Smiths Group plc
Annual Report 2016

smiths
bringing technology to life

Being the best at what we do

Contents

Highlights

Smiths Group is a global technology company listed on the London Stock Exchange. Our vision is to build Smiths Group into one of the world's leading technology companies.

Revenue
£2,949m

Headline operating profit
£510m

Headline free cash-flow
£400m

Headline earnings per share
85.2p

Key highlights

- Growth in reported revenue and headline operating profit in four out of five divisions
- Group revenue declined 2% on an underlying[1] basis; up 2% on a reported basis
- 53% of Group revenues derived from aftermarket and consumables
- Headline operating profit declined 4% on an underlying[1] basis, driven by tough global energy market conditions for John Crane
- Good margin expansion in Smiths Medical, Smiths Detection and Smiths Interconnect
- John Crane margins resilient at 21.9%; Flex-Tek margins stable
- Earnings per share of 85.2 pence fell 1% year-on-year driven by higher finance costs
- 102% cash conversion drove an underlying reduction in net debt
- Proposed final dividend of 28.75 pence per share. Full year dividend growth of 2.4%
- $710m acquisition of Morpho Detection expected to complete in early 2017, subject to regulatory clearances

1 Underlying excludes the impact of acquisitions and divestments, and the effects of foreign exchange translation

Read more at
www.smiths.com

Strategic report

Strategic overview

Operational review

Risks and responsibility

Transforming engineering with 3D technology

John Crane uses advanced 3D scanning to create digital engineering models from field installations, allowing our engineers to spend more time troubleshooting our customers' mission-critical rotating equipment, and enabling future 3D printing capabilities.

Smiths at a glance

We apply leading-edge technology to design, manufacture and deliver innovative solutions that meet our customers' needs. Our products and services – often hidden from view – touch the lives of millions of people every day.

Revenue in 2016

£2,949m

Headline operating profit in 2016

£510m

Employees worldwide

22,000

Our markets
We serve a wide range of end markets – from healthcare, energy and petrochemicals through to threat and contraband detection, telecommunications and equipment manufacture. Our customers range from governments and their agencies, to hospitals, petrochemical companies and equipment manufacturers and service providers in various sectors around the world.

Our competitive advantage
Our products and services are often critical to our customers' operations, while our proprietary technology and high service levels help create competitive advantage.

Our structure
We employ 22,000 people in more than 50 countries through our five divisions: John Crane, Smiths Medical, Smiths Detection, Smiths Interconnect and Flex-Tek.

Our approach
We do this responsibly, through the combined expertise of our people and effective, focused leadership, to deliver value to our customers, shareholders and wider stakeholders.

Where we operate

Group manufacturing and service locations

Countries our products and services reach

>200

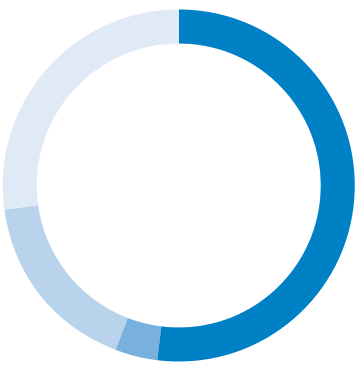
Our market split

68% of our revenue comes from three markets: healthcare, energy, and homeland security and defence. Our aftermarket products and services account for 53% of our business.

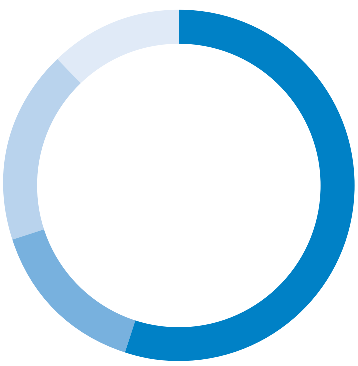
Percentage of revenue from emerging markets

17%

Group revenue by destination
- North America 52%
- United Kingdom 4%
- Europe exc. UK 17%
- Rest of World 27%

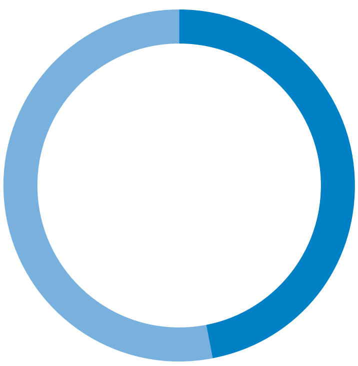


Location of assets
- North America 55%
- United Kingdom 15%
- Europe exc. UK 18%
- Rest of World 12%



Excludes cash and cash equivalents

Revenue from equipment sales and aftermarket/consumables
- Equipment sales 47%
- Aftermarket/consumables 53%



Read more in note 1 on page 144

Our divisions

Smiths Group has five divisions each serving specialist technology markets worldwide

	John Crane	Smiths Medical
		
	Providing engineered products and services to global energy and process industry customers	**Supplying medical devices and consumables that are vital to patient care globally**
Revenue	£830m	£874m
Headline operating profit margin	21.9%	21.4%
Employees	6,550	7,600
Competitive strengths	Market leader in mechanical seals Strong proprietary technology and expertise in applied engineering High degree of customisation to meet specific demands Global network of c. 230 sales and service centres Over half of sales in aftermarket	Strong market positions in chosen clinical areas Highly recognised and respected brands Reputation for quality and safety Extensive global sales network Innovative pipeline of new products in development

Read more on pages 32-35 or www.johncrane.com

Read more on pages 36-39 or www.smiths-medical.com

Divisional revenue
- John Crane 28%
- Smiths Medical 30%
- Smiths Detection 18%
- Smiths Interconnect 15%
- Flex-Tek 9%

Read more on page 144

Smiths Detection

Designing and manufacturing technology solutions that detect and identify security threats and contraband

£526m

13.0%

2,050

- Strong global brand
- Operates in regulated markets requiring rigorous product certification
- Technologies leveraged across many markets and applications
- Investment in continuous improvement driving division-wide efficiencies
- Growing aftermarket revenues (37% of total revenues)

Read more on pages 40-43 or www.smithsdetection.com

Smiths Interconnect

Developing electronic components and sub-systems that connect, protect and control critical telecommunications systems

£435m

13.1%

3,400

- Innovative and technically differentiated offerings
- Ultra-high reliability solutions used in demanding applications
- Customer intimacy, responsiveness and product customisation
- Highly regulated markets with strong barriers to entry
- Global presence, reach and support

Read more on pages 44-47 or www.smithsinterconnect.com

Flex-Tek

Providing engineered components that heat and move fluids and gases

£284m

18.0%

2,050

- High-performance flexible tubing products for aerospace
- High capability to design and manufacture heating solutions for bespoke applications
- Strong customer relationships
- Market-leading product performance in residential gas tubing

Read more on pages 48-51 or www.flextekgroup.com

Divisional headline operating profit*

- John Crane 33%
- Smiths Medical 34%
- Smiths Detection 13%
- Smiths Interconnect 11%
- Flex-Tek 9%

*Before corporate costs

Read more on page 144

Chairman's statement

Smiths Group has embarked on a new and exciting phase in its evolution.

A revitalised sense of mission and a renewed focus on technology leadership, together with the diversity of our end markets, help to provide the scope for business growth and security against challenging trading conditions.

Building a viable dream

Throughout my career, I've passionately believed that every company should have the courage to build a dream. Setting out a viable dream for our employees, customers and shareholders, appointing great leaders and then building a compelling strategy to drive relentlessly towards that end – these are the hallmarks and seeds of growing and building great companies.

Smiths Group is no different. With a proud legacy of technological innovation, market leadership positions across many of our businesses, and a large cadre of experienced people, there is much that is inspirational and extraordinary in what we do every day. Rather than feel conditioned and constrained by our past, or even by new circumstances, we should be intent on recapturing the company's historical and innate spirit of enquiry and innovation in order to bring new levels of ambition to our purpose. Our employees' qualities and resourcefulness provide a powerful platform for injecting new momentum into our business. But a vital part of this mission is inspiring our people and instilling them with a renewed sense of self-belief.

Focusing on the areas of greatest market attractiveness, and pursuing these through initiatives to drive organic and inorganic growth, we will create the conditions for long-term sustainable competitive advantage. This is what the world's great companies do; relentlessly build sustainable competitive advantage, mixed in with an honourable and ethical approach to business. Reinvigorating innovation and supporting it through more disciplined commercialisation processes, as well as through increasing resources, has a vital role to play here. Faster growth is the answer to our value creation challenge and in my mind, the best kind of growth is organic growth. This is because it points to the ability of a company to adapt, adjust and reinvent itself as new times and competition dictates. We have, and will continue to, supplement it with acquisitions because they bring the additional needed element of speed.

Thanks to the progress that has been made to address our pension scheme liabilities, long-term funding arrangements are now in place which will materially increase the cash resources available to invest in these growth opportunities.

On several occasions over the past year, I have reflected on the following observation from that great man of letters, George Bernard Shaw. It might apply, equally, to companies: "People are always blaming their circumstances for what they are. I don't believe in (blaming) circumstances. The people who get on in this world are the people who get up and look for the circumstances they want, and if they can't find them, they make them."

At an important point in this great engineering company's fortunes, it is an honour for the Board to have played a significant part in 'making the circumstances' for a revitalised sense of mission at Smiths Group. More than at any time during my tenure as Chairman, I am convinced that we are in a better position to build and grow. Under the energetic leadership of Andy Reynolds Smith, and with a renewed commitment to innovation, a single-minded focus on targeting attractive markets and a relentless drive to improve operational excellence, the next few years hold out exciting opportunities for us to be the architects of our own fortune.

Renewing our purpose and resolve

Smiths Group embarks on this journey in a period of ongoing volatility in the external environment. Uncharted territories are becoming ever more commonplace on the roadmaps of the world. Economic forecasts are generally weaker, political turbulence is higher and personal security has generally worsened over the past couple of years. The implications of other significant events, such as the outcome of the UK's referendum on EU membership and the ongoing US presidential election campaign, will be with us for many years to come. Continuing

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Sir George Buckley
Chairman

factors such as low oil prices, low interest rates and currency volatility create additional planning uncertainties for every company. Add to that an evolving threat environment and increasing geopolitical unrest, and it is clear that the risks that companies must navigate in today's world show little sign of abating. But, usually, inside every threat is a hidden opportunity.

Rather than be disheartened by these prospects, our resolve should be steadied by the recognition that our Group's very diversity serves us well. Along those lines, Smiths delivered a robust and improved performance this year. Our broad end market exposures helped us to offset the anticipated net declines in John Crane's oil industry oriented revenues, with profitable growth in our other two large divisions. Smiths Medical continued its record of profitable growth, fuelled in part by increased investment over recent years in product innovation and expansion into new geographies. For the Group as a whole, incidentally, there continues to be much opportunity to expand into emerging markets. Smiths Detection's strong performance was built on improving sales volumes, particularly in ports and borders, and on the hard work done in that division to improve operational performance through value engineering and programme management initiatives.

The levers of value creation

With the vast majority of our revenues derived from markets with long-term growth potential – nearly two-thirds comes from the three key markets of healthcare, energy, and homeland security and defence – we have taken some important steps this year to equip ourselves to face the future with confidence. Your Board has been deeply and vigorously engaged in assessing strategic opportunities to position Smiths Group for future growth.

Typical Western engineering companies have been caught in a high margin, low growth trap for many years. With this financial backdrop, profitably growing the top line is the most important lever of value creation. Higher levels of organic growth, driven by innovation, imagination and creativity remain our principal objective. The world's great companies are all innovative ones.

Success, however, does not come overnight. Rebuilding this kind of capability and confidence in a company requires a good measure of patience and determination. So we will continue to pull hard on all the other growth levers that the company has at its disposal, such as initiatives to improve margins and working capital turns. Success in these endeavours will not only deliver a keener edge to our competitiveness, but also ensure greater consistency of execution across our businesses.

As someone who is passionate about growth and innovation, a focus on increasing technological differentiation has a powerful resonance. As a businessman concerned with delivering new value for shareholders, it also happens to make perfect sense. Innovation is not done for its own sake, but done to create relative competitive advantage, increasing customer satisfaction and greater employee engagement. It's an 'everybody wins' strategy. We have many compelling and recognised brands with an enviable reputation for quality. By showing a greater appetite for innovation across our manufacturing, logistics, product and service lines, as well as more adventurousness in our geographic reach, our ambition will ultimately turn these brands into enduring franchises.

In April, we announced the largest acquisition for the Group in more than a decade, with the agreement to purchase Morpho Detection. Completion is subject to a number of regulatory clearances, which we continue to expect in early 2017. The combined business will provide us with technology and innovation resources to deploy against growing and ever more sophisticated global security and contraband threats. In many ways, this acquisition should also be seen as a signal of our intent to accelerate sustainable growth in attractive markets. We will continue to take an active approach to portfolio management as we seek to simplify and strengthen the Group's structure.

Behaving responsibly

The theme of this year's report is 'Being the best at what we do', and throughout you will find numerous examples of how our employees strive to achieve excellence across our operational, commercial and technical activities. On my visits with Smiths Group colleagues across the world, I have continued to be impressed by their spirit, commitment and creativity. With operational excellence and innovation now firmly on the agenda at Smiths, we set great store by attracting, retaining, developing, engaging and inspiring our many employees.

During the year, we conducted a comprehensive MyVoice employee survey across all our divisions and we will listen hard to what our employees are telling us, and take action to improve where we can. With the well-being and safety of our people as a vital need, I am pleased to note that recordable injury incident rates are now at their lowest historical level. There is no room for complacency, and our goal continues to be zero incidents. We have also continued our long-term trend of improving our environmental performance, with material reductions in energy, GHG emissions, water usage and non-recyclable waste during the year.

Dividend

The Board has a progressive dividend policy for future payouts, with the aim of increasing dividends in line with the long-term underlying growth in earnings. This policy will enable us to retain sufficient cash-flow to finance our investment in the drivers of growth and to meet our financial obligations. In setting the level of dividend payments, the Board will take into account prevailing economic conditions and future investment plans, along with the objective to maintain minimum dividend cover of around 2.0. The Board is recommending a final dividend per share of 28.75 pence, giving a total dividend for the year of 42 pence, an increase of 2.4% year-on-year. The final dividend will be paid on 18 November to shareholders registered at close of business on 21 October. The ex-dividend date is 20 October.

Board changes

As I mentioned in these pages last year, David Challen decided to step down from the Board after the AGM, having served with distinction as Chair of the Audit Committee and as Senior Independent Director. I am delighted to welcome Mark Seligman to the Board, who brings with him the valuable perspectives gleaned from a long and successful career in banking. I am also pleased that Sir Kevin Tebbit agreed to underscore his many years of insightful service to the Board by becoming our Senior Independent Director.

Sir George Buckley
Chairman

Dividend per share
Up 2%
42.0p

Chief Executive's review

In my first year as CEO, my aim has been to lay the foundations for future value creation through stronger growth, improved competitiveness, more robust and consistent execution and a better focused portfolio.

Group results overview

Group revenue fell 2% on an underlying[1] basis, a robust performance highlighting the benefits of our broad range of end market exposures. Good growth was reported in Smiths Medical and Smiths Detection. John Crane experienced tough trading conditions as volatility in the global energy markets continued to reduce demand. Revenue in Smiths Interconnect and Flex-Tek was slightly down on the prior year on an underlying[1] basis. On a reported basis, Group revenue grew 2%, benefitting from foreign exchange, and in particular the strength of the US dollar.

Reported Group headline operating profit of £510m was in line with the prior year, although on an underlying basis this fell 4%. The Group's operating profit margin fell 40 basis points on an underlying basis. Margin expansion in Smiths Medical, Smiths Detection and Smiths Interconnect reflected strong trading performance in addition to cost control and restructuring activities, but was offset by weakness in John Crane's end markets.

1 Underlying excludes the impact of acquisitions and divestments, and the effects of foreign exchange translation

The Group delivered an improvement in cash generation with a cash conversion rate of 102%. We have made progress in improving stock turns this year, with £30m cash inflow from inventory reductions. Headline free cash-flow of £400m increased 18%. Net debt of £978m reduced by £23m on an underlying basis, despite a significantly higher pension contribution in the year.

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Outlook

We anticipate a broad continuation of the trends experienced in 2016, with ongoing challenges in John Crane's end markets being more than offset by moderate underlying[1] revenue growth in our other divisions. As is typically the case, Group performance in 2017 is expected to be weighted towards the second half. We expect cash conversion to continue to be strong in the coming year and the recent depreciation of sterling is expected to provide a tailwind to reported revenue and operating profit, should current rates prevail.

I am confident that, over the long-term, our strategy will drive Smiths to become one of the world's leading technology companies.

Andy Reynolds Smith
Chief Executive

Headline earnings per share

85.2p

Read more on pages 25-31
and in note 5 on page 151

Cash conversion

102%

Read more in note 26
on page 182

Headline free cash-flow

£400m

Read more on pages 26-31
and in note 26 on page 182

Strategy update

Introduction

Everything I felt about Smiths Group on my first day as Chief Executive – strength in depth but great opportunity for improvement – I now believe even more passionately. The Group has a number of businesses, grouped into five high-quality divisions. Many of the businesses occupy leading positions in the markets they serve. This forms a solid platform, and provides a clear opportunity to build on the Group's innate DNA to take us to the next level of growth, innovation and competitive differentiation.

In my first few months, I set up a strategic review of our businesses to identify the drivers for future growth and value creation, with a particular focus on market attractiveness and our competitiveness – essentially asking the question 'How good can it be?' The review has provided clarity on the 'doability' – the risks, costs and time required – and we have aligned its findings with a more robust capital allocation process. As a result of our detailed knowledge of our businesses and the actions we have taken to date, our ambitions for Smiths Group are well-founded.

Vision

My vision is to establish Smiths as one of the world's leading technology companies, with sustainable outperformance in our chosen markets. We will achieve this by focusing on our two strategic priorities:

- Outperforming our chosen markets – the Growth Framework
- Achieving world-class competitiveness – the Smiths Excellence system

As we target leadership positions in our chosen markets, everything we do in pursuit of these priorities will be based on the quality of our people, doing the right thing and the rigour of our financial discipline.

Outperforming our chosen markets – the Growth Framework

In order to achieve sustainable growth, it is important to target the right segments within markets, the right geographies and the right customers, and to increase the value of the content we have with our customers. All of these, of course, should be underpinned by world-class competitiveness. We call this our Growth Framework. As a result of our strategic review's detailed assessment of our divisions by market sub-segment, we now have a much more granular understanding of the growth characteristics of the markets that each of our divisions serves. For example:

John Crane

John Crane's performance this year has demonstrated the importance of maintaining exposure to a broad range of end markets. While oil and gas capital expenditure has been a catalyst for growth and margin expansion over the past decade, and this segment accounted for 57% of John Crane's revenues in 2016, we will do more to expand into non-oil and gas verticals which make up the remaining 43%, such as the chemical, pharmaceutical, and pulp and paper industries. We will also consider organic and inorganic means to expand into adjacent mission-critical products and components with similar business characteristics to our current offering, as well as investing in digital solutions such as predictive diagnostics and reviewing potential breakthrough disruptive technologies, particularly in the field of advanced materials and 3D printing. We will do more to improve our market positioning in key geographies, such as China, and John Crane must also position itself better to take advantage of the long-term implications of increasing environmental regulations and the drive towards lower emissions and higher energy efficiency. Many of our products, including dry gas seals, have demonstrable benefits in this regard. With 59% of revenue derived from aftermarket products and services, we view John Crane as a 20%+ margin business.

Smiths Medical

Smiths Medical's portfolio incorporates several strong brands and market leadership positions, particularly within Infusion Systems, Vascular Access and Vital Care. Our market sub-segmentation review has led us to identify with more precision the areas that are growing and those that are not, so that we can focus our significantly increased investment in higher-growth categories. We will position ourselves better to address key global trends, such as increasing digitalisation and the growth of alternate sites of care, which we expect to do by strengthening our category leadership positions through greater innovation and competitive differentiation and by building our 'pump to patient' strategy – and beyond. We view Smiths Medical as a 20%+ margin business.

Smiths Detection

Smiths Detection's strong revenue growth and margin expansion this year comes from high new business wins, increasing initiatives to capture aftermarket service revenues, and sustained management action to improve productivity and operations. With a broad portfolio in a global homeland security market which we estimate will grow at a mid-single digits CAGR to 2021, the business benefits from a global reach and strong existing relationships with some customers. We view Smiths Detection as a mid-teens margin business. In April, I announced that we had agreed to purchase Morpho Detection from Safran S.A., for an enterprise value of $710m. Morpho Detection is a high quality business, with a strong management team, and this combination provides a compelling competitive platform for product, service and technology leadership. The acquisition will better position us to meet customer requirements for high-technology, cost-efficient solutions and services, including software. We continue to anticipate completion of the acquisition to take place in early 2017, subject to regulatory clearances.

Smiths Interconnect

Smiths Interconnect provides high reliability electronic components to multiple industries, including the defence, telecoms, aerospace and medical end verticals. Our review has given us clarity on the most attractive customer segments within these verticals, and led us to conclude that Smiths Interconnect is better positioned to serve those customers who seek more sophisticated and differentiated technology solutions. We will therefore focus increasingly on select customer types in the most attractive verticals, and align our investment in new product development accordingly to meet electronics industry trends such as miniaturisation, power efficiency and processing speed. We view Smiths Interconnect as a mid-teens margin business.

Flex-Tek

Flex-Tek provides a range of engineered components for the aerospace, medical, industrial, construction and domestic appliance end markets. With a more in-depth understanding of the relative attractiveness of these end markets, we will prioritise areas of faster growth and where Flex-Tek can deliver competitive differentiation, including in technology expertise and customer service. We view Flex-Tek as a mid-teens margin business.

We have undertaken a strategic review across the Group to examine in detail the growth characteristics of the markets we serve and our competitive positioning within those markets. We start from a solid base with a Group of well-run and well-positioned businesses.

Achieving world-class competitiveness – the Smiths Excellence system

A key conclusion of our strategic review is that there is material opportunity to improve competitiveness by ensuring robust and consistent execution across Smiths Group – achieving excellence. We have defined six core pillars of Excellence at Smiths, which will be leveraged across the Group: Customer, People, Technology, Production, Programme and Supply Chain. Each pillar has an Executive Committee sponsor. Employees throughout the organisation have been engaged in how they can play their role in this agenda, and in April we held the inaugural Smiths Excellence Awards to recognise outstanding examples of initiatives and behaviours in each of the Excellence categories.

The Smiths Excellence System will drive continuous improvement and consistent execution across our businesses, focused on speed and efficiency. Key priorities over the next year include:

Customer Excellence

Increasing our service offering through initiatives on pricing and channel management.

People Excellence

Recognising that people are our one true source of sustainable competitive advantage, we are implementing a People Plan along with culture change initiatives to build a learning organisation that attracts, retains, develops, engages and inspires the very best people.

Technology Excellence

To build a culture of innovation, we are investing in a Group-wide New Product Innovation process that will ensure our product and service vitality is strong and will sharpen our focus on commercialisation. We are reviewing the efficiency and quantum of total R&D spend and I am also leading the implementation of the Group-wide *i*³ innovation forum. We plan to invest in building digital capabilities in the coming year through a central Innovation Fund and expect to invest increasingly in this area over time.

Production Excellence

Developing a culture of Continuous Improvement and lean enterprise, supported by the correct structures, processes, enablers, measures, and people capabilities and skills.

Programme Excellence

Executing complex programmes is critical to our customer relationships, and we are developing a gated programme management process and an ever-increasing focus on rigorous contract management.

Supply Chain Excellence

Improving the speed of flow through the business from the supplier through to our plants and the customer will reduce lead times, reduce working capital and ensure customers get what they want when they want it.

We will increase expenditure on research and development by around £20m in the coming year to invest in future growth opportunities.

Conclusion

As we take action to develop market leadership positions and to improve our own competitiveness, we will continue to take a disciplined approach to balance sheet management. We have increased the focus on cash generation as a primary measure of performance, and have taken steps to improve inventory management across our businesses which will ultimately improve working capital. By adopting a Group-wide approach to capital allocation in order to maximise risk-adjusted returns, we will apply strong financial discipline to acquisition and disposal activities where opportunities present a compelling strategic rationale, aligned with our focus on investing in attractive technology-led areas.

As we position Smiths Group for long-term growth, we will target organic and inorganic opportunities that offer the best levels of sustainable growth and value creation. We will build market-leading positions in our chosen markets with a more focused portfolio of businesses that embody the essential characteristics of where Smiths Group creates value.

These characteristics include having:

- good competitive positioning in attractive growth markets;
- strength in technology differentiation, including digital capabilities;
- asset-light operations; and
- a high proportion of aftermarket service revenues.

By pursuing this strategy, I am confident that over the long-term Smiths can outperform our chosen markets and achieve world-class competitiveness as we realise our vision of becoming one of the world's leading technology companies.

Andy Reynolds Smith
Chief Executive

Delivering excellence across Smiths

Customer

Building intimacy with our customers and aligning strategically with their needs is critical to broadening and deepening the level of value we provide and driving growth.

Smiths Interconnect used its reputation as a technical innovator and trusted supplier to develop its relationship with Space Systems Loral (SSL), a major commercial satellite customer. By focusing additional resources on the account and proving ourselves as a technology partner, we were contracted to provide critical microwave components that enabled SSL to standardise their equipment design and react more quickly to their own customers' needs.

©gettyimages

People

People are our one true source of sustainable competitive advantage. That's why we're building a learning organisation which attracts, retains, engages, develops and inspires all of our employees.

We're proud of how Smiths Medical's Women's Leadership Network has grown in reach and depth in recent years. Starting as a group of 50 women leaders, there are now local chapters in every region of the world – fostering engagement and collaboration right across Smiths Group, and breaking the barriers that may get in the way of women moving into more senior leadership roles.

Technology

Innovation is at the heart of what we do. Pursuing areas of technological differentiation and accelerating the digital evolution of our business can help us to deliver value to our customers and unlock our growth potential.

John Crane's new diagnostic system Sense™ is designed to reduce customers' operational costs by predicting the maintenance needs of critical components and minimising disruption to their operations. Currently in customer trials, this marks an exciting milestone as we move beyond simple monitoring to become the industry leader in predictive diagnostics.

Production

Transforming our operations through new manufacturing techniques and automation is central to how we improve efficiency and deliver competitive advantage for our customers.

Just look at what Smiths Detection has achieved at its site in Wiesbaden, Germany. By applying LEAN production principles to how we assemble generators and X-ray scanners, we were able to improve productivity, as well as cutting manufacturing lead times for high volume products by more than 50%.

Programme

Working closely with customers on complex programmes is one of our core capabilities. Delivering outstanding value and quality to demanding deadlines is critical to our success.

Smiths Interconnect delivers complex solutions that offer real value to our customers. Working in partnership every step of the way to provide antenna systems enabling encryption-protected communication for the US Navy, from supporting the customer design phase through prototyping and into full production, shows our strong commitment to programme execution.

Supply Chain

We know the value of optimising our supply chain. Developing deeper relationships with our key suppliers helps us to deliver our own strategic objectives.

That's why we held our first ever Group-wide Strategic Supplier Conference this year, bringing together nearly 50 select suppliers from across our business. It was an opportunity to build partnership and engagement in our drive for operational efficiency, innovation and growth.

Smiths Group's vision is to become one of the world's leading technology companies. Our business model is built on our commitment to six pillars of Excellence.

Customer Excellence
Greater intimacy with our customers and strategic alignment with their needs, to broaden and deepen the level of value we provide.

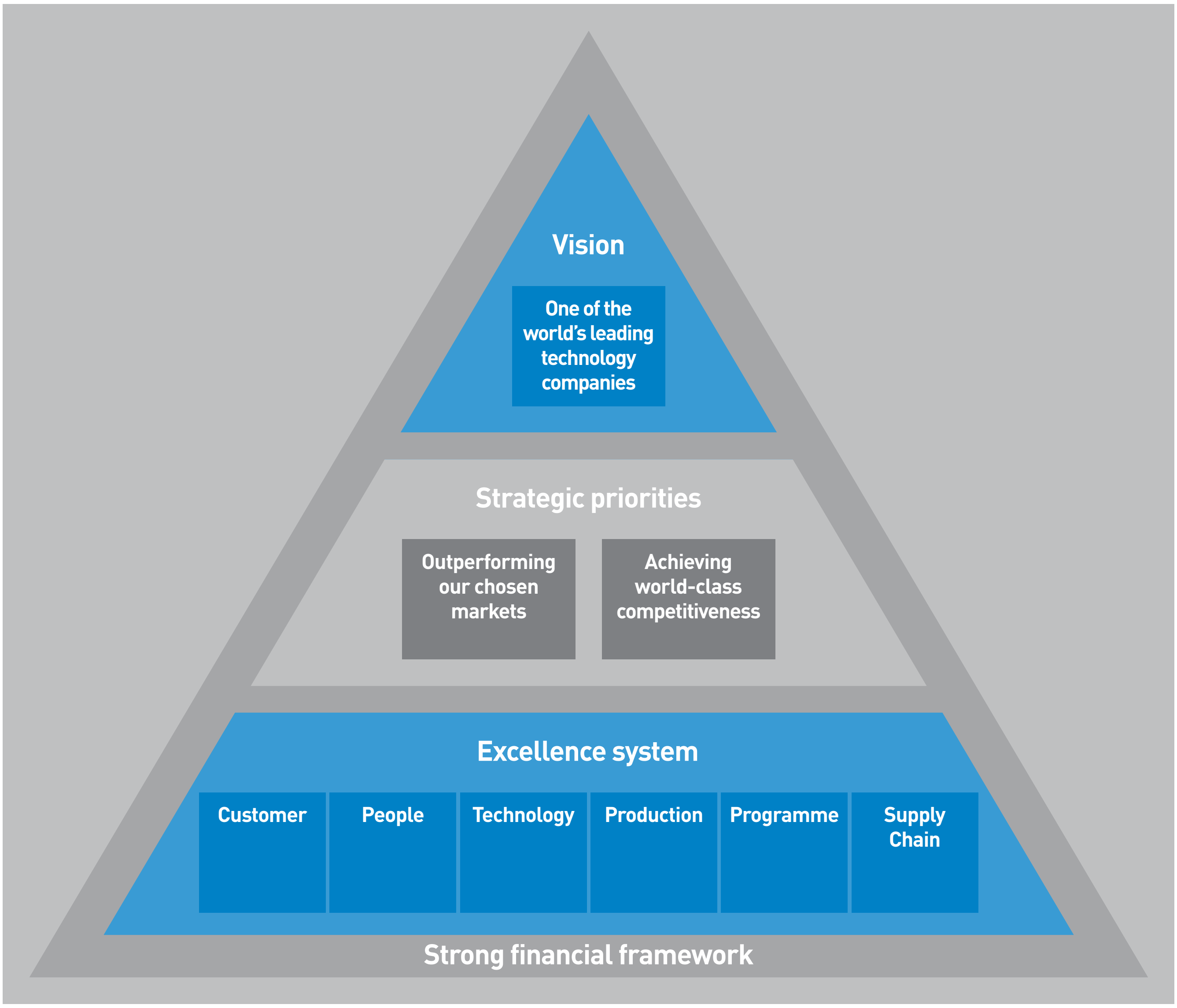
People Excellence
Building a learning organisation and developing the best ways to attract, retain, develop, engage and inspire our colleagues.

Technology Excellence
Building a culture of innovation through technological differentiation, digital capabilities and improved R&D and New Product Introduction processes.

Production Excellence
A culture of Continuous Improvement and lean enterprise, supported by the right structures, processes, enablers, measures and people capabilities and skills.

Programme Excellence
Consistent and flawless execution of complex programmes to meet our commitments, supported by rigorous contract management.

Supply Chain Excellence
Improving flow through the business to improve stock turns, and management of strategic suppliers.



Smiths Excellence underpins our strategic priorities of outperforming our markets and achieving world-class competitiveness. Everything we do in pursuit of these priorities will be based on the quality of our people, doing the right thing and the rigour of our strong financial framework.

My objective is to create value for all of our stakeholders through a renewed emphasis on growth, innovation and focusing the portfolio – supported by the best execution, improved productivity and effective capital allocation.

Andy Reynolds Smith
Chief Executive

Strong financial framework

We aim to invest in opportunities that create value for the Group by maximising the efficient use of capital while carefully managing cash and Group liquidity.

Our balance sheet continues to be strong, allowing us to fund growth opportunities to generate superior shareholder returns.

At the core of our financial strategy is a simple financial management framework:

- Maintain a strong investment-grade credit rating
- Invest in opportunities which create value
- Measured balance sheet management
- Active portfolio management
- Maintain a competitive tax rate
- Robust enterprise risk management framework

Outperforming our markets

What we've done

- Conducted in-depth business reviews to identify the drivers for future growth and value creation
- Findings provide clarity on market positioning of our businesses and competitiveness
- Agreement to acquire Morpho Detection shows our willingness to invest in attractive opportunities which improve our competitiveness and technology capabilities

Priorities for action

- Deploy our strategy throughout the organisation, so that all employees know their role
- Manage the integration of Morpho Detection, subject to regulatory approvals for the completion of the acquisition
- Take further steps to focus and strengthen the portfolio in order to maximise long-term shareholder value

Achieving world-class competitiveness

What we've done

- Identified six pillars of Excellence at Smiths – Customer, People, Technology, Production, Programme and Supply Chain
- Launched Smiths Excellence Awards to recognise outstanding achievements and behaviours across the six pillars
- Held first-ever Group-wide Strategic Suppliers conference to build long-term relationships based on value and innovation
- We invested £112m in company-funded R&D, equivalent to 3.8% of revenue
- *i*³ Group-wide innovation forum established to focus on new product development and medium- to long-term technology trends
- Established consistent measures of customer quality

Priorities for action

- Deploy Smiths Excellence System across the business, implementing top priorities for each pillar
- Introduce a revised incentive system to reflect the importance of driving performance improvements
- Establish a central Innovation Fund to drive focus on technological differentiation
- Develop and deploy a common and measurable New Product Introduction process across the Group

Our markets

Smiths Group serves a wide range of end markets that have the potential for long-term profitable growth.

Our businesses are either market leaders in their sectors or are well placed in attractive niches. 68% of our revenue comes from end markets in healthcare, energy, and homeland security and defence. Around half of our revenue is derived from servicing our customers' aftermarket needs or from supplying single-use consumables that are used as part of our customers' everyday procedures. This provides a resilience to our revenues and strong, stable cash-flows.

Healthcare

Our largest single end market is healthcare. The majority of revenue comes from medical devices supplied by Smiths Medical, and both Smiths Interconnect and Flex-Tek supply components to medical device manufacturers. The medical device market is driven over the long-term by ageing populations, patient and health worker safety legislation and increasing healthcare spending in developing countries. Some 83% of Smiths Medical's revenue is from single-use devices used in everyday hospital procedures. The remaining 17% of revenue is from capital equipment, such as infusion pumps.

Homeland security and defence

Smiths Detection provides threat detection equipment for airports, ports and borders, critical infrastructure, military and emergency responder markets. Demand is driven in the medium-term by ongoing geopolitical unrest and associated terrorist and criminal threats, but there is considerable variation by geography and end market. The growing installed base creates opportunities for aftermarket and upgrade revenues. The defence segment, representing 6% of Group revenue, is served by both Smiths Interconnect and Smiths Detection, and is primarily driven by spending on specific programmes in developed markets like the US.

Oil, gas & petrochemical

This market is primarily served by John Crane, representing c. 60% of its revenues. The long-term drivers include the global demand for energy, a desire for national energy independence and increasing environmental and safety requirements.

Did you know...

68% of our revenue comes from three markets: healthcare, oil and gas, and homeland security and defence.

John Crane's mechanical seals and seal support systems are primarily used in the process equipment found in downstream (eg: refineries, ethylene crackers) and midstream (eg: pipelines, gas storage, LNG transportation) applications. Demand for original equipment (41% of revenue) is affected by customer capital expenditure cycles, while aftermarket service (59% of revenue) depends on utilisation rates and equipment age. The drop in oil prices in late 2014 has reduced customer capital expenditure, causing declines in revenue in original equipment and, to a lesser extent, aftermarket service.

Industrial

Smiths Group serves a range of general industrial sectors including power generation, alternative energy, mining, automotive, test equipment and rail, among others. There are different drivers for each of these markets but overall they tend to track GDP. They are served by John Crane, Smiths Interconnect and Flex-Tek.

Semiconductors, data centres and telecoms

Smiths Interconnect supplies a range of high-performance microwave equipment to support the build-out and upgrade of wireless telecommunications infrastructure. It also provides power supply equipment for data centres and high-reliability connectors for semiconductor testing. Growth is driven by the proliferation of mobile communication devices, internet usage and the demand for higher data rates, and by the capital expenditure of network operators and data centre providers.

US residential construction and household appliances

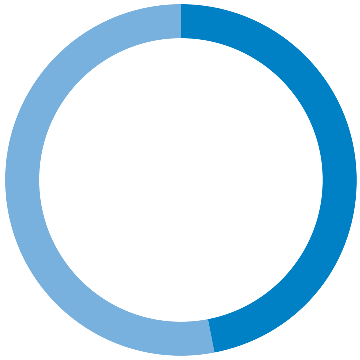
Flex-Tek manufactures a range of products such as flexible gas piping and ducting for HVAC applications that are used in the construction of homes, primarily in the US. Demand for single family home starts is driven by population growth.

Aerospace and space

Flex-Tek provides hydraulic hoses and fuel lines for airframes and aeroengines and Smiths Interconnect sells connectors and microwave components for aircraft and satellite communications. Aerospace demand is driven by investment in new fuel-efficient aircraft and by increasing passenger and freight traffic.

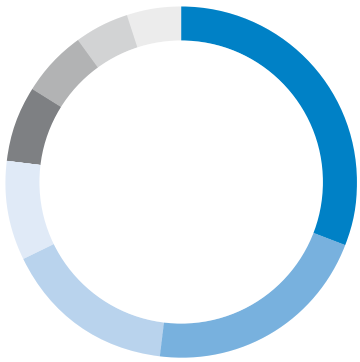
Revenue from equipment sales and aftermarket/consumables

- Equipment sales 47%
- Aftermarket/consumables 53%



Revenue by end market

- Healthcare 31%
- Homeland security and defence 21%
- Oil, gas and petrochemical 16%
- Industrial 9%*
- Semiconductors, data centres and telecoms 7%
- US residential construction and household appliances 6%
- Aerospace and space 5%
- Chemical and pharma 5%



*Industrial includes power generation, alternative energy, mining, test, rail and other general industrial applications

More detailed market commentary can be found in the divisional operational reviews

CFO report

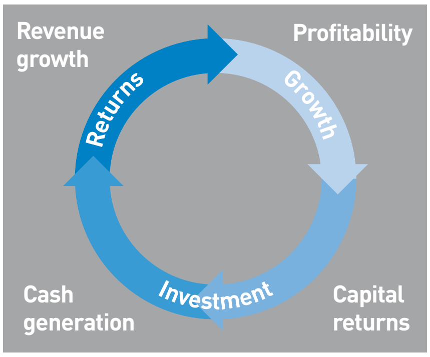
Introduction

Our financial strategy is designed to support the delivery of the corporate strategy outlined by the Chief Executive on pages 10 to 13. We aim to invest in opportunities that create value for the Group by maximising the efficient use of capital while carefully managing cash and Group liquidity. Our balance sheet continues to be strong, allowing us to fund growth opportunities to generate superior shareholder returns.

At the core of our financial strategy is a simple financial management framework:

- maintain a strong investment-grade credit rating
- invest in opportunities which create value
- measured balance sheet management
- active portfolio management
- maintain a competitive tax rate
- robust enterprise risk management framework

Squaring the circle to optimise growth, investment and returns



Squaring the circle

The aim of our strategy is to drive a 'virtuous circle' of growth with an unrelenting focus on cash generation being at the heart of everything we do.

Cash generation

We will generate cash through:

- profitable operations
- reducing working capital
- disposing of non-core assets.

Revenue growth

We will invest our cash in activities which will generate profitable revenue growth.

Profitability

We will ensure our costs are appropriate to maintain and where possible improve the profitability of the base business.

Capital returns

We will create shareholder value by ensuring our capital is invested in opportunities which maximise the risk adjusted return on that capital.

- Reducing working capital will allow us to redeploy that capital in value-creating opportunities.
- Investing in long-term profitable revenue growth will allow us to grow the capital available to invest.

Capital structure and dividend policy

The Board has a progressive dividend policy for future payouts, with the aim of increasing dividends in line with the long-term underlying growth in earnings. This policy will enable us to retain sufficient cash-flow to finance our investment in the drivers of growth and to meet our financial obligations.

In setting the level of dividend payments, the Board will take into account prevailing economic conditions and future investment plans, along with the objective to maintain minimum dividend cover of around 2.0.

As part of our disciplined approach to balance sheet management, we seek to maintain a strong investment-grade credit rating with a net debt:EBITDA ratio of no more than 2.0 over the medium-term. We would be willing to temporarily exceed this upper limit in the case of acquisitions, provided there were clear actionable plans to return to the upper limit of 2.0 within an acceptable timeframe.

Our balance sheet continues to be strong, allowing us to fund growth opportunities to generate superior shareholder returns.

Chris O'Shea
Chief Financial Officer

Talent management
To deliver our financial strategy we will focus on functional excellence across the Group and improve substantially our talent development. We have a strong cadre of finance people across the Group but we have not managed our talent as well as we could. During the year we have laid the foundations for improvement as follows:

- establishment of the Finance Leadership Team, comprising the Group Chief Financial Officer, the CFOs of the Group's five divisions, the Group Financial Controller, the Group Director of Tax and Treasury, and the Group Director of Internal Audit, to manage the finance function globally
- introduced the Smiths Finance Intern Programme with our first interns employed in 2016
- achieved accreditation from the Institute of Chartered Accountants of Scotland to allow us to train Chartered Accountants
- recommenced the Smiths Finance Graduate Programme after a hiatus of almost ten years.

These steps are intended to help ensure we share best practice across the Group and create a culture of continuous improvement. Underpinning that is a desire to return to a position where Smiths Group is recognised for the quality of talent in the finance community. Internal succession is a hallmark of a great company, and this requires a well-stocked and well-managed talent pipeline. The Smiths Finance Intern Programme will feed the Smiths Finance Graduate Programme, and this in turn will supply the Group with high-quality staff to progress through the organisation and hopefully one day to the position of Group CFO.

During the year, two of our divisional CFOs (Mary Heitmann in Smiths Interconnect and Bob Speer in Flex-Tek) decided to step down from their positions and I am proud that they were both succeeded by internal candidates: Alain McInnes transferred from Smiths Detection to become CFO in Smiths Interconnect and Patrick Henry stepped up from his role as VP Strategy in Flex-Tek to become CFO.

The Finance Leadership Team rolled out a personal development planning process in 2016 to ensure that all staff in the finance function across the Group have a discussion at least annually on their development. This is being cascaded throughout the organisation. During 2017 we will turn our focus to reinvigorating development programmes for our existing staff, using the output from our development discussions as input to these programmes.

Policies and judgements
Accounting policies
The accounts in this report are prepared under International Financial Reporting Standards (IFRS), as adopted by the European Union (EU). The accounting policies used in preparing these accounts are set out on pages 196 to 198.

Significant judgements, key assumptions and estimates
Applying accounting policies requires the use of certain judgements, assumptions and estimates. The most important of these are set out on page 197.

Essential contracts
The divisional reviews describe our main customer and supplier relationships and the 'Risks and uncertainties' section outlines the risk management aspects of our contractual arrangements. Smiths Group has a wide range of suppliers and customers and, while the loss of, or disruption to, certain of these arrangements could temporarily affect the operations of an individual division, no single contract is considered essential to the Group.

2016 performance overview
As a global business Smiths Group is exposed to a number of different industries and macroeconomic trends but the nature of our diversified portfolio means that we are well placed to mitigate exposure to any specific sector or industry. This can be seen in a solid set of 2016 results, with strong performance in four of our five divisions mostly offsetting the impact of turmoil in the oil and gas market on John Crane. It was particularly pleasing to see continued revenue growth, albeit at a modest rate, in Smiths Medical, a good improvement in profitability at Smiths Interconnect, and the continuation of the strong recovery in Smiths Detection, which gave us the confidence to commit over $700m of capital to the acquisition of Morpho Detection from Safran. We expect that acquisition to complete during 2017, subject to regulatory clearances.

Revenue
Reported revenue increased by £52m (2%) to £2,949m, including the positive effects of foreign currency translation (£98m). On an underlying basis, revenue declined 2% as growth in Smiths Detection (+£43m; 9%) and Smiths Medical (+£6m; 1%) was offset by declines in John Crane (£87m; 10%) and Smiths Interconnect (£6m; 1%). In John Crane the reduction in revenue was more pronounced in the sales of original equipment, where revenues declined by 16% on an underlying basis; the aftermarket business was more resilient where the underlying revenue decline was 4%.

Revenue
Up 2% to
£2,949m

Read more in note 1 on page 144

Headline operating profit
Flat at
£510m

Read more in note 1 on page 144 and in note 3 on page 149

Statutory operating profit
Down 2% to
£387m

Read more in note 1 on page 144

Headline operating profit

Reported headline operating profit of £510m was in line with the prior year (2015: £511m) including the positive effects of foreign currency translation (£19m). On an underlying basis operating profit declined 4%, driven principally by a £47m fall in John Crane. Operating margin decreased by 30 basis points to 17.3% (2015: 17.6%), driven by continued challenging conditions in global energy markets which impacted performance in John Crane, where margin declined 290 basis points to 21.9% (2015: 24.8%). Despite this decline, John Crane's margins remain the highest in the Group, demonstrating the underlying quality of this business.

Smiths Detection and Smiths Medical delivered strong margin improvement. Smiths Medical increased 160 basis points to 21.4% (2015: 19.8%) boosted by higher revenue, particularly in Vital Care, as well as a continued focus on cost management. Smiths Detection increased operating margin by 110 basis points to 13.0% (2015: 11.9%) supported by a strong revenue performance, a focus on operational efficiencies and strong cost management. Smiths Interconnect improved operating margin by 150 basis points to 13.1% (2015: 11.6%) by focusing on higher value customers, coupled with a range of productivity, efficiency and cost reduction initiatives. Operating margins of 18% in Flex-Tek were marginally lower than last year (2015: 18.5%) reflecting the impact of a product transition in the Gastite business.

Operating profit on a statutory basis, after taking account of the items excluded from the headline figures, was £387m (2015: £394m) – see notes 3 and 28 for information on the excluded items. The decrease was driven by an increase in non-headline charges of £6m reflecting an increase in the charge relating to legacy pension schemes, partially offset by a reduction in the charge for legacy liabilities due to settlement in our favour of a claim against an insurer relating to the John Crane, Inc. asbestos litigation.

Headline finance costs

Headline finance cost during the year totalled £59m, £7m higher than the previous year. This was principally due to an increase in interest payable on bonds of £7m, due to a full year's interest expense on the €600m bond issued at April 2015.

Non-headline items relating to continuing activities excluded from headline profit before tax

These items amounted to a charge of £105m compared to a charge of £134m in 2015. They comprised:

- amortisation of intangible assets acquired in business combinations of £15m (2015: £33m). The ongoing amortisation charge relates principally to technology and customer relationships;
- £23m goodwill impairment charge (2015: £27m), a £6m impairment charge on property, plant and equipment and a £2m charge on impairment of a trade investment. Goodwill impairment included impairment for John Crane Production Solutions (£5m), Smiths Interconnect Microwave Components (£7m) and Smiths Interconnect Microwave Telecoms (£11m);
- £27m charge (2015: £23m) and £16m cost recovery in connection with John Crane, Inc. asbestos litigation;
- £12m charge (2015: £9m) in connection with Titeflex Corporation litigation including a change to the provision length;
- £37m charge for restructuring (2015: £38m) in respect of the Fuel for Growth programme;
- £9m charge for changes to post-retirement benefits including the cost of a buyout of retirees in the US pension scheme (2015: £14 gain);
- £3m gain on retirement benefit finance (2015: £8m charge);
- £7m charge for legacy retirement benefit administration (2015: £8m);
- £1m of financing gains (2015: £4m loss);
- £19m fair value gain on contributing government bonds to a pension scheme; and
- £6m net loss (2015: £2m gain) on disposals and other acquisition costs.

Taxation

The principles of the Group's approach to taxation remain unchanged. The Group seeks to manage the cost 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 2016 of £113m (2015: £117m) represented an effective rate of 25% on the headline profit before taxation (2015: 25.5%). On a statutory basis, the tax charge on continuing activities was £85m (2015: £77m).

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.

In 2016, Smiths Group paid £62m in direct corporate tax on profits and £105m in employment and other taxes. The Group additionally collected £210m on behalf of tax authorities, primarily from employees but also other indirect taxes such as VAT. The total amount of tax paid over to tax authorities during the year totalled £377m. A rate of between 26% and 27% is expected in the year ending 31 July 2017.

Earnings per share

Basic headline earnings per share from continuing activities were 85.2p (2015: 86.1p). The reported 1% decline was mainly driven by higher finance charges for the year (£59m vs £52m), partly offset by a reduction in the effective tax rate to 25% from 25.5% in 2015 reflecting the successful conclusion of a number of historic tax disputes.

On a statutory basis, the basic earnings per share from continuing activities were 65.6p (2015: 62.4p), reflecting the recognition of a gain in non-headline finance costs relating to the contribution to the SIPS pension scheme of a portfolio of GILTS previously held in escrow for the scheme.

Cash generation and net debt

Operating cash generation remained strong, with headline operating cash-flow of £520m (2015: £484m), representing 102% (2015: 95%) 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).

