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News release

London, Wednesday 20 March 2013
For immediate release

Interim results for the six months ended 31 January 2013

	Headline*				Statutory	
	2013 £m	2012 £m	Growth	Underlying#	**2013 £m**	2012 £m
Revenue	**1,475**	1,415	4%	6%	**1,475**	1,407
Operating profit	**253**	244	4%	5%	**215**	132
Operating margin	**17.1%**	17.2%	(10) bps	–	**14.6%**	9.4%
Pre-tax profit	**223**	217	3%	6%	**188**	111
Basic EPS	**40.9p**	40.4p	1%		**35.8p**	21.4p
Free cash-flow	**71**	81				
Dividend	**12.50p**	11.75p	6%		**12.50p**	11.75p
Return on capital employed	**16.7%**	16.0%	70 bps			

*In addition to statutory reporting, Smiths Group reports its continuing operations on a headline basis. Headline revenue and profit is before exceptional items, amortisation and impairment of acquired intangible assets, profit/loss on disposal of businesses, costs of acquisitions, pension finance credit and financing gains/losses from currency hedging. Free cash-flow and return on capital employed are described in the Financial review.

#Organic growth at constant currency.

Highlights

- Underlying headline revenue up 6%; growth across all divisions
- Headline operating profit 5% higher, margin affected by increased growth investment
- Company-funded investment in new product development up 8% to £54m
- Emerging market revenue up 9%; representing 15% of Group revenues
- Improved headline operating cash conversion at 88%
- Dividend up 6%; reflecting strong cash conversion in the period

“Smiths Group has continued to make good progress with underlying revenue growth across all its businesses. Headline margins rose in all divisions except Smiths Medical where, as part of our growth strategy, we have significantly increased our investment in sales and marketing in emerging markets and new product development. We delivered improved cash conversion and return on capital against last year.

“Our priority is driving operational improvements and efficiencies across our businesses while increasing our investment in high growth markets and new product development to accelerate medium-term revenue growth.

“Looking to the second half, we see tough trading conditions as a result of the US medical device tax, slower demand in some parts of John Crane, and the impact of further government budget cuts. However, despite these challenges, there remain significant opportunities to generate value for shareholders over the medium term. We will continue to focus on investing to drive sales growth, and delivering further operational improvements, while maintaining strong cash conversion and improved returns.”

Philip Bowman
Chief Executive

Divisional highlights*

	% of Group headline revenue	Underlying headline revenue growth*	Underlying headline operating profit growth*	Headline operating profit margin		Return on capital employed	
				2013	2012	**2013**	2012
John Crane	32%	**3%**	**7%**	**21.8%**	20.9%	**24.3%**	23.8%
Smiths Medical	28%	**2%**	**(10)%**	**21.1%**	23.5%	**16.9%**	17.3%
Smiths Detection	17%	**19%**	**56%**	**12.0%**	9.3%	**12.2%**	7.6%
Smiths Interconnect	15%	**4%**	**13%**	**13.5%**	13.1%	**12.3%**	12.8%
Flex-Tek	8%	**11%**	**20%**	**16.7%**	15.5%	**29.8%**	25.1%
Group	100%	**6%**	**5%**	**17.1%**	17.2%	**16.7%**	16.0%

John Crane

- Revenue up 3% driven by both original equipment and aftermarket revenue
- Demand from first-fit OEM customers has slowed, particularly turbo machinery and general industrial applications
- Margins improved 90 basis points to 21.8%, while increasing investment in future growth drivers
- Order book points to a slower growth rate with a similar level of sales in the second half as prior period last year

Smiths Medical

- Revenue up 2% driven by growth in emerging markets (up 12%) while developed markets remain challenging
- Extra £10m investment in strategic growth initiatives: emerging markets and new product development (up 16%)
- New product pipeline: e.g. CADD-Solis VIP cleared by FDA in February for sale in USA
- Despite continued focus on cost savings, profitability expected to be lower with investment and US device tax

Smiths Detection

- Revenue up 19% as transportation and ports and borders lead recovery momentum
- Margins up 270 basis points on higher volumes and cost savings
- Strong batch of new products: including Hi-Scan 10080 XCT scanner, and CIP-300 car screener
- Targeting a similar level of sales in the second half as the same strong period last year, with improving margins

Smiths Interconnect

- Revenue up 4% against a weak comparator period
- Delivering growth in Connectors and Microwave, partially offset by weak demand in Power
- Margins up 40 basis points with better volumes and restructuring efficiencies
- Markets remain challenging, particularly for US defence customers affected by sequestration

Flex-Tek

- Revenue up 11% driven mainly by aerospace and US residential construction
- Margins continued to improve, helped by better volumes, mix and pricing.
- Aerospace and revival in US construction should support continued sales growth
- Margins are geared to volume improvements across Flex-Tek's end markets

**All figures are on a headline basis. Revenue and profit growth are at constant currency and exclude the impact of acquisitions and disposals*

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Presentation

The presentation slides and a live webcast of the presentation to analysts are available at www.smiths.com/results at 09.00 (UK time) on Wednesday 20 March. A recording of the webcast is available later that day. A live audio broadcast of the presentation is also available by dialling (no access code required):

UK toll free: 0808 237 0030

International: +44 (0)20 3139 4830

US/Canada toll free: 1 866 928 7517

Access code: 40110528#

An audio replay is available for seven days on the following numbers (access PIN 636069#):

UK toll free: 0808 237 0026

International: +44 (0)20 3426 2807

US/Canada toll free: 1 866 535 8030

Photography

Original high-resolution photography and broadcast quality video is available to the media from the media contacts above or from http://www.smiths.com/images.aspx.

Statutory reporting

Statutory reporting takes account of all items excluded from headline performance. On a statutory basis, pre-tax profit from continuing operations was £188m (2012: £111m) and earnings per share were 35.8p (2012: 21.4p).

The items excluded from headline performance comprise:

- amortisation of acquired intangible assets of £23m (2012: £25m);
- £11m in connection with John Crane, Inc. asbestos litigation (2012: £18m);
- £3m in connection with Titeflex Corporation litigation (2012: £52m);
- £5m of exceptional restructuring costs (2012: £12m);
- £1m of gains on changes to pension plans (2012: £nil);
- £1m profit on disposal of businesses (2012: £1m);
- £6m for retirement benefit finance income (2012: £11m); and
- financing losses of £1m (2012: £1m)

In the period to 28 January 2012, in addition to the above, acquisition costs of £2m and an £8m charge in relation to a change in the basis of estimating sales rebates in Smiths Medical were also excluded from headline performance.

Chief Executive's review

Results overview

Smiths Group has delivered a good performance against a challenging economic environment. Our priority is to drive operational improvements and efficiencies across our businesses while increasing our investment in high growth markets and new product development to accelerate medium-term revenue growth.

We achieved improvements on safety and environmental metrics and on sales, profit, cash and return on capital. Our strategic initiatives to accelerate revenue growth have increased revenue across all five divisions. Headline operating profit margins improved in all but Smiths Medical where an additional £10m was spent on increasing sales and marketing in emerging markets and on new product development.

John Crane grew revenue on continued demand from both first-fit OEM and aftermarket customers, particularly in the oil and gas sector. However, the overall rate of growth slowed between the first and second quarters as demand fell from OEM customers in the turbo-machinery and general industrial areas. Margins reached record highs because of better volumes and pricing, more than offsetting cost inflation and investment in growth opportunities. Smiths Medical grew revenues 2% − driven by an emerging markets increase of 12% − despite weak demand in developed markets, particularly Europe. Margins declined while we substantially increased investment in the future growth drivers of new product development and sales and marketing. Smiths Detection started the year strongly in both sales and profit, against a weak comparator period. Growth was generated by demand from airports and cargo inspection and good progress was made in growing its aftermarket service offering. The performance improvement programme, announced last year, also delivered cost savings and operational enhancements. Smiths Interconnect also saw a relatively strong first half against a weak performance last year, reflecting growth in its microwave and connectors businesses which offset declines in its power business. Margins benefited from better volumes and cost saving initiatives. Flex-Tek delivered strong revenue across the aerospace and construction markets, generating higher margins as a result of its strong operational gearing.

Strategy

Our strategy is to continue to grow shareholder value by:

- Delivering sales growth through investment in organic drivers including new product development and expansion in high growth markets
- Enhancing margins through a relentless drive for operational improvement across all our businesses
- Generating strong cash-flows with better balance sheet management
- Implementing a rigorous approach to allocating capital across the businesses through active and disciplined portfolio management and a targeted acquisition strategy
- Improving returns on capital.

We made continued progress towards these objectives and some examples from the period are set out below. Clear opportunities remain, however, for Smiths Group to improve performance progressively and generate further value for shareholders.

Investing to accelerate revenue growth – new products

Our technology leadership in many areas is the result of a consistent commitment to new product development and innovation. This is key to driving future revenue and margin growth as new products typically command higher margins. We raised company-funded investment in R&D by 8% to £54m and secured a further £5m of customer-funded investment to take our total spend to £59m, or 4.0% of revenue (2012: 3.9%). This long-term investment is delivering results with several important new product launches. The FDA gave Smiths Medical clearance for US sales of its CADD Solis VIP platform which has already proved successful in international markets.

Smiths Detection unveiled the CIP-300, a new, low-energy X-ray scanner specifically designed for the fast and efficient screening of cars and light vehicles. Its revolutionary XCT checked baggage screener, already certified by the EU, is currently being evaluated by the US authorities. It uses multi-view X-ray and three-dimensional computed tomography for enhanced detection and throughput capabilities.

John Crane has introduced a high-temperature Fiberod for use in upstream oil production where customers operate at extreme 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 public mobile phone signals interfering with vital train network communications

Investing to accelerate revenue growth – high-growth markets

We expanded our presence in emerging markets, a 9% increase in revenue so that their share now represents around 15% of Group sales. Investment in these high growth regions remains a priority as part of an investment strategy to enhance the Group's profile to these markets over the medium term. We recognise that it takes time to establish a local sales presence through recruitment, training and brand building. In addition, there may also be product registration processes to overcome in many markets. However, we believe that this the right strategy for the Group to accelerate its growth profile and generate improved returns in the medium term. For example, in Smiths Medical, we expanded 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 exposure to high growth markets.

Operational improvements to improve margins and invest in growth

Margins have continued to benefit from a sustained focus across all businesses on operational efficiencies and cost savings. In some businesses, such as Smiths Medical, John Crane and Smiths Interconnect, this is a programme of continuous improvement. In Smiths Detection, we launched a performance improvement programme in 2011 to transform the cost base. We have continued to make good progress with a further £4m of savings generated in the period, bringing total savings to date to £19m. We expect to deliver another £5m of savings in the second half. We have also revisited the timescales and are now expecting to deliver £36m of annual savings at a cost of £33m by the end of financial year 2015. This compares with the original targeted savings of £40m by the end of financial year 2014 at a cost of £40m. This will lower the fixed cost base and enable the business to respond better to variations in demand while improving customer service.

Enhancing talent throughout the organisation

The success of our strategic initiatives is greatly dependent on having the talent in place to deliver the desired results. Our processes to foster and retain the necessary skills have been reinforced at all levels across the Group. Duncan Gillis, widely experienced in a range of sectors and blue chip companies, was recruited to take John Crane into the next phase of its development. Mark Reckitt, Group Strategy Director since 2011, is now overseeing the restructuring of Smiths Interconnect into a more clearly defined three-technology based business. At both senior and junior management levels leadership programmes have been refreshed as we work ever harder to ensure that the appropriate competencies needed to strengthen the organisation are in place across the Group.

Dividend

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

The Board has declared an interim dividend of 12.50p per share, an increase of 6% reflecting the strong cash conversion in the period. The interim dividend will be paid on 26 April to shareholders registered at the close of business on 2 April. The ex-dividend date is 27 March.

