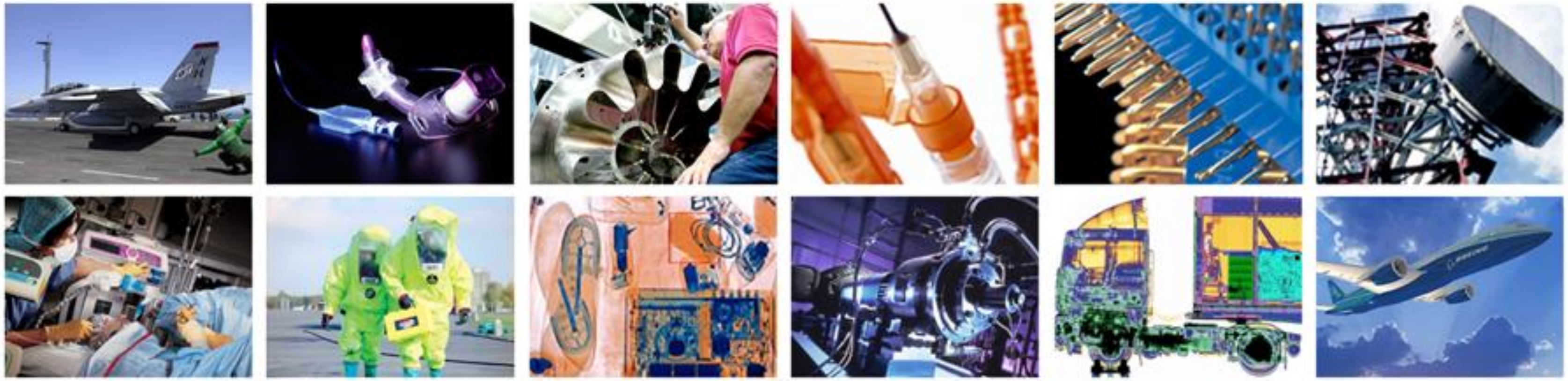
Smiths Group

Meeting with Analysts and Investors
Wiesbaden, Thursday, 23 March 2006

An insight into Smiths R&D Investment

1. Some general information on the key contracts
2. IFRS accounting

Presentation by: **Alan Thomson,** Financial Director



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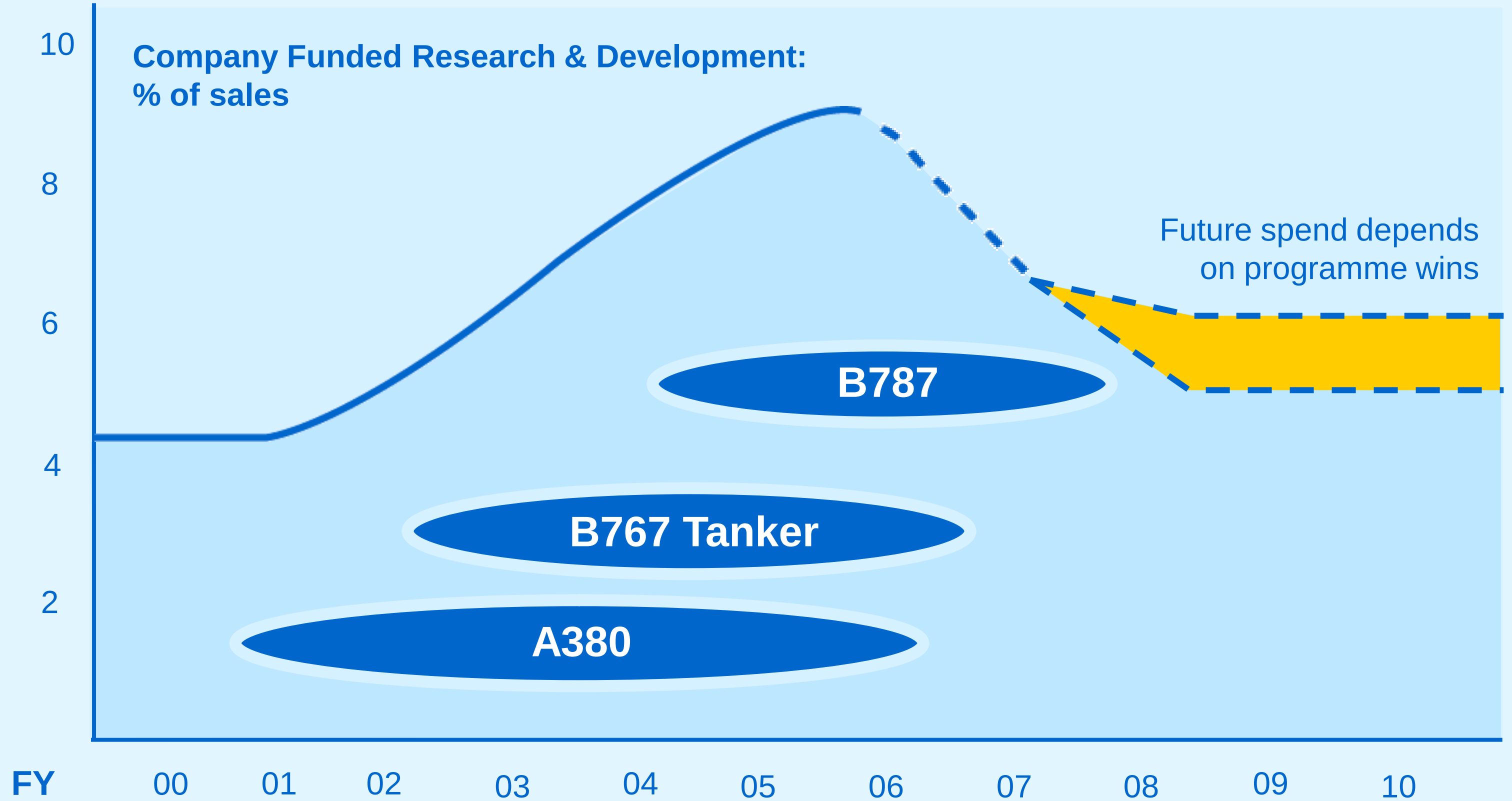
Investing in the future of Smiths Aerospace



