps, interest rate instruments and embedded derivatives – net present value of the future cash-flows, calculated using market data at the balance sheet date (principally exchange rates and yield curves) (level 2).

Borrowings are carried on the balance sheet at amortised cost adjusted for fair value interest rate hedging. The fair value of fixed rate borrowings is only used for supplementary disclosures.

#### **Dividends**

Dividends are recognised as a liability in the period in which they are authorised. The interim dividend is recognised when it is paid and the final dividend is recognised when it has been approved by shareholders at the Annual General Meeting.

#### **Recent accounting developments**

The following standards and interpretations have been issued by the IASB and may affect future annual reports and accounts.

- 'IFRS 9: Financial instruments'
- 'IFRS 10: Consolidated financial statements'
- 'IAS 27 (Revised 2011): Separate financial statements'
- 'IFRS 11: Joint arrangements'
- 'IAS 28 (Revised 2011): Investments in associates and joint ventures'
- 'IFRS 12: Disclosure of interests in other entities'
- 'IFRS 13: Fair value measurement'
- 'IAS 19 (Revised 2011): Employee benefits'
- 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. Based on the work completed to date, the changes are not expected to have a material impact on the Group's reported position or performance, except for the implementation of IAS 19 (Revised 2011): Employee benefits. An estimate of the impact of adopting this standard, which is expected to be implemented in the year ending 31 July 2014, is provided at the end of note 9.

#### **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 148 to 156.

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 2013						
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £m
Revenue	<b>985.7</b>	<b>850.4</b>	<b>559.0</b>	<b>460.6</b>	<b>252.9</b>		<b>3,108.6</b>
Divisional headline operating profit	<b>230.5</b>	<b>189.1</b>	<b>58.0</b>	<b>68.8</b>	<b>43.2</b>		<b>589.6</b>
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>	(29.9)	<b>559.7</b>
Exceptional operating items (note 4)	(10.8)	1.2	(4.9)	(0.2)	(7.0)	1.8	(19.9)
Amortisation and impairment of acquired intangible assets	(14.2)	(11.4)	(1.1)	(19.7)	(0.2)		(46.6)
<b>Operating profit/(loss)</b>	<b>205.5</b>	<b>178.9</b>	<b>52.0</b>	<b>48.9</b>	<b>36.0</b>	(28.1)	<b>493.2</b>
Exceptional finance costs – adjustment to discounted provision (note 4)		(3.3)				(0.9)	
Net finance costs – other							(4.2)
<b>Profit before taxation</b>							<b>441.8</b>

	Year ended 31 July 2012						
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £m
Revenue	973.4	855.8	519.2	448.5	233.2		3,030.1
Divisional headline operating profit	209.9	202.5	69.1	66.0	38.0		585.5
Corporate headline operating costs						(31.8)	(31.8)
<b>Headline operating profit/(loss)</b>	<b>209.9</b>	<b>202.5</b>	<b>69.1</b>	<b>66.0</b>	<b>38.0</b>	(31.8)	<b>553.7</b>
Exceptional operating items (note 4)	[39.9]	[8.8]	16.1	(1.2)	(54.5)	2.8	[85.5]
Amortisation and impairment of acquired intangible assets	(15.0)	(14.2)	(1.4)	(30.8)	(0.2)		(61.6)
<b>Operating profit/(loss)</b>	<b>155.0</b>	<b>179.5</b>	<b>83.8</b>	<b>34.0</b>	<b>(16.7)</b>	(29.0)	<b>406.6</b>
Exceptional finance costs – adjustment to discounted provision (note 4)		(4.0)				(0.5)	
Net finance costs – other							(4.5)
Share of post-tax profits of associate companies					5.7		5.7
<b>Profit before taxation</b>							<b>365.9</b>

Smiths Medical revenue for the year ended 31 July 2012 includes the impact of a £7.8m charge for revision of estimated rebates, which was included in divisional exceptional operating items (see note 4). Revenue calculated on the same basis as headline operating profit was £863.6m for Smiths Medical and £3,037.9m for Smiths Group.

## Notes to the accounts

### Continued

## 1 Segment information continued

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

	Year ended 31 July 2013						
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
Depreciation	<b>14.4</b>	<b>19.1</b>	<b>6.6</b>	<b>7.5</b>	<b>3.3</b>	<b>1.4</b>	<b>52.3</b>
Amortisation	<b>2.6</b>	<b>15.8</b>	<b>12.1</b>	<b>0.8</b>		<b>49.8</b>	<b>81.1</b>
Other non-cash items							
- share-based payment	<b>1.7</b>	<b>1.7</b>	<b>0.7</b>	<b>0.6</b>	<b>2.0</b>	<b>6.1</b>	<b>12.8</b>

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

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 2013</b>	<b>17.3</b>	<b>39.8</b>	<b>22.4</b>	<b>9.7</b>	<b>2.6</b>	<b>5.7</b>	<b>97.5</b>
Capital expenditure year ended 31 July 2012	16.8	31.7	20.2	7.9	2.9	12.6	92.1

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

	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	<b>100.8</b>	<b>163.8</b>	<b>108.7</b>	<b>36.7</b>	<b>20.4</b>	<b>430.4</b>
Working capital assets	<b>363.0</b>	<b>245.2</b>	<b>343.1</b>	<b>159.5</b>	<b>78.1</b>	<b>1,188.9</b>
<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						<b>355.0</b>
Goodwill and acquired intangibles						<b>1,576.9</b>
Corporate assets						<b>121.1</b>
Cash						<b>393.8</b>
<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	<b>897.9</b>	<b>1,141.4</b>	<b>657.4</b>	<b>554.4</b>	<b>140.2</b>	<b>3,391.3</b>
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.

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 (2012: £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

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

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

### Analysis of revenue

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

	Original equipment manufacture					Aftermarket	Total
	£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 2013</b>	<b>363.5</b>	<b>379.8</b>	<b>84.3</b>	<b>71.2</b>	<b>86.9</b>	<b>985.7</b>	
Revenue year ended 31 July 2012	359.5	374.2	80.6	68.6	90.5	973.4	
<b>Smiths Medical</b>							
<b>Revenue year ended 31 July 2013</b>				<b>237.7</b>	<b>354.5</b>	<b>258.2</b>	<b>850.4</b>
Revenue year ended 31 July 2012				241.2	346.6	268.0	855.8
<b>Smiths Detection</b>							
<b>Revenue year ended 31 July 2013</b>	<b>286.2</b>	<b>95.7</b>	<b>69.3</b>	<b>13.7</b>	<b>91.3</b>	<b>2.8</b>	<b>559.0</b>
Revenue year ended 31 July 2012	245.4	81.4	55.6	20.2	110.1	6.5	519.2
<b>Smiths Interconnect</b>							
<b>Revenue year ended 31 July 2013</b>				<b>161.2</b>	<b>200.8</b>	<b>98.6</b>	<b>460.6</b>
Revenue year ended 31 July 2012				156.3	202.9	89.3	448.5
<b>Flex-Tek</b>							
<b>Revenue year ended 31 July 2013</b>	<b>87.8</b>	<b>35.7</b>	<b>56.1</b>	<b>73.3</b>	<b>252.9</b>		
Revenue year ended 31 July 2012	80.1	36.0	55.6	61.5	233.2		

## Notes to the accounts

**Continued**

## 1 Segment information continued

### Analysis of revenue continued

The Group's statutory revenue is analysed as follows:

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Sale of goods	<b>2,855.5</b>	2,792.0
Services	<b>213.5</b>	212.5
Contracts	<b>39.6</b>	25.6
	<b>3,108.6</b>	3,030.1

### Analysis by geographical areas

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

	Revenue		Intangible assets, property plant and equipment and investments accounted for using the equity method	
	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m	31 July 2013 £m	31 July 2012 £m
United Kingdom	<b>128.8</b>	130.3	<b>140.9</b>	143.8
Germany	<b>155.7</b>	171.8	<b>334.6</b>	299.4
France	<b>93.5</b>	95.8	<b>20.2</b>	15.8
Other European	<b>356.8</b>	374.8	<b>78.0</b>	72.0
United States of America	<b>1,398.1</b>	1,353.0	<b>1,278.3</b>	1,276.0
Canada	<b>122.3</b>	125.8	<b>12.6</b>	10.7
Mexico	<b>33.1</b>	34.7	<b>10.4</b>	9.2
Japan	<b>114.3</b>	129.5	<b>18.4</b>	22.7
China	<b>99.1</b>	92.8	<b>60.3</b>	60.3
Rest of the World	<b>606.9</b>	521.6	<b>72.3</b>	77.7
	<b>3,108.6</b>	3,030.1	<b>2,026.0</b>	1,987.6

## 2 Operating profit is stated after charging

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Research and development expense	<b>82.6</b>	78.5
Operating leases		
– land and buildings	<b>30.4</b>	27.0
– other	<b>10.8</b>	11.6
Audit services		
Fees payable to the Company's auditors for the audit of the parent company and consolidated accounts	<b>0.5</b>	0.5
Fees payable to the Company's auditors and its associates for other services		
– the audit of the Company's subsidiaries, pursuant to legislation	<b>3.8</b>	3.4
– other services pursuant to legislation	<b>0.1</b>	0.1
	<b>4.4</b>	4.0
Tax services		
– advisory services	<b>0.1</b>	0.1
– compliance services	<b>0.1</b>	0.1
Other assurance services relating to corporate transactions	<b>0.6</b>	0.3
All other services	<b>0.1</b>	0.2

Other services relate to one-off projects.

### 3 Headline profit measures

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

The following items have been excluded from the headline measure:

- exceptional items, including income and expenditure relating to material litigation in respect of products no longer in production;
- amortisation and impairment of intangible assets acquired in a business combination – the charge is a non-cash item, and the directors believe that it should be added back to give a clearer picture of underlying performance;
- other financing gains and losses, which represent the potentially volatile gains and losses on derivatives and other financial instruments which do not fall to be hedge accounted under IAS 39; and
- financing credits and charges relating to retirement benefits.

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

	Notes	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
<b>Operating profit</b>		<b>493.2</b>	406.6
Exclude			
– exceptional operating items	4	<b>19.9</b>	85.5
– amortisation and impairment of acquired intangible assets	11	<b>46.6</b>	61.6
Non-headline items in operating profit		<b>66.5</b>	147.1
<b>Headline operating profit</b>		<b>559.7</b>	553.7
<b>Finance costs</b>		<b>(51.4)</b>	(46.4)
Exclude			
– exceptional finance costs	4	<b>4.2</b>	4.5
– other financing gains and losses		<b>1.9</b>	2.8
– other financing income – retirement benefits	5	<b>(16.4)</b>	(23.5)
Non-headline items in finance costs		<b>(10.3)</b>	(16.2)
<b>Headline finance costs</b>		<b>(61.7)</b>	(62.6)
<b>Profit before taxation</b>		<b>441.8</b>	365.9
Non-headline items in operating profit		<b>66.5</b>	147.1
Non-headline items in finance costs		<b>(10.3)</b>	(16.2)
<b>Headline profit before taxation</b>		<b>498.0</b>	496.8
<b>Profit after taxation – continuing operations</b>		<b>358.2</b>	258.3
Exclude			
– non-headline items in profit before taxation		<b>56.2</b>	130.9
– tax on excluded items	6	<b>(48.4)</b>	(62.0)
– exceptional taxation items	4, 6		37.7
		<b>7.8</b>	106.6
<b>Headline profit after taxation – continuing operations</b>		<b>366.0</b>	364.9
<b>Headline earnings before interest, tax depreciation and amortisation</b>			
Headline EBITDA, calculated as follows, is used to calculate one of Smiths cash-flow targets, see note 23 for details.			
		Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
<b>Headline operating profit</b>		<b>559.7</b>	553.7
Exclude:			
Depreciation		<b>52.3</b>	59.0
Amortisation of development costs		<b>21.3</b>	19.3
Amortisation of software, patents and intellectual property		<b>13.2</b>	12.9
<b>Headline EBITDA</b>		<b>646.5</b>	644.9

## Notes to the accounts

**Continued**

### 4 Exceptional items

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

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
<b>Operating items</b>		
Restructuring programmes	<b>(7.8)</b>	(15.4)
Revision of estimated rebates	1.2	(7.8)
Sale of intellectual property relating to diabetes	3.5	0.6
Gains on changes to post-retirement benefits (note 9)	0.9	30.8
Profit on disposal of businesses	5.0	
Profit on disposal of property	1.4	2.4
Adjustment to contingent consideration provided on acquisitions	(3.0)	(2.0)
Costs of acquisitions, disposals and aborted transactions	(14.3)	(39.6)
Litigation	(19.9)	(85.5)
– provision for Titeflex Corporation claims (note 21)	(6.8)	(54.5)
– provision for John Crane, Inc. asbestos litigation (note 21)	(24.1)	(90.0)
	(24.1)	(127.7)
<b>Financing items</b>		
Exceptional finance costs – adjustment to discounted provision	(0.9)	(0.5)
– provision for Titeflex Corporation claims (note 21)	(3.3)	(4.0)
	(24.1)	(127.7)
<b>Taxation items</b>		
Exceptional tax costs – write off UK deferred tax asset	(37.7)	
	(24.1)	(127.7)

#### Year ended 31 July 2013

Restructuring costs include £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, is considered exceptional by virtue of its size.