Outlook

Our priority is driving operational improvements and efficiencies across our businesses while increasing our investment in high growth markets and new product development to accelerate medium-term revenue growth.

Looking to the second half, we see tough trading conditions as a result of the US medical device tax, slower demand in some parts of John Crane, and the risk of further government budget cuts. However, despite these challenges, there remain significant opportunities to generate value for shareholders over the medium term. We will continue to focus on investing to drive sales growth, and delivering further operational improvements, while maintaining strong cash conversion and improved returns.

Business review

Revenue

Headline revenue increased by 6%, or £78m, on an underlying basis to £1,475m. The benefit of acquisitions contributed £15m, which was more than offset by adverse currency translation of £33m. On a reported basis, including currency translation and acquisitions, headline revenue grew £60m. The £78m underlying increase was achieved by revenue growth across all five divisions: Detection (up £41m), Flex-Tek (up £12m), John Crane (up £12m), Smiths Interconnect (up £7m) and Smiths Medical (up £6m). As a consequence of a decision to align the reporting period for first half results to 31 January, these results benefited from two additional trading days compared with the equivalent reporting period last year. Furthermore, the second half will have two fewer trading days compared with the prior year.

Profit

Headline operating profit rose £9m to £253m. Headline operating margin fell slightly to 17.1% (2012: 17.2%) reflecting the additional investment in strategic growth initiatives in Smiths Medical. These have focused on adding sales and marketing resources in high growth markets and on new product development. The growth comprises a £13m, or 5%, underlying increase in headline operating profit, a £1m benefit from the net impact of acquisitions, offset by £5m of unfavourable currency translation. The main drivers of this £13m underlying improvement were higher volumes and cost savings at Smiths Detection (up £11m), increased volumes and pricing at John Crane (up £6m), better volumes and cost savings at Smiths Interconnect (up £3m), increased volumes at Flex-Tek (up £3m), partly offset by additional spend on strategic growth initiatives at Smiths Medical (down £9m). Corporate centre costs were up £1m on last year.

Operating profit on a statutory basis, after taking account of the items excluded from the headline figures, was £215m (2012: £132m). The increase was in large part a result of reduced exceptional costs (see note 4).

The net interest charge on debt was down slightly at £30m (2012: £31m). Following the disposal of our equity interest in Cross Match Technologies Inc. last July, the contribution from associates was zero (2012: £4m). Headline profit before tax increased by £6m to £223m (2012: £217m). On an underlying basis, headline profit before tax grew by 6%.

The Group's tax rate on headline profit for the period was 27.5% (2012: 26.5%). Headline earnings per share increased by 1% to 40.9p (2012: 40.4p).

On a statutory basis, profit before tax increased £77m to £188m (2012: £111m); it is stated after taking account of the lower exceptional costs referred to above, a pensions finance credit of £6m (2012: £11m) and other items excluded from the headline measure.

Cash generation

Operating cash generation remained strong with headline operating cash of £223m (2012: £201m), representing 88% (2012: 82%) of headline operating profit (see note 14 to the accounts for a reconciliation of headline operating cash and free cash-flow to statutory cash-flow measures). Free cash-flow fell £10m to £71m (2012: £81m). 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 £120m (2012: £133m).

Dividends paid in the period on ordinary shares amounted to £103m (2012: £98m).

Net debt at 31 January was £855m, up from £791m at 31 July 2012. The increase in net debt reflects strong cash generation that was more than offset by outflows from dividends (£103m) and pension funding (£41m).

In October, the Group closed a US$400 million dollar-denominated bond offering with a 10-year maturity and a fixed coupon of 3.625%. This financed the repayment of the private placement of US$250m at 5.45% in January 2013.

John Crane

	2013 £m	2012 £m	Reported growth	Underlying growth
Revenue	**469**	469	0%	3%
Headline operating profit	**102**	98	4%	7%
Headline operating margin	**21.8%**	20.9%	90 bps	
Statutory operating profit	**87**	75		
Return on capital employed	**24.3%**	23.8%	50 bps	

John Crane posted solid results with underlying revenue up £12m, or 3%, excluding unfavourable exchange translation and acquisitions. Higher aftermarket and first-fit original equipment revenue drove the underlying growth, fuelled primarily by the oil & gas, and chemical sectors. There was a £1m benefit from the acquisition of the business of Turbo Components and Engineering Inc. (TCE). Adverse currency translation of £13m, predominantly from a weaker Euro, offset the underlying growth and the benefit from acquisitions to leave reported revenue flat.

Reported headline operating profit rose 4%, driven by a £6m (7%) increase in underlying profit but partially offset by adverse currency translation of £2m. Headline operating margin increased 90 basis points to 21.8%. The underlying improvement in profitability stems largely from increased volumes, productivity initiatives, and better pricing in aftermarket sales. Margins improved despite increased investment in highly competitive first-fit original equipment projects and higher spend in sales, marketing and new product development. We believe such investment will provide a solid platform for mid-term growth in our key end markets. Return on capital employed improved 50 basis points to 24.3% because of improved profitability.

Statutory operating profit at £87m reflects the cost of John Crane, Inc. asbestos litigation, a gain on changes to pension plans and amortisation of acquired intangible assets.

Overall aftermarket revenue grew 4% on an underlying basis, stemming mainly from rotating equipment (seals, seal support systems, couplings, bearings and filtration, together representing about 90% of revenue) which offset a weaker performance from John Crane Production Solutions (JCPS). We have seen continued growth in midstream pipeline expansion projects resulting from the increased oil shale activity in North America. Underlying sales in first-fit original equipment rose a modest 1% as customer investments in new capital projects slowed.

In response to a growing range of market demands and local service infrastructure needs, new service centres opened in Busan, South Korea, and Georgia, USA. High-growth emerging markets now represent over 21% of John Crane sales, with steady expansion in these markets expected to continue.

Research and development

John Crane increased investment in new product development and engineering by 16%, in line with previously announced targets, reflecting our commitment to developing new products that will support future growth. The company's focus remains on developing engineered solutions that address customers' growing processing demands while supporting reduced environmental impact and energy efficiency.

John Crane is at the forefront of ultra-high pressure designs that can meet the increasing demands of compression equipment and new markets, including subsea applications. To advance its forensics and design capabilities further, John Crane has invested in an infrared spectroscopy system that provides advanced materials analysis. This enhanced capability is essential for diagnosing the root cause of equipment failure and is a key enabler to our research and development activities.

JCPS has introduced a high-temperature fibreglass sucker rod used for upstream oil production in shale fields where customers operate in extreme high temperatures. The high-temperature Fiberod provides an energy efficient option for use in difficult conditions, where heavy and more costly pumping units were previously needed.

Business developments

Several significant commercial developments in the first half are expected to contribute to the long-term strength of the business. For example, a global, five-year enterprise framework agreement has been signed with Shell for John Crane to supply mechanical seals and seal support systems used in Shell's global operations. The accord allows John Crane to accelerate growth in all segments of the oil & gas market. In addition, JCPS entered into a four-year contract extension to support OMV Petrom's oil extraction operations across Romania.

A review of the company's business strategy is underway to examine ways to reorganise the business with the aim of improving customer service, exploring areas for organic growth through new product development, lowering costs and value creation through further targeted acquisitions. We expect to give more details on the outcome of this review at a capital markets day in December 2013.

Outlook

Although John Crane's order book has continued to grow, we expect underlying revenue in the second half at similar levels to the equivalent period last year as our first-fit original equipment customers remain cautious about the immediate future. Full-year revenue growth is consequently likely to be muted. Thereafter we expect the market to improve slowly and the benefits of our strategic investments in longer-term growth opportunities and in high-growth markets should start to bear fruit. Margins should continue to benefit from productivity efforts, despite these current investments in longer-term growth.

Smiths Medical

	2013 £m	2012 £m	Reported growth	Underlying growth
Headline revenue	**413**	417	(1)%	2%
Headline operating profit	**87**	98	(11)%	(10)%
Headline operating margin	**21.1%**	23.5%	(240) bps	
Statutory revenue	**413**	409	1%	
Statutory operating profit	**82**	82		
Return on capital employed	**16.9%**	17.3%	(40) bps	

Smiths Medical delivered underlying headline revenue growth of 2%, or £6m, helped by our planned acceleration into emerging markets and continued strength in consumables. Reported headline revenue declined 1% reflecting a £10m impact from adverse currency translation. The underlying growth was achieved despite difficult trading conditions in the developed market medical devices sector, given adverse pricing, capital spending constraints and relatively flat procedure growth rates. These pressures were particularly acute in Europe with the prevailing austerity measures and economic uncertainty. Underlying sales of consumables, which represent almost 85% of our total revenue, were up 2%, despite some distributor destocking and a £2m decline from product areas such as veterinary, kitting and interventional imaging, where we continue to focus on more profitable product lines. Hardware sales improved 1%, driven by modest growth in temperature management and infusion systems, constrained partly by patient monitoring declines and flat ambulatory infusion sales.

Headline operating profit declined 11% and headline operating margin decreased 240 basis points to 21.1%. This decline reflects a £10m incremental investment in our strategic growth initiatives, including emerging market expansion and new product development. We also experienced additional costs to meet the EU regulations for Registration, Evaluation, Authorisation & restriction of Chemicals (REACH) and Restriction of Hazardous Substances Directive (RoHS) and the 2.3% US medical device excise tax that took effect on 1 January, 2013, The medical device tax is expected to cost about £4m in the current financial year and £8m annually. We aim to offset the medical device tax impact by focusing on higher margin products, continuing productivity efforts and driving further operational efficiencies.

Return on capital employed declined 40 basis points to 16.9% as a result of the lower profits.

Sales of safety devices were flat, with 4% growth in sharps safety devices offset by declines in Peripheral Intravenous Catheter (PIVC) and vascular access sales. However, with the emphasis on provider and patient safety, interest in both safety needle and catheter products remains high in developed markets and is growing in emerging markets. In the period, we launched two innovative PIVC devices, ViaValve and Jelco IntuitIV. The US launch of our new blood control safety PIVC device, ViaValve, has seen very positive customer reviews and robust early demand. In Europe, the Jelco IntuitIV safety catheter is well placed to benefit from the EU Directive, adopted in 2010 and effective in 2013, to improve workplace safety by preventing sharps injuries.

Medication delivery underlying sales (excluding diabetes) were slightly positive, with modest hardware growth and flat disposables sales. Following a strong second half performance last year, sales of our new Medfusion 4000 wireless syringe pump have been slower in the first half as capital budgets have been under pressure. We believe that our Medfusion 4000 pipeline is well positioned for growth. Ambulatory infusion sales were flat, primarily due to the delayed FDA clearance of the CADD-Solis VIP pump and a sales slowdown in CADD-Solis in the US, given continued capital budget constraints in the acute care sector. The CADD-Solis VIP pump received FDA clearance in February 2013, providing growth opportunities for this innovative product, particularly in the alternate site channel.

Vital care underlying sales improved 4% despite continued sluggish procedure volumes and pricing pressures in developed countries. The assisted reproduction business grew strongly while the general anaesthesia, invasive blood pressure monitoring, respiratory, tracheostomy, and patient monitoring businesses all contributed positive growth. These gains were offset by declines in veterinary, kitting and interventional imaging product lines, given our focus on more profitable product lines.

While developed markets remain challenging, emerging markets continue to provide growth opportunities. We began accelerating investment and presence in these markets during last year, and have continued during the first half having now added almost 300 commercial and support staff into China, Brazil, India, and various Southeast Asia and Middle East markets over the past 18 months. We are beginning to see some initial fruits of this strategy, with 12% emerging market sales growth in the first half. This includes strong growth in China (17%) and Brazil (18%). Emerging markets now represent 11% of sales, up from 10% in the prior period. The pace of executing this strategy is constrained by the lengthy product registration process in some markets and the time taken to recruit and train staff. However, we anticipate accelerated growth in subsequent years as our expansion plans continue to gain traction.