Today's major development programmes will drive future growth

Smiths Group: R&D investment

A380

1. Very high shipset content
2. Mechanical equipment
3. Ratio of unit cost to upfront cost is normal
4. OE and aftermarket characteristics normal
5. Final stage of development – aircraft already flying

Smiths Group: R&D investment

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B787

1. Very high shipset content
2. Mechanical equipment and Common Core Computing
3. Common Core Computing is the software Operating System
4. Very high upfront cost – low unit cost
5. With capitalised development, will achieve good margins
6. Technology a development of C130AMP – reduces risk

Smiths Group: R&D investment

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Tanker

Operational testing commences midyear

First deliveries at } end of 2006

1. Very high shipset content, Mechanical equipment & software
2. Ratio of unit cost to upfront cost reflects hardware/software mix
3. Upfront costs also reflect the learning curve with new technology
4. Economics only make sense with significant US orders
5. Orders uncertain so cost expensed
6. Outlook more encouraging following “AoA” and QDR

Smiths Group: R&D investment

What next?

Several opportunities ahead

Aim to “read across” recent technology

Overall scale of investment lower

Developing technology to help customers succeed

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Research & Development

£m (for six months ended 31 January)	**2006**	**of sales**	2005	of sales
Company-funded				
Charged to P&L	**62**		58	
Added to Balance Sheet	**33**		14	
	95	**6%**	72	5%
Customer-funded				
No impact on P&L	**70**	**4%**	63	5%
Total	**165**	**10%**	135	10%

Total R&D increased in line with sales

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IFRS accounting treatment

- Required to capitalise spend where return is reasonably assured
- Generally equates to “develop and supply” contracts
- Matches expenditure with income

July 2005 position:	Aerospace £m	Other £m	Total £m
Balance sheet: Intangible asset	173	25	198
less: Amortisation	-20	-7	-27
Total identified on interim bal sheet:	153	18	171
less: Deferred Income*	-65	-	-65
Total balance sheet effect	88	18	106
Amortisation	c7 p.a.	c7 p.a.	

* Deferred income on balance sheet is included within creditors. It is a contra to customer funded capitalised development costs – required under IFRS to be included within the capitalised development costs total.

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IFRS accounting treatment

H1 2006 position:	Aerospace	Other	Total	
	£m	£m	£m	
Identified on balance sheet:				
Intangible asset	50	5	55	
less: Amortisation	-3	-3	-6	
Net	47	2	49	Shows in cash flow statement
less: Deferred Income	-10	-	-10	Within creditors
Transfer from stock	-6	-	-6	Contra
Net Balance sheet addition	31	2	33	Net effect

Developing technology to help customers succeed

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Research & Development

£m (for six months ended 31 January)	2006	of sales	Aero	Other
Company-funded				
Charged to P&L	62	4%	5%	3%
Added to Balance Sheet	33	2%	5%	<1%
	95	6%	10%	3%
Customer-funded				
No impact on P&L	70	4%		
Total	165	10%		

Expect to trend to:
3%
3%
6%
(by 2008)

Matching expense with income is principally an Aerospace issue, and better reflects the underlying economics

Amortisation periods: Aerospace: Up to 15 years, other divs: 3– 5 years