Gains on changes to post retirement benefits comprise a settlement gain of £2.2m on the closure of a defined benefit pension scheme which is 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 has generated a £0.6m additional profit on disposal of businesses. The profit on disposal of property has arisen from the sale of two sites which were formerly occupied by businesses which are no longer owned by Smiths.

Professional fees of £3m have been incurred in relation to potential acquisitions and disposals.

A charge of £6.8m has been 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 comprises £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.

#### Year ended 31 July 2012

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

A charge of £7.8m was made by Smiths Medical to reflect a change to the historical basis of estimating the accrual for rebates to distributors. This change arose due to the availability of improved data from distributors. Had this approach been used in previous years, there would have been no material impact on the revenue or operating profits of Smiths Medical in any of the prior five financial years and no material impact is expected on future revenue or profit. The charge, which was recognised as a reduction in revenue, was treated as an exceptional item on the basis that it was an unusual non-recurring item that distorts trading performance for the year ended 31 July 2012.

The profit on disposal of businesses comprised £26.8m profit on the sale of the Group's interest in Cross Match (see note 13), £0.1m relating to small non-core business sold in the year and £3.9m from the resolution of indemnities in respect of disposals in previous years.

A charge of £54.5m was made by Titeflex Corporation in respect of the estimated cost of future claims from insurance companies seeking recompense for damage allegedly caused by lightning strikes.

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

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

## 5 Net finance costs

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
<b>Interest receivable</b>	<b>2.6</b>	2.2
Interest payable		
– bank loans and overdrafts, including associated fees	(7.4)	(7.1)
– other loans	(56.9)	(57.7)
<b>Interest payable</b>	<b>(64.3)</b>	(64.8)
Other financing gains/(losses)		
– fair value gains/(losses) on hedged debt	9.7	(4.0)
– fair value (losses)/gains on fair value hedge	(9.7)	4.0
– net foreign exchange (losses)/gains	(1.9)	(2.8)
– exceptional finance costs – adjustment to discounted provision	(4.2)	(4.5)
<b>Other financing losses</b>	<b>(6.1)</b>	(7.3)
Retirement benefits		
– return on plan assets	173.4	203.0
– interest cost	(157.0)	(179.5)
<b>Retirement benefits</b>	<b>16.4</b>	23.5
<b>Net finance costs</b>	<b>(51.4)</b>	(46.4)

## 6 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.

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
The taxation charge in the consolidated income statement for the year comprises		
– current income tax charge	86.7	94.5
– current tax adjustments in respect of prior periods	8.1	1.0
Current taxation	94.8	95.5
– deferred taxation	(11.2)	12.1
<b>Total taxation expense in the consolidated income statement</b>	<b>83.6</b>	107.6

### 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 23.7% (2012: 25.3%). The difference is reconciled as follows:

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
<b>Profit before taxation – continuing operations</b>	<b>441.8</b>	365.9
Notional taxation expense at UK rate of 23.7% (2012: 25.3%)	104.6	92.6
Different tax rates on non-UK profits and losses	3.0	2.7
Non-deductible expenses, tax credits and non-taxable income	(7.1)	(6.9)
Adjustments to unrecognised deferred tax	(18.4)	(5.9)
Non-taxable profit on disposal of businesses	(0.6)	(8.3)
Exceptional deferred tax write off		37.7
Prior year true-up	2.1	(4.3)
	83.6	107.6
Comprising		
– taxation on headline profit	132.0	131.9
– tax on non-headline loss	(48.4)	(62.0)
– exceptional taxation items (see note 4)		37.7
<b>Taxation expense in the income statement</b>	<b>83.6</b>	107.6

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.

## Notes to the accounts

**Continued**

### 6 Taxation continued

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
<b>Tax on items charged/(credited) to equity</b>		
Deferred tax charge/(credit)		
- retirement benefit schemes	<b>34.5</b>	(52.4)
- cash-flow hedges	<b>1.0</b>	(1.5)
- share options	<b>(1.0)</b>	0.8
	<b>34.5</b>	(53.1)

The net retirement benefit credit to equity includes £4.2m (2012: £6.5m) relating to UK schemes. The UK schemes are closed and this amount represents tax relief that was set off against amounts previously charged to equity.

#### Deferred taxation

	Excess tax depreciation on fixed assets and goodwill £m	Share-based payment £m	Retirement benefit obligations £m	Capitalised development expenditure £m	Other £m	Total £m
At 31 July 2011	(54.9)	8.8	52.7	(26.9)	117.5	97.2
Credit/(charge) to income statement	(6.5)	(3.8)	(13.5)	(5.6)	17.3	(12.1)
Credit/(charge) to equity		(0.8)	52.4		1.5	53.1
Business combinations	(12.3)				4.7	(7.6)
Exchange adjustments	(1.7)		1.2	(1.2)	4.9	3.2
At 31 July 2012	(75.4)	4.2	92.8	(33.7)	145.9	133.8
Deferred tax assets	(9.2)	4.1	89.7	(8.4)	127.1	203.3
Deferred tax liabilities	(66.2)	0.1	3.1	(25.3)	18.8	(69.5)
At 31 July 2012	(75.4)	4.2	92.8	(33.7)	145.9	133.8
Credit/(charge) to income statement	(6.3)	1.5	(7.8)	(2.2)	26.0	11.2
Credit/(charge) to equity		1.0	(34.5)		(1.0)	(34.5)
Exchange adjustments	(2.6)		1.8	(1.3)	3.9	1.8
<b>At 31 July 2013</b>	<b>(84.3)</b>	<b>6.7</b>	<b>52.3</b>	<b>(37.2)</b>	<b>174.8</b>	<b>112.3</b>
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)
<b>At 31 July 2013</b>	<b>(84.3)</b>	<b>6.7</b>	<b>52.3</b>	<b>(37.2)</b>	<b>174.8</b>	<b>112.3</b>

Included in other deferred tax balances above is:

- a deferred tax asset of £28.1m (2012: £16.1m) relating to losses carried forward;
- a deferred tax asset of £99.0m (2012: £76.2m) relating to provisions where current tax relief is only available as payments are made. Of this asset, £60.7m (2012: £51.1m) relates to the John Crane, Inc. litigation provision, and £24.9m (2012: £23.0m) relates to Titeflex Corporation. See note 21 for additional information on provisions; and
- a deferred tax asset of £22.2m (2012: £15.1m) 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 £392.9m (2012: £380.4m) and pensions and other long term liabilities of £284.5m (2012: £504.3m) due to uncertainty as to their recoverability. This includes £71.5m (2012: £327.1m) relating to the UK pension deficit.

In 2012 deferred tax of £23.5m on UK losses and £14.2m on other assets was derecognised as potentially higher contributions to retirement benefit schemes mean the UK is unlikely to generate sufficient taxable profits to utilise the deductible temporary differences related to the deferred tax assets. The resulting charge of £37.7m was treated as an exceptional tax item (note 4). These tax allowances remain available to the Group and can be utilised should the UK tax base improve.

The expiry date of operating losses carried forward is dependent upon the law of the various territories in which the losses arise. A summary of expiry dates for losses in respect of which deferred tax has not been recognised is set out below.

#### Restricted losses

	2013 £m	Expiry of losses	2012 £m	Expiry of losses
Territory				
- Americas	<b>15.6</b>	<b>2016-2033</b>	13.5	2019-2025
- Asia	<b>3.9</b>	<b>2016-2020</b>	4.2	2016-2019
Total restricted losses	<b>19.5</b>		17.7	
Unrestricted losses				
- operating losses	<b>373.4</b>	<b>No expiry</b>	362.7	No expiry
<b>Total</b>	<b>392.9</b>		380.4	

## 7 Dividends

The following dividends were declared and paid in the period:

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Ordinary final dividend of 26.25p for 2012 (2011: 25.0p) paid 23 November 2012	<b>103.2</b>	98.1
Ordinary interim dividend of 12.50p for 2013 (2012: 11.75p) paid 26 April 2013	<b>49.2</b>	46.0
	<b>152.4</b>	144.1

The final dividend for the year ended 31 July 2013 of 27.0p per share was recommended by the Board on 17 September 2013 and will be paid to shareholders on 22 November 2013, 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 25 October 2013.

On 17 September 2013, the Board also recommended a special dividend of 30.0p per share. Subject to approval by the shareholders, the special dividend will be paid with the final dividend for the year.

## 8 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 2013 £m	Year ended 31 July 2012 £m
Profit attributable to equity shareholders for the year		
– continuing	<b>356.6</b>	256.7
– total	<b>356.6</b>	256.6
Average number of shares in issue during the year	<b>393,323,206</b>	392,583,140

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 397,467,678 (2012: 395,479,272) 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 2013 no options (2012: 869,284 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 2013		Year ended 31 July 2012	
	£m	EPS (p)	£m	EPS (p)
Profit attributable to equity shareholders of the Parent Company	<b>356.6</b>	<b>90.7</b>	256.7	65.4
Exclude				
Non-headline items and related tax (note 3)	<b>7.8</b>	<b>2.0</b>	106.6	27.2
Headline	<b>364.4</b>	<b>92.7</b>	363.3	92.6
Headline EPS – diluted (p)			<b>91.7</b>	91.9

## Notes to the accounts

Continued

### 9 Post-retirement benefits

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

#### Defined contribution plans

The Group operates a number of defined contribution plans across many countries. In the UK a defined contribution plan has been offered since the closure of the UK defined benefit pension plans. In the US a 401k defined contribution plan operates. The total expense recognised in the income statement in respect of all these plans was £29.9m (2012: £29.0m).

#### 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.

Pension costs are assessed in accordance with the advice of independent, professionally-qualified actuaries. The most recent actuarial valuations of the two principal UK schemes (SIPS and TIGPS) were performed using the Projected Unit Method as at 31 March 2012 and 5 April 2012. The most recent valuations of the six principal US pension and post-retirement healthcare plans were performed at 1 January 2010. These valuations have been updated by independent qualified actuaries in order to assess the liabilities of the schemes as at 31 July 2013. Scheme assets are stated at their market values. Contributions to the schemes are made on the advice of the actuaries.

#### The principal assumptions used in updating the valuations are set out below:

	UK	US	2013 Other	UK	US	2012 Other
Rate of increase in salaries	n/a	n/a	2.7%	n/a	n/a	3.1%
Rate of increase for active deferred members	4.3%	n/a	n/a	3.7%	n/a	n/a
Rate of increase in pensions in payment	3.4%	n/a	0.9%	2.8%	n/a	0.8%
Rate of increase in deferred pensions	3.4%	n/a	1.0%	2.8%	n/a	0.8%
Discount rate	4.4%	4.8%	4.0%	4.1%	3.8%	4.1%
Inflation rate	3.4%	n/a	1.7%	2.8%	n/a	1.6%
Healthcare cost increases	5.0%	n/a	2.6%	5.0%	n/a	2.3%

The assumptions used are estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily occur in practice. For countries outside the UK and USA these are disclosed as a weighted average.

