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News release

London, Wednesday 18 September 2013
For immediate release

Annual results for the year ended 31 July 2013

	Headline*				Statutory	
	2013 £m	2012 £m	Growth	Underlying#	**2013 £m**	2012 £m
Revenue	**3,109**	3,038	2%	2%	**3,109**	3,030
Operating profit	**560**	554	1%	1%	**493**	407
Operating margin	**18.0%**	18.2%	(20) bps	–	**15.9%**	13.4%
Pre-tax profit	**498**	497	0%	1%	**442**	366
Basic EPS	**92.7p**	92.6p	0%		**90.7p**	65.4p
Free cash-flow	**237**	217				
Dividend	**39.5p**	38.0p	4%		**39.5p**	38.0p
Special dividend	**30.0p**	-			**30.0p**	-
Return on capital employed	**16.6%**	16.5%	10 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, 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

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

“We continued to invest to rebalance revenue and profit streams away from government to commercial customers, and also raise our exposure to faster growing markets. This on-going realignment allowed us to grow revenue, despite a difficult trading environment. Underlying revenue growth in Smiths Detection, John Crane and Flex-Tek more than offset declines in Smiths Medical and Smiths Interconnect. Headline margins were affected by the increased investment in future growth drivers across the Group, contract challenges in Smiths Detection, and the introduction of the US medical device tax in Smiths Medical.

“Our priority is to continue to raise our investment in sales, marketing and new product development to generate medium to long-term value for our shareholders through sustainable growth. We are funding this investment by delivering operational improvements and efficiencies with initiatives underway across all divisions. We are also committed to managing Group capital allocation to increase shareholder value.

“The Group’s capital structure and its strong and stable cash flows are more than adequate to meet the immediate investment needs of the business. The Board is recommending a return of cash to shareholders of around £118m, in the form of a special dividend of 30 pence per share.”

Philip Bowman
Chief Executive

Divisional highlights*

	% of Group headline revenue	Underlying headline revenue growth*	Underlying headline profit growth*	Headline operating profit margin		Headline return on capital employed	
				2013	2012	**2013**	2012
John Crane	32%	**2%**	**10%**	**23.4%**	21.6%	**25.7%**	24.0%
Smiths Medical	27%	**(1)%**	**(7)%**	**22.2%**	23.5%	**16.6%**	17.6%
Smiths Detection	18%	**8%**	**(16)%**	**10.4%**	13.3%	**8.8%**	10.3%
Smiths Interconnect	15%	**(1)%**	**3%**	**14.9%**	14.7%	**12.4%**	12.3%
Flex-Tek	8%	**8%**	**13%**	**17.1%**	16.3%	**30.8%**	28.4%
Group	100%	**2%**	**1%**	**18.0%**	18.2%	**16.6%**	16.5%

John Crane

- Revenue up 2% driven by both original equipment and aftermarket revenue, particularly in the oil and gas sector
- Margins improved 180 basis points to 23.4%, a new high
- Sales to emerging markets grew 7% while investment in new products rose 9%
- Order book provides visibility for continued growth through the first half of financial year 2014.

Smiths Medical

- Revenue declined 1% on lower hardware sales and flat single-use consumables
- Trading in developed markets affected by constrained hospital budgets, slow procedure rates and adverse pricing
- Invested in additional sales capabilities in emerging markets; 12% increase in new product development
- Margins constrained by incremental investment in growth drivers (£10m) and US medical device tax (£4m)
- Developed markets likely to be challenging; margins should benefit from restructuring initiatives

Smiths Detection

- Revenue up 8%, driven by transportation, ports and borders
- Margins affected by the impact of execution challenges on certain contracts
- Strong new product pipeline: including Hi-Scan 10080 XCT scanner and CIP-300 car screener
- Order book slightly behind last year; scope to improve margins through cost-saving initiatives

Smiths Interconnect

- Revenue down 1% as growth in connectors offset by declines in microwave and power management
- Investment in new products increased 5% while emerging market sales grew 5%
- Margins up 20 basis points reflecting productivity gains
- Markets remain challenging, particularly for US and European defence customers

Flex-Tek

- Revenue up 8% driven primarily by aerospace and US residential construction
- Improved volumes, mix and pricing contributed to a 13% increase in profit
- Aerospace and US construction sectors expected to support continued sales growth
- Margins 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 18 September. 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 0033

International: +44 (0)20 3426 2845

US/Canada toll free: 1 866 928 6048

An audio replay is available for seven days on the following numbers (access PIN 641156#):

UK toll free: 0808 237 0026

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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 £442m (2012: £366m) and earnings per share were 90.7p (2012: 65.4p).

The items excluded from headline performance comprise:

- amortisation and impairment of acquired intangible assets of £47m (2012: £62m);
- £17m in connection with John Crane, Inc. asbestos litigation (2012: £44m);
- £8m associated with Titeflex Corporation litigation following establishment last year of a 10-year rolling provision in respect of future claims (2012: £55m);
- £8m of exceptional restructuring costs (2012: £15m);
- costs of acquisitions, disposals and aborted transactions of £3m (2012: £2m);
- £5m profit on disposal of property (2012: nil);
- £1m profit on disposal of diabetes intellectual property (2012: £1m);
- £1m profit on disposal of businesses (2012: £31m);
- £2m gain on reassessed contingent consideration provided on acquisitions (2012: £2m);
- £4m gain on changes to pensions plans (2012: nil);
- £16m for retirement benefit finance income (2012: £24m); and
- financing losses of £2m (2012: £3m).

Chief Executive's review

Results summary

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

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

John Crane grew revenue despite a cyclical slowdown in some of its end markets, particularly first-fit OEM customers in the turbo-machinery and general industrial areas. However, overall growth rates have shown some recent signs of improvement. Margins increased again to record highs because of better volumes and pricing, more than offsetting cost inflation and investment in growth initiatives. Smiths Medical saw sales decline as weakness in developed markets outweighed growth in emerging markets. Trading in developed economies deteriorated during the year reflecting hospital capital budget constraints and falling medical procedures weighing on infusion pump and safety sales. It also reflects a strong comparator period which was boosted by the launch of the new Medfusion 4000 infusion pump. Margins also fell with the introduction of the US medical device tax and with significantly increased investment to drive future growth through new product development and expanded sales and marketing capabilities in emerging markets. Smiths Detection saw good revenue growth across most of its market segments, driven by a strong first half. As anticipated, sales growth flattened in the second half against a strong comparator period. Profitability fell, as mentioned above. The performance improvement programme, underway since September 2011, generated cost savings and operational enhancements. Smiths Interconnect revenues fell slightly as growth in connectors was offset by declines in power management and microwave. Productivity gains helped enhance margins, despite the lower volumes. Flex-Tek achieved strong revenue growth across the aerospace and construction markets, pushing margins to recent highs as a result of its operational gearing.

Strategy

Our strategy is to grow shareholder value by:

- Delivering revenue growth through investment in organic drivers, including new product development and expansion in high-growth markets, and through targeted acquisitions
- Enhancing margins through a relentless drive for operational improvement across all our businesses
- Transforming Smiths into a world-class organisation through smarter ways of working and having the best people
- Promoting a culture of responsibility in everything we do
- Generating strong cash-flows with better balance sheet management
- Allocating capital rigorously across the business through active and disciplined portfolio management and a targeted acquisition strategy.

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

Investing to accelerate revenue growth – new products

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

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

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

Investing to accelerate revenue growth – high-growth markets

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

Operational improvements to enhance margins and invest in growth

We are currently evaluating another phase of restructuring opportunities across all divisions. This next phase will concentrate on three areas: site rationalisation with a particular focus on manufacturing footprint to support future growth while lowering costs; organisational effectiveness through delayering and broadening management spans of control; and the upgrading of information systems - particularly in John Crane - to improve decision-making and to support the next stage of globalisation. We anticipate these plans will generate £50m of annualised savings for reinvestment in sales, marketing and new product development, and will cost around £100m over a three-year period. These will be charged as exceptional items. There will be some accompanying capital expenditure. We expect to provide further details of John Crane's programme at the investor day in December and for the other divisions at the interim results in March 2014.

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

Towards a world-class organisation

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

Promoting responsibility

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

We have also undertaken several initiatives during the year to promote our Code of Business Ethics. We built on the anti-bribery and corruption course that we launched last year by updating the training on international trade compliance and competition & anti-trust. We also recognise the growing importance of the emerging markets and the challenges of operating in these markets. We built on the success of the global ethics forum held in China last year by hosting our second in Brazil in October 2012.

Strong cash generation and capital allocation

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

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

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

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

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

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

Dividend

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

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

Outlook

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

We see significant opportunities to generate value for shareholders although we continue to be cautious about sectors such as defence and healthcare which are subject to government funding constraints. However, we remain well placed to benefit from growth in energy demand, the need for new fuel-efficient aircraft, increased US residential construction and the ever present need for improved security in an uncertain world. We will continue to focus on investing to grow sales, delivering further operational improvements, while maintaining strong cash conversion and improved returns. Outlook statements for the divisions are provided in the Business review.

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

Philip Bowman
Chief Executive

Business review

Revenue

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

Profit

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

Operating profit on a statutory basis, after taking account of the items excluded from the headline figures, was £493m (2012: £407m).

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

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

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

Cash generation

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

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

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

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

John Crane

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

Performance

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

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

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

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

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

Business developments

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

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

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

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

Research and development

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

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

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

Smiths Medical

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

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

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

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

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

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

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

The medication delivery business was unable to repeat the strong second half seen in 2012, and full year results declined 2%. However, ambulatory infusion revenue grew well, through the continued success of our CADD-Solis pumps and dedicated disposable sets, as well as launches of CADD-Solis PIB in Canada and CADD-Solis VIP in the US. Infusion system revenue fell, reflecting hospital capital constraints and deferrals, with spending priorities currently on EMR and IT infrastructure. Medfusion 4000 continues to have a robust order pipeline, and we are well placed to capture further growth as conditions improve.

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

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

Research and development

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

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

Outlook

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

Smiths Detection

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

Performance

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

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

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

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

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

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

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

Transportation revenue grew 17% including airport contracts from customers in Qatar, Spain, New Zealand and Canada. Smiths Detection was selected to equip the new Terminal 2 at Heathrow Airport with advanced X-ray machines to check passengers' hand-baggage, and to upgrade security checkpoints in other terminals. Investment by most existing airport operators and governments has been curtailed but new airports and terminals are planned, mainly in the Middle East and Asia Pacific.

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

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

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

Research and development

Smiths Detection remains committed to the funded development of its main technologies and new products and systems, to maintain its competitive position. Company-funded R&D was broadly stable at £36m or 6.5% of revenue (2012: £37m or 7.2%). This includes £16m of capitalised projects. Smiths Detection actively seeks customer and government support for R&D which totalled £6m in the period (2012: £6m). Total R&D spend was £42m (2012: £43m) or 7.6% of revenue. Main developments included the CIP-300 low-energy X-ray scanner to meet increasing demand for a system to detect explosives, drugs, stowaways and contraband hidden in cars and light motor vehicles. The system allows drivers and passengers to remain in their vehicles during screening. The launch of a Threat Identification Module (TIM) allows airport operators to upgrade existing X-ray systems to comply with the January 2014 EU change to the regulations on transfer passengers carrying liquids on board flights.

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

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

Outlook

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

Smiths Interconnect

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

Performance

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

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

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

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

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

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

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

After exceptional growth in 2012, Microwave's underlying revenue declined 2% against a strong comparator, but consolidated its position despite significant headwinds. In defence, Microwave's largest end market, we experienced delays in follow-on production awards for several projects, particularly in the second half, although good progress was made on several existing military programmes. In wireless telecoms, there was continued traction in developing regions as Indian and Chinese network operators started to recognise the benefits of using PIM (passive intermodulation) test equipment. We also significantly increased market share in the US, gaining a key new customer and increasing sales to other operators for our network optimisation products. Sales of the KuStream airborne antenna system weakened in the second half as no new notable airline orders were secured by our major customer. Nonetheless, new opportunities with new products and alternative customers are being progressed. Despite strong competition, we successfully retained a major cable assembly project for the production testing of consumer handheld devices, which generated sufficient demand to match the strong growth achieved in the prior year.

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

Research and development

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

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

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

Outlook

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

Flex-Tek

	2013 £m	2012 £m	Reported growth	Underlying growth
Revenue	**253**	233	9%	8%
Headline operating profit	**43**	38	14%	13%
Headline operating margin	**17.1%**	16.3%	80 bps	
Statutory operating profit/(loss)	**36**	(17)		
Return on capital employed	**30.8%**	28.4%	240 bps	

Performance

Flex-Tek's reported revenue grew 9%, or £20m, driven by an underlying increase of £18m (8%) and a £2m gain from currency translation. Continued revenue growth in Fluid Management and sales to the reviving US residential construction market formed the basis for the improvement. Heat Solutions and Flexible Solutions revenues were flat to prior year. Headline operating margin rose 80 basis points to 17.1% as a result of the increased volumes and associated operational gearing and positive mix from faster growing aerospace sales. The underlying increase in operating profit of 13% (£5m) stemmed from higher volumes, pricing and the benefits of our cost-saving initiatives.

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

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

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

Sales of our flexible gas piping and HVAC ducting to the construction market rose 18%. According to the US Census Bureau, the July 2013 seasonally adjusted annual rate of new single family home starts was slightly below 600,000, a 15% increase from July 2012. Our efforts to cross-sell our ducting, flexible gas piping and HVAC heating element product lines to the US distribution market continue to be successful as we gain market share. We have also invested in new sales efforts for our flexible gas piping to be introduced into the UK market.

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

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

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

Outlook

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

Financial review

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

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

Exceptional and other items relating to continuing activities excluded from headline profit before tax
These items amounted to a charge of £56m compared to a charge of £131m in 2012. They comprised:

- Amortisation and impairment of intangible assets acquired in business combinations of £47m (2012: £62m). The charge relates principally to technology and customer relationships;
- A charge of £17m (2012: £44m) in connection with John Crane, Inc. asbestos litigation;
- A charge of £8m (2012: £55m) associated with Titeflex Corporation litigation following the establishment last year of a 10-year rolling provision in respect of future claims;
- A charge of £8m (2012: £15m) in respect of restructuring, principally relating to a performance improvement programme in Smiths Detection that will conclude in 2015;
- Costs of acquisitions, disposals and aborted transactions of £3m (2012: £2m);
- £5m profit on disposal of property (2012: nil);
- £1m profit on disposal of diabetes intellectual property (2012: £1m);
- £1m profit on disposal of businesses (2012: £31m);
- £2m gain on reassessed contingent consideration provided on acquisitions (2012: £2m);
- £4m gain on changes to pension plans (2012: nil);
- A credit of £16m for retirement benefit income (2012: £24m); and
- A financing loss of £2m (2012: £3m). This represents exchange movements on derivatives and other financing instruments not hedge accounted under IFRS.

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

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

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

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

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

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

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

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

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

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

Taxation

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

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

The Group continues to take advantage of global manufacturing, research and development and other tax incentives, the tax-efficient use of capital and tax compliance management. A rate of between 26% and 28% is expected in the year ending 31 July 2014.

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

Return on capital employed

The return on capital employed (ROCE) is calculated over a rolling 12-month period and is the percentage that headline operating profit comprises of monthly average capital employed. Capital employed comprises total equity adjusted for goodwill recognised directly in reserves, post-retirement benefit related assets and liabilities net of tax, litigation provisions relating to exceptional items net of tax, and net debt. ROCE increased 10 basis points to 16.6% (2012: 16.5%) as a result of improved profitability across John Crane, Flex-Tek and Smiths Interconnect which was offset by reduced profitability in Smiths Medical as a result of its increased growth investment and in Smiths Detection, reflecting both its trading performance and capital management.

Retirement benefits

As required by IFRS the balance sheet reflects the net surplus or deficit in retirement benefit plans, taking assets at their market values at 31 July 2013 and evaluating liabilities at period-end AA corporate bond interest rates.

The tables below disclose the net status across a number of individual plans. Where any individual plan shows a surplus under IAS 19, this is disclosed on the balance sheet as a retirement benefit asset. The IAS 19 surplus of any one plan is not available to fund the IAS 19 deficit of another plan. The net pension deficit has declined to £254m at 31 July 2013 from £620m at 31 July 2012. The deficit reduction reflects the benefit of asset returns and, for the US, a slight increase in the discount rates upon which the liability is calculated.