Research and development

Investment in R&D remains a priority. Our total first half R&D cash spend of £18m (2012: £16m) grew 16% and amounted to 4.4% of sales (2012: 3.8%). At the same time, we have continued our initiative to streamline the organisation, upgrade talent, and improve processes. We also continue to invest in emerging market R&D, expanding our product development team in Shanghai by more than 20% this year. We have also further invested in clinical research to drive efficacy and economic benefits for our products, as customers increasingly demand evidence of performance and value.

We continue to see sales traction with our Graseby 2000/2100 syringe pumps in emerging markets and the CADD-Solis VIP pump in Europe. The pipeline for Medfusion 4000, the recent clearance of the CADD-Solis VIP, and the Jelco IntuitIV and ViaValve launches leave us well positioned for accelerated new product sales. In addition to new launches, we are also extending the penetration of existing products into new regions, broadening our offering particularly in emerging markets.

Outlook

Developed markets are likely to remain challenging in the short term, but our pipeline of innovative products, broad portfolio offering, and increasing success in emerging markets is expected to drive sales growth. While we will continue to seek cost saving initiatives and operational enhancements, we expect profitability will be lower this year as a result of the US medical device excise tax, pricing pressure, and the increased investment in new product development and emerging market sales as we position the business for future growth.

Smiths Detection

	2013 £m	2012 £m	Reported growth	Underlying growth
Revenue	**255**	220	+16%	+19%
Headline operating profit	**31**	20	+49%	+56%
Headline operating margin	**12.0%**	9.3%	270 bps	
Statutory operating profit	**26**	9		
Return on capital employed	**12.2%**	7.6%	460 bps	

Revenue at Smiths Detection rose 19% (£41m) on an underlying basis, excluding a £6m impact from adverse currency translation. Reported sales grew 16%. The increase in underlying revenue was driven by growth in the transportation and ports and borders markets, partially offset by declines in critical infrastructure.

Greater focus on servicing the installed base of our equipment is also providing growth opportunities with a 5% increase in aftermarket sales in the first half. We have scaled up our investment in customer and distributor training which is leading to fewer service interventions and better customer service. The aftermarket area is well-positioned for future growth in line with our strategic plans.

Headline operating margins improved 270 basis points to 12.0% as headline operating profit rose £11m or 56% on an underlying basis. The increase was driven by the higher volumes and cost savings delivered by the performance improvement programme. Announced in 2011, this programme generated savings of £4m in the period as well the year-on-year benefit of £3m from restructuring costs that were not repeated. At the same time, we increased spend on sales and marketing and incurred one-off costs of £5m relating to additional restructuring and some legal costs for intellectual property case litigation.

The performance improvement programme has delivered site rationalisation and headcount reduction, notably in North America, with the relocation of the US HQ to Edgewood, Maryland, and most recently the closure of a Canadian sales and service site. A restructuring plan has been agreed with the workers council at the X-ray manufacturing site in Wiesbaden, Germany. This will result in a workforce cut of around 170 by the end of 2014. Wiesbaden will remain a major production centre, chiefly serving the European markets, and will continue as the R&D centre of excellence for X-ray technology. Our global development strategy to create a flexible manufacturing base, where customer proximity provides a major competitive advantage, has made significant progress during the first half. Our new manufacturing facility in Johor Bahru, Malaysia, is now supplying X-ray units to the Asia Pacific region. Plans are underway to leverage the shorter delivery time for X-ray customers throughout Asia Pacific. The performance improvement programme has delivered savings to date of £19m and is expected to generate overall savings of £36m at a cost of £33m by the end of financial year 2015. This compares with the original programme of £40m of savings for a cost of £40m by the end of financial year 2014. The timeframe and benefits have been reviewed as we experienced delays in implementing the changes in Western Europe and in increasing the production volumes in the new and expanded facilities in the USA and Asia. We expect to deliver £5m of savings in the second half.

Value engineering projects are being widely adopted and a close focus on daily operating expenditure is delivering savings. Furthermore a new operations team has been set up specifically to target quality and delivery as well as increased integration between contracts, sales and programmes. This is designed to deliver margin improvements across all product lines.

Transportation sales increased 40% due to the timing of several major airport projects, the largest being the delivery of X-ray and trace detection units to the new Doha International Airport project in Qatar which will continue into 2014. The US Transportation Security Administration placed a large follow-on order for the IONSCAN 500DT trace detectors for delivery during the current financial year. Our new HI-SCAN 10080 XCT automatic explosives scanner for checked baggage, developed in conjunction with Analogic, passed EU Standard 3 tests that will be required for all new airport applications from September 2014. The XCT is currently undergoing laboratory testing with the TSA. This new technology will offer airport customers a significant increase in baggage handling capacity, as well as a reduction in the overall lifecycle costs.

Revenue from critical infrastructure fell 22%, primarily due to the uncertainty generated around the US Federal Government's budget negotiations and the "fiscal cliff". However, this market still shows considerable long term growth opportunities and our product portfolio and sales force deployment have been optimised to take advantage of the potential development in this market over the next few years.

Underlying sales in ports and borders grew 41%. This has been driven by the delivery of a programme to improve security at 21 Brazilian ports. Market prospects remain strong; we recently announced a €19m order from Italian Customs for cargo scanners to secure six Italian ports and customer enquiry levels are generally high. There is also growing confidence in the outlook in emerging markets which are increasingly recognising the revenue-earning opportunities for more efficient tax collection and improved border security.

Underlying military sales grew 14% reflecting the continuation of major contracts and the acceptance of some of our major US military programmes. An additional order of $21m was received from the US DOD for the latest JCAD (Joint Chemical Agent Detector) our principal long-running military contract. Activity in major programmes for integrated systems remains at encouraging levels. At the start of the period, the US Navy announced the award of an additional $7.9m contract for our mobile weather information systems which support mission planning and military operations. We also started delivering the Chemical Biological Protection System mobile shelter to the US Army, which will provide a steady revenue stream into 2014, under current contracts.

Research and development

Smiths Detection remains committed to the development of its principal technologies and new products and systems, the great majority funded and managed internally. Company funded R&D was maintained at £17m although it decreased as a percentage of sales to 6.6% (2012: 7.6%). Smiths Detection actively seeks customer and government support for R&D which totalled £3m or 1.4% of sales in the period (2012: £3m). Total R&D spend was £20m (2012: £20m) or 8.0% of sales.

We are continuing to focus on bringing innovative products to the market. The CIP-300 is a new, low energy X-ray scanner specifically designed for the fast and efficient screening of cars and light vehicles. It will identify explosives, narcotics and contraband at border crossings or access points to any high security area.

The GUARDION high-resolution gas chromatography and miniaturised toroidal ion trap mass spectrometer, launched on to the market during last year, has now secured its first orders and is generating positive levels of interest amongst military and emergency responder teams.

Outlook

We are targeting a similar level of sales in the second half as the very strong equivalent period last year, subject to the timing of orders progressing as expected and the impact of any Government budget cuts. The future order book remains healthy and will benefit from an increased emphasis on higher margin contracts and a longer term focus on pipeline management and growing aftermarket revenues. Headline operating margins will benefit from our restructuring initiatives partially offset by greater investment in sales and marketing capabilities. New product launches will open up opportunities for new technologies while expansion in emerging markets will boost revenues and help reduce reliance on western economies which are experiencing only a slow return to growth.

Smiths Interconnect

	2013 £m	2012 £m	Reported growth	Underlying growth
Sales	**218**	200	9%	4%
Headline operating profit	**30**	26	13%	13%
Headline operating margin	**13.5%**	13.1%	40 bps	
Statutory operating profit	**20**	16		
Return on capital employed	**12.3%**	12.8%	(50) bps	

Reported sales for Smiths Interconnect grew 9%, or £18m. Underlying sales rose £7m against a weak comparator period with strong growth in Connectors and Microwave, partially offset by a weaker performance in Power. Acquisitions contributed £14m and there was a negative currency translation impact of £3m.

Across all three business units, we have continued to focus resources and investment on markets, customers and programmes that provide the best growth opportunities. This has led to a shift towards commercial customers − those operating in non-government funded markets − and more exposure to emerging geographies. The proportion of total first half revenues to commercial customers has increased from around one half to two thirds over the last three years. Emerging market revenues have grown by over a quarter in the last two years. Interconnect continues to drive incremental cost management actions such as procurement initiatives, automation, production process improvements and back office consolidation.

Reported headline operating profit increased 13%, or £4m. Excluding a £1m benefit from acquisitions, underlying headline operating profit increased £3m. Margins improved 40 basis points to 13.5%, despite a dilution impact of 70 basis points due to the lower relative margins at PDI. Return on capital employed reduced by 50 basis points due to acquisitions (-240 bps) offsetting the underlying improvement (+190 bps).

In Connectors, underlying sales rose 7% over a weak prior year on the back of a significant recovery in demand from medical customers and strong growth in commercial aerospace and space applications. The business maintained its focus on introducing new technically differentiated products with a number of notable successes. Two new medical projects demonstrated the value in combining our core connector technologies. One packages high speed fibre optics contacts in an existing connector platform for an application providing high definition video displays in operating rooms, the second uses spring probe technology for a catheter junction box. Defence remains a significant market with a robust sales performance in the period as we continue to target specific applications where our technology provides our customers with distinct performance enhancements. One example was high power and high speed connectors for the electrical power and video/data storage systems of a new fighting vehicle. We continue to grow our presence in Asia, particularly in commercial aerospace.

Microwave performed strongly with underlying sales growth of 13% driven by the military, aerospace and test markets offsetting a decline in the wireless telecoms area against a strong comparator period. In defence, we benefitted from a mixture of new contract wins and volume increases on major production programmes. There were strong recurring production orders for antennas, and new awards for high rate data link applications, especially for unmanned aerial vehicles. Compared with the prior year period, there was also a strong contribution from cable assemblies for production testing of new devices such as smart phones and we are working with major customers in this space to replicate previous project successes. Demand held up for our PIM (passive intermodulation) test instruments, including gaining some traction in Asia. We are continuing to develop and offer products that support the evolving wireless telecoms market. For example, we launched a new wireless network interface product that connects operator base stations with in-building distributed antenna systems as mobile phone communications from within buildings now account for 70% of all mobile traffic.

Underlying sales in the Power business fell 21%, mainly due to difficult market conditions facing the PDI business and delays in expected US military orders for power and electromagnetic pulse protection devices. The enterprise sector of the data centre market was significantly weaker as economic and political concerns restricted large capital expenditures. However this did lead to robust demand in the co-location data centre market and PDI won its single largest order in this sector since acquisition to provide power conditioning and distribution systems. Demand for transformers and power controllers from the alternative energy and industrial markets was extremely weak. In response to these challenging trading conditions, we have progressed a number of strategic initiatives aimed at accelerating the turnaround of the PDI business. Resources are firmly focused on generating growth through the creation of commercially-led value streams targeting specific markets and geographies, including redeployment of resources to international regions of greatest opportunity. The new organisational alignment has led to recent improvements in both the sales pipeline and win rates. Procurement and lean manufacturing process initiatives, combined with higher volumes, are expected to drive significant margin accretion in the second half of the year.

Both the telecoms and rail sectors provided some growth for Power: in telecoms, the North American market was resilient as several operators undertook major installations in support of LTE/4G network deployments; in rail, we launched several new products, such as radio frequency filters and track arrestors.

Research and development

Interconnect continued to increase investment in research and product development, focusing on opportunities in higher growth markets and those with the best returns. Company-funded R&D spend increased 3% to £11m or 5.2% of sales. Total R&D spend, including customer-funded spend, was flat at £13m as the additional company-funded investment offset a 33% reduction in the customer-funded portion, reflecting constraints in US Department of Defense budgets.