The mortality assumptions used in the principal UK schemes are based on the recent actual mortality experience of members within each scheme. The assumptions are based on the new SAPS All birth year tables with relevant scaling factors based on the experience of the schemes. The assumption also allows for future improvements in life expectancy in line with the 2012 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		US	
	Male	Female	Male	Female
Member who retires next year at age 65	23	25	20	21
Member, currently 45, when they retire in 20 years time	25	27	20	21

The assets in the scheme and the expected rates of return as at 31 July 2013 were:

	31 July 2013						
	UK schemes		US schemes		Other countries	Total	
	Long-term rate of return	Value £m	Long-term rate of return	Value £m	Long-term rate of return	Value £m	£m
Equities	7.2%	1,618.3	7.9%	311.2	8.0%	19.4	1,948.9
Government bonds	3.3%	187.2	3.4%	29.1	5.5%	11.2	227.5
Corporate bonds	4.4%	274.2	4.8%	158.9	4.9%	2.3	435.4
Insured liabilities	4.4%	672.1			4.1%	0.5	672.6
Property	6.8%	176.4			5.9%	0.5	176.9
Other	3.4%	217.7	1.0%	2.0	3.1%	15.2	234.9
Total market value		3,145.9		501.2		49.1	3,696.2
Present value of funded scheme liabilities		(3,160.6)		(620.5)		(61.5)	(3,842.6)
Deficit		(14.7)		(119.3)		(12.4)	(146.4)
Unfunded pension plans		(48.3)		(6.5)		(31.3)	(86.1)
Post-retirement healthcare		(8.5)		(11.6)		(1.0)	(21.1)
Present value of unfunded obligations		(56.8)		(18.1)		(32.3)	(107.2)
Unrecognised asset due to surplus restriction							
<b>Net pension liability</b>		<b>(71.5)</b>		<b>(137.4)</b>		<b>(44.7)</b>	<b>(253.6)</b>
Post-retirement assets		120.6				1.1	121.7
Post-retirement liabilities		(192.1)		(137.4)		(45.8)	(375.3)
<b>Net pension liability</b>		<b>(71.5)</b>		<b>(137.4)</b>		<b>(44.7)</b>	<b>(253.6)</b>

## 9 Post-retirement benefits continued

	31 July 2012						
	UK schemes		US schemes		Other countries		Total
	Long-term rate of return	Value £m	Long-term rate of return	Value £m	Long-term rate of return	Value £m	£m
Equities	7.2%	1,294.1	7.3%	245.1	9.2%	12.9	1,552.1
Government bonds	2.5%	168.0	2.3%	43.5	4.8%	7.0	218.5
Corporate bonds	4.1%	81.8	3.8%	169.5	5.0%	0.5	251.8
Insured liabilities	4.1%	665.7			4.1%	3.7	669.4
Property	6.8%	177.1			10.4%	0.8	177.9
Other	2.9%	458.2			3.7%	19.7	477.9
Total market value		2,844.9		458.1		44.6	3,347.6
Present value of funded scheme liabilities		(3,116.7)		(680.6)		(66.3)	(3,863.6)
Surplus/(deficit)		(271.8)		(222.5)		(21.7)	(516.0)
Unfunded pension plans		(46.1)		(6.9)		(28.0)	(81.0)
Post-retirement healthcare		(9.2)		(13.0)		(0.9)	(23.1)
Present value of unfunded obligations		(55.3)		(19.9)		(28.9)	(104.1)
Unrecognised asset due to surplus restriction						(0.1)	(0.1)
<b>Net pension liability</b>		(327.1)		(242.4)		(50.7)	(620.2)
Post-retirement assets		7.2					7.2
Post-retirement liabilities		(334.3)		(242.4)		(50.7)	(627.4)
<b>Net pension liability</b>		(327.1)		(242.4)		(50.7)	(620.2)

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

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

The scheme assets do not include any of the Group's own financial instruments, nor any property occupied by, nor other assets used by, the Group. The expected rates of return on individual categories of scheme assets are determined by reference to relevant industries. The overall rate of return is calculated by weighting the individual rates in accordance with the anticipated balance in the schemes' investment portfolios.

### Amounts recognised in the income statement

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
<b>Amounts (credited)/charged to operating profit</b>		
Current service cost	4.1	3.4
Past service (gain)/cost	(2.1)	(0.4)
Settlement (gain)/loss	(2.2)	
Curtailment (gain)/loss		(0.1)
	(0.2)	2.9
<b>The operating cost is charged/(credited) as follows:</b>		
Cost of sales	1.0	0.7
Sales and distribution costs	1.2	0.8
Administrative expenses	1.9	1.4
Exceptional operating items	(4.3)	
	(0.2)	2.9
<b>Amounts (credited)/charged to finance costs</b>		
Expected return on pension scheme assets	(173.4)	(203.0)
Interest on pension scheme liabilities	157.0	179.5
	(16.4)	(23.5)

The actual return on scheme assets was a profit of £448.8m (2012: profit of £104.4m).

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

Net actuarial gains of £280.5m (2012: losses of £559.0m) have been reported in the statement of comprehensive income. This includes a gain of £0.1m (2012: gain of £1.1m) in respect of unrecognised assets owing to surplus restriction. Cumulative actuarial losses from 1 August 2004 reported in the statement of comprehensive income are £837.0m (2012: cumulative losses of £1,117.5m).

## Notes to the accounts

Continued

## 9 Post-retirement benefits continued

### Changes in present value of funded scheme assets

	Year ended 31 July 2013				Year ended 31 July 2012			
	UK £m	US £m	Other £m	Total £m	UK £m	US £m	Other £m	Total £m
At beginning of period	<b>2,844.9</b>	<b>458.1</b>	<b>44.6</b>	<b>3,347.6</b>	2,813.6	412.8	46.2	3,272.6
Expected return on assets	<b>146.1</b>	<b>25.0</b>	<b>2.3</b>	<b>173.4</b>	170.4	29.9	2.7	203.0
Actuarial gain/(loss) on scheme assets	<b>243.3</b>	<b>22.3</b>	<b>9.9</b>	<b>275.5</b>	(94.2)	(1.6)	(2.9)	(98.7)
Employer contributions	<b>53.5</b>	<b>7.7</b>	<b>9.8</b>	<b>71.0</b>	88.2	23.3	3.8	115.3
Employee contributions			<b>0.2</b>	<b>0.2</b>			0.4	0.4
Assets distributed on settlement			<b>(16.8)</b>	<b>(16.8)</b>				
Exchange adjustments		<b>15.7</b>	<b>1.4</b>	<b>17.1</b>		20.4	(3.3)	17.1
Benefits paid	<b>(141.9)</b>	<b>(27.6)</b>	<b>(2.3)</b>	<b>(171.8)</b>	(133.1)	(26.7)	(2.3)	(162.1)
<b>At end of period</b>	<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

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

	Year ended 31 July 2013				Year ended 31 July 2012			
	UK £m	US £m	Other £m	Total £m	UK £m	US £m	Other £m	Total £m
At beginning of period	<b>(3,116.7)</b>	<b>(680.6)</b>	<b>(66.3)</b>	<b>(3,863.6)</b>	(2,775.7)	(543.8)	(60.2)	(3,379.7)
Current service cost	<b>(0.3)</b>		<b>(2.1)</b>	<b>(2.4)</b>	(0.3)		(2.0)	(2.3)
Interest on obligations	<b>(125.0)</b>	<b>(25.4)</b>	<b>(2.7)</b>	<b>(153.1)</b>	(143.6)	(28.2)	(3.2)	(175.0)
Employee contributions			<b>(0.2)</b>	<b>(0.2)</b>			(0.4)	(0.4)
Past service gain/(cost)			<b>2.1</b>	<b>2.1</b>			0.4	0.4
Actuarial (loss)/gain on liabilities	<b>(60.5)</b>	<b>77.5</b>	<b>(11.3)</b>	<b>5.7</b>	(330.2)	(107.9)	(7.5)	(445.6)
Liabilities extinguished on settlement			<b>19.0</b>	<b>19.0</b>				
Curtailment gain/(cost)							0.1	0.1
Exchange adjustments		<b>(19.6)</b>	<b>(2.3)</b>	<b>(21.9)</b>		(27.4)	4.2	(23.2)
Benefits paid	<b>141.9</b>	<b>27.6</b>	<b>2.3</b>	<b>171.8</b>	133.1	26.7	2.3	162.1
<b>At end of period</b>	<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)

### Changes in present value of unfunded defined benefit pensions and post retirement healthcare plans

	Assets				Obligations			
	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
At beginning of period							<b>(104.1)</b>	(90.7)
Current service cost							<b>(1.7)</b>	(1.1)
Interest on obligations							<b>(3.9)</b>	(4.5)
Actuarial (loss)/gain							<b>(0.7)</b>	(15.8)
Employer contributions			<b>6.5</b>	6.3				
Exchange adjustments							<b>(3.3)</b>	1.7
Benefits paid			<b>(6.5)</b>	(6.3)			<b>6.5</b>	6.3
<b>At end of period</b>							<b>(107.2)</b>	(104.1)

### Cash contributions

Company contributions to the funded defined benefit pension plans for 2013 totalled £71.0m (2012: £115.3m, including £50m to the TIGPS).

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 connect 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 (see note 14) 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.
- Cash contributions to TIGPS of £16m a year until April 2016.

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

In 2014 the following cash contributions to the Group's principal defined benefit schemes are expected: £36m to SIPS; £16m to TIGPS; and approximately £38m to other plans, including the US defined benefit scheme. Expected cash payments for 2014 total £90m. In addition, £24m will be invested in UK government bonds held in escrow, in accordance with the funding plan explained above.

### Investment

In September 2013, the Trustees of the TIGPS invested approximately £160m in annuities which are matched with specific liabilities of the Scheme.

## 9 Post-retirement benefits continued

### History of schemes

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
<b>Assets and liabilities</b>					
Fair value of scheme assets	<b>3,696.2</b>	3,347.6	3,272.6	3,043.1	2,775.1
Present value of defined benefit obligations	<b>(3,949.8)</b>	(3,967.7)	(3,470.4)	(3,347.7)	(3,112.1)
Unrecognised asset due to surplus restriction		(0.1)	(1.2)	(0.7)	(2.0)
<b>Deficit</b>	<b>(253.6)</b>	(620.2)	(199.0)	(305.3)	(339.0)
Post-retirement assets	<b>121.7</b>	7.2	140.6	80.3	39.2
Post-retirement liabilities	<b>(375.3)</b>	(627.4)	(339.6)	(385.6)	(378.2)
<b>Deficit</b>	<b>(253.6)</b>	(620.2)	(199.0)	(305.3)	(339.0)

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m	Period ended 31 July 2010 £m	Period ended 31 July 2009 £m
<b>Experience gains/(losses)</b>					
Experience gains/(losses) on scheme liabilities	<b>(3.1)</b>	45.4	(25.5)	31.5	100.5
Experience gains/(losses) on scheme assets	<b>275.5</b>	(98.7)	139.4	167.5	(345.4)
Movement on restricted surplus	<b>0.1</b>	1.1	(0.5)	1.3	(0.5)

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

### Sensitivity

The valuation of post-retirement schemes involves judgements about uncertain future events. Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 July 2013 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 2013 £m	Increase/ (decrease) in scheme assets £m	(Increase)/ decrease in scheme liabilities £m
Rate of mortality – 1 year increase in life expectancy	(4.1)	32.8	(123.3)
Rate of mortality – 1 year decrease in life expectancy	4.0	(32.8)	124.0
Rate of inflation – 0.25% increase	(3.3)	11.0	(85.6)
Discount rate – 0.25% increase	(5.6)	(16.2)	139.8
Market value of scheme assets – 2.5% increase	3.3	74.6	
Healthcare cost trends – 1% increase			(0.2)
Healthcare cost trends – 1% decrease			0.2

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

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.

### Adoption of 'IAS 19 (Revised 2011): Employee benefits'

From 1 August 2013 Smiths Group will be applying 'IAS 19 (Revised 2011): Employee benefits'. Implementing this standard is expected to have the following impact on the reported position and performance of Smiths Group:

Financing credits and charges relating to retirement benefits are excluded from headline profit measures. In future years, operating profit charges relating to retirement benefit schemes which are closed to future accruals will be excluded from headline profit measures.

	Operating profit for year ended 31 July 2013 £m	Interest for year ended 31 July 2013 £m	Profit before tax for year ended 31 July 2013 £m	Actuarial gain/(loss) for year ended 31 July 2013 £m	Net pension liability 31 July 2013 £m
<b>As currently disclosed</b>	0.2	16.4	16.6	280.5	(253.6)
Separate recognition of scheme administration costs	(6.7)	4.9	(1.8)	1.8	
Revised calculation of finance charges		(44.3)	(44.3)	44.3	
<b>Calculated in accordance with IAS 19 (Revised 2011)</b>	(6.5)	(23.0)	(29.5)	326.6	(253.6)

## Notes to the accounts

**Continued**

### 10 Employees

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
<b>Staff costs during the period</b>		
Wages and salaries	<b>756.3</b>	740.5
Social security	<b>89.2</b>	84.4
Share-based payment (note 27)	<b>12.8</b>	14.3
Pension costs (including defined contribution schemes) (note 9)	<b>33.8</b>	32.4
	<b>892.1</b>	871.6

The average number of persons employed was:

	Year ended 31 July 2013	Year ended 31 July 2012
John Crane	<b>7,000</b>	7,000
Smiths Medical	<b>7,900</b>	7,750
Smiths Detection	<b>2,250</b>	2,300
Smiths Interconnect	<b>3,850</b>	4,100
Flex-Tek	<b>2,000</b>	2,000
Smiths Business Information Services	<b>200</b>	
Corporate	<b>50</b>	50
	<b>23,250</b>	23,200

Smiths Business Information Services has centralised employment contracts for 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 84 to 95.