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

The retirement benefit position was:

	31July 2013	31 January 2013	31 July 2012
Funded plans			
UK plans – funding status	**99%**	97%	91%
US plans – funding status	**81%**	74%	67%
Other plans – funding status	**80%**	71%	67%

	31July 2013	31 January 2013	31 July 2012
Deficit			
Funded plans	**(147)**	(276)	(516)
Unfunded plans	**(107)**	(106)	(104)
Total deficit	**(254)**	(382)	(620)
Retirement benefit assets	**121**	83	7
Retirement benefit liabilities	**(375)**	(465)	(627)
	(254)	(382)	(620)

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

£78m). In addition, the Group will invest £24m in an escrow account as part of the funding plan agreed with the Smiths Industries Pension Scheme (SIPS).

The approximate pension membership for the three main schemes at around the end of July 2013 is set out in the table below:

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

Exchange rates

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

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

Financial information

The financial information in this preliminary announcement which comprises the consolidated income statement, consolidated statement of comprehensive income, consolidated balance sheet, consolidated cash-flow statement, consolidated statement of changes in equity, accounting policies and related notes does not constitute statutory accounts within the meaning of Section 434 of the Companies Act 2006.

The statutory accounts for the year ended 31 July 2012 have been filed with the Registrar of Companies. The auditors have reported on those accounts and on the statutory accounts for the year ended 31 July 2013, which will be filed with the Registrar of Companies following the Annual General Meeting. Both the audit reports were unqualified and did not contain any statement under section 498 of the Companies Act 2006.

Consolidated income statement

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

Consolidated statement of comprehensive income

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

Consolidated balance sheet

	Notes	31 July 2013 £m	31 July 2012 £m
Non-current assets			
Intangible assets	11	**1,746.0**	1,717.1
Property, plant and equipment	12	**280.0**	270.5
Financial assets – other investments	14	**86.1**	60.9
Retirement benefit assets	9	**121.7**	7.2
Deferred tax assets	6	**185.4**	203.3
Trade and other receivables	16	**34.1**	37.4
Financial derivatives	20	**6.4**	7.2
		2,459.7	2,303.6
Current assets			
Inventories	15	**475.6**	438.5
Current tax receivable		**33.4**	15.3
Trade and other receivables	16	**695.5**	634.4
Cash and cash equivalents	18	**393.8**	205.6
Financial derivatives	20	**8.1**	7.9
		1,606.4	1,301.7
Total assets		**4,066.1**	3,605.3
Non-current liabilities			
Financial liabilities			
– borrowings	18	**(951.1)**	(821.7)
– financial derivatives	20	**(11.0)**	(1.1)
Provisions for liabilities and charges	21	**(258.1)**	(254.4)
Retirement benefit obligations	9	**(375.3)**	(627.4)
Deferred tax liabilities	6	**(73.1)**	(69.5)
Trade and other payables	17	**(31.0)**	(37.5)
		(1,699.6)	(1,811.6)
Current liabilities			
Financial liabilities			
– borrowings	18	**(187.1)**	(175.3)
– financial derivatives	20	**(5.8)**	(10.6)
Provisions for liabilities and charges	21	**(78.1)**	(77.3)
Trade and other payables	17	**(521.8)**	(468.2)
Current tax payable		**(80.1)**	(81.5)
		(872.9)	(812.9)
Total liabilities		**(2,572.5)**	(2,624.5)
Net assets		**1,493.6**	980.8
Shareholders' equity			
Share capital	22	**147.7**	147.3
Share premium account		**340.8**	331.9
Capital redemption reserve		**5.8**	5.8
Revaluation reserve		**1.7**	1.7
Merger reserve		**234.8**	234.8
Retained earnings	23	**929.2**	376.1
Hedge reserve	23	**(174.0)**	(124.8)
Total shareholders' equity		**1,486.0**	972.8
Non-controlling interest equity		**7.6**	8.0
Total equity		**1,493.6**	980.8

Consolidated statement of changes in equity

	Notes	Share capital and share premium £m	Other reserves £m	Retained earnings £m	Hedge reserve £m	Equity shareholders' funds £m	Non-controlling Interest £m	Total equity £m
At 31 July 2012		479.2	242.3	376.1	(124.8)	972.8	8.0	980.8
Profit for the year				356.6		356.6	1.6	358.2
Other comprehensive income								
Actuarial gains on retirement benefits and related tax				246.0		246.0		246.0
Exchange gains/(losses)				101.7	(0.2)	101.5	(1.7)	99.8
Fair value gains/(losses) and related tax				(0.9)	(49.0)	(49.9)		(49.9)
Total comprehensive income for the year				703.4	(49.2)	654.2	(0.1)	654.1
Transactions relating to ownership interests								
Exercises of share options	22	9.3				9.3		9.3
Taxation recognised on share options	6			1.0		1.0		1.0
Purchase of own shares	23			(11.0)		(11.0)		(11.0)
Dividends								
– equity shareholders	7			(152.4)		(152.4)		(152.4)
– non-controlling interest							(0.3)	(0.3)
Share-based payment	27			12.1		12.1		12.1
At 31 July 2013		**488.5**	**242.3**	**929.2**	**(174.0)**	**1,486.0**	**7.6**	**1,493.6**

	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 year				256.6		256.6	1.6	258.2
Other comprehensive income								
Actuarial losses on retirement benefits and related tax				(506.6)		(506.6)		(506.6)
Exchange (losses)/gains				(15.2)	0.1	(15.1)	0.3	(14.8)
Fair value gains/(losses) and related tax				5.9	(4.3)	1.6		1.6
Total comprehensive income for the year				(259.3)	(4.2)	(263.5)	1.9	(261.6)
Transactions relating to ownership interests								
Exercises of share options	22	3.0				3.0		3.0
Taxation recognised on share options	6			(0.8)		(0.8)		(0.8)
Purchase of own shares	23			(9.7)		(9.7)		(9.7)
Dividends								
– equity shareholders	7			(144.1)		(144.1)		(144.1)
– non-controlling interest							(0.3)	(0.3)
Share-based payment	27			14.4		14.4		14.4
At 31 July 2012		**479.2**	**242.3**	**376.1**	**(124.8)**	**972.8**	**8.0**	**980.8**

Consolidated cash-flow statement

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

Reconciliation of net cash-flow to movement in net debt

	Notes	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Net increase/(decrease) in cash and cash equivalents		**170.1**	(55.0)
Net (increase)/decrease in borrowings resulting from cash-flows		**(88.1)**	(1.3)
Movement in net debt resulting from cash-flows		**82.0**	(56.3)
Capitalisation, interest accruals and unwind of capitalisation fees		**(3.8)**	(0.5)
Movement from fair value hedging		**9.7**	(4.2)
Exchange differences		**(40.9)**	(1.4)
Movement in net debt in the year	18	**47.0**	(62.4)
Net debt at start of year		**(791.4)**	(729.0)
Net debt at end of year	18	**(744.4)**	(791.4)

Accounting policies

Basis of preparation

The accounts have been prepared in accordance with the Companies Act 2006 applicable to companies reporting under International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee (IFRS IC) interpretations, as adopted by the European Union, on a going concern basis and under the historical cost convention modified to include revaluation of certain financial instruments, share options and pension assets and liabilities, held at fair value as described below.

The accounting policies adopted are consistent with those of the previous financial year except for the adoption of 'Amendment to IAS 1: Presentation of Financial Statements - Presentation of items of other comprehensive income'. Adopting this new accounting requirement has changed the layout of the consolidated statement of comprehensive income.

Significant judgements, key assumptions and estimates

The preparation of the accounts in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the accounts and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from these estimates. The key estimates and assumptions used in these consolidated financial statements are set out below.

Revenue recognition

The timing of revenue recognition on contracts depends on the assessed stage of completion of contract activity at the balance sheet date. This assessment requires the expected total contract revenues and costs to be estimated based on the current progress of the contract. Revenue of £53.0m (31 July 2012: £34.5m) has been recognised in the period in respect of contracts in progress at the period end with a total expected value of £149.7m (31 July 2012: £172.2m). A 5% reduction in the proportion of the contract activity recognised in the current year would have reduced operating profit by an estimated £0.5m (31 July 2012: £0.1m) for Smiths Detection and £0.3m (31 July 2012: £0.6m) for Smiths Interconnect.

In addition to contracts accounted for on a percentage of completion basis, Smiths Detection also has long-term contractual arrangements for the sale of goods and services. Margins achieved on these contracts can reflect the impact of commercial decisions made in different economic circumstances. In addition, contract delivery is subject to commercial and technical risks which can affect the outcome of the contract. Smiths Detection recognised revenue of £244.5m for goods and services this year in respect of contracts which were signed before the start of the year.

Smiths Medical has rebate arrangements in place with some distributors in respect of sales to end customers where sales prices have been negotiated by Smiths Medical. Rebates are estimated based on the level of discount derived from sales data from distributors, the amount of inventory held by distributors and the time lag between the initial sale to the distributor and the rebate being claimed. The rebate accrual at 31 July 2013 was £17.0m (31 July 2012: £18.8m).

Impairment

Goodwill is tested at least annually for impairment and intangible assets acquired in business combinations are tested if there are any indications of impairment, in accordance with the accounting policy set out below. The recoverable amounts of cash generating units and intangible assets are determined based on value in use calculations. These calculations require the use of estimates including projected future cash-flows and other future events.

See note 11 for details of the critical assumptions made, including the sales and margin volatility in Smiths Detection and Smiths Interconnect and disclosures on the sensitivity of the impairment testing to these key assumptions, including details of the changes in assumptions required to trigger an impairment in Smiths Interconnect Power Management.

Provisions for liabilities and charges

As previously reported, John Crane, Inc., a subsidiary of the Group, is currently one of many co-defendants in litigation relating to products previously manufactured which contained asbestos. Provision of £210.0m (31 July 2012: £213.1m) has been made for the future defence costs which the Group is expected to incur and the expected costs of future adverse judgments against John Crane, Inc. Whilst published incidence curves can be used to estimate the likely future pattern of asbestos related disease, John Crane, Inc.'s claims experience is significantly impacted by other factors which influence the US litigation environment. These can include: changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels; and legislative and procedural changes in both the state and federal court systems. Therefore, because of the significant uncertainty associated with the future level of asbestos claims and of the costs arising out of the related litigation, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred. As a result, the provision may be subject to potentially material revisions from time to time if new information becomes available as a result of future events. John Crane, Inc. takes account of the advice of an expert in asbestos liability estimation in quantifying the expected costs.

As previously reported, Titeflex Corporation, a subsidiary of the Group in the Flex-Tek division, has received a number of claims from insurance companies seeking recompense on a subrogated basis for the effects of damage allegedly caused by lightning strikes in relation to its flexible gas piping product. It has also received a number of product liability claims regarding this product, some in the form of purported class actions. Titeflex Corporation believes that its products are a safe and effective means of delivering gas when installed in accordance with the manufacturer's instructions and local and national codes, however some claims have been settled on an individual basis without admission of liability. Provision of £65.6m (31 July 2012: £61.8m) has been made for the costs which the Group is expected to incur in respect of these claims. However, because of the significant uncertainty associated with the future level of claims, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred. As a result the provision may be subject to potentially material revisions if new information becomes available.

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

Retirement benefits

The consolidated financial statements include costs in relation to, and provision for, retirement benefit obligations. The costs and the present value of any related pension assets and liabilities depend on such factors as life expectancy of the members, the returns that plan assets generate and the discount rate used to calculate the present value of the liabilities. The Group uses previous experience and impartial actuarial advice to select the values of critical estimates. The estimates, and the effect of variances in key estimates, are disclosed in note 9.

At 31 July 2013 there is a retirement benefit asset of £121.7m (2012: £7.2m) which arises from the rights of the employers to recover the surplus at the end of the life of the scheme. If the pension schemes were wound up while they still had members, the schemes would need to buy out the benefits of all members. The buy outs would cost significantly more than the present value of the scheme liabilities calculated in accordance with IAS 19: Employee benefits.

Taxation

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

Accounting policies

Basis of consolidation

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

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

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

Foreign currencies

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

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

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

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

Revenue

Revenue is measured at the fair value of the consideration received, net of trade discounts and sales taxes. Revenue is discounted only where the impact of discounting is material.

Sale of goods

Revenue from the sale of goods is recognised when the risks and rewards of ownership have been transferred to the customer, the amount of revenue can be measured reliably and recovery of the consideration is probable. For established products with simple installation requirements, revenue is recognised when the product is delivered to the customer in accordance with the agreed delivery terms. For products which are technically innovative, highly customised or require complex installation, revenue is recognised when the customer has completed its acceptance procedures.

Services

Revenue from services is recognised in accounting periods in which the services are rendered, by reference to completion of the specific transaction, assessed on the basis of the actual service provided as a proportion of the total services to be provided. Depending on the nature of the contract, revenue will be recognised on the basis of the proportion of the contract term completed, the proportion of the contract costs incurred or the specific services provided to date.

Construction contracts

Contracts for the construction of substantial assets are accounted for as construction contracts if the customer specifies major structural elements of the design, including the ability to amend the design during the construction process. These projects normally involve installing customised systems with site specific integration requirements.

Where the outcome of a construction contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date. The Group uses the 'percentage of completion method' to determine the appropriate amount to recognise in a given period. The assessment of the stage of completion is dependent on the nature of the contract, but will generally be based on the estimated proportion of the total contract costs which have been incurred to date. If a contract is expected to be loss-making, a provision is recognised for the entire loss.

Employee benefits

Share-based compensation

The Group operates a number of equity-settled and cash-settled share-based compensation plans.

The fair value of the shares or share options granted is recognised as an expense over the vesting period to reflect the value of the employee services received. The fair value of options granted, excluding the impact of any non-market vesting conditions, is calculated using established option pricing models, principally binomial models. The probability of meeting non-market vesting conditions, which include profitability targets, is used to estimate the number of share options which are likely to vest.

For cash-settled share-based payment, a liability is recognised based on the fair value of the payment earned by the balance sheet date. For equity-settled share-based payment, the corresponding credit is recognised directly in reserves.

Pension obligations and post-retirement benefits

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

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

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

Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

Exceptional items

Items which are material either because of their size or their nature, and material items which are non-recurring, are presented within their relevant consolidated income statement category, but highlighted through separate disclosure. The separate reporting of exceptional items helps provide a better picture of the Company’s underlying performance. Items which are included within the exceptional category include:

- profits/(losses) on disposal of businesses and costs of acquisitions and disposals;
- spend on the integration of significant acquisitions and other major restructuring programmes;
- significant goodwill or other asset impairments;
- income and expenditure relating to material litigation in respect of products no longer in production; and
- other particularly significant or unusual items.

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

Taxation

The charge for taxation is based on profits for the year and takes into account taxation deferred because of temporary differences between the treatment of certain items for taxation and accounting purposes.

Deferred tax is provided in full using the balance sheet liability method. A deferred tax asset is recognised where it is probable that future taxable income will be sufficient to utilise the available relief. Tax is charged or credited to the income statement except when it relates to items charged or credited directly to equity, in which case the tax is also dealt with in equity.

Deferred tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary differences is controlled by the Company and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax liabilities and assets are not discounted.

Discontinued operations

A discontinued operation is a component of the Group’s business that represents a separate major line of business or geographical area of operations that has been disposed of, has been abandoned or meets the criteria to be classified as held for sale.

Discontinued operations are presented on the income statement as a separate line and are shown net of tax.

Intangible assets

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the identifiable net assets of the acquired subsidiary at the date of acquisition.

Goodwill arising from acquisitions of subsidiaries after 1 August 1998 is included in intangible assets, tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold. Goodwill arising from acquisitions of subsidiaries before 1 August 1998 was set against reserves in the year of acquisition.

Goodwill is tested for impairment at least annually. Any impairment is recognised immediately in the income statement. Subsequent reversals of impairment losses for goodwill are not recognised.

Research and development

Expenditure on research and development is charged to the income statement in the year in which it is incurred with the exception of:

- amounts recoverable from third parties; and
- expenditure incurred in respect of the development of major new products where the outcome of those projects is assessed as being reasonably certain as regards viability and technical feasibility. Such expenditure is capitalised and amortised straight line over the estimated period of sale for each product, commencing in the year that sales of the product are first made.

The cost of development projects which are expected to take a substantial period of time to complete, and commenced after 1 August 2009, includes attributable borrowing costs.

Intangible assets acquired in business combinations

The identifiable net assets acquired as a result of a business combination may include intangible assets other than goodwill. Any such intangible assets are amortised straight line over their expected useful lives as follows:

Patents, licences and trademarks	up to 20 years
Technology	up to 12 years
Customer relationships	up to 7 years

The assets' useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Software, patents and intellectual property

The estimated useful lives are as follows:

Software	up to 7 years
Patents and intellectual property	shorter of the economic life and the period the right is legally enforceable

The assets' useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Property, plant and equipment

Property, plant and equipment is stated at historical cost less accumulated depreciation and any recognised impairment losses.