Core areas for investment included further product developments aimed at maintaining market leading positions in airborne satellite communications antenna systems and PIM test equipment. Specifically, our new lightweight battery-powered PIM tester that enables network installers and maintenance crews to undertake high power tests at the top of cell towers. We also completed the development of a high performance microwave filtering product to prevent public mobile phone signals interfering with vital train network communications. Connectors R&D continues to focus on developing new product platforms including miniaturised high density semiconductor test sockets and a new range targeted at industrial and rail markets, both of which will launch in the next few months.

Outlook

The outlook for the remainder of the year is cautious given the uncertainty in most of Interconnect's markets. Defence continues to face headwinds, particularly in the US with the expected impact of sequestration, and in Europe with continued low industrial growth. Interconnect has successfully repositioned itself to ensure that about two thirds of revenue now comes from non-government funded markets. These commercial markets, such as wireless telecoms, semiconductor test and data centres, are expected to generate longer term growth. While Interconnect is well placed to benefit from recoveries in demand in these sectors, timing is difficult to predict.

Flex-Tek

	2013 £m	2012 £m	Reported growth	Underlying growth
Revenue	**120**	109	10%	11%
Headline operating profit	**20**	17	18%	20%
Headline operating margin	**16.7%**	15.5%	120 bps	
Statutory operating profit	**17**	(35)		
Return on capital employed	**29.8%**	25.1%	470 bps	

Flex-Tek's reported revenue grew 10% or £11m. Excluding adverse currency translation, underlying revenue grew 11%, or £12m, reflecting growth in aerospace components and an improvement in the US residential construction market. Sales of heating elements and flexible hose were flat to prior year. Headline operating profit margins improved 120 basis points to 16.7%. The £3m increase in operating profit resulted from higher volumes and pricing which offset raw material inflation. Return on capital employed rose 470 basis points because of the improved profitability.

The Fluid Management division continued to perform strongly with sales 11% higher on an underlying basis. This includes sales of components to aerospace customers, such as major airframe manufacturers Airbus and Boeing, and engine manufacturers Pratt & Whitney, GE, and Rolls-Royce. The order book for our commercial aviation OEM business remains healthy and sales to the US automotive market for both fuel and brake applications are strong.

Revenues from flexible gas piping and HVAC (Heating, Ventilation & Air Conditioning) ducting to the US construction market rose £7m or 25% versus prior year. According to the US Census Bureau, the December 2012 seasonally adjusted annual rate of new single family home starts was 616,000 or 18% higher than December 2011. We continue to gain market share by cross-selling our ducting, flexible gas piping and HVAC heating element product lines to the US distribution market.

Underlying revenues for Heat Solutions were down 1% to prior year; reflecting weaker sales of heating elements to household appliance and residential HVAC OEM customers, balanced by improved performance from specialty heating elements and aftermarket applications. Consumer confidence remains cautious in the US and OEM appliance manufacturers continue to project low, single digit growth rates in US markets.

Revenues in Flexible Solutions were up 4% underlying. Increased sales of new sleep apnoea products offset continued weakness in the floorcare market. Revenues for industrial ducting in the US were flat.

Research and development

Flex-Tek has increased its first half R&D spend on aerospace product qualification for new engines for the Boeing 737MAX and Airbus A320neo. Continued R&D investment in Heat Solutions will support new technologies in the growing specialty segment of this division. We have increased our investment in our facility in India to support sales to Airbus. We continue to seek new investments to grow our market share, expand our product portfolio, and target potential bolt-on acquisitions to exploit the strength of the management team.

Outlook

The improved first half performance stemmed from continued strength in the aerospace market, tentative signs of optimism and recovery in the US housing market, and operational gearing. We expect further growth in the second half, albeit against a stronger comparator and continued uncertainty in the household appliance sector. Margins will benefit from higher volumes but face pressure from increased investment in new product development, competitive pricing and potential commodity price inflation.

Financial review

Earnings per share
Basic headline earnings per share from continuing activities were 40.9p (2012: 40.4p), a growth of 1%. This reflects an increased headline operating profit which has been partly offset by a higher tax rate.

On a statutory basis, the basic earnings per share from continuing activities were 35.8p (2012: 21.4p).

Exceptional and other items relating to continuing activities excluded from headline profit before tax
These items amounted to a charge of £35m compared to a charge of £106m in 2012. They comprised:

- Amortisation of intangible assets acquired in business combinations of £23m (2012: £25m). The charge relates principally to technology and customer relationships;
- A charge of £11m (2012: £18m) in connection with John Crane, Inc. asbestos litigation;
- A charge of £3m (2012: £52m) in connection with Titeflex Corporation litigation following the prior year establishment of a 10-year rolling provision in respect of future claims.
- A charge of £5m (2012: £12m) in respect of a restructuring and performance improvement programme in Smiths Detection that will conclude in 2015;
- £1m of gains on changes to pension plans (2012: £nil);
- £1m profit on disposal of businesses (2012: £1m);
- A credit of £6m for retirement benefit income (2012: £11m);and
- A financing loss of £1m (2012: £1m). This represents exchange movements on derivatives and other financing instruments not hedge accounted under IFRS.

In the period to 28 January 2012, in addition to the above, acquisition costs of £2m and an £8m charge in relation to a change in the basis of estimating sales rebates in Smiths Medical were also excluded from headline performance.

Cash generation and net debt
Operating cash generation remained strong with headline operating cash of £223m (2012: £201m), representing 88% (2012: 82%) of headline operating profit (see note 14 to the accounts for a reconciliation of headline operating cash and free cash-flow to statutory cash-flow measures). Free cash-flow fell £10m to £71m (2012: £81m). 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 £120m (2012: £133m).

Dividends paid in the period on ordinary shares amounted to £103m (2012: £98m).

Net debt at 31 January was £855m, up from £791m at 31 July 2012. The increase in net debt reflects strong cash generation that was more than offset by outflows from dividends (£103m) and pension funding (£41m).

In October, the Group closed a US$400 million dollar-denominated bond offering with a 10-year maturity and a fixed coupon of 3.625%. This financed the repayment of the private placement of $250m at 5.45% in January 2013.

Headline interest and other financing costs
Interest payable on debt, net of interest earned on cash deposits, was £30m (2012: £31m). Interest costs were covered 8.3 times by headline operating profits.

The Group accounts for pensions using IAS19. As required by this standard, a finance credit is recognised reflecting the expected return on pension scheme assets and a finance charge is recognised reflecting the unwinding of the discount on the future pension liability. The net financing credit was £6m (2012: £11m).

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 £59m in R&D (2012: £55m), equivalent to 4.0% of revenue (2012: 3.9%). Of that total, £54m was funded by the Company compared with £50m in 2012, an increase of 8%. We actively seek funding from customers to support R&D and this amounted to £5m (2012: £5m). Under IFRS, certain development costs are capitalised, and this amounted to £14m in the period (2012: £14m). The gross capitalisation is shown as an intangible asset. Where customers contribute to the costs of development, the contribution is included as deferred income and disclosed within trade and other payables.

Taxation
The headline tax charge of £61m (2012: £57m) represented an effective rate of 27.5% on the headline profit before taxation (2012: 26.5%). This rate is expected to be sustained for the full year. On a statutory basis, the tax charge on continuing activities was £47m (2012: £26m).

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. The tax rate is expected to be within the range of 26% and 28% over the medium term.

Return on capital employed

The return on capital employed (ROCE) is calculated over a rolling 12-month period and is the percentage that headline operating profit comprises of monthly average capital employed. Capital employed comprises total equity adjusted for goodwill recognised directly in reserves, post-retirement benefit assets and liabilities net of tax, litigation provisions relating to exceptional items net of tax, and net debt. The ROCE improved 70 basis points to 16.7% (2012: 16.0%) as a result of improved profitability across most divisions which more than offset reduced profitability in Smiths Medical caused by its investment in growth initiatives.

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 January 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 fallen to £382m at 31 January 2013 from £620m at 31 July 2012. The decrease reflects the benefit of asset returns and 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:

	31 January 2013	31 July 2012	28 January 2012
Funded plans			
UK plans – funding status	**97%**	91%	94%
US plans – funding status	**74%**	67%	70%
Other plans – funding status	**71%**	67%	77%

	31 January 2013 £m	31 July 2012 £m	28 January 2012 £m
Deficit			
Funded plans	**(276)**	(516)	(367)
Unfunded plans	**(106)**	(104)	(92)
Total deficit	**(382)**	(620)	(459)
Retirement benefit assets	**83**	7	51
Retirement benefit liabilities	**(465)**	(627)	(510)
	(382)	(620)	(459)

In the current year, cash contributions to the schemes are expected to total approximately £90m (2012: £115m). In addition, the Group will invest £24m (2012: £24m) in an escrow account as part of the 10-year funding plan agreed with the Smiths Industries Pension Scheme (SIPS).

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

Pension scheme membership	**SIPS**	**TIGPS**	**US plans**	**Total**
Deferred active	560	290	3,500	**4,350**
Deferred	12,110	14,550	6,710	**33,370**
Pensioners	12,990	18,350	5,400	**36,740**
Total	**25,660**	**33,190**	**15,610**	**74,460**

Exchange rates

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

	31 January 2013	28 January 2012		31 July 2012
Average rates:				
US dollar	**1.60**	1.58	Dollar weakened 1%	1.58
Euro	**1.24**	1.16	Euro weakened 7%	1.20
Period end rates:				
US dollar	**1.59**	1.57	Dollar weakened 1%	1.57
Euro	**1.17**	1.19	Euro strengthened 2%	1.27

Risk management

The principal risks and uncertainties affecting the business activities of the Group and relevant mitigating activities were set out on pages 54 to 58 of the Annual Report for the year ended 31 July 2012, a copy of which is available at the Company's website at www.smiths.com. The key risks and uncertainties are summarised below:

Economic outlook

Economic and financial market conditions may lead to recession and may cause adverse effects on customers or suppliers with consequential capacity or cash-flow implications for Smiths Group.

Financial risks

Financial risk, whether from foreign exchange fluctuations, availability of funding, changes in tax rates or availability of insurance cover may cause adverse effects on the Group's net assets, earnings or liquidity.

***Eurozone* break-up**

Political and economic structural weaknesses in the single currency framework may result in the Eurozone breaking up which could affect our business through currency devaluations and a wider economic uncertainty.

Global supply chain/concentration of manufacturing

Reliance on sole suppliers or concentration of manufacturing in the supply chain – especially in areas exposed to natural catastrophe – may result in disruption to the supply of products.

Government customers

Over 35% of revenues are from governments or influenced by governments. Many such governments are reducing expenditure in the present economic environment with consequential risks to revenue.

Information technology and cyber-security

Information systems are subject to security risk and play an important part in business processes, both internally and externally.

Acquisitions and disposals

Acquisitions are subject to execution risk and may be more difficult to integrate than expected so that the full benefits are not realised.

Compliance with legislation and regulations

A complex legislative and regulatory environment applies to the Group's activities such that failure to comply could lead to financial penalty.

Pension funding

Defined benefit pension scheme obligations are funded by Group companies based on actuarial assumptions. Changes in discount rates, inflation, returns or mortality could lead to material changes in funding requirements.

Product liability and litigation

Product liability claims and litigation, particularly given the Group's significant sales exposure to the US market, may have a significant impact on the financial results.

Technology and innovation

Product innovation is key to long-term revenue growth. Failure of the Group to innovate its products and services could materially affect market share and sales growth.

Talent and succession planning

Suitably qualified personnel are an important asset that underpins the Group's success; failure to attract or retain such personnel may result in weaker growth and returns.