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
<b>Key management compensation</b>		
Salaries and short-term employee benefits	<b>8.5</b>	10.1
Cost of post-retirement benefits	0.1	0.1
Cost of share-based incentive plans	<b>4.5</b>	5.7

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

	Year ended 31 July 2013		Year ended 31 July 2012	
	Number of instruments '000	Weighted average price	Number of instruments '000	Weighted average price
CIP	<b>834</b>		778	
ESOS	<b>126</b>	<b>£8.71</b>	168	£8.93
VSP	<b>78</b>		611	
LTIP	<b>1,251</b>		728	
SAYE	<b>5</b>	<b>£7.28</b>	5	£7.28

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

#### Related party transactions

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

## 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 2011	1,389.7	162.5	351.9	132.2	2,036.3
Exchange adjustments	(1.4)	3.5	8.5	0.3	10.9
Business combinations	100.2		53.2		153.4
Additions		28.5		13.5	42.0
Disposals	(0.4)	(13.2)		(2.6)	(16.2)
At 31 July 2012	1,488.1	181.3	413.6	143.4	2,226.4
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)
<b>At 31 July 2013</b>	<b>1,553.3</b>	<b>217.4</b>	<b>430.2</b>	<b>155.7</b>	<b>2,356.6</b>
<b>Amortisation</b>					
At 1 August 2011	93.9	63.4	183.6	85.2	426.1
Exchange adjustments	(0.2)	1.1	3.9	(0.1)	4.7
Charge for the year		19.3	50.9	12.9	83.1
Impairment charge			10.7		10.7
Disposals		(13.2)		(2.1)	(15.3)
At 31 July 2012	93.7	70.6	249.1	95.9	509.3
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)
<b>At 31 July 2013</b>	<b>98.6</b>	<b>93.5</b>	<b>308.0</b>	<b>110.5</b>	<b>610.6</b>
<b>Net book value at 31 July 2013</b>	<b>1,454.7</b>	<b>123.9</b>	<b>122.2</b>	<b>45.2</b>	<b>1,746.0</b>
Net book value at 31 July 2012	1,394.4	110.7	164.5	47.5	1,717.1
Net book value at 1 August 2011	1,295.8	99.1	168.3	47.0	1,610.2

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 2011	66.6	117.4	167.9	351.9
Exchange adjustments	3.0	5.5		8.5
Business combinations	3.8	16.1	33.3	53.2
At 31 July 2012	73.4	139.0	201.2	413.6
Exchange adjustments	1.8	4.8	10.0	16.6
<b>At 31 July 2013</b>	<b>75.2</b>	<b>143.8</b>	<b>211.2</b>	<b>430.2</b>
<b>Amortisation</b>				
At 1 August 2011	25.2	57.1	101.3	183.6
Exchange adjustments	1.1	2.7	0.1	3.9
Charge for the year	6.0	15.4	29.5	50.9
Impairment charge	0.9	2.7	7.1	10.7
At 31 July 2012	33.2	77.9	138.0	249.1
Exchange adjustments	1.0	3.2	8.1	12.3
Charge for the year	5.8	16.5	24.3	46.6
<b>At 31 July 2013</b>	<b>40.0</b>	<b>97.6</b>	<b>170.4</b>	<b>308.0</b>
<b>Net book value at 31 July 2013</b>	<b>35.2</b>	<b>46.2</b>	<b>40.8</b>	<b>122.2</b>
Net book value at 31 July 2012	40.2	61.1	63.2	164.5
Net book value at 1 August 2011	41.4	60.3	66.6	168.3

## Notes to the accounts

Continued

### 11 Intangible assets continued

#### Impairment testing

##### Goodwill

Goodwill is not amortised but is tested for impairment at least annually. Value in use calculations are used to determine the recoverable amount of goodwill held allocated to each group of cash generating units (CGU). Value in use is calculated as the net present value of the projected risk-adjusted cash-flows of the CGU. These forecast cash-flows are based on the 2014 budget and the four year divisional strategic plan, which have both been approved by the Board. Goodwill is allocated by division as follows:

	2013 £m	2013 Number of CGUs	2012 £m	2012 Number of CGUs
John Crane	<b>142.7</b>	<b>4</b>	139.2	4
Smiths Medical	<b>529.5</b>	<b>1</b>	514.5	1
Smiths Detection	<b>407.8</b>	<b>1</b>	376.9	1
Smiths Interconnect	<b>351.6</b>	<b>3</b>	341.5	3
Flex-Tek	<b>23.1</b>	<b>2</b>	22.3	2
	<b>1,454.7</b>	<b>11</b>	1,394.4	11

John Crane and Smiths Medical have strong aftermarket and consumables businesses, with consistent sales trends. Smiths Detection and Smiths Interconnect have greater sales and margin volatility due to lower levels of recurring revenue and involvement in government funded programmes, particularly defence, and customer led technology innovation. The key assumptions used in value in use calculations are:

- Sales: projected sales are built up with reference to markets and product categories. They incorporate past performance, historical growth rates and projections of developments in key markets.
- Margins: projected margins reflect historical performance and the impact of all completed projects to improve operational efficiency and leverage scale. The projections do not include the impact of future restructuring projects to which the Group is not yet committed.
- Discount rate: the discount rates have been calculated based on the Group's weighted average cost of capital and risks specific to the CGU being tested. Pre-tax rates of 10.9% to 14.9% (2012: 12.3% to 14.1%) have been used for the impairment testing.
- Long term growth rates: As required by IAS 36, growth rates for the period after the detailed forecasts are based on the long-term GDP projections of the primary market for the CGU. The average growth rate used in the testing was 2.13% (2012: 2.29%). 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 2013				
	Smiths Medical	Smiths Detection	Smiths Interconnect		
			Microwave	Connectors	Power management
Net book value of goodwill (£m)	<b>529.5</b>	<b>407.8</b>	<b>137.3</b>	<b>87.4</b>	<b>126.9</b>
Discount rate	<b>10.9%</b>	<b>14.9%</b>	<b>13.2%</b>	<b>13.8%</b>	<b>13.3%</b>
Period covered by management projections	<b>5 years</b>	<b>5 years</b>	<b>5 years</b>	<b>5 years</b>	<b>5 years</b>
Long-term growth rates	<b>2.12%</b>	<b>1.60%</b>	<b>2.76%</b>	<b>2.55%</b>	<b>2.40%</b>

	Year ended 31 July 2012				
	Smiths Medical	Smiths Detection	Smiths Interconnect		
			Microwave	Connectors	Power management
Net book value of goodwill (£m)	514.5	376.9	134.2	84.7	122.6
Discount rate	12.3%	13.5%	14.1%	14.1%	13.1%
Period covered by management projections	5 years	5 years	5 years	5 years	5 years
Long-term growth rates	2.20%	2.50%	2.72%	2.32%	2.59%

The remaining balance of the goodwill represents smaller individual amounts which have been allocated to smaller CGUs.

## 11 Intangible assets continued

### Impairment testing continued

#### Goodwill continued

##### Sensitivity analysis

Smiths Interconnect Power management's value in use exceeds its carrying value by £7.8m (2012: £27.4m). Sensitivity analysis performed around the base case assumptions has indicated that for Smiths Interconnect Power management, the following changes in assumptions (in isolation), would cause the value in use to fall below the carrying value:

	Year ended 31 July 2013 Change required to trigger impairment	Year ended 31 July 2012 Change required to trigger impairment
Forecast operating cash-flow	<b>4% reduction</b>	12% reduction
Discount rate	<b>0.5% higher</b>	1.4% higher
Long-term growth rates	<b>0.9% lower</b>	2.8% lower

Sales assumptions for Smiths Interconnect Power management 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 management are based on current variable costs and production capacity, and the expected costs of increasing capacity to support higher levels of sales.

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

#### Other intangible assets

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

In the year ended 31 July 2012 impairment charges of £10.7m were incurred on intangible assets arising from the PDI acquisition. Value in use calculations were used to determine the recoverable values of these assets. The impairment charges arose because product sales were lower than expected with a consequential impact on the future value of the technology, customer relationships and brands. The impairment charge was included in Smiths Interconnect administrative expenses and it was excluded from the calculation of headline operating profit.

## 12 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 2011	190.3	495.7	209.5	895.5
Exchange adjustments	0.6	5.7	(3.4)	2.9
Business combinations	0.3	1.0	0.2	1.5
Additions	6.0	27.8	16.3	50.1
Disposals	(4.3)	(12.9)	(8.9)	(26.1)
Business disposals	(0.2)	(1.3)		(1.5)
At 31 July 2012	192.7	516.0	213.7	922.4
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)
<b>At 31 July 2013</b>	<b>199.6</b>	<b>553.9</b>	<b>229.6</b>	<b>983.1</b>
<b>Depreciation</b>				
At 1 August 2011	87.1	362.7	162.9	612.7
Exchange adjustments	1.0	5.1	(2.4)	3.7
Charge for the year	7.5	34.7	16.8	59.0
Disposals	(2.7)	(12.1)	(7.7)	(22.5)
Business disposals	(0.2)	(0.8)		(1.0)
At 31 July 2012	92.7	389.6	169.6	651.9
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)
<b>At 31 July 2013</b>	<b>98.3</b>	<b>419.7</b>	<b>185.1</b>	<b>703.1</b>
<b>Net book value at 31 July 2013</b>	<b>101.3</b>	<b>134.2</b>	<b>44.5</b>	<b>280.0</b>
Net book value at 31 July 2012	100.0	126.4	44.1	270.5
Net book value at 1 August 2011	103.2	133.0	46.6	282.8

## Notes to the accounts

Continued

### 13 Investments accounted for using the equity method

	31 July 2013 £m	31 July 2012 £m
<b>Investments in associated companies</b>		
At start of period		18.5
Exchange adjustment		(0.9)
Share of results after tax		5.7
Disposal		(23.3)
Dividend received		
<b>At end of period</b>		

On 16 July 2012 the Group disposed of its interest in Cross Match Technologies, Inc., incorporated in the United States, for a consideration of £45.0m. The Group's share of the revenue of associates for the year ended 31 July 2012 was £28.8m.

### 14 Financial assets

Available for sale financial assets include £83.0m (2012: £58.4m) 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.

### 15 Inventories

	31 July 2013 £m	31 July 2012 £m
<b>Inventories comprise</b>		
Raw materials and consumables	<b>155.5</b>	147.9
Work in progress	<b>110.2</b>	91.3
Finished goods	<b>227.3</b>	209.5
	<b>493.0</b>	448.7
Less: payments on account	<b>(17.4)</b>	(10.2)
	<b>475.6</b>	438.5

The Group consumed £1,408.7m (2012: £1,397.7m) of inventories during the period. £12.3m (2012: £10.9m) was recognised as an expense resulting from the write-down of inventory and £4.8m (2012: £2.9m) was released to the income statement from inventory provisions charged in earlier years but no longer required.

### 16 Trade and other receivables

	31 July 2013 £m	31 July 2012 £m
<b>Non-current</b>		
Trade receivables	<b>23.6</b>	27.9
Prepayments and accrued income	<b>5.6</b>	4.1
Other receivables	<b>4.9</b>	5.4
	<b>34.1</b>	37.4
<b>Current</b>		
Trade receivables	<b>628.2</b>	578.9
Prepayments and accrued income	<b>50.4</b>	40.6
Other receivables	<b>16.9</b>	14.9
	<b>695.5</b>	634.4

Trade receivables do not carry interest. Management considers that the carrying value of trade and other receivables approximates to the fair value. Trade and other receivables, including prepayments, accrued income and other debtors qualifying as financial instruments are classified as 'loans and receivables'. The maximum credit exposure arising from these financial assets is £677.2m (2012: £628.4m).

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% (2012: 4%) of Group revenue.

## 16 Trade and other receivables continued

### Ageing of trade receivables

	31 July 2013 £m	31 July 2012 £m
Trade receivables which are not impaired and not yet due	<b>516.7</b>	485.7
Trade receivables which are not impaired and less than three months overdue	<b>99.5</b>	89.0
Trade receivables which are not impaired and more than three months overdue	<b>30.9</b>	28.5
Gross value of partially and fully provided receivables	<b>22.5</b>	21.2
	<b>669.6</b>	624.4
Provision for bad and doubtful debts	<b>(17.8)</b>	(17.6)
<b>Trade receivables</b>	<b>651.8</b>	606.8

## 17 Trade and other payables

	31 July 2013 £m	31 July 2012 £m
<b>Non-current</b>		
Other creditors	<b>31.0</b>	37.5
<b>Current</b>		
Trade creditors	<b>213.5</b>	193.8
Bills of exchange payable	<b>2.7</b>	2.2
Other creditors	<b>10.7</b>	15.4
Other taxation and social security costs	<b>23.0</b>	21.3
Accruals and deferred income	<b>271.9</b>	235.5
	<b>521.8</b>	468.2

Trade and other payables, including accrued expenses and other creditors qualifying as financial instruments, are accounted for at amortised cost and are categorised as other financial liabilities.