Land is not depreciated. Depreciation is provided on other assets estimated to write off the depreciable amount of relevant assets by equal annual instalments over their estimated useful lives. In general, the rates used are: Freehold and long leasehold buildings – 2%; Short leasehold property – over the period of the lease; Plant, machinery, etc. – 10% to 20%; Fixtures, fittings, tools and other equipment – 10% to 33%.

The cost of any assets which are expected to take a substantial period of time to complete whose construction began after 1 August 2009 includes attributable borrowing costs.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in, first-out (FIFO) method. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). The cost of items of inventory which take a substantial period of time to complete includes attributable borrowing costs for all items whose production began after 1 August 2009. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

Trade and other receivables

Trade receivables are initially recognised at fair value and subsequently measured at amortised cost, less any appropriate provision for estimated irrecoverable amounts. A provision is established for irrecoverable amounts when there is objective evidence that amounts due under the original payment terms will not be collected.

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

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

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

Assets and businesses held for sale
Assets and businesses classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell. Impairment losses on initial classification as held for sale and gains or losses on subsequent remeasurements are included in the income statement. No depreciation is charged on assets and businesses classified as held for sale.

Assets and businesses are classified as held for sale if their carrying amount will be recovered or settled principally through a sale transaction rather than through continuing use. The asset or business must be available for immediate sale and the sale must be highly probable within one year.

Cash and cash equivalents
Cash and cash equivalents include cash at bank and in hand and highly liquid interest-bearing securities with maturities of three months or less.

In the cash-flow statement, cash and cash equivalents are shown net of bank overdrafts, which are included as current borrowings in liabilities on the balance sheet.

Financial assets
The classification of financial assets depends on the purpose for which the assets were acquired. Management determines the classification of an asset at initial recognition and re-evaluates the designation at each reporting date. Financial assets are classified as: loans and receivables, available for sale financial assets or financial assets where changes in fair value are charged (or credited) to the income statement.

Financial assets are initially recognised at transaction price when the Group becomes party to contractual obligations. The transaction price used includes transaction costs unless the asset is being fair valued through the income statement.

The subsequent measurement of financial assets depends on their classification. Loans and receivables are measured at amortised cost using the effective interest rate method. Available for sale financial assets are subsequently measured at fair value, with unrealised gains and losses being recognised in other comprehensive income. Financial assets where changes in fair value are charged (or credited) to the income statement are subsequently measured at fair value. Realised and unrealised gains and losses arising from changes in the fair value of the ‘financial assets at fair value through the income statement’ category are included in the income statement in the period in which they arise.

Financial assets are derecognised when the right to receive cash-flows from the assets has expired, or has been transferred, and the Company has transferred substantially all of the risks and rewards of ownership. When securities classified as available for sale are sold or impaired, the accumulated fair value adjustments previously taken to reserves are included in the income statement.

Financial assets are classified as current if they are expected to be realised within 12 months of the balance sheet date.

Financial liabilities
Borrowings are initially recognised at the fair value of the proceeds, net of related transaction costs. These transaction costs, and any discount or premium on issue, are subsequently amortised under the effective interest rate method through the income statement as interest over the life of the loan, and added to the liability disclosed in the balance sheet. Related accrued interest is included in the borrowings figure.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least one year after the balance sheet date.

Derivative financial instruments and hedging activities
Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. The method of recognising any resulting gain or loss depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged.

Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in the income statement.

Fair value hedge
Changes in the fair values of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair values of the hedged assets or liabilities that are attributable to the hedged risk.

Net investment hedge
Hedges of net investments in foreign operations are accounted for similarly to cash-flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in other comprehensive income; the gain or loss relating to any ineffective portion is recognised immediately in the income statement.

When a foreign operation is disposed of gains and losses accumulated in equity related to that operation are included in the income statement.

Cash-flow hedge

The effective portions of changes in the fair values of derivatives that are designated and qualify as cash-flow hedges are recognised in equity. The gain or loss relating to any ineffective portion is recognised immediately in the income statement.

Amounts accumulated in the hedge reserve are recycled in the income statement in the periods when the hedged items will affect profit or loss (for instance when the forecast sale that is hedged takes place). If a forecast transaction that is hedged results in the recognition of a non-financial asset (for example, inventory) or a liability, the gains and losses previously deferred in the hedge reserve are transferred from the reserve and included in the initial measurement of the cost of the asset or liability.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in the hedge reserve at that time remains in the reserve and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in other comprehensive income is immediately transferred to the income statement.

Fair value of financial assets and liabilities

The fair values of financial assets and financial liabilities are the amounts at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

'IFRS 7: Financial instruments: Disclosures' requires fair value measurements to be classified according to the following hierarchy:

- level 1 – quoted prices in active markets for identical assets or liabilities;
- level 2 – valuations in which all inputs are observable either directly (ie as prices) or indirectly (ie derived from prices); and
- level 3 – valuations in which one or more inputs are not based on observable market data.

The Group uses the following methods to estimate the fair values of its financial instruments:

- cash, trade receivables and payables and floating rate borrowings – the carrying value is a good approximation of the fair value;
- government bonds – quoted market prices (level 1);
- fixed rate borrowings – quoted market prices of equivalent instruments (level 2); and
- forward exchange contracts, currency swaps, interest rate instruments and embedded derivatives – net present value of the future cash-flows, calculated using market data at the balance sheet date (principally exchange rates and yield curves) (level 2).

Borrowings are carried on the balance sheet at amortised cost adjusted for fair value interest rate hedging. The fair value of fixed rate borrowings is only used for supplementary disclosures.

Dividends

Dividends are recognised as a liability in the period in which they are authorised. The interim dividend is recognised when it is paid and the final dividend is recognised when it has been approved by shareholders at the Annual General Meeting.

Recent accounting developments

The following standards and interpretations have been issued by the IASB and may affect future annual reports and accounts.

- 'IFRS 9: Financial instruments'
- 'IFRS 10: Consolidated financial statements'
- 'IAS 27 (Revised 2011): Separate financial statements'
- 'IFRS 11: Joint arrangements'
- 'IAS 28 (Revised 2011): Investments in associates and joint ventures'
- 'IFRS 12: Disclosure of interests in other entities'
- 'IFRS 13: Fair value measurement'
- 'IAS 19 (Revised 2011): Employee benefits'
- Amendment to 'IAS 36: Impairment of assets' on recoverable amount disclosures.

A review of the impact of these standards and interpretations is being undertaken, and the impact of adopting them will be determined once this review has been completed. Based on the work completed to date, the changes are not expected to have a material impact on the Group's reported position or performance, except for the implementation of IAS 19 (Revised 2011): Employee benefits. An estimate of the impact of adopting this standard, which is expected to be implemented in the year ending 31 July 2014, is provided at the end of note 9.

Notes to the accounts

1 Segment information

Analysis by operating segment

The Group is organised into five divisions: John Crane, Smiths Medical, Smiths Detection, Smiths Interconnect and Flex-Tek. These divisions design and manufacture the following products:

- John Crane – mechanical seals, seal support systems, engineered bearings, power transmission couplings and specialist filtration systems;
- Smiths Medical – medication delivery systems, vital care products and safety devices that prevent needlestick injuries and reduce cross-infection;
- Smiths Detection – sensors that detect and identify explosives, narcotics, weapons, chemical agents, biohazards and contraband;
- Smiths Interconnect – specialised electronic and radio frequency components and sub-systems that connect, protect and control critical systems;
- Flex-Tek – engineered components that heat and move fluids and gases, flexible hosing and rigid tubing.

The position and performance of each division is reported monthly to the Board of Directors. This information is prepared using the same accounting policies as the consolidated financial information except that the Group uses headline operating profit to monitor divisional results and operating assets to monitor divisional position. See note 3 for an explanation of which items are excluded from headline measures.

Intersegment sales and transfers are charged at arm's length prices.

							Year ended 31 July 2013
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £m
Revenue	**985.7**	**850.4**	**559.0**	**460.6**	**252.9**		**3,108.6**
Divisional headline operating profit	**230.5**	**189.1**	**58.0**	**68.8**	**43.2**		**589.6**
Corporate headline operating costs						**(29.9)**	**(29.9)**
Headline operating profit/(loss)	**230.5**	**189.1**	**58.0**	**68.8**	**43.2**	**(29.9)**	**559.7**
Exceptional operating items (note 4)	**(10.8)**	**1.2**	**(4.9)**	**(0.2)**	**(7.0)**	**1.8**	**(19.9)**
Amortisation and impairment of acquired intangible assets	**(14.2)**	**(11.4)**	**(1.1)**	**(19.7)**	**(0.2)**		**(46.6)**
Operating profit/(loss)	**205.5**	**178.9**	**52.0**	**48.9**	**36.0**	**(28.1)**	**493.2**
Exceptional finance costs – adjustment to discounted provision (note 4)	**(3.3)**				**(0.9)**		**(4.2)**
Net finance costs – other							**(47.2)**
Profit before taxation							**441.8**

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

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

1 Segment information continued

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

	Year ended 31 July 2013						
	John Crane £m	**Smiths Medical £m**	**Smiths Detection £m**	**Smiths Interconnect £m**	**Flex-Tek £m**	**Reconciling items £m**	**Total £m**
Depreciation	**14.4**	**19.1**	**6.6**	**7.5**	**3.3**	**1.4**	**52.3**
Amortisation	**2.6**	**15.8**	**12.1**	**0.8**		**49.8**	**81.1**
Other non-cash items							
– share-based payment	**1.7**	**1.7**	**0.7**	**0.6**	**2.0**	**6.1**	**12.8**

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

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

The capital expenditure for each division is:

	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
Capital expenditure year ended 31 July 2013	**17.3**	**39.8**	**22.4**	**9.7**	**2.6**	**5.7**	**97.5**
Capital expenditure year ended 31 July 2012	16.8	31.7	20.2	7.9	2.9	12.6	92.1

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

	31 July 2013					
	John Crane £m	**Smiths Medical £m**	**Smiths Detection £m**	**Smiths Interconnect £m**	**Flex-Tek £m**	**Total £m**
Property, plant, equipment, development projects and other intangibles	**100.8**	**163.8**	**108.7**	**36.7**	**20.4**	**430.4**
Working capital assets	**363.0**	**245.2**	**343.1**	**159.5**	**78.1**	**1,188.9**
Operating assets	**463.8**	**409.0**	**451.8**	**196.2**	**98.5**	**1,619.3**
Derivatives, tax and retirement benefit assets						**355.0**
Goodwill and acquired intangibles						**1,576.9**
Corporate assets						**121.1**
Cash						**393.8**
Total assets						**4,066.1**
Working capital liabilities	**(166.8)**	**(96.8)**	**(202.0)**	**(69.5)**	**(28.5)**	**(563.6)**
Corporate and non-headline liabilities						**(325.4)**
Derivatives, tax and retirement benefit liabilities						**(545.3)**
Borrowings						**(1,138.2)**
Total liabilities						**(2,572.5)**
Average divisional capital employed	**897.9**	**1,141.4**	**657.4**	**554.4**	**140.2**	**3,391.3**
Average corporate capital employed						**(29.6)**
Average total capital employed						**3,361.7**

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

Capital employed is a non-statutory measure of invested resources. It comprises statutory net assets adjusted to add goodwill recognised directly in reserves in respect of subsidiaries acquired before 1 August 1998 of £815.2m (2012: £815.2m) and eliminate post-retirement benefit related assets and liabilities and litigation provisions relating to exceptional items, both net of related tax, and net debt.

1 Segment information continued

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

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

Analysis of revenue

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

John Crane	Original equipment manufacture £m	Aftermarket: Oil, gas and petrochemical £m	Aftermarket: Chemical and pharmaceutical £m	Aftermarket: Distributors £m	Aftermarket: General industry £m	Total £m
Revenue year ended 31 July 2013	**363.5**	**379.8**	**84.3**	**71.2**	**86.9**	**985.7**
Revenue year ended 31 July 2012	359.5	374.2	80.6	68.6	90.5	973.4

Smiths Medical	Medication delivery £m	Vital care £m	Safety devices £m	Total £m
Revenue year ended 31 July 2013	**237.7**	**354.5**	**258.2**	**850.4**
Revenue year ended 31 July 2012	241.2	346.6	268.0	855.8

Smiths Detection	Transportation £m	Ports and borders £m	Military £m	Emergency responders £m	Critical infrastructure £m	Non-security £m	Total £m
Revenue year ended 31 July 2013	**286.2**	**95.7**	**69.3**	**13.7**	**91.3**	**2.8**	**559.0**
Revenue year ended 31 July 2012	245.4	81.4	55.6	20.2	110.1	6.5	519.2

Smiths Interconnect	Connectors £m	Microwave £m	Power management £m	Total £m
Revenue year ended 31 July 2013	**161.2**	**200.8**	**98.6**	**460.6**
Revenue year ended 31 July 2012	156.3	202.9	89.3	448.5

Flex-Tek	Fluid Management £m	Flexible Solutions £m	Heat Solutions £m	Construction Products £m	Total £m
Revenue year ended 31 July 2013	**87.8**	**35.7**	**56.1**	**73.3**	**252.9**
Revenue year ended 31 July 2012	80.1	36.0	55.6	61.5	233.2

1 Segment information continued

Analysis of revenue continued

The Group's statutory revenue is analysed as follows:

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Sale of goods	**2,855.5**	2,792.0
Services	**213.5**	212.5
Contracts	**39.6**	25.6
	3,108.6	3,030.1

Analysis by geographical areas

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

	Revenue		Intangible assets, property plant and equipment and investments accounted for using the equity method	
	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m	31 July 2013 £m	31 July 2012 £m
United Kingdom	**128.8**	130.3	**140.9**	143.8
Germany	**155.7**	171.8	**334.6**	299.4
France	**93.5**	95.8	**20.2**	15.8
Other European	**356.8**	374.8	**78.0**	72.0
United States of America	**1,398.1**	1,353.0	**1,278.3**	1,276.0
Canada	**122.3**	125.8	**12.6**	10.7
Mexico	**33.1**	34.7	**10.4**	9.2
Japan	**114.3**	129.5	**18.4**	22.7
China	**99.1**	92.8	**60.3**	60.3
Rest of the World	**606.9**	521.6	**72.3**	77.7
	3,108.6	3,030.1	**2,026.0**	1,987.6

2 Operating profit is stated after charging

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Research and development expense	**82.6**	78.5
Operating leases		
– land and buildings	**30.4**	27.0
– other	**10.8**	11.6

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Audit services		
Fees payable to the Company's auditors for the audit of the parent company and consolidated accounts	**0.5**	0.5
Fees payable to the Company's auditors and its associates for other services		
– the audit of the Company's subsidiaries, pursuant to legislation	**3.8**	3.4
– other services pursuant to legislation	**0.1**	0.1
	4.4	4.0
Tax services		
– advisory services	**0.1**	0.1
– compliance services	**0.1**	0.1
Other assurance services relating to corporate transactions	**0.6**	0.3
All other services	**0.1**	0.2

Other services relate to one-off projects.

3 Headline profit measures

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

The following items have been excluded from the headline measure:

- exceptional items, including income and expenditure relating to material litigation in respect of products no longer in production;
- amortisation and impairment of intangible assets acquired in a business combination – the charge is a non-cash item, and the directors believe that it should be added back to give a clearer picture of underlying performance;
- other financing gains and losses, which represent the potentially volatile gains and losses on derivatives and other financial instruments which do not fall to be hedge accounted under IAS 39; and
- financing credits and charges relating to retirement benefits.

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

	Notes	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Operating profit		**493.2**	406.6
Exclude			
– exceptional operating items	4	**19.9**	85.5
– amortisation and impairment of acquired intangible assets	11	**46.6**	61.6
Non-headline items in operating profit		**66.5**	147.1
Headline operating profit		**559.7**	553.7
Finance costs		**(51.4)**	(46.4)
Exclude			
– exceptional finance costs	4	**4.2**	4.5
– other financing gains and losses		**1.9**	2.8
– other financing income – retirement benefits	5	**(16.4)**	(23.5)
Non-headline items in finance costs		**(10.3)**	(16.2)
Headline finance costs		**(61.7)**	(62.6)
Profit before taxation		**441.8**	365.9
Non-headline items in operating profit		**66.5**	147.1
Non-headline items in finance costs		**(10.3)**	(16.2)
Headline profit before taxation		**498.0**	496.8
Profit after taxation – continuing operations		**358.2**	258.3
Exclude			
– non-headline items in profit before taxation		**56.2**	130.9
– tax on excluded items	6	**(48.4)**	(62.0)
– exceptional taxation items	4, 6		37.7
		7.8	106.6
Headline profit after taxation – continuing operations		**366.0**	364.9

Headline earnings before interest, tax depreciation and amortisation

Headline EBITDA, calculated as follows, is used to calculate one of Smiths cash-flow targets, see note 23 for details.