Headline free cash-flow increased by £61m to £400m, reflecting the £36m increase in headline operating cash-flow, a reduction in cash tax payments of £29m to £62m, (2015: £91m), partially offset by an increase in net interest payments of £4m, from £54m in 2015 to £58m in 2016. Total free cash-flow, stated after all legacy costs, interest and taxes but before acquisitions and dividends, increased by £85m to £243m, reflecting the increase of £61m in headline free cash-flow and a reduction of £24m in the cash outflows on non-headline items principally due to cash inflows on foreign exchange hedging transactions of £41m partially offset by increased contributions to legacy defined benefit pension schemes.

On a statutory basis, net cash inflow from operations was £358m (2015: £266m).

Net debt at 31 July 2016 was £978m, an increase of £160m in the year. With the majority of the Group's net debt held in currencies other than pounds sterling to hedge the underlying asset base of the Group, the sharp decline in the value of sterling at the end of the financial year resulted in a foreign exchange translation-driven increase of £187m in net debt. The underlying debt in foreign currencies was unaffected by the change in the value of sterling. On an underlying basis, excluding the impact of foreign exchange movements, net debt reduced by £23m, reflecting good operational cash generation and a reduction in tax payments, partially offset by an increase in pension contributions.

At the end of the period, the Group had gross debt of £1,409m (2015: £1,313m) and cash reserves of £431m (2015: £495m). Of this gross debt, £270m (2015: £163m) falls due for repayment within one year. The maturity profile of the major tranches of the remaining £1,139m debt is as follows;

2018 – £132m ($175m 7.37% bond)

2019 – £189m ($250m 7.20% bond)

2022 – £304m ($400m 3.625% bond)

2023 – £512m (€600m 1.25% bond)

Dividend

Dividends paid in the year on ordinary shares amounted to £163m (2015: £160m). The Board has recommended a final dividend of 28.75 pence per share to be paid on 18 November 2016 to shareholders on the register at close of business on 21 October. When added to the 2016 interim dividend of 13.25p per share paid on 22 April 2016, this represents an increase of 2.4% on the 2015 full year dividend of 41 pence per share.

Acquisitions and Disposals

During the year we completed the purchase of XPD8, a conditioning monitoring business in John Crane, for £8m. In April 2016 we announced the acquisition of Morpho Detection for US$710m. The transaction is expected to complete during 2017, subject to regulatory clearances, and on completion will be merged with Smiths Detection. In September 2016 we announced the disposal of our Artificial lift business in John Crane for US$39.5m. This transaction is expected to conclude during 2017.

Other financial information

Retirement benefits

During the year agreement was reached on the triennial valuations with the Trustees of both major UK pension schemes. As a result, total required cash contributions to defined benefit pension schemes will fall substantially from £124m in 2016 to around £50m in 2017.

Following the transfer of all current US pensioners to Voya Retirement Insurance and Annuity Company in August 2015, around 60% of the gross liabilities of the US scheme are insured through a buyout contract.

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 2016 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 position has improved to a surplus of £80m at 31 July 2016 from a deficit of £108m at 31 July 2015.

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 is shown below:

	31 July 2016	31 January 2016	31 July 2015
Funded plans			
UK plans – funding status	109%	111%	104%
US plans – funding status	69%	61%	78%
Other plans – funding status	88%	85%	86%
Total – funding status	**105%**	**107%**	**100%**

	31 July 2016	31 January 2016	31 July 2015
Surplus /(deficit)			
Funded plans	218	249	7
Unfunded plans	(137)	(120)	(115)
Total deficit	**80**	**129**	**(108)**
Retirement benefit assets	328	361	170
Retirement benefit liabilities	(248)	(232)	(278)
	80	**129**	**(108)**

The approximate pension membership for the three main schemes at 31 July 2016 is set out in the table below:

Pension scheme members as at 31 July 2016	SIPS	TIGPS	US plans	Total
Deferred active	350	240	2,250	**2,840**
Deferred	10,310	12,160	3,020	**25,490**
Pensioners	12,560	16,300	250	**29,110**
Total	**23,220**	**28,700**	**5,520**	**57,440**

Goodwill and intangibles

Goodwill on acquisitions has been capitalised since 1998. Until 1 August 2004 it was amortised over a maximum 20-year period. Under IFRS goodwill is no longer amortised but instead is subject to annual reviews to test for impairment.

Intangible assets arising from business combinations ('acquired intangibles') are assessed at the time of acquisition in accordance with IFRS 3 (Revised) and are amortised over their expected useful life. This amortisation is excluded from the measure of headline profits. When indicators of impairments are identified, the intangible assets are tested and any impairment identified is charged in full. The impairment charge is excluded from the measure of headline profits. Other intangible assets comprise development costs or software which are capitalised as intangible assets as required by IFRS. Amortisation charged on these assets is deducted from headline profits.

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 decreased 70 basis points to 15.3% (2015: 16.0%) as a result of reduced profitability in John Crane and Flex-Tek. ROCE in Smiths Medical, Smiths Detection and Smiths Interconnect have improved.

Risk and Controls

Financial controls

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

The Internal Audit Department completes site-based reviews of reporting units, as set out in a risk-based audit plan reviewed and approved by the Group CFO and Audit Committee. Further information regarding the Group's risk management procedures is set out in the Principal risks and uncertainties on pages 52 to 60 and the Corporate governance statement on pages 75 to 93.

Treasury

The Board maintains a Treasury Risk Management Policy which governs the treasury operations of the Group and its subsidiary companies and the consolidated financial risk profile to be maintained. A report on treasury activities, financial metrics and compliance with the Policy is prepared monthly for the Executive Committee, for every Board meeting and on a semi-annual basis for the Audit Committee.

The Policy maintains a treasury control framework within which counterparty risk, financing and debt strategy, interest rate risk and currency translation management are reserved for Group Treasury, while cash and currency transaction management are devolved to operating divisions.

Centrally directed cash management systems exist globally to manage overall liquid resources efficiently across the divisions. The Group uses financial instruments to raise financing for its global operations, to manage related interest rate and currency financial risk and to hedge transaction risk within subsidiary companies. The Group does not speculate in financial instruments. All financial instruments hedge existing business exposures and all are recognised on the balance sheet.

The Policy defines four treasury risk components and for each component a set of financial metrics to be measured and reported monthly compared against pre-agreed objectives.

1 Credit quality

The Group's strategy is to maintain a solid investment-grade rating to ensure access to the widest possible sources of financing at the right time and to minimise the resulting cost of debt capital. The credit ratings at the end of July 2016 were BBB+ / Baa2 (both stable) from Standard & Poor's and Moody's respectively. An essential element of an investment-grade rating is consistent and robust cash-flow metrics. The Group's objective is to maintain a net debt/headline EBITDA ratio at less than two times over the medium term.

2 Debt and interest rate management

Debt financing is managed centrally. At 31 July 2016 net debt was £978m (2015: £818m). The Group's strategy remains to finance the significant majority of its debt capital from long-term bond markets and at 31 July 2016 £1,392m of bonds were outstanding (2015: £1,298m). The core backstop financing for the Group is provided by a $800m committed revolving credit facility provided by a group of ten global banking partners. This facility has a maturity in February 2021. The Group remains in full compliance with all covenants within its debt agreements. The Group's risk management objectives are to ensure that over time funding drawn from the bank market is less than 30% of net debt, the average maturity profile of gross debt is at or greater than four years and over 55% of gross debt is at fixed rates. At 31 July 2016, these measures were 0% (2015: 0%); 4.5 years (2015: 5.0 years) and 47% (2015: 58%).

3 Liquidity management

At 31 July 2016, the $800m committed bank facility was undrawn. The Group's objective is to ensure that at any time undrawn committed facilities net of short-term overdraft financing are greater than £200m and that committed facilities have at least 18 months to run until maturity. At 31 July 2016, these measures were £605m (2015: £512m) and 55 months (2015: 55 months). At 31 July 2016, cash resources were £430m (2015: £495m). These included funds received from the 2015 €600m 1.25% Senior Notes issuance net of repayment of the 7.25% £150m sterling bond on its normal maturity date in June 2016.

The Group aims to ensure that these resources are placed on deposit with highly rated relationship bank counterparties at short-notice availability. Credit exposure to every approved bank is defined by the Treasury Risk Management Policy, with counterparty limits established by reference to their Standard & Poor's long-term debt rating and CDS trading levels. Compliance is measured and reported to the Executive Committee and the Board. At 31 July 2016, 98% (2015: 99%) of cash resources were on deposit with the ten global banking partners. Of these resources £90m (2015: £33m) was invested with counterparties rated less than A+.

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:

	31 July 2016	31 July 2015		31 January 2016
Average rates:				
US dollar	1.46	1.56	Dollar strengthened 6%	1.51
Euro	1.32	1.33	Euro strengthened 1%	1.37
Year-end rates:				
US dollar	1.32	1.56	Dollar strengthened 15%	1.42
Euro	1.19	1.42	Euro strengthened 17%	1.31

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

The Group is an international business with the majority of its net assets denominated in foreign currency. It protects its balance sheet and reserves from adverse foreign exchange movements by financing its currency assets in the same currency such that, where the value of net asset exposure is over £30m equivalent, over 50% of those assets are matched with the same currency liability. At 31 July 2016, 50% (2015: 53%) of total foreign currency assets were matched by related currency liabilities.

Litigation

Smiths Group faces different types of litigation in different jurisdictions. The high level of activity in the US, for example, exposes the Company to the likelihood of various types of litigation commonplace in that country, such as 'mass tort' and 'class action' litigation, legal challenges to the scope and validity of patents and product liability and insurance subrogation claims. These types of proceedings (or the threat of them) are also used to create pressure to encourage negotiated settlement of disputes.

John Crane, Inc. litigation

John Crane, Inc. (JCI), a subsidiary of the Group, is currently one of many co-defendants in litigation in the US relating to products previously manufactured which contained asbestos. This litigation began more than 30 years ago and, typically, involves claims for a number of diseases including asbestosis, lung cancer and mesothelioma. The JCI products generally referred to in these cases consist of industrial sealing products, primarily packing and gaskets. The asbestos was encapsulated within these products in such a manner that, according to tests conducted on behalf of JCI, the products were safe. John Crane ceased manufacturing products containing asbestos in 1985.

The litigation involves claims for a number of allegedly asbestos-related diseases, with awards, when made, for mesothelioma tending to be larger than those for the other diseases. JCI's ability to defend mesothelioma cases successfully is, therefore, likely to have a significant impact on its annual aggregate adverse judgement and defence costs.

JCI continues to actively monitor the conduct and effect of its current and expected asbestos litigation, including the efficacious presentation of its 'safe product' defence, and intends to resist these asbestos cases based on this defence. Approximately 247,000 claims against JCI have been dismissed before trial over the last 37 years. JCI is currently a defendant in cases involving approximately 74,000 claims. Despite these large numbers of claims, since the inception of litigation JCI has had final judgements against it in 137 cases, and has had to pay awards amounting to approximately US$158m.

At 31 July 2016, the aggregate provision for JCI asbestos litigation, including for adverse judgements and defence costs, amounted to £252m expressed at the then current exchange rate. In deciding upon the amount of the provision, JCI has relied on independent expert advice from a specialist. The provision is based on past history and published tables of asbestos incidence projections and uses a 10-year time horizon. Moreover, in establishing this provision no account has been taken of any recoveries from insurers as their nature and timing are subject to pending litigation. Because of the significant uncertainty associated with the future level of asbestos claims and of the costs arising out of the related litigation, there is no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred.

Titeflex Corporation litigation

Titeflex Corporation, a subsidiary of the Group in the Flex-Tek division, has received a number of claims in recent years from insurance companies seeking recompense on a subrogated basis for the effects of damage allegedly caused by its flexible gas piping products being energised by lightning strikes. It has also received a number of product liability claims relating to this product, some in the form of purported class actions. Titeflex Corporation believes that its products are a safe and effective means of delivering gas when installed in accordance with the manufacturer's instructions and local and national codes; however some claims have been settled on an individual basis without admission of liability.

At 31 July 2016, provision of £94m has been made for the costs which the Group expects to incur in respect of these claims. Because of the significant uncertainty associated with the future level of claims and of the costs arising out of the related litigation, there is no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred.

Key performance indicators

The KPIs we used to manage the Group in 2016 are unchanged from 2015. These are set out overleaf. As we move into the execution of our new strategy these will be updated.

Driving growth

Revenue grew by 2% on a reported basis benefitting from £98m currency tailwinds. On an underlying basis revenue declined 2% as growth in Smiths Medical and Smiths Detection was more than offset by declines in John Crane and Smiths Interconnect.

	Revenue £m	Reported	Underlying
2016	2,949	2%	(2)%
2015	2,897	(2)%	(2)%
2014	2,952	(5)%	–
2013	3,109	2%	2%
2012	3,038	7%	5%

Earnings per share Pence

85.2p down 1%

Headline earnings per share declined by 1% reflecting flat operating profit performance, a lower tax rate and higher finance costs.

Attracting the best talent and developing smarter ways of working

Building a learning organisation that attracts, retains, develops, engages and inspires our employees is central to our ambition of transforming Smiths into a world-class organisation and supporting our growth ambitions.

Leadership

We have appointed a new CEO and CFO. We have continued to invest in our leadership development programmes across the Group. More than 600 leaders from across the business have been or are currently participating in these programmes.

Talent pipeline

We constantly challenge ourselves to have the right skills and competencies to support our growth ambitions and to strengthen our internal talent pipeline. We have improved our recruitment and assessment techniques, succession planning and development and put in place year-on-year improvement plans.

People management

Managing and differentiating performance is critical to ensuring our employees fulfil their potential and deliver outstanding business results. We have created the new Smiths Excellence Awards to reward and recognise the highest level of achievement. We conducted our fourth comprehensive MyVoice global employee engagement survey and achieved a participation rate of 86% across the Group.

Promoting a culture of responsibility

We promote a culture of responsibility throughout Smiths Group. This requires us all to work according to our Code of Ethics. We are committed to working in a way that protects the health and safety of employees and minimises the environmental effects of our activities and detrimental effects of our products and services. This delivers real business benefits, while ensuring that we meet our obligations to our stakeholders.

A range of indicators for safety and environmental impact

	2016	2015
Recordable incident rate per 100 employees (RIR)	0.47	0.55

	2013-2018 Reduction target	2016 v 2013
Energy	15%	7%
Greenhouse gas emissions	15%	22%
Total non-recycled waste	15%	18%
Water consumption	10%	3%

Our goal is zero harm and we made strides towards this in 2016, achieving our lowest RIR of 0.47. Compared to our baseline year of 2013, we have made good progress in reducing our environmental metrics, with GHG and non-recycled waste already exceeding our five-year goal. During 2016 we achieved reductions in energy, GHG emissions and non-recycled waste while water usage increased slightly.

Allocating capital to maximise returns

Return on capital employed decreased 70 basis points to 15.3% predominantly as a result of lower profitability at John Crane. Further details about return on capital employed can be found in note 28 on page 184.

Return on capital employed %

15.3% down 70bps

This is headline operating profit divided by monthly average capital employed, expressed as a percentage. Capital employed is total equity, adjusted for goodwill recognised directly in reserves, net post-retirement benefit-related assets and liabilities, litigation provisions relating to exceptional items and net debt.

Enhancing margins through operational excellence

Headline operating profit margin declined 30 basis points, reflecting lower profitability at John Crane. Margins improved in Smiths Medical, Smiths Detection and Smiths Interconnect.

Headline operating margin %

17.3% down 30bps

Based on our headline operating profit, which excludes a number of items that do not reflect the portfolio's underlying performance.

Generating cash and managing the balance sheet effectively

Operating cash generation was strong with cash conversion at 102% of headline operating profit.

Cash conversion %

102% up 7%

Chris O'Shea
Chief Financial Officer

John Crane

Contribution to 2016 Group revenue

28%

Contribution to 2016 Group headline operating profit

33%

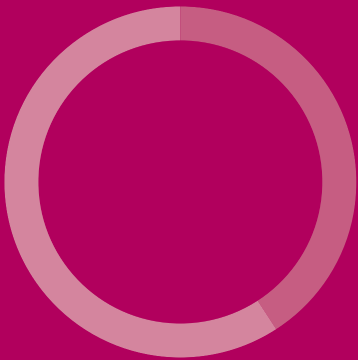
Percentage relates to headline operating profit before corporate costs

John Crane provides engineered products and services to global energy and process industry customers.

Revenue performance
£m
£830m down 8%

2016	830
2015	905
2014	941

Revenue by sector
- First-fit 41%
- Aftermarket: 59%



Principal operating regions
We are a global business in more than 50 countries, with over 230 sales and service centres and 19 manufacturing sites in 14 countries.

Customers
We serve process industries like refining and chemical, as well as pump and compressor OEMs. Our customers include Chevron, BP, ExxonMobil, Saudi Aramco, Shell, BASF, Sulzer, GE and Siemens.

Competitors
We compete in seals, engineering bearings, filtration and couplings markets. Examples include Flowserve, Kingsbury and Danaher.

Suppliers
Our global supply chain aligns purchasing activity to leverage regional suppliers. Direct sourcing includes metals, ceramics, and advanced materials and parts.

Did you know…
Our seals can endure extreme conditions, withstanding temperatures as icy as the coldest town in Siberia, -75°C.

Markets and trends

Recognised globally across process industry sectors, John Crane provides mission-critical technologies that drive reliability improvements and sustain the effective operation of customers' rotating equipment and other machinery. Our comprehensive product portfolio includes mechanical seals, seal support systems, engineered bearings, power transmission couplings and specialised filtration systems. These technologies are supported by the industry's largest global sales and service network that provides performance-enhancing services utilising expertise developed from decades of technology leadership coupled with proven field experience.

John Crane's primary end user vertical of oil and gas has experienced the most severe market downturn seen in the past 30 years, with significant cuts or delays to investment in large projects in the sector, resulting in a large volume impact on our original equipment business. While we believe the oil and gas market will remain challenging in the near-term, we maintain our belief that this sector is attractive in the long-term. Megatrends such as the global demand for energy, an increasing desire for national energy independence, and more stringent environmental and safety requirements will continue to generate demand for John Crane products. John Crane also has a significant presence in non-oil and gas process industry verticals such as chemical, power generation, and general industries, and we expect these verticals will continue to grow in the near-term.

Nearly 60% of John Crane's sales stem from the aftermarket servicing and support of existing installed equipment, which has proven to be resilient during the oil and gas downturn. John Crane's global network is a key asset that allows for quick-response and effective aftermarket service close to customers' operations. These facilities provide a range of value-added services including repair and refurbishment, root-cause analysis, alignment and condition monitoring, all designed to improve the performance of customers' rotating equipment and to reduce operational downtime. The geographic footprint continues to expand through opening additional service centres in key markets, in support of our growth strategy in selected high-growth markets.

Strategy

To meet our vision of being a market leader in technologies and services for rotating equipment, John Crane's business strategy focuses on delivering above-market growth in selective process industry verticals, maximising aftermarket performance, enhancing our cost and productivity competitiveness, and accelerating growth through bolt-on acquisitions. John Crane aims to achieve this through a relentless focus on customer service, improving quality, developing our people, business ethics and safety.

Our global network is a key asset which allows for quick-response and effective aftermarket service close to customers' operations.

Competitive strengths

- Market leader in mechanical seals
- Strong proprietary technology and expertise in applied engineering
- High degree of customisation to meet specific demands
- Global network of c. 230 sales and service centres
- Over half of sales in aftermarket

	2016 £m	2015 £m	Reported growth	Underlying growth
Revenue	830	905	(8)%	(10)%
Headline operating profit	181	225	(19)%	(20)%
Headline operating margin	21.9%	24.8%	(290)bps	
Statutory operating profit	151	165	(9)%	
Return on capital employed	20.3%	25.8%	(550)bps	

During the year the decision was made to sell John Crane's artificial lift business. John Crane Production Solutions is held for sale at the year ended 31 July 2016. The business performance of John Crane Production Solutions is included within the financial summary and results presented above.

1 Underlying excludes the impact of acquisitions and divestments, and the effects of foreign exchange translation

Performance

Revenue fell 10% on an underlying[1] basis as difficult market conditions continued throughout global energy markets. The decline was driven by reduced sales in both the first-fit and aftermarket business. Reported revenue declined 8%, after £13m of foreign exchange benefit.

Underlying[1] aftermarket revenue declined 4%, with continued economic uncertainty driving slower customer upgrades and retrofits, especially with oil and gas customers. Activity levels stabilised in the second half and a number of significant contract wins led to a growing aftermarket order book, reflecting the resilience of this business. While there were pockets of relative strength within certain regions, such as Latin America and Asia Pacific, weakness in the sector was fairly widespread. Underlying[1] first-fit sales fell 16%, as continued volatility in energy prices put pressure on the business across most geographies. Lower underlying[1] revenue was driven in particular by a sharp revenue decline in John Crane Production Solutions and weakness in North America. We continued to focus on expanding the installed base and our investment in first-fit projects was higher than any prior period.

Revenue from emerging markets represented 24% of John Crane sales, in line with the prior year, as headwinds in certain Latin American markets and challenging conditions in China offset efforts to increase our sales into emerging markets.

Headline operating profit fell 20% on an underlying[1] basis driven primarily by lower sales volumes as well as high levels of investment in first-fit strategic projects, partially offset by favourable foreign exchange. Strong cost control actions included a reduction in headcount of more than 400 people. Headline operating profit margin fell 290 basis points to 21.9%. Return on capital declined 550 basis points to 20.3%, principally due to lower profitability. The difference between statutory and headline operating profit primarily reflects a £23m charge in relation to John Crane, Inc. asbestos litigation, a £10m impairment of John Crane Production Solutions goodwill and property, plant & equipment, and £10m of restructuring charges, offset by the recovery of £16m through a settlement with insurers.

Growth drivers

- Growing demand for energy
- Investment in process industry verticals
- Expansion in emerging markets
- Developing new products and technologies

John Crane's R&D projects include engineered solutions and technology advancements to meet customers' increasing demands for rotating equipment in extreme environments.

Aftermarket revenue
59%

Did you know...
Only liquid particles 1 micron wide can pass through our filter elements – that's about 1/100th of a grain of sand.

Research and development

John Crane continued to invest in research and development projects in 2016. This included innovation for engineered solutions and technology advancements to meet customers' increasing demands for rotating equipment availability in extreme environments, while providing intelligence about performance and improving energy efficiency and cost savings. Specific developments included:

- Two additions to the AURA™ line of gas seals – the AURA 100 and AURA 180. These seals will provide increased reliability, reduce customers' operating costs, extend maintenance intervals and reduce spares inventory.
- The launch of 48VBF, a critical boiler feed system for power generation in large utility scale plants or smaller onsite steam plants, reducing costs by eliminating the heat exchanger and preventing leakage.
- Customer trials have succeeded in proving the value of Sense™, a Predictive Diagnostics solution. Manual inspection of equipment is now replaced by continuous performance monitoring, providing intelligence that diagnoses problems, guides decisions about maintenance, and helps to resolve issues with critical pumps and compressors.

Priorities for 2017

- Continue expansion in selective process industry verticals
- Enhance productivity and cost competitiveness
- Build out selective emerging markets
- Maximise aftermarket performance
- Develop new products and digital technologies

Go to www.johncrane.com for more information

Improving efficiency, reducing costs

Performance Plus is John Crane's premier service offering, helping to improve efficiency and reduce operating costs for our customers. Already popular in pump-intensive plants such as refineries, we place reliability engineers at customer sites to maintain equipment and analyse root cause failures.

In late 2015, John Crane won a multi-year Performance Plus contract for two agribusiness plants in South America. Utilising our strong regional footprint we will improve their mean time between repairs on nearly 800 pumps from 17 months to almost 45 months, significantly reducing their operating costs and diversifying our reach into new industries.

Smiths Medical

Contribution to 2016 Group revenue

30%

Contribution to 2016 Group headline operating profit

34%

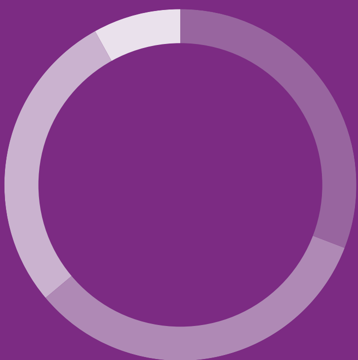
Percentage relates to headline operating profit before corporate costs

Smiths Medical supplies medical devices and consumables that are vital to patient care globally.

Headline revenue performance
£m
£874m up 5%

2016	874
2015	836
2014	804

Revenue by sector
- Infusion systems 31%
- Vascular access 33%
- Vital care 28%
- Specialty products 8%



Principal operating regions
We have operations in over 30 countries, with manufacturing located in North America, Europe and Asia.

Customers
Around three-quarters of our end users are hospitals. The remainder comprise alternate care and OEM partners.

Competitors
Our competitors are diverse and include medical device businesses, as well as single product line companies.

Suppliers
We work continuously with our supplier base to reduce product and supply chain costs, improve delivery performance, ensure continuity of supply and achieve the highest quality. The majority of our direct spending is on resins, plastic injection mouldings and electronics.

Markets and trends
The medical device industry remains attractive, driven by numerous favourable and long-term trends. In turn, procedural growth is improving slightly, but constrained by healthcare system and budget reforms.

The global market we serve is estimated to be approximately £6bn, with numerous adjacent target markets. We are well positioned in lower risk, short-duration, interventional procedural devices that have a wide variety of applications. Our broad portfolio includes strong brands in hardware and consumable products, as well as software and services for both hospital and alternate care settings.

Infusion Systems
Our Infusion Systems products deliver medication and biologic therapies via infusion for the treatment of an array of indications, including acute and chronic pain management, cancer, pulmonary hypertension, and Parkinson's disease in hospital and home settings. We expect market growth through the increasing treatment of chronic conditions, and continued advancement of digital connectivity of medication delivery devices with hospital information technology systems and remote monitoring systems. Smiths Medical has a leading position in ambulatory infusion (CADD) and strong positions in the syringe pump (Medfusion and Graseby) and pain management (Portex) markets.

Vascular Access
Our Vascular Access portfolio protects healthcare workers and patients from the risk of infection and injury through the use of safety-enabled devices. We pioneered safety devices, including the first safety peripheral intravenous catheter and the first port for delivery of chemotherapeutic agents, and our portfolio covers a range of functions, including drawing blood, injections and vaccinations (Jelco and Portex), delivery of chemotherapeutic agents (Deltec), and blood pressure monitoring for critically ill patients (Medex). The global market we serve is expected to grow as safety and infection reduction expands globally. We are well positioned to capitalise on the advancement of global initiatives on the use of safety-engineered syringes to protect healthcare workers from needlestick injuries.

Vital Care
Our Vital Care products help to manage patient airways before, during and after surgery (Portex), alleviate breathing difficulties (Portex), improve bronchial hygiene (Acapella), and help maintain body temperature (Level 1).

Specialty
Our products for specialised care areas improve patient outcomes through in vitro diagnostics and fertilisation (Wallace), animal health and surgery (SurgiVet), emergency transport life support ventilation (Pneupac), and monitoring of critical vital signs (BCI).

Strategy
Our primary focus is on improving patient outcomes and reducing the total cost of care by helping healthcare providers solve their clinical needs safely, efficiently and economically. We achieve this by investing in product development, manufacturing and supply chain optimisation, and efficiency gains in marketing and distribution models. We are investing for growth in both developed and developing markets, and are well positioned to take advantage of the ongoing shift in healthcare delivery from hospitals to alternate sites and home care.

Competitive strengths

- Strong market positions in chosen clinical areas
- Highly recognised and respected brands
- Reputation for quality and safety
- Extensive global sales network
- Innovative pipeline of new products in development

Our broad portfolio includes strong brands in hardware and consumable products, as well as software and services for both hospital and alternate care settings.

Did you know...
In 2016 the length of all our closed suction catheters, SuctionPro 72, sold would span more than 220 miles.

	2016 £m	2015 £m	Reported growth	Underlying growth
Revenue	874	836	5%	1%
Headline operating profit	187	166	13%	7%
Headline operating margin	21.4%	19.8%	160bps	
Statutory operating profit	166	142	17%	
Return on capital employed	15.7%	14.7%	100bps	

Performance

Revenue grew 1% on an underlying[1] basis driven in particular by growth in Vital Care revenue of 3%. Reported revenue grew 5% with favourable foreign exchange adding to strong business performance. Smiths Medical is now the largest division of the Group by both revenue and profit.

Vital Care underlying[1] revenue growth was driven by tracheostomy and bronchial hygiene products. Vascular Access underlying[1] revenue was broadly flat as sales of cardiothoracic and port products were partly offset by price pressure on peripheral intravenous catheters (PIVC). Infusion Systems underlying[1] revenue was also flat as increased sales of hospital syringe infusion hardware and ambulatory infusion disposables were offset by a decline in sales of ambulatory infusion hardware following the strong prior-year performance in that segment. Specialty Products underlying[1] revenue declined 2% as growth from in vitro fertilisation and animal health was offset by declines in patient monitoring and emergency medicine.

Sales into emerging markets increased 10% during the year, with direct sales into China and India up 22% and 21% respectively. Sales into distributor markets in South East Asia also performed well, growing 3%. Economic challenges in Russia, the Middle East and South America led to reduced sales into these markets.

Headline operating profit grew 7% on an underlying[1] basis boosted by revenue gains, operational efficiencies, tight cost controls and restructuring programmes, which more than offset the downward pricing pressure in the sector and £5m adverse transactional foreign exchange. The headline operating margin of 21.4% was 160bps higher than the prior year, with £8m coming from favourable translational foreign exchange. The difference between statutory and headline operating profit reflects £14m of restructuring charges and £6m amortisation of intangible assets.

Return on capital employed increased 100bps to 15.7%, reflecting improved profitability that supported greater capital expenditure in new product development, capacity and manufacturing tooling.

1 Underlying excludes the impact of acquisitions and divestments, and the effects of foreign exchange translation

Growth drivers

- Ageing populations with increasing life expectancy and quality of life expectations
- Growing incidence of chronic diseases
- Increasing need for interoperable and connected systems
- Growth of alternate site and home-based medical care
- Rising healthcare spend in developing markets, offsetting budget constraints in developed markets

Increased investment in R&D has resulted in a robust line-up of new products coming through the pipeline.

Research and development
+17%

Did you know…
acapella® is the most prescribed mechanical secretion mobilisation device in the world.

Research and development
Research and development expenditure of £52m (2015: £45m) represented 6.0% of sales (2015: 5.4%), of which £30m was expensed (2015: £29m). This increased investment, alongside improvements in our new product development processes and productivity over the past two years, has resulted in a robust line-up of new products coming through the pipeline. In 2016, we saw an increase in product launches that will greatly increase our competitiveness and expand our served markets. In particular:

- The Graseby C8 syringe pump, developed by Smiths Medical's R&D team in Shanghai, was launched in China, contributing to 22% growth in that market.
- CADD Solis VIP and wireless pumps fuelled geographic market expansion and wireless connectivity respectively.
- Medfusion expansion into Australia, New Zealand, UK and the Middle East.
- The paraPAC plus transport ventilator was released in Japan, contributing to 15% growth of Pneupac products in that market.

We continue to focus on streamlining the R&D organisation while driving improvements in efficiency, programme discipline and execution, and prioritisation of resources. Further product launches across our portfolio are planned in the coming year.

Priorities for 2017

- Lay the foundation for accelerated growth and continued margin expansion
- Build engagement, excitement and loyalty with customers and colleagues
- Expand our portfolio of products and services
- Improve marketing and sales force excellence
- Drive operational excellence

Go to www.smiths-medical.com for more information

New multi-year contract
We're delighted that leading US hospitals have chosen Smiths Medical to become a key provider of specialty infusion systems for Vizient (formally Novation), the largest member-owned health care performance improvement company in the US.

As part of a new multi-year contract, we'll provide Vizient members with our industry-leading devices such as Medfusion® syringe pumps, CADD®-Solis and CADD®-Solis VIP ambulatory infusion pumps for acute care, alternate care and home infusion needs.

Smiths Detection

Contribution to 2016 Group revenue

18%

Contribution to 2016 Group headline operating profit

13%

Percentage relates to headline operating profit before corporate costs

Smiths Detection designs and manufactures technology solutions that detect and identify security threats and contraband.

Revenue performance
£m
£526m up 13%

2016	526
2015	467
2014	512

Revenue by sector
- Transportation 45%
- Ports and borders 17%
- Military and emergency responders 15%
- Critical infrastructure 23%

Principal operating regions
We manufacture in Germany, France, Malaysia, US and the UK. We sell to over 200 countries.

Customers
The majority of revenues are influenced by over 100 governments and their agencies. Transportation customers account for 45% of revenues.

Competitors
We compete with a wide range of companies in each end-use market. Those with the broadest reach include Rapiscan, L-3 SDS and Nuctech.

Suppliers
We co-ordinate manufacturing and purchasing activity globally to achieve scale economies and meet stringent quality and delivery standards.

Photo courtesy of Kuwait Customs

Markets and trends

Smiths Detection produces equipment for customers in the air transportation, ports and borders, critical infrastructure, military and emergency responders end-use markets, to help them assure the safety and security of people and critical assets.

Demand for detection equipment and service is forecast to continue to grow at mid-single digits per annum over the near term, driven by ongoing geopolitical unrest and the resulting terrorist and criminal threats, but there is considerable variation by geography and end-use market. The growing installed equipment base creates significant opportunities for aftermarket (service and support) and upgrade revenues.

The heavily regulated air transportation sector is our largest market. Rising passenger volumes, continuing security threats, a strong replacement cycle and the increasing globalisation of trade, which boosts air freight volumes, are expected to continue to support market growth and new airport investment. Systems which help to integrate screening equipment with other forms of airport information are being used to improve the efficiency and effectiveness of the security process.

In the ports and borders market, the continuing globalisation of trade combined with increasing regulatory standards will drive the growth in demand for security screening equipment. Powerful technologies are required to address a variety of threats as governments become increasingly concerned about the smuggling of explosives, weapons and radiological materials, while continuing to recognise the strong revenue-generating potential from contraband detection.

The critical infrastructure market is large, but fragmented and unregulated. Growth in demand continues as public and private sector organisations seek to provide better protection for their assets and staff.

Global demand for chemical warfare agent detection equipment and other threat-specific sensors required by the military is forecast to grow steadily. Demand in the emergency responder end-use market, a subset of the military market, is driven by customers needing to deploy equipment as a consequence of both terrorist and non-terrorist events.

Strategy

Our primary goal is to provide the best solutions for customers, delivered through a strategy of balanced growth supported by continuous improvement. Operational improvements based on value engineering, better quality, waste elimination and reduced lead times should deliver savings which will be reinvested in customer-focused development of products and software systems, as well as improvements in aftermarket coverage and service levels. Revenue growth from the aftermarket and digital solutions help to smooth out the volatility of prime contracting and are important sources of profitable revenue in their own right.

Competitive strengths

- Strong global brand
- Operates in regulated markets requiring rigorous product certification
- Technologies leveraged across many markets and applications
- Investment in continuous improvement driving division-wide efficiencies
- Growing aftermarket revenues (37% of total revenues)

Smiths Detection equipment helps assure the safety and security of people and critical assets.

Did you know...

In 2015 Smiths X-ray machines helped screen an estimated 1.6 billion carry-on bags a day at US airports alone.

	2016 £m	2015 £m	Reported growth	Underlying growth
Revenue	526	467	13%	9%
Headline operating profit	69	55	24%	20%
Headline operating margin	13.0%	11.9%	110bps	
Statutory operating profit	63	45	40%	
Return on capital employed	11.9%	9.6%	230bps	

Performance

Revenue grew 9% on an underlying[1] basis with growth in all businesses other than transportation. Initiatives to drive service attach rates and sales of premium service contracts led to a 14% increase in underlying[1] aftermarket revenue, which represented 37% of sales. On a reported basis, revenue grew 13%, boosted by favourable foreign exchange.

Underlying[1] transportation revenue fell 6% due to a lull in US activity levels, offset by strong sales into EMEA which included deliveries to London Heathrow, Abu Dhabi Airport and continued progress in the Middle East. Major contract wins in Saudi Arabia and Egypt were made in the period. Critical infrastructure underlying[1] revenue grew 13%, driven by strength in aftermarket sales. Our revised product offering contributed to 75% underlying[1] revenue growth in Ports & Borders, including deliveries for major programmes in Indonesia, Nicaragua, Kuwait and for the US Customs and Border Protection Agency. Ongoing success in the US under the long-running JCAD and CBPS programmes, in addition to deliveries of RadSeeker detectors to the Domestic Nuclear Detection Office, led to underlying Military revenue[1] growth of 9%.

Operating profit grew 20% on an underlying[1] basis as increased sales, aftermarket strength and business mix were boosted by a number of value engineering and programme management initiatives. The difference between statutory and headline operating profit includes a £4m restructuring charge.

Return on capital employed improved 230 basis points to 11.9%, driven by higher profitability.

1 Underlying excludes the impact of acquisitions and divestments, and the effects of foreign exchange translation

Growth drivers

- Persistent and evolving terror threats
- Changing security regulations for air cargo and passengers
- Equipment replacement cycle – typically 7-10 years
- Software-driven solutions providing functionality, networking and systems integration
- Growth of security infrastructure in emerging markets

A new focus on software development and value engineering will deliver products better able to compete in cost critical sectors.

Aftermarket and consumables revenue

37%

Did you know...

Our Radiation detectors can identify radiation anomalies behind 13 inches of steel shielding.

Research and development

Total research and development expenditure of £28m was in line with the prior year, of which £25m was company funded (2015: £25m). Investment was concentrated on fewer projects to drive a strong product pipeline that will deliver competitive advantages to our customers. This included:

- X-ray machines for the aviation market capable of meeting the new EU/ECAC Standard C3, as well as a new version of our Checkpoint.Evo remote screening software and, following the introduction of the IONSCAN 600 this year, the next generation of explosive trace detectors.
- For the military end-use market, the next generation of chemical warfare detection devices.
- A new focus on software development and value engineering projects which will deliver products better able to compete in some cost-critical sectors, as well as country-specific versions of some of our most successful products.

Priorities for 2017

- Strengthen sales channels in all regions
- Drive R&D investment behind key product initiatives
- Launch value engineered products in specific end markets
- Deliver further growth in aftermarket revenues
- Implement continuous improvement initiatives

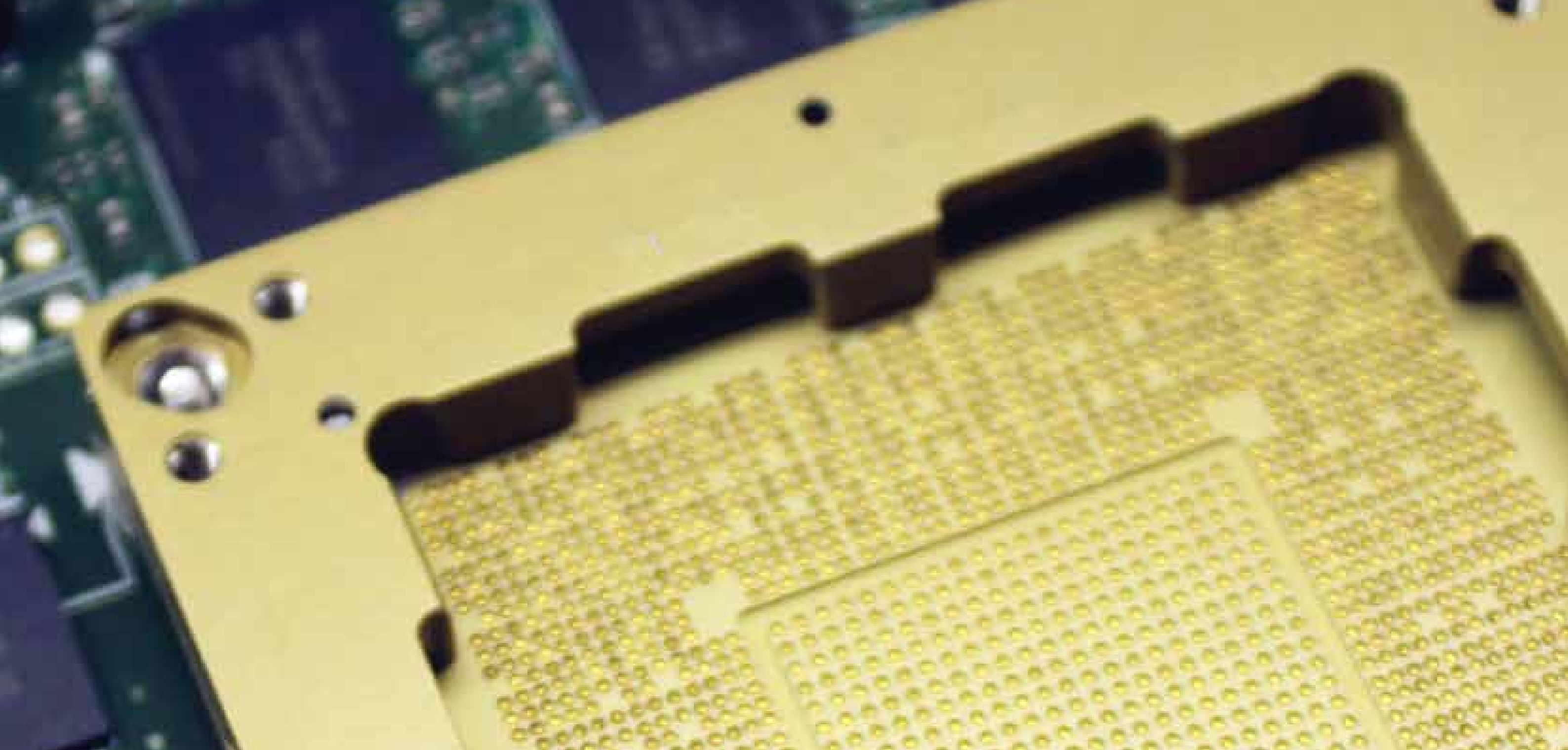
Go to www.smithsdetection.com for more information

Major US contract win

In March, Smiths Detection announced a $65 million five-year agreement to provide X-ray inspection systems to the Federal Protective Service (FPS), helping to protect approximately 1,000 Federal Government facilities across the country.

Through our previous working relationship, Smiths Detection has proven to be a reliable partner of FPS and this contract win demonstrates confidence in our continued service and support.

Smiths Interconnect



Contribution to 2016 Group revenue

15%

Contribution to 2016 Group headline operating profit

11%

Percentage relates to headline operating profit before corporate costs

Smiths Interconnect develops electronic components and sub-systems providing signal, power and microwave solutions.

Revenue performance
£m
£435m up 4%

2016	435
2015	420
2014	445

Revenue by sector
- Connectors 36%
- Microwave 44%
- Power 20%

Principal operating regions
We operate globally with locations in North and Central America, Europe, Asia and Australia.

Customers
Our blue chip customers are prime contractors, OEMs, system suppliers and sub-system manufacturers. Examples include Raytheon, Verizon, Huawei, CyrusOne and NVIDIA.

Competitors
We have many small, medium and larger competitors in various product and technology areas, including Amphenol, Yokowo, Commscope, Anaren, Cobham and Emerson.

Suppliers
We develop supplier partnerships whilst ensuring no material individual dependencies.

Markets and trends
Smiths Interconnect comprises three technology-focused businesses:

Connectors provides application-specific, high-reliability electrical interconnect solutions.

Microwave provides components, sub-assemblies and systems for defence, aerospace and wireless telecommunications.

Power provides distribution, conditioning and monitoring solutions for data centres.

Smiths Interconnect addresses a variety of end markets, particularly defence, aerospace, space, medical, wireless telecommunications, data centres and semiconductor test.

Global defence spending remains constrained as governments maintain tight budget control. New investment is biased towards system upgrades in critical areas such as intelligence, surveillance and reconnaissance, force protection and force multipliers. Our microwave technology, ruggedised connectors and electromagnetic pulse protection solutions are deployed in the most extreme environments, such as enabling sensors, communications and next-generation radar systems.

With a strong backlog, the commercial aerospace market remains robust, driven by increasing passenger and freight demand particularly in developing regions, and the need to upgrade fleets to more efficient aircraft. Smiths Interconnect provides connector and satellite communications antenna solutions for various aircraft and space applications.

The wireless telecommunications infrastructure market is driven by the need for higher data rates and bandwidth utilisation to support mobile communication devices and their data-intensive applications. Smiths Interconnect supplies high-performance microwave components used in cell sites, as well as products and test equipment that help optimise and protect network performance.

Data centre demand is driven by internet traffic growth caused by cloud computing, data regulations, web-enabled devices and mobile applications. Co-location providers continue to grow faster than enterprise demand as companies choose to outsource rather than fund large capital projects. Smiths Interconnect's conditioning, distribution and monitoring solutions ensure power quality is delivered to sensitive IT equipment.

Smiths Interconnect provides connector and cable assembly solutions to semiconductor applications. The high rate of technology refresh, increased functionality and greater connectivity requirements of electronic devices are key drivers for this market.

Strategy
Our global business model is to focus on customers that value our innovative, technically differentiated offerings and our agility, responsiveness and service. We allocate resources to markets, customers and regions with the most attractive prospects, particularly defence, aerospace, medical, semiconductor, wireless telecommunications, data centres and Asia. Restructuring and efficiency initiatives, including lean and value engineering, deliver the funds for investment. By providing a technically challenging, exciting and rewarding environment, we attract and retain the necessary talent to drive our future performance.

Competitive strengths

- Innovative and technically differentiated offerings
- Ultra-high reliability solutions used in demanding applications
- Customer intimacy, responsiveness and product customisation
- Global presence, reach and support

Smiths Interconnect serves a variety of end markets, particularly defence, aerospace, space, medical, wireless telecommunications, data centres and semiconductor test.

Did you know...
Our connectors were used in the mission to land the Philae Probe on the surface of a comet.

	2016 £m	2015 £m	Reported growth	Underlying growth
Revenue	435	420	4%	(1)%
Headline operating profit	57	49	16%	9%
Headline operating margin	13.1%	11.6%	150bps	
Statutory operating profit	26	28	(7)%	
Return on capital employed	10.3%	9.1%	120bps	

Growth drivers

- Proliferation of electronic devices
- Demand for greater connectivity and mobility
- Growth in high data rate applications
- Increasing sophistication of customer needs in emerging markets
- Increasingly sophisticated defence requirements

Performance

Revenue declined 1% on an underlying[1] basis with good growth in the Power business offset by defence programme slowdowns and lower demand for semiconductors. Revenue grew 4% on a reported basis, boosted by £21m foreign exchange benefits.

Underlying[1] revenue growth of 3% in the Power business was driven by strong data centre expansion in North America and an increased focus on preventative maintenance service contracts. Underlying[1] Microwave revenue declined 5% due to lower customer demand and defence programme delays, although major new defence contracts for microwave assemblies were secured. Underlying[1] Connectors revenue remained flat year-on-year as a decline in defence sales was offset by good demand in the commercial aerospace and space markets, which included the supply of high-reliability connectors to the NASA Orion exploration spacecraft.

Headline operating profit grew 9% on an underlying[1] basis and the headline operating margin increased 150 bps to 13.1%, with accretion in all three business areas. Significant benefits came from improvements in productivity through value engineering, lean manufacturing and automation initiatives and from restructuring and procurement savings, which more than offset wage inflation and negative operational gearing from lower volumes and mix effects. The difference between statutory and headline operating profit primarily reflects an £18m goodwill impairment for Microwave, £8m amortisation of acquired intangible assets and £4m for restructuring.

Return on capital employed increased 120 basis points to 10.3% predominantly driven by the higher profitability.

1 Underlying excludes the impact of acquisitions and divestments, and the effects of foreign exchange translation

Significant benefits came from improvements in productivity through value engineering, lean manufacturing and automation initiatives.

Research and development

+6%

Did you know...

Our airborne satellite communication antenna systems have provided over 8 million hours of high-speed inflight connectivity.

Research and development

Total research and development expenditure of £26m was in line with the prior year, representing 6.0% of revenue, of which £24m was company-funded (2015: £23m). Investments were focused on higher growth sectors, supporting key customers' needs or accessing new customers, regions or markets. Highlights included:

- In Microwave, we invested in new telecoms test products targeted at the Asian market, broadened our range of passive components to provide increased functionality and developed millimetre wave products for advanced radar systems and nascent higher frequency commercial applications.
- In Connectors, we launched new high-reliability connector solutions for commercial aerospace and high pressure and temperature oil and gas drilling applications. Elastomeric contact technology was added to our portfolio through a partnership agreement.
- In Power, we developed higher efficiency transformers in compliance with a US Department of Energy regulation that entered into force in early 2016, as well as a new power distribution unit, and remote power panel and busway range extensions.

Priorities for 2017

- Focus on valued customers and sales channels
- International expansion, particularly Asia
- New product investments targeted at higher growth segments
- Reduce costs through value engineering and scale efficiencies
- Embed new leadership team

Go to www.smithsinterconnect.com for more information

Transforming manufacturing in Shanghai

Smiths Microwave Telecoms, Shanghai is transforming its manufacturing, moving from largely manual processes to a high level of automation as part of a five-year programme.

Since September 2014, the team has successfully automated three major processes – screw assembly, pre-tuned alignment, and intermodulation testing – and is on the path to becoming a highly automated manufacturing facility that can lead the market in terms of quality, cost, delivery and service.

Flex-Tek

Contribution to 2016 Group revenue

9%

Contribution to 2016 Group headline operating profit

9%

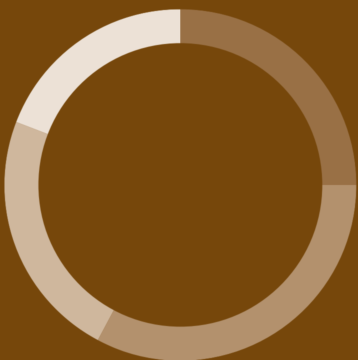
Percentage relates to headline operating profit before corporate costs

Flex-Tek provides engineered components that heat and move fluids and gases for the aerospace, medical, industrial, construction and domestic appliance markets.