## 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 2013 £m	31 July 2012 £m
<b>Cash and cash equivalents</b>		
Net cash and deposits	<b>393.8</b>	205.6
<b>Short-term borrowings</b>		
Bank overdrafts	<b>(7.3)</b>	(1.9)
\$250m 5.45% US\$ Private placement 2013		(161.7)
\$250m 6.05% US\$ Guaranteed notes 2014	<b>(164.5)</b>	
Bank and other loans	<b>(1.2)</b>	(1.2)
Interest accrual	<b>(14.1)</b>	(10.5)
	<b>(187.1)</b>	(175.3)
<b>Long-term borrowings</b>		
\$250m 6.05% US\$ Guaranteed notes 2014		(159.1)
£150m 7.25% Sterling Eurobond 2016	<b>(149.6)</b>	(149.4)
€300m 4.125% Eurobond 2017	<b>(267.5)</b>	(240.9)
\$175m 7.37% US\$ Private placement 2018	<b>(115.3)</b>	(111.6)
\$250m 7.20% US\$ Guaranteed notes 2019	<b>(163.8)</b>	(158.5)
\$400m 3.625% US\$ Guaranteed notes 2022	<b>(253.4)</b>	
Bank and other loans	<b>(1.5)</b>	(2.2)
	<b>(951.1)</b>	(821.7)
<b>Borrowings</b>		(997.0)
<b>Net debt</b>		(744.4)

On 12 October 2012 Smiths Group plc issued US\$400m notes with a ten year maturity and a fixed coupon of 3.625%, and on 28 January 2013 part of the proceeds of this issue were used to repay the maturing 5.45% US\$ Private placement.

Borrowings are accounted for at amortised cost and are categorised as other financial liabilities. See note 19 for a maturity analysis of borrowings. The repayment dates on borrowings repayable after five years range from 2019 to 2022.

Interest of £49.7m (2012: £42.1m) was charged to the consolidated income statement in this period in respect of public bonds.

## Notes to the accounts

**Continued**

## 18 Borrowings and net debt continued

### Net cash and cash equivalents

	31 July 2013 £m	31 July 2012 £m
Cash at bank and in hand	<b>164.2</b>	130.8
Short-term deposits	<b>229.6</b>	74.8
Cash and cash equivalents	<b>393.8</b>	205.6
Bank overdrafts	<b>(7.3)</b>	(1.9)
<b>Net cash and cash equivalents</b>	<b>386.5</b>	203.7

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

### Movements in net debt

	Net cash and cash equivalents £m	Other short-term borrowing £m	Long-term borrowings £m	Net debt £m
At 31 July 2012	203.7	(173.4)	(821.7)	(791.4)
Foreign exchange gains and losses	12.7	(0.1)	(53.5)	(40.9)
Net cash inflow/(outflow)	170.1			170.1
Repayment of borrowings		159.1		159.1
Drawdown of borrowings		(247.2)		(247.2)
Capitalisation, interest accruals and unwind of capitalised fees		(2.7)	(1.1)	(3.8)
Fair value movement from interest rate hedging		1.3	8.4	9.7
Change in maturity analysis	(164.0)		164.0	
<b>At 31 July 2013</b>	<b>386.5</b>	<b>(179.8)</b>	<b>(951.1)</b>	<b>(744.4)</b>

### Secured loans

Loans amounting to £2.7m (2012: £3.4m) were secured on plant and equipment with a book value of £2.5m (2012: £3.3m).

## 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 16.

### (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.

	Sterling £m	US\$ £m	Euro £m	Other £m	Total £m
<b>Financial assets and liabilities</b>					
Financial instruments included in trade and other receivables	<b>34.8</b>	<b>349.0</b>	<b>145.2</b>	<b>148.2</b>	<b>677.2</b>
Financial instruments included in trade and other payables	<b>(34.0)</b>	<b>(191.0)</b>	<b>(82.6)</b>	<b>(70.9)</b>	<b>(378.5)</b>
Cash and cash equivalents	<b>129.5</b>	<b>142.7</b>	<b>34.5</b>	<b>87.1</b>	<b>393.8</b>
Borrowings not designated as net investment hedges	<b>(149.9)</b>	<b>(13.8)</b>	<b>(9.6)</b>	<b>(0.4)</b>	<b>(173.7)</b>
	<b>(19.6)</b>	<b>286.9</b>	<b>87.5</b>	<b>164.0</b>	<b>518.8</b>
Exclude balances held in operations with the same functional currency	<b>19.1</b>	<b>(168.3)</b>	<b>(87.8)</b>	<b>(163.5)</b>	<b>(400.5)</b>
Exposure arising from intra-group loans		<b>(61.6)</b>		<b>4.3</b>	<b>(57.3)</b>
Forward foreign exchange contracts	<b>(1.0)</b>	<b>(75.6)</b>	<b>76.6</b>		
	<b>(1.5)</b>	<b>(18.6)</b>	<b>76.3</b>	<b>4.8</b>	<b>61.0</b>

## 19 Financial risk management continued

	Sterling £m	US\$ £m	Euro £m	Other £m	Total £m
	At 31 July 2012				
Financial assets and liabilities					
Financial instruments included in trade and other receivables	30.4	327.3	127.8	142.9	628.4
Financial instruments included in trade and other payables	(42.4)	(170.9)	(69.4)	(68.3)	(351.0)
Cash and cash equivalents	18.5	88.8	24.4	73.9	205.6
Borrowings not designated as net investment hedges	(149.4)	(11.4)	(4.0)	(0.4)	(165.2)
	(142.9)	233.8	78.8	148.1	317.8
Exclude balances held in operations with the same functional currency	142.6	(154.2)	(78.8)	(143.1)	(233.5)
Exposure arising from intra-group loans		(144.0)		(20.5)	(164.5)
Forward foreign exchange contracts	(48.0)	(34.7)	95.0	(12.3)	
	(48.3)	(99.1)	95.0	(27.8)	(80.2)

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

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

	Impact on profit for the year 31 July 2013 £m	Gain/(loss) recognised in reserves 31 July 2013 £m	Impact on profit for the year 31 July 2012 £m	Gain/(loss) recognised in reserves 31 July 2012 £m
US dollar	2.9	(1.7)	0.1	(4.2)
Euro	5.3	2.0	3.6	4.1
Sterling	(0.6)	0.9	(4.1)	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 2013 contracts with a nominal value of £234.0m (2012: £279.4m) were designated as hedging instruments. In addition, the Group had outstanding foreign currency contracts with a nominal value of £87.5m (2012: £249.9m) 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 income statement in the same period that the cash-flows are expected to occur, with the only differences arising as a result of normal commercial credit terms on sales and purchases. Of the foreign exchange contracts designated as hedging instruments 99.9% are for periods of 12 months or less (2012: 98.5%).

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

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Brought forward cash-flow hedge reserve at start of year	(4.7)	(0.3)
Exchange adjustments	(0.2)	0.1
Gains/(losses) on effective cash-flow hedges recognised in equity	11.0	(10.9)
Amounts removed from the hedge reserve and recognised in the following lines on the income statement		
– revenue	(3.8)	5.5
– cost of sales	(0.5)	0.9
<b>Carried forward cash-flow hedge reserve at end of year</b>	<b>1.8</b>	<b>(4.7)</b>

## Notes to the accounts

### Continued

## 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 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 2012				
	Sterling £m	US\$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges		(590.9)	(240.9)		(831.8)
Currency swap contracts	192.4	(69.4)	(39.2)	(83.8)	
	192.4	(660.3)	(280.1)	(83.8)	(831.8)

At 31 July 2013 swap contracts in other currencies hedged the Group's exposure to Canadian dollars, Japanese yen and Chinese renminbi (31 July 2012: Canadian dollars, Japanese yen and Chinese renminbi).

Of the contracts designated as net investment hedges, 55% (2012: 55%) are current and the balance matures over the next three years (2012: 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 2013 £m	Year ended 31 July 2012 £m
Brought forward net investment hedge reserve at start of year	(120.1)	(120.3)
Amounts deferred in the period on effective net investment hedges	(55.7)	0.2
<b>Carried forward net investment hedge reserve at end of year</b>	<b>(175.8)</b>	<b>(120.1)</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 2013 £m	Loss recognised in hedge reserve 31 July 2012 £m
US dollar	76.2	65.6
Euro	29.2	25.0

These movements would be fully offset by an opposite movement on the retranslation of the net assets of the overseas subsidiaries. These sensitivities were calculated before adjusting for tax.

### (b) Interest rate risk

The Group operates an interest rate policy designed to optimise interest cost and reduce volatility in reported earnings. The Group's current policy is to require interest rates to be fixed for greater than 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 2013 76% (2012: 75%) 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. 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 2013, after interest rate swaps, is 5.2% (2012: 5.5%).

## 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 2013 £m	Cash and cash equivalents 31 July 2013 £m	Borrowings 31 July 2013 £m	Fair value of borrowings 31 July 2013 £m	Available for sale investments 31 July 2012 £m	Cash and cash equivalents 31 July 2012 £m	Borrowings 31 July 2012 £m	Fair value of borrowings 31 July 2012 £m
Fixed interest								
Less than one year				(165.7)	(170.9)		(65.0)	(66.1)
Between one and five years				(423.3)	(483.7)		(451.5)	(500.8)
Greater than five years	83.0			(327.3)	(349.0)	58.4	(270.2)	(333.4)
Total fixed interest financial assets/(liabilities)	83.0			(916.3)	(1,003.6)	58.4	(786.7)	(900.3)
Floating rate interest financial assets/(liabilities)		339.8		(221.9)	(221.9)		189.0	(210.3)
Total interest bearing financial assets/(liabilities)	83.0	339.8		(1,138.2)	(1,225.5)	58.4	189.0	(997.0)
Non-interest bearing assets/(liabilities) in the same category	3.1		54.0			2.5	16.6	
<b>Total</b>	<b>86.1</b>	<b>393.8</b>		<b>(1,138.2)</b>	<b>(1,225.5)</b>	60.9	205.6	(997.0)
								(1,110.6)

### Interest rate hedging

At 31 July 2013 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 2012 the same euro hedge was in place, and US\$150m interest rate swaps which matured on 28 January 2013 were designated as fair value hedges on the US Private placement which matured this year. 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 £203.8m (2012: £190.0m) 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 2013, 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 £0.4m (2012: £0.6m) impact on the Group's profit before tax.

Based on the investments held at 31 July 2013 a one percentage point (100 basis points) increase in sterling interest rates would reduce the carrying value of investments by £11.8m (2012: £8.7m), generating a corresponding charge to reserves.

### (c) Financial credit risk

The Group is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, but does not currently expect any counterparties to fail to meet their obligations. Credit risk is mitigated by the Board approved policy of only 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 £479.9m at 31 July 2013 (2012: £266.5m).

	31 July 2013 £m	31 July 2012 £m
UK government bonds with at least a AA credit rating (note 14)	83.0	58.4
Cash at banks with at least a AA- credit rating	230.2	135.1
Cash at banks with a A+ credit rating	89.6	57.4
Cash at other banks	74.0	13.1
Other investments	3.1	2.5
<b>Total</b>	<b>479.9</b>	266.5

At 31 July 2013 the maximum exposure with a single bank for deposits and cash is £121.8m (2012: £55.8m), whilst the maximum mark to market exposure for derivatives is £3.1m (2012: £3.5m). These banks have AA- and A credit rating, respectively (2012: AA- and A+).

## Notes to the accounts

Continued

## 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. This is provided by a US\$800m multi-currency revolving credit facility, which matures in December 2015. At the balance sheet date the Group had the following undrawn credit facilities:

	31 July 2013 £m	31 July 2012 £m
Expiring within one year		
Expiring between one and two years		
Expiring after two years	<b>527.1</b>	510.6
	<b>527.1</b>	510.6

#### Cash deposits

As at 31 July 2013, £229.6m (2012: £74.8m) of cash and cash equivalents was on deposit with various banks of which £167.1m (2012: £35.9m) was on deposit in the UK.

#### Gross contractual cash-flows for borrowings

	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	Borrowings (Note 18) 31 July 2012 £m	Fair value adjustments 31 July 2012 £m	Contractual interest payments 31 July 2012 £m	Total contractual cash-flows 31 July 2012 £m
Less than one year	<b>(187.1)</b>	<b>(0.2)</b>	<b>(51.2)</b>	<b>(238.5)</b>	(175.3)	1.2	(44.0)	(218.1)
Between one and two years	<b>(0.9)</b>	<b>(51.7)</b>	<b>(52.6)</b>	<b>(160.3)</b>	(0.5)	(50.1)	(210.9)	
Between two and three years	<b>(150.1)</b>	<b>(0.4)</b>	<b>(51.6)</b>	<b>(202.1)</b>	(1.0)	(40.4)	(41.4)	
Between three and four years	<b>(267.5)</b>	<b>5.1</b>	<b>(40.7)</b>	<b>(303.1)</b>	(149.4)	(0.6)	(40.3)	(190.3)
Between four and five years	<b>(115.3)</b>	<b>(0.1)</b>	<b>(29.9)</b>	<b>(145.3)</b>	(240.9)	5.3	(29.4)	(265.0)
Greater than five years	<b>(417.3)</b>	<b>(11.0)</b>	<b>(54.9)</b>	<b>(483.2)</b>	(270.1)	(1.1)	(31.2)	(302.4)
<b>Total</b>	<b>(1,138.2)</b>	<b>(6.6)</b>	<b>(280.0)</b>	<b>(1,424.8)</b>	(997.0)	4.3	(235.4)	(1,228.1)

The figures presented in the borrowings column include the non-cash adjustments which are highlighted in the adjacent column.