Developments since the Annual Report

In the view of the Board, the risks and uncertainties affecting the Group for the remaining six months of the financial year continue to be those set out briefly above and more fully in the Annual Report. Since the Annual Report, continued constraints on government budgets are likely to put pressure on public sector spending in areas such as healthcare, defence and homeland security in markets in which the Group operates. Currency volatility has also increased since the annual report which could cause variations in the Group's reported results as average exchange rates fluctuate and variations in the value of the Group's reported net assets as the year end exchange rate changes.

Statement of directors' responsibilities

The Interim report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the Interim report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority. The Disclosure and Transparency Rules ("DTR") require that the accounting policies and presentation applied to the half-yearly figures must be consistent with those applied in the latest published annual accounts, except where the accounting policies and presentation are to be changed in the subsequent annual accounts, in which case the new accounting policies and presentation should be followed, and the changes and the reasons for the changes should be disclosed in the Interim report, unless the United Kingdom Financial Services Authority agrees otherwise.

The directors confirm that this condensed set of financial statements has been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting' as adopted by the European Union, and that the interim management report herein includes a fair review of:

- the important events that have occurred during the first six months of the financial year and their impact on the condensed set of financial statements as required by DTR 4.2.7;
- the principal risks and uncertainties for the remaining six months of the year as required by DTR 4.2.7; and
- related party transactions that have taken place in the first six months of the current financial year and changes in the related party transactions described in the previous annual report that have materially affected the financial position or performance of the group during the first six months of the current financial year as required by DTR 4.2.8.

The directors of Smiths Group plc are listed in the Smiths Group plc Annual Report for the year ended 31 July 2012, and there have been no changes in the membership of the board.

For and on behalf of the Board of Directors:

Philip Bowman
Chief Executive

Peter Turner
Finance Director

19 March 2013

Independent review report to Smiths Group plc

Introduction

We have been engaged by the Company to review the condensed set of financial statements in the Interim report for the period ended 31 January 2013, which comprises the consolidated income statement, consolidated statement of comprehensive income, consolidated balance sheet, consolidated statement of changes in equity, consolidated cash flow statement and related notes. We have read the other information contained in the Interim report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

Directors' responsibilities

The Interim report is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the Interim report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

As disclosed in note 1, the annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this Interim report has been prepared in accordance with International Accounting Standard 34, "Interim Financial Reporting", as adopted by the European Union.

Our responsibility

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the Interim report based on our review. This report, including the conclusion, has been prepared for and only for the Company for the purpose of the Disclosure and Transparency Rules of the Financial Services Authority and for no other purpose. We do not, in producing this report, 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 review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the Interim report for the period ended 31 January 2013 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

PricewaterhouseCoopers LLP
Chartered Accountants
London
19 March 2013

(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.

Consolidated income statement (unaudited)

	Notes	Period ended 31 January 2013 £m	Period ended 28 January 2012 £m	Year ended 31 July 2012 £m
Continuing operations				
Revenue	2	**1,475.2**	1,407.4	3,030.1
Cost of sales		**(799.4)**	(764.6)	(1,645.9)
Gross profit		**675.8**	642.8	1,384.2
Sales and distribution costs		**(214.0)**	(200.3)	(411.9)
Administrative expenses		**(247.5)**	(311.8)	(596.5)
Profit on disposal of businesses	4	**0.7**	0.9	30.8
Operating profit		**215.0**	131.6	406.6
Comprising				
– headline operating profit	3	**252.7**	244.0	553.7
– exceptional items, amortisation of acquired intangibles	3	**(37.7)**	(112.4)	(147.1)
		215.0	131.6	406.6
Interest receivable		**1.2**	1.3	2.2
Interest payable		**(31.4)**	(32.6)	(64.8)
Other financing losses		**(2.9)**	(3.8)	(7.3)
Other finance income – retirement benefits		**5.9**	10.5	23.5
Finance costs		**(27.2)**	(24.6)	(46.4)
Share of post-tax profits of associated companies			4.2	5.7
Profit before taxation		**187.8**	111.2	365.9
Comprising				
– headline profit before taxation	3	**222.5**	216.9	496.8
– exceptional items, amortisation of acquired intangibles and other financing gains and losses	3	**(34.7)**	(105.7)	(130.9)
		187.8	111.2	365.9
Taxation	5	**(46.5)**	(26.4)	(107.6)
Profit after taxation – continuing operations		**141.3**	84.8	258.3
(Loss)/profit after taxation – discontinued operations			(0.1)	(0.1)
Profit for the period		**141.3**	84.7	258.2
Attributable to				
Smiths Group shareholders		**140.6**	83.8	256.6
Non-controlling interests		**0.7**	0.9	1.6
		141.3	84.7	258.2
Earnings per share	7			
Basic		**35.8p**	21.4p	65.4p
Diluted		**35.4p**	21.2p	64.9p
Dividends per share (declared)	6			
– interim		**12.50p**	11.75p	11.75p
– final				26.25p
		12.50p	11.75p	38.00p

Consolidated statement of comprehensive income (unaudited)

	Notes	Period ended 31 January 2013 £m	Period ended 28 January 2012 £m	Year ended 31 July 2012 £m
Profit for the period		**141.3**	84.7	258.2
Other comprehensive income				
Actuarial gains/(losses) on retirement benefits		**190.5**	(286.4)	(559.0)
Taxation recognised on actuarial movements		**(19.5)**	18.2	52.4
Other comprehensive income which will not be reclassified to the consolidated income statement		**171.0**	(268.2)	(506.6)
Other comprehensive income which will be, or has been, reclassified				
Exchange gains/(losses)		**29.0**	30.3	(9.9)
Cumulative exchange gains recycled on disposals				(4.9)
Fair value gains/(losses)				
– on available for sale financial assets		**3.4**	4.5	4.4
– deferred in the period on cash-flow and net investment hedges		**(2.0)**	(22.7)	(10.7)
– reclassified to income statement		**(1.5)**	3.2	6.4
Taxation recognised on fair value gains and losses				1.5
Total other comprehensive income		**199.9**	(252.9)	(519.8)
Total comprehensive income		**341.2**	(168.2)	(261.6)
Attributable to				
Smiths Group shareholders		**342.0**	(169.4)	(263.5)
Non-controlling interests		**(0.8)**	1.2	1.9
		341.2	(168.2)	(261.6)

Consolidated balance sheet (unaudited)

	Notes	31 January 2013 £m	28 January 2012 £m	31 July 2012 £m
Non-current assets				
Intangible assets	9	**1,710.6**	1,779.8	1,717.1
Property, plant and equipment	10	**266.7**	279.7	270.5
Investments accounted for using the equity method			21.8	
Financial assets – other investments		**76.8**	48.3	60.9
Retirement benefit assets	8	**83.0**	51.4	7.2
Deferred tax assets		**181.1**	231.8	203.3
Trade and other receivables		**28.0**	36.3	37.4
Financial derivatives		**10.8**	6.5	7.2
		2,357.0	2,455.6	2,303.6
Current assets				
Inventories		**480.7**	476.6	438.5
Current tax receivable		**17.3**	15.0	15.3
Trade and other receivables		**626.0**	616.2	634.4
Cash and cash equivalents	11	**275.5**	145.8	205.6
Financial derivatives		**11.8**	13.1	7.9
		1,411.3	1,266.7	1,301.7
Total assets		**3,768.3**	3,722.3	3,605.3
Non-current liabilities				
Financial liabilities				
– borrowings	11	**(1,084.2)**	(907.0)	(821.7)
– financial derivatives		**(3.9)**	(1.3)	(1.1)
Provisions for liabilities and charges	12	**(253.1)**	(239.0)	(254.4)
Retirement benefit obligations	8	**(464.9)**	(510.3)	(627.4)
Deferred tax liabilities		**(68.8)**	(92.3)	(69.5)
Trade and other payables		**(37.4)**	(44.3)	(37.5)
		(1,912.3)	(1,794.2)	(1,811.6)
Current liabilities				
Financial liabilities				
– borrowings	11	**(46.3)**	(195.8)	(175.3)
– financial derivatives		**(3.3)**	(12.3)	(10.6)
Provisions for liabilities and charges	12	**(76.2)**	(81.0)	(77.3)
Trade and other payables		**(443.3)**	(432.2)	(468.2)
Current tax payable		**(67.3)**	(94.9)	(81.5)
		(636.4)	(816.2)	(812.9)
Total liabilities		**(2,548.7)**	(2,610.4)	(2,624.5)
Net assets		**1,219.6**	1,111.9	980.8
Shareholders' equity				
Share capital		**147.5**	147.2	147.3
Share premium account		**336.5**	330.7	331.9
Capital redemption reserve		**5.8**	5.8	5.8
Revaluation reserve		**1.7**	1.7	1.7
Merger reserve		**234.8**	234.8	234.8
Retained earnings		**614.7**	524.6	376.1
Hedge reserve		**(128.3)**	(140.2)	(124.8)
Total shareholders' equity		**1,212.7**	1,104.6	972.8
Non-controlling interest equity		**6.9**	7.3	8.0
Total equity		**1,219.6**	1,111.9	980.8

Consolidated statement of changes in equity (unaudited)

	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 period				140.6		140.6	0.7	141.3
Other comprehensive income								
Exchange gains/(losses)				30.5		30.5	(1.5)	29.0
Actuarial gains on retirement benefits net of tax				171.0		171.0		171.0
Fair value gains/(losses)				3.4	(3.5)	(0.1)		(0.1)
Total comprehensive income for the period				345.5	(3.5)	342.0	(0.8)	341.2
Transactions relating to ownership interests								
Exercises of share options		4.8				4.8		4.8
Purchase of own shares				(11.0)		(11.0)		(11.0)
Dividends								
– equity shareholders	6			(103.2)		(103.2)		(103.2)
– non-controlling interest							(0.3)	(0.3)
Share-based payment				7.3		7.3		7.3
At 31 January 2013		**484.0**	**242.3**	**614.7**	**(128.3)**	**1,212.7**	**6.9**	**1,219.6**

	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 period				83.8		83.8	0.9	84.7
Other comprehensive income								
Exchange gains/(losses)				30.1	(0.1)	30.0	0.3	30.3
Actuarial losses on retirement benefits net of tax				(268.2)		(268.2)		(268.2)
Fair value gains/(losses)				4.5	(19.5)	(15.0)		(15.0)
Total comprehensive income for the period				(149.8)	(19.6)	(169.4)	1.2	(168.2)
Transactions relating to ownership interests								
Exercises of share options		1.7				1.7		1.7
Taxation recognised on share options				(0.9)		(0.9)		(0.9)
Purchase of own shares				(9.7)		(9.7)		(9.7)
Dividends								
– equity shareholders	6			(98.1)		(98.1)		(98.1)
– non-controlling interest							(0.3)	(0.3)
Share-based payment				7.5		7.5		7.5
At 28 January 2012		**477.9**	**242.3**	**524.6**	**(140.2)**	**1,104.6**	**7.3**	**1,111.9**

Consolidated cash-flow statement (unaudited)

	Notes	**Period ended 31 January 2013 £m**	Period ended 28 January 2012 £m	Year ended 31 July 2012 £m
Net cash inflow from operating activities	14	**119.9**	133.2	331.5
Cash-flows from investing activities				
Expenditure on capitalised development		**(13.0)**	(13.1)	(27.6)
Expenditure on other intangible assets		**(3.0)**	(5.5)	(13.5)
Purchases of property, plant and equipment		**(23.1)**	(21.1)	(50.1)
Disposals of property, plant and equipment		**2.0**		0.7
Investment in financial assets		**(12.1)**	(12.0)	(24.3)
Acquisition of businesses		**(0.5)**	(169.0)	(167.5)
Disposals of businesses		**0.7**	0.9	47.3
Net cash-flow used in investing activities		**(49.0)**	(219.8)	(235.0)
Cash-flows from financing activities				
Proceeds from exercise of share options		**4.8**	1.7	3.0
Purchase of own shares		**(11.0)**	(9.7)	(9.7)
Dividends paid to equity shareholders		**(103.2)**	(98.1)	(144.1)
Dividends paid to non-controlling interests		**(0.3)**	(0.3)	(0.3)
Cash outflow from matured derivative financial instruments		**(2.0)**	(2.6)	(1.7)
Increase in new borrowings		**247.2**	92.3	174.8
Reduction and repayment of borrowings		**(158.8)**	(16.7)	(173.5)
Net cash-flow used in financing activities		**(23.3)**	(33.4)	(151.5)
Net (decrease)/increase in cash and cash equivalents		**47.6**	(120.0)	(55.0)
Cash and cash equivalents at beginning of the period		**203.7**	260.7	260.7
Exchange differences		**3.2**	1.4	(2.0)
Cash and cash equivalents at end of the period		**254.5**	142.1	203.7
Cash and cash equivalents at end of the period comprise				
– cash at bank and in hand		**191.1**	122.3	130.8
– short-term deposits		**84.4**	23.5	74.8
– bank overdrafts		**(21.0)**	(3.7)	(1.9)
		254.5	142.1	203.7

Notes to the Interim report (unaudited)

1 Basis of preparation

The condensed interim financial information covers the six month period ended 31 January 2013 and has been prepared under International Financial Reporting Standards (IFRS) as adopted by the European Union, in accordance with International Accounting Standard 34 'Interim Financial Reporting' and the Disclosure and Transparency Rules of the Financial Services Authority. It is unaudited but has been reviewed by the auditors and their report is attached to this document.