Revenue performance
£m
£284m up 6%

2016	284
2015	269
2014	250

Revenue by sector
- Fluid Management 25%
- Construction Products 33%
- Heat Solutions 23%
- Flexible Solutions 19%



Principal operating regions
Our operations are mainly located in the US and Mexico, with Asian operations in India, China and Malaysia, and European facilities in France, Germany and the UK.

Customers
We serve the US construction industry, domestic appliance, aerospace engine and airframe manufactures and other niche markets. Large customers include Watsco, Ferguson, Boeing, Airbus, Pratt & Whitney, GE, Samsung, Trane and Carrier.

Competitors
We compete with leading suppliers across our product range. Examples include Parker-Hannifin, Zoppas and Ward.

Suppliers
We source key materials from world-class companies selected to provide exceptional quality, service and value.

Markets and trends

Flex-Tek designs and manufactures engineered components which heat and move fluids and gases for aerospace, consumer products, construction, medical, and industrial applications. The diverse nature of these markets reduces Flex-Tek's reliance on any specific technology, although the division is highly leveraged to the US economy.

Flex-Tek is organised under four market-specific segments:

Heat Solutions

As the world's largest manufacturer of open coil heating elements, our products serve customers that manufacture tumble dryers, HVAC equipment, medical devices, and bespoke applications. Our specialised elements and thermal systems provide consistent temperature controls which improve system efficiency and performance. Revenue growth is driven by the US housing market, along with an increasing number of specialty heating applications in North America and Asia.

Construction Products

Flex-Tek manufactures market-leading flexible gas piping and HVAC flexible ducting for the US construction market. Our customers are large national wholesale distributors in North America, supplying both plumbing and HVAC tradesmen. The US housing market is driving positive revenue and market share gains.

Fluid Management

We are a market-leading manufacturer of specialty high-performance, flexible and rigid tubing assemblies for aerospace applications worldwide. Our specialised tubing provides reliable and efficient delivery of hydraulic fluids and jet fuel for both commercial and military aircraft. The market for commercial aircraft remains strong, with an OEM commercial aircraft order book of over 13,000 units.

Flexible Solutions

Flexible Solutions hoses and hose assemblies are focused into four distinct markets: medical respiratory care, floor care appliances, industrial ventilation and automotive. Automotive applications include petrol and brake fluid delivery in traditional automobiles as well as next-generation fuels for natural gas and hydrogen-powered vehicles.

The business performance generally follows macroeconomic indicators such as healthcare spending, US GDP and capital goods expenditure.

Strategy

Our Construction Products segment is positioned to continue to grow revenue and market share in the US housing market, along with expanded geography and applications for our gas tubing products. In Heat Solutions we are expanding our product portfolio through new product development. Our Fluid Management business is focused on securing positions on next-generation aircraft in order to support the delivery of the commercial aircraft order book. We also continue to seek out strategic bolt-on acquisitions to support business development, through expansion of our product portfolio and market share gains.

Competitive strengths

- High-performance flexible tubing products for aerospace
- High capability to design and manufacture heating solutions for bespoke applications
- Strong customer relationships
- Market-leading product performance in residential gas tubing

The diverse nature of Flex-Tek's markets reduces reliance on any specific technology.

Did you know...

Our Teflon braided hose can reach temperatures ranging from 230°C to -100°C.

	2016 £m	2015 £m	Reported growth	Underlying growth
Revenue	284	269	6%	0%
Headline operating profit	51	50	3%	(3)%
Headline operating margin	18.0%	18.5%	(50)bps	
Statutory operating profit	37	41	(10)%	
Return on capital employed	31.6%	33.6%	(200)bps	

Performance

Revenue was in line with the prior year on an underlying[1] basis. On a reported basis, foreign exchange benefits led to revenue growth of 6%.

Construction revenue grew 3% on an underlying[1] basis, with both Gastite and Thermaflex benefitting from the growing US housing market. A softening of orders in aerospace led to a 1% underlying[1] decline in Fluid Management revenue. Heat Solutions revenue fell 5% on an underlying[1] basis, principally due to lower nickel prices reducing our own selling prices to customers. Flexible Solutions underlying[1] revenue growth of 1% was driven by increased demand from the medical sector, although this was offset by a decline in the floorcare segment.

Headline operating profit of £51m delivered a margin of 18.0%, slightly lower than the prior year. A Gastite product transition was the primary driver of lower performance, even though Gastite margins were better than expected due to lower material costs. Profits and margins in Heat Solutions, Thermaflex, and Flexible Solutions improved slightly over the last year. The difference between statutory and headline operating profit primarily reflects a £12m charge to extend the provision for litigation in relation to damage allegedly caused by lightning strikes.

Return on capital employed decreased 200 basis points to 31.6%, driven by the slightly lower rate of return on sales and by investment in expanding site capacity.

1 Underlying excludes the impact of acquisitions and divestments, and the effects of foreign exchange translation

Growth drivers

- Strong commercial aerospace market growth
- Steady growth in US housing construction
- Expanding base of bespoke heating element solutions
- Growing European sales of gas tubing
- Additional applications for gas tubing products

Research and development

Spending on research and development remained constant, focused on innovation to meet specific customer needs. We continued our focus on the development of specialty heating elements, expanded applications for gas tubing products and on products to meet the requirements of the next generation of quieter, more fuel-efficient aircraft.

Priorities for 2017

- Continue growth of Heat Solutions specialty segment business
- Drive European growth of Gastite
- Improve execution and growth in Fluid Management
- New product development in key areas

Go to www.flextekgroup.com for more information

Flex-Tek's R&D spend is focused on innovation to meet specific customer needs.

International sales

+4%

Did you know...

Our Titeflex Aerospace hoses can be found on the International Space Station.

Game-changing capabilities
As one of the leading printer suppliers, Hewlett Packard (HP) is a pioneer of new technologies, so it's no surprise that they partnered with Flex-Tek's subsidiary, Tutco, when they needed to develop new heating applications for their large, industrial graphic printers.

Working with HP's design team, Tutco developed the designs and prototypes at its facilities in the US and China, and managed the pre-build and production of new heating elements used to dry ink during printing to deliver a range of heating applications across several HP platforms. These developments give HP game-changing capabilities as they aim to set benchmarks for speed and quality products.

Principal risks and uncertainties

Smiths Group is exposed to a wide range of risks in running its businesses. We regularly review these risks and ensure we have the appropriate processes and policies in place to manage them.

Viability statement

In accordance with the requirements of the 2014 revision of the UK Corporate Governance Code, the directors have assessed the longer-term prospects of the Group, taking into account the current position of the Group and a range of internal and external factors, including the principal risks detailed on pages 55 to 60 (the 'viability assessment').

The directors have determined that a three-year period to 31 July 2019 is an appropriate time frame for the viability assessment. The selected period is considered to be appropriate as, based on the historic performance of the Group, a three-year outlook represents an optimum balance of long-term projection and acceptable forecasting accuracy. This time period also takes into account considerations such as the maturity of the Group's borrowing facilities and the cyclicality of the performance of the Group's underlying markets.

In making this viability assessment, the directors have considered the current financial position and prospects of the Group, including the current year business performance, the detailed budget for 2017 and the Strategic Plan. Against these financial projections the directors took into account the principal risks (as outlined on pages 55 to 60) to develop a set of plausible scenarios with potentially high-impact outcomes including:

- Product liability and litigation;
- Product liability and programme delivery;
- Supply chain disruption and business continuity;
- Fraud and corruption;
- Compliance with laws and regulations.

Consideration was then given to the magnitude of the gross risks and their potential impact, directly or indirectly, on the Group's future performance and liquidity. The assessment included stress testing of the Group's financial capacity to absorb the impact of such adverse events, either individually or in combination, and what mitigating actions the Group could take to respond to them in order to protect its business. The directors also considered the Group's ability to raise additional liquidity. In performing this assessment the directors have taken comfort from the diversity of the Group's businesses across different markets, industries, geographies, products and customers.

Based on the robust assessment, the directors confirm that they have a reasonable expectation the Group will remain viable for the period being assessed and will continue to operate and meet its liabilities as they fall due. The directors have no reason to doubt that the Group will continue in business beyond the period under assessment.

Introduction

The Group operates in global markets. In pursuing growth targets and strategic objectives we are prepared to accept certain levels of risk. We are very clear about the specific risks faced by our businesses and have robust actions in place to manage them. Our approach to each risk will vary over time and will depend on changing circumstances and the external environment.

Risk governance

The Board and its committees set the 'tone at the top' and approve the strategy of the business. On behalf of the Board, the Audit Committee is responsible for reviewing and assessing the effectiveness of the Group's risk management policies and processes, and the effectiveness of internal controls. The review covers all material controls, including financial, operational and compliance controls, as well as the Group's principal risks.

The Board ensures appropriate oversight and monitoring through a number of Board processes (strategy reviews, disclosures, Committee meetings, management reports and deep dives of selected risk areas). The Board is supported with input from a number of functions. Internal Audit is one of them and facilitates the Group's risk management processes, assesses the effectiveness of internal controls and identifies areas for improvement.

The Executive Committee is responsible for designing the system of internal control and risk management, and ensuring it is in place and effectively deployed throughout the business. It is responsible for ensuring the risk appetite of the Board is understood by risk owners and decision makers in the business. It is also responsible for conducting an annual assessment of strategic risk.

Divisional and functional teams are responsible for the day-to-day management and reporting of risks. They will identify new and emerging risks, ensure they are escalated where appropriate and take action to manage risks as required.

Tone at the top Set the strategy	Design the system	Complete risk reviews
Board and Audit Committee	**Executive Committee**	**Divisional and Functional Teams**
Review and assess risk management processes	Identify and assess strategic and operational risks	Management of risk/ risk registers

How we manage risks

Running any business involves constant risk management. It is an integral and often implicit part of day-to-day operations.

For the purposes of review and assessment we draw out the principal risks and uncertainties using the Enterprise-wide Risk Management (ERM) process.

The 'three lines of defence' approach is an industry-recognised best practice model supporting ERM and an effective controls framework. It can help increase clarity regarding roles and responsibilities and improve the effectiveness of risk management systems. It is a model we have adopted.

Board/Audit Committee
- Tone at the top
- Setting the strategy
- Ensuring sound system of internal control is in place
- Reviewing effectiveness of Group's risk management system and internal control
- Monitoring through Board processes

Executive Committee and senior management
- Designing and establishing the risk management system and internal control
- Ensuring risk appetite of the Board is understood by decision makers
- Ensuring risks are adequately managed

Regulators

First line of defence
Operational teams
- Establish and apply internal controls systems
- Document and conform to policies and procedures
- Understand roles and responsibilities
- Follow risk process

Functions that own and manage risks

Second line of defence
Risk and compliance
- Financial controls
- Risk management
- Security
- Quality
- Compliance
- Monitoring

Functions that oversee risks

Third line of defence
Internal audit
- Internal audit
- Internal controls assurance
- Programme assurance
- IT assurance
- Fraud risk management

Functions that provide independent assurance

In delivering our strategy it is important to understand and manage the risks that face us. We achieve this through our ERM approach which has been built to identify, evaluate, analyse and manage risks which threaten the successful achievement of our business strategy and objectives.

We do this by combining a top-down strategic view of risks driven by the Executive Committee with a bottom-up divisional process of identifying and managing risks. The process is continuous and is reflected in the chart below.

Our top-down approach involves a review of the internal and external environment, and an assessment by the Executive Committee of the principal risks that face the Group.

In an enhancement of the process during 2016, risk management papers have been presented at four Executive Committee meetings (two in 2015) with two of the sessions facilitated by the Director of Internal Audit. As part of this focus during the year a 'clean sheet of paper' approach was adopted in order to identify and assess strategic business risks, with time dedicated to identifying and discussing emerging risks.

Our bottom-up approach is driven by each of our divisions. They each operate their own risk management process, in line with Group guidelines, in order to manage risks specific to each business. This is an integral part of the Group ERM process.

Another enhancement of the risk management process was an additional Audit Committee meeting, held during May 2016, with a principal focus on reviewing all divisional and corporate risk in one session. This gave members of the Audit Committee the opportunity to assess the effectiveness of risk management processes, as well as strategic business risks and mitigating actions. In addition to the regular attendees of the Audit Committee, the CEO also attended.

In addition to the Audit Committee meeting held in May to consider risk, principal risks and uncertainties were reviewed and discussed at the March and July 2016 Audit Committee meetings. The Chief Executive now attends Audit Committee meetings.

This enhanced process provides a framework such that the Group's strategic, financial and operational risks are adequately considered by the Executive Committee and the Board.

The Board has reviewed the effectiveness of the risk management process, considering the principal risks and uncertainties, actions taken by management to manage those risks and the Board's risk appetite in respect of each risk. The Board considers the risk management process to be effective. It recognises this is an ongoing process and work will continue in 2017 to ensure it remains the case.

The principal risks we have identified

We maintain a detailed register of principal risks and uncertainties covering strategic, operational, financial and compliance risks. We rate them according to likelihood of occurrence and their potential impact. In 2016 we have begun to rate the 'velocity' of each risk. This measure is intended to reflect the time we would have to react to a risk were it to materialise. In the table to the right we provide a summary of each risk, a description of the potential impact and a summary of mitigating actions. We also provide ratings describing the potential impact, the trend versus 2015 and the 'velocity' of each risk.

2016 Highlights

Audit Committee
- An additional Audit Committee meeting in May 2016 with the primary focus of reviewing all divisional risk registers – attended by all divisional presidents and Chief Information Officer
- Attendance by the Chief Executive at all Audit Committee meetings

Executive Committee
- Facilitated risk sessions at two Executive Committee meetings – 'clean sheet of paper' approach to ensure principal risks document accurately reflects the strategic risks of the business, and emerging risks are understood and managed
- Executive Committee meeting sessions dedicated to reviewing specific principal risks

Compliance
- Requirements of the Financial Reporting Council (FRC) changes to the corporate governance code reviewed, understood and addressed
- Annual 'Letter of Assurance' certification on compliance with policies from the divisional executives to the Chief Executive extended to include the topic of risk management. Certification also extended to functional heads

Risk Management Process
- Velocity of principal risks now captured (high-velocity risks leave us little time to react)
- Use of multiple measures for the potential impact of a risk reflecting different types of risk facing the business (eg market value, profit, Health & Safety and reputational)

Our principal risks as assessed by the Board

Risks caused by uncontrollable external factors

Economic outlook and geopolitical environment

Potential impact
High

Trend
No change

Velocity
Medium

Risk and potential impact

Global economic and financial market conditions have stabilised after the turmoil following the 2008 financial crisis, in large part due to the various impacts of quantitative easing and austerity measures. However, there remains continued uncertainty arising from a range of geopolitical and economic issues across the world. Smiths operates in more than 50 countries and is affected by global economic and political conditions. The business is affected by government spending priorities, in particular in the US and UK, and the willingness of governments to commit substantial resources to homeland security and defence.

The change in the leadership of the UK government and the upcoming US presidential election are two notable events that are likely to have an impact on the economic and political conditions in which we operate.

Global security concerns continue to drive uncertainty. These include the continuing situation in Syria and the Middle East and events in Ukraine that have led to economic and political sanctions against Russia and the devaluation of the Russian rouble. With the UK referendum result we will see uncertainty in the UK, Eurozone and elsewhere as the economic and political relationship between the UK and EU is determined.

The global oil price continues to trade at levels well below the average of the past few years which impacts the medium-term capital expenditure plans of a number of our customers, predominantly within the John Crane division.

Mitigation

The Group has a diversified portfolio of businesses that mitigates exposure to any one country or sector.

The divisions regularly monitor their order flows and other leading indicators, where available, so that they may respond quickly to deteriorating trading conditions.

Maintaining our competitiveness and continually improving our product offering for our customers ensures we remain resilient and well placed to take advantage of commercial opportunities.

Compliance with legislation and regulations

Potential impact
Low to medium

Trend
No change

Velocity
High

Risk and potential impact

There is a risk that the Group may not always be in complete compliance with laws, regulations or permits, for example concerning environmental or safety requirements worldwide. The Group could be held responsible for liabilities and consequences arising from past or future environmental damage, including potentially significant remedial costs. There can also be no assurance that any provisions for expected environmental liabilities and remediation costs will adequately cover these liabilities or costs.

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

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

In addition, new legislation, regulations or certification requirements may require additional expense, restrict commercial flexibility and business strategies or introduce additional liabilities for the Company or directors.

Should a regulator's approval process take a particularly long time, our products may be delayed in getting to market, which could lead to a loss of revenue or benefit a competitor with a similar product.

Fraud or corruption on the part of a single employee could have severe consequences for the Group.

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

Mitigation

Environmental, health and safety data are reported to the Executive Committee and the Board, along with actions to improve performance.

Smiths Medical has dedicated staff who maintain close contact with the US Food and Drug Administration and other key regulators.

All divisions have ethics and trade compliance training and access to advice. This includes training on the Group's Code of Business Ethics and assessments to support compliance.

Divisional and Group General Counsel monitor legislative changes (assisted by Government Relations staff) and report and monitor actions as necessary. This may require modifications to our supply chains and customer arrangements.

Risks caused by uncontrollable external factors

Pension funding

Potential impact
Low

Trend
Reduced

Velocity
Low

Risk and potential impact

At 31 July 2016, the Group has legacy defined benefit pension plans, with aggregate liabilities of approximately £4.1bn on an accounting basis, with 2016 returning accounting funding to a surplus of £0.2bn.

Changes in discount rates, inflation, asset returns or mortality assumptions could lead to a materially higher deficit. For example, the cost of a buyout on a discontinued basis, and therefore using more conservative assumptions, is likely to be significantly higher than the accounting deficit. In addition, there is a risk that the plan's assets, such as investments in equity and debt securities, will not be sufficient to cover the value of those benefits.

The implications of a worsening position include a direct impact on the Group's valuation and credit rating, and potential additional funding requirements at subsequent triennial reviews.

Mitigation

All major schemes (US/UK) have been closed to new members and future accrual.

Agreed funding plans are in place with the major UK schemes following the last triennial reviews. The Group seeks a good working relationship with the Trustees through regular update meetings.

Pension matters are regularly reported to the Board.

The investment strategies of the three main plans (UK and US) are well hedged against changes in interest rate and inflation movements which has stabilised the overall funded position.

Read more in note 8 on page 155

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

Potential impact
Low to medium

Trend
No change

Velocity
Low

Risk and potential impact

Exchange rate fluctuations have had, and could continue to have, a material impact on the reported results. The Group is exposed to two types of currency risk: transaction and translation. The Group's reported results will fluctuate as average exchange rates change. The Group's reported net assets will fluctuate as the year-end exchange rate changes.

The Group's ability to refinance its borrowings in the bank or capital markets is dependent on market conditions and the proper functioning of financial markets. The Group may be unable to refinance its debt when due.

The Group's future profitability, particularly in the US where there are higher rates of corporation tax, may cause the headline tax rate to increase over time. Changes in tax and fiscal regulations and transfer pricing rules in the countries in which we operate could affect the Group, particularly at times when public sector debt is high. Taxation costs could rise and earnings per share could deteriorate, which could affect the Group's market valuation.

The Group cannot be certain that it will be able to obtain insurance on acceptable terms or at all. Furthermore, the Group cannot be certain that its insurance will cover losses arising from events or that insurers will not dispute coverage. In addition, even if our coverage is sufficient, the insurance industry is subject to credit risk, particularly in the event of a catastrophe or where an insurer has substantial exposure to a specific risk. If insurance cover is inadequate or does not pay out as expected, the Group could be exposed to an unexpected material cash outflow, which may impact the Group's liquidity and/or share price.

Mitigation

The Group's hedging strategy, whereby larger transactions are hedge accounted, mitigates the risk to profitability to some extent. Net investment hedging of overseas assets of approximately 50%, through borrowing in non-sterling currencies, mitigates the impact of exchange rate fluctuations on net assets.

The Group's debt maturity is staggered so that the refinancing risk is minimised. As at 31 July 2016, the US$800m committed revolving credit facility was undrawn.

The Group's taxation staff co-ordinate tax management to mitigate possible increases in the effective tax rate. Regular reporting to the Board of tax risks and exposures provides good visibility of issues.

Insurance risk is spread across a number of carriers to minimise individual insured risk and counterparty risk.

Read more on page 29

Business challenges / thematic risks

Product liability and litigation

Potential impact
Medium

Trend
No change

Velocity
High

Risk and potential impact

In the ordinary course of its business, the Group is subject to litigation such as product liability claims and lawsuits, including potential class actions, alleging that the Group's products have resulted or could result in an unsafe condition or injury.

In addition, manufacturing flaws, component failures or design defects could require us to recall products. Many of our products are used in critical applications where the consequences of a failure could be extremely serious and, in some cases, potentially catastrophic.

Products sold to the aviation, security, healthcare, energy and consumer/domestic industries are critical products, where the consequences of failure could be particularly severe.

Furthermore, over half the Group's sales are in the US, where there is potentially increased litigation risk.

Any liability claim against the Group, with or without merit, could be costly to defend and could increase our insurance premiums. Some claims might not be covered by our insurance policies, either adequately or at all.

An adverse event involving one of our products could damage our reputation and reduce market acceptance and demand for all of our products.

Mitigation

Quality assurance processes are embedded in our manufacturing locations for critical equipment, supporting compliance with industry regulations.

A global best practice programme is continuing to enhance product quality processes across the Group. This is sponsored by the Executive Committee and leverages the ongoing work in Smiths Medical and John Crane.

The divisions have procedures for dealing with product liability issues and potential product recalls. These procedures are informed by crisis management planning workshops and rehearsals.

The Group has insurance cover for certain product liability risks. The US Safety Act provides legislative protection for certain Smiths Detection products in the US; and we support efforts to implement similar legislation in other markets.

Any litigation is managed under the supervision of the Group's legal function. We have detailed action plans to manage actual or threatened litigation.

Read more on page 30
and in note 22 on page 178

Supply chain disruption and business continuity

Potential impact
Medium

Trend
No change

Velocity
Medium

Risk and potential impact

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

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

The concentration of manufacturing in lower cost countries, in particular in Mexico and China, increases the length of the supply chain and means that an adverse event could have more significant consequences for our ability to supply customers on time. A longer supply chain also affects transport costs, which could be exacerbated by energy cost inflation.

Mitigation

Business continuity and disaster recovery plans are in place and tested for critical locations, to reduce the impact of an event.

Single-source supplier risks are identified and, where possible, key materials or components are dual sourced to mitigate the impact of an event.

The Group regularly evaluates its key sites for a range of risk factors using externally benchmarked assessments, and takes action to improve these ratings where appropriate.

The Group has business interruption and property damage insurance.

Business challenges / thematic risks

Government customers

Potential impact
Medium

Trend
No change

Velocity
Medium

Risk and potential impact

We derive a significant proportion of our revenues in mature Western economies with a notable element directly related to government expenditure. Additionally, a high proportion of our products and services are in some way influenced by government regulation and certification.

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

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

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

Mitigation

The Group has a diversified portfolio of businesses that mitigates exposure to any one country or sector.

Some of our government-related business has a services or consumables component, which can be more resilient during an economic downturn.

The Group has a Government Relations function so that it can inform policy and maintain close relationships with customers.

Technology and innovation

Potential impact
Medium

Trend
No change

Velocity
Medium

Risk and potential impact

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

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

The failure of the Group to develop its products and services, or more effective innovation by a competitor, could have a materially adverse effect on sales growth.

Mitigation

The Group has a diversified technology portfolio in a range of sectors and geographies.

Our continued investment in R&D supports new product and service development.

The Group looks to expand the addressable markets of its key businesses by building capabilities in adjacent markets, through organic investment and through targeted acquisitions.

Talent and succession planning

Potential impact
Medium

Trend
Reduced

Velocity
Low

Risk and potential impact

The loss of key personnel, or the failure to plan adequately for succession or develop new talent may impact the reputation of the Group, or lead to a disruption in the leadership of the business.

Competition for personnel is intense and the Group may not be successful in attracting or retaining qualified personnel, particularly engineering professionals. In addition, certain personnel may be required to receive security clearance and substantial training to work on certain programmes. The loss of key employees, the Group's inability to attract new or adequately trained employees, or a delay in hiring key personnel, could seriously harm the Group's business.

Over time, our competitive advantage is defined by the quality of our people – should we fail to attract, develop and retain key talent, in time our competitive advantage will erode, leading to weaker growth potential or returns.

Mitigation

Each division or function holds talent and succession plan reviews at least annually. These plans are reviewed by the Nomination Committee.

Remuneration packages, including variable and long-term elements of the compensation arrangements, are evaluated regularly against market practice.

The Chief Executive assesses, on an annual basis, the Top 25 people in the organisation for performance, skills and competencies and presents development and succession plans to the Board.

Leadership development programmes and formal career counselling support the talent pipeline.

Read more on pages 67-69

Business challenges / thematic risks

Programme delivery

Potential impact
Medium

Trend
No change

Velocity
Low

Risk and potential impact

Failure to deliver, in a timely fashion or at all, the products and services Smiths is obliged to deliver, or any fault in contract execution due to delays or breaches by its suppliers or other counterparties, may lead to higher costs, liquidated damages or other penalties.

Differences between the estimated costs in the Group's medium- and long-term contracts and actual costs may arise from a number of factors including production delays, cost overruns and other items.

Certain of the Group's contracts, particularly those with governments, may include terms that provide for unlimited liabilities on the part of the Group or allow the government body or counterparty to terminate unilaterally, reduce or modify the relevant contracts or seek alternative sources of supply at the Group's expense.

Mitigation

Contracts are managed and delivered by programme management teams that regularly review contract risks and take appropriate action.

A Group-level procedure for reviewing and approving high-risk contracts is in place.

Divisional boards review significant contracts.

The diversified nature of the Group mitigates the exposure to any single contract.

Acquisitions and disposals

Potential impact
Low

Trend
No change

Velocity
Low

Risk and potential impact

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

The Group may not be able to integrate the businesses that it acquires. If integration is unsuccessful, anticipated benefits are not realised or trading by acquired businesses falls below expectations, it may be necessary to impair the carrying value of these assets.

The Group's return on capital employed may fall if acquisition hurdle rates are not met. The Group's financial performance may suffer from goodwill or other acquisition-related impairment charges. Insufficient allowance for indemnities and warranties given at disposal may affect our financial position.

Mitigation

The Executive Committee and Board review the acquisition pipeline. There are monthly reviews by the divisional presidents with strategy leads for each division.

We perform comprehensive strategic and financial reviews of all opportunities. Detailed due diligence, including an assessment of the target's talent and competencies, and integration planning is undertaken and reviewed in accordance with Group policy.

The Board only authorises acquisitions after completion of due diligence, and approval is subject to meeting the capital allocation and other financial hurdles set by the Board. The Executive Committee reviews post-acquisition performance and integration.

On disposals, the Group seeks to minimise its exposure to indemnities and warranties and any that are provided are reviewed on a regular basis.

Business challenges / thematic risks

Information technology and cyber-security

Potential impact
Medium to high

Trend
No change

Velocity
High

Risk and potential impact

The Group's information systems, personnel, facilities and products are subject to security risk. The Group is dependent on information technology systems for both internal and external communications and for the day-to-day management of its operations. The incidence and sophistication of cyber-security crime is on the rise and some Group companies operate in sectors where cyber-criminals are active.

Any disruption to the information systems could have significant adverse consequences on the Group's operations or its ability to trade. It could result in the loss of confidential information and intellectual property, which could affect the Group's competitive position and cause reputational damage.

Mitigation

Oversight by the Board ensures information and cyber-security risks have an ongoing and proactive focus with an integrated business-wide approach.

Over the last year, Group capabilities were further evolved and Information Technology and Product resources and capabilities were expanded.

The Group works with advanced technology partners to implement technology solutions as well as following industry-recognised frameworks.

Compulsory awareness training has been deployed to all employees, alongside a rolling real-life simulation programme which ensure that employees are fully aware of the external threats faced by individuals from attacks such as Phishing on a daily basis.

The Group also works with external cyber sharing partnerships, sharing best practice and threat information.

At the heart of our business is a commitment to doing the right thing: behaving ethically, working safely, reducing our environmental impact, attracting and developing our people and contributing to our communities.

Our Code of Business Ethics

Our Code of Business Ethics provides the framework for our approach and CR focus areas.

Promoting a culture of responsibility, developing smarter ways of working and attracting the best talent, and delivering operational efficiencies to enhance margins form key elements of our values and business strategy, and add long-term value for our shareholders and our wider stakeholders.

Read more at www.smiths.com/responsibility

1
We comply with the law

2
We compete fairly

3
We act with integrity in all our business dealings

4
We treat suppliers, partners and customers properly

5
We treat our co-workers respectfully

6
We contribute to healthy, safe and secure workplaces

7
We respect the environment

8
We contribute to our communities

9
We participate in relevant public debates

10
We respect human rights

11
We have high standards of financial record-keeping and reporting

12
The Code applies to all of us

Why Corporate responsibility (CR) is important to Smiths

Many of our products and services benefit the environment and contribute to the safety, health, security and productivity of people around the world. For example, Smiths Detection's security scanners play a vital role in helping to prevent terror attacks, while John Crane's seals help its customers to reduce their environmental impact. Similarly, how we do business is critical to our long-term success.

Conducting our business responsibly enables us to meet our obligations to our stakeholders and delivers real business benefits, creating long-term value for shareholders by:

- Protecting our reputation and ability to grow
- Helping us to win business from customers who value strong CR performance
- Enhancing our efficiency
- Enabling our people to work productively, in a safe and ethical environment
- Helping us to attract and retain talent, and encouraging employees to take pride in working for us
- Reducing the risk of incidents and their associated costs.

Our approach also helps us to address key trends in our markets, including an increased focus on avoiding bribery and corruption, increased competition for talent in many of the global markets in which we operate, focusing more pressure on energy and water use, climate change, and materials safety, and enhancing our ability to recycle waste and products which have reached the end of their useful life.

Here we provide an overview of our approach and performance. Further detail on our approach, CR governance, performance and case studies can be found in our 2016 CR Report, which is available to download from www.smiths.com

Our Code of Business Ethics ('the Code')

Our Code of Business Ethics sets out 12 broad principles for how we do business, based on integrity, honesty, fairness and transparency. It provides the framework for our policies, programmes and procedures for a range of CR issues and is intended to instil responsible business practices across the business, enabling our employees to make ethical decisions, every time.

Our strategic focus areas

We focus on five priority issues: ethics, the environment, health and safety, our people, and the communities in which we operate.

Key relationships

As a global technology company operating in highly regulated sectors, building strong relationships with our employees, customers, governments and their agencies, regulators and suppliers across the globe is critical to our long-term success.

Our employees are key to delivering our strategy and are committed to attracting, retaining, developing, engaging and inspiring the best talent.

Strong, long-term customer relationships underpin our success. Many of our products are developed to meet customers' specific needs and our aftermarket services, especially in Smiths Detection and John Crane, help to build customer loyalty and improve our insight.

We engage with governments, their agencies and regulators directly through our divisions and a centralised Government Relations team, as well as working in partnership with industry bodies to leverage the benefits of scale.

We work with a broad range of suppliers and partners, such as distributors, across the Group and we require them to maintain high ethical standards comparable to our own (see pages 63 to 64).

Global Business Ethics Forum

"Don't let your ethics slip" was just one of the sessions at the regional ethics forums hosted in Brazil and China, and an International Trade Compliance Forum in Washington, DC in 2016. These forums brought together senior executives and managers from across the Group to consider the business and ethical risks of doing business in challenging business environments, with a particular focus on the individual ethical responsibility of all employees.

These events are all part of a series of interactive learning programmes addressing business and compliance issues in many of the developing or emerging markets in which we operate.

Ethics

We believe ethical behaviour is the responsibility of every Smiths employee, at every level of the organisation.

Our objective is not only to protect the reputation of our company and to safeguard the investment of our shareholders, but also to protect the interests of every employee by ensuring he or she has the knowledge and tools necessary for individual legal or regulatory compliance and ethical decision-making.

2016 Highlights

- Held regional Business Ethics Forums in Brazil and China. These highlighted the need for all employees to take responsibility for ethical compliance
- Met with key suppliers to discuss the Supplier Code of Business Ethics, which sets a minimum standard for ethical operations and behaviours of third parties
- Held an International Trade Compliance Forum in Washington, DC to focus on specific trade compliance risks
- Updated online training courses addressing the Smiths Code of Business Ethics and held employee focus sessions to gauge knowledge and understanding
- Extended MyVoice global employee engagement survey to offer all employees an opportunity to assess the effectiveness of the Smiths Ethics programme
- Engaged an external data collection agency to assess compliance risks for certain of our suppliers in high-risk countries

Strategy and objectives

Our ethics programme is focused on continuing to embed the Code and ethics- and compliance-related policies through communication, training and awareness programmes. We aim to ensure our employees understand our expectations and are able to make the right, ethical decision every time and to know when to ask for help, as well as to ensure compliance with our ethics-related policies and controls and the laws and regulations of the jurisdictions in which we operate.

We continually review and update our policies and business controls to mitigate changing areas of risk. We also review, evaluate and update our ethics programme, systems and procedures for fostering, monitoring and auditing ethical business conduct.

Other focus areas include expanding our online training, encouraging open discussion of ethical risks with employees at every level of the organisation, developing additional policies to enhance governance of key risk areas, and continued collaboration with Internal Audit, as part of our risk management and assurance processes.

Communication, policies and training

We regularly expand and update communications and training on key compliance areas to address evolving global risks, changes in laws and regulations, and enforcement trends in jurisdictions around the world. We also increase the number of languages in which training is offered to ensure we reach Smiths employees around the world as we expand. Our courses include global competition and international trade law, encompassing compliance with national laws governing import and export, and applicable embargoes and sanction programmes.

We use frequent, targeted communication and face-to-face training to spread the ethics and compliance message to every employee. Following the success of our global ethics forums over the past four years we have held several regional programmes in Brazil and China, exploring the individual ethical responsibility of every employee.

We also require our suppliers and partners to uphold our standards. To support this, we offer online training on Ethics for Third Parties for our agents, distributors and external sales representatives. Our Supplier Code of Business Ethics is available externally on the Smiths website and is provided to all major suppliers. The Supplier Code and our contractual provisions require suppliers to maintain high ethical standards in line with our Supplier Code or their own comparable ethics programme.

Reporting concerns and managing specific issues

We encourage employees who have concerns or queries about the Code to raise them with line management, Human Resources or their local in-house legal counsel. If employees have concerns they do not feel comfortable discussing with line management or their local HR or Legal teams, they can report those concerns through our confidential Ethics Alertline, which is managed by a third party and enables them to report these directly to the Ethics and Compliance function. It is available 24/7 via email, the internet and toll-free phone numbers, in every language used by Smiths employees. All issues are addressed promptly and referred, as required, to relevant internal or external specialists for investigation. Our non-retaliation policy means that any employee who in good faith reports an act of apparent misconduct or unethical behaviour will not be victimised or treated adversely.

Controls on defence sales

We seek to ensure that all sales and exports of defence equipment are undertaken in accordance with international trade regulations and national government export approval procedures and regulations, such as the International Traffic in Arms Regulation and the Export Administration Regulations in the US. These laws prohibit export of certain items to specific countries. The Group's policy is to adhere to all relevant government guidelines designed to ensure that products are not incorporated into weapons or other equipment used for the purposes of terrorism or abuse of human rights, with internal controls to ensure compliance with these guidelines.

Human rights

Smiths seeks to uphold all internationally recognised human rights wherever its operations are located. Within this framework, we do not tolerate the use of child or forced labour at Smiths facilities or those of our suppliers. The Supplier Code of Business Ethics and contractual clauses incorporate and implement these prohibitions. Furthermore, we take all steps reasonably possible to ensure our products are not used to abuse human rights. This year Smiths produced its first Modern Slavery Statement in line with the UK Modern Slavery Act. This can be found at www.smiths.com

Priorities for 2017

- Hold regional ethics conferences in countries considered a compliance risk
- Continue to update our training and compliance programmes in line with changing business needs and regulations
- Continue to refresh employees' online Code of Business Ethics training every two years
- Ensure suppliers understand our ethical standards and requirements to support the new Supplier Code of Business Ethics, including the prohibition of any abuse of human rights, such as slavery and human trafficking
- Continue to ensure ethics messages are received and understood by all employees worldwide
- Refresh our compliance risk assessments for all businesses and all regions
- Expand our positive assurance programmes for significant risk areas

Creating a supportive safety culture

To reduce the risk of injury in the workplace, we promote a positive health and safety culture where employees aren't afraid to suggest improvements.

John Crane's facility in Stoney Creek, Canada has redesigned its racking system for raw materials and the associated procedures for handling materials. While the old system relied on a dedicated forklift to load and unload heavy materials from a cantilever storage rack and move them to the manufacturing line, the new storage system is based on rails and no longer needs a forklift to move materials, minimising the risk to employees.

EHS

We are committed to achieving excellence in environment, health and safety management and performance.

Our aim is to provide effective leadership in the pursuit of injury-free and environmentally responsible workplaces.

2016 Highlights

- Developed new global technical minimum safety standards for serious EHS risks
- Completed formal sustainability materiality assessments in two divisions
- Reduced injury incident rate to lowest historical level
- Environmental performance continued its long-term improvement trend
- Updated our multi-year EHS strategy with increased focus on safety culture and behaviours

EHS governance and management

Our environmental, health and safety (EHS) approach starts with our EHS policy, and is supported by our EHS strategy, KPIs and goals. Our divisions have responsibility for EHS matters within their business, and adapt the Group EHS strategy to improve their EHS management and performance.

We believe in continuous improvement and use management systems to realise its benefits. These systems identify risks and issues, helping sites to prioritise the most significant risks.

EHS strategy

We aim to provide injury-free and environmentally responsible workplaces in order to protect our employees, communities, environment and shareholder value by effectively managing safety and environmental risks.

We align our EHS KPIs to our strategy, allowing us to assess our progress and form part of our senior management performance assessment.

Environmental targets

In 2013, we set new five-year targets for our environmental metrics. Our targets are to achieve 15% reductions in energy usage, greenhouse gas emissions and waste generation, and a 10% reduction in water usage by 2018, all normalised to revenue against a baseline of 2013.

Our greenhouse gas (GHG) emissions calculation methodology closely follows the Greenhouse Gas Protocol and includes emissions from sources under our control. In addition, the inventory consists of Scope 1 (direct GHG emissions from sources owned or controlled by the company) and Scope 2 (GHG emissions from the generation of purchased electricity consumed by the company) emissions. In 2014, an external adviser performed a review of our GHG emissions calculation methodology and prepared a GHG Inventory Management Plan that has been used to further align our emissions calculation methodology with the GHG Protocol. It was concluded that emissions from vehicles, production processes and fugitive sources are small and not material compared to our total GHG emissions. Due to the difficult nature of collecting emission data from these sources and their immateriality, they have been excluded from the inventory totals. The materiality of these sources will be reviewed again in the future.

Over the past six years, we have significantly reduced our environmental impact with 21% energy, 38% GHG, 16% water and 25% non-recycled waste reductions, normalised to revenue.

Compared to our baseline year of 2013, we have achieved good progress in reducing our environmental metrics with GHG and non-recycled waste reductions already exceeding our five-year goal. During 2016, our overall environmental performance continued its long-term improvement trend with normalised reductions in energy, GHG emissions, and non-recycled waste while water usage increased slightly. Absolute environmental metrics reduced in 2016 with 9% energy, 17% GHG and 5% non-recycled waste. Absolute water usage increased 1%.

Health and safety management

The Group is committed to protecting, as far as reasonably practicable, the health and safety of its employees. Our employees recognise this commitment and workplace safety continues to be the highest scoring dimension in our Group-wide employee engagement surveys.

Our Group-wide activities to reduce incidents have focused on improving our safety culture, behaviours and risk reduction. We continue to implement and build on these activities and are monitoring them through our Safety Leading Indicator Activities Programme. We use a safety leading indicator activity score as a KPI, which is supported by the recordable incident rate (RIR).

Health and safety targets

Our 2016 safety performance metrics were the Safety Leading Indicator Activity score, RIR and Lost Time Incident Rate (LTIR). Our safety leading indicator activities were split between Group-wide and division-specific activities, which allowed us to further target the individual improvement needs of each division.

As part of our strategic plan update and benchmarking in 2013, we also revised our safety performance targets. These targets increase our focus on leading indicator activities designed to improve safety culture, behaviours and reduce the risk of incidents. Our ultimate goal is 'zero harm' to employees. Adopting this aim further emphasises to employees and other stakeholders how seriously we take our safety performance. These metrics have placed less emphasis on RIR, but we continue to monitor RIR and the LTIR, and investigate incidents for contributing factors and trends to help focus risk assessments.

Total energy
'000MWh
252,000 MWh

2016	252
2015	278
2014	284
2013	280
2012	279

Total energy efficiency
MWh/£m revenue
86 MWh/£m revenue

2016	86
2015	93
2014	93
2013	92
2012	94

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

2016	0.47
2015	0.55
2014	0.50
2013	0.54
2012	0.60

Total CO_2 emissions
'000 tonnes
79,000 tonnes

2016	79
2015	95
2014	102
2013	104
2012	107

Total CO_2 emissions
Tonnes/£m revenue
27 tonnes/£m revenue

2016	27
2015	32
2014	33
2013	34
2012	36

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

2016	0.14
2015	0.22
2014	0.22
2013	0.22
2012	0.21

Water use
'000m^3
428,000m^3

2016	428
2015	425
2014	457
2013	456
2012	456

Water consumption
m^3/£m revenue
145 m^3/£m revenue

2016	145
2015	142
2014	150
2013	150
2012	153

Total non-recycled waste
'000 tonnes
4,900 tonnes

2016	4.9
2015	5.1
2014	5.6
2013	6.1
2012	5.8

Total non-recycled waste
Tonnes/£m revenue
1.7 tonnes/£m revenue

2016	1.7
2015	1.7
2014	1.8
2013	2.0
2012	2.0

A small number of historical metrics have been revised marginally to reflect refinements in monitoring

Performance against environmental targets

	Target 2013-18	2016 progress against 2013
Energy	15% reduction	**7% reduction**
Greenhouse gas emissions	15% reduction	**22% reduction**
Total non-recycled waste	15% reduction	**18% reduction**
Water consumption	10% reduction	**3% reduction**

Reduction targets are compared to the 2013 baseline year and normalised to revenue consolidated at 2016 closing exchange rates.

Health and safety performance

From 2004 to 2016, we achieved a significant reduction in our RIR, improving from 4.6 to 0.47, achieving our lowest RIR in 2016. We also focus on sites that experience increased incidents. This focus has already delivered significant improvements as we continue to drive world-class standards across the business.

After several years of a steady LTIR, we experienced a good reduction in 2016 to 0.14. Over the past thirteen years, we experienced three occupational fatalities with an employee at a former facility in Sweden in 2003, a contractor in Costa Rica in 2007, and an employee in a vehicle accident in 2014.

Priorities for 2017

- Implement new global technical minimum standards to address serious EHS risks
- Focused leadership and employee training to support safety culture and behaviours
- Update safety external benchmarking study to further identify areas of opportunity to support world-class safety

People

Building a learning organisation that attracts, retains, develops, engages and inspires the right people with the right skills is central to our ambition of transforming Smiths into a world-class organisation and supporting our growth ambitions.

We believe that people excellence is a strong enabler of business growth, and we develop our employees' capabilities so they can fulfil their potential and help us reach ours.

2016 Highlights

- Conducted a comprehensive MyVoice global employee engagement survey
- Launched the Smiths Excellence Awards to showcase and celebrate exceptional behaviours and achievements across the Group
- Implemented several new programmes to provide learning and career development opportunities for our employees
- Created additional HR efficiencies to ensure employees get the right information, faster

Governance

The Board places a high priority on attracting and retaining the right people and the Chief Executive is the Board member nominated to bring these ambitions to life. He is supported by the Group Human Resources Director, a team of Human Resources professionals and line managers across the organisation.

Strategy and objectives

We have consistently focused on strengthening our leadership capabilities and talent pipeline at both senior and junior levels, improving our recruitment and assessment techniques, succession planning and development, enhancing employee engagement, and transforming our HR function to provide a strong platform for growth. We benchmark the effectiveness of our processes against world-class standards and put in place year-on-year improvement plans to help us become best-in-class.

As we work to transform Smiths into a world-class organisation, a talented and determined workforce, united by commercial acumen, an appetite for innovation, strong leadership and a commitment to collaboration and inclusion, will be essential to achieving our ambitions. To support this, we will continue to develop our leadership capabilities throughout the organisation to ensure we have the depth and breadth necessary to support growth; deepen our focus on our technological and engineering expertise in order to drive innovation and maintain our technological leadership; and continue to build employee engagement across the business in response to the global employee engagement survey and ongoing feedback.

Culture, engagement and communication

We aspire to have a culture that is engaging, respectful, fair and diverse, and rooted in the regular giving and receiving of feedback. We recognise our employees' contributions and growth, and we are proud of both our heritage and our future.

We are on a journey to transform our culture, and to bring greater unity and strength across the Smiths divisions. These efforts will create more development opportunities for our employees and leaders and bring greater strength and recognition of the Smiths Group brand.

Communication, engagement and inclusion are at the heart of this journey. We have reached out to more than 600 employees across 20 countries to hear their feedback and insights into what makes Smiths great, and what we can do to better support employees. We will continue to engage with employees in different ways as we focus on culture and communication as part of our renewed focus on people excellence.

Our MyVoice survey is one valuable tool we use for measuring engagement and providing insights into our employees' experiences and perceptions. In March, we conducted our fourth global survey. We achieved a participation rate of 86% across the Group, and benchmarked results against global norms for the manufacturing industry. We will use the data and insights gained from this survey to identify our global priorities for 2017 and beyond.

Leadership

Our focus on leadership development has delivered enhanced capability in our talent pipeline, through a more rigorous and consistent approach to assessing and developing talent and a greater focus on personal development plans. We have also invested significantly in our leadership development programmes across the Group and continue to add new opportunities to ensure our leaders have the skills, insights and support to be truly effective. These programmes challenge and engage our employees, build their understanding of the wider Group, increase their exposure to our senior leaders and enhance their core leadership competencies. The programmes will also improve the diversity of candidates, especially in the areas of gender, geography, and educational routes. More than 600 leaders from across the business have been on or are currently participating in these programmes.

Learning and capability

We provide a variety of other learning and training opportunities, ranging from workshops and mentoring to online resources and internal and external training courses. Personal development planning and identification of training and development needs form a key part of our annual performance review process and we have implemented a new development programme for managers that helps them better coach and develop their employees, maximising the outcomes of the annual review process through ongoing development conversations and feedback.

We constantly challenge ourselves to have the right skills and competencies to support our growth ambitions. We believe this is best achieved through a healthy balance of recruiting the very best external candidates to bring fresh approaches and perspectives, while also strengthening our internal talent pipeline. For 2017, we will focus on building new relationships with universities, and new rotational and apprentice programmes for new graduates while continuing to expand our internal learning programme offerings and other development opportunities.

Reward and recognition

Managing and differentiating performance is critical to ensuring our employees fulfil their potential and deliver outstanding business results. In a competitive marketplace, we recognise the importance of rewarding employees appropriately and aim to offer compensation and benefits packages that enable us to attract, develop and retain key talent. We have also created the new Smiths Excellence Awards to reward and recognise the highest levels of achievement and impact in the six areas of our Excellence system: Customer, People, Production, Programme, Supply Chain and Technology.

Diversity and inclusion

With operations in more than 50 countries and a strategic focus on innovation and expanding into new geographic markets, having a diverse, engaged workforce that reflects our geographic footprint and brings local knowledge, fresh perspectives and constructive challenge is critical. We aim to provide an inclusive, collaborative culture that values every individual, fosters collaboration, and provides the tools, opportunities and challenges to enable them to fulfil their potential and add value to the business.