The contractual interest reported for borrowings is before the effect of interest rate swaps.

#### Gross contractual cash-flows for derivative financial instruments

	Receipts 31 July 2013 £m	Payments 31 July 2013 £m	Net cash-flow 31 July 2013 £m	Receipts 31 July 2012 £m	Payments 31 July 2012 £m	Net cash-flow 31 July 2012 £m
<b>Assets</b>						
Less than one year	<b>214.2</b>	<b>(204.2)</b>	<b>10.0</b>	285.9	(276.4)	9.5
Greater than one year	<b>12.0</b>	<b>(5.3)</b>	<b>6.7</b>	76.3	(69.5)	6.8
<b>Liabilities</b>						
Less than one year	<b>171.9</b>	<b>(176.6)</b>	<b>(4.7)</b>	295.8	(306.4)	(10.6)
Greater than one year	<b>102.3</b>	<b>(93.8)</b>	<b>8.5</b>	30.2	(31.1)	(0.9)
<b>Total</b>	<b>500.4</b>	<b>(479.9)</b>	<b>20.5</b>	688.2	(683.4)	4.8

This table presents the undiscounted future contractual cash-flows for all derivative financial instruments. For this disclosure, cash-flows in foreign currencies are translated using the spot rates at the balance sheet date. The fair values of these financial instruments are presented in note 20.

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

The contractual cash-flows for financial liabilities included in trade and other payables are: £360.8m (2012: £328.4m) due in less than one year, £12.6m (2012: £18.4m) due between one and five years and £5.1m (2012: £4.2m) due after more than five years.

## 20 Financial derivatives

The tables below set out the nominal amount and fair value of derivative contracts held by the Group, identifying the derivative contracts which qualify for hedge accounting treatment:

	At 31 July 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>

	At 31 July 2012			
	Contract or underlying nominal amount	Fair value		
	£m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	279.4	2.7	(8.6)	(5.9)
Foreign exchange contracts (not hedge accounted)	249.9	1.4	(1.7)	(0.3)
Total foreign exchange contracts	529.3	4.1	(10.3)	(6.2)
Currency swaps (net investment hedges)	192.5	2.6	(1.4)	1.2
Interest rate swaps (fair value hedges)	190.0	8.4		8.4
<b>Total financial derivatives</b>	<b>911.8</b>	<b>15.1</b>	<b>(11.7)</b>	<b>3.4</b>
Balance sheet entries				
Non-current		7.2	(1.1)	6.1
Current		7.9	(10.6)	(2.7)
<b>Total financial derivatives</b>		<b>15.1</b>	<b>(11.7)</b>	<b>3.4</b>

### Currency swaps not hedge accounted

These contracts comprise derivatives which were previously part of the net investment hedging programme and matching contracts to eliminate this exposure. There is no further net exposure arising from these contracts.

### Accounting for other derivative contracts

Any foreign exchange contracts which are not formally designated as hedges and tested are classified as 'held for trading' and not hedge accounted.

### Fair value hierarchy

All derivatives values are calculated using valuation methodologies in which all the inputs are either market data or derived from market data.

## Notes to the accounts

**Continued**

### 21 Provisions for liabilities and charges

	Trading		Exceptional and legacy		Total £m
			John Crane, Inc. litigation £m	Titeflex Corporation litigation £m	
	£m	£m	£m	£m	
At 31 July 2012	35.7	213.1	61.8	21.1	331.7
Exchange adjustments	2.0	6.6	2.1	0.4	11.1
Provision charged	23.0	33.9	6.8	4.7	68.4
Provision released	(4.9)	(20.1)		(1.6)	(26.6)
Unwind of provision discount		3.3	0.9		4.2
Utilisation	(15.1)	(26.8)	(6.0)	(4.7)	(52.6)
<b>At 31 July 2013</b>	<b>40.7</b>	<b>210.0</b>	<b>65.6</b>	<b>19.9</b>	<b>336.2</b>

Analysed as:

	31 July 2013 £m	31 July 2012 £m
Current liabilities	<b>78.1</b>	77.3
Non-current liabilities	<b>258.1</b>	254.4
	<b>336.2</b>	331.7

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 2013 there are warranty and product liability provisions of £40.0m (2012: £34.5m). 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.

##### Litigation in respect of current products or 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.

#### 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. An adverse judgment at first instance from the Circuit Court of Cook County, Illinois is currently under appeal. Pending the outcome of that litigation, JCI has begun to meet defence costs directly. Provision is made in respect of the expected costs of defending known and predicted future claims and of adverse judgments in relation thereto, to the extent that such costs can be reliably estimated. No account has been taken of recoveries from insurers as their nature and timing are not yet sufficiently certain to permit recognition as an asset for these purposes.

The JCI products generally referred to in these cases consist of industrial sealing product, primarily packing and gaskets. The asbestos was encapsulated within these products in such a manner that causes JCI to believe, based on tests conducted on its behalf, that the products were safe. JCI ceased manufacturing products containing asbestos in 1985.

JCI continues to actively monitor the conduct and effect of its current and expected asbestos litigation, including the most efficacious presentation of its 'safe product' defence, and intends to continue to resist these asbestos claims based upon this defence. Approximately 230,000 claims against JCI have been dismissed before trial over the last 34 years. JCI is currently a defendant in cases involving approximately 81,000 claims. Despite the large number of claims brought against JCI, it has had final judgments against it, after appeals, in only 121 cases over the period, and has had to pay awards amounting to approximately US\$120m. JCI has also incurred significant additional defence costs and, whilst the number of claims being filed against JCI and other defendants has been declining, the proportion of mesothelioma claims has increased, and JCI's ability to defend these cases successfully is likely to have a significant impact on its annual aggregate adverse judgment and defence costs.

The provision is based on past history and allows for decreasing levels of new claims based on published tables of asbestos incidence projections and is determined using asbestos valuation experts, Bates White LLC. 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, see note 24.

## 21 Provisions for liabilities and charges continued

### Exceptional and legacy continued

#### John Crane, Inc. continued

The assumptions made in assessing the appropriate level of provision include:

- The period over which the expenditure can be reliably estimated.
- The future trend of legal costs.
- The rate of future claims filed.
- The rate of successful resolution of claims.
- The average amount of judgments awarded.

However, because of the significant uncertainty associated with the future level of asbestos claims and of the costs arising out of related litigation, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred and, as a result, the provision may be subject to potentially material revision from time to time if new information becomes available as a result of future events.

The provision in respect of JCI is a discounted pre-tax provision using discount rates, being the risk-free rate on US debt instruments for the appropriate period. The deferred tax asset related to this provision is shown within the deferred tax balance (note 6). Set out below is the gross, discounted and post-tax information relating to this provision:

	31 July 2013 £m	31 July 2012 £m
Gross provision	<b>232.8</b>	226.3
Discount	<b>(22.8)</b>	[13.2]
Discounted pre-tax provision	<b>210.0</b>	213.1
Deferred tax	<b>(60.7)</b>	[51.1]
Discounted post-tax provision	<b>149.3</b>	162.0

### 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 subrogation claims have been settled on an individual basis without admission of liability. Equivalent third-party products in the US marketplace face similar challenges with the profile of legal activity appearing to increase in recent times. The continuing progress of claims and the pattern of settlement, together with the recent market place activity, 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, see note 24.

However, because of the significant uncertainty associated with the future level of claims and of the costs arising out of related litigation, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred and, as a result, the provision may be subject to potentially material revision from time to time if new information becomes available as a result of future events.

The provision of £65.6m (2012: £61.8m) is a discounted pre-tax provision using discount rates, being the risk-free rate on US debt instruments for the appropriate period.

### Other

#### Reorganisation and property

At 31 July 2013 a provision of £10.7m (2012: £9.4m) relates to the performance improvement programme in Smiths Detection.

#### Disposal

Other provisions include disposal provisions of £3.6m (2012: £4.0m) 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.

## Notes to the accounts

Continued

## 22 Share capital

	Number of shares	Issued capital £m	Consideration £m
<b>Ordinary shares of 37.5p each</b>			
At 31 July 2011	392,350,403	147.1	
Exercise of share options	375,540	0.2	3.0
At 31 July 2012	392,725,943	147.3	
Exercise of share options	1,092,567	0.4	9.3
<b>Total share capital at 31 July 2013</b>	<b>393,818,510</b>	<b>147.7</b>	

At 31 July 2013 all of the issued share capital was in free issue. All issued shares are fully paid.

## 23 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 (2012: nil) shares to the Trust, and the Trust purchased 1,027,540 shares (2012: 1,026,514 shares) in the market. At 31 July 2013 the Trust held 855 (2012: 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 16.6% (2012: 16.5%).

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 13% (2012: 17%).

The Group has surplus cash on the balance sheet and the ratio of net debt to headline EBITDA of 1.2 is well below 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. The Board has therefore recommended a return of cash to shareholders of approximately £118m in the form of a special dividend of 30.0p per share.

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 2013 the Group had a credit rating of BBB+/Baa2 (2012: 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 2013 these measures were 98% (2012: 99%) and 1.2 (2012: 1.2).

The Board aims for dividend cover of around 2.5 times, to ensure that the Group retains sufficient cash to finance investment in growth.

### Hedge reserve

	31 July 2013 £m	31 July 2012 £m
The hedge reserve on the balance sheet comprises		
- cash-flow hedge reserve	1.8	(4.7)
- net investment hedge reserve	(175.8)	(120.1)
	<b>(174.0)</b>	(124.8)

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.

## 24 Contingent liabilities and commitments

### John Crane, Inc.

As stated in note 21, John Crane, Inc. ("JCI") is involved in numerous lawsuits pending in the United States in which plaintiffs are claiming damages arising from exposure to, or use of, products containing asbestos. The JCI products generally referred to in these cases are ones in which the asbestos fibres were encapsulated in such a manner that, according to tests conducted on behalf of JCI, the products were safe. JCI ceased manufacturing products containing asbestos in 1985.

Provision has been made for future defence costs and the cost of adverse judgments expected to occur. 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.

## 24 Contingent liabilities and commitments continued

### Titeflex Corporation

As stated in note 21, Titeflex Corporation has made provision for the cost of expected future subrogation and product liability claims. 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 contingent liabilities and commitments

In the ordinary course of its business, the Group is subject to commercial disputes and litigation such as product liability claims, employee disputes and other kinds of lawsuits, and faces different types of legal issues in different jurisdictions. The high level of activity in the US, for example, exposes the Group to the likelihood of various types of litigation commonplace in that country, such as 'mass tort' and 'class action' litigation, legal challenges to the scope and validity of patents, and product liability and insurance subrogation claims. These types of proceedings (or the threat of them) are also used to create pressure to encourage negotiated settlement of disputes.

Any claim brought against the Group (with or without merit), could be costly to defend. These matters are inherently difficult to quantify.

In appropriate cases a provision is recognised based on best estimates and management judgement but there can be no guarantee that these provisions (which may be subject to potentially material revision from time to time) will result in an accurate prediction of the actual costs and liabilities that may be incurred. There are also contingent liabilities in respect of litigation for which no provisions are made.

At 31 July 2013, contingent liabilities, comprising bonds and guarantees arising in the normal course of business, amounted to £166.0m (2012: £167.4m), including pension commitments of £52.1m (2012: £49.5m).

From time to time the Group co-operates with relevant authorities in investigating business conduct issues. The Group is not aware of any issues which are expected to generate material financial exposures.

## 25 Operating lease commitments – minimum lease payments

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

	31 July 2013		31 July 2012	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Payments due				
– not later than one year	<b>32.3</b>	<b>8.2</b>	31.0	8.4
– later than one year and not later than five years	<b>69.0</b>	<b>8.8</b>	66.8	10.8
– later than five years	<b>12.6</b>		12.6	
	<b>113.9</b>	<b>17.0</b>	110.4	19.2

## 26 Cash-flow

### Cash-flow from operating activities

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Operating profit – continuing	<b>493.2</b>	406.6
Amortisation of intangible assets	<b>81.1</b>	83.1
Impairment of intangible assets		10.7
(Profit)/loss on disposal of property, plant and equipment	<b>(4.3)</b>	3.7
Profit on disposal of business	<b>(0.9)</b>	(30.8)
Depreciation of property, plant and equipment	<b>52.3</b>	59.0
Share-based payment expense	<b>12.1</b>	14.4
Retirement benefits	<b>(77.7)</b>	(118.6)
Increase in inventories	<b>(20.3)</b>	(4.3)
Increase in trade and other receivables	<b>(30.3)</b>	(6.8)
Increase in trade and other payables	<b>31.8</b>	0.9
(Decrease)/increase in provisions	<b>(9.9)</b>	71.8
Cash generated from operations	<b>527.1</b>	489.7
Interest	<b>(59.6)</b>	(64.5)
Tax paid	<b>(114.1)</b>	(93.7)
<b>Net cash inflow from operating activities</b>	<b>353.4</b>	331.5

## Notes to the accounts

Continued

## 26 Cash-flow continued

### Smiths Group cash-flow measures

The Group uses two non-statutory cash-flow measures to monitor performance: headline operating cash-flow and free cash-flow. Headline operating cash-flow is net cash inflow from headline operating activities less capital expenditure. See note 3 for a description of headline profit measures. Free cash-flow is cash-flow after interest and tax but before acquisitions, financing activities and dividends. The tables below reconcile these two measures to statutory cash-flow measures.