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Headline operating profit	**559.7**	553.7
Exclude:		
Depreciation	**52.3**	59.0
Amortisation of development costs	**21.3**	19.3
Amortisation of software, patents and intellectual property	**13.2**	12.9
Headline EBITDA	**646.5**	644.9

4 Exceptional items

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

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Operating items		
Restructuring programmes	**(7.8)**	(15.4)
Revision of estimated rebates		(7.8)
Sale of intellectual property relating to diabetes	**1.2**	0.6
Gains on changes to post-retirement benefits (note 9)	**3.5**	
Profit on disposal of businesses	**0.9**	30.8
Profit on disposal of property	**5.0**	
Adjustment to contingent consideration provided on acquisitions	**1.4**	2.4
Costs of acquisitions, disposals and aborted transactions	**(3.0)**	(2.0)
Litigation		
– provision for Titeflex Corporation claims (note 21)	**(6.8)**	(54.5)
– provision for John Crane, Inc. asbestos litigation (note 21)	**(14.3)**	(39.6)
	(19.9)	(85.5)
Financing items		
Exceptional finance costs – adjustment to discounted provision		
– provision for Titeflex Corporation claims (note 21)	**(0.9)**	(0.5)
– provision for John Crane, Inc. asbestos litigation (note 21)	**(3.3)**	(4.0)
	(24.1)	(90.0)
Taxation items		
Exceptional tax costs – write off UK deferred tax asset		(37.7)
	(24.1)	(127.7)

Year ended 31 July 2013

Restructuring costs include £6.9m in respect of the improvement programme in Smiths Detection announced in September 2011. This programme, which involves redundancy, relocation, and consolidation of manufacturing, is considered exceptional by virtue of its size.

Gains on changes to post retirement benefits comprise a settlement gain of £2.2m on the closure of a defined benefit pension scheme which is net of professional costs of £0.8m, and a past service gain of £2.1m on a scheme which has been closed to future accruals.

The agreement of the Cross Match Technologies, Inc closing balance sheet and tax position has generated a £0.6m additional profit on disposal of businesses. The profit on disposal of property has arisen from the sale of two sites which were formerly occupied by businesses which are no longer owned by Smiths.

Professional fees of £3m have been incurred in relation to potential acquisitions and disposals.

A charge of £6.8m has been made by Titeflex Corporation in respect of changes to the estimated cost of future claims including those from insurance companies seeking recompense for damage allegedly caused by lightning strike, net of gains of £2.6m relating to changes in discounting.

The operating charge in respect of John Crane, Inc. litigation comprises £22.6m in respect of increased provision for adverse judgments and legal defence costs, £0.5m in respect of legal fees in connection with litigation against insurers, less £8.8m arising from the increase in US risk free rates.

Year ended 31 July 2012

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

A charge of £7.8m was made by Smiths Medical to reflect a change to the historical basis of estimating the accrual for rebates to distributors. This change arose due to the availability of improved data from distributors. Had this approach been used in previous years, there would have been no material impact on the revenue or operating profits of Smiths Medical in any of the prior five financial years and no material impact is expected on future revenue or profit. The charge, which was recognised as a reduction in revenue, was treated as an exceptional item on the basis that it was an unusual non-recurring item that distorts trading performance for the year ended 31 July 2012.

The profit on disposal of businesses comprised £26.8m profit on the sale of the Group's interest in Cross Match (see note 13), £0.1m relating to small non-core business sold in the year and £3.9m from the resolution of indemnities in respect of disposals in previous years.

A charge of £54.5m was made by Titeflex Corporation in respect of the estimated cost of future claims from insurance companies seeking recompense for damage allegedly caused by lightning strikes.

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

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

5 Net finance costs

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Interest receivable	**2.6**	2.2
Interest payable		
– bank loans and overdrafts, including associated fees	**(7.4)**	(7.1)
– other loans	**(56.9)**	(57.7)
Interest payable	**(64.3)**	(64.8)
Other financing gains/(losses)		
– fair value gains/(losses) on hedged debt	**9.7**	(4.0)
– fair value (losses)/gains on fair value hedge	**(9.7)**	4.0
– net foreign exchange (losses)/gains	**(1.9)**	(2.8)
– exceptional finance costs – adjustment to discounted provision	**(4.2)**	(4.5)
Other financing losses	**(6.1)**	(7.3)
Retirement benefits		
– return on plan assets	**173.4**	203.0
– interest cost	**(157.0)**	(179.5)
Retirement benefits	**16.4**	23.5
Net finance costs	**(51.4)**	(46.4)

6 Taxation

The Group's approach to taxation is set out in the Financial review. This note only provides information about corporate income taxes under IFRS. Smiths companies operate in over 50 countries across the world. They pay and collect many different taxes in addition to corporate income taxes including: payroll taxes; value added and sales taxes; property taxes; product specific taxes and environmental taxes. The costs associated with these other taxes are included in profit before tax.

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
The taxation charge in the consolidated income statement for the year comprises		
– current income tax charge	**86.7**	94.5
– current tax adjustments in respect of prior periods	**8.1**	1.0
Current taxation	**94.8**	95.5
– deferred taxation	**(11.2)**	12.1
Total taxation expense in the consolidated income statement	**83.6**	107.6

Reconciliation of the tax charge

The tax expense on the profit for the year for continuing operations is different from the standard rate of corporation tax in the UK of 23.7% (2012: 25.3%). The difference is reconciled as follows:

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Profit before taxation – continuing operations	**441.8**	365.9
Notional taxation expense at UK rate of 23.7% (2012: 25.3%)	**104.6**	92.6
Different tax rates on non-UK profits and losses	**3.0**	2.7
Non-deductible expenses, tax credits and non-taxable income	**(7.1)**	(6.9)
Adjustments to unrecognised deferred tax	**(18.4)**	(5.9)
Non-taxable profit on disposal of businesses	**(0.6)**	(8.3)
Exceptional deferred tax write off		37.7
Prior year true-up	**2.1**	(4.3)
	83.6	107.6
Comprising		
– taxation on headline profit	**132.0**	131.9
– tax on non-headline loss	**(48.4)**	(62.0)
– exceptional taxation items (see note 4)		37.7
Taxation expense in the income statement	**83.6**	107.6

The head office of Smiths Group is domiciled in the UK, so the tax charge has been reconciled to UK tax rates. In recent years, Smiths has made substantial payments to its UK defined benefit pension plans which generated significant UK tax losses.

6 Taxation continued

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Tax on items charged/(credited) to equity		
Deferred tax charge/(credit)		
– retirement benefit schemes	**34.5**	(52.4)
– cash-flow hedges	**1.0**	(1.5)
– share options	**(1.0)**	0.8
	34.5	(53.1)

The net retirement benefit credit to equity includes £4.2m (2012: £6.5m) relating to UK schemes. The UK schemes are closed and this amount represents tax relief that was set off against amounts previously charged to equity.

Deferred taxation

	Excess tax depreciation on fixed assets and goodwill £m	Share-based payment £m	Retirement benefit obligations £m	Capitalised development expenditure £m	Other £m	Total £m
At 31 July 2011	(54.9)	8.8	52.7	(26.9)	117.5	97.2
Credit/(charge) to income statement	(6.5)	(3.8)	(13.5)	(5.6)	17.3	(12.1)
Credit/(charge) to equity		(0.8)	52.4		1.5	53.1
Business combinations	(12.3)				4.7	(7.6)
Exchange adjustments	(1.7)		1.2	(1.2)	4.9	3.2
At 31 July 2012	(75.4)	4.2	92.8	(33.7)	145.9	133.8
Deferred tax assets	(9.2)	4.1	89.7	(8.4)	127.1	203.3
Deferred tax liabilities	(66.2)	0.1	3.1	(25.3)	18.8	(69.5)
At 31 July 2012	(75.4)	4.2	92.8	(33.7)	145.9	133.8
Credit/(charge) to income statement	(6.3)	1.5	(7.8)	(2.2)	26.0	11.2
Credit/(charge) to equity		1.0	(34.5)		(1.0)	(34.5)
Exchange adjustments	(2.6)		1.8	(1.3)	3.9	1.8
At 31 July 2013	**(84.3)**	**6.7**	**52.3**	**(37.2)**	**174.8**	**112.3**
Deferred tax assets	(20.2)	6.6	49.6	(10.0)	159.4	185.4
Deferred tax liabilities	(64.1)	0.1	2.7	(27.2)	15.4	(73.1)
At 31 July 2013	**(84.3)**	**6.7**	**52.3**	**(37.2)**	**174.8**	**112.3**

Included in other deferred tax balances above is:

- a deferred tax asset of £28.1m (2012: £16.1m) relating to losses carried forward;
- a deferred tax asset of £99.0m (2012: £76.2m) relating to provisions where current tax relief is only available as payments are made. Of this asset, £60.7m (2012: £51.1m) relates to the John Crane, Inc. litigation provision, and £24.9m (2012: £23.0m) relates to Titeflex Corporation. See note 21 for additional information on provisions; and
- a deferred tax asset of £22.2m (2012: £15.1m) relating to inventory where current tax relief is only available when the inventory is sold.

The Group has not recognised deferred tax assets relating to tax losses of £392.9m (2012: £380.4m) and pensions and other long term liabilities of £284.5m (2012: £504.3m) due to uncertainty as to their recoverability. This includes £71.5m (2012: £327.1m) relating to the UK pension deficit.

In 2012 deferred tax of £23.5m on UK losses and £14.2m on other assets was derecognised as potentially higher contributions to retirement benefit schemes mean the UK is unlikely to generate sufficient taxable profits to utilise the deductible temporary differences related to the deferred tax assets, The resulting charge of £37.7m was treated as an exceptional tax item (note 4). These tax allowances remain available to the Group and can be utilised should the UK tax base improve.

The expiry date of operating losses carried forward is dependent upon the law of the various territories in which the losses arise. A summary of expiry dates for losses in respect of which deferred tax has not been recognised is set out below.

Restricted losses

	2013 £m	Expiry of losses	2012 £m	Expiry of losses
Territory				
– Americas	**15.6**	**2016-2033**	13.5	2019-2025
– Asia	**3.9**	**2016-2020**	4.2	2016-2019
Total restricted losses	**19.5**		17.7	
Unrestricted losses				
– operating losses	**373.4**	**No expiry**	362.7	No expiry
Total	**392.9**		380.4	

7 Dividends

The following dividends were declared and paid in the period:

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Ordinary final dividend of 26.25p for 2012 (2011: 25.0p) paid 23 November 2012	**103.2**	98.1
Ordinary interim dividend of 12.50p for 2013 (2012: 11.75p) paid 26 April 2013	**49.2**	46.0
	152.4	144.1

The final dividend for the year ended 31 July 2013 of 27.0p per share was recommended by the Board on 17 September 2013 and will be paid to shareholders on 22 November 2013, subject to approval by the shareholders. This dividend has not been included as a liability in these accounts and is payable to all shareholders on the register of Members at close of business on 25 October 2013.

On 17 September 2013, the Board also recommended a special dividend of 30.0p per share. Subject to approval by the shareholders, the special dividend will be paid with the final dividend for the year.

8 Earnings per share

Basic earnings per share are calculated by dividing the profit for the year attributable to equity shareholders of the Parent Company by the average number of ordinary shares in issue during the year.

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Profit attributable to equity shareholders for the year		
– continuing	**356.6**	256.7
– total	**356.6**	256.6
Average number of shares in issue during the year	**393,323,206**	392,583,140

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 397,467,678 (2012: 395,479,272) ordinary shares, being the average number of ordinary shares in issue during the year adjusted by the dilutive effect of employee share schemes. For the year ended 31 July 2013 no options (2012: 869,284 options) were excluded from this calculation because their effect was anti-dilutive for continuing operations.

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

	Year ended 31 July 2013		Year ended 31 July 2012	
	£m	EPS (p)	£m	EPS (p)
Profit attributable to equity shareholders of the Parent Company	**356.6**	**90.7**	256.7	65.4
Exclude				
Non-headline items and related tax (note 3)	**7.8**	**2.0**	106.6	27.2
Headline	**364.4**	**92.7**	363.3	92.6
Headline EPS – diluted (p)		**91.7**		91.9

9 Post-retirement benefits

Smiths provides post retirement benefits to employees in a number of countries throughout the world. The arrangements include defined benefit and defined contribution plans and, mainly in the United Kingdom (UK) and United States of America (US), post retirement healthcare.

Defined contribution plans

The Group operates a number of defined contribution plans across many countries. In the UK a defined contribution plan has been offered since the closure of the UK defined benefit pension plans. In the US a 401k defined contribution plan operates. The total expense recognised in the income statement in respect of all these plans was £29.9m (2012: £29.0m).

Defined benefit and post retirement healthcare plans

The principal defined benefit pension plans are in the UK and in the US and these have been closed so that no future benefits are accrued.

Pension costs are assessed in accordance with the advice of independent, professionally-qualified actuaries. The most recent actuarial valuations of the two principal UK schemes (SIPS and TIGPS) were performed using the Projected Unit Method as at 31 March 2012 and 5 April 2012. The most recent valuations of the six principal US pension and post-retirement healthcare plans were performed at 1 January 2010. These valuations have been updated by independent qualified actuaries in order to assess the liabilities of the schemes as at 31 July 2013. Scheme assets are stated at their market values. Contributions to the schemes are made on the advice of the actuaries.

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

	UK	US	2013 Other	UK	US	2012 Other
Rate of increase in salaries	**n/a**	**n/a**	**2.7%**	n/a	n/a	3.1%
Rate of increase for active deferred members	**4.3%**	**n/a**	**n/a**	3.7%	n/a	n/a
Rate of increase in pensions in payment	**3.4%**	**n/a**	**0.9%**	2.8%	n/a	0.8%
Rate of increase in deferred pensions	**3.4%**	**n/a**	**1.0%**	2.8%	n/a	0.8%
Discount rate	**4.4%**	**4.8%**	**4.0%**	4.1%	3.8%	4.1%
Inflation rate	**3.4%**	**n/a**	**1.7%**	2.8%	n/a	1.6%
Healthcare cost increases	**5.0%**	**n/a**	**2.6%**	5.0%	n/a	2.3%

The assumptions used are estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily occur in practice. For countries outside the UK and USA these are disclosed as a weighted average.

The mortality assumptions used in the principal UK schemes are based on the recent actual mortality experience of members within each scheme. The assumptions are based on the new SAPS All birth year tables with relevant scaling factors based on the experience of the schemes. The assumption also allows for future improvements in life expectancy in line with the 2012 CMI projections blended to a long term rate of 1.25%.

The mortality assumptions used in the principal US schemes are based on the RP 2000 table projected to 2025. The table selected allows for future mortality improvements and applies an adjustment for job classification (blue collar versus white collar). The assumptions give the following:

Expected further years of life		UK		US
	Male	Female	Male	Female
Member who retires next year at age 65	23	25	20	21
Member, currently 45, when they retire in 20 years time	25	27	20	21

The assets in the scheme and the expected rates of return as at 31 July 2013 were:

							31 July 2013
		UK schemes		US schemes		Other countries	Total
	Long-term rate of return	Value £m	Long-term rate of return	Value £m	Long-term rate of return	Value £m	£m
Equities	**7.2%**	**1,618.3**	**7.9%**	**311.2**	**8.0%**	**19.4**	**1,948.9**
Government bonds	**3.3%**	**187.2**	**3.4%**	**29.1**	**5.5%**	**11.2**	**227.5**
Corporate bonds	**4.4%**	**274.2**	**4.8%**	**158.9**	**4.9%**	**2.3**	**435.4**
Insured liabilities	**4.4%**	**672.1**			**4.1%**	**0.5**	**672.6**
Property	**6.8%**	**176.4**			**5.9%**	**0.5**	**176.9**
Other	**3.4%**	**217.7**	**1.0%**	**2.0**	**3.1%**	**15.2**	**234.9**
Total market value		**3,145.9**		**501.2**		**49.1**	**3,696.2**
Present value of funded scheme liabilities		**(3,160.6)**		**(620.5)**		**(61.5)**	**(3,842.6)**
Deficit		**(14.7)**		**(119.3)**		**(12.4)**	**(146.4)**
Unfunded pension plans		**(48.3)**		**(6.5)**		**(31.3)**	**(86.1)**
Post-retirement healthcare		**(8.5)**		**(11.6)**		**(1.0)**	**(21.1)**
Present value of unfunded obligations		**(56.8)**		**(18.1)**		**(32.3)**	**(107.2)**
Unrecognised asset due to surplus restriction							
Net pension liability		**(71.5)**		**(137.4)**		**(44.7)**	**(253.6)**
Post-retirement assets		**120.6**				**1.1**	**121.7**
Post-retirement liabilities		**(192.1)**		**(137.4)**		**(45.8)**	**(375.3)**
Net pension liability		**(71.5)**		**(137.4)**		**(44.7)**	**(253.6)**

9 Post-retirement benefits continued

							31 July 2012
	UK schemes		US schemes		Other countries		Total
	Long-term rate of return	Value £m	Long-term rate of return	Value £m	Long-term rate of return	Value £m	£m
Equities	7.2%	1,294.1	7.3%	245.1	9.2%	12.9	1,552.1
Government bonds	2.5%	168.0	2.3%	43.5	4.8%	7.0	218.5
Corporate bonds	4.1%	81.8	3.8%	169.5	5.0%	0.5	251.8
Insured liabilities	4.1%	665.7			4.1%	3.7	669.4
Property	6.8%	177.1			10.4%	0.8	177.9
Other	2.9%	458.2			3.7%	19.7	477.9
Total market value		2,844.9		458.1		44.6	3,347.6
Present value of funded scheme liabilities		(3,116.7)		(680.6)		(66.3)	(3,863.6)
Surplus/(deficit)		(271.8)		(222.5)		(21.7)	(516.0)
Unfunded pension plans		(46.1)		(6.9)		(28.0)	(81.0)
Post-retirement healthcare		(9.2)		(13.0)		(0.9)	(23.1)
Present value of unfunded obligations		(55.3)		(19.9)		(28.9)	(104.1)
Unrecognised asset due to surplus restriction						(0.1)	(0.1)
Net pension liability		(327.1)		(242.4)		(50.7)	(620.2)
Post-retirement assets		7.2					7.2
Post-retirement liabilities		(334.3)		(242.4)		(50.7)	(627.4)
Net pension liability		(327.1)		(242.4)		(50.7)	(620.2)

Where any individual scheme shows a recoverable surplus under IAS 19, this is disclosed on the balance sheet as a retirement benefit asset. The IAS 19 surplus of any one scheme is not available to fund the IAS 19 deficit of another scheme. The retirement benefit asset disclosed arises from the rights of the employers to recover the surplus at the end of the life of the scheme. If the pension schemes were wound up while they had members, the schemes would need to buy out the benefits of all members. The buy outs would cost significantly more than the present value of the scheme liabilities calculated in accordance with IAS 19.