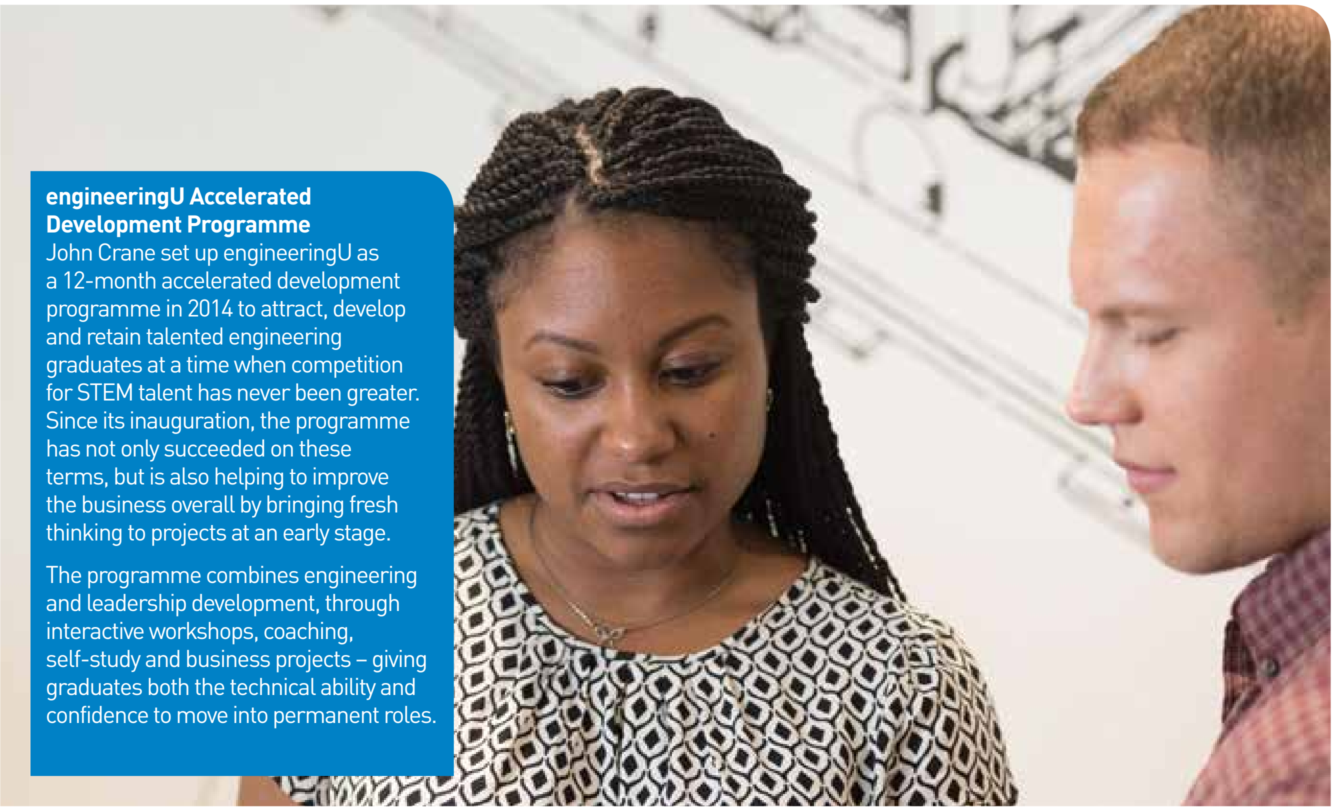
At the end of 2016, 38% of our global workforce and 18% of our senior managers were women. We are committed to increasing the diversity (in its broadest sense) of our workforce, and our two leadership development programmes aim to increase the diversity of candidates for senior positions. Two of our Board directors are women, representing 22% of the Board as at 31 July 2016, which is slightly below the level recommended by the Women on Boards Davies Report.

	Male	Female	Total
Board directors	7	2	**9**
Senior managers*	209	46	**255**
Total employees	13,700	8,300	**22,000**

*Senior managers are as defined by the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013, which includes employees who have responsibility for planning, directing or controlling the activities of the Group or a strategically significant part of the Group (other than Board members) and/or who are directors of subsidiary undertakings

It is our policy to provide equal employment opportunities. The Group recruits, selects and promotes employees on the basis of their qualifications, skills, aptitude and attitude. In employment-related decisions, we comply with all applicable anti-discrimination requirements in the relevant jurisdictions. People with disabilities are given full consideration for employment and subsequent training (including retraining, if needed, for people who have become disabled), career development and promotion on the basis of their aptitudes and abilities. We endeavour to find appropriate alternative jobs for those who are unable to continue in their existing job because of disability.

All our employees are treated with respect and dignity. Accordingly, any harassment or bullying is unacceptable. The Group respects the right of each employee to join or not to join a trade union or other bona fide employee representative organisation.



engineeringU Accelerated Development Programme

John Crane set up engineeringU as a 12-month accelerated development programme in 2014 to attract, develop and retain talented engineering graduates at a time when competition for STEM talent has never been greater. Since its inauguration, the programme has not only succeeded on these terms, but is also helping to improve the business overall by bringing fresh thinking to projects at an early stage.

The programme combines engineering and leadership development, through interactive workshops, coaching, self-study and business projects – giving graduates both the technical ability and confidence to move into permanent roles.

Acquisition integration
When new businesses are acquired, we implement plans to integrate them into the Group, ensuring that our business ethics, employee development and EHS policies and programmes are well embedded. We regularly review our processes in these areas, to identify any opportunities to improve.

Priorities for 2017

- Introduce a culture transformation focused on enhanced communication, collaboration, inclusion and excellence
- Continue to develop leadership capabilities across the organisation
- Deepen our commitment to and our development of STEM talent, including an increased focus on recruiting new graduates and providing expanded internship opportunities
- Continue to align our reward and recognition approaches to highlight and reinforce excellence

Community

Contributing to the communities in which we operate benefits both local people and our business.

It helps to drive prosperity in local communities, enhances our profile and reputation, promotes employee engagement and attracts new employees.

Governance
Given the diversity of our business and our decentralised structure, our community relationships and charitable programmes are primarily managed at a local level to allow our businesses to focus on the needs of their markets and communities. We also offer some Group-level support to charities and organisations that can demonstrate how a donation will enhance the well-being of people through improved education, health and welfare, or environment.

In 2016, we made charitable donations of £258,000 as a Group. Our employees also raised money for a wide range of charitable causes through a variety of fund-raising initiatives across the business.

Priority for 2017

- Continue to engage with the communities in which we operate across the Group

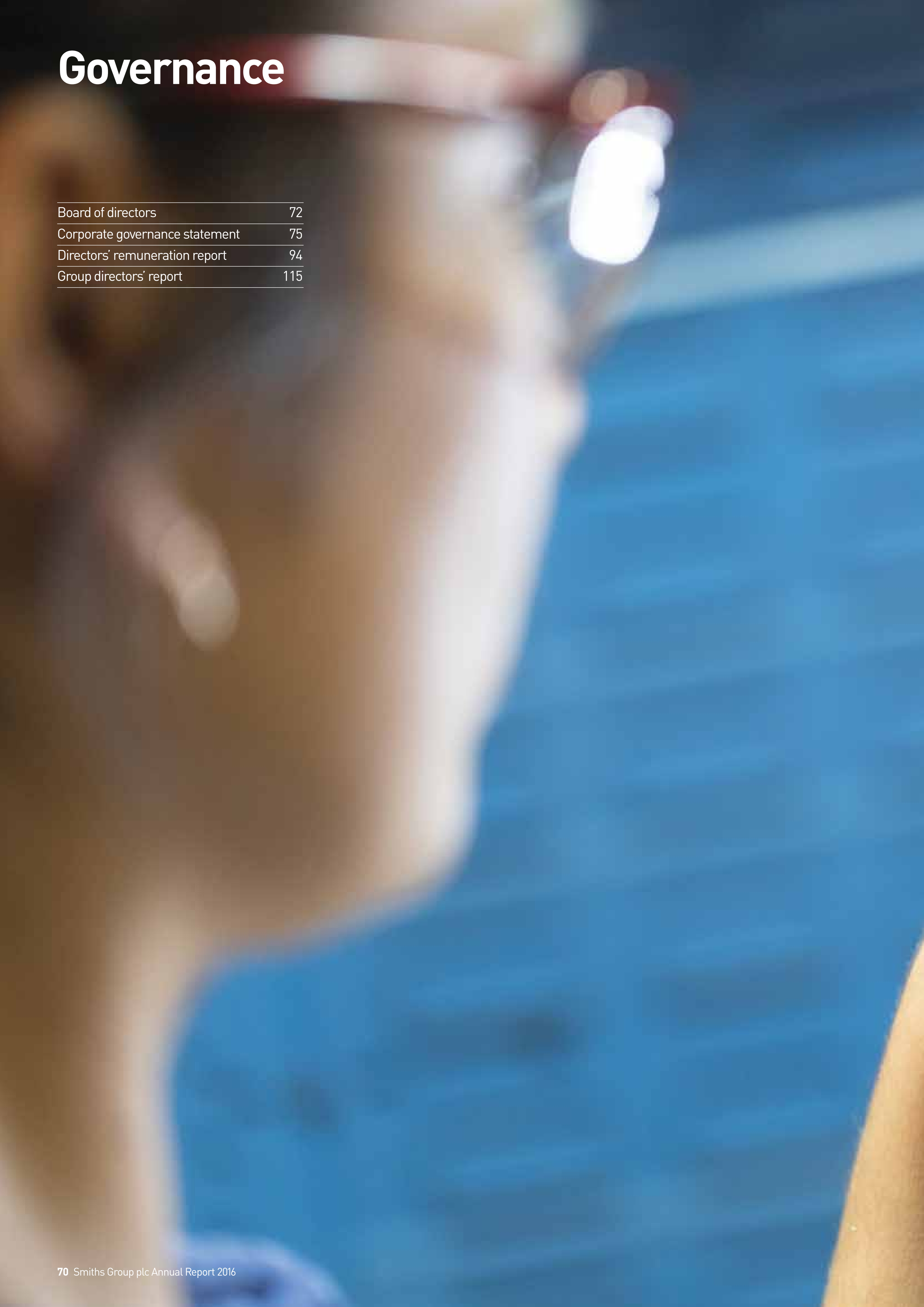
Strategic report
The Strategic report was approved by the Board on 27 September 2016.

By order of the Board

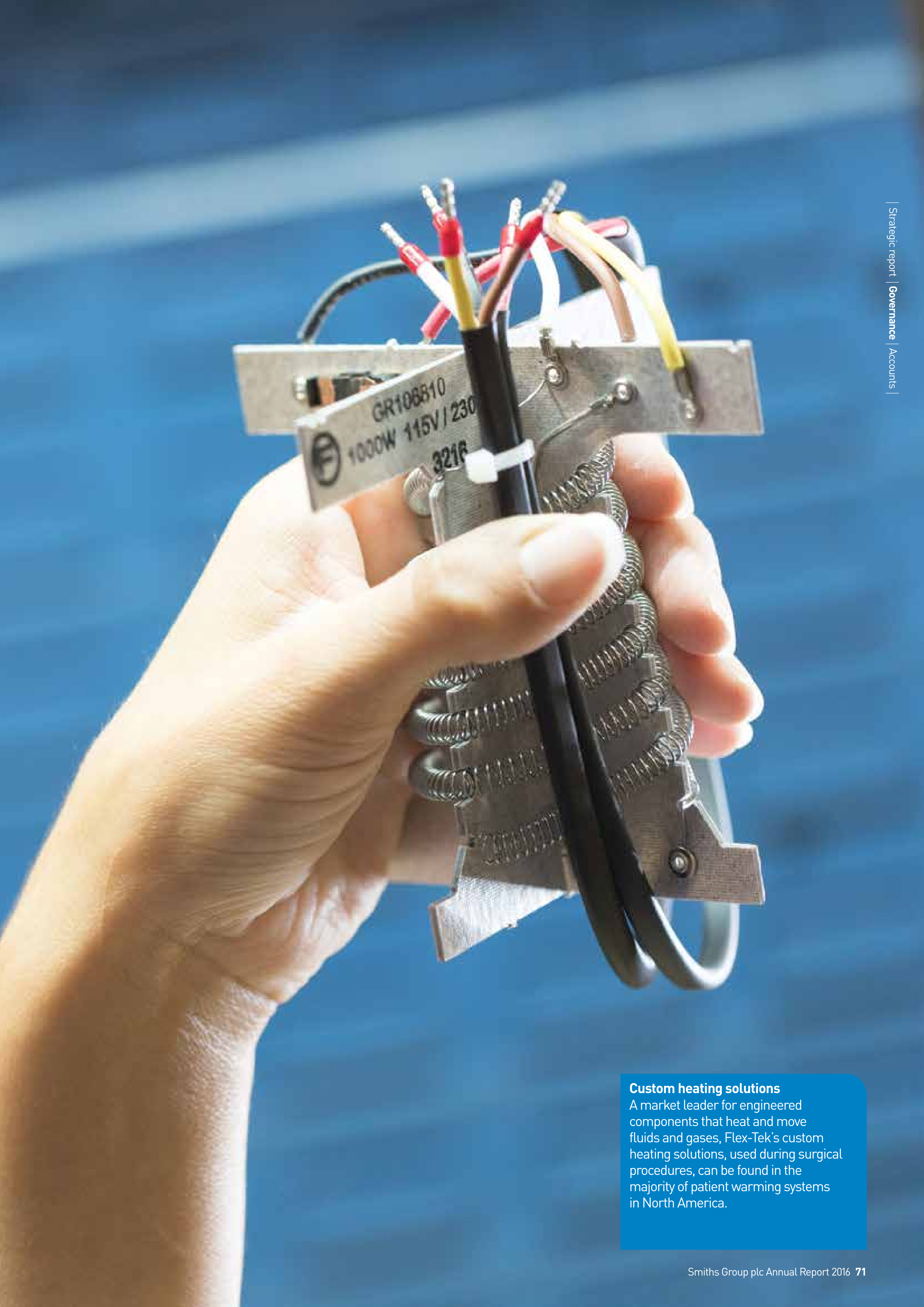
Andy Reynolds Smith
Chief Executive

Giving back to the community
Flex-Tek's Tutco facility in Cookeville, Tennessee has created a strong culture of giving back to the community, hosting a different activity every year to support local engagement. From renovating a playground at a shelter for abused women, to hosting a carnival for children with special needs, Tutco is constantly searching for a new cause or need in the community.

Tutco General Manager Dane Owen said: "This year we all enjoyed a day replanting the garden at a local nursing home. It was such a pleasure to meet all the staff and we had a great time organising social activities for the residents."



Governance



Custom heating solutions

A market leader for engineered components that heat and move fluids and gases, Flex-Tek's custom heating solutions, used during surgical procedures, can be found in the majority of patient warming systems in North America.

Board of directors

Sir George Buckley
Chairman

Committee membership N R

Appointment to Board
Sir George Buckley joined the Board on 1 August 2013 as a non-executive director and Deputy Chairman and was appointed as its Chairman on 19 November 2013.

Experience
Sir George has a PhD in Electrical Engineering. Sir George retired in 2012 as Chairman and CEO of 3M, the US-based global technology company and Dow Jones 30 component, after a long and successful business career spent mainly in the United States. He was previously Chairman and CEO of Brunswick Corporation and Chief Technology Officer for appliances, motors and controls at Emerson Electric Company. Sir George's expertise in engineering and innovation, combined with his extensive experience of large, multi-industry businesses that operate in global markets, are of huge benefit to Smiths.

External appointments

- Chairman of Ownership Capital
- Non-executive director of Hitachi, Ltd.
- Non-executive director and a member of the Audit Committee of PepsiCo, Inc.
- Non-executive director and member of the Audit and Compensation Committees of Stanley Black & Decker, Inc.

Andy Reynolds Smith
Chief Executive

Appointment to Board
Andy Reynolds Smith joined the Company as Chief Executive on 25 September 2015.

Experience
Before joining Smiths Group, Andy was Chief Executive Automotive at GKN plc, serving on the Board from 2007. He joined GKN in 2002 and held a number of senior positions across the Group, which included leading the Driveline, Powder Metallurgy and Land Systems divisions. In previous roles, Andy was Managing Director Europe for Ingersoll Rand's Bearings and Components business, Vice President International Operations at Invensys, and UK Country Director and Global Customer Director (Japan) for Delphi Automotive Systems. Andy began his career as an electrical and electronic apprentice with Texas Instruments. He is a former Chairman of the CBI Manufacturing Council and a former member of HM Government's Ministerial Advisory Group for Manufacturing and Green Economy Council. Until May 2016, he was a non-executive director of Morgan Advanced Materials plc. Andy has extensive experience in delivering significant growth in China and in driving business strategy, technological innovation and operational excellence.

Chris O'Shea
Chief Financial Officer

Appointment to Board
Chris O'Shea joined the Company as Chief Financial Officer on 18 September 2015.

Experience
Chris is a qualified Chartered Accountant with a finance degree from the University of Glasgow and an MBA from Duke University. Chris joined Smiths Group from the metals technology company, Vesuvius plc, where he was the CFO from 2012, following its demerger from Cookson Group plc. He was also a non-executive director of Foseco India Ltd, an Indian-listed supplier to the foundry industry and a part of Vesuvius plc. Chris has also held a number of senior finance roles at BG Group, latterly serving as CFO for the group's businesses in Africa, the Middle East and Asia. From 1998 to 2005 Chris worked in the UK, the US and Nigeria for Royal Dutch Shell in a variety of roles, including CFO for Shell's offshore exploration and production business in Nigeria. Chris has wide knowledge and experience of multi-national operations, including the manufacturing and oil and gas sectors. He also has experience of international tax and financing through roles at Ernst & Young and Royal Dutch Shell.

Melanie Rowlands
Company Secretary & Deputy Group General Counsel

Appointment
Mel was appointed as Company Secretary on 29 May 2015.

Experience
Mel holds an MA in Law from Oxford University and is a qualified solicitor. She joined Smiths in 2013, having previously held senior roles in BG Group plc and Linde AG. Most recently, she was the General Counsel of British Gas and Legal & HR Director of Edwards Group.

Committee membership key
A Audit Committee
N Nomination Committee
R Remuneration Committee
● Denotes Chair of the Committee

Bruno Angelici
Non-executive director

Committee membership A N R

Appointment to Board
Bruno Angelici was appointed to the Board as a non-executive director on 1 July 2010.

Experience
Bruno has Business and Law degrees from Reims and an MBA from Kellogg School of Management. His career includes senior management roles in pharmaceutical and medical device companies. Bruno retired from AstraZeneca in 2010 as Executive Vice President, International after a 20-year career. He was responsible for Europe, Japan, Asia Pacific, Latin America, Middle East and Africa and originally joined as President of ICI Pharma France. Prior to this, he was at Baxter, a US-based global supplier of medical devices. He has extensive international experience, including in the US, and brings a deep understanding to the Group of the medical device and pharmaceutical industries.

External appointments

Member of the Global Advisory Board of Takeda Pharmaceutical Company Ltd, Japan

Non-executive director and a member of the Nomination Committee of Novo Nordisk A/S, a Danish healthcare company

Member of the Supervisory Board and the Audit Committee of Wolters Kluwer nv, a Dutch-based information services and publishing company

Chairman of the Board and a member of the Nomination and Remuneration Committees of Vectura Group plc, a UK-listed specialty pharmaceutical company

Tanya Fratto
Non-executive director

Committee membership A N R

Appointment to Board
Tanya Fratto was appointed to the Board as a non-executive director on 1 July 2012.

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

External appointments

Non-executive director and a member of the Audit Committee of Advanced Drainage Systems, Inc., a US-listed water management and drainage company

Non-executive director and a member of the Nomination and Remuneration Committees of Ashtead Group plc, a UK-listed international equipment rental company

Anne Quinn, CBE
Non-executive director

Committee membership A N R

Appointment to Board
Anne Quinn was appointed to the Board as a non-executive director on 1 August 2009.

Experience
Anne has a BCom from Auckland University and MSc in Management Science from the Massachusetts Institute of Technology. Anne spent her early career with NZ Forest Products Limited and US management consulting company, Resource Planning Associates. She has extensive overseas experience in the oil and gas sector, having enjoyed a successful 25-year career with Standard Oil of Ohio and BP. She held a number of executive positions including Group Vice President in the US, Belgium, Colombia and the UK. Following her career with BP, Anne was the managing director of Riverstone LLP, an energy private equity group. Anne's experience is a great benefit to the Group in its development of new geographic markets and its exposure to the oil and gas sector.

External appointments

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

Bill Seeger
Non-executive director

Committee membership A N R

Appointment to Board
Bill Seeger was appointed to the Board as a non-executive director on 12 May 2014.

Experience
Bill has a BA in Economics and an MBA, both from UCLA (University of California, Los Angeles). Bill joined GKN plc, the global engineering company, in 2003 as Senior Vice-President and Chief Financial Officer of Aerospace. In 2007 he became a member of the Executive Committee as President and Chief Executive Propulsion Systems and Special Products before being appointed to the Board as Group Finance Director the same year. Bill retired as the Finance Director of GKN in 2014. He previously held a number of senior finance posts during a 28-year career with TRW, the US-based automotive and aerospace group. His long career in finance in the engineering sector and in-depth knowledge of global markets, contracting and strategy execution greatly benefits Smiths.

External appointments
- Non-executive director and Chairman of the Audit and Risk Committee of Spectris plc, a UK-listed instrumentation and controls company
- Visiting Professor – UCLA Anderson School of Management

Mark Seligman
Non-executive director

Committee membership A N R

Appointment to Board
Mark Seligman was appointed to the Board as a non-executive director on 16 May 2016.

Experience
Mark is a Chartered Accountant, with a MA in Philosophy, Politics and Economics. He is a former Chairman of UK investment banking for Credit Suisse and previously served in senior roles at S.G. Warburg. He is also a former Chairman of the UK Government's Industrial Development Advisory Board. He has served as non-executive Deputy Chairman of G4S plc and chaired its Audit Committee. He was also a non-executive director and the chairman of the Audit Committee of BG Group plc. He brings to the Board a long and successful career in investment banking and extensive experience in corporate finance and capital markets.

External appointments
- Senior Independent Director and member of the Audit and Nomination Committees of Kingfisher plc
- Alternate member of the Panel on Takeovers and Mergers for the Association for Financial Markets in Europe

Sir Kevin Tebbit, KCB, CMG
Senior Independent Director

Committee membership A N R

Appointment to Board
Sir Kevin Tebbit was appointed to the Board as a non-executive director on 14 June 2006 and was appointed as the Senior Independent Director on 17 November 2015.

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

External appointments
- Executive Vice President, Government and Defence of AECOM
- Senior Associate Fellow at Royal United Services Institute
- Visiting Professor at Kings College, London
- Member of the Advisory Board of the Imperial College Institute for Security, Science and Technology

Committee membership key
- A Audit Committee
- N Nomination Committee
- R Remuneration Committee
- Denotes Chair of the Committee

Corporate governance statement

Chairman's introduction

Smiths has a long and proud history, and excellence in corporate governance is essential to ensuring the Company's continued and long-term success. As the Board of Smiths we are responsible for the good stewardship of our shareholders' investment; we set the strategic direction and risk appetite within which the executive management team generate and drive value but all underpinned by a strong framework of good governance.

In this Annual Report we are reporting against the FRC's new revised UK Corporate Governance Code and the Board has adopted the revised principles and requirements it contains, including assessing the Company's long-term viability and increased focus on the Company's assurance framework for risk management. During the year we introduced an extra meeting of the Audit Committee at which the committee was able to obtain a deeper understanding of the risks of each of the business divisions and to give added focus to specific risks such as cyber-security, as well as considering the strategic risks for the Group as a whole. I am pleased with the work done in relation to setting the risk appetite for the Group, and in understanding the material risk areas in terms of multiple dimensions that include reputational impact and velocity. I think this puts us in much better shape to weather the storms to which all businesses are subject from time to time.

I reported last year that the Board had overseen a great deal of change in 2015, and we continued to support Andy Reynolds Smith and Chris O'Shea through their inductions and during their first year as Chief Executive and Chief Financial Officer, respectively. Following the retirement of David Challen from the Board after last year's Annual General Meeting, the Nomination Committee carried out a thorough review of the Board's composition, looking at the skills, knowledge and experience needed to take Smiths forward. Following a rigorous selection process I was delighted that Mark Seligman joined the Board in May as a non-executive director. Mark has had a good induction and it was helpful that he was able to join us in time for the Board's strategic review at its three-day meeting in May. I was also extremely pleased when Sir Kevin Tebbit agreed to take on the position of Senior Independent Director, as were the rest of the Board.

Throughout the year the Board has met regularly with members of the executive management team and other senior managers, during Board meetings and at other times. In particular the Board has participated in detailed strategic reviews, operating reviews and risk reviews for each of the business areas of the Group. Non-executive directors have also had the opportunity to meet with senior management less formally, during dinners and during business visits, in order to give them the opportunity to connect with individuals at various levels in the organisation.

I was interested to see the FRC's report on Corporate Culture and the Role of Boards published in July of this year which explores the responsibility of Boards for setting the right "tone at the top" and overseeing the values and culture of a business and the importance of this in ensuring effective business decisions and risk management. The Board spent time during Board meetings this year to consider the Company's ethics and anti-bribery programme, the health and safety programme, and its security and environmental sustainability programmes. The Board also considered work undertaken around the Group's supplier code of conduct and endorsed a statement for publication reinforcing our commitment to ensure there is no slavery in our operations. Which takes me back to my original theme – the key to resilience is to ensure that a business keeps the trust and respect of its internal and external stakeholders, and Smiths is absolutely committed to demanding the right behaviours at all times.

Sir George Buckley
Chairman

Excellence in corporate governance is essential to ensuring the Company's continued and long-term success.

Sir George Buckley
Chairman

Compliance with the UK Corporate Governance Code

Throughout the period 1 August 2015 to 31 July 2016 the Company has been in full compliance with the September 2014 edition of the UK Corporate Governance Code (the 'Code'), published by the Financial Reporting Council ('FRC') and available on its website (https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx) except that:

1) The Company has not put the external audit contract out to tender for more than ten years. Details of the Company's intention in respect of competitive audit tendering and audit firm rotation and its compliance with the Competition & Markets Authority's Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 are described in the Audit Committee report on pages 88 and 89.

2) The value of any fees received by Philip Bowman in respect of his external non-executive directorships up to the time that he ceased to be a director of the Company on 24 September 2015 is not disclosed in the Directors' remuneration report, as this has not been considered relevant to the Company.

Disclosure Guidance & Transparency Rule 7

This Corporate governance statement is a section of the Group directors' report and is incorporated into the report by reference. This statement complies with sub-sections 2.1; 2.2(1); 2.3(1); 2.5; 2.7; and 2.10 of Rule 7 of the UK Listing Authority Disclosure Guidance & Transparency Rules. The information required to be disclosed by sub-section 2.6 of Rule 7 is shown in the Group directors' report on page 117 and is incorporated into this Corporate governance statement by reference.

2016 in summary

Succession planning for the Board and senior management remained a priority together with oversight of a focused, comprehensive induction programme for the new executive directors. The Board held its annual senior management talent and succession planning review.

Andy Reynolds Smith appointed as Chief Executive and Chris O'Shea appointed as Chief Financial Officer.

Appointment of Sir Kevin Tebbit as SID and recruitment and induction of Mark Seligman as non-executive director.

The Audit Committee added a fourth meeting to its annual schedule in order to enable a greater focus on risk assessment and management; it also monitored reporting in accordance with the UK Corporate Governance Code 2014.

The Board supported a number of Ethics programmes, including regional Business & Ethics Forums in Sao Paulo, Washington, DC and Shanghai, and approved the Smiths Modern Slavery Act Statement and a positive assurance programme for compliance issues at key suppliers in high-risk countries.

With oversight by the Board, information and cyber-security risks continued to have a proactive focus. Compulsory training was deployed to all employees, alongside a rolling real-life simulation programme aimed to make employees aware of the external threats from attacks such as phishing.

Governance structure

The governance structure of the Group is illustrated below. The Board is responsible to stakeholders for overseeing these activities and supervising management in its implementation of the strategy within a framework of prudent and effective controls which enables risk to be assessed and managed. The Board is also responsible for setting the Company's culture of ethical behaviour and compliance, and for promoting policies and providing oversight. The main activities of the Board are listed on page 78. In line with the UK Corporate Governance Code certain Board responsibilities are delegated to Board Committees which play an important role in supporting the Board (their terms of reference are available on our website). In addition, the work of the Chief Executive's Committee in executing the Group's strategy is supported by a number of sub-committees.

Governance model

Board and Board Committees

Board

Reviews and approves strategy, budgets and plans and ensures governance, risk and control framework

Nomination Committee

Reviews and makes recommendations to the Board on structure, size and composition of Board and Board Committees and succession planning for directors and senior management

Remuneration Committee

Makes recommendations to Board on remuneration framework and remuneration of Chairman, executive directors and senior management

Audit Committee

Monitors integrity of financial statements, internal control systems and risk management and internal and external audit controls

Executive Management structure

Executive Committee

Develops and recommends strategy to Board, recommends budgets and plans to Board and executes strategy and drives performance to budget and plans

Investment Committee

Assesses high-value/ high-risk proposals, capital expenditure, asset disposal and special revenue expenditure projects that need Board or CEO approval

Disclosure Committee

Advises CEO and Board in accordance with Disclosure Policy. Makes recommendations concerning identification of inside information and the timing and method of disclosure

Acquisitions & Divestments Committee

Approves mergers, acquisitions, disposals and joint ventures within parameters delegated by Board

In addition to the above there are a number of functional committees which include the Environmental Health & Safety Steering Committee, the Company's innovation council, known as i^3, and the Ethics Code Compliance Council.

The Board

Board role and responsibilities

The Board holds formal meetings at least six times a year to make and review major decisions and monitor trading against the plans which it has approved, and holds additional meetings to consider the strategy of each of the divisions and the overall strategy of the Company. Further meetings are arranged as necessary to deal with urgent items. The Board exercises control by determining matters specifically reserved to it in a formal schedule which only the Board may change: these matters include the acquisition or divestment of significant companies or businesses, the issue of shares, significant contractual commitments, the review of the effectiveness of risk management processes and major capital expenditure.

The Board sets the Company's values and standards, including the Company's Code of Business Ethics which is referred to on pages 61 to 64. The role of the Board in the governance of the Group is illustrated in the diagram on page 77 and its main activities are outlined in the diagram below.

The executive directors and senior management team are responsible for the Company's financial performance, the day-to-day management of the Company's businesses and implementation of the strategy and direction approved by the Board.

Board activities

Culture, trust and values

- Ethics and compliance
- Health and safety
- Environmental management
- Security of people, assets and information

Strategy

- Group strategic plans and annual budget
- M&A strategy, pipeline
- Major acquisitions (and post-acquisition reviews)
- Financing

Performance

- Talent pipeline and succession
- CEO's report
- Divisional performance updates and operating reviews
- KPIs

Risk and controls

- Internal audit reports
- Risk management process
- Viability testing

Financial

- Financial performance versus budget and forecasts
- Trading statements
- Annual results
- Financial risk and treasury reports
- Tax risk and status reports

Governance and compliance

- Board effectiveness review
- Corporate governance updates
- Director conflicts of interest review
- Share register and investors
- Inside information and disclosure requirements
- Legal issues and litigation report

Board composition; balance and tenure

As at 27 September 2016, the Board comprises Sir George Buckley (Chairman), Andy Reynolds Smith (Chief Executive), Chris O'Shea (Chief Financial Officer) and six independent non-executive directors: Bruno Angelici, Tanya Fratto, Anne Quinn, Bill Seeger, Mark Seligman and Sir Kevin Tebbit (Senior Independent Director). On 18 September 2015 Chris O'Shea was appointed as Chief Financial Officer and succeeded Peter Turner (who resigned as Finance Director on 24 April 2015) and Rob White (who acted as interim CFO until Chris O'Shea's appointment). Andy Reynolds Smith was appointed as an executive director and as the Chief Executive on 25 September 2015 (his predecessor, Philip Bowman, having stepped down as Chief Executive and as a director of the Company on 24 September 2015). David Challen retired as a non-executive director at the conclusion of the Annual General Meeting ('AGM') in November 2015. On 16 May 2016 Mark Seligman was appointed as a non-executive director of the Company. Biographies of the current directors are set out on pages 72 to 74.

The Board and its committees have the appropriate balance of skills, experience, independence and knowledge of the Company to enable them to discharge their respective duties and responsibilities effectively. The wide-ranging experience and backgrounds of the non-executive directors ensure that they can debate and constructively challenge management in relation to both the development of strategy and the evaluation of performance against the goals set by the Board.

The Chairman meets the non-executive directors without the executive directors present after each Board meeting in order to understand their priorities and issues. He also meets with the Senior Independent Director and the Chairs of the Audit and Remuneration Committees. The Senior Independent Director meets the other non-executive directors without the Chairman present at least annually and is available to provide support to the Chairman and to serve as an intermediary for the other directors, if required.

Board balance and independence

There is a balance of executive and non-executive directors such that no individual or small group can dominate the Board's decision making. Throughout the financial year at least half the Board, excluding the Chairman, has comprised independent non-executive directors.

The FRC's UK Corporate Governance Code 2014 states that diversity is as much about differences of approach and experience as it is about gender. The Board does not endorse the setting of rigid quotas to achieve diversity but it does believe in the merits of a diverse mix of experience, interests and personalities to ensure the effective functioning of a Board in which the dialogue is both challenging and constructive. The diagrams overleaf illustrate the good balance of longer standing Board members and more recent appointments, and the diversity in gender and nationality.

The individual qualifications, strengths and experiences of the directors are included in their biographies on pages 72 to 74.

In deciding the chairmanship and membership of the Board committees, the need to refresh membership of the committees is taken into account. The table on page 79 indicates the service, to 31 July 2016, of each of the directors.

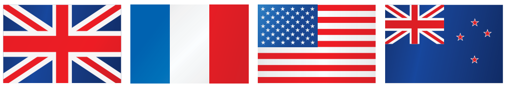
Each of the non-executive directors is considered to be independent and Sir George Buckley was considered to be independent at the time of his appointment as Chairman. In the light of the length of service of Sir Kevin Tebbit on the Board, the Board and each of its committees undertook a rigorous review of his performance, including his independence in order to evaluate his contribution to the Board and to the committees on which he sits. Sir Kevin continues to demonstrate attributes of an independent non-executive director, including contributing constructive challenge and debate at meetings, and there has been no evidence that his tenure on the Board has impacted his independence. As such the Board is satisfied that Sir Kevin continues to bring robust non-executive oversight. During the review, the Board also determined that Sir Kevin should remain in the role of Senior Independent Director (following his appointment to that role on the retirement of the previous incumbent, David Challen, on 17 November 2015).

Board balance, diversity and tenure

These charts illustrate the diversity and tenure of board members as at 31 July 2016.

Nationality

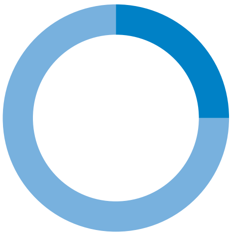
Four nationalities are represented on the Board (United Kingdom, France, United States and New Zealand), although the international experience of Board members is much wider than this.



United Kingdom France United States New Zealand

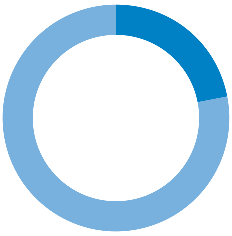
Executive balance

- Executive directors 2 (25%)
- Non-executive directors 6 (75%) (excluding the Chairman)



Gender balance

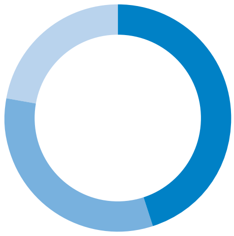
- Female 2 (22%)
- Male 7 (78%)



Board tenure

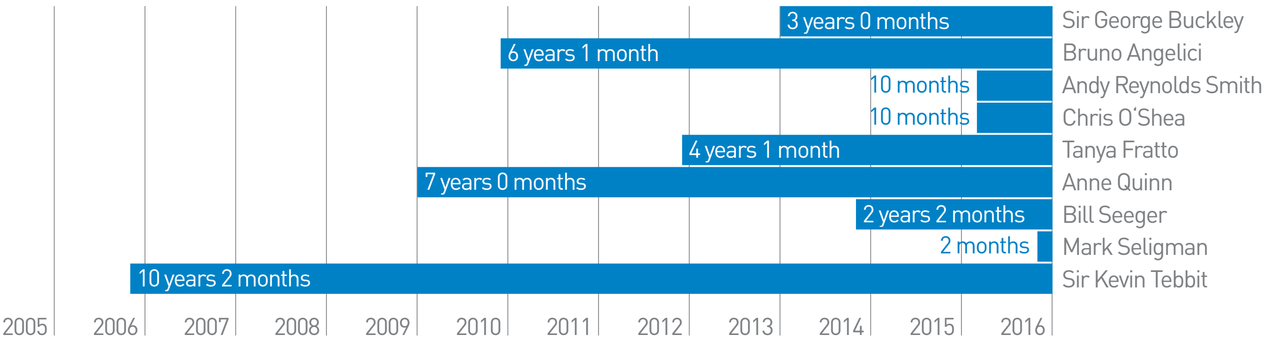
- From 0 to 2 years 45%
- From 3 to 6 years 33%
- From 7 to 10 years 22%

Further details on the tenure of each director are shown on pages 72 to 74.



Tenure of the Board

The Board and Nomination Committee regularly review the mix of skills and experience on the Board. The chart illustrates the good balance of longer standing Board members and more recent appointments, providing both continuity and fresh perspectives.



Chairman and Chief Executive

The Board has established clearly defined roles for the Chairman and the Chief Executive. The Chairman is responsible for leadership of the Board, ensuring its effectiveness and setting its agenda. Once agreed by the Board as a whole, it is the Chief Executive's responsibility to ensure delivery of the strategic and financial objectives approved by the Board. During the year, the Chairman and Chief Executive have had meetings or calls at least weekly.

Key roles and responsibilities

Chairman

The Chairman's responsibilities include:
- Leadership of the Board
- Setting the agenda and tone for the Board
- Promoting high standards of integrity and corporate governance
- Ensuring the effectiveness of the Board

Chief Executive

The Chief Executive's responsibilities include:
- Ensuring implementation of the strategic and financial objectives approved by the Board
- Providing leadership on all executive management matters affecting the Company
- Leadership of his Executive Committee
- Ensuring the Company's diverse stakeholder relationships (including with shareholders, employees and customers) are properly managed

Senior Independent Director

The Senior Independent Director's responsibilities include:
- Acting as a sounding board for the Chairman
- Acting as an intermediary for the directors where necessary
- Being available to shareholders if they have concerns which cannot be resolved through the Chairman or executive management
- Conducting an annual review of the Chairman's performance

Company Secretary

The Company Secretary's responsibilities include:
- Maintaining the Group's governance and listing rule compliance framework
- Ensuring that all Board and Board committee meetings are properly held and advising the Board on matters of governance and on legislative and regulatory developments
- Assisting the Chairman and the Chief Executive in ensuring that the directors are provided with all relevant information in a timely manner
- Organising new director induction and ongoing director training

Appointments to the Board

The Nomination Committee has a formal, rigorous and transparent procedure for the appointment of new directors, which are made on merit and against objective criteria, having due regard for the benefits of diversity, including gender. This procedure was followed in the selection and appointments of Chris O'Shea, as an executive director and Chief Financial Officer on 18 September 2015; Andy Reynolds Smith, as an executive director and Chief Executive on 25 September 2015; and Mark Seligman, as a non-executive director on 16 May 2016. Further information in relation to the recruitment of Messrs O'Shea, Reynolds Smith and Seligman is contained in the Nomination Committee report on pages 91 and 92.

The Board is satisfied that the directors are able to allocate sufficient time to their responsibilities relating to the Company. During the year, the Board considered the other engagements and proposed engagements of the directors as part of the director conflicts of interest procedure, as further described below.

Re-election

All directors stand for election by the shareholders at the first AGM following their appointment. The Board has resolved that all directors who are willing to continue in office will stand for re-election by the shareholders each year at the AGM. Non-executive directors are appointed for a specified term of three years, subject now to annual re-election at each AGM, and reappointment for a second three-year term is not automatic. Any term for a non-executive director beyond six years is subject to a particularly rigorous review. The Chairman has confirmed that, following the performance reviews undertaken in 2016, the performance of each of the directors standing for re-election at this year's AGM continues to be effective and that they each continue to demonstrate commitment to their respective roles and dedicate the time necessary to perform their duties.

Conflicts of interest

Under the Companies Act 2006 (the '2006 Act') a director must avoid a situation where he or she has, or could have, a direct or indirect interest that conflicts or possibly may conflict with the Company's interests. The 2006 Act allows directors of public companies to authorise conflicts and potential conflicts where appropriate and where the articles of association contain a provision to this effect. Article 65 of the Company's Articles of Association provides that the directors can authorise potential conflicts of interest.

The Board has put procedures in place for directors to report any potential or actual conflicts to the other members of the Board for their authorisation where appropriate. Each director is aware of the requirement to seek approval of the Board for any new conflict situations, as they may arise. The process of formally reviewing conflicts disclosed, and authorisations given (including such conditions as the Board may determine in each case), is repeated twice a year. Any conflicts or potential conflicts considered by the Board and any authorisations given are recorded in the Board minutes and in a register of director conflicts which is maintained by the Company Secretary.

The current directorships in listed companies and other significant commitments of the Chairman and the non-executive directors are shown on pages 72 to 74. During the year, Andy Reynolds Smith resigned as a non-executive director of Morgan Advanced Materials plc and Tanya Fratto was appointed as a non-executive director of Ashtead Group plc. It is confirmed that the Chairman and the non-executive directors have sufficient time to fulfil their commitments to the Company and that no executive director holds more than one non-executive directorship of another FTSE 100 company.

Board meetings and visits

The table below shows the number of Board meetings held during the financial year ended 31 July 2016 and, opposite each director's name, the number of meetings they were eligible to attend and the number actually attended.

	Board meetings	
	Attended*	Eligible to attend*
Sir George Buckley (Chairman)	11	11
Andy Reynolds Smith (appointed 25 September 2015)	8	8
Chris O'Shea (appointed 18 September 2015)	9	9
Bruno Angelici	10†	11
Tanya Fratto	10†	11
Anne Quinn	11	11
Bill Seeger	11	11
Mark Seligman (appointed 16 May 2016)	2	2
Sir Kevin Tebbit	10†	11
Philip Bowman (resigned 24 September 2015)	3	3
David Challen (retired 17 November 2015)	4	4

*Includes four occasions where matters were conducted by telephone conference calls and one matter approved by written resolution

†Bruno Angelici, Tanya Fratto and Sir Kevin Tebbit were each unable to attend a non-scheduled conference call meeting, called at short notice, due to prior commitments

Rob White also attended three meetings as Interim Chief Financial Officer prior to the appointment of Chris O'Shea as Chief Financial Officer

During the year, the divisional general managers, heads of Corporate departments, senior managers and other external advisers were invited to attend certain Board meetings, as and when required.

The Board regards attendance at meetings as only one measure of directors' contributions to the Company. In addition to formal Board meetings, the directors attend other meetings and make site visits during the year.

Board visit to Smiths Medical, Minneapolis, USA

As part of its 2016 schedule, the Board visited the head office and research and development laboratory of Smiths Medical in Minneapolis in July 2016. The visit included presentations on strategy, performance, operations, R&D and quality from senior management, a tour of the facility and the opportunity to meet employees in a less formal setting.

Induction, information and professional development

The Board is provided with detailed information up to a week in advance on matters to be considered at its meetings and non-executive directors have ready access to the executive directors and other senior corporate staff. Non-executive directors are also provided with information and updates between meetings. Regular site visits are arranged and non-executive directors are encouraged to visit sites independently. During site visits, briefings are arranged and the directors are free to discuss aspects of the business with employees at all levels.

Newly appointed directors undergo an induction programme to ensure that they have the necessary knowledge and understanding of the Company and its activities. They undertake briefing sessions on corporate governance, strategy, stakeholder issues, finance and risk management and HR, as well as meetings and site visits to business locations. Each director's individual experience and background is taken into account in developing a programme tailored to his or her own requirements. The suitability of external courses is kept under review by the Company Secretary who is charged with facilitating the induction of new directors and with assisting in the ongoing training and development of all directors. Tailored induction programmes were designed for Chris O'Shea, Andy Reynolds Smith and Mark Seligman in order to ease their transitions into their respective new roles and to expedite their integration into the Group.

Advice and insurance

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

The directors and officers of the Company and its subsidiaries have the benefit of a directors' and officers' liability insurance policy.

Performance

The Board and its committees undertake an annual evaluation of their own performance. This is conducted by external consultants at least once every three years. Last year the Board evaluation was conducted by an external consultant and the resulting actions included the introduction of a framework of periodic Board agenda items, focusing on certain key areas, such as succession planning and cyber-security risks.

In view of the changes in composition of the Board during the year, the evaluation for this financial year is being conducted with the assistance of an external consultant, Lintstock Limited (which also provides the Company with software and services for maintaining its insider list under the EU Market Abuse Regulation). The evaluation involved the completion by the directors of questionnaires relating to the performance of the Board and its committees collectively and to the personal contributions of the individual directors. The questionnaires were administered confidentially by Lintstock. The Board members were asked to mark the performance of the Board in areas such as strategy, risk management, succession planning and the overall efficiency and effectiveness of the Board. They were also asked to make specific comments and suggestions for improving the performance and efficiency of the Board. Lintstock's analysis of and report on the responses to the questionnaire will be discussed by the Board, which will review the findings and agree appropriate actions.

In addition, an evaluation of the Chairman was carried out by Sir Kevin Tebbit, as the Senior Independent Director, who sought the individual views of each of the directors. Sir Kevin then met with the Chairman to discuss feedback.

The Board continued with its practice of setting itself a series of written objectives for the financial year. Those for the year ended 31 July 2016 included the following:

- on-boarding of the new executive directors
- creating a vision for Smiths that equates to the drive and imagination shown by the Smiths of the past
- developing the growth strategy
- succession planning for CEO and senior leadership

Relations with shareholders and other capital providers

Dialogue with shareholders

The Chief Executive, the Chief Financial Officer and the Group Director, Corporate Affairs communicate with institutional investors through analysts' briefings and extensive investor roadshows in the UK, US and continental Europe, as well as timely Stock Exchange announcements, meetings with management and site visits, as shown in the table below. The Chairman also met with investors. The Senior Independent Director and the other non-executive directors are available to meet shareholders on request. Members of the Board, and in particular non-executive directors, are kept informed of investors' views, in the main through distribution of analysts' and brokers' briefings. At least twice a year a report is made to the Board on the number and types of meetings between the Company and institutional shareholders. The Board is confident that this process enables the non-executive directors to maintain a balanced understanding of the views and concerns of major shareholders.

During the year, the Chief Executive and Chief Financial Officer continued the programme of dialogues with shareholders in the UK, US and continental Europe as part of the 2016 investor relations programme, detailed below.

Dialogue with other capital providers

The Company values the contribution of its committed lending banks and bond holders to the achievement of its strategic aims. The Chief Financial Officer and the Director, Tax and Treasury meet with and communicate proactively with this investor base and the rating agencies, Standard & Poor's and Moody's, on a regular basis. There is also a formal, annual meeting with the rating agencies. They communicate with the debt markets generally via investor roadshows at the time of financing activity. Committed banks are invited to the biannual presentations of its trading results and the Capital Markets Days to enable them to keep informed of business strategy and meet both senior corporate and divisional management. Members of the Board are kept informed of the current credit views of debt investors, generally, and the rating agencies, specifically, by regular commentary and financial metric reporting to meetings.

Constructive use of the Company's Annual General Meeting

All directors normally attend the AGM and shareholders are invited to ask questions during the meeting and to meet directors before and after the formal proceedings have ended. The Board values the AGM as an opportunity to meet with those shareholders who are able to attend and to take their questions.

At the 2015 AGM all directors in post, including the Chairs of the Audit, Nomination and Remuneration Committees, were available to answer shareholders' questions. The notice of the AGM and related papers were sent to shareholders at least 20 working days before the meeting.

The 2016 AGM will be held on 15 November 2016 and is an opportunity for shareholders to vote on certain aspects of Group business in person. It is intended that there shall be a poll vote on each resolution at the 2016 AGM. The audited, final results of the poll votes will be released to the London Stock Exchange and published on the Company's website, www.smiths.com, as soon as is practicable after the conclusion of the AGM.

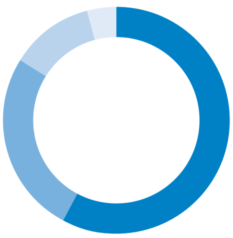
Investor relations activities timeline 2016

	Roadshows	Presentations
June 2016	Hong Kong equity	
May 2016	France and Germany equity	
April 2016	US equity	
March 2016	UK equity	Interim results
December 2015	Private client brokers	
November 2015	Private client brokers	AGM
October 2015	CEO and CFO introductory roadshow	
September 2015		Annual results

During financial year 2016, senior management and the investor relations team had contact with over 250 analysts and investors.

Contact with investors/analysts

- United Kingdom 58%
- US and Canada 26%
- Rest of Europe 12%
- Rest of World 4%



Accountability and audit

Financial reporting

The Board is required to present a fair, balanced and understandable assessment of the Company's position and prospects in the Annual Report and in interim and other public reports. The directors are required to explain in the Annual Report the basis on which the Company both generates and preserves value over the longer term and its strategy for delivering the Company's objectives. The Board is satisfied that it has met these obligations in this Annual Report. A summary of the directors' responsibilities for the financial statements is set out on page 124.

The assessment of the fairness, balance and understandability of the Annual Report is described on page 86.

The 'going concern' statement required by the Code is set out in the Group directors' report on page 116.

A report on the viability assessment made by the Board in accordance with requirements of the Code is included in the Strategic report on page 52.

Internal control

The Board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its particular objectives and ensuring that there are sound risk management and internal control systems in place to safeguard shareholders' investments and the Company's assets. Throughout the financial year the Board, through the Audit Committee, reviews the effectiveness of internal control and the management of risks. In addition to financial and business reports, the Board has reviewed medium- and longer-term strategic plans; management development programmes; reports on key operational issues; tax; treasury; risk management; insurance; legal matters; and Audit Committee reports, including internal and external auditors' reports. The Audit Committee carried out a formal review of the effectiveness of the internal control system, covering all material controls, including financial, operational and compliance controls, and risk management systems, during the year ended 31 July 2016.

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

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

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

The Group has an embedded process for the identification, evaluation and management of its principal business risks. The process is reviewed through the Audit Committee and monitored by the Group Internal Audit department. The Company has during the year identified the principal risks and the controls and procedures that are in place to manage these risks. The directors have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency and liquidity, and the controls and procedures put in place to manage and mitigate the risks and defend the Group (as described on pages 52 to 60).

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

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

Audit Committee and auditors

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

Remuneration

Information regarding the Remuneration Committee is set out on page 93 and the Directors' remuneration report is on pages 94 to 114.

Board Committees

The Company has established the Audit, Nomination and Remuneration Committees of the Board. Each such committee meets regularly in accordance with its respective terms of reference. Each committee's responsibilities, activities and membership are described in this Corporate governance statement. The full terms of reference of the following Board committees are available upon request and on the Company's website, www.smiths.com.

