

Chief Executive's statement

Keith Butler-Wheelhouse
Chief Executive



Sales

£2,161m

Headline pre-tax profit

+9%
£344m

Statutory pre-tax profit

£256m

The past financial year has seen Smiths exit the aerospace market – in which it has operated for some 90 years – and come of age as the world's leading detection business capable of forging its own future.

In January we announced the sale of our aerospace businesses to General Electric Company (GE) and this resulted in the return of £2.1 billion of the proceeds to shareholders. This transaction was completed during the second quarter creating a new-look Smiths founded on three excellent divisions with reduced debt (down to £588m from £923m last year), improved growth prospects, increasing margins and excellent cash conversion.

Looking at this year's results, headline pre-tax profit increased by 9% in 2007, while headline operating profit increased only slightly, held back by a £21m currency translation effect. On an underlying basis, sales increased by 5% and headline operating profit by 7%.

Driving for Full Potential

In past Annual Reports I have outlined how we use the Smiths Full Potential process to identify the management actions needed to achieve the best possible long-term performance. And in financial terms Full Potential is the performance arising from excellent execution of these management actions combined with a market environment that meets expectations. In practice, we establish a programme of both incremental and step change to take the business to a higher level of performance.

Last year I spoke about metrics that demonstrate the trajectory of the Full Potential process. The blue box on the facing page illustrates how these metrics and other non-financial factors measure progress in achieving the six fundamental strengths that are the basis of our Full Potential programme. These six strengths help us to shape Smiths, defining our markets, creating opportunities and growing from our core businesses.

In the following passage I have highlighted recent business examples that illustrate in practice how we are successfully executing implementation of the Smiths Full Potential process.

Strategy in action

Operating in sectors of high growth:

Across Smiths we focus on the sectors where high growth can be achieved and work hard to secure this growth. This is noticeable in Specialty Engineering where Interconnect and John Crane are successfully exploiting the high-growth wireless communications and energy markets.

A continuing theme for this year has been the growing need across the world for enhanced vigilance in response to the attempts of terrorists to disrupt our lives. Smiths Detection has played a major role in this. In airports, for example, the newly-introduced HI-SCAN 6040aTiX will be the first system deployed that allows automatic explosives detection at security checkpoints which screen carry-on luggage. With the implementation of this ground-breaking technology, Smiths Detection is helping airports and airlines tackle the key issue of enhancing security while trying to ensure the flow of passengers onto aircraft.

Smiths Full Potential programme: How we do what we do

Our six fundamental strengths	What this means in practice	How we measure performance
1 Operate in sectors of high growth	We choose to operate in sectors of high growth. Each of our three divisions has an attractive margin profile, with a strong presence in sectors that have high barriers to entry.	Sales growth Profit Growth
2 Reach deep into global markets	We focus on getting the most appropriate geographic footprint for manufacturing, sales and support. As we establish more of our manufacturing in developing countries, we gain the benefit of lower costs and of direct entry into those markets.	Geographic footprint
3 Develop technology to help customers succeed	Technology is our lifeblood. We anticipate change, invest in product development, and make appropriate acquisitions to gain competitive advantage and thus drive future growth. In addition, our manufacturing know-how is an important part of securing competitive advantage.	R&D/Sales ratio
4 Deliver constant improvement	Smiths drives hard to improve operational efficiency. Throughout the business there is a focus on productivity. We measure results in terms of both gross and net margin, seeking continually to reduce overheads and costs.	Cash generation Return on shareholders' funds Margin improvements
5 Improve the business mix	We refine our profile to the areas of best opportunity. Since 2001, in addition to the sale of our aerospace businesses, we have generated disposal proceeds of around £1 billion, spending a similar amount on acquisitions that strengthen our technologies and market presence.	Cash generation Return on shareholders' funds Margin improvements
6 Do business the right way	Smiths always seeks to maintain high ethical standards – it's what we believe in, and what our customers, employees and all other stakeholders have a right to expect.	Safety and environmental indices Code compliance People development

Reaching deep into global markets:

The exceptional global reach of Smiths is clearly evident throughout our operations, whether in developing markets in Russia or moving manufacturing to Mexico. Building the right manufacturing, sales, R&D and support footprint is a vital element in the daily process of optimising costs while maximising customer service. In the past we have reported developments in China, India and Russia and we continue to build capacity and presence in these countries. Another way of reaching more deeply into markets is via e-commerce. Outside the US, following an e-business initiative, Smiths Medical has seen a 35% growth in website sales of its products. Electronic transactions are now a significant proportion of total sales in some territories, with India proving to be a particularly strong market.

Developing technology to help customers succeed:

The application of technology to help our customers is the core that runs throughout Smiths. In Medical, for example, our pump technology is helping to move people from acute care in hospitals to chronic care through clinics and at home. This technology thread is never more apparent than in Smiths Specialty Engineering where, based on strong relationships with customers, we deliver a range of solutions to meet their rigorous needs. The reliability of Smiths Interconnect products has ensured they are consistently used in major space exploration projects. Most recently, attenuators, manufactured by Interconnect business EMC, have been selected by the Jet Propulsion Laboratory, California Institute of Technology, for its Mars Science Laboratory to be launched in 2009.