Other assets in the UK and US comprise cash and current assets.

The scheme assets do not include any of the Group’s own financial instruments, nor any property occupied by, nor other assets used by, the Group. The expected rates of return on individual categories of scheme assets are determined by reference to relevant industries. The overall rate of return is calculated by weighting the individual rates in accordance with the anticipated balance in the schemes’ investment portfolios.

Amounts recognised in the income statement

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Amounts (credited)/charged to operating profit		
Current service cost	**4.1**	3.4
Past service (gain)/cost	**(2.1)**	(0.4)
Settlement (gain)/loss	**(2.2)**	
Curtailment (gain)/loss		(0.1)
	(0.2)	2.9
The operating cost is charged/(credited) as follows:		
Cost of sales	**1.0**	0.7
Sales and distribution costs	**1.2**	0.8
Administrative expenses	**1.9**	1.4
Exceptional operating items	**(4.3)**	
	(0.2)	2.9
Amounts (credited)/charged to finance costs		
Expected return on pension scheme assets	**(173.4)**	(203.0)
Interest on pension scheme liabilities	**157.0**	179.5
	(16.4)	(23.5)

The actual return on scheme assets was a profit of £448.8m (2012: profit of £104.4m).

Amounts recognised directly in the consolidated statement of comprehensive income

Net actuarial gains of £280.5m (2012: losses of £559.0m) have been reported in the statement of comprehensive income. This includes a gain of £0.1m (2012: gain of £1.1m) in respect of unrecognised assets owing to surplus restriction. Cumulative actuarial losses from 1 August 2004 reported in the statement of comprehensive income are £837.0m (2012: cumulative losses of £1,117.5m).

9 Post-retirement benefits continued

Changes in present value of funded scheme assets

	Year ended 31 July 2013				Year ended 31 July 2012			
	UK £m	US £m	Other £m	Total £m	UK £m	US £m	Other £m	Total £m
At beginning of period	**2,844.9**	**458.1**	**44.6**	**3,347.6**	2,813.6	412.8	46.2	3,272.6
Expected return on assets	**146.1**	**25.0**	**2.3**	**173.4**	170.4	29.9	2.7	203.0
Actuarial gain/(loss) on scheme assets	**243.3**	**22.3**	**9.9**	**275.5**	(94.2)	(1.6)	(2.9)	(98.7)
Employer contributions	**53.5**	**7.7**	**9.8**	**71.0**	88.2	23.3	3.8	115.3
Employee contributions			**0.2**	**0.2**			0.4	0.4
Assets distributed on settlement			**(16.8)**	**(16.8)**				
Exchange adjustments		**15.7**	**1.4**	**17.1**		20.4	(3.3)	17.1
Benefits paid	**(141.9)**	**(27.6)**	**(2.3)**	**(171.8)**	(133.1)	(26.7)	(2.3)	(162.1)
At end of period	**3,145.9**	**501.2**	**49.1**	**3,696.2**	2,844.9	458.1	44.6	3,347.6

Changes in present value of funded defined benefit obligations

	Year ended 31 July 2013				Year ended 31 July 2012			
	UK £m	US £m	Other £m	Total £m	UK £m	US £m	Other £m	Total £m
At beginning of period	**(3,116.7)**	**(680.6)**	**(66.3)**	**(3,863.6)**	(2,775.7)	(543.8)	(60.2)	(3,379.7)
Current service cost	**(0.3)**		**(2.1)**	**(2.4)**	(0.3)		(2.0)	(2.3)
Interest on obligations	**(125.0)**	**(25.4)**	**(2.7)**	**(153.1)**	(143.6)	(28.2)	(3.2)	(175.0)
Employee contributions			**(0.2)**	**(0.2)**			(0.4)	(0.4)
Past service gain/(cost)			**2.1**	**2.1**			0.4	0.4
Actuarial (loss)/gain on liabilities	**(60.5)**	**77.5**	**(11.3)**	**5.7**	(330.2)	(107.9)	(7.5)	(445.6)
Liabilities extinguished on settlement			**19.0**	**19.0**				
Curtailment gain/(cost)							0.1	0.1
Exchange adjustments		**(19.6)**	**(2.3)**	**(21.9)**		(27.4)	4.2	(23.2)
Benefits paid	**141.9**	**27.6**	**2.3**	**171.8**	133.1	26.7	2.3	162.1
At end of period	**(3,160.6)**	**(620.5)**	**(61.5)**	**(3,842.6)**	(3,116.7)	(680.6)	(66.3)	(3,863.6)

Changes in present value of unfunded defined benefit pensions and post retirement healthcare plans

	Assets		Obligations	
	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
At beginning of period			**(104.1)**	(90.7)
Current service cost			**(1.7)**	(1.1)
Interest on obligations			**(3.9)**	(4.5)
Actuarial (loss)/gain			**(0.7)**	(15.8)
Employer contributions	**6.5**	6.3		
Exchange adjustments			**(3.3)**	1.7
Benefits paid	**(6.5)**	(6.3)	**6.5**	6.3
At end of period			**(107.2)**	(104.1)

Cash contributions

Company contributions to the funded defined benefit pension plans for 2013 totalled £71.0m (2012: £115.3m, including £50m to the TIGPS).

Following completion of the 2012 triennial valuations for the principal UK schemes, agreement has been reached with the trustees that the current contributions will continue as follows:

- Cash contributions to SIPS of £36m a year until October 2019.
- In connect with SIPS, an on-going investment of £24m a year in index-linked gilts held in an escrow account. The escrow account remains an asset of the Group (see note 14) until 2020. At that time the assets in escrow will be allocated subject to the funding position of SIPS. In addition, the escrow account may revert to the Group, should there be a surplus at an intervening triennial review.
- Cash contributions to TIGPS of £16m a year until April 2016.

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

In 2014 the following cash contributions to the Group's principal defined benefit schemes are expected: £36m to SIPS; £16m to TIGPS; and approximately £38m to other plans, including the US defined benefit scheme. Expected cash payments for 2014 total £90m. In addition, £24m will be invested in UK government bonds held in escrow, in accordance with the funding plan explained above.

Investment

In September 2013, the Trustees of the TIGPS invested approximately £160m in annuities which are matched with specific liabilities of the Scheme.

9 Post-retirement benefits continued

History of schemes

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
Assets and liabilities					
Fair value of scheme assets	**3,696.2**	3,347.6	3,272.6	3,043.1	2,775.1
Present value of defined benefit obligations	**(3,949.8)**	(3,967.7)	(3,470.4)	(3,347.7)	(3,112.1)
Unrecognised asset due to surplus restriction		(0.1)	(1.2)	(0.7)	(2.0)
Deficit	**(253.6)**	(620.2)	(199.0)	(305.3)	(339.0)
Post-retirement assets	**121.7**	7.2	140.6	80.3	39.2
Post-retirement liabilities	**(375.3)**	(627.4)	(339.6)	(385.6)	(378.2)
Deficit	**(253.6)**	(620.2)	(199.0)	(305.3)	(339.0)

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m	Period ended 31 July 2010 £m	Period ended 31 July 2009 £m
Experience gains/(losses)					
Experience gains/(losses) on scheme liabilities	**(3.1)**	45.4	(25.5)	31.5	100.5
Experience gains/(losses) on scheme assets	**275.5**	(98.7)	139.4	167.5	(345.4)
Movement on restricted surplus	**0.1**	1.1	(0.5)	1.3	(0.5)

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

Sensitivity

The valuation of post-retirement schemes involves judgements about uncertain future events. Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 July 2013 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions. While each of these sensitivities holds all other assumptions constant, in practice such assumptions rarely change in isolation and the impacts may offset to some extent.

	Profit before tax for year ended 31 July 2013 £m	Increase/ (decrease) in scheme assets £m	(Increase)/ decrease in scheme liabilities £m
Rate of mortality – 1 year increase in life expectancy	(4.1)	32.8	(123.3)
Rate of mortality – 1 year decrease in life expectancy	4.0	(32.8)	124.0
Rate of inflation – 0.25% increase	(3.3)	11.0	(85.6)
Discount rate – 0.25% increase	(5.6)	(16.2)	139.8
Market value of scheme assets – 2.5% increase	3.3	74.6	
Healthcare cost trends – 1% increase			(0.2)
Healthcare cost trends – 1% decrease			0.2

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

The value of the scheme assets is affected by changes in mortality rates, inflation and discounting because they affect the carrying value of the insurance assets.

Adoption of 'IAS 19 (Revised 2011): Employee benefits'

From 1 August 2013 Smiths Group will be applying 'IAS 19 (Revised 2011): Employee benefits'. Implementing this standard is expected to have the following impact on the reported position and performance of Smiths Group:

Financing credits and charges relating to retirement benefits are excluded from headline profit measures. In future years, operating profit charges relating to retirement benefit schemes which are closed to future accruals will be excluded from headline profit measures.

	Operating profit for year ended 31 July 2013 £m	Interest for year ended 31 July 2013 £m	Profit before tax for year ended 31 July 2013 £m	Actuarial gain /(loss) for year ended 31 July 2013 £m	Net pension liability 31 July 2013 £m
As currently disclosed	0.2	16.4	16.6	280.5	(253.6)
Separate recognition of scheme administration costs	(6.7)	4.9	(1.8)	1.8	
Revised calculation of finance charges		(44.3)	(44.3)	44.3	
Calculated in accordance with IAS 19 (Revised 2011)	(6.5)	(23.0)	(29.5)	326.6	(253.6)

10 Employees

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Staff costs during the period		
Wages and salaries	**756.3**	740.5
Social security	**89.2**	84.4
Share-based payment (note 27)	**12.8**	14.3
Pension costs (including defined contribution schemes) (note 9)	**33.8**	32.4
	892.1	871.6

The average number of persons employed was:

	Year ended 31 July 2013	Year ended 31 July 2012
John Crane	**7,000**	7,000
Smiths Medical	**7,900**	7,750
Smiths Detection	**2,250**	2,300
Smiths Interconnect	**3,850**	4,100
Flex-Tek	**2,000**	2,000
Smiths Business Information Services	**200**	
Corporate	**50**	50
	23,250	23,200

Smiths Business Information Services has centralised employment contracts for people working in its operations. All the costs of IT infrastructure and support, including these employment costs, are reflected in reported divisional operating profit.

Key management

The key management of the Group comprises Smiths Group plc Board directors and Executive Committee members. Their aggregate compensation is shown below.

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Key management compensation		
Salaries and short-term employee benefits	**8.5**	10.1
Cost of post-retirement benefits		0.1
Cost of share-based incentive plans	**4.5**	5.7

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

	Year ended 31 July 2013		Year ended 31 July 2012	
	Number of instruments '000	Weighted average price	Number of instruments '000	Weighted average price
CIP	**834**		778	
ESOS	**126**	**£8.71**	168	£8.93
VSP	**78**		611	
LTIP	**1,251**		728	
SAYE	**5**	**£7.28**	5	£7.28

The disclosure above does not include options held by individuals who left or retired before the year end.

Related party transactions

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

11 Intangible assets

	Goodwill £m	Development costs £m	Acquired intangibles (see table below) £m	Software, patents and intellectual property £m	Total £m
Cost					
At 1 August 2011	1,389.7	162.5	351.9	132.2	2,036.3
Exchange adjustments	(1.4)	3.5	8.5	0.3	10.9
Business combinations	100.2		53.2		153.4
Additions		28.5		13.5	42.0
Disposals	(0.4)	(13.2)		(2.6)	(16.2)
At 31 July 2012	1,488.1	181.3	413.6	143.4	2,226.4
Exchange adjustments	69.2	7.7	16.6	2.6	96.1
Additions		29.9		11.1	41.0
Disposals	(4.0)	(1.5)		(1.4)	(6.9)
At 31 July 2013	**1,553.3**	**217.4**	**430.2**	**155.7**	**2,356.6**
Amortisation					
At 1 August 2011	93.9	63.4	183.6	85.2	426.1
Exchange adjustments	(0.2)	1.1	3.9	(0.1)	4.7
Charge for the year		19.3	50.9	12.9	83.1
Impairment charge			10.7		10.7
Disposals		(13.2)		(2.1)	(15.3)
At 31 July 2012	93.7	70.6	249.1	95.9	509.3
Exchange adjustments	4.9	3.1	12.3	2.4	22.7
Charge for the year		21.3	46.6	13.2	81.1
Disposals		(1.5)		(1.0)	(2.5)
At 31 July 2013	**98.6**	**93.5**	**308.0**	**110.5**	**610.6**
Net book value at 31 July 2013	**1,454.7**	**123.9**	**122.2**	**45.2**	**1,746.0**
Net book value at 31 July 2012	1,394.4	110.7	164.5	47.5	1,717.1
Net book value at 1 August 2011	1,295.8	99.1	168.3	47.0	1,610.2

In addition to goodwill, the acquired intangible assets comprise:

	Patents, licences and trademarks £m	Technology £m	Customer relationships £m	Total acquired intangibles £m
Cost				
At 1 August 2011	66.6	117.4	167.9	351.9
Exchange adjustments	3.0	5.5		8.5
Business combinations	3.8	16.1	33.3	53.2
At 31 July 2012	73.4	139.0	201.2	413.6
Exchange adjustments	1.8	4.8	10.0	16.6
At 31 July 2013	**75.2**	**143.8**	**211.2**	**430.2**
Amortisation				
At 1 August 2011	25.2	57.1	101.3	183.6
Exchange adjustments	1.1	2.7	0.1	3.9
Charge for the year	6.0	15.4	29.5	50.9
Impairment charge	0.9	2.7	7.1	10.7
At 31 July 2012	33.2	77.9	138.0	249.1
Exchange adjustments	1.0	3.2	8.1	12.3
Charge for the year	5.8	16.5	24.3	46.6
At 31 July 2013	**40.0**	**97.6**	**170.4**	**308.0**
Net book value at 31 July 2013	**35.2**	**46.2**	**40.8**	**122.2**
Net book value at 31 July 2012	40.2	61.1	63.2	164.5
Net book value at 1 August 2011	41.4	60.3	66.6	168.3

11 Intangible assets continued

Impairment testing

Goodwill

Goodwill is not amortised but is tested for impairment at least annually. Value in use calculations are used to determine the recoverable amount of goodwill held allocated to each group of cash generating units (CGU). Value in use is calculated as the net present value of the projected risk-adjusted cash-flows of the CGU. These forecast cash-flows are based on the 2014 budget and the four year divisional strategic plan, which have both been approved by the Board. Goodwill is allocated by division as follows:

	2013 £m	2013 Number of CGUs	2012 £m	2012 Number of CGUs
John Crane	**142.7**	**4**	139.2	4
Smiths Medical	**529.5**	**1**	514.5	1
Smiths Detection	**407.8**	**1**	376.9	1
Smiths Interconnect	**351.6**	**3**	341.5	3
Flex-Tek	**23.1**	**2**	22.3	2
	1,454.7	**11**	1,394.4	11

John Crane and Smiths Medical have strong aftermarket and consumables businesses, with consistent sales trends. Smiths Detection and Smiths Interconnect have greater sales and margin volatility due to lower levels of recurring revenue and involvement in government funded programmes, particularly defence, and customer led technology innovation. The key assumptions used in value in use calculations are:

- Sales: projected sales are built up with reference to markets and product categories. They incorporate past performance, historical growth rates and projections of developments in key markets.
- Margins: projected margins reflect historical performance and the impact of all completed projects to improve operational efficiency and leverage scale. The projections do not include the impact of future restructuring projects to which the Group is not yet committed.
- Discount rate: the discount rates have been calculated based on the Group's weighted average cost of capital and risks specific to the CGU being tested. Pre-tax rates of 10.9% to 14.9% (2012: 12.3% to 14.1%) have been used for the impairment testing.
- Long term growth rates: As required by IAS 36, growth rates for the period after the detailed forecasts are based on the long-term GDP projections of the primary market for the CGU. The average growth rate used in the testing was 2.13% (2012: 2.29%). These rates do not reflect the long-term assumptions used by the Group for investment planning.