The interim financial information does not constitute statutory accounts within the meaning of Section 434 of the Companies Act 2006. It should be read in conjunction with the statutory accounts for the year ended 31 July 2012, which were prepared in accordance with IFRS as adopted by the European Union and have been filed with the Registrar of Companies. The auditors' report on these statutory accounts was unqualified and did not contain a statement under Section 498(2) or (3) of the Companies Act 2006.

Accounting policies

The condensed interim financial information has been prepared on the basis of the accounting policies applicable for the year ending 31 July 2013. These accounting policies are consistent with those applied in the preparation of the financial statements for the year ended 31 July 2012, 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 £30.5m (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 £148.2m (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 £0.4m (31 July 2012: £0.7m).

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 January 2013 was £18.4m (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 policies set out in the Annual Report 2012. 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.

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 £208.7m (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. However, because of the significant uncertainty associated with the future level of asbestos claims and of the costs arising out of the related litigation, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred and, as a result, the provision may be subject to potentially material revisions from time to time if new information becomes available as a result of future events. John Crane, Inc. takes account of the advice of an expert in asbestos liability estimation in quantifying the expected costs.

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. Titeflex Corporation believes that its products are a safe and effective means of delivering gas when installed in accordance with the manufacturer's instructions and local and national codes, however some claims have been settled on an individual basis without admission of liability. Provision of £61.0m (31 July 2012: £61.8m) has been made for the costs which the Group is expected to incur in respect of subrogation claims. However, because of the significant uncertainty associated with the future level of subrogation claims, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred. As a result the provision may be subject to potentially material revisions if new information becomes available.

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

Retirement benefits

The consolidated financial statements include costs in relation to, and provision for, retirement benefit obligations. The costs and the present value of any related pension assets and liabilities depend on such factors as life expectancy of the members, the returns that plan assets generate and the discount rate used to calculate the present value of the liabilities. The Group uses previous experience and independent actuarial advice to select the values of critical estimates.

At 31 January 2013 there is a retirement benefit asset of £83.0m (31 July 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 £17.8m (31 July 2012: £16.1m) relating to losses and £73.5m (31 July 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.

2 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.

							Period ended 31 January 2013
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £m
Revenue	**469.5**	**412.9**	**254.6**	**218.5**	**119.7**		**1,475.2**
Divisional headline operating profit	**102.1**	**87.1**	**30.5**	**29.6**	**20.0**		**269.3**
Corporate headline operating costs						**(16.6)**	**(16.6)**
Headline operating profit	**102.1**	**87.1**	**30.5**	**29.6**	**20.0**	**(16.6)**	**252.7**
Divisional exceptional operating items (note 4)	**(8.1)**	**0.3**	**(4.2)**		**(2.6)**	**(0.2)**	**(14.8)**
Amortisation of acquired intangible assets	**(7.1)**	**(5.6)**	**(0.6)**	**(9.5)**	**(0.1)**		**(22.9)**
Operating profit/(loss)	**86.9**	**81.8**	**25.7**	**20.1**	**17.3**	**(16.8)**	**215.0**
Exceptional finance costs – adjustment to discounted provision (note 4)	**(1.4)**				**(0.4)**		**(1.8)**
Net finance costs – other							**(25.4)**
Profit before taxation							**187.8**

							Period ended 28 January 2012
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £m
Revenue	469.3	408.7	220.0	200.1	109.3		1,407.4
Divisional headline operating profit	97.9	97.9	20.5	26.2	16.9		259.4
Corporate headline operating costs						(15.4)	(15.4)
Headline operating profit	97.9	97.9	20.5	26.2	16.9	(15.4)	244.0
Exceptional operating items (note 4)	(15.8)	(8.2)	(11.0)	(1.9)	(51.7)	1.0	(87.6)
Amortisation of acquired intangible assets	(7.5)	(7.9)	(0.7)	(8.6)	(0.1)		(24.8)
Operating profit/(loss)	74.6	81.8	8.8	15.7	(34.9)	(14.4)	131.6
Exceptional finance costs – adjustment to discounted provision (note 4)	(2.4)						(2.4)
Net finance costs – other							(22.2)
Share of post-tax profits of associate companies			4.2				4.2
Profit before taxation							111.2

Smiths Medical revenue for period ended 28 January 2012 (and year ended 31 July 2012) includes the impact of a £7.8m charge for revision of estimated rebates, which has been included in divisional exceptional operating items (see note 4). Revenue calculated on the same basis as headline operating profit would be £416.5m (year: £863.6m) for Smiths Medical and £1,415.2m (year: £3,037.9m) for Smiths Group.

	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £m
							Year ended 31 July 2012
Revenue	973.4	855.8	519.2	448.5	233.2		3,030.1
Divisional headline operating profit	209.9	202.5	69.1	66.0	38.0		585.5
Corporate headline operating costs						(31.8)	(31.8)
Headline operating profit/(loss)	209.9	202.5	69.1	66.0	38.0	(31.8)	553.7
Exceptional operating items (note 4)	(39.9)	(8.8)	16.1	(1.2)	(54.5)	2.8	(85.5)
Amortisation and impairment of acquired intangible assets	(15.0)	(14.2)	(1.4)	(30.8)	(0.2)		(61.6)
Operating profit/(loss)	155.0	179.5	83.8	34.0	(16.7)	(29.0)	406.6
Exceptional finance costs – adjustment to discounted provision (note 4)	(4.0)				(0.5)		(4.5)
Net finance costs – other							(41.9)
Share of post-tax profits of associate companies			5.7				5.7
Profit before taxation							365.9

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

	John Crane £m	**Smiths Medical £m**	**Smiths Detection £m**	**Smiths Interconnect £m**	**Flex-Tek £m**	**Total £m**
						31 January 2013
Property, plant, equipment, development projects and other intangibles	**96.6**	**152.4**	**102.8**	**34.1**	**21.5**	**407.4**
Working capital assets	**343.0**	**232.0**	**331.2**	**141.1**	**70.6**	**1,117.9**
Operating assets	**439.6**	**384.4**	**434.0**	**175.2**	**92.1**	**1,525.3**
Derivatives, tax and retirement benefit assets						**304.0**
Goodwill and acquired intangibles						**1,552.6**
Corporate assets						**110.9**
Cash						**275.5**
Total assets						**3,768.3**
Working capital liabilities	**(155.5)**	**(91.3)**	**(171.0)**	**(55.3)**	**(23.4)**	**(496.5)**
Corporate and non-headline liabilities						**(313.5)**
Derivatives, tax and retirement benefits						**(608.2)**
Borrowings						**(1,130.5)**
Total liabilities						**(2,548.7)**
Average divisional capital employed	**881.2**	**1,136.4**	**651.0**	**562.8**	**137.5**	**3,368.9**
Average corporate capital employed						**(4.3)**
Average total capital employed						**3,364.6**

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 (28 January 2012: £815.2m) and eliminate post-retirement benefit assets and liabilities and litigation provisions relating to exceptional items, both net of related tax, and net debt.

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

Analysis of revenue

The revenue for the main product and service lines for each division is:

	Original equipment manufacture	Aftermarket				Total
John Crane	£m	Oil, gas and petrochemical £m	Chemical and pharmaceutical £m	Distributors £m	General industry £m	£m
Revenue period ended 31 January 2013	**168.5**	**184.8**	**40.2**	**33.1**	**42.9**	**469.5**
Revenue period ended 28 January 2012	172.4	181.7	38.2	33.1	43.9	469.3

Smiths Medical	Medication delivery £m	Vital care £m	Safety devices £m	Total £m
Revenue period ended 31 January 2013	**111.8**	**173.3**	**127.8**	**412.9**
Revenue period ended 28 January 2012	112.4	168.4	127.9	408.7

Smiths Detection	Transportation £m	Ports and borders £m	Military £m	Emergency responders £m	Critical infrastructure £m	Non-security £m	Total £m
Revenue period ended 31 January 2013	**131.1**	**44.5**	**24.4**	**6.6**	**41.0**	**7.0**	**254.6**
Revenue period ended 28 January 2012	97.2	32.5	21.6	9.7	53.7	5.3	220.0

Smiths Interconnect	Connectors £m	Microwave £m	Power Management £m	Total £m
Revenue period ended 31 January 2013	**74.9**	**97.1**	**46.5**	**218.5**
Revenue period ended 28 January 2012	71.9	86.3	41.9	200.1

Flex-Tek	Fluid Management £m	Flexible Solutions £m	Heat Solutions £m	Construction £m	Total £m
Revenue period ended 31 January 2013	**41.2**	**17.5**	**25.0**	**36.0**	**119.7**
Revenue period ended 28 January 2012	37.8	17.1	25.5	28.9	109.3

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 of intangible assets acquired in a business combination – the amortisation charge is a non-cash item, and the directors believe that it should be added back to give a clearer picture of underlying performance;
- 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	**Period ended 31 January 2013 £m**	Period ended 28 January 2012 £m	Year ended 31 July 2012 £m
Operating profit		**215.0**	131.6	406.6
Exclude				
– exceptional operating items	4	**14.8**	87.6	85.5
– amortisation of acquired intangible assets	9	**22.9**	24.8	61.6
Non-headline items in operating profit		**37.7**	112.4	147.1
Headline operating profit		**252.7**	244.0	553.7
Finance costs		**(27.2)**	(24.6)	(46.4)
Exclude				
– exceptional finance costs	4	**1.8**	2.4	4.5
– other financing gains and losses		**1.1**	1.4	2.8
– other finance income – retirement benefits		**(5.9)**	(10.5)	(23.5)
Non-headline items in finance costs		**(3.0)**	(6.7)	(16.2)
Headline finance costs		**(30.2)**	(31.3)	(62.6)
Profit before taxation		**187.8**	111.2	365.9
Non-headline items in operating profit		**37.7**	112.4	147.1
Non-headline items in finance costs		**(3.0)**	(6.7)	(16.2)
Headline profit before taxation		**222.5**	216.9	496.8
Profit after taxation – continuing operations		**141.3**	84.8	258.3
Exclude				
– non-headline items in profit before taxation		**34.7**	105.7	130.9
– tax on excluded items		**(14.6)**	(31.1)	(62.0)
– exceptional taxation items				37.7
		20.1	74.6	106.6
Headline profit after taxation – continuing operations		**161.4**	159.4	364.9

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

4 Exceptional items

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

	Period ended 31 January 2013 £m	Period ended 28 January 2012 £m	Year ended 31 July 2012 £m
Operating items			
Restructuring programmes	**(4.8)**	(11.4)	(15.4)
Revision of estimated rebates		(7.8)	(7.8)
Diabetes			0.6
Gains on changes to post-retirement benefits	**1.7**		
Profit on disposal of businesses	**0.7**	0.9	30.8
Adjustment to contingent consideration provided on acquisitions			2.4
Costs of acquisitions		(2.0)	(2.0)
Litigation			
– provision for Titeflex Corporation subrogation claims (note 12)	**(2.6)**	(51.7)	(54.5)
– provision for John Crane, Inc. asbestos litigation (note 12)	**(9.8)**	(15.6)	(39.6)
	(14.8)	(87.6)	(85.5)
Financing items			
Exceptional finance costs – adjustment to discounted provision			
– provision for Titeflex Corporation subrogation claims (note 12)	**(0.4)**		(0.5)
– provision for John Crane, Inc. asbestos litigation (note 12)	**(1.4)**	(2.4)	(4.0)
	(16.6)	(90.0)	(90.0)
Taxation items			
Exceptional tax costs – write off UK deferred tax asset			(37.7)
	(16.6)	(90.0)	(127.7)

Period ended 31 January 2013

Restructuring costs include £4.8m 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.