#### Headline operating cash-flow

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
<b>Net cash inflow from operating activities</b>	<b>353.4</b>	331.5
Exclude:		
Interest	59.6	64.5
Tax paid	114.1	93.7
Cash outflow in respect of exceptional operating items	43.9	38.2
Pension deficit payments	71.4	111.2
Include:		
Expenditure on capitalised development, other intangible assets and property, plant and equipment	(96.0)	(91.2)
Disposals of property, plant and equipment in the ordinary course of business	1.5	0.7
<b>Headline operating cash-flow</b>	<b>547.9</b>	548.6

#### Free cash-flow

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Net cash inflow from operating activities	353.4	331.5
Expenditure on capitalised development, other intangible assets and property, plant and equipment	(96.0)	(91.2)
Disposals of property, plant and equipment	3.9	0.7
Investment in financial assets relating to pensions financing	(24.0)	(24.0)
<b>Free cash-flow</b>	<b>237.3</b>	217.0
Investment in other financial assets	(0.3)	(0.3)
Acquisition of businesses	(0.5)	(167.5)
Disposal of businesses	0.3	47.3
Net cash-flow used in financing activities	(66.7)	(151.5)
<b>Net (decrease)/increase in cash and cash equivalents</b>	<b>170.1</b>	(55.0)

## 27 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. The awards have the same structure and calculation methods as the 2008 VSP. The performance conditions are measured over a three-year period commencing with the financial year 2010/11, and the Group scheme hurdle rate is 8.5% a year.

## 27 Employee share schemes continued

### 2008 Value Sharing Plan (2008 VSP)

The VSP was a long-term incentive plan approved by the shareholders in July 2008 rewarding executives for value creation at Group and Divisional levels. The final vesting took place in November 2008. 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 were measured over three-year and four-year periods commencing with the financial year 2008/09. For the Group scheme, the growth in internal value was tested against a hurdle rate of 9.5% a year.

### Smiths Group Co-Investment Plan (CIP)

Under the CIP, as introduced in October 2005, the executive directors and senior executives are able, if invited, to use their after tax bonus or 25% of their basic salary after tax, whichever is the greater, to invest in the Company's shares at the prevailing market price. At the end of a three year period, if the executive is still in office and provided the performance test is passed, matching shares will be awarded in respect of any invested shares retained for that period. The number of matching shares to be awarded is determined by the Remuneration Committee at the end of the year in which the bonus is earned by reference to annual bonus, and other corporate financial criteria. The maximum award will not exceed the value, before tax, of the bonus or salary invested in shares by the executive. Vesting of matching shares will occur and the matching shares will be released at the end of the three year period if the Group's Return on Capital Employed ('ROCE') over the Performance Period exceeds the Group's weighted average cost of capital ('WACC') over the Performance Period by an average margin of at least 1% per annum.

In July 2008 the CIP was amended. From 2009 participants have been required to invest 50% of their post tax bonus in purchased shares. The performance conditions have been expanded to include an enhanced performance condition of ROCE exceeding WACC by an average margin of 3% per annum. If the enhanced performance condition is met, two matching shares will be issued for every purchased share.

	CIP	Long term incentive plans	Other share schemes	Total	Weighted average price for option plans £
<b>Ordinary shares under option ('000)</b>					
1 August 2011	1,340	1,857	4,438	7,635	£5.37
Granted	752	1,133	257	2,142	£0.97
Update of estimates		96		96	£0.00
Exercised	(254)	(773)	(393)	(1,420)	£2.20
Lapsed	(130)	(14)	(827)	(971)	£7.07
31 July 2012	1,708	2,299	3,475	7,482	£4.10
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
<b>31 July 2013</b>	<b>1,874</b>	<b>2,367</b>	<b>2,086</b>	<b>6,327</b>	<b>£2.98</b>

Options were exercised on an irregular basis during the period. The average closing share price over the financial year was 1,195.79p (2012: 992.15p). 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 2013 ('000)	Options exercisable at 31 July 2012 ('000)	Exercisable weighted average exercise price for options exercisable at 31 July 2013
£0.00 – £2.00	4,242	17			
£2.01 – £6.00	169	21		2	
£6.01 – £10.00	1,215	51	<b>1,071</b>	1,387	<b>£8.74</b>
£10.01 – £14.00	701	48	<b>532</b>	947	<b>£10.97</b>

For the purposes of valuing options to arrive at the share-based payment charge, the Binomial option pricing model has been used for most schemes and the Monte Carlo method is used for schemes with total shareholder return performance targets. The key assumptions used in the models for 2013 and 2012 are volatility of 25% to 27% (2012: 27% to 30%) and dividend yield of 3.75% (2012: 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 £10.84 (2012: £9.44), group long term incentive plans of £9.18 (2012: £7.14) and divisional long term incentive plans of £10.84 (2012: £8.94). 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 £12.8m (2012: £14.3m), of which £12.1m (2012: £14.4m) relates to equity-settled share-based payment.

At 31 July 2013 the creditor relating to cash-settled schemes is £0.5m (2012: £0.4m).

# Group financial record 2009-2013

	<b>Year ended 31 July 2013 £m</b>	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m
Revenue	<b>3,108.6</b>	3,030.1	2,842.0	2,769.6	2,664.6
<b>Headline operating profit</b>	<b>559.7</b>	553.7	516.9	492.4	417.5
Amortisation of acquired intangible assets	(46.6)	(61.6)	(49.5)	(42.1)	(34.6)
Exceptional items	(19.9)	(85.5)	(29.4)	(14.4)	45.6
<b>Operating profit</b>	<b>493.2</b>	406.6	438.0	435.9	428.5
Net finance costs	(51.4)	(46.4)	(44.4)	(64.6)	(58.1)
Share of post-tax profits of associated companies		5.7	4.3	1.8	0.4
<b>Profit before taxation</b>	<b>441.8</b>	365.9	397.9	373.1	370.8
Taxation	(83.6)	(107.6)	(91.8)	(78.9)	(94.9)
<b>Profit after taxation – continuing operations</b>	<b>358.2</b>	258.3	306.1	294.2	275.9
<b>Profit/(loss) after taxation – discontinued operations</b>		(0.1)	79.0	16.4	(5.9)
<b>Shareholders' equity</b>	<b>1,486.0</b>	972.8	1,373.5	1,094.8	859.0
Represented by					
– intangible assets	<b>1,746.0</b>	1,717.1	1,610.2	1,638.6	1,500.3
– property, plant & equipment and investments	<b>366.1</b>	331.4	332.9	343.3	337.0
– net current assets/provisions/retirement benefit liabilities	<b>118.3</b>	(284.3)	159.4	(50.3)	(93.4)
Net borrowings	<b>(744.4)</b>	(791.4)	(729.0)	(836.8)	(884.9)
<b>Funds employed</b>	<b>1,486.0</b>	972.8	1,373.5	1,094.8	859.0
<b>Ratios</b>					
Headline operating profit: turnover (%)	<b>18.0</b>	18.2	18.2	17.8	15.7
Headline effective tax rate (%)	<b>26.5</b>	26.5	26.5	24.7	24.0*
Return on capital employed (%)	<b>16.6</b>	16.5	16.4	15.9	14.7*
Return on shareholders' funds (%)	<b>17.8</b>	18.3	17.7	18.4	16.5
<b>Cash-flow</b>					
Headline operating cash	<b>547.9</b>	548.6	488.7	564.8	435.0
Headline operating cash conversion (%)	<b>98</b>	99	95	115	104
Free cash-flow (before acquisitions and dividends, after capital expenditure)	<b>237.3</b>	217.0	236.1	331.3	256.1
Free cash-flow per share (p)	<b>60.3</b>	55.3	60.4	84.9	65.9
<b>Earnings per share</b>					
Headline earnings per share (p)	<b>92.7</b>	92.6	86.5	83.4	72.4*
<b>Dividends</b>					
Pence per share	<b>39.50</b>	38.00	36.25	34.00	34.00
Special dividend	<b>30.00</b>				
Headline dividend cover	<b>2.3</b>	2.4	2.4	2.5	2.1*
<b>Number of employees (000s)</b>					
United Kingdom	<b>1.9</b>	1.9	2.0	2.0	2.0
Overseas	<b>21.4</b>	21.3	20.9	21.6	19.8
	<b>23.3</b>	23.2	22.9	23.6	21.8

\*Headline effective tax rate, return on capital employed, headline earnings per share and headline dividend cover have been restated when the definition of headline profit was amended to exclude financing credits and charges relating to retirement benefits. Headline earnings per share for 2009 are calculated on the old basis.

# Independent auditors' report to the members of Smiths Group plc

We have audited the Parent Company financial statements of Smiths Group plc for the year ended 31 July 2013 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 2013;
- 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 2013.

### Martin Hodgson

#### (Senior Statutory Auditor)

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

17 September 2013

### 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 2013 £m	31 July 2012 £m
<b>Fixed assets</b>			
Tangible assets	2	<b>1.5</b>	2.8
Investments and advances	3	<b>3,884.4</b>	3,217.9
Available for sale financial assets	4	<b>83.0</b>	58.4
		<b>3,968.9</b>	3,279.1
<b>Current assets</b>			
Debtors			
– amounts falling due within one year	5	<b>56.2</b>	123.3
Cash at bank and on deposit		<b>172.9</b>	40.9
Financial derivatives			
– amounts falling due within one year		<b>2.3</b>	4.1
– amounts falling due after more than one year		<b>6.4</b>	7.2
		<b>237.8</b>	175.5
Creditors: amounts falling due within one year	6	<b>(254.3)</b>	(262.3)
<b>Net current liabilities</b>		<b>(16.5)</b>	(86.8)
<b>Total assets less current liabilities</b>		<b>3,952.4</b>	3,192.3
Creditors: amounts falling due after more than one year	6	<b>(949.6)</b>	(820.1)
Provisions for liabilities and charges	7	<b>(2.3)</b>	(2.6)
Financial derivatives		<b>(11.0)</b>	(0.4)
<b>Net assets excluding pension liabilities</b>		<b>2,989.5</b>	2,369.2
Retirement benefit liabilities	8	<b>(189.6)</b>	(330.2)
<b>Net assets including pension liabilities</b>		<b>2,799.9</b>	2,039.0
<b>Capital and reserves</b>			
Called up share capital	9	<b>147.7</b>	147.3
Share premium account	10	<b>340.8</b>	331.9
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>2,125.1</b>	1,373.5
<b>Shareholders' equity</b>		<b>2,799.9</b>	2,039.0

The accounts on pages 148 to 156 were approved by the Board of Directors on 17 September 2013 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 109 to 114 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.

## **Company accounting policies**

### **Continued**

#### **Post-retirement benefits**

The Company has both defined benefit and defined contribution plans.

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

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

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

#### **Share-based payment**

The Company operates a number of equity-settled and cash-settled share-based compensation plans.

The fair value of the shares or share options granted is recognised over the vesting period to reflect the value of the employee services received. The charge relating to grants to employees of the Company is recognised as an expense in the profit and loss account and the charge for grants to employees of other group companies is recognised as an investment in the relevant subsidiary.

The fair value of options granted, excluding the impact of any non-market vesting conditions, is calculated using established option pricing models, principally Binomial models. The probability of meeting non-market vesting conditions, which include profitability targets, is used to estimate the number of share options which are likely to vest.

For cash-settled share-based payment a liability is recognised based on the fair value of the payment earned by the balance sheet date. For equity-settled share-based payment the corresponding credit is recognised directly in reserves.

#### **Dividends**

Dividends are recognised as a liability in the period in which they are authorised. The interim dividend is recognised when it is paid and the final dividend is recognised when it has been approved by shareholders at the Annual General Meeting.

# Notes to the Company accounts

## 1 Audit fee

The audit fee for the parent company was £0.1m (2012: £0.1m).