Audit Committee

Bill Seeger
Chairman of the Audit Committee

Introduction from the Chairman of the Audit Committee
I am pleased to report to our stakeholders that the audit committee remains focused, diligent and aligned to providing a strong control environment for Smiths Group. Working together, real progress has been made to bring together our risk assessment with our strategic agenda and priorities. This year, as outlined in the detailed report of the committee, our focus was to integrate the work we do with the operational and strategic blueprint for the business under our new CEO and CFO. We also took a thorough look at the Group's 'lines of defence' strategy for modelling the effectiveness of the enterprise risk management and control systems.

This year we introduced a fourth annual meeting to the Committee's schedule at which the risk reviews for all the Group's businesses were brought together into a single, focused session. This has been of particular benefit in considering the potential impacts of the differing industry and geographical risks presented by our diverse businesses, both individually and in combination. This has also been used in assessing the risk profile of the Group as a whole and the effect that has on the 'long-term viability' assessment of the Group, as described in this Annual Report.

Throughout the year we have benefited from productive and open relationships with our external auditor, Internal Audit and Group management. We have also welcomed the new executive team of Andy Reynolds Smith and Chris O'Shea who have provided the Committee with their strategic vision for the Group. The contributions of PwC, Internal Audit and senior management have all enhanced the effective operation of the Committee and its oversight of the Company's controls and risk management. In a business with the scale, diversity and geographical spread of Smiths Group, issues relating to internal financial and other risk controls, codes of conduct and ethical standards arise from time to time for review by the Committee. We are satisfied that the Group has systems in place to identify such issues promptly and that management has the appropriate processes and resources available to address them effectively.

The Committee has continued to monitor the changing rules and regulations applicable to the external auditor and its own role in the governance of the Group audit. Following its review of the independence and effectiveness of our external auditor, the Committee affirmed its recommendation last year that the most practical and business-driven approach to our external auditor appointment would be to conduct a competitive tendering and rotation in 2019. This timeframe would coincide with the normal audit partner rotation and comply with the auditor rotation transition rules. The Committee has recommended to the Board that PwC should be proposed for reappointment as auditor at this year's AGM.

We strive to achieve continuous improvement in our financial and risk controls and our high standards of corporate governance as Smiths Group evolves and grows. Sincere thanks to my audit committee colleagues as well as the executive team for the transparency with which they have supported the Committee.

Committee membership
The members of the Committee during the 2016 financial year were:

	Appointed/last re-appointed
Bill Seeger (Chairman)	12 May 2014
Bruno Angelici	1 July 2016
Tanya Fratto	1 July 2015
Anne Quinn	1 August 2015
Mark Seligman	16 May 2016
Sir Kevin Tebbit	17 July 2016
David Challen (retired 17 November 2015)	

All members served on the Committee throughout the year, except for Mark Seligman, who joined the Committee on his appointment as a non-executive director of the Company, and David Challen, who retired from the Board and the Committee on 17 November 2015.

All members of the Committee are independent non-executive directors and, in the view of the Board, have recent and relevant financial and accounting experience gained from their respective business activities in international businesses. In particular, Bill Seeger was the Group Finance Director of GKN plc, which post he had held for over six years before his retirement in 2014. Tanya Fratto, Anne Quinn and Bruno Angelici have extensive senior management experience in international oil & gas, engineering and medical devices industries, respectively; Mark Seligman has a long history in corporate finance; and Sir Kevin Tebbit has substantial knowledge of international governmental relationships. As part of his induction programme as a director of the Company (which included a detailed overview of the Company's business models, strategy and risk profile), Mark Seligman was provided with relevant material on the constitution and working of the Committee and copies of recent papers and presentations. Further details of the qualifications and experience of the members of the Committee are contained in the biographies of the directors on pages 72 to 74.

There have been no changes to the membership of the Committee since the financial year-end.

Meetings and attendance

The Committee met four times during the 2016 financial year, with three meetings timed to align with the financial reporting and audit cycles of the Company, namely: the approval of the Annual Report in September; the approval of the half-year report in March; and the presentation of the pre-year-end 'early warnings' report from the external auditor, PricewaterhouseCoopers LLP ('PwC'), in July. A meeting was also held in May 2016 at which the Committee reviewed the risk management reports of the Group's five divisions.

The attendance record of the members of the Committee was:

	Attendance
Bill Seeger (Chairman)	4/4
Bruno Angelici	4/4
Tanya Fratto	4/4
Anne Quinn	4/4
Mark Seligman (appointed 16 May 2016)	2/2
Sir Kevin Tebbit	4/4
David Challen (retired 17 November 2015)	1/1

In order to maintain effective communications between all relevant parties, the following were frequent attendees at the meetings:

- the Chairman of the Board
- the Chief Executive
- the Group Chief Financial Officer
- the Group Financial Controller
- the Company Secretary
- the Director of Internal Audit
- the Group Director of Tax and Treasury and
- the Group audit partners of the external auditor, PwC.

In addition, annual presentations on risk management were given to the Committee by the divisional general manager of each of the Group's five divisions and the head of Business Information Services ('BIS', the Group's IT function). The Senior Vice-President & General Counsel – Ethics & Compliance reported to the Committee on the implementation of the Business Ethics Programme; the work of the Company's Code Compliance Council; and the investigations into allegations of non-compliance with the Ethics Code, including issues raised through the Group's whistleblowing procedures.

At the conclusion of the meetings, the representatives of the external auditor and the Director of Internal Audit were each given the opportunity to discuss matters without executive management being present. The Director of Internal Audit, the Senior Vice-President & General Counsel – Ethics & Compliance and the external auditor have direct access to the Chairman and the members of the Committee should they wish to raise any concerns outside formal Committee meetings.

The members of the Committee also had the opportunity to meet separately at each meeting to discuss any relevant matters in the absence of all the invitees.

The members of the Committee receive briefing notes from the Company and from PwC on all relevant developments in company law; governance standards; and international and domestic financial accounting practices and regulations.

All the members of the Committee at the time attended the AGM in November 2015.

Outside of the formal meetings schedule, the Chairman of the Audit Committee has met separately with the senior management of the Company, the representatives of PwC and the Director of Internal Audit to discuss the Company's financial reporting and governance.

Role and responsibilities

The primary role of the Audit Committee is to ensure the integrity of the financial reporting and audit processes and the maintenance of sound internal control and risk management systems. This includes responsibility for monitoring and reviewing:

- the integrity of the Group's financial statements; the significant reporting issues and judgements contained therein; and the reports of the external and internal auditors;
- the bases for the Board's statement on the adoption of the 'going concern' basis of accounting; its assessment of the long-term viability of the Company; and its description of the information contained in the Annual Report as enabling a 'fair, balanced and understandable' assessment of the Group;
- the consistency of the Annual Report and the annual financial statements;
- financial announcements released by the Company and any reports or returns made by the Group to financial regulators;
- the appropriateness of the Group's relationship with the external auditor, including auditor independence and objectivity; auditor compliance with relevant ethical and professional standards and guidance; audit fees; and provision of non-audit services;
- the terms of engagement of the external auditor;
- the scope of the annual external audit plan and the quality and experience of the external audit team assigned to its execution;
- the reports of the external auditor, including any major issues or reservations and significant accounting and audit judgements highlighted therein;
- the effectiveness of the external audit process, making recommendations to the Board on the appointment or re-appointment or the removal of the external auditor;
- the remit and effectiveness of the internal audit function and the appropriateness of the resources available thereto;
- the effectiveness of the Group's policies on internal control and risk management systems in the evaluation and management of significant business risk;
- statements on the assessment and management of risks and on internal controls;
- the Group's implementation of the Company's Code of Business Ethics and Business Ethics Programme, including the Group's arrangements for its employees to raise any issues of concern (whistleblowing) and the process for the investigation and resolution of any such issues; and
- the Group's procedures for detecting fraud and systems and controls for preventing bribery.

The Chairman of the Audit Committee reports formally to the full Board on the activities of the Committee after each Committee meeting.

Written terms of reference that define the Committee's authority and responsibility are available on our website at www.smiths.com.

Financial and narrative reporting

During the financial year, the Committee has:

- considered information presented by management on key matters of accounting judgements and policies, adopted in respect of the Company's 2015 Annual Report and 2016 half-year report, and relevant changes to accounting standards and agreed their appropriateness;
- discussed with PwC the firm's audit reports and noted the key accounting matters and significant judgements highlighted by PwC in respect of each set of financial statements;
- reviewed documentation prepared to support the statement on internal control in the 2015 Annual Report and was satisfied that the Company was operating an effective system of internal controls to manage risk;
- reviewed documentation prepared to support the going concern judgement in the 2015 Annual Report and concluded that the accounts had been properly prepared on a going concern basis;
- assessed the processes and activities undertaken by the Group in order to ensure that the 2015 Annual Report, taken as a whole, would be 'fair, balanced and understandable' and concluded that the quality and range of information provided in the Annual Report was sufficient to enable shareholders to assess properly the Group's position, performance, business model and strategy;
- examined key points of disclosure and presentation to ensure the adequacy, clarity and completeness of the 2015 Annual Report and 2016 half-year report and the preliminary announcement of the annual results;
- reported to the Board its views on significant financial reporting issues and judgements applied to the 2015 Annual Report, the 2016 half-year report and the associated information releases (including matters communicated to the Committee by the external auditor);
- evaluated the bases for and the content of the Strategic report, the operational review and the corporate governance statement contained in the 2015 Annual Report;
- satisfied itself that the 2015 Annual Report was consistent within itself and that the 'front half' and the 'back half' of the publication were thoughtfully cohesive;
- reviewed documentation prepared to support the going concern judgement in the 2016 half-year report, including the review of the principal risks for the second half of the financial year, and concluded that the accounts had been properly prepared on a going concern basis;
- in addition to the press releases for the preliminary annual results for 2015 and the 2016 half-year results, reviewed the Company's press releases and announcements containing price-sensitive material and reports made to financial regulators during the year; and
- analysed the methodology and processes presented by the management for the assessment in the 2016 Annual Report of the prospects of the Company over the longer-term ('long-term viability assessment') and agreed that a three-year period is appropriate for this purpose, taking into consideration the Company's various business cycles and forecasting models. The Committee considered scenario-based stress testing models, prepared by the Company, to assess the impact on Group cash and finances if one or more of the Group's principal risks occurred. The Committee concurred with the conclusion that the Group's balance sheet and ability to raise cash were more than sufficient to withstand such occurrences comfortably for at least the three-year period under review.

Subsequent to the end of the financial year, the Committee has also reviewed and reported to the Board on the reports and information supplied by management and by PwC on the judgements and policies adopted for the 2016 Annual Report and the content of that document. The Committee considered that the quality and range of the material included within the 2016 Annual Report was sufficient to provide shareholders with the necessary information for them to assess properly the Group's position, performance, business model and strategy and that the report was presented in such a way as could be considered 'fair, balanced and understandable'. The Committee reviewed the statement on risk management and internal controls; the going concern statement; the assessment of the long-term viability of the Group; and the content of the announcement of the financial results for 2016.

In assessing the fairness, balance and understandability of the 2016 Annual Report, the Committee considered:

- the accuracy and integrity of the messages conveyed in the report; the appropriateness of the level of detail in the narrative reporting; the correlation between the judgements and issues and the disclosures and estimation uncertainties;
- the consistency between the narrative reporting in the front half and the financial reporting in the back half of the report; the explanations of the differences between statutory and headline reported results; and
- the overall design and layout of the information and data; the clarity of the messages and the reporting; the holistic nature of the report.

Following its review of the 2016 Annual Report, the Committee was of the opinion that it is representative of the year and presents a fair, balanced and understandable overview, providing the necessary information for shareholders to assess the Group's position, performance, business model and strategy.

Corporate governance

During the year, the Audit Committee has reviewed the Company's compliance with its governance obligations and its plans to comply with forthcoming changes thereto. In particular, the Committee has:

- monitored the changes introduced by the Company to ensure full compliance in the 2015 Annual Report with the requirements of the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013; the 2014 edition of the UK Corporate Governance Code (the 'Code'); and The Large & Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 – all of which also govern the 2016 Annual Report;
- considered the amendments to and developments in the International Financial Reporting Standards that affected the 2016 financial year; and the adoption of FRS 101 in place of the UK GAAP accounting framework;

- taken account of the Competition & Markets Authority's Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 (the 'CMA Order');
- considered the changes to the Code contained in the 2016 edition (which will apply to the Company's 2017 financial year) and the Company's plans to comply with them; and
- reviewed the changes in the Financial Reporting Council's 2016 Guidance to Audit Committees and Ethical Standards for Auditors, reflecting the implementation in the UK of the EU Audit Directive and Regulation.

In relation to the Code, the Committee noted and approved the Company's plan to introduce the 'long-term viability' assessment and the detailed description of the strategies for managing and mitigating principal risks and threats in the 2016 financial year. Certain other changes introduced by the Code had already been adopted by the Company and reflected in the 2015 Annual Report.

The CMA Order applied to the Company's 2016 financial year. Under the transitional provisions of the order, the competitive audit tendering regulations require the Company to put the external auditor role out to tender by 2023. The Committee decided not to recommend a competitive tender this year in order to enable the Company's recently appointed Chief Executive and Chief Financial Officer the opportunity to acquaint themselves fully with the Group. The Committee took into account that the current audit engagement partner had had a full year in the role, in addition to his experience in shadowing the 2014 audit. The Committee's proposal for a competitive audit tender and auditor rotation is described in the External Auditor effectiveness and reappointment section below.

The Company has complied with the provisions of the CMA Order during the financial year ended 31 July 2016.

External audit

In relation to the activities of the external auditor, during the financial year, the Committee:

- considered PwC's audit report on the 2015 Annual report; its review of the 2016 half-year results; and its 'Early Warning' report on the 2016 audit;
- monitored PwC's execution of the audit plans for 2015 and 2016, taking into consideration the change of audit partner after rotation for the 2015 audit;
- discussed all major issues identified by PwC during the course of the audits, including the key accounting and audit judgements taken by management and management's responses to the audit findings;
- agreed materiality and de minimis levels with PwC;
- considered the draft letter of representation from the Company to PwC in connection with the audit of the 2015 financial statements;
- reviewed the non-audit fees paid to PwC and found them to have been incurred in accordance with the policy on the provision of non-audit services;
- conducted the annual review of the independence and objectivity of PwC and was satisfied that PwC's behaviour had been professional in both respects;
- determined that PwC remained effective in its role as external auditor; and
- recommended to the Board that PwC be proposed for re-appointment as external auditor at the 2015 AGM for a further year.

Subsequent to the financial year-end, the Committee has considered and approved the same items in respect of the 2016 audit and the preparation of the 2016 Annual Report. The Committee has recommended that PwC be proposed for reappointment as external auditor at the 2016 AGM.

The Committee considered that each of the Company's directors had taken all necessary steps to ensure that he or she was aware of all pertinent audit information and that such information had been properly communicated to PwC in a timely manner.

External audit plan

PwC presented its Group Audit Plan for the financial year ending 31 July 2016. The Committee discussed with PwC:

- its risk matrix and the factors affecting the various audit risk assessments; the proposed audit scope, taking into consideration statutory audit requirements, financially significant components and significant risk components and central programme testing;
- materiality levels;
- the impairment risk relating to John Crane Production Solutions;
- the adverse effect on working capital of aged inventory and receivables; and
- the impact of changes in governance regulations and professional standards.

The Committee noted the focus on the audit risks associated with revenue recognition; certain litigation risks; impairment of goodwill; and management override of controls. PwC's proposal to decrease the overall materiality level to £17m (approximately 3.5% of headline operating profit) (2015: £18m) and an unchanged de-minimis reporting threshold of £500,000 was accepted as prudent and appropriate. The Committee considered the resources proposed by PwC, including the qualities, seniorities and experience of the audit team members, to be consistent with the scope of the audit. It was noted that the Audit Plan had been discussed and co-ordinated with Internal Audit. Through a combination of full-scope audits, specified audit procedures and local GAAP statutory audits, business units producing 89% of the Group's forecast headline operating profit for 2016 would be audited by PwC under the 2016 Audit Plan.

The fee structure and terms of the audit engagement letter, which had been agreed with Smiths management, and PwC's assessment of its independence were considered appropriate for the work proposed and were approved.

Non-audit services

In order to safeguard auditor independence, the Committee has monitored compliance with the Group policy on the engagement of external audit firms for non-audit work. Non-audit services were divided into three categories in relation to the incumbent external auditor:

- Pre-approved (but subject to the Group Chief Financial Officer's approval for projects likely to exceed £10,000) – where the threat to auditor objectivity and independence is considered low, such as regulatory compliance work; tax advisory work; and low-level acquisition work;
- Permitted (but subject to the approval of the Audit Committee for projects over £10,000 and competitive tendering for projects over £100,000) – such as larger acquisitions; corporate reorganisation; tax structuring; and IT risk and security; and
- Not permitted – such as book keeping; financial system design; actuarial services; management functions; and internal audit.

The Committee recognises that non-audit services falling in the Pre-approved category can be purchased more cost effectively from and completed more efficiently by the incumbent auditor due to the audit firm's existing knowledge of the Group and its systems. The Committee is satisfied that the non-audit work performed by PwC during the financial year had been properly assessed and authorised in accordance with the Group policy.

On 17 June 2016, the EU Audit Directive and Regulation came into force and the FRC published a revised Ethical Standard for Auditors in respect of audits of financial years beginning on or after that date. As a consequence of the new regulation and standard, the Committee has reviewed and approved changes to the Group policy on the engagement of audit firms for non-audit work in order to take account of the prohibited list of non-audit services that an incumbent auditor is not permitted to provide in the EU under the regulation and the cap on the level of permitted non-audit services that can be billed.

External auditor independence
The Committee is responsible for the development, implementation and monitoring of the Company's policies on external audit which are designed to maintain the objectivity and independence of the external auditor. These policies also regulate the appointment by the Group of former employees of PwC and set out the approach to be taken when using the external auditor for non-audit work.

The external auditor is not permitted to provide services which could result in:

- the external auditor auditing its own firm's work;
- the external auditor making management decisions for the Group;
- a mutuality of interests being created; or
- the external auditor being put in the role of advocate for the Group.

The Committee's review of the independence of the external auditor included:

- examining written confirmation from PwC that they remained independent and objective within the context of applicable professional standards;
- considering the tenure of the audit engagement partner, who is required to rotate every five years in line with ethical standards (and has so rotated following the conclusion of the 2015 audit);
- monitoring the ratio between the fees for audit work and non-audit services (12% in 2015); and
- checking that management confirmed compliance with the Group's policies on the employment of former employees of PwC and the use of PwC for non-audit work.

As a result of this review, the Committee concluded that PwC remained appropriately independent in the role of external auditor.

Details of the fees paid to PwC in 2016 can be found in note 2 on page 149. Non-audit fees incurred during 2016 amounted to £0.3m which related principally to tax advisory services and audit-related assurance services in connection with the interim report. Non-audit fees as a percentage of audit fees totalled 6%. All such activities remained within the policy approved by the Board.

External auditor effectiveness and reappointment
The Committee's review of the performance of PwC and the effectiveness of the external audit process included consideration of the views and opinions of the executive directors and senior management on PwC's effectiveness in a number of areas including independence and objectivity, audit strategy and planning, conduct and communication, audit findings and feedback, and expertise and resourcing. The results were positive and confirmed that both PwC and its audit process were appropriate and effective and that the relationships between the audit teams and the Company's businesses were strengthening. The Committee recognised the challenges in ensuring consistency in the audit process across the whole Group and the need to continue to improve communication at local and divisional levels.

The Committee received and considered the Independence Letters, sent by PwC in September 2015 in respect of its 2015 audit and September 2016 in respect of the 2016 audit, and concurred with PwC's opinion that it had complied with all relevant regulatory and professional requirements and that the firm's objectivity had not been compromised.

The Committee noted the findings in the Financial Reporting Council's May 2016 Audit Quality Inspection report on PwC. It evaluated a summary of PwC's internal quality control procedures and noted that the lead engagement partner, Andy Kemp, is accountable directly to the Committee for the execution of the audit. The Committee satisfied itself that the quality of the work exhibited by the firm and its commitment to improvements were of a high standard.

PwC has been the Company's external auditor since its formation in 1998, although a predecessor organisation of PwC held office as sole auditor in 1997. In determining whether to recommend PwC for reappointment as auditor in 2016, the Committee took into consideration the following factors:

- the length of PwC's appointment and the guidance on the new audit firm rotation regulations and proposals;
- the results of the effectiveness review detailed above;
- the qualities and experience of the audit partner (following the rotation of the previous audit partner whose five-year term expired at the completion of the 2014 audit), and
- the changes in the executive management team during 2016, in particular the appointments of a new Chief Financial Officer who took up his post on 18 September 2015 and a new Chief Executive who was appointed on 25 September 2015.

Taking these elements into account and acknowledging that it would take some time to stage a competitive audit tender from initial planning to final selection, the Committee concluded (a) that it would not be practical to put the auditor appointment for 2016 out to competitive tender at this stage and (b) that it was appropriate to recommend to the Board that the reappointment of PwC as the Company's auditor for a further year be proposed to shareholders at the 2016 AGM.

Recognising the various requirements in the Code, the CMA Order and the Statutory Auditors and Third Country Auditors Regulations 2016 (implementing the EU's June 2014 Audit Directive and Regulation), the Committee reviewed its decision last year and concluded that it would remain in the best interests of the Company to plan for a competitive audit tender for the rotation of the external auditor in 2019. This would coincide with the end of the current PwC audit partner's five-year term and enable the Company to plan its implementation of the final audit firm rotation regulations. Notwithstanding its continued recommendation for tendering in 2019, the Committee will keep the performance of the incumbent audit firm under annual review.

The Board has considered and adopted the Committee's recommendations to propose the reappointment of PwC as auditor in 2016 and to plan for a competitive audit tender and auditor rotation in 2019.

There are no contractual obligations restricting the Group's choice of external auditor.

Internal control and risk management
In fulfilling its responsibilities, the Committee:

- reported to the Board on its evaluation of the Group's risk assurance framework and embedded risk management processes, based on consideration of the reports by PwC on the Group's control environment and ERP systems and on fraud risk; the audits undertaken by Internal Audit; and the risk management reports presented by and discussed with each of the divisions and BIS; and
- reviewed management's plans to mitigate and remedy the failings and weaknesses in the Company's internal financial and risk controls that were identified by PwC and Internal Audit and has monitored their effectiveness. The Committee did not view any of the issues that had been identified and addressed as significant.

The Committee has reviewed the effectiveness of the identification and management of risk at the Group level. Each division also presents an analysis of its own business strategic risks to the Committee on an annual basis.

Further information on the Group's systems of internal control and risk management is given on page 83.

Internal audit
During the financial year the Committee:

- received progress reports on the execution of the 2016 Internal Audit Plan (which comprised 50 site audits, nine programme management and process reviews and four IT reviews);
- discussed the recommendations made by the internal auditors;
- noted the progress being made by management in reducing the numbers of aged outstanding recommendations;
- reviewed the effectiveness of Internal Audit as a part of the Company's risk management process, including its use of KPMG as an external contractor to provide additional resources and capabilities in certain areas;
- considered the remit of Internal Audit, its budget and resources and the nature and extent of the outsourcing to KPMG; and
- approved the 2017 Internal Audit Plan (49 site visits, eight programme and process reviews and seven IT reviews), including the proposed audit scope, approach, coverage and allocation of resources. The Committee noted the number, quality and skills of staff employed within Internal Audit.

Treasury and tax
During the financial year, the Committee reviewed the report of the Treasury department of the Group on financial risk and treasury management, noting the Group's borrowing position and debt capacity. The extension of the Group's revolving credit facility to 2021, at no cost, and the repayment of the Sterling bond, on 30 June 2016, were noted.

The Committee also received status reports on tax risk from the Group's Tax department, noting the assessments of compliance, tax audit risk, tax provisions and international tax rates. The Company's assessment of its appetite for tax risk was also reviewed.

Ethics
During the financial year, the Committee reviewed the annual report of the Group's Business Ethics Council on the Group-wide Ethics programme. The report included details of the investigations into allegations of non-compliance with the Ethics Code and whistleblowing events, including bribery and corruption, and the Council's work programme to support the initiatives of the businesses and monitor compliance with both the Group's Code of Business Ethics and the various applicable national regulations. The Committee received a report on the first phase of an external review of compliance with Group and divisional ethical policies and procedures. The Committee considered that the Company's processes and arrangements for staff to report concerns about any improprieties were both appropriate and effective. The Committee also considered that the Company's investigation of such reports and consequential actions (where required) were timely and effective.

Constitution and membership
During the year the Committee considered and approved changes to its terms of reference to reflect the changes contained in the Code and CMA Order, which applied to the Company's 2016 financial year.

During the year, the committee memberships of Bruno Angelici and Sir Kevin Tebbit came up for review. After a rigorous review of their individual performances as members of and their history on the Committee (with each individual not participating in the discussion concerning their own performance), the Committee determined to recommend to the Nomination Committee to propose to the Board that Bruno Angelici should be reappointed as a member of the Committee for a further three-year term. In the case of Sir Kevin Tebbit, who has over ten years' service as a non-executive director of the Company but was still considered to be independent, the Committee recommended that Sir Kevin should be reappointed as a member of the Committee for a further year. It was noted that Bill Seeger's first term as a member and as Chairman of the Committee would expire on 12 May 2017. In recognition that the Company's evaluation of Committee memberships usually takes place in July annually, it was agreed that it would be prudent to recommend extending Bill Seeger's term to the date on which Committee memberships are considered by the Board in 2017. It was further noted that membership of the Committee would automatically lapse if a member ceased to be a director of the Company.

Performance evaluation
An annual evaluation of the performance of the Committee is conducted as part of the annual evaluation of the performance of the Board. Details of the latest evaluation are given in the Corporate governance statement on page 81.

Significant judgements and issues

An important responsibility of the Audit Committee is to review and agree the most significant management judgements and issues. To satisfy this responsibility, the Committee requests a written formal update from the Chief Financial Officer and Director of Tax and Treasury three times a year and requires regular reports from the external auditors at each Committee meeting. The Committee carefully considers the content of these reports and the most significant issues and areas of judgement raised. The key areas of judgement in the year were as follows:

Revenue recognition

The Committee reviewed the key judgements on revenue recognition. Attention was given to large, multi-faceted and nonstandard contracts in Smiths Detection and to contracts where 'percentage of completion' accounting was used in Smiths Detection and Smiths Interconnect. The Committee reviewed the accounting treatment of three large programmes in Smiths Detection where management has assessed the portion of revenue to be attributed and the anticipated profit margin and concluded that the revenue judgements made were appropriate. The Committee also reviewed 'bill and hold' transactions in Smiths Detection and were satisfied with the adopted accounting treatment.

Impairment

The Committee considered the Group's intangible assets and the assumptions used to justify the carrying values of these assets, including 'fair value less costs to sell'. Particular attention was given to John Crane Production Solutions, Smiths Interconnect Power and Smiths Interconnect Microwave Telecoms and Components. The Committee also reviewed the carrying value of capitalised development assets for Smiths Medical and Smiths Detection. The Committee agreed that the projected future cash-flows from these businesses either supported the carrying value of the assets or agreed with the value of the impairments recorded. In the case of Smiths Interconnect Telecoms, the Committee reviewed the 'fair value less costs to sell' model and agreed the value of the impairment. The Committee reviewed the disclosures contained in the financial statements and agreed that they appropriately reflect the sensitivity of the judgements made. Details of impairment testing and sensitivities are included in note 11 of the financial statements.

Working capital

The Committee considered the key judgements within working capital and, in particular, the level of inventory provisions and overdue receivables in emerging markets. The Committee determined that the judgements made were appropriate to justify the working capital provision levels at 31 July 2016.

Provisions for liabilities and charges

The Committee continued to monitor carefully the expert assessments of the financial exposure of the Group to the John Crane, Inc. asbestos litigation and to the Titeflex Corp. CSST claims. In particular, the Committee considered the treatment of potential liabilities and the changes to the assumptions made in calculating the provisions, including the reassessment of the time period for the Titeflex Corp. CSST provision and the continued appropriateness of the ten-year time period for John Crane, Inc. asbestos litigation. In both these cases, it was determined that the assumptions fairly reflect the position at 31 July 2016. Further details of the assumptions used are included in note 22 of the financial statements.

Taxation

The Committee assessed the appropriateness of the Group's assumptions and judgements in relation to the estimates of the assets and liabilities to be recognised in income and deferred tax as well as the treatment of losses in the UK. Particular focus was given to deferred tax assets relating to the John Crane, Inc. asbestos provision, the Titeflex Corp. CSST provision, the write-off of tax assets in John Crane Production Solutions and the recognition of tax assets in Detection USA and France. In reviewing projected profit streams the Committee was satisfied that, where appropriate, the relevant entities will generate sufficient future taxable profits to utilise those assets recognised. Further details on movements in tax balances are set out in note 6 of the financial statements.

Post-retirement benefits

The Committee reviewed and agreed the methods, assumptions and benchmarks used by the actuaries to calculate the position of the UK and US schemes at 31 July 2016. The Committee agreed the treatment and the corresponding disclosures on these matters. More detail on post-retirement benefits is contained in note 8 of the financial statements.

FRC Corporate Reporting Review

During the year the FRC's Conduct Committee raised a number of points on the Company's 2015 Annual Report. The Committee has monitored the dialogue between the Company and the FRC and discussed with the external auditors the matters raised and the responses to date provided by the Company. The Committee noted that the Company has responded to all of the points raised by the FRC, with additional disclosures being included in the 2016 Annual Report in respect of provisions, revenue, tax, inventory provisioning and post-retirement benefits. The Committee is aware of the continuing correspondence over the remaining open item, namely the period over which a range of possible outcomes can be estimated sufficiently reliably for the provision by John Crane, Inc. in respect of its continuing asbestos litigation and related disclosures, including estimation uncertainty.

Discharge of responsibilities

During the year, the Committee has monitored its discharge of responsibilities. In addition to the actions reported in the sections above, the Committee has:

- observed the induction and on-boarding of the new Chief Executive and new Chief Financial Officer;
- welcomed Mark Seligman as a new member; and
- considered practical ways to improve the quality and clarity of the Company's reporting.

The Committee has enjoyed a positive relationship with the Board throughout the year and has no contentious or unresolved issues to report.

Advice

The Committee has independent access to the services of Internal Audit and to the external auditor and may obtain outside professional advice, at the expense of the Company, as it sees fit, in the performance of its duties.

Nomination Committee

Sir George Buckley
Chairman of the Nomination Committee

Introduction from the Chairman of the Nomination Committee
During the 2016 financial year the Nomination Committee worked to find the Company's two new executive directors and we were delighted to appoint Andy Reynolds Smith and Chris O'Shea. In addition, after the retirement from the Board of David Challen I took the opportunity for the Nomination Committee to review the composition and balance of skills of the Board and to plan for succession in view of the Company's strategic aims. The review informed our search for a new non-executive director and I was delighted that Mark Seligman was appointed to the Board in May 2016. This report sets out details of these director appointments and their induction into the Company.

Meeting attendance

The attendance record of the members of the Committee was:

	Attendance
Sir George Buckley (Chairman)	3/3
Bruno Angelici	3/3
Tanya Fratto	2*/3
Anne Quinn	2*/3
Bill Seeger	3/3
Mark Seligman (appointed 16 May 2016)	1/1
Sir Kevin Tebbit	3/3
David Challen (retired 17 November 2015)	1/1

*Tanya Fratto and Anne Quinn were unable to attend a meeting called at short notice, due to prior commitments

Committee membership

The Committee meets periodically, as and when required. During the financial year the members of the Committee were: Sir George Buckley (Chairman), Bruno Angelici, David Challen (until November 2015), Tanya Fratto, Anne Quinn, Bill Seeger, Sir Kevin Tebbit and Mark Seligman (from his appointment in May 2016).

The Chief Executive is normally invited to attend the Nomination Committee. The HR Director, the Director of Talent and the Director of Reward have also attended these meetings in order to advise the Committee. External advisers may also be invited by the Committee to aid its deliberations.

Role and responsibilities

The Committee leads the process for identifying and makes recommendations to the Board regarding candidates for appointment as directors of the Company and as Company Secretary (and their removal or retirement), giving full consideration to succession planning and the leadership needs of the Group. It also makes recommendations to the Board on the composition of the Nomination Committee and the composition and chairmanship of the Audit and Remuneration Committees. It reviews the structure, size and composition of the Board, including the balance of skills, knowledge and experience and the independence of the non-executive directors, and makes recommendations to the Board with regard to any changes. The Committee also has responsibility for the annual review of the talent pipeline for senior management roles.

The Chairman and the rest of the Board continue to support Lord Davies' aspiration for female board representation, but this presents a particular challenge for a small board. The Nomination Committee and the Board remain committed to ensuring diversity is included within the remit for appointments at all levels in the Company, but do not think it is appropriate to set specific Group-wide targets or objectives at this stage. Further information on diversity is provided in the Strategic Report.

The Committee has access to such information and advice both from within the Group and externally, at the cost of the Company, as it deems necessary. This may include the appointment of external search consultants, where appropriate.

The Committee reviews annually its terms of reference and effectiveness and recommends to the Board any changes required as a result of such review. The annual review of the Committee's terms of reference was conducted in July 2016 and certain changes were approved with effect from 1 August 2016.

Committee activities during 2016

Chris O'Shea and Andy Reynolds Smith were appointed as executive directors of the Company, on 18 and 25 September 2015, respectively, successfully concluding the searches, instigated by the Committee during the previous financial year and run in conjunction with Egon Zehnder (in Andy Reynolds Smith's case) and Inzito (in Chris O'Shea's case) and interview process.

David Challen retired from the Board on 17 November 2015, after 11 years' service. The Nomination Committee carried out a review of the skills and experience of the Board and embarked upon a search for a new non-executive director. The Committee appointed Lygon, an independent search firm with no other connections with the Company, to carry out the search. The Nomination Committee worked with Lygon to produce a detailed specification for the role including the capabilities and attributes which were either required or desirable. These included the benefits to the Board of diversity in its widest sense (gender, nationality, age, experience, and background) and the particular skills which would benefit the Company as a multi-industry company operating in a global market. From the candidates produced by the search, Mark Seligman was selected. He agreed to the appointment as a non-executive director and duly joined the Board and its Audit, Nomination and Remuneration Committees on 16 May 2016.

David Challen's retirement also created a vacancy in the position of Senior Independent Director. After due consideration, the Committee recommended to the Board that the role should be offered to Sir Kevin Tebbit. The Board concurred and Sir Kevin accepted the position with effect from 17 November 2015.

The Company Secretary is responsible for ensuring that new directors have a thorough and appropriate induction programmes when joining the Company's board of directors. Each of the directors who were appointed during the financial year received a comprehensive induction data reading room and hard copy data pack, containing detailed information on the Company and its business and on the proceedings of the Board and its committees. Each of these inductions was based on the individual directors' requirements and included meetings with Board members, divisional presidents, functional heads and other relevant employees and external advisers. Mark Seligman has visited some Smiths sites in order to gain a deeper understanding of the Group's business operations and these visits are ongoing. Andy Reynolds Smith and Chris O'Shea both received comprehensive on-boarding when they joined and they met with the Company's largest investors and spent several weeks visiting Smiths sites around the world, meeting employees at all levels of the organisation, as well as senior personnel and board members. Andy Reynolds Smith met with key customers and suppliers and also conducted town hall meetings at sites that he visited where he also listened to feedback from various parts of the organisation. Upon his appointment as Senior Independent Director Sir Kevin Tebbit received some additional focused training from the Company's external legal counsel.

During the year, the Committee conducted its annual review of senior management and succession plans with a view to ensuring a strong and robust plan exists in all parts of the Group.

In July 2016 the Committee considered the appointment and re-appointment of certain members of the Audit, Remuneration and Nomination Committees and the appointment of the Chairs of those committees and recommended the appointment and reappointment of members and Chairs as set out in more detail in the relevant sections of this Statement.

Also in July 2016 the Committee carefully assessed the independence of each of the non-executive directors and concluded that all of them were independent notwithstanding in the case of Sir Kevin Tebbit, the Senior Independent Director, that he had served on the Board for more than nine years. The Committee and the Board each considered the matter carefully and decided that Sir Kevin continues to demonstrate the qualities of independence and judgement in carrying out his role, supporting the executive directors and senior management in an objective manner. In addition, based on the recommendation of the Nomination Committee, the Board resolved that Sir Kevin should continue as Senior Independent Director.

Remuneration Committee

Anne Quinn, CBE
Chair of the Remuneration Committee

Introduction from the Chair of the Remuneration Committee
The responsibilities of the Remuneration Committee are to make recommendations to the Board on the Company's remuneration framework, giving full consideration to the matters set out in the Code. The Committee also agrees with the Board the policy for the remuneration of the Chairman, the Chief Executive, the Chief Financial Officer and senior management. The Committee sets the remuneration for these individuals within the agreed policy having regard to a number of factors, including their performance, remuneration across the Company and market positioning. The Committee takes note of the policies and trends in remuneration across the whole Group in relation to all levels of employees. Further information about the activities and focus of the Remuneration Committee during the year is set out in the Directors' remuneration report.

Meeting attendance
The attendance record of the members of the Committee was:

	Attendance
Anne Quinn (Chair)	5/5
Sir George Buckley	5/5
Bruno Angelici	5/5
Tanya Fratto	5/5
Bill Seeger	5/5
Mark Seligman (appointed 16 May 2016)	2/2
Sir Kevin Tebbit	5/5
David Challen (retired 17 November 2015)	1/1

Committee membership
The members of the Committee during the financial year were: Anne Quinn (Chair of the Committee), Bruno Angelici, Sir George Buckley, David Challen (until his retirement in November 2015), Tanya Fratto, Bill Seeger, Sir Kevin Tebbit and Mark Seligman (from his appointment in May 2016).

The Chief Executive is normally invited to attend Remuneration Committee meetings (except when his own remuneration is under discussion). The HR Director, the Director of Reward and Kepler Associates, the external remuneration adviser, have also attended meetings in order to advise the Committee, as and when required.

The Committee's activities are further described in the following Directors' remuneration report. The Committee reviews its terms of reference annually and recommends to the Board any changes required as a result of such review. The latest annual review of the Committee's terms of reference was conducted in July 2016.

Directors' remuneration report

Remuneration Committee

Annual Statement
On behalf of the Board, I am pleased to present the report of the Remuneration Committee for the year to 31 July 2016. As last year, this report is split into three parts:

- this Annual Statement;
- a policy report, which presents the Group's forward-looking Directors' remuneration policy; and
- an Annual Report on Remuneration, which details how our remuneration policy was implemented during the year to 31 July 2016 and how we intend to apply our policy in the year to 31 July 2017.

Following the approval of the revised Policy at last year's AGM, there are no proposed changes to the Policy this year.

As highlighted by the Chairman and Chief Executive in their annual statements on pages 8 to 13 of this Annual Report, the markets remained challenging in the year to 31 July 2016. However, four of the five divisions reported growth in reported revenue and headline operating profit. Even though the operating profit declined in John Crane driven by the tough global energy market conditions, the division reported resilient margin performance. At a Group level, cash conversion remained very strong at 102% and ROCE, at 15%, remains well ahead of the Group's weighted average cost of capital. Against this backdrop, annual bonus payouts are between target and maximum but the TSR and EPS elements of 2013 LTIP awards lapsed in full following the end of the performance period on 31 July 2016. The Group's cash conversion, however, warranted the full payout of that element of the annual bonus and a partial vesting of the LTIP. The matching award under the CIP vested based on our sustained ROCE performance. The Committee recognises the importance of close alignment of remuneration with Group performance and we consider the incentive outcomes for this year to demonstrate this link (further details of which are disclosed in this year's Annual Report on Remuneration).

On behalf of the Board, I would like to thank shareholders for their continued support.

Anne Quinn, CBE
Chair of the Remuneration Committee

Summary of 2016

Strong cash conversion performance

Appointment of a new Chief Executive and Finance Director

Approved simplification of long-term incentives for 2016

The Directors' remuneration report is presented to shareholders by the Board. The report complies with Regulation 11 and Schedule 8 of the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008 (the 'Regulations'). As required by the Regulations, the Annual Report on Remuneration will be put to an advisory shareholder vote at the Annual General Meeting on 15 November 2016. The Committee also continues to comply with the provisions of the UK Corporate Governance Code relating to directors' remuneration, except as disclosed in the Corporate governance statement on page 75.

Remuneration policy report

This section of the report sets out our remuneration policy for directors, which shareholders approved at the 2015 AGM and is effective for a period of three years from the date of the 2015 AGM. The only amendments to this policy report from the version approved by shareholders in 2015 are to update the data used in the pay-for-performance scenarios, to add page references, and to remove any references on the implementation of this policy in 2016.

Remuneration policy for the executive directors

The remuneration policy for the executive directors at Smiths is summarised in the table below:

Base salary

Element and link to strategy	Operation	Opportunity	Performance measures
To attract, motivate and retain executive directors with the required skills and expertise to deliver the Group's objectives.	Salaries are reviewed (but not necessarily increased) annually and benchmarked against comparable roles at companies of similar market capitalisation, revenues and complexity. The review also takes into account individual performance and experience, the relative performance of the Company and the remuneration policy operated across the Company as a whole. Salary increases are typically effective 1 August.	Base salaries are adjusted according to the outcome of the annual review and will be disclosed in the Annual Report on Remuneration. Salary increases for the executive directors will normally be in line with those awarded to Smiths wider employee population. Where increases are awarded in excess of this, for example if there is a material change in the responsibility, size or complexity of the role, or a significant change in the market competitiveness of salary, the Committee will provide the rationale in the relevant year's Annual Report on Remuneration.	Not applicable.

Pension

Element and link to strategy	Operation	Opportunity	Performance measures
Enables executive directors to save for their retirement in a cost-efficient manner.	Executives may choose either to participate in the Company's defined contribution pension plan or to receive a pension allowance in lieu thereof (and thus arrange their own pension provision). Pension allowances are reviewed periodically to ensure market competitiveness. Salary is the only element of remuneration that is taken into account when determining pension contributions or allowances.	Pension contributions (or cash allowances in lieu thereof) are set at a level that the Committee considers appropriate having regard to prevailing market practice at other FTSE 100 companies of similar market capitalisation, revenues and complexity. Pension arrangements for current executive directors are set out in the Annual Report on Remuneration. The maximum level of pension contribution (or allowance in lieu thereof) is 30% of annual base salary.	Not applicable.

Annual bonus

Element and link to strategy	Operation	Opportunity	Performance measures
Incentivises short-term cash management and profit growth, as well as annually defined non-financial goals.	Annual bonus payments are determined based upon performance against measures and targets set by the Committee at the start of each financial year. After the end of the financial year, to the extent that the performance criteria have been met, up to 67% of the earned annual bonus is paid in cash. The balance is deferred into shares and released after a further period of three years, subject to continued employment only. The Committee may use its discretion to adjust payout of the annual bonus to executive directors, within the range of the minimum to maximum opportunity. Such discretion will only be used where the Committee believes that performance against the prescribed targets does not accurately reflect the Company's underlying performance. In addition, cash and deferred share bonuses awarded for performance in 2015/16 onwards will be subject to malus and/or clawback for a period of three years from the end of the relevant performance year in case of misconduct or material misstatement in the published results of the Group.	The maximum annual bonus opportunity for executive directors is up to 180% of salary. The annual bonus opportunities for the year under review and the coming year are disclosed in the Annual Report on Remuneration. Under the financial element of the annual bonus, threshold performance must be exceeded before any annual bonus becomes payable. The % payout then increases according to the level of achievement against targets.	Based on a combination of financial and non-financial performance measures linked to short-term objectives. Financial performance will account for no less than 70% of the bonus opportunity and may include, but is not limited to, profit and cash measures.

Long-Term Incentive Plan (LTIP)

Element and link to strategy	Operation	Opportunity	Performance measures
Incentivises long-term value creation for shareholders, sustainable profit growth and effective management of the balance sheet.	Awards of conditional shares are granted annually and vest after a performance period of at least three years, subject to the achievement of performance targets set by the Committee at the start of each cycle. For awards made in 2016 onwards, vested shares may also be subject to a post vesting holding period. Details of any such holding period will be disclosed in the Annual Report on Remuneration for the year in which the relevant award is made. To the extent that the performance targets are not met over the performance period, awards will lapse. No retesting of awards under any performance condition is permitted. Dividends accrue and are paid in cash at the end of the vesting period, on shares that vest. The Committee may use its discretion to adjust payout of the LTIP to executive directors, within the limits of the Plan rules. Such discretion will only be used where the Committee believes that performance against the prescribed targets does not accurately reflect the Company's underlying performance. Awards are also subject to clawback for a period of five years from the date of grant in case of misconduct or material misstatement in the published results of the Group.	The maximum LTIP award opportunity for executive directors is up to 400% of salary. LTIP award sizes for the year under review and the coming year are disclosed in the Annual Report on Remuneration. At threshold performance against each measure, up to 25% of the award subject to that measure vests, increasing on a straight-line basis to 100% for achieving stretch targets.	Based on measures of performance that are aligned with the Group's strategy. To ensure continued alignment with the Company's strategic priorities, the Committee may, at its discretion, vary the measures and their weightings from time to time (but will consult shareholders before making significant changes to the performance measures).

Benefits

Element and link to strategy	Operation	Opportunity	Performance measures
To provide market-competitive benefits to executive directors.	Benefits comprise car allowance, life assurance and private healthcare insurance, and other such benefits as the Committee may from time to time determine are appropriate. These include, but are not limited to, relocation allowances, as well as any other future benefits made available either to all employees globally or all employees in the region in which the executive director is employed.	Benefits vary by role and individual circumstances. Benefits in respect of the year under review are disclosed in the Annual Report on Remuneration. It is not anticipated that the costs of benefits provided will increase significantly in the financial years over which this policy will apply, although the Committee retains discretion to approve a higher cost in exceptional circumstances (eg to facilitate recruitment, relocation, expatriation, etc) or in circumstances where factors outside the Group's control have changed materially (eg market increases in insurance costs).	Not applicable.

Sharesave

Element and link to strategy	Operation	Performance measures
Encourages ownership of shares in the Company and alignment with shareholder interests.	All UK employees (including executive directors) may save up to a maximum monthly savings limit (as determined by UK legislation, or other such lower limit as the Committee may determine at its discretion) for three or five years. At the end of the savings period, participants may use their savings to exercise options to acquire shares, which may be granted at a discount of up to 20% to the market price on grant. The Company intends to look into introducing all-employee share schemes to some non-UK countries on a basis consistent with local laws and market practice.	Not applicable.

Shareholding guidelines

Element and link to strategy	Operation	Performance measures
Encourages ownership of shares in the company and alignment with shareholder interests.	Executive directors must build a minimum shareholding of two times base salary within five years of appointment to the Board. 50% of any net vested share awards (after sales to meet tax liabilities) must be retained until the minimum shareholding requirements are met.	Not applicable.

Existing grants or entitlements
It is the Company's intention to honour all pre-existing commitments at the date of this report and to honour all future obligations entered into, consistent with the approved remuneration Policy in force at that time. In the case of internal promotion to the Board, the Committee intends to honour any pre-existing commitments made prior to becoming a member of the Board, including where these differ from the approved remuneration Policy.

Performance measure selection and approach to target setting
Annual bonus measures are selected to reflect the Company's short-term financial and non-financial priorities. At its discretion, the Committee may vary these measures at the start of each financial year to maintain close alignment between executive incentives and the annual business plan.

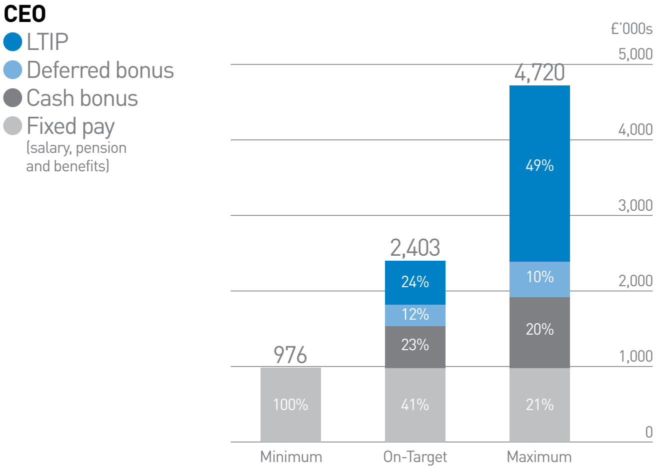
The measures used in the Long-Term Incentive Plan are selected to reflect Smiths prevailing strategy and to reinforce the key drivers of value creation highlighted elsewhere in this Annual Report: operating margin, cash conversion and ROCE.

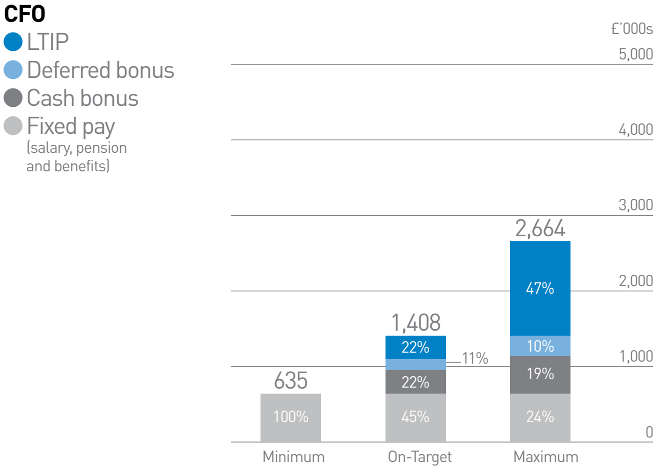
Annual bonus and LTIP targets are reviewed annually, and take into account the Company's strategic plan, analyst forecasts for Smiths and its sector comparators and external expectations for Smiths key markets. The Remuneration Committee sets targets that it considers to be challenging but attainable and aligned to the Company's business objectives over the short term, as reflected in the annual business plan, and longer term, consistent with the strategic plan. On top of aligning strategy with incentives, targets are designed to ensure that participants are aligned with the interests of shareholders.