A settlement gain of £2.1m arose on the closure of a defined benefit pension scheme, net of professional costs of £0.4m.

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.

A charge of £2.6m has been made by Titeflex Corporation in respect of changes to the estimated cost of future claims from insurance companies seeking recompense for damage allegedly caused by lightning strike (see note 12), net of gains of £1.2m relating to changes in discounting.

The operating charge in respect of John Crane, Inc. litigation comprises £13.7m in respect of increased provision for adverse judgments and legal defence costs, £0.2m in respect of legal fees in connection with litigation against insurers, less £4.1m arising from the increase in US risk free rates.

5 Taxation

The interim tax charge of 24.8% is calculated by applying the estimated effective headline tax rate of 27.5% for the year ended 31 July 2013 to headline profit before tax and then taking into account the tax effect of non-headline items in the interim period.

A reconciliation of total and headline tax charge is as follows:

	Period ended 31 January 2013 £m		Period ended 28 January 2012 £m		Year ended 31 July 2012 £m	
	Continuing operations £m	**Tax rate**	Continuing operations £m	Tax rate	Continuing operations £m	Tax rate
Profit before taxation	**187.8**		111.2		365.9	
Taxation	**(46.5)**	**24.8%**	(26.4)	23.8%	(107.6)	29.4%
Adjustments						
Non-headline items excluded from profit before taxation (note 3)	**34.7**		105.7		130.9	
Taxation on non-headline items	**(14.6)**		(31.1)		(62.0)	
Exceptional taxation items (note 4)					37.7	
Headline						
Headline profit before taxation	**222.5**		216.9		496.8	
Taxation on headline profit	**(61.1)**	**27.5%**	(57.5)	26.5%	(131.9)	26.5%

The changes in the value of the net tax liability in the period were:

	Current tax £m	Deferred tax £m	Net tax balance £m
At 31 July 2012	(66.2)	133.8	67.6
Foreign exchange gains and losses	(0.1)	(2.5)	(2.6)
Credit/(charge) to income statement	(47.0)	0.5	(46.5)
Credit to reserves		(19.5)	(19.5)
Tax paid	63.3		63.3
At 31 January 2013	**(50.0)**	**112.3**	**62.3**

The deferred tax credit to reserves relates to actuarial gains on the US funded pension plans.

6 Dividends

The following dividends were declared and paid in the period:

	Period ended 31 January 2013 £m	Period ended 28 January 2012 £m	Year ended 31 July 2012 £m
Ordinary final dividend of 26.25p for 2012 (2011: 25.0p) paid 23 November 2012	**103.2**	98.1	98.1
Ordinary interim dividend of 11.75p for 2012 paid 20 April 2012			46.0
	103.2	98.1	144.1

An interim dividend of 12.50p per share was declared by the Board on 19 March 2013 and will be paid to shareholders on 26 April 2013. 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 2 April 2013.

7 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.

	Period ended 31 January 2013 £m	Period ended 28 January 2012 £m	Year ended 31 July 2012 £m
Profit attributable to equity shareholders for the year			
– continuing	**140.6**	83.9	256.7
– total	**140.6**	83.8	256.6
Average number of shares in issue during the year	**393,075,730**	392,520,793	392,583,140

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 396,725,564 (period ended 28 January 2012: 394,811,180; year ended 31 July 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.

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

	Period ended 31 January 2013 £m		Period ended 28 January 2012 £m		Year ended 31 July 2012 £m	
	£m	**EPS (p)**	£m	EPS (p)	£m	EPS (p)
Profit attributable to equity shareholders of the Parent Company	**140.6**	**35.8**	83.9	21.4	256.7	65.4
Exclude						
Non-headline items and related tax (note 3)	**20.1**	**5.1**	74.6	19.0	106.6	27.2
Headline	**160.7**	**40.9**	158.5	40.4	363.3	92.6
Headline EPS – diluted (p)		**40.5**		40.1		91.9

8 Post-retirement benefits

Smiths provides post retirement benefits to employees in a number of countries throughout the world. The arrangements include defined benefit and defined contribution plans and, mainly in the United Kingdom (UK) and United States of America (US), post retirement healthcare. The principal defined benefit pension plans are in the UK and in the US and these have been closed so that no future benefits are accrued.

Where any individual scheme 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 scheme is not available to fund the IAS 19 deficit of another scheme. The retirement benefit asset 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 scheme liabilities calculated in accordance with IAS 19: Employee benefits.

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

	31 January 2013		28 January 2012		31 July 2012	
	UK	**US**	UK	US	UK	US
Rate of increase for active deferred members	**4.3%**	**n/a**	3.9%	n/a	3.7%	n/a
Rate of increase in pensions in payment	**3.4%**	**n/a**	3.0%	n/a	2.8%	n/a
Rate of increase in deferred pensions	**3.4%**	**n/a**	3.0%	n/a	2.8%	n/a
Discount rate	**4.5%**	**4.2%**	4.7%	4.5%	4.1%	3.8%
Inflation rate	**3.4%**	**n/a**	3.0%	n/a	2.8%	n/a
Healthcare cost increases	**5.0%**	**n/a**	5.0%	n/a	5.0%	n/a

The amounts recognised in the balance sheet were as follows:

	31 January 2013 £m	28 January 2012 £m	31 July 2012 £m
Balance sheet			
Market value of funded plan assets	**3,516.6**	3,231.6	3,347.6
Present value of funded scheme liabilities	**(3,792.1)**	(3,597.4)	(3,863.6)
Unfunded pension plans	**(84.7)**	(69.1)	(81.0)
Post-retirement healthcare	**(21.6)**	(22.9)	(23.1)
Unrecognised asset due to surplus restriction	**(0.1)**	(1.1)	(0.1)
Net retirement benefit liability	**(381.9)**	(458.9)	(620.2)
Retirement benefit assets	**83.0**	51.4	7.2
Retirement benefit obligations	**(464.9)**	(510.3)	(627.4)
Net retirement benefit liability	**(381.9)**	(458.9)	(620.2)

The changes in the present value of the net pension liability in the period were:

	31 January 2013 £m	28 January 2012 £m	31 July 2012 £m
At beginning of period	**(620.2)**	(199.0)	(199.0)
Exchange adjustment	**0.9**	(6.0)	(4.4)
Current service cost	**(2.1)**	(1.9)	(3.4)
Past service cost, curtailments and settlements	**2.1**		0.5
Other finance income/(charges) – retirement benefits	**5.9**	10.5	23.5
Contributions by employer	**41.0**	23.9	121.6
Actuarial gain/(loss)	**190.5**	(286.5)	(560.1)
Movement in surplus restriction		0.1	1.1
Net retirement benefit liability	**(381.9)**	(458.9)	(620.2)

During the period an overseas defined benefit pension scheme was closed and scheme liabilities of £18.5m were settled by transferring assets of £16.4m.

Actuarial gains have primarily arisen from better than expected investment returns (£150.8m) and higher US discount rates (£36.0m).

9 Intangible assets

	Goodwill £m	Development costs £m	Acquired intangibles £m	Software, patents and intellectual property £m	Total £m
Cost					
At 1 August 2012	1,488.1	181.3	413.6	143.4	2,226.4
Exchange adjustments	19.2	0.1	0.1	0.2	19.6
Additions		13.5		3.0	16.5
Disposals				(0.7)	(0.7)
At 31 January 2013	**1,507.3**	**194.9**	**413.7**	**145.9**	**2,261.8**
Amortisation					
At 1 August 2012	93.7	70.6	249.1	95.9	509.3
Exchange adjustments	1.5		1.2	0.3	3.0
Charge for the period		10.0	22.9	6.5	39.4
Disposals				(0.5)	(0.5)
At 31 January 2013	**95.2**	**80.6**	**273.2**	**102.2**	**551.2**
Net book value at 31 January 2013	**1,412.1**	**114.3**	**140.5**	**43.7**	**1,710.6**
Net book value at 28 January 2012	1,423.2	108.1	202.2	46.3	1,779.8
Net book value at 31 July 2012	1,394.4	110.7	164.5	47.5	1,717.1

Goodwill sensitivity analysis

The financial statements for the year ended 31 July 2012 disclosed that reasonable changes in the assumptions used to calculate the value of Smiths Interconnect Power Management would cause the value in use to fall below the carrying value. This impairment testing has been updated to 31 January 2013. No impairment has been identified, but sensitivity analysis identifies the following risks:

	Change required to trigger impairment
Forecast operating cash-flow	7% reduction
Discount rate	0.8% higher
Long-term growth rates	1.4% lower

For the other cash generating units, nothing has occurred since the year end which would require additional review of carrying values before the annual testing is carried out.

10 Property, plant and equipment

	Land and buildings £m	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
Cost or valuation				
At 1 August 2012	192.7	516.0	213.7	922.4
Exchange adjustments	1.7	2.7	3.2	7.6
Additions	3.8	13.4	5.9	23.1
Disposals	(2.3)	(7.0)	(2.8)	(12.1)
At 31 January 2013	**195.9**	**525.1**	**220.0**	**941.0**
Depreciation				
At 1 August 2012	92.7	389.6	169.6	651.9
Exchange adjustments	0.5	1.9	2.6	5.0
Charge for the period	3.9	14.9	8.3	27.1
Disposals	(1.4)	(6.0)	(2.3)	(9.7)
At 31 January 2013	**95.7**	**400.4**	**178.2**	**674.3**
Net book value at 31 January 2013	**100.2**	**124.7**	**41.8**	**266.7**
Net book value at 28 January 2012	103.8	130.7	45.2	279.7
Net book value at 31 July 2012	100.0	126.4	44.1	270.5

11 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 January 2013 £m	28 January 2012 £m	31 July 2012 £m
Cash and cash equivalents			
Net cash and deposits	**275.5**	145.8	205.6
Short-term borrowings			
Bank overdrafts	**(21.0)**	(3.7)	(1.9)
$250m 5.45% US$ Private placement 2013		(163.4)	(161.7)
Bank and other loans	**(1.1)**	(2.8)	(1.2)
Interest accrual	**(24.2)**	(25.9)	(10.5)
	(46.3)	(195.8)	(175.3)
Long-term borrowings			
$250m 6.05% US$ Guaranteed notes 2014	**(157.2)**	(158.5)	(159.1)
$800m Revolving Credit Facility 2015		(73.2)	
£150m 7.25% Sterling Eurobond 2016	**(149.5)**	(149.4)	(149.4)
€300m 4.125% Eurobond 2017	**(261.8)**	(254.6)	(240.9)
$175m 7.37% US$ Private placement 2018	**(110.2)**	(111.3)	(111.6)
$250m 7.20% US$ Guaranteed notes 2019	**(156.5)**	(158.0)	(158.5)
$400m 3.625% US$ Guaranteed notes 2022	**(247.3)**		
Bank and other loans	**(1.7)**	(2.0)	(2.2)
	(1,084.2)	(907.0)	(821.7)
Borrowings	**(1,130.5)**	(1,102.8)	(997.0)
Net debt	**(855.0)**	(957.0)	(791.4)

On 12 October 2012 Smiths Group plc issued US$400m notes with a ten year maturity and a fixed coupon of 3.625%, and on 28 January 2013 part of the proceeds of this issue was used to repay the maturing 5.45% US$ Private placement.