The assumptions used in the impairment testing of significant CGUs are as follows:

	Year ended 31 July 2013				
	Smiths Medical	Smiths Detection	Smiths Interconnect		
			Microwave	Connectors	Power management
Net book value of goodwill (£m)	**529.5**	**407.8**	**137.3**	**87.4**	**126.9**
Discount rate	**10.9%**	**14.9%**	**13.2%**	**13.8%**	**13.3%**
Period covered by management projections	**5 years**	**5 years**	**5 years**	**5 years**	**5 years**
Long-term growth rates	**2.12%**	**1.60%**	**2.76%**	**2.55%**	**2.40%**

	Year ended 31 July 2012				
	Smiths Medical	Smiths Detection	Smiths Interconnect		
			Microwave	Connectors	Power management
Net book value of goodwill (£m)	514.5	376.9	134.2	84.7	122.6
Discount rate	12.3%	13.5%	14.1%	14.1%	13.1%
Period covered by management projections	5 years	5 years	5 years	5 years	5 years
Long-term growth rates	2.20%	2.50%	2.72%	2.32%	2.59%

The remaining balance of the goodwill represents smaller individual amounts which have been allocated to smaller CGUs.

11 Intangible assets continued

Impairment testing continued

Goodwill continued

Sensitivity analysis

Smiths Interconnect Power management's value in use exceeds its carrying value by £7.8m (2012: £27.4m). Sensitivity analysis performed around the base case assumptions has indicated that for Smiths Interconnect Power management, the following changes in assumptions (in isolation), would cause the value in use to fall below the carrying value:

	Year ended 31 July 2013 Change required to trigger impairment	Year ended 31 July 2012 Change required to trigger impairment
Forecast operating cash-flow	**4% reduction**	12% reduction
Discount rate	**0.5% higher**	1.4% higher
Long-term growth rates	**0.9% lower**	2.8% lower

Sales assumptions for Smiths Interconnect Power management are based on:

• the current order book;

• proportion of recent tenders which have been successful; and

• independent projections of the expected growth of the data centre market in North America.

Margin projections for Smiths Interconnect Power management are based on current variable costs and production capacity, and the expected costs of increasing capacity to support higher levels of sales.

For the other CGUs, sensitivity analysis performed around the base case assumptions has indicated that no reasonable changes in key assumptions would cause the carrying amount of any of the CGUs to exceed their respective recoverable amounts.

Other intangible assets

The Group has no indefinite life intangible assets other than goodwill. During the year impairment tests were carried out for development projects which have not yet started to be amortised and acquired intangibles where there were indications of impairment.

In the year ended 31 July 2012 impairment charges of £10.7m were incurred on intangible assets arising from the PDI acquisition. Value in use calculations were used to determine the recoverable values of these assets. The impairment charges arose because product sales were lower than expected with a consequential impact on the future value of the technology, customer relationships and brands. The impairment charge was included in Smiths Interconnect administrative expenses and it was excluded from the calculation of headline operating profit.

12 Property, plant and equipment

	Land and buildings £m	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
Cost or valuation				
At 1 August 2011	190.3	495.7	209.5	895.5
Exchange adjustments	0.6	5.7	(3.4)	2.9
Business combinations	0.3	1.0	0.2	1.5
Additions	6.0	27.8	16.3	50.1
Disposals	(4.3)	(12.9)	(8.9)	(26.1)
Business disposals	(0.2)	(1.3)		(1.5)
At 31 July 2012	192.7	516.0	213.7	922.4
Exchange adjustments	7.4	20.0	8.0	35.4
Additions	7.8	33.0	15.7	56.5
Disposals	(8.3)	(15.1)	(7.8)	(31.2)
At 31 July 2013	**199.6**	**553.9**	**229.6**	**983.1**
Depreciation				
At 1 August 2011	87.1	362.7	162.9	612.7
Exchange adjustments	1.0	5.1	(2.4)	3.7
Charge for the year	7.5	34.7	16.8	59.0
Disposals	(2.7)	(12.1)	(7.7)	(22.5)
Business disposals	(0.2)	(0.8)		(1.0)
At 31 July 2012	92.7	389.6	169.6	651.9
Exchange adjustments	3.4	15.1	6.7	25.2
Charge for the year	7.5	29.3	15.5	52.3
Disposals	(5.3)	(14.3)	(6.7)	(26.3)
At 31 July 2013	**98.3**	**419.7**	**185.1**	**703.1**
Net book value at 31 July 2013	**101.3**	**134.2**	**44.5**	**280.0**
Net book value at 31 July 2012	100.0	126.4	44.1	270.5
Net book value at 1 August 2011	103.2	133.0	46.6	282.8

13 Investments accounted for using the equity method

	31 July 2013 £m	31 July 2012 £m
Investments in associated companies		
At start of period		18.5
Exchange adjustment		(0.9)
Share of results after tax		5.7
Disposal		(23.3)
Dividend received		
At end of period		

On 16 July 2012 the Group disposed of its interest in Cross Match Technologies, Inc., incorporated in the United States, for a consideration of £45.0m. The Group's share of the revenue of associates for the year ended 31 July 2012 was £28.8m.

14 Financial assets

Available for sale financial assets include £83.0m (2012: £58.4m) UK government bonds. This investment forms part of the deficit funding plan agreed with the trustee of one of the principal UK pension schemes. See note 9 for additional details.

15 Inventories

	31 July 2013 £m	31 July 2012 £m
Inventories comprise		
Raw materials and consumables	**155.5**	147.9
Work in progress	**110.2**	91.3
Finished goods	**227.3**	209.5
	493.0	448.7
Less: payments on account	**(17.4)**	(10.2)
	475.6	438.5

The Group consumed £1,408.7m (2012: £1,397.7m) of inventories during the period. £12.3m (2012: £10.9m) was recognised as an expense resulting from the write-down of inventory and £4.8m (2012: £2.9m) was released to the income statement from inventory provisions charged in earlier years but no longer required.

16 Trade and other receivables

	31 July 2013 £m	31 July 2012 £m
Non-current		
Trade receivables	**23.6**	27.9
Prepayments and accrued income	**5.6**	4.1
Other receivables	**4.9**	5.4
	34.1	37.4
Current		
Trade receivables	**628.2**	578.9
Prepayments and accrued income	**50.4**	40.6
Other receivables	**16.9**	14.9
	695.5	634.4

Trade receivables do not carry interest. Management considers that the carrying value of trade and other receivables approximates to the fair value. Trade and other receivables, including prepayments, accrued income and other debtors qualifying as financial instruments are classified as 'loans and receivables'. The maximum credit exposure arising from these financial assets is £677.2m (2012: £628.4m).

Trade receivables are disclosed net of provisions for bad and doubtful debts. The provisions for bad and doubtful debts are based on specific risk assessment and reference to past default experience.

Credit risk is managed separately for each customer and, where appropriate, a credit limit is set for the customer based on previous experience of the customer and third party credit ratings. The Group has no significant concentration of credit risk, with exposure spread over a large number of customers. The largest single customer is the US Federal Government, representing less than 4% (2012: 4%) of Group revenue.

16 Trade and other receivables continued

Ageing of trade receivables

	31 July 2013 £m	31 July 2012 £m
Trade receivables which are not impaired and not yet due	**516.7**	485.7
Trade receivables which are not impaired and less than three months overdue	**99.5**	89.0
Trade receivables which are not impaired and more than three months overdue	**30.9**	28.5
Gross value of partially and fully provided receivables	**22.5**	21.2
	669.6	624.4
Provision for bad and doubtful debts	**(17.8)**	(17.6)
Trade receivables	**651.8**	606.8

17 Trade and other payables

	31 July 2013 £m	31 July 2012 £m
Non-current		
Other creditors	**31.0**	37.5
Current		
Trade creditors	**213.5**	193.8
Bills of exchange payable	**2.7**	2.2
Other creditors	**10.7**	15.4
Other taxation and social security costs	**23.0**	21.3
Accruals and deferred income	**271.9**	235.5
	521.8	468.2

Trade and other payables, including accrued expenses and other creditors qualifying as financial instruments, are accounted for at amortised cost and are categorised as other financial liabilities.

18 Borrowings and net debt

This note sets out the calculation of net debt, an important measure in explaining our financing position. The net debt figure includes accrued interest and the fair value adjustments relating to hedge accounting.

	31 July 2013 £m	31 July 2012 £m
Cash and cash equivalents		
Net cash and deposits	**393.8**	205.6
Short-term borrowings		
Bank overdrafts	**(7.3)**	(1.9)
$250m 5.45% US$ Private placement 2013		(161.7)
$250m 6.05% US$ Guaranteed notes 2014	**(164.5)**	
Bank and other loans	**(1.2)**	(1.2)
Interest accrual	**(14.1)**	(10.5)
	(187.1)	(175.3)
Long-term borrowings		
$250m 6.05% US$ Guaranteed notes 2014		(159.1)
£150m 7.25% Sterling Eurobond 2016	**(149.6)**	(149.4)
€300m 4.125% Eurobond 2017	**(267.5)**	(240.9)
$175m 7.37% US$ Private placement 2018	**(115.3)**	(111.6)
$250m 7.20% US$ Guaranteed notes 2019	**(163.8)**	(158.5)
$400m 3.625% US$ Guaranteed notes 2022	**(253.4)**	
Bank and other loans	**(1.5)**	(2.2)
	(951.1)	(821.7)
Borrowings	**(1,138.2)**	(997.0)
Net debt	**(744.4)**	(791.4)

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

Borrowings are accounted for at amortised cost and are categorised as other financial liabilities. See note 19 for a maturity analysis of borrowings. The repayment dates on borrowings repayable after five years range from 2019 to 2022.

Interest of £49.7m (2012: £42.1m) was charged to the consolidated income statement in this period in respect of public bonds.

18 Borrowings and net debt continued
Net cash and cash equivalents

	31 July 2013 £m	31 July 2012 £m
Cash at bank and in hand	**164.2**	130.8
Short-term deposits	**229.6**	74.8
Cash and cash equivalents	**393.8**	205.6
Bank overdrafts	**(7.3)**	(1.9)
Net cash and cash equivalents	**386.5**	203.7

Cash and cash equivalents include highly liquid investments with maturities of three months or less.

Movements in net debt

	Net cash and cash equivalents £m	Other short-term borrowing £m	Long-term borrowings £m	Net debt £m
At 31 July 2012	203.7	(173.4)	(821.7)	(791.4)
Foreign exchange gains and losses	12.7	(0.1)	(53.5)	(40.9)
Net cash inflow/(outflow)	170.1			170.1
Repayment of borrowings		159.1		159.1
Drawdown of borrowings			(247.2)	(247.2)
Capitalisation, interest accruals and unwind of capitalised fees		(2.7)	(1.1)	(3.8)
Fair value movement from interest rate hedging		1.3	8.4	9.7
Change in maturity analysis		(164.0)	164.0	
At 31 July 2013	**386.5**	**(179.8)**	**(951.1)**	**(744.4)**

Secured loans
Loans amounting to £2.7m (2012: £3.4m) were secured on plant and equipment with a book value of £2.5m (2012: £3.3m).

19 Financial risk management
The Group's international operations and debt financing expose it to financial risks which include the effects of changes in foreign exchange rates, changes in debt market prices, interest rates, credit risks and liquidity risks.

Treasury and risk management policies are set by the Board. The policy sets out specific guidelines to manage foreign exchange risk, interest rate risk, credit risk and the use of financial instruments to manage risk. The instruments and techniques used to manage exposures include foreign currency derivatives, debt and other interest rate derivatives. The central treasury function monitors financial risks and compliance with risk management policies. The management of operational credit risk is discussed in note 16.

(a) Foreign exchange risk
Transactional currency exposure
The Group is exposed to foreign currency risks arising from sales or purchases by businesses in currencies other than their functional currency. It is Group policy that, when the net foreign exchange exposure to known future sales and purchases is material, this exposure is hedged using forward foreign exchange contracts. The net exposure is calculated by adjusting the expected cash-flow for payments or receipts in the same currency linked to the sale or purchase. This policy minimises the risk that the profits generated from the transaction will be affected by foreign exchange movements which occur after the price has been determined.

Hedge accounting documentation and effectiveness testing are only undertaken if it is cost effective.

The following table shows the currency of financial instruments. It excludes loans and derivatives designated as net investment hedges.

					At 31 July 2013
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Financial assets and liabilities					
Financial instruments included in trade and other receivables	**34.8**	**349.0**	**145.2**	**148.2**	**677.2**
Financial instruments included in trade and other payables	**(34.0)**	**(191.0)**	**(82.6)**	**(70.9)**	**(378.5)**
Cash and cash equivalents	**129.5**	**142.7**	**34.5**	**87.1**	**393.8**
Borrowings not designated as net investment hedges	**(149.9)**	**(13.8)**	**(9.6)**	**(0.4)**	**(173.7)**
	(19.6)	**286.9**	**87.5**	**164.0**	**518.8**
Exclude balances held in operations with the same functional currency	**19.1**	**(168.3)**	**(87.8)**	**(163.5)**	**(400.5)**
Exposure arising from intra-group loans		**(61.6)**		**4.3**	**(57.3)**
Forward foreign exchange contracts	**(1.0)**	**(75.6)**	**76.6**		
	(1.5)	**(18.6)**	**76.3**	**4.8**	**61.0**

19 Financial risk management continued

	At 31 July 2012				
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Financial assets and liabilities					
Financial instruments included in trade and other receivables	30.4	327.3	127.8	142.9	628.4
Financial instruments included in trade and other payables	(42.4)	(170.9)	(69.4)	(68.3)	(351.0)
Cash and cash equivalents	18.5	88.8	24.4	73.9	205.6
Borrowings not designated as net investment hedges	(149.4)	(11.4)	(4.0)	(0.4)	(165.2)
	(142.9)	233.8	78.8	148.1	317.8
Exclude balances held in operations with the same functional currency	142.6	(154.2)	(78.8)	(143.1)	(233.5)
Exposure arising from intra-group loans		(144.0)		(20.5)	(164.5)
Forward foreign exchange contracts	(48.0)	(34.7)	95.0	(12.3)	
	(48.3)	(99.1)	95.0	(27.8)	(80.2)

Financial instruments included in trade and other receivables comprise trade receivables, accrued income and other debtors which qualify as financial instruments. Similarly, financial instruments included in trade and other payables comprise trade payables, accrued expenses and other creditors which qualify as financial instruments.

Based on the assets and liabilities held at the year end, if the specified currencies were to strengthen 10% while all other market rates remained constant, the change in the fair value of financial instruments not designated as net investment hedges would have the following effect:

	Impact on profit for the year 31 July 2013 £m	**Gain/(loss) recognised in reserves 31 July 2013 £m**	Impact on profit for the year 31 July 2012 £m	Gain/(loss) recognised in reserves 31 July 2012 £m
US dollar	**2.9**	**(1.7)**	0.1	(4.2)
Euro	**5.3**	**2.0**	3.6	4.1
Sterling	**(0.6)**	**0.9**	(4.1)	0.9

These sensitivities were calculated before adjusting for tax and exclude the effect of quasi-equity intra-group loans.

Cash-flow hedging

The Group uses foreign currency contracts to hedge future foreign currency sales and purchases. At 31 July 2013 contracts with a nominal value of £234.0m (2012: £279.4m) were designated as hedging instruments. In addition, the Group had outstanding foreign currency contracts with a nominal value of £87.5m (2012: £249.9m) which were being used to manage transactional foreign exchange exposures, but were not accounted for as cash-flow hedges. The fair value of the contracts is disclosed in note 20.