Difference in policy between executive director and other employees
The reward policy for other senior employees is broadly consistent with that for executive directors, and the Company does not currently operate any incentive plans in which only executive directors participate. The Remuneration Committee reviews each year the all-employee pay and incentive trends and takes these into account in setting executive director pay levels. The principles of remuneration packages being market related, performance sensitive and driven by business needs are applied at all levels and geographies in the Group.

Pay scenarios

The graphs below provide estimates of the potential future reward opportunity for executive directors, and the potential mix between the different elements of remuneration under three different performance scenarios; 'Minimum', 'On-Target' and 'Maximum'.





Potential opportunities illustrated above are based on the Policy, which will apply in the 2017 financial year, applied to the annualised base salary in force from 1 August 2016 for Andy Reynolds Smith and Chris O'Shea. For the annual bonus, the amounts illustrated are those potentially receivable in respect of performance for 2017. It should be noted that any awards granted under the LTIP in a year do not normally vest until at least the third anniversary of the date of grant. This illustration is intended to provide further information to shareholders on the relationship between executive pay and performance. Please note, however, that actual pay delivered will further be influenced by factors such as share price appreciation or depreciation and the value of dividends paid. The following assumptions have been made in compiling the above charts:

CEO			
Base salary	Annual base salary		
Pension	Company pension allowance		
Other benefits	Taxable value of annual benefits provided		
Cash bonus	'Minimum' 0% of salary (Minimum)	'On-Target' 72% of salary (Target)	'Maximum' 120% of salary (Maximum)
Deferred bonus	'Minimum' 0% of salary	'On-Target' 36% of salary (Target)	'Maximum' 60% of salary (Maximum)
LTIP	'Minimum' 0% of salary (Minimum)	'On-Target' 75% of salary (Threshold)	'Maximum' 300% of salary (Maximum)

CFO			
Base salary	Annual base salary		
Pension	Company pension allowance		
Other benefits	Taxable value of annual benefits provided		
Cash bonus	'Minimum' 0% of salary (Minimum)	'On-Target' 60% of salary (Target)	'Maximum' 100% of salary (Maximum)
Deferred bonus	'Minimum' 0% of salary	'On-Target' 30% of salary (Target)	'Maximum' 50% of salary (Maximum)
LTIP	'Minimum' 0% of salary (Minimum)	'On-Target' 62.5% of salary (Threshold)	'Maximum' 250% of salary (Maximum)

Chairman and non-executive directors

The policy for the remuneration of the Chairman and non-executive directors at Smiths is summarised in the table below:

Annual fee

Element and link to strategy	Operation	Opportunity	Performance measures
To attract, motivate and retain non-executive directors with the required skills and expertise.	Fees may be paid in cash or a combination of cash and shares and are reviewed annually (but not necessarily increased) to ensure they compare appropriately to fees payable at companies of similar size and complexity to Smiths. Additional fees are paid to the chairs of the Remuneration, Nomination and Audit Committees and to the Senior Independent Director to reflect the additional time commitment of these roles. The additional fee paid to the Chairman of the Board is determined by the Committee, absent the Chairman, while the fees for all non-executive directors are agreed by the Chairman and executive directors.	Fees are adjusted according to the outcome of the annual reviews. The basic fee for non-executive directors is subject to the maximum aggregate annual fee of £750,000, as approved by shareholders in 2006 in the Company's Articles of Association. Fee levels for the year under review and for the current year are disclosed in the Annual Report on Remuneration.	Not applicable.

Other

The Chairman and non-executive directors are not eligible for benefits. The Chairman and the non-executive directors are not eligible for bonuses or participation in share schemes or any pension provision. They are paid an attendance allowance for each overseas meeting attended in addition to the annual fee and are reimbursed for actual expenses incurred (transportation, hotels etc.).

Approach to recruitment remuneration

External appointments

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

External appointments

Pay element	***Policy on recruitment***
Salary	Salary on recruitment is determined based on the same principles as the annual salary review, as outlined in the policy table.
Pension	As described in the policy table.
Benefits	As described in the policy table.
Annual Bonus	As described in the policy table and typically pro-rated for the proportion of year served. Maximum annual award opportunity: 180% of salary with mandatory deferral of 33% into shares.
LTIP	May be considered for an award under the LTIP on similar terms to other executives. Maximum annual award opportunity: 400% of salary.
Other	The Remuneration Committee may make an award in recognition of incentive arrangements forfeited on leaving a previous employer. Any such award will take account of relevant factors including the fair value of awards forfeited, any performance conditions attached, the likelihood of those conditions being met and the proportion of the vesting period remaining. For the purposes of making such awards, but for no other reason, the Committee may avail itself of Listing Rule 9.4.2R. The Remuneration Committee may also make payments to cover reasonable expenses in recruitment and relocation, and any other miscellaneous expenses including but not limited to housing, tax and immigration support.

Internal promotions
In cases of appointing a new executive director by way of internal promotion, the policy will be consistent with that for external appointees, as detailed above. Any commitments made prior to an individual's promotion will continue to be honoured even if they would not otherwise be consistent with the policy prevailing when the commitment is fulfilled, although the Company may, where appropriate, seek to revise an individual's existing service contract on promotion to ensure it aligns with other executive directors and prevailing market best practice.

Disclosure on the remuneration structure of any new executive director (external or internal), including details of any exceptional payments, will be disclosed in the RNS notification made at the time of appointment and in the Annual Report on Remuneration for the year in which the recruitment occurred.

Non-executive directors
In recruiting a new non-executive director, the Committee will use the policy as set out in the table on page 100.

Service contracts
The Company's policy is that executive directors are normally employed on terms which include a one-year rolling period of notice and provision for the payment of a predetermined sum in the event of termination of employment in certain circumstances (but excluding circumstances where the Company is entitled to dismiss without compensation). In addition to payment of basic salary, pension allowance and benefits in respect of the unexpired portion of the one-year notice period, the predetermined sum would include annual bonus and share awards only in respect of the period they have served, payable following the end of the relevant performance period and subject to the normal performance conditions. Existing service contracts are available for viewing at the Company's Registered Office.

Andy Reynolds Smith
Andy Reynolds Smith is employed under a service contract with the Company dated 6 July 2015 and effective from 25 September 2015. It may be terminated by 12 months' notice given by the Company or six months' notice given by Andy Reynolds Smith. The Company may elect to terminate the contract by making a payment in lieu of notice equal to Andy Reynolds Smith's base salary and benefits (including pension allowance) in respect of any unserved period of notice. The service contract contains specific provisions enabling a reduction in any phased payments in lieu of notice, in the event that Andy Reynolds Smith finds alternative employment during the notice period.

Chris O'Shea
Chris O'Shea is employed under a service contract with the Company dated 30 April 2015 and effective from 18 September 2015. It may be terminated by 12 months' notice given by the Company or six months' notice given by Chris O'Shea. The Company may elect to terminate the contract by making a payment in lieu of notice equal to Chris O'Shea's base salary and benefits (including pension allowance) in respect of any unserved period of notice. The service contract contains specific provisions enabling a reduction in any phased payments in lieu of notice, in the event that Chris O'Shea finds alternative employment during the notice period.

Philip Bowman
Philip Bowman was employed under a service contract with the Company dated 15 November 2007 and effective from 10 December 2007. It could be terminated with six months' notice given by Philip Bowman. Philip Bowman gave more than his contractual six months' notice when he signalled his intention to retire in December 2014. He was employed by the Company until 31 December 2015.

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

Non-executive director	Date of appointment	Expiry of current term	Date of election/last re-election
Bruno Angelici	1 July 2010	2016	17 November 2015
Sir George Buckley	1 August 2013	2016	17 November 2015
David Challen (retired 17 November 2015)	21 September 2004	N/A	N/A
Tanya Fratto	1 July 2012	2016	17 November 2015
Anne Quinn	1 August 2009	2016	17 November 2015
Bill Seeger	12 May 2014	2016	17 November 2015
Mark Seligman	16 May 2016	2017	N/A
Sir Kevin Tebbit	14 June 2006	2016	17 November 2015

Leaving and change-of-control provisions

For those individuals regarded as 'bad leavers' (eg voluntary resignation or dismissals for cause), annual bonus awards are forfeited, and outstanding matching awards under the CIP and outstanding awards under the LTIP automatically lapse.

A 'good leaver' will typically remain eligible for a pro-rated annual bonus award to be paid after the end of the financial year and LTIP awards will typically vest at the normal vesting date to the extent that the associated performance conditions are met, but will normally be pro-rated on the basis of actual service within the performance period. In cases of death or disability, individuals are automatically deemed to be good leavers under the plan rules of the LTIP. All other good leavers will be defined at the discretion of the Committee on a case-by-case basis.

In the event of a change of control, LTIP awards will vest to the extent that each of the performance conditions is met based on the Committee's assessment of performance over the performance period to the date of change of control. For internal performance measures, the Committee may exercise its judgment in determining the outcome based on its assessment of whether or not the performance conditions would have been met to a greater or lesser extent at the end of the full performance period. Awards will also normally be pro-rated to reflect the time that has elapsed between the grant of the award and the date of change of control.

The Committee retains discretion to vary these provisions on a case-by-case basis.

In connection with the termination of an executive director's contract, the Company may make a payment on account of accrued but untaken leave and may pay outplacement and legal fees for support provided to the individual.

External appointments

Subject to the overriding requirements of the Company, the Committee allows executive directors to accept external appointments where it considers that such appointments will contribute to the director's breadth of knowledge and experience. Directors are permitted to retain fees associated with such appointments.

Consideration of employment conditions

The Committee always takes into account pay and employment conditions elsewhere in the Company. We do not consult directly with employees regarding executive director pay. Each year the Committee is provided with information on pay trends and ratios of the wider employee population across the Group.

Consideration of shareholder views

The Committee has actively consulted with major shareholders whenever there have been changes to the remuneration policy in a manner that is receptive to and respectful of shareholder views.

Annual Report on Remuneration

This section of the remuneration report details how our Policy was implemented in the year ended 31 July 2016.

Committee members and meeting attendance in 2016

The members of the Committee are Anne Quinn (Chair of the Committee), Sir George Buckley, Sir Kevin Tebbit, Bruno Angelici, Tanya Fratto, Bill Seeger and Mark Seligman (from his appointment on 16 May 2016). David Challen was a member of the Committee until his retirement on 17 November 2015. Their attendance at meetings held during the year is set out in the Corporate governance statement on page 81.

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

Advisers to the Committee

During the year, the Committee received material assistance and advice from the Chief Executive, the HR Director, the Group Director of Reward, Kepler a brand of Mercer (the Committee's appointed independent remuneration adviser) and Freshfields Bruckhaus Deringer LLP. The Company Secretary has been secretary to the Committee since May 2016.

The Company paid a total annual fee of £58,306 to Kepler in relation to remuneration advice to the Remuneration Committee during the year. Fees were determined on the basis of time and expenses. During 2016, Kepler provided the Remuneration Committee with benchmarking analysis of executive and non-executive directors' pay, information on market trends, drafting support for this and last year's Directors' remuneration report, and other relevant assistance on determining directors' remuneration. Kepler was reappointed by the Remuneration Committee via competitive tender in 2013. Kepler is a founding member of the Remuneration Consultants Group and a signatory to its Code of Conduct. Kepler's parent company, Mercer provides unrelated services to the Group in the areas of all-employee reward and retirement benefits. However, the Committee is satisfied that the advice provided by Kepler is objective and independent. Freshfields Bruckhaus Deringer LLP was appointed by the Company to advise the Group on various legal matters during the year.

Main activities during the year

During the year under review, the Committee's main activities included:

- aligning remuneration arrangements to the new business strategy;
- consideration of market trends and pay levels for the executive directors and the Chairman;
- review of all senior executive salary and bonus payments;
- target setting for both the Annual Incentive Plan and Long-Term Incentive Plan;
- performance review of the executive directors against the targets for the financial year; and
- other activities including a review of the effectiveness of senior executive incentive arrangements.

Summary of shareholder binding vote on Directors' Remuneration Policy (2015)

The resulting voting outcome for last year's Directors' Remuneration Policy was as follows:

Votes for	% of votes cast for	Votes against	% of votes cast against	Total votes cast	Votes withheld (abstentions)
278,345,426	96.4%	10,397,058	3.6%	288,742,484	22,481,558

Summary of shareholder advisory vote on Directors' Remuneration Report (2015)

The resulting voting outcome for last year's Directors' Remuneration Report was as follows:

Votes for	% of votes cast for	Votes against	% of votes cast against	Total votes cast	Votes withheld (abstentions)
264,500,742	91.6%	24,254,693	8.4%	288,755,435	22,468,607

Directors' single figure of annual remuneration (auditable)

Executive directors

	Salary / fees		Benefits[7]		Annual bonus[8]		Long-term incentives[9]		Payments in lieu of pension contribution		Other[10]		Total	
	2016 £000	2015 £000	2016 £000	2015 £000	2016 £000	2015 £000	2016 £000	2015 £000	2016 £000	2015 £000	2016 £000	2015 £000	2016 £000	2015 £000
Andy Reynolds Smith	650	–	1	–	1,038	–		–	163	–	1,112	–	2,964	–
Chris O'Shea	430	–	1	–	572	–		–	108	–	751	–	1,862	–
Philip Bowman	127	860	3	32	201	1,239	960	1,703	53	361		–	1,344	4,195

Chairman and non-executive directors

	Salary / fees		Benefits[7]		Annual bonus		Long-term incentives		Payments in lieu of pension contribution		Other		Total	
	2016 £000	2015 £000	2016 £000	2015 £000	2016 £000	2015 £000	2016 £000	2015 £000	2016 £000	2015 £000	2016 £000	2015 £000	2016 £000	2015 £000
Sir George Buckley[1]	413	410	105	134									518	544
David Challen[2]	28	91											28	91
Sir Kevin Tebbit[3]	82	74											82	74
Anne Quinn[4]	88	91											88	91
Bruno Angelici	68	74	7	4									75	78
Tanya Fratto	80	77	40	54									120	131
Bill Seeger[5]	100	89	56	64									156	153
Mark Seligman[6]	14												14	

[1] Sir George Buckley's fee comprised his non-executive director's fee; an additional fee for being Chairman and his additional fee for the Chairmanship of the Nomination Committee.

[2] David Challen waived his right to the fee payable to the Senior Independent Director but he did receive the fee paid for his Chairmanship of the Audit Committee, in addition to his non-executive director's fee. His fees for 2016 reflect the fact that he retired on 17 November 2015.

[3] Sir Kevin Tebbitt's fees comprised his non-executive director's fee and his additional fee payable to the Senior Independent Director from November 2015.

[4] Anne Quinn's fees comprised her non-executive director's fee and her additional fee for Chairing the Remuneration Committee.

[5] Bill Seeger's fees comprised his non-executive director's fee and his additional fee for Chairing the Audit Committee.

[6] Mark Seligman's fees for 2016 are for a part year following his appointment on 16 May 2016.

[7] Benefits for executive directors include car allowance, life assurance and private healthcare insurance. For the Chairman and non-executive directors, this value relates to reimbursed travel-related expenses, which is grossed-up for the UK income tax and National Insurance contributions paid by the company on their behalf.

[8] Andy Reynolds Smith and Chris O'Shea each deferred 33% of their 2016 bonus earned into Smiths shares. The total bonus paid during the year, including deferral, is captured under 'annual bonus' above.

[9] Figure for 2016 has been valued using the three-month average share price to 31 July 2016 (£11.36) and includes the projected payouts from the 2013 CIP and 2013 LTIP awards. Figures for 2015 has been trued up (compared to last year's figure) to reflect the vest-date share price on 30 September 2015 of £10.05.

[10] Other includes the face values of restricted share awards made to Andy Reynolds Smith and Chris O'Shea to reflect outstanding awards forfeited on their joining Smiths Group and a cash payment made to Andy Reynolds Smith to reflect the pro-rated 2015 annual bonus foregone in respect of his former employment. These values also include amounts received from the Company's Sharesave Scheme in 2016. Further details of the buyout arrangements are set out on page 108 of this report.

Incentive outcomes for 2016 (auditable)

2016 annual bonus outcome for Andy Reynolds Smith, Chris O'Shea and Philip Bowman

The table below summarises the structure of the 2016 annual bonus, our performance and the resulting annual bonus payout for each of the executive directors.

					Earned bonus		
Director	Measure	Weighting	Maximum opportunity (% of salary)	Performance level	(% of max. bonus)	(% salary)	£000
Andy Reynolds Smith	EPS	50%	90%	Just below target	81.9%	73.7%	480
	Cash conversion	20%	36%	At maximum	100.0%	36.0%	234
	Personal objectives	30%	54%	See below	92.0%	49.7%	324
Total		**100%**	**180%**		**88.6%**	**159.4%**	**1,038**
Chris O'Shea	EPS	50%	75%	Just below target	81.9%	61.4%	265
	Cash conversion	20%	30%	At maximum	100.0%	30.0%	129
	Personal objectives	30%	45%	See below	92.0%	41.4%	178
Total		**100%**	**150%**		**88.6%**	**132.8%**	**572**
Philip Bowman	EPS	50%	90%	Just below target	81.9%	73.7%	93
	Cash conversion	20%	36%	At maximum	100.0%	36.0%	46
	Personal objectives	30%	54%	See below	90.0%	48.6%	62
Total		**100%**	**180%**		**88.0%**	**158.3%**	**201**

Personal objectives

Challenging personal objectives are derived from the Company's annual and strategic plans. For 2016, these targets included establishing the Smiths Excellence System to drive continuous improvement and consistent execution, leadership talent development and succession planning with an emphasis on building key functional capability, implementing a new organisation structure to bring higher rates of growth in Asia, bringing back Divisional earnings growth and measurable improvements in the commercial and programme management of the Group.

Incentive outcomes for 2015 (auditable)

As disclosed last year, the Committee will disclose annual bonus targets at such time as these are considered to be no longer commercially sensitive. In line with this commitment, the table below summarises the financial targets and the Company's actual performance against these for the 2015 annual bonus.

		Performance targets and actual performance			
Measure		Threshold	Target	Maximum	Actual
EPS		82.5p	84.7p	87.0p	84.6p
Cash conversion[1]	Q1	–	55%	–	>55%
	Q2	–	85%	–	>85%
	Q3	–	85%	–	>85%
	Q4	–	85%	–	>85%
	FY	–	85%	–	94.7%

[1] Maximum payout requires the meeting or exceeding of all quarterly targets and the full year target.

2013 CIP outcome

Included in the 2016 'Long-term incentives' column of the executive director annual remuneration table above is the outcome of CIP awards granted in 2013 to Philip Bowman. Matching awards granted under the CIP in 2013 were subject to the following performance condition:

			Vesting schedule		Actual performance	
Measure	Weighting	Performance period	ROCE performance	% match	ROCE	% match
Group ROCE	100%	1 August 2013 to 31 July 2016	< WACC+1% p.a.	0%	>WACC+3% p.a.	200%
			WACC+1% p.a.	100%		
			WACC+1% to 3% p.a.	100%		
			≥ WACC+3% p.a.	200%		

2013 CIP	Interests held	Vesting %	Interests vesting	Date of vesting	Market price[1]	Value £000
Philip Bowman	41,913	100%	41,913	Oct 2016	£11.36	476

[1] Based on the average share price over the three months to 31 July 2016 of £11.36.

The CIP values carried in the 2016 long-term incentive element of the single figure table also include dividend equivalents of £69,936 for Philip Bowman in respect of the vested 2013 CIP shares.

2013 LTIP outcome

Also included in the 2016 'Long-term incentives' column of the executive director annual remuneration table above, is the outcome of the LTIP awards granted in 2013 to Philip Bowman, details of which are summarised in the table below:

			Vesting schedule		Actual performance	
Measure	Weighting	Performance period	Performance	% vesting	Outturn	% vesting
Group EPS growth	50%	1 August 2013 to 31 July 2016	< 6% p.a.	0%	< 6% p.a.	0%
			6% p.a.	12.5%		
			≥ 14% p.a.	50.0%		
			Straight-line vesting between these points			
Total Shareholder Return rank vs. FTSE 100 companies (excluding financial services)	30%	1 August 2013 to 31 July 2016	Below median	0%	Below median	0%
			Median	7.5%		
			Upper quartile or above	30.0%		
			Straight-line vesting between these points			
Average cash conversion	20%	1 August 2013 to 31 July 2016	< 85%	0%	97.8%	17.8%
			85%	5.0%		
			≥ 100%	20.0%		
			Straight-line vesting between these points			
Total						**17.8%**

2013 LTIP	Interests held	Vesting %	Interests vesting	Date of vesting	Market price[1]	Value £000
Philip Bowman	178,470	17.8%	31,809	Oct 2016	£11.36	361

[1] Based on the average share price over the three months to 31 July 2016 of £11.36.

The 2013 LTIP values carried in the single figure table also include dividend equivalents of £53,008 for Philip Bowman in respect of the vested LTIP shares.

Scheme interests awarded in 2016 (auditable)

2015 LTIP

During the year ended 31 July 2016, the executive directors were awarded conditional share awards under the LTIP details of which are summarised in the table below:

Executive	Form of award	Date of grant	Number of shares awarded	Award price[1]	Face value £'000	Face value % of salary	Date of vesting
Andy Reynolds Smith	Conditional shares	26 Nov 2015	226,524	£10.33	2,340	300%	Oct 2018
Chris O'Shea	Conditional shares	26 Nov 2015	119,796	£10.33	1,238	250%	Oct 2018

[1] The closing price on 25 November 2015.

The performance conditions attached to these 2015 LTIP awards are as follows:

Measure	Weighting	Performance period	Vesting schedule: Performance	Vesting schedule: % vesting
Group EPS growth	30%	1 August 2015 to 31 July 2018	< 3% p.a.	0%
			3% p.a.	7.5%
			≥ 12% p.a.	30.0%
			Straight-line vesting between these points	
Revenue Growth	30%	1 August 2015 to 31 July 2018	< 2% p.a.	0%
			2% p.a.	7.5%
			≥ 5% p.a.	30.0%
			Straight-line vesting between these points	
Return on Capital Employed	20%	1 August 2015 to 31 July 2018	< 15%	0%
			15%	5.0%
			≥ 18%	20.0%
			Straight-line vesting between these points	
Average cash conversion	20%	1 August 2015 to 31 July 2018	< 85%	0%
			85%	5.0%
			≥ 100%	20.0%
			Straight-line vesting between these points	

SAYE

During the year ended 31 July 2016, Andy Reynolds Smith and Chris O'Shea became participants in the Smiths Group Sharesave Scheme. Andy Reynolds Smith has 2,078 share options under the scheme and Chris O'Shea has 3,464 share options under the scheme.

Buyout awards

During the year ended 31 July 2016 (and as disclosed in last year's Remuneration Report), the following awards were made to Andy Reynolds Smith and Chris O'Shea to replicate the structure and fair value of incentives forfeited by each director as a consequence of their joining Smiths Group:

Executive	Form of award	Date of grant	Number of shares awarded	Award price[1]	Face value £'000	Date of vesting
Andy Reynolds Smith	Restricted shares	26 Nov 2015	30,412	£10.33	314	30 Jun 2016
			56,481	£10.33	583	30 Jun 2017
	Conditional shares	26 Nov 2015	79,806	£10.33	824	Oct 2018
			26,602	£10.33	275	Oct 2019
			26,602	£10.33	275	Oct 2020
Chris O'Shea	Restricted shares	26 Nov 2015	35,969	£10.33	372	18 Sep 2016
			35,969	£10.33	372	18 Sep 2017

[1] The closing price on 25 November 2015.

Restricted share awards will vest on the date of vesting shown, subject to the director remaining employed by Smiths Group at that date. The conditional shares awarded to Andy Reynolds Smith are based on performance over a period of three financial years preceding the vesting date, and will each vest subject to satisfaction of the same performance conditions that apply to awards made under the Company's LTIP vesting at the same time. The performance conditions for the first tranche of this award (vesting in October 2018) are as set out in the table summarising the 2015 LTIP performance conditions, above.

Andy Reynolds Smith and Chris O'Shea were each also entitled to a cash payment in early 2016, reflecting the actual reported outcome of the pro-rated 2015 annual bonus in respect of each director's former employment that was forfeited on joining Smiths Group. The amount of the cash payment for Andy Reynolds Smith (paid in April 2016) was £209,402 and is captured in the 'Other' column of the single figure of annual remuneration table on page 104. For Chris O'Shea, the actual reported outcome was for a zero payment and therefore no cash payment was made.

Percentage change in remuneration from 2014/15 to 2015/16

	Salary	Benefits	Bonus
CEO remuneration	(9.6)%	(87.5)%	(1.0)%
Average of all employees	2.6%	0%	17.9%

CEO remuneration is based on a comparison of Philip Bowman's remuneration for 2015, and the sum of remuneration paid in 2016 to Andy Reynolds Smith and Philip Bowman (in relation to the period for which he remained CEO, ie to 25 September 2015).

'All employees' is defined as the global senior management population of approximately 60 individuals who are eligible to participate in the same incentive arrangements as the Chief Executive.

Relative importance of spend on pay

The table below shows shareholder distributions (ie dividends and share buybacks) and total employee pay expenditure for the financial years ended 31 July 2015 and 31 July 2016, and the percentage change.

	2016 £m	2015 £m	Change
Shareholder distributions	163	160	1.9%
Employee costs	872	857	1.8%

Payments to past directors (auditable)

No payments have been made to past directors in the year, other than those disclosed in the single figure of annual remuneration table on page 104.

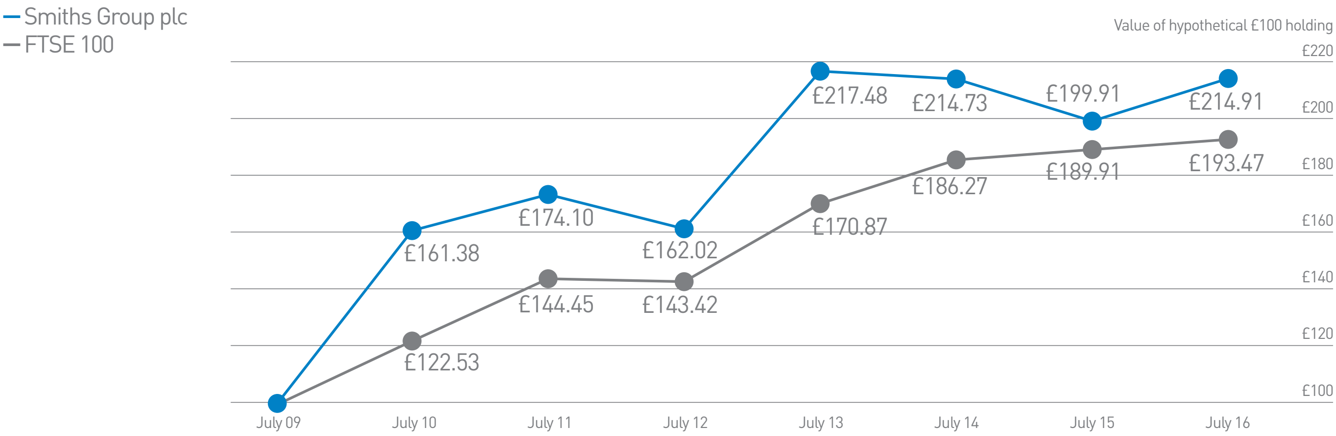
Payments for loss of office (auditable)

Philip Bowman stepped down from the Board on 24 September 2015 and retired from the Company on 31 December 2015. Philip Bowman's remuneration as CEO for the year under review is captured in the single figure table. He continued to receive salary and benefits (including pension allowance) until his retirement and remained eligible for a pro-rata annual bonus for 2016. As disclosed in last year's Remuneration Report, the Committee exercised its discretion not to time pro-rate his outstanding CIP and LTIP awards. These vest on their normal vesting dates subject to the achievement of the original performance conditions over the relevant performance periods.

TSR performance

The following graph shows the Company's total shareholder return (TSR) performance over the past seven years compared to the FTSE 100 Index. The FTSE 100 Index, of which the Company has been a member throughout the period, has been selected to reflect the TSR performance of other leading UK-listed companies. The values of hypothetical £100 investments in the FTSE 100 Index and Smiths Group plc shares were £193.47 and £214.91 respectively.

Total shareholder return



CEO remuneration for the last seven years

CEO	2010 P Bowman	2011 P Bowman	2012 P Bowman	2013 P Bowman	2014 P Bowman	2015 P Bowman	2016 P Bowman	2016 A Reynolds Smith
CEO total remuneration £000	3,399	4,776	5,026	3,864	3,912	4,195	1,344	2,964
Annual bonus outcome (% max)	95%	64%	79%	39%	43%	80%	88%	89%
CIP outcome (% max)	n/a	100%	100%	100%	100%	100%	100%	n/a
2007 PSP outcome (% max)[1]	46%	33%	n/a	n/a	n/a	n/a	n/a	n/a
LTIP outcome (% max)					18%	17%	18%	n/a

[1] The 2007 PSP outcome shown for 2010 represents the outcome under the EPS element of that award only (2/3 of the award). The 2007 PSP outcome shown for 2011 represents the outcome under the TSR element of that award (1/3 of the award) as TSR performance was measured over a three-year period commencing on the date of the grant.

Note: VSP outcome as a percentage of maximum is not shown in table above as award opportunity was uncapped. Awards received are included in the CEO total remuneration table above and the values are: £1,453,000 for 2011 (150,694 shares at a price of £9.64); £1,899,000 for 2012 (175,193 shares at a price of £10.84); and £364,000 for 2013 at (25,885 shares at a price of £14.06).

Statement of implementation of remuneration policy in 2017

Base salary and benefits

Salaries are reviewed (but not necessarily increased) annually and benchmarked against comparable roles at other FTSE 100 companies of similar market capitalisation, revenues and complexity. Having considered a number of important factors including individuals' performance and experience, the relative performance of the Company and the remuneration policy within the Company, the Committee has determined the following annualised salaries for executive directors for 2017:

Executive director	2015/16	2016/17
Andy Reynolds Smith	£780,000 From date of joining	£780,000
Chris O'Shea	£495,000 From date of joining	£507,375 From 1 August 2016

Pension and benefits

Andy Reynolds Smith and Chris O'Shea will each continue to receive a cash allowance in lieu of pension of 25% of their base salaries.

Annual bonus

For 2017, Andy Reynolds Smith will continue to have a maximum bonus opportunity of 180% of salary and Chris O'Shea will continue to have a maximum bonus opportunity of 150% of salary. Annual bonus measures (and their weightings) will remain unchanged from 2016. 33% of any bonus earned will be deferred into shares for three years. Specific targets cannot be disclosed at this time due to the commercially sensitive nature of these objectives, but they will be disclosed at such a time as the Committee deems them to no longer affect the commerciality of the Company.

Long-Term Incentive Plan

The LTIP is a conventional share plan under which an award over a capped number of shares will vest if demanding performance conditions are met. LTIP awards of conditional shares are granted to selected senior executives (including the executive directors) with face values (from 2016 onwards) of up to 400% of salary. Under the LTIP, the normal annual grants are 300% of salary for the Chief Executive and 250% of salary for the Finance Director.

LTIP awards granted to Andy Reynolds Smith and Chris O'Shea in 2016/17 (at the normal annual grant levels of 300% and 250% of salary respectively) will vest on the achievement of the following performance conditions:

Performance measure	Weighting	Threshold performance target	Maximum performance target (full vesting of element)
3-year EPS growth	35%	3% p.a.	12% p.a.
3-year average return on capital employed	35%	15%	18%
3-year average annual cash conversion	30%	85%	100%

The only change proposed to the LTIP for the 2016/17 cycle is a simplification of the scorecard from four to three measures. The Committee believes the proposed structure provides an appropriate balance between earnings growth, returns and cash. The Committee recognises that this balanced performance of the Group's performance remains very important for many of our largest shareholders. The scorecard will be reviewed at the start of each future LTIP cycle to ensure it continues to reflect the Group's strategic priorities.

For performance between 'threshold' and 'maximum', awards vest on a straight-line sliding scale.

Non-executive director fees

NED fees paid for 2016 and to be paid in 2017 are shown below:

	2016	2017
NED base fee	£64,575	£66,200
Additional fee payable to the Chairman of the Board	£328,425	£336,636
Additional fee payable to the Senior Independent Director	£20,000	No change
Additional fees for Audit, Nomination and Remuneration Committee Chairs	£20,000	No change
Attendance allowance for meetings outside the NED's home continent	£3,000 per meeting	No change

Share ownership guidelines

It is proposed that executive directors should, over time, acquire a shareholding with a value equal to at least two years' base salary. Executive directors are required to retain at least 50% of any net vested share awards (after sales to meet tax liabilities) until those guidelines are achieved. There is no shareholding policy for non-executive directors.

Directors' shareholdings (auditable)

The table below shows the shareholding of each director and for executive directors the shareholding against their respective shareholding requirement as at 31 July 2016.

	Shareholding requirement (% 2015/16 salary)	Shares owned outright	Shares subject to performance	Performance tested but unvested shares	Shares subject to CIP deferral	Save As You Earn (SAYE)	Current shareholding (% 2015/16 salary)	Guideline met[3]
Andy Reynolds Smith	200%	116,716	416,015			2,078	189%	No
Chris O'Shea	200%	20,069	191,734			3,464	51%	No
Philip Bowman[1]	200%	610,599	472,382		22,935	0	692%	Yes
Bruno Angelici		2,000						
Sir George Buckley		10,000						
David Challen[2]		1,333						
Tanya Fratto		1,500						
Anne Quinn		1,024						
Bill Seeger		5,000						
Mark Seligman		5,000						
Sir Kevin Tebbit		1,000						

[1] The shares owned outright is at the date that Philip Bowman retired from the Company on 24 September 2015 and the value of his shareholding is based upon the share price on that date of £9.75.

[2] The shares owned outright is at the date that David Challen retired from the Company on 17 November 2015.

[3] Both Andy Reynolds Smith and Chris O'Shea have five years from the date of their appointment to meet the required personal shareholding.

There are no changes in the interests of the directors and their connected persons between 31 July 2016 and the date of this report.

Share scheme dilution limits

The Company complies with the guidelines laid down by the Investment Association. These restrict the issue of new shares under all the Company's share schemes in any 10-year period to 10% of the issued ordinary share capital and under the Company's discretionary schemes to 5% in any 10-year period. As at 31 July 2016, the headroom available under these limits was 7.07% and 2.77%, respectively.

Auditable part

The directors' single figure of annual remuneration and accompanying notes on page 104; the incentive outcomes for 2015 and 2016 on page 105; the scheme interests awarded in 2016 and accompanying notes on page 107; the payments to past directors and payments for loss of office on page 109; the directors' shareholdings on page 111 and the directors' share options and long-term plans table on pages 112 to 114 have been audited.

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

Anne Quinn
27 September 2016

Directors' share options and long-term share plans (Auditable)

Director and Plans	Options and awards held on 31 July 2016 Number	Options and awards held on 31 July 2015 Number	Option and award data: Performance test	Exercise price	Grant date	Vesting date*	Expiry date**	Awards vested 2015/16: Exercise/ vesting date	Number	Exercise price	Market price at date of grant#	Market price at date of exercise##
Andy Reynolds Smith (appointed 25 September 2015)												
CEO Buyout	0	0		n/a	26/11/15			30/06/16	31,597	n/a	1034.00p	1114.50p
award	56,481	0		n/a	26/11/15	30/06/17	30/06/17					
Restricted	79,806	0	A	n/a	26/11/15	Oct 2018						
Share Award	26,602	0	F	n/a	26/11/15	Oct 2019						
	26,602	0	TBD	n/a	26/11/15	Oct 2020						
LTIP 2015	226,524	0	A	n/a	26/11/15	Oct 2018						
SAYE	2,078	0	–	866.00p	11/05/16	01/08/19	01/02/20					
Chris O'Shea (appointed 18 September 2015)												
CFO Buyout	35,969	0		n/a	26/11/15	18/09/16	18/09/16					
award	35,969	0		n/a	26/11/15	18/09/17	18/09/17					
LTIP 2015	119,796	0	A	n/a	26/11/15	Oct 2018						
SAYE	3,464	0	–	866.00p	11/05/16	01/08/21	01/02/22					
Philip Bowman (stepped down 24 September 2015, ceased employment 31 December 2015)												
LTIP 2011	0†	113,469	D	n/a	19/10/12			30/09/15	0			
	0†	68,081	C	n/a	19/10/12			30/09/15	0			
	0††	45,387	E	n/a	19/10/12		◊	30/09/15	37,823	n/a	1076.00p	999.62p
	89,235	89,235	D	n/a	19/09/13	Oct 2016	Oct 2016					
	53,541	53,541	C	n/a	19/09/13	Oct 2016	Oct 2016					
	35,694	35,694	E	n/a	19/09/13	Oct 2016	Oct 2016					
	100,398	100,398	D	n/a	26/09/14	Oct 2017	Oct 2017					
	60,239	60,239	C	n/a	26/09/14	Oct 2017	Oct 2017					
	40,159	40,159	E	n/a	26/09/14	Oct 2017	Oct 2017					
CIP	0	107,704	B	n/a	19/10/12			30/09/15	107,704	n/a	1076.00p	999.62p
	41,913	41,913	B	n/a	26/09/13	Oct 2016	Oct 2016					
	51,203	51,203	B	n/a	26/09/14	Oct 2017	Oct 2017					
SAYE	0	1,818	–	990.00p	14/05/14	01/08/17		15/06/16	1,161	990.00p	1237.00p	1085.00p

Key

CEO Buyout award	Under the terms of his contract of employment on joining the Company, Andy Reynolds Smith was granted a Buyout award over 86,893 shares of which 35% vested on 30 June 2016 and 65% will vest on 30 June 2017 (subject to Andy Reynolds Smith remaining an employee of the Company). The terms of the award provide that additional shares are awarded on vesting to a value equivalent to the notional dividends that would have been earned on the number of shares that vest. On 30 June 2016, Andy Reynolds Smith received 1,185 additional shares in respect of the notional dividends on the tranche of his award that vested that day.
Restricted Share Award	Under the terms of his contract of employment on joining the Company, Andy Reynolds Smith was also granted a conditional award over 133,010 shares of which up to 60% are expected to vest in October 2018 (subject to the performance tests applicable to awards granted under LTIP 2015 in 2015); up to 20% are expected to vest in October 2019 (subject to performance tests applicable to awards granted under long-term incentive plans in 2016); and up to 20% are expected to vest in October 2020 (subject to the performance tests applicable to awards granted under long-term incentive plans in 2017). The terms of the award provide that additional shares are awarded on vesting to a value equivalent to the notional dividends that would have been earned on the number of shares that vest.
CFO Buyout award	Under the terms of his contract of employment on joining the Company, Chris O'Shea was granted a Buyout award over 71,938 shares of which 50% will vest on 18 September 2016 (or at the end of any closed period in force at the time and subject to Chris O'Shea remaining an employee of the Company) and 20% will vest on 18 September 2017 (or at the end of any closed period in force at the time and subject to Chris O'Shea remaining an employee of the Company). The terms of the award provide that additional shares are awarded on vesting to a value equivalent to the notional dividends that would have been earned on the number of shares that vest.
CIP	The Smiths Group Co-Investment Plan
LTIP 2011	The Smiths Group Long Term Incentive Plan 2011
LTIP 2015	The Smiths Group Long Term Incentive Plan 2015
SAYE	The Smiths Group Sharesave Scheme
*	The Vesting Dates shown above in respect of awards made under CIP and the LTIPs are subject to the relevant performance test(s) being passed.
**	The Expiry dates shown above apply in normal circumstances. No Expiry date is shown if the option or award was exercised or vested or lapsed prior to 23 September 2016.
#	Mid-market closing price of a Smiths share on the business day preceding the date of grant. Note: the exercise price of an option under the SAYE is set at 20% less than the mid-market closing price of a Smiths share on the business day immediately preceding the day on which employees are invited to participate in the grant.
##	Actual sale price of shares sold on date of exercise of an option or the vesting of an award or the mid-market closing quotation on the date of exercise when no shares are sold.
†	Awards which lapsed during the period 1 August 2015 to 31 July 2016.
††	Award which partially lapsed during the period 1 August 2015 to 31 July 2016.
◊	Awards which vested or were exercised after Philip Bowman ceased to be a director of the Company.

Performance tests

A	LTIP 2015 awards – 30% subject to revenue growth; 30% subject to EPS element; 20% subject to cash conversion; 20% subject to return on capital employed.
B	CIP Return on Capital Employed (ROCE) test
C	LTIP Relative shareholder return (TSR) test
D	LTIP EPS growth test (EPS) test
E	LTIP Cash conversion (CC) test
F	LTIP 2016 awards (to be granted in the 2017 financial year) – 35% subject to EPS element; 35% subject to return on capital employed; 30% subject to cash conversion.
TBD	Each tranche of Andy Reynolds Smith's Restricted Share Award will vest subject to the same performance conditions as the LTIP award, which will vest at the same time as that tranche. Where these have yet to be agreed, these performance conditions will be confirmed in the relevant Remuneration Report.
–	There are no performance criteria for SAYE

Notes

The high and low market prices of the ordinary shares during the period 1 August 2015 to 31 July 2016 were 858p and 1275p respectively.

The mid-market closing price on 31 July 2015 was 1129p and on 31 July 2016 was 1263p.

The mid-market closing prices of a Smiths share on the dates of the awards made to directors in the 2016 financial year was 1034p (26 November 2015).

The options over 5,542 shares granted to and held by the directors under SAYE at 31 July 2016 were granted at exercise prices below the market price of a Smiths Group share on 23 September 2016 (1420p).

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

No other directors held any options over the Company's shares during the period 1 August 2015 to 31 July 2016.

No options or awards have been granted to or exercised by directors or have lapsed during the period 1 August to 23 September 2016.

At 31 July 2016, the trustee of the Employee Share Trust held 852 shares (none of the directors had an interest in these shares at 31 July 2016). The market value of the shares held by the trustee on 31 July 2016 was £10,761 and dividends of approximately £351 were waived in the year in respect of the shares held by the trustee during the year.

Special provisions permit early exercise of options and vesting of awards in the event of retirement; redundancy; death; etc.

CIP awards granted in 2012

Smiths return on capital employed (ROCE) over the performance period for the 2012 CIP awards (1 August 2012 to 31 July 2015) exceeded the Company's weighted average costs of capital (WACC) over the period by more than 3% p.a. Accordingly the 2012 CIP Awards vested in full. The notional gross dividends accrued in respect of the performance period amounted to 165.56p per share. This amount, after deduction of income tax and National Insurance Contributions, was paid in cash in respect of each share that vested.

Group LTIP awards granted in 2012

Over the three-year period from 1 August 2012 to 31 July 2015, Smiths TSR performance and EPS performance did not result in the vesting of any shares under those elements of the 2012 LTIP awards. The Cash Conversion element of the awards partially vested (83.3%) which resulted in 37,283 shares vesting for Philip Bowman. All the share awards under the TSR and EPS elements and the balance of the share awards under the Cash conversion element lapsed. The notional gross dividends accrued in respect of the performance period amounted to 165.56p per share. This amount, after deduction of income tax and National Insurance Contributions, was paid in cash in respect of each share that vested.

Group directors' report

Results and dividends

The results for the financial year ended 31 July 2016 are set out in the Consolidated income statement. Revenues for the year amounted to £2,949m (2015: £2,897m). The profit for the year after taxation amounted to £261m (2015: £248m).

An interim dividend of 13.25p per ordinary share of 37.5p ('ordinary share') was paid on 22 April 2016. The directors recommend for payment on 18 November 2016 a final cash dividend of 28.75p on each ordinary share, making a total dividend of 42p for the financial year.

The Group's progressive dividend policy is described in the CFO report on page 25.

Directors

Sir George Buckley; Bruno Angelici; Tanya Fratto; Anne Quinn, CBE; Bill Seeger; and Sir Kevin Tebbit, KCB, CMG all served as directors of the Company throughout the year. Chris O'Shea and Andy Reynolds Smith were appointed as executive directors on 18 September and 25 September 2015, respectively. Mark Seligman was appointed as a non-executive director on 16 May 2016. Philip Bowman resigned as a director and retired as Chief Executive on 24 September 2015. In accordance with section 430(2B) of the Companies Act 2006 (the '2006 Act'), details of the arrangements made in respect of Philip Bowman's retirement are available on the Company's website – www.smiths.com – and contained in the Directors' remuneration report on page 94. David Challen, CBE retired at the conclusion of the AGM on 17 November 2015 and has not received any payment following his retirement.

Reappointment of directors

In accordance with the UK Corporate Governance Code, all the directors, apart from Mark Seligman, will retire voluntarily from office at the AGM and will seek re-election. Mark Seligman will retire at the AGM under Article 49 of the Company's Articles of Association, following his appointment during the year, and will seek election. Separate resolutions to re-elect or elect each of them as a director of the Company will be proposed at the AGM.

Biographical details of all the directors at the date of this report are set out on pages 72 to 74.

Directors' remuneration report

The Directors' remuneration report is on pages 94 to 114.

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

Directors' interests in contracts

Details of the executive directors' service contracts are disclosed in the service contracts section of the Directors' remuneration report on page 101. Details of the interests of the executive directors in the Company's share option schemes and plans are shown in the Directors' remuneration report on pages 112 and 113.

Qualifying third-party indemnity provisions (as defined by section 234 the 2006 Act) have remained in force for the directors of the Company and certain other employees in respect of their directorships of some subsidiary companies during the financial year ended 31 July 2016 and, at the date of this report, are in force for the benefit of the current directors and certain other employees who are directors of some subsidiary companies in relation to certain losses and liabilities which they may incur (or may have incurred) to third parties in the course of their professional duties for the Company or a subsidiary company, as applicable.

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

Changes in the Company and its interests during the financial year

On 17 November 2015 the Company announced the finalisation of the triennial valuation of the Smiths Industries Pension Scheme as at 31 March 2015 under which the actuarial deficit was £285m, £250m lower than the previous triennial valuation. Following agreement with the Scheme Trustee, the Company's annual contribution to the Scheme has reduced from £60m per annum to £24m per annum. In August 2015 the Company concluded a partial buy-out of its US pension scheme under which US$527m of liabilities was transferred to Voya Retirement Insurance and Annuity Company, thereby insuring around 60% of the of the gross liabilities of that scheme. On 1 March 2016 the Company announced the finalisation of the triennial valuation of the TI Group Pension Scheme under which the actuarial valuation had reduced from £117m to £16m. The Company has agreed with the Trustee to pay off the remaining deficit over three financial years, with the Company's contributions reducing from £16m in 2015 to £3m in 2017 and 2018.

On 21 April 2016 the Company announced it had agreed with Safran S.A. to purchase its Morpho Detection business for US$710m. The acquisition is subject to customary conditions and regulatory approvals in several countries and is expected to be completed in early 2017.

On 25 July 2016 the Company moved its headquarters and its registered office to 4th Floor 11-12 St James's Square, London SW1Y 4LB.

Post balance sheet events

On 23 September 2016 the Company announced that it had reached agreement to sell John Crane's Artificial Lift business for a cash consideration of US$39.5m. Completion of the transaction is subject to customary regulatory approvals.

There have been no other post-balance sheet events.

Interests in voting rights

As at 31 July 2016 the Company had been notified, pursuant to the Disclosure Guidance & Transparency Rules ('DTRs') of the Financial Conduct Authority ('FCA'), of notifiable voting rights in its issued share capital or had received disclosures pursuant to the 2006 Act of shareholding interests in excess of 3% of its share capital, as follows:

	Number of shares	Percentage of issued ordinary share capital*	Date of notification or disclosure
Ameriprise Financial	23.1m	5.9%	11/08/2016
BlackRock	26.9m	6.8%	08/08/2016
Dodge & Cox	28.4m	7.2%	12/08/2016
Harris Associates LP	28.3m	7.2%	10/08/2016

*Percentage of ordinary share capital in issue on 31 July 2016.

During the period 1 August to 23 September 2016 the Company has received the following notifications or disclosures:

	Number of shares	Percentage of issued ordinary share capital*	Date of notification or disclosure
Ameriprise Financial	23.0m	5.8%	20/09/2016
BlackRock	27.8m	7.0%	21/09/2016
Harris Associates LP	22.0m	5.6%	22/09/2016
Jupiter Asset Management	14.8m	3.8%	22/09/2016

*Percentage of ordinary share capital in issue on 23 September 2016.

Note: The DTRs oblige a shareholder to notify to a company when his interests in the voting rights of that company's shares exceed or fall below 3% of the company's issued share capital and every whole percentage point above 3%. Where the voting rights in shares are managed by an investment manager under certain defined schemes, the manager is obliged to notify a company when its interests in the voting rights in the shares it manages under such schemes exceed or fall below 5% or 10% of the company's issued share capital.

The interests of the directors, their families and any connected persons in the issued share capital of the Company are shown in the Directors' remuneration report on page 111.

Corporate responsibility
The Company has Group policies on environmental, employee and health & safety matters and operates a Code of Business Ethics. The Company seeks to minimise, as far as is reasonably practicable, any detrimental effects on the environment of its operations and products. The Group HR director has responsibility for environmental, health and safety matters, which are subject to preventative, investigatory and consultative systems, overseen by the Group Environment, Health and Safety Committee, and reports regularly to the Board on these matters. Issues relevant to the Company pension schemes are likewise covered by means of structured committees, including representation from recognised trade unions.

Further information on environmental, employee and health and safety matters, including key performance indicators, is contained in the Corporate responsibility summary on pages 61 to 69. The full Corporate responsibility report is available online at www.smiths.com/responsibility.