## 2 Property, plant and equipment

	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
<b>Cost or valuation</b>			
At 31 July 2012	6.6	0.4	7.0
Disposals		(0.1)	(0.1)
<b>At 31 July 2013</b>	<b>6.6</b>	<b>0.3</b>	<b>6.9</b>
<b>Depreciation</b>			
At 31 July 2012	4.1	0.1	4.2
Charge for the period	1.2	0.1	1.3
Disposals		(0.1)	(0.1)
<b>At 31 July 2013</b>	<b>5.3</b>	<b>0.1</b>	<b>5.4</b>
<b>Net book value at 31 July 2013</b>	<b>1.3</b>	<b>0.2</b>	<b>1.5</b>
Net book value at 31 July 2012	2.5	0.3	2.8

## 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 2012	2,384.7	2,226.3	(1,370.2)	3,240.8
Exchange adjustments		53.4		53.4
Contribution through share options	6.7			6.7
Reduction in advances (due from)/due to subsidiaries		(455.0)	1,061.4	606.4
<b>At 31 July 2013</b>	<b>2,391.4</b>	<b>1,824.7</b>	<b>(308.8)</b>	<b>3,907.3</b>
<b>Provision for impairment</b>				
At 31 July 2012 and 31 July 2013	22.0	0.9		22.9
<b>Net book value at 31 July 2013</b>	<b>2,369.4</b>	<b>1,823.8</b>	<b>(308.8)</b>	<b>3,884.4</b>
Net book value at 31 July 2012	2,362.7	2,225.4	(1,370.2)	3,217.9

Loans due to subsidiaries are only offset against loans due from subsidiaries to the extent that there is a legal right of set off and an intention to settle the balances net. The Company has large offsetting loan balances because it uses loans to reduce its foreign currency exposures and separately monitor net cash generated from trading activities.

The Company's subsidiaries are largely held according to business lines by the following holding companies, which are incorporated in England:

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

## Notes to the Company accounts

Continued

### 3 Investments and advances continued

The principal subsidiaries and their countries of incorporation are:

#### England

Smiths Detection – Watford Ltd  
Smiths Medical International Limited  
John Crane UK Limited

#### Europe

Smiths Heimann SAS (France)  
Smiths Heimann GmbH (Germany)  
Smiths Medical France SA (France)  
Smiths Medical Deutschland GmbH (Germany)  
John Crane Italia SpA (Italy)

#### Other

Smiths Detection (Asia-Pacific) Pte Ltd (Singapore)  
Smiths Medical Japan Limited (Japan)  
John Crane Middle East FZE (UAE)

#### United States

Smiths Detection, Inc.  
Smiths Medical ASD, Inc.  
John Crane, Inc.  
Titeflex Corporation  
Flexible Technologies, Inc.  
Tutco, Inc.  
Hypertronics Corporation  
Transtector Systems, Inc.  
Interconnect Devices, Inc  
Power Distribution, Inc  
JC Production Solutions, Inc.

Of the companies above, Smiths Group International Holdings Limited is 100% owned directly by the Company. The others are 100% owned through intermediate holding companies. Shareholdings are of ordinary shares or common stock. All subsidiaries operate in their country of incorporation.

### 4 Available for sale financial assets

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

### 5 Debtors

	31 July 2013 £m	31 July 2012 £m
<b>Amounts falling due within one year</b>		
Amounts owed by subsidiaries	<b>52.2</b>	101.5
Other debtors	<b>4.0</b>	4.0
Corporation tax		12.0
Prepayments and accrued income		5.8
	<b>56.2</b>	123.3

### 6 Creditors

	31 July 2013 £m	31 July 2012 £m
<b>Amounts falling due within one year</b>		
Term loans	<b>164.5</b>	151.8
Amounts owed to subsidiaries	<b>61.5</b>	84.7
Other creditors	<b>19.7</b>	16.5
Other taxation and social security costs	<b>0.4</b>	0.4
Accruals and deferred income	<b>8.2</b>	8.9
	<b>254.3</b>	262.3

## 6 Creditors continued

	31 July 2013 £m	31 July 2012 £m
<b>Amounts falling due after more than one year</b>		
Term loans	<b>949.6</b>	820.1
	<b>949.6</b>	820.1

### Term loans

The currency and coupons for the term loans are disclosed in note 18 of the Group accounts.

	31 July 2013 £m	31 July 2012 £m
Less than one year	<b>164.5</b>	151.8
Between one and two years		159.1
Between two and three years	<b>149.6</b>	
Between three and four years	<b>267.5</b>	149.4
Between four and five years	<b>115.3</b>	241.4
Greater than five years	<b>417.2</b>	270.2
Smiths Group plc term loans	<b>1,114.1</b>	971.9

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 under the undrawn US\$800m multi-currency revolving credit facility, which matures in December 2015.

## 7 Provisions for liabilities and charges

	At 31 July 2012 £m	Provisions released £m	Utilisation £m	At 31 July 2013 £m
Disposals	2.6	0.3	2.3	2.3
	2.6	0.3	2.3	2.3

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 2013. 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 2013	31 July 2012
Rate of increase in salaries	<b>n/a</b>	n/a
Rate of increase for active deferred members	<b>4.3%</b>	3.7%
Rate of increase in pensions in payment	<b>3.4%</b>	2.8%
Rate of increase in deferred pensions	<b>3.4%</b>	2.8%
Discount rate	<b>4.4%</b>	4.1%
Inflation rate	<b>3.4%</b>	2.8%
Healthcare cost increases	<b>5.0%</b>	5.0%

The assumptions used are estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily occur in practice.

The mortality assumptions used are based on the recent actual mortality experience of members. The assumptions are based on the new SAPS All birth year tables with relevant scaling factors based on the experience of the schemes. The assumption also allows for future improvements in life expectancy in line with the 2012 CMI projections blended to a long term rate of 1.25%. The assumptions give the following:

Expected further years of life	UK	
	Male	Female
Member who retires next year at age 65	23	25
Member, currently 45, when they retire in 20 years time	25	27

## Notes to the Company accounts

Continued

### 8 Post-retirement benefits continued

The assets in the scheme and the expected rates of return as at 31 July 2013 were:

	31 July 2013	31 July 2012		
	Long-term rate of return	Value £m	Long-term rate of return	Value £m
Equities	<b>7.2%</b>	<b>903.6</b>	7.2%	720.0
Government bonds	<b>3.3%</b>	<b>5.4</b>	2.5%	4.9
Corporate bonds	<b>4.4%</b>	<b>273.7</b>	4.1%	81.3
Insured liabilities	<b>4.4%</b>	<b>30.1</b>		
Property	<b>6.8%</b>	<b>176.0</b>	6.8%	176.7
Other	<b>3.4%</b>	<b>192.1</b>	2.9%	430.0
Total market value		<b>1,580.9</b>		1,412.9
Present value of funded pension scheme liabilities		<b>(1,714.4)</b>		[1,687.8]
Deficit		<b>(133.5)</b>		[274.9]
Unfunded pension plans		<b>(48.3)</b>		[46.1]
Post-retirement healthcare		<b>(7.8)</b>		[9.2]
<b>Net retirement benefit liability</b>		<b>(189.6)</b>		[330.2]

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 2013 £m	31 July 2012 £m	31 July 2011 £m	31 July 2010 £m	31 July 2009 £m
Fair value of scheme assets	<b>1,580.9</b>	1,412.9	1,438.9	1,325.6	1,188.9
Present value of pension and post-retirement healthcare obligations	<b>(1,770.5)</b>	[1,743.1]	[1,587.6]	[1,489.9]	[1,382.6]
Net retirement benefit liability	<b>(189.6)</b>	[330.2]	[148.7]	[164.3]	[193.7]
Actual return less expected return on pension scheme assets	<b>126.6</b>	[87.5]	45.6	84.2	[180.9]
As a percentage of scheme assets	<b>8%</b>	[6%]	3%	6%	[15%]
Experience gains and losses arising on the scheme liabilities	<b>(4.8)</b>	78.9	[15.5]	7.1	98.4
As a percentage of present value scheme liabilities	<b>0%</b>	5%	[1%]	0%	7%

#### Changes in present value of scheme assets and defined benefit obligations

	Assets 31 July 2013 £m	Assets 31 July 2012 £m	Obligations 31 July 2013 £m	Obligations 31 July 2012 £m
At beginning of the period	<b>1,412.9</b>	1,438.9	<b>(1,743.1)</b>	[1,587.6]
Service cost			<b>0.5</b>	[0.1]
Expected return on assets	<b>76.6</b>	89.8		
Interest on obligations			<b>(70.0)</b>	[82.3]
Actuarial gain/(loss)	<b>126.6</b>	[87.5]	<b>(32.4)</b>	[140.4]
Contributions by employer	<b>39.3</b>	39.0		
Benefits paid	<b>(74.5)</b>	[67.3]	<b>74.5</b>	67.3
<b>At end of the period</b>	<b>1,580.9</b>	1,412.9	<b>(1,770.5)</b>	[1,743.1]

## 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 connect 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 2012	392,725,943	147.3	
Exercise of share options	1,092,567	0.4	9.3
<b>Total share capital at 31 July 2013</b>	<b>393,818,510</b>		<b>147.7</b>

At 31 July 2013 all of the issued share capital was in free issue. All issued shares are fully paid.

	31 July 2013	31 July 2012
Number of ordinary shares issuable under outstanding options	<b>1,973,719</b>	3,184,363

	Year issued	Number of shares	Subscription prices	Dates normally exercisable
Smiths Sharesave Scheme	2006	13,534	798.00p	2009/2013
	2007	9,749	868.00p	2010/2014
	2008	44,372	724.00p	2011/2015
	2009	169,219	569.00p	2012/2016
	2010	87,784	894.00p	2013/2017
	2011	74,573	1035.00p	2014/2018
	2012	242,823	811.00p	2015/2019
	2013	147,682	1008.00p	2016/2020
Smiths Industries Executive Share Option Schemes	2003	6,844	669.00p	2006/2013
	2004	147,786	774.00p	2007/2014
	2005	158,602	901.00p	2008/2015
	2006	307,537	896.50p	2009/2016
	2007	436,923	1,097.00p	2010/2017
	2009	126,291	871.00p	2012/2019

## Notes to the Company accounts

**Continued**

### 10 Share premium account and reserves

	Share premium £m	Capital redemption reserve £m	Other reserves £m	Profit and loss account £m
At 31 July 2012	331.9	5.8	180.5	1,373.5
Exercise of share options	8.9			
Purchase of own shares				(11.0)
Profit for the period				808.8
Dividends paid to equity shareholders				(152.4)
Actuarial gain on retirement benefits				94.2
Fair value losses on available for sale financial assets				(0.1)
Share-based payment				12.1
<b>At 31 July 2013</b>	<b>340.8</b>	<b>5.8</b>	<b>180.5</b>	<b>2,125.1</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 £11.0m (2012: £9.7m) and £nil (2012: £nil) was received as a result of the issue of shares. At 31 July 2013 the Trust held 855 (2012: 855) ordinary shares.

The Company's profit and loss reserve of £2,125.1m includes £895.7m (2012: £923.6m) not available for distribution as dividend.

During the year, the Company received £9.3m (2012: £3.0m) on the issue of shares in respect of the exercise of options awarded under various share option schemes.

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

### 11 Deferred tax

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
<b>Deferred taxation</b>		
At beginning of period		31.8
Charge to profit and loss account		(31.8)
Credit to equity		
At end of period		

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 2013 the Company has unrecognised deferred tax assets of £90.0m (2012: £127.9m) relating to:

- retirement benefit obligations £36.5m (2012: £76.9m)
- losses carried forward £49.9m (2012: £47.1m);
- share based payments £2.0m (2012: £2.4m); and
- other timing differences £1.6m (2012: £1.5m).

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 £52.1m (2012: £49.5m).

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 27.0p per share (totalling approximately £106.3m) for the year ended 31 July 2013. The dividend will be submitted for formal approval at the Annual General Meeting to be held on 19 November 2013. On 17 September 2013, the Board also recommended a special dividend of 30.0p per share. Subject to approval by the shareholders, the special dividend will be paid with the final dividend for the year.

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 2014. During the year ended 31 July 2013, a final dividend of 26.25p per share (totalling £103.2m) was paid in respect of the dividend declared for the year ended 31 July 2012.

# Financial calendar

	2013
Preliminary announcement of results for 2012/13	18 September
Ordinary shares final dividend ex-dividend date	23 October
Ordinary shares final dividend record date	25 October
Annual General Meeting	19 November
Ordinary shares final dividend payment date	22 November

	2014
2013/14 interim results announced	19 March (provisional)
Ordinary shares interim dividend ex-dividend date	26 March (provisional)
Ordinary shares interim dividend record date	28 March (provisional)
Ordinary shares interim dividend payment date	25 April (provisional)
Smiths Group financial year end	31 July
Preliminary announcement of results for 2013/14	17 September (provisional)
Ordinary shares final dividend ex-dividend date	22 October (provisional)
Ordinary shares final dividend record date	24 October (provisional)
Annual General Meeting	18 November (provisional)
Ordinary shares final dividend payment date	21 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 2013 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 19 November 2013 at 9:30am.

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## Auditor

PricewaterhouseCoopers LLP

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