The majority of hedged transactions will be recognised in the income statement in the same period that the cash-flows are expected to occur, with the only differences arising as a result of normal commercial credit terms on sales and purchases. Of the foreign exchange contracts designated as hedging instruments 99.9% are for periods of 12 months or less (2012: 98.5%).

The movements in the cash-flow hedge reserve during the period are summarised in the table below:

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Brought forward cash-flow hedge reserve at start of year	**(4.7)**	(0.3)
Exchange adjustments	**(0.2)**	0.1
Gains/(losses) on effective cash-flow hedges recognised in equity	**11.0**	(10.9)
Amounts removed from the hedge reserve and recognised in the following lines on the income statement		
– revenue	**(3.8)**	5.5
– cost of sales	**(0.5)**	0.9
Carried forward cash-flow hedge reserve at end of year	**1.8**	(4.7)

19 Financial risk management continued

Translational currency exposure

The Group has significant investments in overseas operations, particularly in the United States and Europe. As a result, the sterling value of the Group's balance sheet can be significantly affected by movements in exchange rates. The Group seeks to mitigate the effect of these translational currency exposures by matching the net investment in overseas operations with borrowings denominated in their functional currencies, except where significant adverse interest differentials or other factors would render the cost of such hedging activity uneconomic. This is achieved by borrowing primarily in the relevant currency or in some cases indirectly through the use of forward foreign exchange contracts and cross currency swaps.

Net investment hedges

The table below sets out the currency of loans and swap contracts designated as net investment hedges:

					At 31 July 2013
	Sterling £m	**US$ £m**	**Euro £m**	**Other £m**	**Total £m**
Loans designated as net investment hedges		**(697.0)**	**(267.5)**		**(964.5)**
Currency swap contracts	**197.1**	**(56.2)**	**(52.4)**	**(88.5)**	
	197.1	**(753.2)**	**(319.9)**	**(88.5)**	**(964.5)**

					At 31 July 2012
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges		(590.9)	(240.9)		(831.8)
Currency swap contracts	192.4	(69.4)	(39.2)	(83.8)	
	192.4	(660.3)	(280.1)	(83.8)	(831.8)

At 31 July 2013 swap contracts in other currencies hedged the Group's exposure to Canadian dollars, Japanese yen and Chinese renminbi (31 July 2012: Canadian dollars, Japanese yen and Chinese renminbi).

Of the contracts designated as net investment hedges, 55% (2012: 55%) are current and the balance matures over the next three years (2012: three years).

The gains and losses that have been deferred in the net investment hedge reserve are shown in the table below:

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Brought forward net investment hedge reserve at start of year	**(120.1)**	(120.3)
Amounts deferred in the period on effective net investment hedges	**(55.7)**	0.2
Carried forward net investment hedge reserve at end of year	**(175.8)**	(120.1)

The fair values of these net investment hedges are subject to exchange rate movements. Based on the hedging instruments in place at the year end, if the specified currencies were to strengthen 10% while all other market rates remained constant, it would have the following effect:

	Loss recognised in hedge reserve 31 July 2013 £m	Loss recognised in hedge reserve 31 July 2012 £m
US dollar	**76.2**	65.6
Euro	**29.2**	25.0

These movements would be fully offset by an opposite movement on the retranslation of the net assets of the overseas subsidiaries. These sensitivities were calculated before adjusting for tax.

(b) Interest rate risk

The Group operates an interest rate policy designed to optimise interest cost and reduce volatility in reported earnings. The Group's current policy is to require interest rates to be fixed for greater than 70% of the level of gross debt. This is achieved primarily through fixed rate borrowings, and also through the use of interest rate swaps. At 31 July 2013 76% (2012: 75%) of the Group's gross borrowings were at fixed interest rates, after adjusting for interest rate swaps and the impact of short maturity derivatives designated as net investment hedges. The Group monitors its fixed rate risk profile against both gross and net debt. For medium term planning, it now focuses on gross debt to eliminate the fluctuations of variable cash levels over the cycle.

The weighted average interest rate on borrowings and cross-currency swaps at 31 July 2013, after interest rate swaps, is 5.2% (2012: 5.5%).

19 Financial risk management continued

Interest rate profile of financial assets and liabilities and the fair value of borrowings

The following table shows the interest rate risk exposure of investments, cash and borrowings, with the borrowings adjusted for the impact of interest rate hedging. The other financial assets and liabilities do not earn or bear interest and for all financial instruments except for borrowings the carrying value is not materially different from their fair value.

	Available for sale investments 31 July 2013 £m	Cash and cash equivalents 31 July 2013 £m	Borrowings 31 July 2013 £m	Fair value of borrowings 31 July 2013 £m	Available for sale investments 31 July 2012 £m	Cash and cash equivalents 31 July 2012 £m	Borrowings 31 July 2012 £m	Fair value of borrowings 31 July 2012 £m
Fixed interest								
Less than one year			**(165.7)**	**(170.9)**			(65.0)	(66.1)
Between one and five years			**(423.3)**	**(483.7)**			(451.5)	(500.8)
Greater than five years	**83.0**		**(327.3)**	**(349.0)**	58.4		(270.2)	(333.4)
Total fixed interest financial assets/(liabilities)	**83.0**		**(916.3)**	**(1,003.6)**	58.4		(786.7)	(900.3)
Floating rate interest financial assets/(liabilities)		**339.8**	**(221.9)**	**(221.9)**		189.0	(210.3)	(210.3)
Total interest bearing financial assets/(liabilities)	**83.0**	**339.8**	**(1,138.2)**	**(1,225.5)**	58.4	189.0	(997.0)	(1,110.6)
Non-interest bearing assets/(liabilities) in the same category	**3.1**	**54.0**			2.5	16.6		
Total	**86.1**	**393.8**	**(1,138.2)**	**(1,225.5)**	60.9	205.6	(997.0)	(1,110.6)

Interest rate hedging

At 31 July 2013 the Group has designated US$150.0m interest rate swaps which mature on 12 October 2022 and €120.0m interest rate swaps which mature on 5 May 2017 as fair value hedges on the US$ 2022 Guaranteed notes and the € 2017 Eurobond respectively which mature on the same dates. At 31 July 2012 the same euro hedge was in place, and US$150m interest rate swaps which matured on 28 January 2013 were designated as fair value hedges on the US Private placement which matured this year. These positions hedge the risk of variability in the fair value of borrowings arising from fluctuations in base rates.

The fair values of the hedging instruments are disclosed in note 20. The effect of the swaps is to convert £203.8m (2012: £190.0m) debt from fixed rate to floating rate.

Sensitivity of interest charges to interest rate movements

The Group has exposure to sterling, US dollar and euro interest rates. However the Group does not have a significant exposure to interest rate movements for any individual currency. Based on the composition of net debt and foreign exchange rates at 31 July 2013, and taking into consideration all fixed rate borrowings and interest rate swaps in place, a one percentage point (100 basis points) change in average floating interest rates for all three currencies would have a £0.4m (2012: £0.6m) impact on the Group's profit before tax.

Based on the investments held at 31 July 2013 a one percentage point (100 basis points) increase in sterling interest rates would reduce the carrying value of investments by £11.8m (2012: £8.7m), generating a corresponding charge to reserves.

(c) Financial credit risk

The Group is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, but does not currently expect any counterparties to fail to meet their obligations. Credit risk is mitigated by the Board approved policy of only placing cash deposits with highly rated relationship bank counterparties within counterparty limits established by reference to their Standard & Poor's long-term debt rating. In the normal course of business, the Group operates cash pooling systems, where a legal right of set-off applies.

The maximum credit risk exposure in the event of other parties failing to perform their obligations under financial assets, excluding trade and other receivables and derivatives, totals £479.9m at 31 July 2013 (2012: £266.5m).

	31 July 2013 £m	31 July 2012 £m
UK government bonds with at least a AA credit rating (note 14)	**83.0**	58.4
Cash at banks with at least a AA- credit rating	**230.2**	135.1
Cash at banks with a A+ credit rating	**89.6**	57.4
Cash at other banks	**74.0**	13.1
Other investments	**3.1**	2.5
	479.9	266.5

At 31 July 2013 the maximum exposure with a single bank for deposits and cash is £121.8m (2012: £55.8m), whilst the maximum mark to market exposure for derivatives is £3.1m (2012: £3.5m). These banks have AA- and A credit rating, respectively (2012: AA- and A+).

19 Financial risk management continued
(d) Liquidity risk
Borrowing facilities
The Board policy specifies the maintenance of unused committed credit facilities of at least £200m at all times to ensure it has sufficient available funds for operations and planned development. This is provided by a US$800m multi-currency revolving credit facility, which matures in December 2015. At the balance sheet date the Group had the following undrawn credit facilities:

	31 July 2013 £m	31 July 2012 £m
Expiring within one year		
Expiring between one and two years		
Expiring after two years	**527.1**	510.6
	527.1	510.6

Cash deposits
As at 31 July 2013, £229.6m (2012: £74.8m) of cash and cash equivalents was on deposit with various banks of which £167.1m (2012: £35.9m) was on deposit in the UK.

Gross contractual cash-flows for borrowings

	Borrowings (Note 18) 31 July 2013 £m	**Fair value adjustments 31 July 2013 £m**	**Contractual interest payments 31 July 2013 £m**	**Total contractual cash-flows 31 July 2013 £m**	Borrowings (Note 18) 31 July 2012 £m	Fair value adjustments 31 July 2012 £m	Contractual interest payments 31 July 2012 £m	Total contractual cash-flows 31 July 2012 £m
Less than one year	**(187.1)**	**(0.2)**	**(51.2)**	**(238.5)**	(175.3)	1.2	(44.0)	(218.1)
Between one and two years	**(0.9)**		**(51.7)**	**(52.6)**	(160.3)	(0.5)	(50.1)	(210.9)
Between two and three years	**(150.1)**	**(0.4)**	**(51.6)**	**(202.1)**	(1.0)		(40.4)	(41.4)
Between three and four years	**(267.5)**	**5.1**	**(40.7)**	**(303.1)**	(149.4)	(0.6)	(40.3)	(190.3)
Between four and five years	**(115.3)**	**(0.1)**	**(29.9)**	**(145.3)**	(240.9)	5.3	(29.4)	(265.0)
Greater than five years	**(417.3)**	**(11.0)**	**(54.9)**	**(483.2)**	(270.1)	(1.1)	(31.2)	(302.4)
Total	**(1,138.2)**	**(6.6)**	**(280.0)**	**(1,424.8)**	(997.0)	4.3	(235.4)	(1,228.1)

The figures presented in the borrowings column include the non-cash adjustments which are highlighted in the adjacent column. The contractual interest reported for borrowings is before the effect of interest rate swaps.

Gross contractual cash-flows for derivative financial instruments

	Receipts 31 July 2013 £m	**Payments 31 July 2013 £m**	**Net cash-flow 31 July 2013 £m**	Receipts 31 July 2012 £m	Payments 31 July 2012 £m	Net cash-flow 31 July 2012 £m
Assets						
Less than one year	**214.2**	**(204.2)**	**10.0**	285.9	(276.4)	9.5
Greater than one year	**12.0**	**(5.3)**	**6.7**	76.3	(69.5)	6.8
Liabilities						
Less than one year	**171.9**	**(176.6)**	**(4.7)**	295.8	(306.4)	(10.6)
Greater than one year	**102.3**	**(93.8)**	**8.5**	30.2	(31.1)	(0.9)
Total	**500.4**	**(479.9)**	**20.5**	688.2	(683.4)	4.8

This table presents the undiscounted future contractual cash-flows for all derivative financial instruments. For this disclosure, cash-flows in foreign currencies are translated using the spot rates at the balance sheet date. The fair values of these financial instruments are presented in note 20.

Gross contractual cash-flows for other financial liabilities
The contractual cash-flows for financial liabilities included in trade and other payables are: £360.8m (2012: £328.4m) due in less than one year, £12.6m (2012: £18.4m) due between one and five years and £5.1m (2012: £4.2m) due after more than five years.

20 Financial derivatives

The tables below set out the nominal amount and fair value of derivative contracts held by the Group, identifying the derivative contracts which qualify for hedge accounting treatment:

				At 31 July 2013
	Contract or underlying nominal amount			Fair value
	£m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	**234.0**	**5.0**	**(2.3)**	**2.7**
Foreign exchange contracts (not hedge accounted)	**87.5**	**1.1**	**(1.4)**	**(0.3)**
Total foreign exchange contracts	**321.5**	**6.1**	**(3.7)**	**2.4**
Currency swaps (net investment hedges)	**197.1**	**2.0**	**(5.4)**	**(3.4)**
Interest rate swaps (fair value hedges)	**203.8**	**6.4**	**(7.7)**	**(1.3)**
Total financial derivatives	**722.4**	**14.5**	**(16.8)**	**(2.3)**
Balance sheet entries				
Non-current		**6.4**	**(11.0)**	**(4.6)**
Current		**8.1**	**(5.8)**	**2.3**
Total financial derivatives		**14.5**	**(16.8)**	**(2.3)**

				At 31 July 2012
	Contract or underlying nominal amount			Fair value
	£m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	279.4	2.7	(8.6)	(5.9)
Foreign exchange contracts (not hedge accounted)	249.9	1.4	(1.7)	(0.3)
Total foreign exchange contracts	529.3	4.1	(10.3)	(6.2)
Currency swaps (net investment hedges)	192.5	2.6	(1.4)	1.2
Interest rate swaps (fair value hedges)	190.0	8.4		8.4
Total financial derivatives	911.8	15.1	(11.7)	3.4
Balance sheet entries				
Non-current		7.2	(1.1)	6.1
Current		7.9	(10.6)	(2.7)
Total financial derivatives		15.1	(11.7)	3.4

Currency swaps not hedge accounted

These contracts comprise derivatives which were previously part of the net investment hedging programme and matching contracts to eliminate this exposure. There is no further net exposure arising from these contracts.

Accounting for other derivative contracts

Any foreign exchange contracts which are not formally designated as hedges and tested are classified as 'held for trading' and not hedge accounted.

Fair value hierarchy

All derivatives values are calculated using valuation methodologies in which all the inputs are either market data or derived from market data.

21 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	2.0	6.6	2.1	0.4	11.1
Provision charged	23.0	33.9	6.8	4.7	68.4
Provision released	(4.9)	(20.1)		(1.6)	(26.6)
Unwind of provision discount		3.3	0.9		4.2
Utilisation	(15.1)	(26.8)	(6.0)	(4.7)	(52.6)
At 31 July 2013	**40.7**	**210.0**	**65.6**	**19.9**	**336.2**

Analysed as:

	31 July 2013 £m	31 July 2012 £m
Current liabilities	**78.1**	77.3
Non-current liabilities	**258.1**	254.4
	336.2	331.7

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

Trading

Warranty provision and product liability

At 31 July 2013 there are warranty and product liability provisions of £40.0m (2012: £34.5m). Warranties over the Group's products typically cover periods of between one and three years. Provision is made for the likely cost of after-sales support based on the recent past experience of individual businesses.

Litigation in respect of current products or ongoing business activities

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

Exceptional and legacy

John Crane, Inc.

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

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

JCI continues to actively monitor the conduct and effect of its current and expected asbestos litigation, including the most efficacious presentation of its 'safe product' defence, and intends to continue to resist these asbestos claims based upon this defence. Approximately 230,000 claims against JCI have been dismissed before trial over the last 34 years. JCI is currently a defendant in cases involving approximately 81,000 claims. Despite the large number of claims brought against JCI, it has had final judgments against it, after appeals, in only 121 cases over the period, and has had to pay awards amounting to approximately US$120m. JCI has also incurred significant additional defence costs and, whilst the number of claims being filed against JCI and other defendants has been declining, the proportion of mesothelioma claims has increased, and JCI's ability to defend these cases successfully is likely to have a significant impact on its annual aggregate adverse judgment and defence costs.

The provision is based on past history and allows for decreasing levels of new claims based on published tables of asbestos incidence projections and is determined using asbestos valuation experts, Bates White LLC. Whilst published incidence curves can be used to estimate the likely future pattern of asbestos related disease, John Crane, Inc.'s claims experience is significantly impacted by other factors which influence the US litigation environment. These can include: changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels; and legislative and procedural changes in both the state and federal court systems. The projections use a 10 year time horizon on the basis that Bates White LLC consider that there is substantial uncertainty in the asbestos litigation environment so probable expenditures are not reasonably estimable beyond this time horizon, see note 24.

21 Provisions for liabilities and charges continued
Exceptional and legacy continued

John Crane, Inc. continued

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

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

However, because of the significant uncertainty associated with the future level of asbestos claims and of the costs arising out of related litigation, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred and, as a result, the provision may be subject to potentially material revision from time to time if new information becomes available as a result of future events.