Corporate governance statement
The Corporate governance statement is on pages 75 to 93 and is incorporated in this Directors' report by reference. PricewaterhouseCoopers LLP has reviewed the Company's statements as to compliance with the UK Corporate Governance Code, to the extent required by the UK Listing Authority Listing Rules. The results of its review are set out in the Independent auditors' report on pages 125 to 131.

Strategic report
The statements and reviews on pages 2 to 69 comprise the Group Strategic report which contains certain information, outlined below, that is incorporated into this Directors' report by reference:

- an indication of the Group's likely future business developments;
- an indication of the Group's research and development activities;
- information on the Company's policies for the employment of disabled persons and employee involvement; and
- the Group's disclosures regarding greenhouse gas emissions.

Branches
The Company does not operate through any branches. Some Group subsidiary companies have established branch operations outside the UK.

Financial instruments
The financial risk management objectives and policies of the Group; the policy for hedging each major type of forecasted transaction for which hedge accounting is used; and the exposure of the Group to foreign exchange risk, interest rate risk, price risk, financial credit risk, liquidity risk and cash-flow risk is outlined in note 18 of the Group accounts.

Going concern
The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic report on pages 2 to 69. The financial position of the Company, its cash-flows, liquidity position and borrowing facilities are described in the CFO report on pages 25 to 31. In addition, the notes to the accounts include the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk.

On 30 June 2016 the Group paid off £150m of debt on maturity. The bond repayment resulted in the decrease of the average maturity of gross debt to 4.5 years (from 5.1 years at 31 July 2015).

The Group holds its debt in the currency of its underlying assets and as such most debt is held in US dollars and euros. The strengthening of both these currencies against the British pound in late June 2016 contributed to the Group's net debt, as reported in British pounds, increasing. At 31 July 2016 the net debt of the Group was £978m, a £160m increase from 31 July 2015. At 31 July 2016 the Group had available cash and short-term deposits of £431m. These liquid resources are immediately available with 98% invested with the Group's global banking partners.

The Group maintains a core US$800m committed revolving credit facility from these banks which was undrawn at 31 July 2016. This committed facility matures in February 2021. This facility has certain financial covenants: however these are not expected to prevent utilisation at the Group's discretion if required.

This financial position and debt maturity profile provides confidence that the Group has sufficient financial resources for the foreseeable future. As a consequence, the directors believe that the Company is well placed to manage its business and its liabilities as they fall due. In coming to this conclusion, the directors have taken account of the Group's risk management process described on pages 52 to 60, and have paid particular attention to the financial and pension funding risks and their mitigation (see page 56).

The directors, having made appropriate enquiries, have a reasonable expectation that the Company and the Group have adequate resources to continue in operation for a period of at least twelve months from the date of this report. Thus they continue to adopt the going concern basis of accounting in preparing the annual accounts of the Company and the Group.

Viability
The directors' assessment of the long-term prospects of the Company is described in the Strategic report on page 52.

Share capital and control

As at 31 July 2016, the Company's nominal issued share capital was £148,208,652 and comprised 395,223,072 ordinary shares. The ordinary shares are listed and admitted to trading on the Main Market of the London Stock Exchange (symbol: SMIN). The Company has an American Depositary Receipt ('ADR') programme for which J.P. Morgan acts as Depositary and transfer agent. One ADR equates to one Smiths Group ordinary share. The programme trades 'over-the-counter' as a level 1 ADR programme under the ticker symbol SMGZY. At the year-end, 5,580,727 ordinary shares were held by the nominee of the programme depositary in respect of the same number of ADRs in issue at that time.

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

There are no restrictions on transfer or limitations on the holding of any class of shares and no requirements for prior approval of any transfers. None of the shares carries any special rights with regard to control of the Company. There are no restrictions on the voting rights attaching to the ordinary shares (other than a 48 hour cut-off for the casting of proxy votes prior to a general meeting). There are no arrangements of which the directors are aware under which financial rights are held by a person other than the holder of the shares and no known agreements relating to or restrictions on share transfers or voting rights.

Shares acquired through Company share schemes and plans rank pari passu with the shares in issue and have no special rights. The Company operates an employee benefit trust, with an independent trustee, to hold shares pending employees becoming entitled to them under the Company's share schemes and plans. On 31 July 2016 the trust held 852 ordinary shares in the Company. The trust waived its dividend entitlement on its holding during the year: the trust abstains from voting the shares at general meetings.

The tables on pages 115 and 116 set out the notifications received by the Company pursuant to the FCA's DTRs and the 2006 Act, as at 31 July 2016 and any changes thereto up to 23 September 2016, from persons with significant direct or indirect holdings in the Company's share capital.

The rules about the appointment and replacement of directors are contained in the Company's Articles of Association and legislation in force from time to time. Changes to the Articles of Association must be approved by the shareholders in accordance with the legislation in force from time to time.

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

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

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

Purchase of own shares

No shares in the Company were either purchased or acquired or charged or disposed of by the Company or any nominee of the Company during the financial year ended 31 July 2016.

Electronic communications at www.smiths.com

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

Electronic copies of the Annual Report 2016 and the Notice of AGM will be posted on the Company's website, www.smiths.com. The Company's announcements to the Stock Exchange and press releases are available online through the website. Shareholding details and practical help on share transfers and changes of address can be found at www.shareview.co.uk.

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

Annual General Meeting ('AGM')

The 2016 AGM will be held on Tuesday 15 November 2016 at 11:00 am. The Notice of the AGM will be published on the Company's website, www.smiths.com, on or around 13 October 2016.

Remuneration policy
Details of the Directors' remuneration policy as approved at the AGM in 2015, are shown on pages 95 to 98. Under the regulations which now form part of the 2006 Act, the remuneration policy must be put to a binding shareholder vote at least once every three years. All payments to former and current directors must comply with the terms of the policy, unless specifically approved by shareholders in general meeting.

Authority to issue shares
At the AGM shareholders will be asked to renew and extend the authority, given to the directors at the last AGM, to allot shares in the Company, or grant rights to subscribe for, or to convert any security into, shares in the Company for the purposes of Section 551 of the 2006 Act (the 'Allotment Resolution').

The authority in the first part of the Allotment Resolution will allow the directors to allot new shares in the Company or to grant rights to subscribe for or convert any security into shares in the Company up to a nominal value which is equivalent to approximately one-third of the total issued ordinary share capital of the Company as at the latest practical date prior to the publication of the Notice of AGM.

The authority in the second part of the Allotment Resolution will allow the directors to allot new shares or to grant rights to subscribe for or convert any security into shares in the Company only in connection with a rights issue up to a nominal value which is equivalent to approximately one-third of the total issued ordinary share capital of the Company as at the latest practical date prior to the publication of the Notice of AGM. This is in line with corporate governance guidelines. The Board has undertaken to seek the re-election of each director annually by the shareholders, whether or not this authority were to be used.

There are no present plans to undertake a rights issue or to allot new shares other than in connection with the Company's share option schemes and plans. The directors intend to take note of relevant corporate governance guidelines on the use of such powers in the event that the authority is exercised.

If the Allotment Resolution is passed the authority will expire on the earlier of 31 January 2018 and the end of the next AGM, due to be held in 2017.

Also at the AGM shareholders will be asked to pass two special resolutions to renew the powers granted to directors to disapply shareholders' pre-emption rights under certain circumstances (the 'Pre-emption Resolutions').

If the directors wish to allot new shares and other equity securities, or sell treasury shares, for cash (other than in connection with an employee share scheme) company law requires that these shares are offered first to shareholders in proportion to their existing holdings. There may be occasions, however, when the directors need the flexibility to finance business opportunities by the issue of shares without a pre-emptive offer to existing shareholders. This cannot be done under the 2006 Act unless the shareholders have first waived their pre-emption rights. The purpose of the Pre-emption Resolutions is to enable shareholders to so waive their pre-emption rights.

The Pre-emption Resolutions authorise the directors to allot new shares, pursuant to the authority given by the Allotment Resolution, or to sell treasury shares for cash:

a) in connection with a rights issue or pre-emptive offer; and/or

b) otherwise up to a nominal value equivalent to 5% of the total issued ordinary share capital of the Company as at the latest practical date prior to the publication of the Notice of AGM; and

c) in connection with the financing (or refinancing, if the authority is to be used within six months after the original transaction) of an acquisition or specified capital investment which is announced contemporaneously with the allotment or which has taken place in the preceding six-month period and is disclosed in the announcement of the allotment (provided that the nominal value equivalent is no more than 5% of the total issued share capital of the Company at the latest practical date prior to the publication of the Notice of AGM),

in each case without the shares first being offered to existing shareholders in proportion to their existing holdings.

The Board intends to adhere to the provisions in the Pre-emption Group's Statement of Principles, as updated in March 2015, and not to allot shares for cash on a non pre-emptive basis pursuant to the authority in Pre-emption Resolutions:

- in excess of an amount equal to 5% of the total issued ordinary share capital of the Company (excluding treasury shares); or
- in excess of an amount equal to 7.5% of the total issued ordinary share capital of the Company (excluding treasury shares) within a rolling three-year period, without prior consultation with shareholders,

in each case other than in connection with an acquisition or specified capital investment which is announced contemporaneously with the allotment or which has taken place in the preceding six-month period and is disclosed in the announcement of the allotment.

The Pre-emption Resolutions also authorise the directors to allot new shares, pursuant to the authority given by the Allotment Resolution, or to sell treasury shares for cash in connection with a rights issue, without the shares first being offered to existing shareholders in proportion to their existing holdings. This is to allow the directors to make exclusions or such other arrangements as may be appropriate to resolve legal or practical problems which, for example, might arise with overseas shareholders. This is in line with corporate governance guidelines.

If the Pre-emption Resolutions are passed, the authorities they confer will expire on the earlier of 31 January 2018 and the end of the next AGM, due to be held in 2017.

During the financial year ended 31 July 2016, the following ordinary shares in the Company were issued:

- 363,068 ordinary shares pursuant to the terms of the Company's shareholder-approved share option schemes and share plans.

Authority to purchase own shares
At the AGM the Company will seek to renew the authority, granted at the last AGM to the directors, to purchase the Company's ordinary shares in the market.

The effect of the resolution is to renew the authority granted to the Company to purchase its own ordinary shares until the next AGM (due to be held in 2017) or 31 January 2018 whichever is the earlier. This authority is limited to 10% of the ordinary shares in issue as at the latest practical date prior to the publication of the Notice of AGM and the Company's exercise of this authority is subject to the stated upper and lower limits on the price payable, which reflect the requirements of the Listing Rules.

Pursuant to the 2006 Act, the Company can hold the shares which have been purchased as treasury shares and either resell them for cash, cancel them, either immediately or at a point in the future, or use them for the purposes of its employee share schemes. The directors believe that it is desirable for the Company to have this choice as holding the purchased shares as treasury shares would give the Company the ability to resell or transfer them in the future, and so provide the Company with additional flexibility in the management of its capital base. No dividends will be paid on, and no voting rights will be exercised in respect of, treasury shares. However, it is not the Company's present intention to hold shares in treasury in the event that any shares were to be purchased under this authority.

Shares will only be purchased if the directors consider such purchases to be in the best interests of shareholders generally and that they can be expected to result in an increase in earnings per share. The authority will only be used after careful consideration, taking into account market conditions prevailing at the time, other investment opportunities, appropriate gearing levels and the overall financial position of the Company. Shares held as treasury shares will not automatically be cancelled and will not be taken into account in future calculations of earnings per share (unless they are subsequently resold or transferred out of treasury).

If any shares purchased by the Company are held in treasury and used for the purposes of its employee share schemes, the Company will count those shares towards the limits on the number of new shares which may be issued under such schemes.

At 27 September 2016, the Company did not hold any shares in treasury.

Political donations
The Group made contributions to non-EU political parties totalling US$36,500 (£28,000) during the year. The political contributions were made on a bi-partisan basis in the US, in accordance with US state and federal election laws, in order to raise awareness and to promote the interests of the Company. The Group has a number of key manufacturing sites and approximately 7,900 employees in the US.

A resolution will be proposed at the AGM to renew the authority, granted by the shareholders at the last AGM to the Company and its UK subsidiaries, to make donations to political organisations and to incur political expenditure.

Part 14 of the 2006 Act requires companies to obtain shareholders' authority for donations to registered political parties and other political organisations in the EU totalling more than £5,000 in any twelve-month period, and for any political expenditure in the EU, subject to limited exceptions. The definition of donation in this context is very wide and extends to bodies such as those concerned with policy review, law reform and the representation of the business community. It could include special interest groups, such as those involved with the environment, which the Company and its UK subsidiaries might wish to support, even though these activities are not designed to support or influence support for a particular political party.

It is the policy of the Company not to make political donations or incur political expenditure in the EU, as those expressions are normally understood. To avoid inadvertent infringement of the 2006 Act, the directors are seeking shareholders' authority for the Company and its UK subsidiaries to make political donations (as defined in the 2006 Act) and to incur political expenditure (as defined in the 2006 Act) for the period from the date of the AGM to the conclusion of next year's AGM up to a maximum aggregate amount of £50,000.

Auditors
Resolutions will be proposed at the AGM to reappoint PricewaterhouseCoopers LLP as independent auditors, to hold office until the next meeting at which the accounts are laid, and to authorise the directors to determine the auditors' remuneration. Further information on the process for recommending the appointment of auditors is contained in the Audit Committee report on pages 88 and 89.

Notice period for extraordinary general meetings
A special resolution will be proposed at the AGM to renew the authority, granted by the shareholders at the last AGM to the Company, to call a general meeting of the Company (other than an AGM) with a minimum notice period of 14 clear days. Changes made to the 2006 Act by the Shareholders' Rights Regulations increased the notice period required for general meetings of the Company to 21 days unless shareholders approve a shorter notice period, which cannot, however, be less than 14 clear days. AGMs will continue to be held on at least 21 clear days' notice.

Before the coming into force of the Shareholders' Rights Regulations on 3 August 2009, the Company was able to call general meetings other than an AGM on 14 clear days' notice without obtaining such shareholder approval. In order to preserve this ability, such approval is sought at the AGM. Any exercise of this power by the Company will be conducted in accordance with any relevant corporate governance guidelines applicable at the time. In particular, the shorter notice period will only be used where flexibility is merited by the business of the meeting and is thought to be to the advantage of shareholders as a whole. The approval will be effective until the Company's next AGM, when it is intended that a similar resolution will be proposed.

The Company will comply with the requirement to provide appropriate facilities for all shareholders to vote by electronic means at general meetings held on less than 21 clear days' notice.

Disclosure table pursuant to Listing Rule LR9.8.4C

Listing Rule	Information to be included	Disclosure
9.8.4(1)	Interest capitalised by the Group	£1.8m interest was capitalised as part of the costs of development projects. £0.4m of tax relief has been recognised as current tax relief in the period
9.8.4(2)	Unaudited financial information (LR9.2.18)	The supplementary US dollar financial statements on pages 186 to 190 The Group financial record 2012-2016 on page 185
9.8.4(4)	Long-term incentive scheme only involving a director (LR9.4.3)	The terms of the contracts entered into with Chris O'Shea, appointed as Chief Financial Officer on 18 September 2015, and Andrew Reynolds Smith, appointed as Chief Executive on 25 September 2015, are described on page 101 and include details of their incentive arrangements
9.8.4(5)	Directors' waivers of emoluments	None
9.8.4(6)	Directors' waivers of future emoluments	None
9.8.4(7)	Non pro-rata allotments for cash (issuer)	Shares have been issued and allotted pursuant to the exercise of options awarded under shareholder-approved schemes
9.8.4(8)	Non pro-rata allotments for cash (major subsidiaries)	None
9.8.4(9)	Listed company is a subsidiary of another company	Not applicable
9.8.4(10)	Contracts of significance involving (a) a director or (b) a controlling shareholder	(a) None; (b) Not applicable
9.8.4(11)	Contracts for the provision of services by a controlling shareholder	Not applicable
9.8.4(12)	Waivers of dividends	(1) Wealth Nominees Limited WAIVED a/c (per pro the Smiths Industries Employee Share Trust) waived all the dividends payable in the year on its holding of 852 shares; and (2) Reuter File Limited waived its dividends in full (on 2 shares)
9.8.4(13)	Waivers of future dividends	(1) Wealth Nominees Limited WAIVED a/c (full waiver) (2) Reuter File Limited (full waiver)
9.8.4(14)	Agreement with a controlling shareholder LR9.2.2AR(2)(a)	Not applicable

Additional information pursuant to LR9.8.6

Listing Rule	Information to be included	Disclosure
9.8.6(1)	Directors' (and their connected persons') interests in Smiths shares at year-end and at not more than one month prior to date of the Notice of AGM	See page 111
9.8.6(2)	Interests in Smiths shares disclosed under DTR5 at year-end and not more than one month prior to date of the Notice of AGM	See pages 115 and 116
9.8.6(3)(a)	Directors' going concern statement	See page 116
9.8.6(3)(b)	Directors' assessment of the Company's prospects	See page 52
9.8.6(4)(a)	Amount of the authority to purchase own shares available at year-end	Authority available in full at year-end
9.8.6(4)(b)	Off-market purchases of own shares during the year	None
9.8.6(4)(c)	Off-market purchases of own shares post year-end	None
9.8.6(4)(d)	Non pro-rata sales of treasury shares during the year	None
9.8.6(5)	Compliance with the Main Principles of the UK Corporate Governance Code	See the Corporate governance statement on page 76
9.8.6(6)(b)	Details of non-compliance with UK Corporate Governance Code and reasons	See the Corporate governance statement on page 76
9.8.6(7)	Re directors proposed for re-election: the unexpired term of any director's service contract and a statement about directors with no service contracts	Details of the executive directors' service contracts are given in the Directors' remuneration report on page 101 The Chairman and the non-executive directors serve under letters of appointment – see page 101

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

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

Shareholders who will not be able to attend the AGM on 15 November 2016 in person are encouraged to vote their shares by appointing a proxy and issuing voting instructions (either electronically or by completing and returning their proxy cards). Electronic and paper proxy appointments and voting instructions must be received by the Company's Registrar not later than 48 hours before the AGM in order to be valid.

Adoption of financial reporting standard FRS 101
Following the publication of FRS 100 'Application of financial reporting requirements' by the Financial Reporting Council, the Company was required to change its accounting framework for its financial statements, which previously had followed UK GAAP, for the financial year commencing 1 August 2015.

The Board considered that it would be in the best interests of the Company to adopt FRS 101 'Reduced Disclosure Framework'. No disclosures in the current UK GAAP financial statements would be omitted on adoption of FRS 101.

Shareholders were invited to register any objection to the use of this Reduced Disclosure Framework no later than 10:30 am on 15 November 2015. No objections were received. The 2016 financial statements contained in this Annual Report have been prepared using the FRS 101 framework.

Registrar
The address and contact details of Equiniti Limited, the Company's Registrar, are listed on the inside back cover of this report. Individual shareholders' access to their personal shareholder information is available online, through the www.shareview.co.uk website. The UK shareholder helpline telephone number is 0371 384 2943. Helpline services are available from 08:30 to 17:30, Monday to Friday. The international shareholder helpline telephone number is +44 (0) 121 415 7047.

Important information
If you are in any doubt as to what action you should take in relation to the resolutions being proposed at the AGM, you are recommended to consult your stockbroker, bank manager, solicitor, accountant or other independent professional adviser authorised under the Financial Services and Markets Act 2000. If you received this document in printed form from the Company and have recently sold or transferred all your shares in Smiths Group plc, please pass this document to the purchaser or transferee or to the agent through whom the sale or transfer was effected for transmission to the purchaser or transferee.

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

Recommendation
Your directors believe that all the proposals to be considered at the AGM are in the best interests of the Company and its shareholders as a whole and recommend shareholders to vote in favour of the resolutions. The directors intend to vote in favour of the resolutions in respect of their own beneficial holdings.

By Order of the Board

Melanie Jane Rowlands
Secretary
Smiths Group plc
4th Floor, 11-12 St James's Square, London SW1Y 4LB

27 September 2016

Accounts

Larger packages, smaller space
Smiths Detection took on a customer's challenge to develop a mobile x-ray unit that could accommodate larger packages, but be available in a smaller vehicle. Applying continuous improvement techniques, we not only succeeded in producing the much smaller ScanVan, but also increased the efficiency, safety and throughput of the manufacturing process – cutting manufacturing costs by up to 50%.

Statement of directors' responsibilities

The directors are responsible for preparing the Annual Report and the Group and Parent Company financial statements in accordance with applicable law and regulations.

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

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

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's and the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and the Company and enable them to ensure that the accounts and the Directors' remuneration report comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Directors' responsibility statement

The directors consider that the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

Each of the directors (who are listed on pages 72 to 74) confirms that to the best of his or her knowledge:

- the Group's financial statements have been prepared in accordance with IFRS as adopted by the European Union and give a true and fair view of the Group's assets, liabilities and financial position as at 31 July 2016 and of its profit for the financial year then ended; and
- the Group directors' report and Strategic report include a fair review of the development and performance of the business and the position and performance of the Group, together with a description of the principal risks and uncertainties that the Group faces.

Signed on behalf of the Board of directors:

Andy Reynolds Smith
Chief Executive
27 September 2016

Chris O'Shea
Chief Financial Officer

Independent auditors' report to the members of Smiths Group plc

Report on the Group financial statements

Our opinion

In our opinion, Smiths Group plc's Group accounts (the "financial statements"):

- give a true and fair view of the state of the Group's affairs as at 31 July 2016 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

What we have audited

The financial statements, included within the Annual Report 2016 (the "Annual Report"), comprise:

- the consolidated balance sheet as at 31 July 2016;
- the consolidated income statement and consolidated statement of comprehensive income for the year then ended;
- the consolidated cash-flow statement for the year then ended;
- the consolidated statement of changes in equity for the year then ended;
- the accounting policies; and
- the notes to the financial statements, which include other explanatory information.

Certain required disclosures have been presented elsewhere in the Annual Report, rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

The financial reporting framework that has been applied in the preparation of the financial statements is IFRSs as adopted by the European Union, and applicable law.

Our audit approach

Overview

Materiality	• Overall Group materiality of £17 million.
Audit scope	• We conducted audit work in 13 countries covering 40 reporting units. • The reporting units where we performed audit work accounted for 75% (2015: 75%) of the Group's revenues and 79% (2015: 78%) of the Group's headline operating profit.
Areas of focus	• Revenue recognition (occurrence and cut off), together with accounting for complex programmes and contract accounting in the Smiths Detection and Smiths Interconnect Divisions. • Working capital and associated provisions. • Goodwill and intangible asset impairment assessments, particularly for the Smiths Interconnect, John Crane Production Solutions and Detection CGUs. • Product litigation provisions for asbestos in John Crane, Inc. and flexible gas piping product in Titeflex Corporation, a subsidiary of the Flex-Tek Division. • Taxation provisions and the recognition of deferred tax assets. • Defined benefit pension plan net assets and liabilities.

The scope of our audit and our areas of focus

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)").

We designed our audit by determining materiality and assessing the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are identified as "areas of focus" in the table below. We have also set out how we tailored our audit to address these specific areas in order to provide an opinion on the financial statements as a whole, and any comments we make on the results of our procedures should be read in this context. Each of the areas of focus below is referred to in the Significant Judgements and Issues section of the Audit Committee Report on page 90 and in the Significant judgement, key assumptions and estimates section of the Accounting Policies on pages 137 to 138. This is not a complete list of all risks identified by our audit.

Revenue recognition (occurrence and cut off), together with accounting for complex programmes and contract accounting in the Smiths Detection and Smiths Interconnect Divisions

Area of focus

We focused on revenue recognition for all divisions in the final month of the financial year to check that revenue was recorded in the correct period.

In the Smiths Detection and Smiths Interconnect divisions we focused on the accounting for complex programmes and contract accounting. The recognition of revenue is largely dependent on the terms of the underlying contract with the customer, including the nature of separate deliverables within the contract, achieving milestones within those contracts and the mechanisms in the contract by which risks and rewards of goods and services are transferred to the customer.

These contracts are usually long term in nature, sometimes spanning a number of reporting periods. This means that the final profitability of a contract, which will be based upon forecast revenues and costs to complete, can be uncertain during the earlier phases. Judgement must therefore be applied in order to estimate the profit margins to recognise on revenue that is recorded.

Changes in conditions and circumstances over time can result in variations to the original contract terms or to the overall profitability of the contract. This can include cost overruns which require further negotiation and settlements resulting in the need for provisions.

How our audit addressed the area of focus

For all the divisions we assessed whether the Group's revenue recognition policies complied with IFRSs as adopted by the EU and tested the implementation of those policies. Specifically we considered whether revenue was recognised based on the transfer of the risks and rewards of ownership of goods to the customer or the accounting period in which services were rendered by testing a sample of revenue items to contract and shipping documents, with a specific focus on transactions which occurred near 31 July 2016.

Where appropriate we evaluated the relevant IT systems and tested the operating effectiveness of the internal controls over the recording of revenue in the correct period.

We also tested journal entries posted to revenue accounts to identify any unusual or irregular items, and the reconciliations between the systems used by the Group and its financial ledgers.

In the case of the Smiths Detection and Smiths Interconnect divisions, for a sample of contracts, we read extracts of the relevant customer agreements and tested the accounting for separate deliverables and contractual milestones. This testing included evaluating customer acceptance of the work done to establish whether contractual milestones had been achieved, assessing the impact of any ongoing disputes, and assessing the reasonableness of the directors' estimates of costs to complete the contract by comparing them to actual historical costs incurred on comparable contracts.

We did not identify any material exceptions from the audit work performed and we found estimates to be in line with our expectations.

Working capital and associated provisions

Area of focus

Refer also to notes 13, 14 and 15

We focused on this area because inventory provisions include subjective estimates and are influenced by assumptions concerning future selling prices and the level of sales activity, and the Group also has material amounts of trade receivables that are overdue and not impaired (as disclosed in note 14 to the financial statements).

We focused in particular on inventory levels in those parts of the business experiencing challenging trading environments. We also focused on divisions with inherent judgements associated with large programmes and complex contractual terms.

The key associated risks were recoverability of billed and unbilled trade receivables and the valuation of inventory.

How the scope of our audit addressed the area of focus

Where appropriate, we evaluated the directors' forecasted sales for each significant category of slow moving inventory by comparing them to historical sales and orders for future sales.

We compared the historical provision for bad debts to the actual amounts written off, to determine whether the directors' estimation techniques were reasonable and considered the adequacy of provisions for bad debts for significant customers at reporting unit level, taking into account specific credit risk assessments for each customer.

In addition, we performed the procedures documented above for revenue recognition in relation to the key long term revenue contracts.

As a result, we satisfied ourselves that both inventory and receivables provisions have been prepared in line with Group policy and we found the estimates to be in line with our expectation.

Goodwill and intangible asset impairment assessments, particularly in the Interconnect, JCPS and Detection CGUs

Area of focus

Refer also to note 11

The Group holds significant amounts of goodwill and intangible assets on the balance sheet, as detailed in note 10 to the financial statements. The risk is that these balances are overstated.

Goodwill and indefinite-lived intangible assets must be tested for impairment on at least an annual basis. The determination of recoverable amount, being the higher of value-in-use and fair value less costs to dispose, requires judgement in both identifying and then valuing the relevant CGUs.

The impairment assessment for these assets involves subjective judgements about future business performance, with key assumptions including cash flows, the overall long-term growth rates, discount rates used and to the extent relevant, the fair value less costs to dispose.

In the year ended 31 July 2016, an impairment charge of £23m was recognised in relation to the John Crane Production Solutions, Microwave Components and Microwave Telecoms cash generating units ("CGUs"). We focused, in particular, on the recoverable values of each of these CGUs in the context of challenging trading conditions.

We also focused on the estimated values in use of the Power CGU, which has a combined net book value of goodwill of £128m. As this CGU has a lower headroom between its carrying value and value in use, judgements in the valuation models are even more important.

How the scope of our audit addressed the area of focus

We evaluated the directors' future cash flow forecasts, and the process by which they were drawn up, including testing the underlying calculations and comparing them to the latest Board approved divisional budgets.

We challenged:

- the directors' key assumptions for long term growth rates in the forecasts by comparing them to historical results, and economic and industry forecasts; and
- the discount rate by assessing the cost of capital for the Group.

We found the assumptions to be consistent and in line with our expectations.

We evaluated the reasonableness of the directors' forecast performance by performing a sensitivity analysis around the key drivers of the cash flow forecasts, in particular:

- the current order book;
- the proportion of recent tenders which have been successful; and
- independent projections of the expected growth of key markets.

We also evaluated the directors' assessment of the fair value less costs of disposal by comparing it to external analyst valuations.

In respect of the John Crane Production Solutions and Microwave Components CGUs, we sensitised each key driver of the cash flow forecasts, including the underlying assumptions listed above, by determining what we considered to be a reasonable possible change in assumption, based on current market data and historical and current business performance. Through this we determined an appropriate range of value in use. In respect of the Microwave Telecoms CGU, we assessed the fair value less costs to sell assessment referencing analyses of peer companies and broker reports. We found the assumptions used in determining the £5m, £7m and £11m impairments to be within an appropriate range.

For the Power CGU, having ascertained the extent of change in the assumptions that either individually or collectively would be required for the goodwill to be impaired, we considered the likelihood of such a movement in those key assumptions and resulting sensitivity analyses set out in note 11.

We validated the appropriateness of the related disclosures in note 11 of the financial statements, including sensitivities provided with respect to the Power CGU.

Product litigation provisions for asbestos in John Crane, Inc. and flexible gas piping product in Titeflex Corporation, a subsidiary of the Flex-Tek Division

Area of focus

Refer also to note 22

John Crane, Inc., a US based subsidiary of the Group, is currently one of many co-defendants in litigation relating to products previously manufactured which contained asbestos.

A provision of £252m 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.

Titeflex Corporation, another US based subsidiary of the Group, 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. A provision of £94m has been made for the costs which the Group is expected to incur in respect of these claims.

We focused on these areas because there is significant judgement involved in the assumptions used to estimate the provisions, in particular those relating to the US litigation environment such as the future level of claims and the cost of defence. As a result the provision may be subject to potentially material revisions from time to time.

How the scope of our audit addressed the area of focus

In John Crane Inc. we used our own internal experts to challenge management's assumptions underlying the adverse judgement and defence cost provisions. This included an examination of the model maintained by management's valuation expert and evaluation of the work of the expert, by considering the appropriateness of the methodology used, the reasonableness of assumptions (including the use of a rolling 10 year horizon) and considering alternative outcomes. In addition we tested the mathematical accuracy of the underlying calculations and the input data.

At Titeflex Corporation we challenged management's underlying assumptions supporting their provision. This included an evaluation of the valuation model, by testing the mathematical accuracy of the underlying calculations and the input data such as the average amount of settlements, the number of future settlements and the period over which expenditure can be reasonably estimated by testing them to historic claims.

We also discussed these matters with the Company's internal legal counsel, obtained letters from external counsel and evaluated the appropriateness of the disclosures made in the Group financial statements.

We found the assumptions to be consistent and in line with historical claims, that the provisions have been recognised in line with IAS 37 and that appropriate disclosures have been provided within the financial statements.

Taxation provisions and the recognition of deferred tax assets

Area of focus

Refer also to note 6

The Group has recognised £246m deferred tax assets on the balance sheet, the recognition of which involves judgement by management as to the likelihood of the realisation of these deferred tax assets. The expectation that the benefit of these assets will be realised is dependent on a number of factors, including appropriate taxable temporary timing differences, and whether there will be sufficient taxable profits in future periods to support recognition.

The Group has recognised provisions against uncertain tax positions, the valuation of which is an inherently judgemental area. The Group has a wide geographic footprint and is subject to tax laws in a number of jurisdictions.

How the scope of our audit addressed the area of focus

We evaluated the directors' assessment as to whether there will be sufficient taxable profits in future periods to support the recognition of deferred tax assets by evaluating the directors' future cash flow forecasts, and the process by which they were drawn up, including testing the underlying calculations and comparing them to the latest Board approved divisional budgets. We challenged:

- the directors' key assumptions for long term growth rates in the forecasts by comparing them to historical results, and economic and industry forecasts; and
- the discount rate by assessing the cost of capital for the Group.

We found the assumptions to be consistent and in line with our expectations.

We used our tax specialists to challenge management's assumptions underlying the provisions for uncertain tax positions. We discussed with management the known uncertain tax positions and read communications from taxation authorities to identify uncertain tax positions.

We assessed the adequacy of the directors' taxation provisions by considering factors such as whether the matter represents a permanent or temporary difference, and whether the provision addresses possible penalties and interest.

We did not identify any material exceptions from our audit work.

Defined benefit pension plan net assets and liabilities

Area of focus	How the scope of our audit addressed the area of focus
Refer also to note 8 The Group has defined benefit pension plans with net post-retirement assets of £328m and net post-retirement liabilities of £249m, which are significant in the context of the overall balance sheet of the Group. The valuation of the pension liabilities requires significant levels of judgement and technical expertise in choosing appropriate assumptions. A number of the key assumptions (including salary increases, inflation, discount rates and mortality) can have a material impact on the calculation of the liability. The pension assets include significant pension asset investments, the fair value measurement of which includes some judgement. The recognition of post-retirement plan net assets for accounting purposes is dependent on the rights of the employers to recover the surplus at the end of the life of the scheme.	We evaluated the directors' assessment of the assumptions made in relation to the valuations of the liabilities and assets in the pension plans and the assumptions around salary increases and mortality rates by comparing them to national and industry averages. We also focussed on the valuation of pension plan liabilities and the pension assets as follows: • We agreed the discount and inflation rates used in the valuation of the pension liability to our internally developed benchmarks. • We obtained third party confirmations on ownership and valuation of pension assets. • We checked that the recognition of post retirement plan net assets complies with the Group's investment principles. • Where new census data was available in the year we tested the controls at the scheme administrators and tested it on a sample basis to assess whether this data is accurate. • We verified the basis of recognition of UK pension surplus. • Where there was no new census data in the year we assessed the assumptions used by the actuaries. We did not identify any material exceptions from our audit work.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the geographic structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

The Group is organised into five divisions: John Crane, Smiths Medical, Smiths Detection, Smiths Interconnect and Flex-Tek and is a consolidation of over 250 units.

In establishing the overall approach to the Group audit, we determined the type of work that needed to be performed at the reporting units by us, as the Group Engagement team, or component auditors within PwC UK and from other PwC network firms operating under our instruction. Where the work was performed by component auditors, we determined the level of involvement we needed to have in the audit work at those reporting units to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the financial statements as a whole.

The Group's operating reporting units vary significantly in size and we identified 21 reporting units that, in our view, required an audit of their complete financial information, due to their size or risk characteristics. Specific audit procedures over certain balances and transactions were performed at a further 19 reporting units, to give appropriate coverage of material balances at both divisional and Group levels. Of these, one reporting unit has been determined to be financially significant based on its contribution to Group revenue or headline operating profit. We conducted work in 13 countries and the Group engagement team visited multiple reporting sites in North America and Europe, and participated in each of the divisional audit clearance meetings. Together, the reporting units subject to audit procedures accounted for 75% (2015: 75%) of the Group's revenues and 79% (2015: 78%) of the Group's headline operating profit.

Further specific audit procedures over IT controls, central functions such as treasury and areas of significant judgement, including taxation, goodwill, post-retirement benefits and material litigation, were performed at the local headquarters of each of the divisions and at the Group's Head Office.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall Group materiality	£17 million (2015: £18 million).
How we determined it	Approximately 3.5% of headline operating profit. Headline operating profit is operating profit adjusted for material non-recurring items or items considered non-operational in nature.
Rationale for benchmark applied	Consistent with last year, we applied this benchmark because, in our view, this is the metric against which the performance of the Group is most commonly measured.
Component materiality	For each component in our audit scope, we allocated a materiality that is less than our overall Group materiality. The range of materiality allocated across components was between £0.5 million and £15 million

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £0.5 million (2015: £0.5 million) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Going concern

Under the Listing Rules we are required to review the directors' statement, set out on page 116, in relation to going concern. We have nothing to report having performed our review.

Under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to the directors' statement about whether they considered it appropriate to adopt the going concern basis in preparing the financial statements. We have nothing material to add or to draw attention to.

As noted in the directors' statement, the directors have concluded that it is appropriate to adopt the going concern basis in preparing the financial statements. The going concern basis presumes that the Group has adequate resources to remain in operation, and that the directors intend it to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the directors' use of the going concern basis is appropriate. However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Group's ability to continue as a going concern.

Other required reporting

Consistency of other information

Companies Act 2006 opinion

In our opinion, the information given in the Strategic Report and the Group directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

ISAs (UK & Ireland) reporting

Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

information in the Annual Report is: • materially inconsistent with the information in the audited financial statements; or • apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or • otherwise misleading.	We have no exceptions to report.
the statement given by the directors on page 86 in accordance with provision C.1.1 of the UK Corporate Governance Code (the "Code"), that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group acquired in the course of performing our audit.	We have no exceptions to report.
the section of the Annual Report on page 90, as required by provision C.3.8 of the Code, describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.	We have no exceptions to report.

The directors' assessment of the prospects of the group and of the principal risks that would threaten the solvency or liquidity of the group

Under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to:

• the directors' confirmation on page 52 of the Annual Report, in accordance with provision C.2.1 of the Code, that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.	We have nothing material to add or to draw attention to.
• the disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.	We have nothing material to add or to draw attention to.
• the directors' explanation on page 52 of the Annual Report, in accordance with provision C.2.2 of the Code, as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.	We have nothing material to add or to draw attention to.

Under the Listing Rules we are required to review the directors' statement that they have carried out a robust assessment of the principal risks facing the Group and the directors' statement in relation to the longer-term viability of the Group. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the Code; and considering whether the statements are consistent with the knowledge acquired by us in the course of performing our audit. We have nothing to report having performed our review.

Adequacy of information and explanations received
Under the Companies Act 2006 we are required to report to you if, in our opinion, we have not received all the information and explanations we require for our audit. We have no exceptions to report arising from this responsibility.

Directors' remuneration
Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Corporate governance statement
Under the Listing Rules we are required to review the part of the Corporate Governance Statement relating to ten further provisions of the Code. We have nothing to report having performed our review.

Responsibilities for the financial statements and the audit
Our responsibilities and those of the Directors
As explained more fully in the Statement of directors' responsibilities set out on page 124, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

What an audit of financial statements involves
An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Other matter
We have reported separately on the company financial statements of Smiths Group plc for the year ended 31 July 2016 and on the information in the Directors' Remuneration Report that is described as having been audited.

Andrew Kemp (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London

27 September 2016

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

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

Consolidated income statement

	Notes	Year ended 31 July 2016 Headline £m	Year ended 31 July 2016 Non-headline (note 3) £m	Year ended 31 July 2016 Total £m	Year ended 31 July 2015 Headline £m	Year ended 31 July 2015 Non-headline (note 3) £m	Year ended 31 July 2015 Total £m
Continuing operations							
Revenue	1	2,949		2,949	2,897		2,897
Cost of sales		(1,600)		(1,600)	(1,564)		(1,564)
Gross profit		1,349		1,349	1,333		1,333
Sales and distribution costs		(403)		(403)	(406)		(406)
Administrative expenses		(436)	(139)	(575)	(416)	(117)	(533)
Other operating income			16	16			
Operating profit	2	**510**	**(123)**	**387**	**511**	**(117)**	**394**
Interest receivable		3		3	3		3
Interest payable		(62)		(62)	(55)		(55)
Other financing gains/(losses)			15	15		(9)	(9)
Other finance income/(charges) – retirement benefits	8		3	3		(8)	(8)
Finance costs	4	(59)	18	(41)	(52)	(17)	(69)
Profit before taxation		**451**	**(105)**	**346**	**459**	**(134)**	**325**
Taxation	6	(113)	28	(85)	(117)	40	(77)
Profit for the period		**338**	**(77)**	**261**	**342**	**(94)**	**248**
Attributable to							
Smiths Group shareholders		336	(77)	259	340	(94)	246
Non-controlling interests		2		2	2		2
		338	**(77)**	**261**	**342**	**(94)**	**248**
Earnings per share	5						
Basic				65.6p			62.4p
Diluted				64.9p			61.8p

References in the consolidated income statement, consolidated statement of comprehensive income, consolidated balance sheet, consolidated statement of changes in equity and consolidated cash-flow statement relate to notes on pages 137 to 184, which form an integral part of the consolidated accounts.

Consolidated statement of comprehensive income

	Notes	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Profit for the period		**261**	**248**
Other comprehensive income			
Actuarial (losses)/gains on retirement benefits	8	(40)	60
Taxation recognised on actuarial movements	6	10	21
Other comprehensive income and expenditure which will not be reclassified to the consolidated income statement		**(30)**	**81**
Other comprehensive income which will be reclassified and reclassifications			
Exchange gains		420	9
Fair value gains/(losses) and reclassification adjustments			
– deferred on available for sale financial assets		(2)	11
– reclassified to income statement on available for sale financial assets	4	(19)	
– deferred in the period on cash-flow and net investment hedges		(238)	(6)
– reclassified to income statement on cash-flow and net investment hedges			1
Total other comprehensive income		**131**	**96**
Total comprehensive income		**392**	**344**
Attributable to			
Smiths Group shareholders		386	343
Non-controlling interests		6	1
		392	**344**

Consolidated balance sheet

	Notes	31 July 2016 £m	31 July 2015 £m
Non-current assets			
Intangible assets	10	1,742	1,518
Property, plant and equipment	12	315	259
Financial assets – other investments	16	9	156
Retirement benefit assets	8	328	170
Deferred tax assets	6	246	218
Trade and other receivables	14	51	40
Financial derivatives	19	29	4
		2,720	**2,365**
Current assets			
Inventories	13	478	454
Current tax receivable	6	62	30
Trade and other receivables	14	745	616
Cash and cash equivalents	17	431	495
Financial derivatives	19	13	20
		1,729	**1,615**
Assets of business held for sale	27	24	
Total assets		**4,473**	**3,980**
Non-current liabilities			
Financial liabilities			
– borrowings	17	(1,139)	(1,150)
– financial derivatives	19	(1)	(6)
Provisions for liabilities and charges	22	(305)	(253)
Retirement benefit obligations	8	(248)	(278)
Deferred tax liabilities	6	(95)	(71)
Trade and other payables	15	(29)	(24)
		(1,817)	**(1,782)**
Current liabilities			
Financial liabilities			
– borrowings	17	(270)	(163)
– financial derivatives	19	(19)	(12)
Provisions for liabilities and charges	22	(94)	(79)
Trade and other payables	15	(536)	(466)
Current tax payable	6	(72)	(50)
		(991)	**(770)**
Liabilities of business held for sale	27	(5)	
Total liabilities		**(2,813)**	**(2,552)**
Net assets		**1,660**	**1,428**
Shareholders' equity			
Share capital	23	148	148
Share premium account		352	349
Capital redemption reserve		6	6
Revaluation reserve		1	1
Merger reserve		235	235
Retained earnings		1,205	743
Hedge reserve	25	(301)	(63)
Total shareholders' equity		**1,646**	**1,419**
Non-controlling interest equity		14	9
Total equity		**1,660**	**1,428**

The accounts on pages 132 to 184 were approved by the Board of Directors on 27 September 2016 and were signed on its behalf by:

Andy Reynolds Smith
Chief Executive

Chris O'Shea
Chief Financial Officer

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 2015		497	242	743	(63)	1,419	9	1,428
Profit for the period				259		259	2	261
Other comprehensive income								
Actuarial loss on retirement benefits and tax				(30)		(30)		(30)
Exchange gains				416		416	4	420
Fair value gains/(losses)				(21)	(238)	(259)		(259)
Total comprehensive income for the period				**624**	**(238)**	**386**	**6**	**392**
Transactions relating to ownership interests								
Exercises of share options	23	3				3		3
Purchase of own shares	25			(8)		(8)		(8)
Dividends								
– equity shareholders	24			(163)		(163)		(163)
– non-controlling interests							(1)	(1)
Share-based payment	9			9		9		9
At 31 July 2016		**500**	**242**	**1,205**	**(301)**	**1,646**	**14**	**1,660**

	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 2014		494	242	559	(58)	1,237	8	1,245
Profit for the year				246		246	2	248
Other comprehensive income								
Actuarial losses on retirement benefits and related tax				81		81		81
Exchange (losses)/gains				10		10	(1)	9
Fair value gains/(losses) and related tax				11	(5)	6		6
Total comprehensive income for the year				**348**	**(5)**	**343**	**1**	**344**
Transactions relating to ownership interests								
Exercises of share options	23	3				3		3
Taxation recognised on share options	6			(1)		(1)		(1)
Purchase of own shares	25			(11)		(11)		(11)
Dividends								
– equity shareholders	24			(160)		(160)		(160)
– non-controlling interest								
Share-based payment	9			8		8		8
At 31 July 2015		**497**	**242**	**743**	**(63)**	**1,419**	**9**	**1,428**

Consolidated cash-flow statement

	Notes	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Net cash inflow from operating activities	26	**358**	**266**
Cash-flows from investing activities			
Expenditure on capitalised development		(23)	(18)
Expenditure on other intangible assets		(11)	(18)
Purchases of property, plant and equipment	12	(74)	(59)
Disposals of property, plant and equipment		1	11
Investment in financial assets		(9)	(27)
Acquisition of businesses		(8)	
Disposals of businesses			2
Net cash-flow used in investing activities		**(124)**	**(109)**
Cash-flows from financing activities			
Proceeds from exercise of share options	23	3	3
Purchase of own shares		(8)	(11)
Dividends paid to equity shareholders	24	(163)	(160)
Cash (outflow)/inflow from matured derivative financial instruments		(14)	4
Increase in new borrowings		1	568
Reduction and repayment of borrowings		(151)	(257)
Net cash-flow used in financing activities		**(332)**	**147**
Net (decrease)/increase in cash and cash equivalents		**(98)**	**304**
Cash and cash equivalents at beginning of year		495	189
Exchange differences		33	2
Cash and cash equivalents at end of year	17	**430**	**495**
Cash and cash equivalents at end of year comprise			
– cash at bank and in hand		161	104
– short-term deposits		270	391
– bank overdrafts		(1)	
		430	**495**
Included in cash and cash equivalents per the balance sheet		431	495
Included in overdrafts per the balance sheet		(1)	
		430	**495**

Reconciliation of net cash-flow to movement in net debt

	Notes	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Net debt at start of year	17	**(818)**	**(804)**
Net (decrease)/increase in cash and cash equivalents		(98)	304
Increase in borrowings		(1)	(568)
Reduction and repayment of borrowings		151	257
Movement in net debt resulting from cash-flows		**52**	**(7)**
Capitalisation, interest accruals and unwind of capitalisation fees		(2)	(1)
Movement from fair value hedging		(23)	7
Exchange differences		(187)	(13)
Movement in net debt in the year		**(160)**	**(14)**
Net debt at end of year	17	**(978)**	**(818)**

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.

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 £42m (2015: £39m) has been recognised in the period in respect of contracts in progress at the period end with a total expected value of £175m (2015: £137m) and cumulative revenue recognised to date of £137m (2015: £100m). A 5% reduction in the proportion of the contract activity recognised in the current period would have reduced operating profit by less than £1m for both Smiths Detection and Smiths Interconnect (2015: less than £1m).

Smiths Detection also has multi-year contractual arrangements for the sale of goods and services. Where these contracts have separately identifiable components with distinct patterns of delivery and customer acceptance, revenue is accounted for separately for each identifiable component. Judgement is applied in the identification of the components of the contract, and the allocation of contract revenue to each component.

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 2016 was £28m (2015: £21m).

Contract profitability

Smiths Detection has multi-year 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. At 31 July 2016 there was £4m (2015: £7m) balance sheet liability in respect of ongoing onerous contracts and no other contracts had been assessed as at significant risk of becoming onerous.

Taxation

The Group has recognised deferred tax assets of £87m (2015: £28m) relating to losses and £120m (2015: £99m) 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. This is based on a number of factors, which seek to assess the expectation that the benefit of these assets will be realised, including expected future levels of operating profit, expenditure on litigation, pension contributions and the timing of the unwind of other tax positions. It has been concluded that there are sufficient taxable profits in future periods to support recognition. A 5% reduction in expected future operating profits would reduce the level of deferred tax recognised by £9m (2015: £10m), and a 5% increase in expected future operating profits would increase the level of deferred tax recognised by £11m (2015: £10m). Further detail on the Group's deferred taxation position is included in note 6.

Retirement benefits

The consolidated financial statements include costs in relation to, and provision for, retirement benefit obligations. The costs and the present value of any related pension assets and liabilities depend on such factors as life expectancy of the members, the returns that plan assets generate and the discount rate used to calculate the present value of the liabilities. The Group uses previous experience and independent actuarial advice to select the values of critical estimates. The estimates, and the effect of variances in key estimates, are disclosed in note 8.

At 31 July 2016 there is a retirement benefit asset of £328m (2015: £170m), principally relating to UK schemes, 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 buyouts would cost significantly more than the present value of the scheme liabilities calculated in accordance with IAS 19: Employee benefits.

Receivables provisions

If the carrying value of any receivable is higher than the fair value, the Group makes provisions writing down the balance to its fair value. The fair value of receivables is considered individually for each customer and incorporates past experience and progress with collecting receivables.

At 31 July 2016 the gross value of receivables partly provided for or more than three months overdue was £83m (2015: £57m) and there were provisions of £31m (2015: £22m) against these receivables. Consequently, these receivables were carried at a net value of £52m (2015: £35m). See note 14 for disclosures on credit risk and ageing of trade receivables.

Inventory provisions

The calculation of inventory provisions requires judgement by management of the expected value of future sales. If the carrying value of inventory is higher than the expected recoverable value, the Group makes provisions writing inventory down to its net recoverable value. Inventory is initially assessed for impairment by comparing inventory levels to recent utilisation rates and carrying values to historical selling prices. A detailed review is completed for inventory lines identified in the initial assessment considering sales activity, order flow, customer contracts and current selling prices.