In the UK, John Crane has invested some £4 million in a state of the art high-pressure test facility. This facility, when completed, will be one of the most technologically advanced of its kind in the world and it will help in the development of the ground-breaking equipment our customers need to increase the size of the compressors used in gas pipelines, more efficiently delivering gas from production facility to end users.

Delivering constant improvement:

Across Smiths, we are continually seeking to improve how we do things. This is not just a question of manufacturing, but includes all aspects of the back office, sales and support activities. In each division we are investing in enterprise-wide IT systems that offer long-term efficiencies for our operations.

Nowhere is this process of change more profound than in Smiths Medical. This is multi-faceted work: we are transferring production from high-cost sites principally in the UK and US to plants in lower cost regions, including in Mexico; we are introducing a common computing platform across Medical to improve supply chain management and customer service; and we have been adding capacity at our highly-automated plants producing safety devices in the US.

Such scale of change brings great benefits (margins have already improved), but the business was held back by this supply chain disruption, this has now been resolved. Overall Smiths Medical will be greatly enhanced by its reconfiguration.

Improving the business mix:

Aerospace represented 37% of Smiths sales in 2006 and for many it was the division that defined the most recent identity of Smiths. The Board's rationale behind this transaction is set out by the Chairman in his statement. I would add that this is another example of how Smiths constantly reviews its business profile, ensuring that we have the mix that best exploits opportunities.

On 21 March 2007, Smiths and General Electric Company (GE) announced that they had conditionally agreed to form a joint venture to be named Smiths GE Detection, of which Smiths would have had a 64% share and management control. After careful consideration, Smiths and GE were unable to agree on a strategic vision for the combined business and on 19 September decided not to proceed to form the joint venture.

As an independent business and the world leader in its field, Smiths Detection has the flexibility, resources and technology to continue to serve our customers as their needs change and grow.

Doing business the right way:

The sixth strength – Doing Business the Right Way – is central to everything that we do and is illustrated in the section devoted to Corporate Responsibility in this report (pages 19-20) and in the expanded electronic report available at: www.smiths.com/responsibility.

The past year has seen Smiths team up with the Centre for the Study of Terrorism and Political Violence at the University of St Andrews which looks at the fundamental causes of terrorism. We are proud to be helping this world-leading institution in its work to better understand the causes and drivers of what is increasingly impacting people's lives.

Smiths people

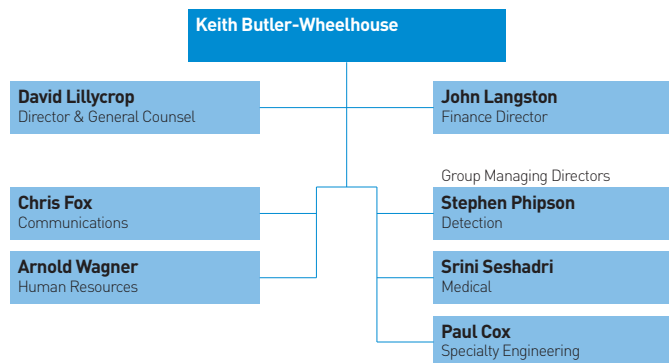
A year dominated by the scale of change we have seen has meant that hundreds of Smiths people have been called on to engage in activities that are additional to their normal 'day job'. Everyone rose magnificently to the challenge of new and extra tasks that had to be conducted, often in highly confidential circumstances. For that I thank everyone and this includes our former aerospace colleagues now working for GE Aviation.

Completion of the Aerospace sale also meant that a share of annual head office costs could no longer be allocated to that division and these were shared across the continuing activities in 2007. To address this, we have carried out a review of head office operations, examining both the scale of activities and in some cases whether these activities are indeed appropriate. As a result of this process we have largely completed a rationalisation of the head office functions and we expect to reduce head office costs by £6m in the year ahead and for this saving to rise to £8m in the years following.

This change, together with the sale of Aerospace, has led to a number of long-standing colleagues leaving Smiths. Their contribution, together with that from the 21,000 current Smiths employees, has been truly appreciated by myself, fellow Executive Directors and the whole Board.

These changes are also reflected in the Smiths Executive Committee which is illustrated here:

Smiths Executive Committee



Looking forward

Smiths continues to build leadership positions in dynamic markets and, looking ahead, the outlook in its sectors remains robust. All three divisions have made a good start to the new financial year and the Board is confident that Smiths can achieve an enhanced performance in the current year and beyond.

Over the course of the past years we have built a business that provides products and services that make the world safer, healthier and more productive. I think these are excellent markets in which to have a presence and offer continued reasons for optimism regarding the future of Smiths.

I step down in December after 11 years as Chief Executive of the Group and I would like to thank all of the employees, past and present, who have contributed to the success, supported the changes and driven the business forward. My successor, Philip Bowman, is an extremely able leader and I know that he will take Smiths to the next level of achievement and success. I wish him and all my Smiths colleagues good fortune.

Keith Butler-Wheelhouse
Chief Executive