The provision in respect of JCI is a discounted pre-tax provision using discount rates, being the risk-free rate on US debt instruments for the appropriate period. The deferred tax asset related to this provision is shown within the deferred tax balance (note 6). Set out below is the gross, discounted and post-tax information relating to this provision:

	31 July 2013 £m	31 July 2012 £m
Gross provision	**232.8**	226.3
Discount	**(22.8)**	(13.2)
Discounted pre-tax provision	**210.0**	213.1
Deferred tax	**(60.7)**	(51.1)
Discounted post-tax provision	**149.3**	162.0

Titeflex Corporation

In recent years Titeflex Corporation, a subsidiary of the Group in the Flex-Tek division, has received a number of claims from insurance companies seeking recompense on a subrogated basis for the effects of damage allegedly caused by lightning strikes in relation to its flexible gas piping product. It has also received a number of product liability claims regarding this product, some in the form of purported class actions. Titeflex Corporation believes that its products are a safe and effective means of delivering gas when installed in accordance with the manufacturer's instructions and local and national codes, however some subrogation claims have been settled on an individual basis without admission of liability. Equivalent third-party products in the US marketplace face similar challenges with the profile of legal activity appearing to increase in recent times. The continuing progress of claims and the pattern of settlement, together with the recent market place activity, provide sufficient evidence to recognise a liability in the accounts. Therefore provision has been made for the costs which the Group is expected to incur in respect of future claims to the extent that such costs can be reliably estimated. Titeflex Corporation sells flexible gas piping with extensive installation and safety guidance (revised in 2008) designed to assure the safety of the product and minimise the risk of damage associated with lightning strikes.

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

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

The projections use a rolling 10 year time horizon on the basis that there is substantial uncertainty in the US litigation environment so probable expenditures are not reasonably estimable beyond this time horizon, see note 24.

However, because of the significant uncertainty associated with the future level of claims and of the costs arising out of related litigation, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred and, as a result, the provision may be subject to potentially material revision from time to time if new information becomes available as a result of future events.

The provision of £65.6m (2012: £61.8m) is a discounted pre-tax provision using discount rates, being the risk-free rate on US debt instruments for the appropriate period.

Other

Reorganisation and property

At 31 July 2013 a provision of £10.7m (2012: £9.4m) relates to the performance improvement programme in Smiths Detection.

Disposal

Other provisions include disposal provisions of £3.6m (2012: £4.0m) relating to warranties and other obligations in respect of the disposal of the Marine Systems and Aerospace businesses. Most of the balance is expected to be utilised within the next five years.

22 Share capital

	Number of shares	Issued capital £m	Consideration £m
Ordinary shares of 37.5p each			
At 31 July 2011	392,350,403	147.1	
Exercise of share options	375,540	0.2	3.0
At 31 July 2012	392,725,943	147.3	
Exercise of share options	1,092,567	0.4	9.3
Total share capital at 31 July 2013	**393,818,510**	**147.7**	

At 31 July 2013 all of the issued share capital was in free issue. All issued shares are fully paid.

23 Reserves

Retained earnings include the value of Smiths Group plc shares held by the Smiths Industries Employee Benefit Trust. In the year the Company issued nil (2012: nil) shares to the Trust, and the Trust purchased 1,027,540 shares (2012: 1,026,514 shares) in the market. At 31 July 2013 the Trust held 855 (2012: 855) ordinary shares.

The capital redemption reserve, revaluation reserve and merger reserve arose from: share repurchases; revaluations of property, plant and equipment; and merger accounting for business combinations before the adoption of IFRS, respectively.

Capital management

Capital employed comprises total equity adjusted for goodwill recognised directly in reserves, net post-retirement benefit related assets and liabilities, net litigation provisions relating to exceptional items and net debt. The efficiency of the allocation of the capital to the divisions is monitored through the return on capital employed (ROCE). This ratio is calculated over a rolling 12-month period and is the percentage that headline operating profit comprises of monthly average capital employed. The ROCE was 16.6% (2012: 16.5%).

The capital structure is based on the directors' judgement of the balance required to maintain flexibility while achieving an efficient cost of capital. The Group has a target gearing, calculated on a market value basis, of approximately 20%. At the balance sheet date the Group had gearing of 13% (2012: 17%).

The Group has surplus cash on the balance sheet and the ratio of net debt to headline EBITDA of 1.2 is well below the medium term target of 1.5 to 2.0. The Group's robust balance sheet and record of strong cash generation is more than able to fund the immediate investment needs and other legacy obligations. The Board has therefore recommended a return of cash to shareholders of approximately £118m in the form of a special dividend of 30.0p per share.

As part of its capital management the Group strategy is to maintain a solid investment grade credit rating to ensure access to the widest possible sources of financing and to minimise the resulting cost of capital. At 31 July 2013 the Group had a credit rating of BBB+/Baa2 (2012: BBB+/Baa2) with Standard & Poor's and Moody's respectively. The credit rating is managed through the following cash-flow targets: headline operating cash conversion of greater than 80% and a ratio of net debt to headline EBITDA of less than two. For the year ended 31 July 2013 these measures were 98% (2012: 99%) and 1.2 (2012: 1.2).

The Board aims for dividend cover of around 2.5 times, to ensure that the Group retains sufficient cash to finance investment in growth.

Hedge reserve

	31 July 2013 £m	31 July 2012 £m
The hedge reserve on the balance sheet comprises		
– cash-flow hedge reserve	**1.8**	(4.7)
– net investment hedge reserve	**(175.8)**	(120.1)
	(174.0)	(124.8)

See transactional currency exposure risk management disclosures in note 19 for additional details of cash-flow hedges, and translational currency exposure risk management disclosure also in note 19 for additional details of net investment hedges.

24 Contingent liabilities and commitments

John Crane, Inc.

As stated in note 21, John Crane, Inc. ("JCI") is involved in numerous lawsuits pending in the United States in which plaintiffs are claiming damages arising from exposure to, or use of, products containing asbestos. The JCI products generally referred to in these cases are ones in which the asbestos fibres were encapsulated in such a manner that, according to tests conducted on behalf of JCI, the products were safe. JCI ceased manufacturing products containing asbestos in 1985.

Provision has been made for future defence costs and the cost of adverse judgments expected to occur. JCI's claims experience is significantly impacted by other factors which influence the US litigation environment. These can include: changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels; and legislative and procedural changes in both the state and federal court systems. As a result, whilst the Group anticipates that asbestos litigation will continue beyond the period covered by the provision, the uncertainty surrounding the US litigation environment beyond this point is such that the costs cannot be reliability estimated.

24 Contingent liabilities and commitments continued

Titeflex Corporation

As stated in note 21, Titeflex Corporation has made provision for the cost of expected future subrogation and product liability claims. The Group anticipates that litigation might continue beyond the period covered by the provision. However, the uncertainty surrounding the US litigation environment beyond this point (which reflects factors such as changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels; and legislative and procedural changes in both the state and federal court systems) is such that the costs cannot be reliably estimated.

Other contingent liabilities and commitments

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

At 31 July 2013, contingent liabilities, comprising bonds and guarantees arising in the normal course of business, amounted to £166.0m (2012: £167.4m), including pension commitments of £52.1m (2012: £49.5m).

From time to time the Group co-operates with relevant authorities in investigating business conduct issues. The Group is not aware of any issues which are expected to generate material financial exposures.

25 Operating lease commitments – minimum lease payments

The minimum uncancellable lease payments which the Group is committed to make are:

	31 July 2013		31 July 2012	
	Land and buildings £m	**Other £m**	Land and buildings £m	Other £m
Payments due				
– not later than one year	**32.3**	**8.2**	31.0	8.4
– later than one year and not later than five years	**69.0**	**8.8**	66.8	10.8
– later than five years	**12.6**		12.6	
	113.9	**17.0**	110.4	19.2

26 Cash-flow

Cash-flow from operating activities

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Operating profit – continuing	**493.2**	406.6
Amortisation of intangible assets	**81.1**	83.1
Impairment of intangible assets		10.7
(Profit)/loss on disposal of property, plant and equipment	**(4.3)**	3.7
Profit on disposal of business	**(0.9)**	(30.8)
Depreciation of property, plant and equipment	**52.3**	59.0
Share-based payment expense	**12.1**	14.4
Retirement benefits	**(77.7)**	(118.6)
Increase in inventories	**(20.3)**	(4.3)
Increase in trade and other receivables	**(30.3)**	(6.8)
Increase in trade and other payables	**31.8**	0.9
(Decrease)/increase in provisions	**(9.9)**	71.8
Cash generated from operations	**527.1**	489.7
Interest	**(59.6)**	(64.5)
Tax paid	**(114.1)**	(93.7)
Net cash inflow from operating activities	**353.4**	331.5

26 Cash-flow continued

Smiths Group cash-flow measures

The Group uses two non-statutory cash-flow measures to monitor performance: headline operating cash-flow and free cash-flow. Headline operating cash-flow is net cash inflow from headline operating activities less capital expenditure. See note 3 for a description of headline profit measures. Free cash-flow is cash-flow after interest and tax but before acquisitions, financing activities and dividends. The tables below reconcile these two measures to statutory cash-flow measures.

Headline operating cash-flow

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Net cash inflow from operating activities	**353.4**	331.5
Exclude:		
Interest	**59.6**	64.5
Tax paid	**114.1**	93.7
Cash outflow in respect of exceptional operating items	**43.9**	38.2
Pension deficit payments	**71.4**	111.2
Include:		
Expenditure on capitalised development, other intangible assets and property, plant and equipment	**(96.0)**	(91.2)
Disposals of property, plant and equipment in the ordinary course of business	**1.5**	0.7
Headline operating cash-flow	**547.9**	548.6

Free cash-flow

	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Net cash inflow from operating activities	**353.4**	331.5
Expenditure on capitalised development, other intangible assets and property, plant and equipment	**(96.0)**	(91.2)
Disposals of property, plant and equipment	**3.9**	0.7
Investment in financial assets relating to pensions financing	**(24.0)**	(24.0)
Free cash-flow	**237.3**	217.0
Investment in other financial assets	**(0.3)**	(0.3)
Acquisition of businesses	**(0.5)**	(167.5)
Disposal of businesses	**0.3**	47.3
Net cash-flow used in financing activities	**(66.7)**	(151.5)
Net (decrease)/increase in cash and cash equivalents	**170.1**	(55.0)

27 Employee share schemes

The Group operates share schemes and plans for the benefit of employees. The nature of the principal schemes and plans, including general conditions, is set out below:

Long-Term Incentive Plan (LTIP)

The LTIP is a share plan under which an award over a capped number of shares will vest after the end of the three year performance period if performance conditions are met. Group LTIP awards are made to selected senior corporate executives, including the executive directors. These awards have three performance conditions: 50% of the award is conditional on 3-year growth of headline EPS adjusted to exclude tax; 30% of the award is conditional on 3-year TSR relative to the FTSE 100 (excluding financial services companies); and 20% of the award is conditional on 3-year average annual headline operating cash conversion.

Divisional LTIP awards are made to selected divisional senior executives. These awards also have three performance conditions, and the relative significance of the conditions reflects the strategic priorities for each division: 20% to 40% of the awards are conditional on 3-year revenue growth; 30% to 40% of the awards are conditional on 3-year average annual headline operating margins; and 30% to 40% of the awards are conditional on 3-year average annual headline operating cash conversion.

Each performance condition has a threshold below which no shares vest and a maximum performance target at or above which the award vests in full. For performance between ‘threshold’ and ‘maximum’, awards vest on a straight-line sliding scale. The performance conditions are assessed separately, so performance on one condition does not affect the vesting of the other elements of the award. To the extent that the performance targets are not met over the three year performance period, awards will lapse. There is no re-testing of the performance conditions.

2010 Value Sharing Plan (2010 VSP)

The 2010 VSP is a long-term incentive plan approved by the shareholders at the Annual General Meeting on 16 November 2010 rewarding executives for value creation at Group and Divisional levels. The awards have the same structure and calculation methods as the 2008 VSP. The performance conditions are measured over a three-year period commencing with the financial year 2010/11, and the Group scheme hurdle rate is 8.5% a year.

27 Employee share schemes continued

2008 Value Sharing Plan (2008 VSP)

The VSP was a long-term incentive plan approved by the shareholders in July 2008 rewarding executives for value creation at Group and Divisional levels. The final vesting took place in November 2008. Corporate participants were rewarded under the VSP for value creation at a Group level, whereas the executives with divisional responsibilities were rewarded for value creation within the division for which they are responsible. For the Group scheme, one-third of the award depended on the growth in Smiths' TSR over and above the median for the companies comprising the FTSE 100 (excluding financial services companies) and the remaining two-thirds of each award was determined by the growth in internal value in excess of fixed rate. The growth in internal value was calculated as follows: adjusted profit before tax ('PBT') times the ratio of PBT to market capitalisation determined at the date of grant plus net equity cash-flows to shareholders. The divisional awards depended on meeting an internal value growth target set for the division in which the participant worked. The performance conditions were measured over three-year and four-year periods commencing with the financial year 2008/09. For the Group scheme, the growth in internal value was tested against a hurdle rate of 9.5% a year.

Smiths Group Co-Investment Plan (CIP)

Under the CIP, as introduced in October 2005, the executive directors and senior executives are able, if invited, to use their after tax bonus or 25% of their basic salary after tax, whichever is the greater, to invest in the Company's shares at the prevailing market price. At the end of a three year period, if the executive is still in office and provided the performance test is passed, matching shares will be awarded in respect of any invested shares retained for that period. The number of matching shares to be awarded is determined by the Remuneration Committee at the end of the year in which the bonus is earned by reference to annual bonus, and other corporate financial criteria. The maximum award will not exceed the value, before tax, of the bonus or salary invested in shares by the executive. Vesting of matching shares will occur and the matching shares will be released at the end of the three year period if the Group's Return on Capital Employed ('ROCE') over the Performance Period exceeds the Group's weighted average cost of capital ('WACC') over the Performance Period by an average margin of at least 1% per annum.

In July 2008 the CIP was amended. From 2009 participants have been required to invest 50% of their post tax bonus in purchased shares. The performance conditions have been expanded to include an enhanced performance condition of ROCE exceeding WACC by an average margin of 3% per annum. If the enhanced performance condition is met, two matching shares will be issued for every purchased share.

	CIP	Long term incentive plans	Other share schemes	Total	Weighted average price for option plans £
Ordinary shares under option ('000)					
1 August 2011	1,340	1,857	4,438	7,635	£5.37
Granted	752	1,133	257	2,142	£0.97
Update of estimates		96		96	£0.00
Exercised	(254)	(773)	(393)	(1,420)	£2.20
Lapsed	(130)	(14)	(827)	(971)	£7.07
31 July 2012	1,708	2,299	3,475	7,482	£4.10
Granted	707	1,020	149	1,876	£0.80
Update of estimates		(64)		(64)	£0.00
Exercised	(306)	(721)	(1,224)	(2,251)	£4.60
Lapsed	(235)	(167)	(314)	(716)	£4.15
31 July 2013	**1,874**	**2,367**	**2,086**	**6,327**	**£2.98**

Options were exercised on an irregular basis during the period. The average closing share price over the financial year was 1,195.79p (2012: 992.15p). There has been no change to the effective option price of any of the outstanding options during the period.

Range of exercise prices	Total shares under option ('000)	Weighted average remaining contractual life (months)	**Options exercisable at 31 July 2013 ('000)**	Options exercisable at 31 July 2012 ('000)	**Exercisable weighted average exercise price for options exercisable at 31 July 2013**
£0.00 – £2.00	4,242	17			
£2.01 – £6.00	169	21		2	
£6.01 – £10.00	1,215	51	**1,071**	1,387	**£8.74**
£10.01 – £14.00	701	48	**532**	947	**£10.97**

For the purposes of valuing options to arrive at the share-based payment charge, the Binomial option pricing model has been used for most schemes and the Monte Carlo method is used for schemes with total shareholder return performance targets. The key assumptions used in the models for 2013 and 2012 are volatility of 25% to 27% (2012: 27% to 30%) and dividend yield of 3.75% (2012: 3.75%). Assumptions on expected volatility and expected option term have been made on the basis of historical data, for the period corresponding with the vesting period of the option. These generated a weighted average fair value for CIP of £10.84 (2012: £9.44), group long term incentive plans of £9.18 (2012: £7.14) and divisional long term incentive plans of £10.84 (2012: £8.94). The fair value disclosed for the CIP award treats the two matching shares as separate options.

Included within staff costs is an expense arising from share-based payment transactions of £12.8m (2012: £14.3m), of which £12.1m (2012: £14.4m) relates to equity-settled share-based payment.

At 31 July 2013 the creditor relating to cash-settled schemes is £0.5m (2012: £0.4m).