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	3.2	1.5	(18.2)	(13.5)
Net cash inflow/(outflow)	47.6			47.6
Repayment of borrowings		158.8		158.8
Drawdown of borrowings			(247.2)	(247.2)
Capitalisation, interest accruals and unwind of capitalised fees		(10.8)	(0.5)	(11.3)
Fair value movement from interest rate hedging		(0.9)	2.9	2.0
Change in maturity analysis		(0.5)	0.5	
At 31 January 2013	**254.5**	**(25.3)**	**(1,084.2)**	**(855.0)**

12 Provisions for liabilities and charges

	Trading	Exceptional and legacy			Total
	£m	John Crane, Inc. litigation £m	Titeflex Corporation litigation £m	Other £m	£m
At 31 July 2012	35.7	213.1	61.8	21.1	331.7
Exchange adjustments	1.4	(2.8)	(0.8)		(2.2)
Provision charged	11.3	29.3	2.6	4.2	47.4
Provision released	(1.7)	(19.7)		(0.4)	(21.8)
Unwind of provision discount		1.4	0.4		1.8
Utilisation	(8.5)	(12.6)	(3.0)	(3.5)	(27.6)
At 31 January 2013	**38.2**	**208.7**	**61.0**	**21.4**	**329.3**

Analysed as:

	31 January 2013 £m	28 January 2012 £m	31 July 2012 £m
Current liabilities	**76.2**	81.0	77.3
Non-current liabilities	**253.1**	239.0	254.4
	329.3	320.0	331.7

The John Crane, Inc. and Titeflex Corporation litigation provisions are the only provisions which are discounted.

Trading

The trading provision primarily relates to warranties £37.5m (31 July 2012: £34.5m) but also includes product liabilities and litigation in respect of current products or on-going business activities.

John Crane, Inc.

John Crane, Inc. ("JCI") is one of many co-defendants in numerous lawsuits pending in the United States in which plaintiffs are claiming damages arising from alleged exposure to, or use of, products previously manufactured which contained asbestos. Until 2006, the awards, the related interest and all material defence costs were met directly by insurers. In 2007, JCI secured the commutation of certain insurance policies in respect of product liability. While JCI has excess liability insurance, the availability of such insurance and scope of the cover are currently the subject of litigation in the United States. Pending the outcome of that litigation, JCI has met defence costs directly. Provision is made in respect of the expected costs of defending known and predicted future claims and of adverse judgments in relation thereto, to the extent that such costs can be reliably estimated. No account has been taken of recoveries from insurers as their nature and timing are not yet sufficiently certain to permit recognition as an asset for these purposes.

The JCI products generally referred to in these cases consist of industrial sealing product, primarily packing and gaskets. The asbestos was encapsulated within these products in such a manner that causes JCI to believe, based on tests conducted on its behalf, that the products were safe. JCI ceased manufacturing products containing asbestos in 1985.

JCI is actively monitoring the conduct and effect of its current and expected asbestos litigation, including the most efficacious presentation of its 'safe product' defence, and intends to continue to resist all asbestos claims based upon this defence. Approximately 229,000 (31 July 2012: 221,000) claims against JCI have been dismissed before trial over the last 33 years. JCI is currently a defendant in cases involving approximately 80,000 (31 July 2012: 86,000) claims. Despite the large number of claims brought against JCI, it has had final judgments against it, after appeals, in only 117 (31 July 2012: 115) cases over the period, and has had to pay awards amounting to approximately US$113m (31 July 2012: US$111m). JCI has also incurred significant additional defence costs and, whilst the number of claims being filed against JCI and other defendants has been declining, the proportion of mesothelioma claims has increased, and JCI's ability to defend these cases is likely to have a significant impact on its annual aggregate adverse judgment and defence costs.

The assumptions made in assessing the appropriate level of provision include:

- The period over which the expenditure can be reliably estimated.
- The future trend of legal costs.
- The rate of future claims filed.
- The rate of successful resolution of claims.
- The average amount of judgments awarded.

The provision is based on past history and allows for decreasing levels of new claims based on published tables of asbestos incidence projections and is determined using asbestos valuations experts, Bates White LLC. The projections use a 10 year time horizon on the basis that Bates White LLC consider that there is substantial uncertainty in the asbestos litigation environment so probable expenditures are not reasonably estimable beyond this time horizon, see note 13.

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. Set out below is the gross, discounted and post-tax information relating to this provision:

	31 January 2013 £m	28 January 2012 £m	31 July 2012 £m
Gross provision	**226.4**	211.2	226.3
Discount	**(17.7)**	(15.9)	(13.2)
Discounted pre-tax provision	**208.7**	195.3	213.1
Deferred tax	**(49.8)**	(44.4)	(51.1)
Discounted post-tax provision	**158.9**	150.9	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. Titeflex Corporation believes that its products are a safe and effective means of delivering gas when installed in accordance with the manufacturer's instructions and local and national codes, however some claims have been settled on an individual basis without admission of liability. The number of claims received each year and the cost of resolving them has varied between £3m and £5m a year. 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 subrogation claims to the extent that such costs can be reliably estimated. Titeflex Corporation sells flexible gas piping with extensive installation and safety guidance (revised in 2008) designed to assure the safety of the product and minimise the risk of damage associated with lightning strikes.

The assumptions made in assessing the appropriate level of provision, which are based on past experience, include:

- The period over which expenditure can be reliably estimated
- The number of future settlements
- The average amount of settlements

The projections use a rolling 10 year time horizon on the basis that there is substantial uncertainty in the US litigation environment so probable expenditures are not reasonably estimable beyond this time horizon, see note 13.

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 is a discounted pre-tax provision using discount rates, being the risk-free rate on US debt instruments for the appropriate period.

Other exceptional and legacy

Legacy provisions comprise provisions relating to former business activities and properties no longer used by Smiths. Exceptional provisions comprise all provisions which were disclosed as exceptional items when they were charged to the income statement.

These provisions cover exceptional reorganisation, vacant properties, disposal indemnities and litigation in respect of old products and discontinued business activities.

13 Contingent liabilities and commitments

John Crane, Inc.

As stated in note 12, John Crane, Inc. ("JCI") is involved in numerous law suits pending in the United States in which plaintiffs are claiming damages arising from exposure to, or use of, products containing asbestos. The JCI products generally referred to in these cases are ones in which the asbestos fibres were encapsulated in such a manner that, according to tests conducted on behalf of JCI, the products were safe. JCI ceased manufacturing products containing asbestos in 1985.

Provision has been made for future defence costs and the cost of adverse judgments expected to occur. The Group anticipates that asbestos litigation will continue beyond the period covered by this provision; however, because of the uncertainty surrounding the outcome of litigation beyond this period, the costs cannot be reliably estimated.

Titeflex Corporation

As stated in Note 12, Titeflex Corporation has made provision for the cost of expected future subrogation claims. The Group considers claims might continue beyond the period covered by the provision; however because of the uncertainty surrounding the US litigation environment beyond this period, the costs cannot be reliably estimated.

Other contingent liabilities and commitments

In the ordinary course of its business, the Group is subject to litigation such as product liability claims, employee disputes and other kinds of lawsuits, and faces different types of legal issues in different jurisdictions. The high level of activity in the US, for example, exposes the Group to the likelihood of various types of litigation commonplace in that country, such as 'mass tort' and 'class action' litigation, and legal challenges to the scope and validity of patents. These types of proceedings (or the threat of them) are also used to create pressure to encourage negotiated settlement of disputes. Any claim brought against the Group (with or without merit), could be costly to defend. These matters are inherently difficult to quantify. In appropriate cases a provision is recognised based on best estimates and management judgement but there can be no guarantee that these provisions (which may be subject to potentially material revision from time to time) will result in an accurate prediction of the actual costs and liabilities that may be incurred. There are also contingent liabilities in respect of litigation for which no provisions are made.

14 Cash-flow from operating activities

	Period ended 31 January 2013 £m	Period ended 28 January 2012 £m	Year ended 31 July 2012 £m
Operating profit – continuing	**215.0**	131.6	406.6
Amortisation of intangible assets	**39.4**	39.0	83.1
Impairment of intangible assets			10.7
Profit/(loss) on disposal of property, plant and equipment	**0.5**	1.3	3.7
Profit/(loss) on disposal of business	**(0.7)**	(0.9)	(30.8)
Depreciation of property, plant and equipment	**27.1**	28.3	59.0
Share-based payment expense	**7.3**	7.5	14.4
Retirement benefits	**(41.0)**	(22.1)	(118.6)
Increase in inventories	**(35.7)**	(32.3)	(4.3)
Decrease/(increase) in trade and other receivables	**22.9**	25.5	(6.8)
Increase/(decrease) in trade and other payables	**(30.3)**	(37.8)	0.9
Increase/(decrease) in provisions	**(1.4)**	59.1	71.8
Cash generated from operations	**203.1**	199.2	489.7
Interest	**(19.9)**	(20.6)	(64.5)
Tax paid	**(63.3)**	(45.4)	(93.7)
Net cash inflow from operating activities	**119.9**	133.2	331.5

Headline operating cash-flow

	Period ended 31 January 2013 £m	Period ended 28 January 2012 £m	Year ended 31 July 2012 £m
Net cash inflow from operating activities	**119.9**	133.2	331.5
Exclude			
Interest	**19.9**	20.6	64.5
Tax paid	**63.3**	45.4	93.7
Cash outflow in respect of exceptional operating items	**18.9**	22.4	38.2
Pension deficit payments	**37.9**	19.3	111.2
Include			
Expenditure on capitalised development, other intangible assets and property, plant and equipment	**(39.1)**	(39.7)	(91.2)
Disposals of property, plant and equipment in the ordinary course of business	**2.0**		0.7
Headline operating cash-flow	**222.8**	201.2	548.6

Free cash-flow

	Period ended 31 January 2013 £m	Period ended 28 January 2012 £m	Year ended 31 July 2012 £m
Net cash inflow from operating activities	**119.9**	133.2	331.5
Expenditure on capitalised development, other intangible assets and property, plant and equipment	**(39.1)**	(39.7)	(91.2)
Disposals of property, plant and equipment in the ordinary course of business	**2.0**		0.7
Investment in financial assets relating to pensions financing	**(12.0)**	(12.0)	(24.0)
Free cash-flow	**70.8**	81.5	217.0
Investment in other financial assets	**(0.1)**		(0.3)
Acquisition of businesses	**(0.5)**	(169.0)	(167.5)
Disposal of businesses	**0.7**	0.9	47.3
Net cash-flow used in financing activities	**(23.3)**	(33.4)	(151.5)
Net increase/(decrease) in cash and cash equivalents	**47.6**	(120.0)	(55.0)

15 Related party transactions

The related party transactions in the period were consistent with the nature and size of transactions disclosed in the Annual Report for the year ended 31 July 2012.