At 31 July 2016, there were provisions of £70m (2015: £72m) against gross inventory of £548m (2015: £528m). See note 13 for a breakdown of inventory.

A 10% increase in the proportion of raw materials provided for would increase the provision by £20m (2015: £18m) and a 10% increase in the proportion of finished goods provided for would increase the provision by £23m (2015: £24m).

Impairment

Goodwill is tested at least annually for impairment and other assets, including 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 assets are determined based on value in use calculations unless future trading projections cannot be adjusted to eliminate the impact of a major restructuring. The value in use 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 Interconnect and disclosures on the sensitivity of the impairment testing to these key assumptions, including details of the changes in assumptions which would be required to trigger an impairment in Smiths Interconnect Power.

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 £252m (2015: £216m) 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. 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 £94m (2015: £71m) 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.

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.

All provisions may be subject to potentially material revisions from time to time if new information becomes available as a result of future events. See note 22 for details of the assumptions and disclosures on the sensitivity of the provision calculations.

Presentation of results

In order to provide users of the accounts with a clear and consistent presentation of the underlying performance of the Group's ongoing trading activity, Smiths Group plc presents its results in the income statements with amounts relating to costs of acquisitions and disposals, amortisation of acquired intangibles, impairments, legacy liabilities, significant restructuring, material one-off items and certain re-measurements in a separate column. See note 3 for a breakdown of the items excluded from headline operating profit and headline finance costs.

Measures of the underlying performance of the Group's ongoing trading activity are described as 'headline' and used by management to measure and monitor performance. See note 1 for disclosures of headline operating profit and note 28 for more information about the calculation of return on capital employed and credit metrics.

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. A list of the subsidiaries of Smiths Group plc is provided on pages 206 to 209.

Subsidiaries are all entities controlled by the Company. Subsidiaries are fully consolidated from the date on which control is obtained by 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.

For the convenience of users, supplementary primary financial statements translated into US dollars have been presented after the Group financial record. Assets and liabilities have been translated into US dollars at the exchange rate at the date of that balance sheet and income, expenses and cash-flows are translated at average exchange rates for the period.

Revenue

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

When the Group enters into complex contracts with multiple, separately identifiable components, the terms of the contract are reviewed to determine whether or not the elements of the contract should be accounted for separately. If a contract is being split into multiple components, the contract revenue is allocated to the different components at the start of the contract. The basis of allocation depends on the substance of the contract. The Group considers relative stand-alone selling prices, contractual prices and relative cost when allocating revenue.

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.

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.

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.

Current income tax assets and liabilities are measured at the amount expected to be recovered from or paid to taxation authorities. Tax benefits are not recognised unless it is likely that the tax positions are sustainable. Once considered to be likely, tax benefits are reviewed to assess whether a provision should be made based on prevailing circumstances. Tax provisions are included in current tax liabilities, including any anticipated interest & penalties. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted, at the reporting date in the countries where the Group operates and generates taxable income.

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.

Employee benefits

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 AA-rated 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.

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.

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 over the estimated period of sale for each product, commencing in the year that sales of the product are first made. Amortisation is charged straight line or based on the units produced, depending on the nature of the product and the availability of reliable estimates of production volumes.

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 and 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 13: Fair value measurement' 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 that are significant to the resulting value are not based on observable market data.

See note 20 for information on the methods the Group uses to estimate the fair values of its financial instruments.

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 will affect future annual reports and accounts.

- 'IFRS 9: Financial instruments'
- 'IFRS 15: Revenue from contracts with customers'
- 'IFRS 16: Leases'

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. In particular the review of the impact of 'IFRS 15: Revenue from contracts with customers' will require an assessment at contract level for the military and long-term service businesses, and the impact of adopting this standard cannot be reliably estimated until this work is substantially complete.

These standards are under review by the EU and Smiths currently applies IFRS as adopted by the EU. Smiths will confirm their adoption date when the standards are applicable to Smiths, depending on the EU approval process and developments in the relationship between the UK and the EU.

Parent Company
The ultimate parent company of the Group is Smiths Group plc, a company incorporated in England and Wales and listed on the London Stock Exchange.

The accounts of the Parent Company, Smiths Group plc, have been prepared in accordance with UK GAAP, applying Financial Reporting Standard 101, "Reduced Disclosure Framework". The Company accounts are presented in separate financial statements on pages 194 to 205. The principal subsidiaries of the Parent Company are listed in the above accounts.

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 – infusion systems, vascular access (including safety needles), patient airway and temperature management equipment and specialty devices in areas of in vitro fertilisation, diagnostics and emergency patient transport;
- 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 at each Board meeting 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.

Segment trading performance

							Year ended 31 July 2016
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £m
Revenue	830	874	526	435	284		2,949
Divisional headline operating profit	181	187	69	57	51		545
Corporate headline operating costs						(35)	(35)
Headline operating profit/(loss)	**181**	**187**	**69**	**57**	**51**	**(35)**	**510**
Items excluded from headline measures (note 3)	(30)	(21)	(6)	(31)	(14)	(21)	(123)
Operating profit/(loss)	**151**	**166**	**63**	**26**	**37**	**(56)**	**387**

							Year ended 31 July 2015
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £m
Revenue	905	836	467	420	269		2,897
Divisional headline operating profit	225	166	55	49	50		545
Corporate headline operating costs						(34)	(34)
Headline operating profit/(loss)	**225**	**166**	**55**	**49**	**50**	**(34)**	**511**
Items excluded from headline measures (note 3)	(60)	(24)	(10)	(21)	(9)	7	(117)
Operating profit/(loss)	**165**	**142**	**45**	**28**	**41**	**(27)**	**394**

1 Segment information continued

Analysis by operating segment continued

Segment trading performance continued

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

	Year ended 31 July 2016						
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
Depreciation	15	20	6	8	3	1	53
Amortisation of capitalised development		14	12				26
Amortisation of software, patents and intellectual property	2	4	3	2		6	17
Amortisation of acquired intangibles						15	15
Impairment of goodwill						23	23
Impairment of trade investments						2	2
Impairment of property, plant and equipment						6	6
Share-based payment	1	2	1	1	1	4	10

	Year ended 31 July 2015						
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
Depreciation	14	18	4	9	3	1	49
Amortisation of capitalised development		13	10				23
Amortisation of software, patents and intellectual property	3	3	2	1		6	15
Amortisation of acquired intangibles						33	33
Impairment of goodwill						27	27
Share-based payment	2	1	1		1	4	9

The reconciling items are central costs and charges that are treated as non-headline (see note 3).

Segment assets and liabilities

Segment assets

	31 July 2016						
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate and non-headline £m	Total £m
Property, plant, equipment, development projects, other intangibles and investments	100	221	95	46	33	15	510
Inventory, trade and other receivables	364	280	316	189	99	26	1,274
Segment assets	**464**	**501**	**411**	**235**	**132**	**41**	**1,784**

	31 July 2015						
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate and non-headline £m	Total £m
Property, plant, equipment, development projects, other intangibles and investments	96	175	84	38	22	167	582
Inventory, trade and other receivables	351	247	260	160	83	9	1,110
Segment assets	**447**	**422**	**344**	**198**	**105**	**176**	**1,692**

1 Segment information continued

Analysis by operating segment continued

Segment assets and liabilities continued

Segment liabilities

							31 July 2016
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate and non-headline £m	Total £m
Divisional liabilities	(124)	(121)	(196)	(78)	(37)		(556)
Corporate and non-headline liabilities						(408)	(408)
Segment liabilities	**(124)**	**(121)**	**(196)**	**(78)**	**(37)**	**(408)**	**(964)**

							31 July 2015
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate and non-headline £m	Total £m
Divisional liabilities	(141)	(108)	(156)	(64)	(37)		(506)
Corporate and non-headline liabilities						(316)	(316)
Segment liabilities	**(141)**	**(108)**	**(156)**	**(64)**	**(37)**	**(316)**	**(822)**

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

Reconciliation to segment assets and liabilities to statutory assets and liabilities

	Assets		Liabilities	
	31 July 2016 £m	31 July 2015 £m	31 July 2016 £m	31 July 2015 £m
Segment assets and liabilities	**1,784**	**1,692**	**(964)**	**(822)**
Goodwill and acquired intangibles	1,556	1,351		
Derivatives	42	24	(20)	(18)
Current and deferred tax	308	248	(167)	(121)
Retirement benefit assets and obligations	328	170	(248)	(278)
Cash and borrowings	431	495	(1,409)	(1,313)
Assets and liabilities of business held for sale	24		(5)	
Statutory assets and liabilities	**4,473**	**3,980**	**(2,813)**	**(2,552)**

Segment capital expenditure

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 2016	14	53	19	12	9	3	**110**
Capital expenditure year ended 31 July 2015	19	44	11	12	5	6	**97**

The reconciling items include corporate capital expenditure through Smiths Business Information Services on IT equipment and software.

1 Segment information continued

Analysis by operating segment continued

Segment capital employed

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 £815m (31 July 2015: £815m) and eliminate post-retirement benefit assets and liabilities and litigation provisions relating to non-headline items, both net of related tax, and net debt. See note 28 for a reconciliation of net assets to capital employed.

The 12-month rolling average capital employed by division, which Smiths use to calculate divisional return on capital employed, is:

						31 July 2016
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Average divisional capital employed	895	1,190	578	549	162	3,374
Average corporate capital employed						(50)
Average total capital employed						**3,324**

						31 July 2015
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Average divisional capital employed	872	1,126	577	535	148	3,258
Average corporate capital employed						(61)
Average total capital employed						**3,197**

Analysis of revenue

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

John Crane	First-fit £m	Aftermarket £m	Total £m
Revenue year ended 31 July 2016	338	492	**830**
Revenue year ended 31 July 2015	396	509	**905**

The detail in the John Crane revenue split has been reduced because the Group considers focusing on the split between First-Fit and Aftermarket revenue provides greater insight into trends affecting John Crane.

Smiths Medical	Infusion systems £m	Vascular access £m	Vital care £m	Specialty products £m	Total £m
Revenue year ended 31 July 2016	273	289	240	72	**874**
Revenue year ended 31 July 2015	262	279	225	70	**836**

Smiths Detection	Transportation £m	Ports and borders £m	Military £m	Critical infrastructure £m	Total £m
Revenue year ended 31 July 2016	235	89	79	123	**526**
Revenue year ended 31 July 2015	243	50	69	105	**467**

Smiths Interconnect	Connectors £m	Microwave £m	Power £m	Total £m
Revenue year ended 31 July 2016	155	192	88	**435**
Revenue year ended 31 July 2015 (restated)	149	192	79	**420**

The allocation of Smiths Interconnect revenue for the year ended 31 July 2015 has been restated following a reorganisation that moved a business from Power to Microwave.

Flex-Tek	Fluid Management £m	Flexible Solutions £m	Heat Solutions £m	Construction Products £m	Total £m
Revenue year ended 31 July 2016	72	54	66	92	**284**
Revenue year ended 31 July 2015	69	51	65	84	**269**

1 Segment information continued

Analysis of revenue continued

The Group's statutory revenue is analysed as follows:

	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Sale of goods	2,607	2,600
Services	312	268
Contracts qualifying as construction contracts	30	29
	2,949	**2,897**

Analysis by geographical areas

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

	Revenue		Intangible assets and property plant and equipment	
	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m	31 July 2016 £m	31 July 2015 £m
United Kingdom	114	121	129	119
Germany	131	128	325	270
France	85	81	17	16
Other European	291	290	70	58
Total European	**621**	**620**	**541**	**463**
United States of America	1,396	1,378	1,349	1,172
Canada	106	111	14	14
Other North American	33	40	10	9
Total North American	**1,535**	**1,529**	**1,373**	**1,195**
Japan	101	93	21	14
China (excluding Hong Kong)	95	98	63	57
Rest of the World	597	557	59	48
	2,949	**2,897**	**2,057**	**1,777**

2 Operating profit is stated after charging

	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Research and development expense	87	84
Operating leases		
– land and buildings	30	31
– other	8	9

	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Audit services		
Fees payable to the Company's auditors for the audit of the Company's annual financial statements	3	3
Fees payable to the Company's auditors and its associates for other services		
– the audit of the Company's subsidiaries	2	2
	5	**5**
All other services		1

Other services comprise audit-related assurance services £0.1m (2015: £nil), tax advisory services £0.1m (2015: £0.1m), tax compliance services £nil (2015: £0.1m), one-off IT and consulting projects £nil (2015: £0.4m) and other services £0.1m (2015: £nil). Total fees for non-audit services comprise 6% (2015: 12%) of audit fees. Audit-related assurance services include the review of the Interim Report.

3 Non-statutory profit measures

Headline profit measures

The Company seeks to present a measure of underlying performance which is not impacted by material non-recurring 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. See the disclosures on presentation of results in accounting policies for an explanation of the excluded items. The excluded items are referred to as 'non-headline' items.

Headline operating profit

The non-headline items included in statutory operating profit are as follows:

	Notes	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Restructuring programmes		(37)	(38)
Changes to post-retirement benefits		(9)	14
Acquisition and disposal costs and profits on disposal		(6)	2
Provision for Titeflex Corporation subrogation claims		(11)	(8)
Provision for John Crane, Inc. asbestos litigation		(23)	(19)
Cost recovery for John Crane, Inc. asbestos litigation		16	
Legacy retirement benefits administration costs	8	(7)	(8)
Impairment of goodwill, property, plant and equipment and trade investments		(31)	(27)
Amortisation of acquired intangible assets	10	(15)	(33)
Non-headline items in operating profit		**(123)**	**(117)**

Material items for the year ended 31 July 2016

Restructuring costs comprise £37m in respect of *Fuel for Growth*. This programme, which involves redundancy, relocation and consolidation of manufacturing, is considered a material non-recurring item by virtue of its size.

The £9m charge relating to post-retirement benefits comprises the £10m settlement cost for the buy-out of retiree liabilities completed by the US pension scheme on 14 August 2015, net of a £1m settlement gain on closing a small scheme in Holland.

An additional provision of £12m has been recognised by Titeflex Corporation in respect of changes to the estimated cost of future claims from insurance companies seeking recompense for damage allegedly caused by lightning strikes, and £1m overprovision for the costs of settling claims in the year has been released, generating a net charge of £11m.

The operating charge for John Crane, Inc. litigation comprises a charge of £8m in respect of the net increased provision for adverse judgments and legal defence costs, a charge of £7m arising from the decrease in US risk free rates, and £8m costs for litigation management, defence strategy and legal fees in connection with litigation against insurers. This is offset in the income statement by the recovery of £16m through a settlement with one insurer.

Impairments comprise £23m goodwill write-downs (see note 11), £6m on property plant and equipment and £2m on trade investments.

3 Non-statutory profit measures continued

Headline profit measures continued

Headline operating profit continued

Material items for the year ended 31 July 2015

Restructuring costs included £39m in respect of *Fuel for Growth* and a £1m credit for provisions relating to earlier restructuring programmes which were released in the period.

Gains of £14m on changes to post-retirement benefits arose from a settlement offer by the US defined benefit pension plans – allowing deferred members a one-off option to elect to cash out their retirement entitlements rather than receive a pension at retirement – which was completed in September 2014.

A charge of £8m was 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 strikes. The change comprised £7m in respect of movements in the gross provision and £1m relating to changes in discounting.

The operating charge in respect of John Crane, Inc. litigation comprised £14m in respect of increased provision, £4m in respect of litigation management and legal fees in connection with litigation against insurers, and £1m arising from the decrease in US risk-free rates.

Headline finance costs

The non-headline items included in statutory finance costs are as follows:

	Notes	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Adjustment to discounted provisions	22	(5)	(5)
Fair value gain realised on contributing government bonds to Smiths Industries Pension Scheme	4	19	
Other financing gains/(losses)		1	(4)
Other finance income/(costs) – retirement benefits	8	3	(8)
Non-headline gains/(losses) in finance costs		**18**	**(17)**

See note 4 for an explanation of the fair value gain on bonds and note 8 for details of the impact of this transaction on the pension funding position.

4 Net finance costs

	Notes	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Interest receivable		**3**	**3**
Interest payable			
– bank loans and overdrafts, including associated fees		(8)	(8)
– other loans		(54)	(47)
Interest payable		**(62)**	**(55)**
Other financing gains/(losses)			
– fair value (losses)/gains on hedged debt		(23)	8
– fair value gains/(losses) on fair value hedges		23	(8)
– fair value gain realised on contributing government bonds to Smiths Industries Pension Scheme		19	
– net foreign exchange gains/(losses)		1	(4)
– adjustment to discounted provisions		(5)	(5)
Other financing losses		**15**	**(9)**
Net interest income/(expense) on retirement benefit obligations	8	**3**	**(8)**
Net finance costs		**(41)**	**(69)**

The government bonds were accounted for as available for sale financial assets, and the cumulative fair value gains of £19m on these assets were recycled from other comprehensive income to the income statement when the bonds were contributed to the Smiths Industries Pension Scheme.

5 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 2016 £m	Year ended 31 July 2015 £m
Profit attributable to equity shareholders for the year – total	259	246
Average number of shares in issue during the year	395,095,591	394,742,972

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 398,957,837 (2015: 398,552,818) 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 2016, 223,993 options (2015: no options) were excluded from this calculation because their effect was anti-dilutive for continuing operations.

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

	Year ended 31 July 2016		Year ended 31 July 2015	
	£m	EPS (p)	£m	EPS (p)
Profit attributable to equity shareholders of the Parent Company	259	65.6	246	62.4
Exclude				
Non-headline items and related tax	77	19.6	94	23.7
Headline profit attributable to equity shareholders for the year	336	85.2	340	86.1
Statutory earnings per share – diluted (p)		64.9		61.8
Headline earnings per share – diluted (p)		84.3		85.3

6 Taxation

The Group's approach to taxation is set out in the CFO report. 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 2016 £m	Year ended 31 July 2015 £m
The taxation charge in the consolidated income statement for the year comprises		
– current income tax charge	56	71
– current tax adjustments in respect of prior periods		(1)
Current taxation	**56**	**70**
– deferred taxation	29	7
Total taxation expense in the consolidated income statement	**85**	**77**

6 Taxation continued

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 20.0% (2015: 20.7%). The difference is reconciled as follows:

	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Profit before taxation – continuing operations	**346**	**325**
Notional taxation expense at UK rate of 20.0% (2015: 20.7%)	69	67
Different tax rates on non-UK profits and losses	9	6
Non-deductible expenses	16	10
Tax credits and non-taxable income	(11)	(16)
Adjustments to unrecognised deferred tax	2	11
Prior year true-up		(1)
	85	**77**
Comprising		
– taxation on headline profit	113	117
– tax on non-headline loss	(34)	(44)
– change in deferred tax recognition treated as non-headline	6	4
Taxation expense in the consolidated income statement	**85**	**77**

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.

	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Tax on items charged/(credited) to equity		
Deferred tax charge/(credit)		
– retirement benefit schemes	(10)	(21)
– share options		1
	(10)	**(20)**

The net retirement benefit charge to equity includes £4m (2015: £nil) relating to UK schemes. The main UK defined benefit pension plans are now in surplus, producing a deferred tax liability

Current taxation

	Current tax £m
At 31 July 2014	(41)
(Charge)/credit to income statement	(70)
Tax paid	91
At 31 July 2015	(20)
Foreign exchange gains and losses	4
(Charge)/credit to income statement	(56)
Tax paid	62
At 31 July 2016	**(10)**
Current tax receivable	62
Current tax payable	(72)
At 31 July 2016	**(10)**

Provisions included in current tax liabilities are established based on reasonable estimates for the possible consequences of tax authority audits in the various countries in which the Group operates. Management judgement is used to determine the amount of such provisions based on an understanding of the relevant local tax law, taking into account the differences of interpretation that can arise on a wide variety of issues, depending on the prevailing circumstances, including the nature of current tax audits and the experience of previous enquiries.

6 Taxation continued

Deferred taxation

	Property, plant and equipment and intangible assets £m	Employment benefits £m	Losses carried forward £m	Provisions £m	Other £m	Total £m
At 1 August 2014	(106)	49	21	117	46	127
Credit/(charge) to income statement	(2)	(10)	5	1	(1)	(7)
Credit/(charge) to equity		20				20
Exchange adjustments	(8)	2	2	8	3	7
At 31 July 2015	**(116)**	**61**	**28**	**126**	**48**	**147**
Deferred tax assets	(23)	61	26	112	42	218
Deferred tax liabilities	(93)		2	14	6	(71)
At 31 July 2015	**(116)**	**61**	**28**	**126**	**48**	**147**
Credit/(charge) to income statement	(7)	(72)	53	(10)	7	(29)
Credit/(charge) to equity		10				10
Acquisitions	(1)					(1)
Exchange adjustments	(21)	9	6	24	6	24
At 31 July 2016	**(145)**	**8**	**87**	**140**	**61**	**151**
Deferred tax assets	(24)	8	84	134	44	246
Deferred tax liabilities	(121)		3	6	17	(95)
At 31 July 2016	**(145)**	**8**	**87**	**140**	**61**	**151**

The deferred tax asset relating to losses carried forward has been recognised on the basis:

- utilisation against offsetting deferred tax liabilities, including £49m relating to UK losses that has been recognised to offset an equivalent liability on the UK pension surplus; or
- evidence that operations show a consistent pattern of improving results and the Group has implemented plans to support continuing improvements or the losses relate to specific, identified non-recurring events.

Deferred tax relating to provisions includes £84m (2015: £72m) relating to the John Crane, Inc. litigation provision, and £36m (2015: £27m) relating to Titeflex Corporation. See note 22 for additional information on provisions; and

Included in other deferred tax balances above is a deferred tax asset of £25m (2015: £26m) relating to inventory where current tax relief is only available when the inventory is sold.

The Group has not recognised deferred tax relating to deductible temporary differences in the UK amounting to £402m (2015: £400m) and non-UK losses amounting to £93m (2015: £126m).

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

	2016 £m	Expiry of losses	2015 £m	Expiry of losses
Territory				
– Americas	36	2019-2036	36	2019-2035
– Asia	11	2017-2023	12	2016-2022
Total restricted losses	**47**		**48**	
Unrestricted losses				
– operating losses	211	No expiry	453	No expiry
Total	**258**		**501**	

7 Employees

	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Staff costs during the period		
Wages and salaries	745	731
Social security	84	86
Share-based payment (note 9)	10	9
Pension costs (including defined contribution schemes) (note 8)	33	31
	872	**857**

The average number of persons employed, rounded to the nearest 50 employees, was:

	Year ended 31 July 2016	Year ended 31 July 2015
John Crane	6,550	6,950
Smiths Medical	7,600	7,950
Smiths Detection	2,050	2,150
Smiths Interconnect	3,400	3,850
Flex-Tek	2,050	2,050
Smiths Business Information Services	250	250
Corporate	100	50
	22,000	**23,250**

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

Key management

The key management of the Group comprises Smiths Group plc Board directors and Executive Committee members. Their aggregate compensation is shown below. Details of directors' remuneration are contained in the report of the Remuneration Committee on pages 94 to 114.

	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Key management compensation		
Salaries and short-term employee benefits	12.8	12.7
Cost of post-retirement benefits	0.1	
Cost of share-based incentive plans	4.5	2.7

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 2016		Year ended 31 July 2015	
	Number of instruments '000	Weighted average price	Number of instruments '000	Weighted average price
CIP	468		589	
ESOS			18	£10.97
LTIP	1,185		1,374	
Restricted stock	261			
SAYE	15	£8.99	11	£9.19

Related party transactions

The only related party transactions in the year ended 31 July 2016 were key management compensation (31 July 2015: no other transactions).

8 Post-retirement benefits

Smiths provides post-retirement benefits to employees in a number of countries. This includes 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 consolidated income statement in respect of all these plans was £30m (2015: £28m).

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.

For all schemes, pension costs are assessed in accordance with the advice of independent, professionally qualified actuaries. These valuations have been updated by independent qualified actuaries in order to assess the liabilities of the schemes as at 31 July 2016. Scheme assets are stated at their market values. Contributions to the schemes are made on the advice of the actuaries, in accordance with local funding requirements.

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

	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
At beginning of period	(108)	(242)
Exchange adjustment	(31)	(3)
Reclassification of small unfunded obligations		(2)
Current service cost	(3)	(3)
Scheme administration costs	(7)	(8)
Past service cost, curtailments, settlements	(9)	14
Finance income/(charges) – retirement benefits	3	(8)
Contributions by employer	275	84
Actuarial (loss)/gain	(39)	60
Movement in surplus restriction	(1)	
Net retirement benefit asset/(liability)	**80**	**(108)**

UK pension schemes

Smiths funded UK pension schemes are subject to a statutory funding objective, as set out in UK pension legislation. Scheme trustees need to obtain regular actuarial valuations to assess the scheme against this funding objective. The trustees and sponsoring companies need to agree funding plans to improve the position of a scheme, when it is below the acceptable funding level.

The UK Pensions Regulator has extensive powers to protect the benefits of members, promote good administration and reduce the risk of situations arising which may require compensation to be paid from the Pension Protection Fund. These powers include imposing a schedule of contributions or the calculation of the technical provisions, where a trustee and company fail to agree appropriate calculations.

Smiths Industries Pension Scheme ("SIPS")

This scheme was closed to future accrual effective 1 November 2009. SIPS provides index-linked pension benefits based on final earnings at date of closure. SIPS is governed by a corporate trustee (SI Trustee Limited, a wholly owned subsidiary of Smiths Group plc). The board of trustee directors comprises five company-nominated trustees and four member-nominated trustees, with an independent chairman selected by Smiths Group plc. Trustee Directors are responsible for the management, administration, funding and investment strategy of the scheme.

The most recent actuarial valuation of this scheme has been performed using the Projected Unit Method as at 31 March 2015, and experience gains and losses identified during this valuation have been incorporated into the IAS 19 valuation. Under the funding plan for SIPS agreed in November 2015 Smiths pays cash contributions of £2m a month until June 2020. As part of this agreement, Smiths contributed the index-linked gilts previously held in an escrow account. Under the governing documentation of the SIPS, any future surplus would be returnable to Smiths Group plc by refund, assuming gradual settlement of the liabilities over the lifetime of the scheme.

SIPS will implement Guaranteed Minimum Pensions equalisation in respect of members contracted out of the State Earnings Related Pensions Scheme prior to 6 April 1997, once the government has completed its consultations and confirmed an approach. It is not yet possible to reliably quantify the impact of this adjustment.

The duration of the SIPS liabilities is around 23 years (2015: 23 years) for active deferred members, 24 years (2015: 23 years) for deferred members and 12 years (2015: 12 years) for pensioners and dependants.

8 Post-retirement benefits continued

Defined benefit and post-retirement healthcare plans continued

UK pension schemes continued

TI Group Pension Scheme ("TIGPS")

This scheme was closed to future accrual effective 1 November 2009. TIGPS provides index-linked pension benefits based on final earnings at the date of closure. TIGPS is governed by a corporate trustee (TI Pension Trustee Limited, an independent company). The board of trustee directors comprises five company-nominated trustees and four member-nominated trustees, with an independent trustee director selected by the Trustee. The Trustee is responsible for the management, administration, funding and investment strategy of the scheme.

The most recent actuarial valuation of this scheme has been performed using the Projected Unit Method as at 5 April 2015. Under the funding plan for TIGPS agreed in March 2016 Smiths pays cash contributions of £3m a year until April 2018. Under the governing documentation of the TIGPS, any future surplus would be returnable to Smiths Group plc by refund, assuming gradual settlement of the liabilities over the lifetime of the scheme.

TIGPS will implement Guaranteed Minimum Pensions equalisation in respect of members contracted out of the State Earnings Related Pensions Scheme prior to 6 April 1997, once the government has completed its consultations and confirmed an approach. It is not yet possible to reliably quantify the impact of this adjustment.

The duration of the TIGPS liabilities is around 25 years (2015: 21 years) for active deferred members, 24 years (2015: 19 years) for deferred members and 11 years (2015: 11 years) for pensioners and dependants.

US pension plans

The most recent valuations of the six principal US pension and post-retirement healthcare plans were performed at 1 January 2015.

The pension plans were closed with effect from 30 April 2009 and benefits were calculated as at that date and are not revalued. Governance of the US pension plans is managed by a Settlor Committee appointed by Smiths Group Services Corp, a wholly owned subsidiary.

The duration of the liabilities for the largest US plan is around 20 years (2015: 14 years) for active deferred members, 20 years (2015: 19 years) for deferred members and 12 years (2015: 10 years) for pensioners and dependants.

On 14 August 2015 the US funded plans completed a buy-out of retiree liabilities for $527m, transferring the obligation to pay pensions to Voya Retirement Insurance and Annuity Company. A settlement loss of £10m has been recognised on this transaction (see note 3). In August 2014, the US pension plans offered deferred members a one-off option to elect to cash out their retirement entitlements rather than receive a pension at retirement. Lump sum payments of $150m were made in August and September 2014. This programme generated a settlement gain of £14m in the year ended 31 July 2015.

Risk management

The pensions schemes are exposed to risks that:

- investment returns are below expectations, leaving the scheme with insufficient assets in future to pay all its pension obligations;
- members and dependants live longer than expected, increasing the value of the pensions the scheme has to pay;
- inflation rates are higher than expected, so amounts payable under index-linked pensions are higher than expected; and
- increased contributions may be required to meet regulatory funding targets if lower interest rates increase the current value of liabilities.

These risks are managed separately for each pension scheme. However Smiths has adopted a common approach of closing defined benefit schemes to cap members' entitlements and supporting trustees in adopting investment strategies which match assets to future obligations, after allowing for the funding position of the scheme.

TI Group Pension Scheme ("TIGPS")

TIGPS with a mature member profile, and a strong funding position, has been able to progress its matching strategy to the point where roughly 50% of liabilities are covered by matching annuities, eliminating investment return, longevity, inflation and funding risks.

Smiths Industries Pension Scheme ("SIPS")

In August 2014 SIPS adjusted the scheme investment strategy. The scheme has investments in diversified growth funds and a portfolio of exchange traded equity index futures managed by BlackRock. The risk and return characteristics of equity index futures are similar to physical equities, but provide the scheme with improved liquidity. As at 31 July 2016 the SIPS portfolio of exchange traded equity index futures generated a £163m (2015: £497m) exposure to equities.

Following the company contribution of £152m UK government bonds to SIPS in December 2015 and the resulting improvement in the funding position, the trustees have adopted a leveraged liability matching strategy. The scheme uses repurchase arrangements, total return swaps, inflation swaps and interest rate swaps to hedge the interest and inflation risks of the scheme liabilities. Repurchase agreements exchange government bonds held by the scheme for cash with an obligation to buy back the asset at a fixed future date and price. The cash is invested in liability matching assets, reducing funding risk. A total return swap exchanges the return on a specified asset (for example an index-linked bond) and an interest payment (fixed or floating). Contracts are spread across a panel of banks. To minimise the risk that counterparties fail to settle obligations, positions are collateralised. For repurchase agreements, collateral is the difference between the present value of the repurchase obligation and the value of the asset exchanged. For swaps, collateral is based on market values. At 31 July 2016 scheme assets were net of £720m (2015: £nil) repurchase obligations, and nominal exposure from interest rate swaps of £293m, inflation swaps of £263m and total return swaps of £14m.

8 Post-retirement benefits continued

Defined benefit and post-retirement healthcare plans continued

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

	2016 UK	2016 US	2016 Other	2015 UK	2015 US	2015 Other
Rate of increase in salaries	n/a	n/a	2.8%	n/a	n/a	2.6%
Rate of increase for active deferred members	3.6%	n/a	n/a	4.1%	n/a	n/a
Rate of increase in pensions in payment	2.7%	n/a	1.6%	3.2%	n/a	1.0%
Rate of increase in deferred pensions	2.7%	n/a	0.1%	3.2%	n/a	0.1%
Discount rate	2.3%	3.45%	2.8%	3.5%	4.35%	3.3%
Inflation rate	2.7%	n/a	2.3%	3.2%	n/a	1.6%
Healthcare cost increases	4.2%	n/a	1.4%	4.7%	n/a	2.1%

The assumptions used in calculating the costs and obligations of the Group's defined benefit pension plans are set by Smiths after consultation with independent professionally qualified actuaries. 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 assumptions are disclosed as a weighted average.

Discount rate assumptions

The UK schemes use a discount rate based on the yield on the iBOXX over 15-year AA-rated corporate bond index, adjusted if necessary to better reflect the shape of the yield curve considering the Aon Hewitt GBP Select AA curve. For the USA, the discount rate is based on the Towers Watson cash-flow matching models and set with reference to Moody's Aa annualised yield, the Citigroup High Grade Index and the Merrill Lynch 15+ years High Quality Index.

Mortality assumptions

The mortality assumptions used in the principal UK schemes are based on the new "SAPS S2" All Birth year tables with relevant scaling factors based on the recent experience of the schemes. The assumption allows for future improvements in life expectancy in line with the 2015 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-2014 table adjusted backward to 2006 with MP-2014 and projected forward using MP-2015 as of 31 July 2016. The table selected allows for future mortality improvements and applies an adjustment for job classification (blue collar versus white collar).

Expected further years of life	UK schemes				US schemes			
	Male 31 July 2016	Female 31 July 2016	Male 31 July 2015	Female 31 July 2015	Male 31 July 2016	Female 31 July 2016	Male 31 July 2015	Female 31 July 2015
Member who retires next year at age 65	23	24	23	24	21	23	22	24
Member, currently 45, when they retire in 20 years' time	24	26	25	27	23	25	23	26

Sensitivity

Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 July 2016 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. In practice, such assumptions rarely change in isolation.

	Profit before tax for year ended 31 July 2016 £m	Increase/ (decrease) in scheme assets 31 July 2016 £m	(Increase)/ decrease in scheme liabilities 31 July 2016 £m	Profit before tax for year ended 31 July 2015 £m	Increase/ (decrease) in scheme assets 31 July 2015 £m	(Increase)/ decrease in scheme liabilities 31 July 2015 £m
Rate of mortality – 1 year increase in life expectancy	(3)	53	(183)	(4)	47	(157)
Rate of mortality – 1 year decrease in life expectancy	3	(53)	183	4	(47)	160
Rate of inflation – 0.25% increase	(2)	16	(119)	(3)	13	(89)
Discount rate – 0.25% increase	4	(19)	168	5	(19)	139
Market value of scheme assets – 2.5% increase	2	86		3	80	

The effect on profit before tax reflects the impact of current service cost and net interest cost. 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.

Asset valuation

Liquidity funds, equities and bonds are valued using quoted market prices in active markets. Exchange traded equity index futures are valued at market prices.

Total return, interest and inflation swaps are bilateral agreements between counterparties and do not have observable market prices. These derivative contracts are valued using observable market inputs.

Insured liabilities comprise annuity policies matching the scheme obligation to identified groups of pensioners. These assets are valued at the actuarial valuation of the corresponding liability, reflecting this matching relationship. Property is valued by specialists applying recognised property valuation methods incorporating current market data on rental yields and transaction prices.

8 Post-retirement benefits continued

Defined benefit and post-retirement healthcare plans continued

Retirement-benefit plan assets

	31 July 2016 £m				31 July 2015 £m			
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
Cash and cash equivalents								
– cash	57	1		58	41	17		58
– liquidity funds	89			89	172	1		173
– cash collateral and liquidity funds held to support exchange traded futures	53			53	29			29
Equities								
– UK funds	111		3	114	123		1	124
– North American funds	124		2	126	129	110	2	241
– other regions and global funds	214		5	219	227	47	16	290
Government bonds								
– index-linked bonds	1,410			1,410	1,052			1,052
– fixed-interest bonds	599	70	20	689	171	71	11	253
Corporate bonds	861	145	5	1,011	284	199	2	485
Insured liabilities	802		1	803	783			783
Property								
– UK property	149			149	174			174
– other property			1	1				
Other								
– diversified growth funds and scheme receivables	285		25	310	338		17	355
– repurchase obligations	(720)			(720)				
Total market value	**4,034**	**216**	**62**	**4,312**	**3,523**	**445**	**49**	**4,017**

SIPS has a portfolio of exchange traded equity index futures, which are valued at market prices. These futures increase "leverage" in SIPS, creating additional asset exposure. At 31 July 2016, the gross equity exposure generated by these exchange traded futures was £163m (2015: £497m). At 31 July 2016 the aggregate value of this strategy, including cash received as collateral, was £9m (2015: a liability of less than £1m). The scheme was holding £44m (2015: £29m) in liquidity funds to meet potential future obligations to collateralise equity index futures.

UK other investments at 31 July 2016 included £162m (2015: £330m) of investments in diversified growth funds held by SIPS, £107m of investments in leveraged index linked UK government bond funds held by TIGPS and £9m (2015: £nil) SIPS interest and inflation swaps.

At 31 July 2016 SIPS assets were net of £720m (2015: £nil) repurchase obligations, and included £11m (2015: £nil) gains on interest rate swaps and £2m (2015: £nil) losses on inflation swaps. See risk management disclosures on page 156 for information on how the scheme is using repurchase arrangements and swap contracts to match the interest rate and inflation exposures of its assets to the interest rate and inflation exposures of the scheme liabilities. The scheme was holding £45m (2015: £nil) in liquidity funds to meet potential future obligations to collateralise repurchase arrangements or swap agreements.

The scheme assets do not include any property occupied by, or other assets used by, the Group. Equities include investments in broad-based equity indices, some of which hold ordinary equity shares in Smiths Group plc.

Present value of funded scheme liabilities and assets for the main UK and US schemes

	31 July 2016 £m			31 July 2015 £m		
	SIPS	TIGPS	US schemes	SIPS	TIGPS	US schemes
Present value of funded scheme liabilities						
– Active deferred members	(82)	(82)	(124)	(92)	(76)	(102)
– Deferred members	(881)	(688)	(175)	(756)	(625)	(130)
– Pensioners	(1,086)	(869)	(16)	(995)	(823)	(336)
Present value of funded scheme liabilities	**(2,049)**	**(1,639)**	**(315)**	**(1,843)**	**(1,524)**	**(568)**
Market value of scheme assets	2,227	1,787	216	1,813	1,693	445
Surplus/(deficit)	**178**	**148**	**(99)**	**(30)**	**169**	**(123)**

8 Post-retirement benefits continued

Defined benefit and post-retirement healthcare plans continued

Net retirement benefit obligations

				31 July 2016 £m				31 July 2015 £m
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
Market value of scheme assets	4,034	216	62	4,312	3,523	445	49	4,017
Present value of funded scheme liabilities	(3,709)	(315)	(70)	(4,094)	(3,385)	(568)	(57)	(4,010)
Surplus/(deficit)	**325**	**(99)**	**(8)**	**218**	**138**	**(123)**	**(8)**	**7**
Unfunded pension plans	(56)	(8)	(52)	(116)	(52)	(7)	(37)	(96)
Post-retirement healthcare	(8)	(12)	(1)	(21)	(7)	(11)	(1)	(19)
Present value of unfunded obligations	**(64)**	**(20)**	**(53)**	**(137)**	**(59)**	**(18)**	**(38)**	**(115)**
Unrecognised asset due to surplus restriction			(1)	(1)				
Net pension liability	**261**	**(119)**	**(62)**	**80**	**79**	**(141)**	**(46)**	**(108)**
Post-retirement assets	327		1	328	169		1	170
Post-retirement liabilities	(66)	(119)	(63)	(248)	(90)	(141)	(47)	(278)
Net pension liability	**261**	**(119)**	**(62)**	**80**	**79**	**(141)**	**(46)**	**(108)**

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.

Amounts recognised in the consolidated income statement

	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Amounts charged/(credited) to operating profit		
Current service cost	3	3
Settlement loss/(gain)	9	(14)
Scheme administration costs	7	8
	19	**(3)**
The operating cost is charged/(credited) as follows:		
Cost of sales	1	1
Sales and distribution costs	1	1
Headline administrative expenses	1	1
Non-headline administrative expenses	16	(6)
	19	**(3)**
Amounts charged to finance costs		
Net interest (income)/cost	**(3)**	**8**

Amounts recognised directly in the consolidated statement of comprehensive income

	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Actuarial gains/(losses)		
Difference between interest credit and return on assets	395	239
Experience gains and (losses) on scheme liabilities	58	46
Actuarial gains/(losses) arising from changes in demographic assumptions	47	(15)
Actuarial gains/(losses) arising from changes in financial assumptions	(539)	(210)
Movements in surplus restriction	(1)	
	(40)	**60**

8 Post-retirement benefits continued

Defined benefit and post-retirement healthcare plans continued

Changes in present value of funded scheme assets

				31 July 2016 £m				31 July 2015 £m
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
At beginning of period	3,523	445	49	4,017	3,249	500	51	3,800
Interest on assets	124	9	3	136	128	20	2	150
Actuarial gain on scheme assets	372	20	3	395	242	(6)	3	239
Employer contributions	199	68	2	269	53	23	3	79
Assets distributed on settlement		(360)		(360)			(1)	(1)
Scheme administration costs	(4)	(3)		(7)	(4)	(4)		(8)
Exchange adjustments		51	8	59		40	(5)	35
Benefits paid	(180)	(14)	(3)	(197)	(145)	(128)	(4)	(277)
At end of period	**4,034**	**216**	**62**	**4,312**	**3,523**	**445**	**49**	**4,017**

Changes in present value of funded defined benefit obligations

				31 July 2016 £m				31 July 2015 £m
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
At beginning of period	(3,385)	(568)	(57)	(4,010)	(3,275)	(595)	(65)	(3,935)
Current service cost			(1)	(1)			(1)	(1)
Interest on obligations	(115)	(12)	(2)	(129)	(128)	(23)	(3)	(154)
Actuarial (loss)/gain on liabilities	(389)	(31)	(3)	(423)	(127)	(43)	1	(169)
Liabilities extinguished on settlement		350	1	351		14		14
Exchange adjustments		(68)	(11)	(79)		(49)	7	(42)
Benefits paid	180	14	3	197	145	128	4	277
At end of period	**(3,709)**	**(315)**	**(70)**	**(4,094)**	**(3,385)**	**(568)**	**(57)**	**(4,010)**

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

		Assets		Obligations
	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
At beginning of period			(115)	(107)
Reclassification of small unfunded obligations				(2)
Current service cost			(2)	(2)
Interest on obligations			(4)	(4)
Actuarial loss			(11)	(10)
Employer contributions	6	6		
Exchange adjustments			(11)	4
Benefits paid	(6)	(6)	6	6
At end of period			**(137)**	**(115)**

Cash contributions

Company contributions to the defined benefit pension plans and post-retirement healthcare plans for 2016 totalled £275m (2015: £84m). This comprised regular contributions to funded schemes of £32m (2015: £36m) to SIPS, £11m (2015: £17m) to TIGPS, £34m (2015: £23m) to US Schemes, £6m to other schemes and additional contributions of $50m to fund the buy-out arrangement for US pensioners in August 2015 and the contribution of £152m UK government bonds to SIPS in December 2015. In addition, £6m (2015: £6m) was spent on providing benefits under unfunded defined benefit pension and post-retirement healthcare plans.

In 2017 the following cash contributions to the Group's principal defined benefit schemes are expected: £24m to SIPS; £3m to TIGPS; approximately £29m to other defined benefit plans, including the US scheme; and £6m to unfunded schemes and post-retirement healthcare. Adding £4m planned buy-out funding for small UK and Canadian schemes, expected cash payments for 2017 total £66m.

9 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. LTIP awards are made to selected senior executives, including the executive directors. Awards made prior to 2016 were made with different targets for corporate executives and divisional executives. From 2016 onwards, all LTIP awards will have one set of targets.

LTIP performance conditions
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.

Group LTIP awards have performance conditions relating to underlying revenue growth, growth in headline EPS adjusted to exclude tax, ROCE, cash conversion and, for awards made before 2015, TSR relative to the FTSE 100 (excluding financial services companies).

Divisional LTIP awards have performance conditions relating to divisional performance against headline KPIs, including underlying revenue and operating profit growth, operating margins, ROCE, operating cash conversion, employee engagement and quality metrics.

Smiths Group Co-Investment Plan (CIP) and Smiths Share Matching Plan (SMP)
In 2015 the CIP was replaced by the SMP. Under the CIP and SMP participants are required to invest between 25% and 50% of their post-tax bonus purchasing 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.

For the CIP, 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. If ROCE exceeds WACC by an average margin of 3% per annum, the enhanced performance condition is met, and a second matching share will be issued for every purchased share. For the SMP, vesting of matching shares will occur, and the matching shares will be released, at the end of the three-year period depending on the performance of the Group LTIP issued for the same performance period. The first matching share is awarded if the Group LTIP vests under any performance condition.

No future awards will be made under the CIP or SMP.

Restricted stock
The restricted stock is used by the Remuneration Committee, as a part of the recruitment strategy, to make awards in recognition of incentive arrangements forfeited on leaving a previous employer. If an award is considered appropriate, the award will take account of relevant factors including the fair value of awards forfeited, any performance conditions attached, the likelihood of those conditions being met and the proportion of the vesting period remaining. See the Directors' Remuneration Report pages 94 to 114 for details of the awards made to executive directors recruited in the year.

	CIP	Long-term incentive plans	Restricted stock	Other share schemes	Total	Weighted average price £
Ordinary shares under option ('000)						
1 August 2014	1,568	2,695		1,744	6,007	£2.67
Granted	533	1,240		302	2,075	£1.31
Exercised	(580)	(258)		(418)	(1,256)	£2.62
Lapsed	(152)	(1,028)		(134)	(1,314)	£0.97
31 July 2015	1,369	2,649		1,494	5,512	£2.57
Granted	635	1,628	303	329	2,895	£0.99
Exercised	(530)	(199)	(30)	(380)	(1,139)	£2.95
Lapsed	(35)	(724)		(222)	(981)	£2.20
31 July 2016	**1,439**	**3,354**	**273**	**1,221**	**6,287**	**£1.83**

9 Employee share schemes continued

Options were exercised on an irregular basis during the period. The average closing share price over the financial year was 1,049.61p (2015: 1,176.19p). 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 at 31 Jul 2016 ('000)	Weighted average remaining contractual life at 31 July 2016 (months)	Total shares under option at 31 Jul 2015 ('000)	Weighted average remaining contractual life at 31 July 2015 (months)	Options exercisable at 31 July 2016 ('000)	Exercisable weighted average exercise price for options exercisable at 31 July 2016	Options exercisable at 31 July 2015 ('000)	Exercisable weighted average exercise price for options exercisable at 31 July 2015
£0.00 – £2.00	5,066	18	4,018	15				
£2.01 – £6.00	17	6	18	17				
£6.01 – £10.00	924	33	1,091	27	60	£9.04	263	£8.97
£10.01 – £14.00	280	13	385	25	175	£10.95	257	£10.96

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 2016 and 2015 are volatility of 25% to 30% (2015: 20% to 25%) and dividend yield of 3.75% (2015: 3.75%), based on historical data, for the period corresponding with the vesting period of the option. These generated a weighted average fair value for SMP/CIP of £10.34 (2015: £12.47), Group LTIP of £10.33 (2015: £10.78) and divisional LTIP of £10.33 (2015: £12.55), and restricted stock of £10.03 (2015: no grants). The fair value disclosed for the SMP/CIP award treats the two matching shares as separate options.

Included within staff costs is an expense arising from share-based payment transactions of £10m (2015: £9m), of which £9m (2015: £8m) relates to equity-settled share-based payment.

10 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 2014	1,395	216	386	164	2,161
Exchange adjustments	26	9	19	2	56
Additions		20		18	38
Disposals		(8)	(2)	(7)	(17)
At 31 July 2015	**1,421**	**237**	**403**	**177**	**2,238**
Exchange adjustments	253	43	71	17	384
Business combinations	5		3		8
Additions		25		11	36
Disposals		(3)		(6)	(9)
At 31 July 2016	**1,679**	**302**	**477**	**199**	**2,657**
Amortisation					
At 1 August 2014	86	102	313	116	617
Exchange adjustments	2	4	14	1	21
Charge for the year		23	33	15	71
Impairment charge	27				27
Disposals		(8)	(2)	(6)	(16)
At 31 July 2015	**115**	**121**	**358**	**126**	**720**
Exchange adjustments	24	22	65	11	122
Charge for the year		26	15	17	58
Impairment charge	23				23
Disposals		(3)		(5)	(8)
At 31 July 2016	**162**	**166**	**438**	**149**	**915**
Net book value at 31 July 2016	**1,517**	**136**	**39**	**50**	**1,742**
Net book value at 31 July 2015	1,306	116	45	51	1,518
Net book value at 1 August 2014	1,309	114	73	48	1,544

10 Intangible assets continued

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 2014	68	128	190	386
Exchange adjustments	4	10	5	19
Disposals		(2)		(2)
At 31 July 2015	**72**	**136**	**195**	**403**
Exchange adjustments	13	24	34	71
Business combinations			3	3
At 31 July 2016	**85**	**160**	**232**	**477**
Amortisation				
At 1 August 2014	41	101	171	313
Exchange adjustments	2	8	4	14
Charge for the year	6	13	14	33
Disposals		(2)		(2)
At 31 July 2015	**49**	**120**	**189**	**358**
Exchange adjustments	9	22	34	65
Charge for the year	3	7	5	15
At 31 July 2016	**61**	**149**	**228**	**438**
Net book value at 31 July 2016	**24**	**11**	**4**	**39**
Net book value at 31 July 2015	23	16	6	45
Net book value at 1 August 2014	27	27	19	73

11 Impairment testing

Goodwill

Goodwill is not amortised but is tested for impairment at least annually. Value in use or fair value less cost to sell 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 2017 budget, the five-year strategic plan approved by the Board and detailed divisional strategic projections, where these have been prepared and approved by the Board. Fair value less cost to sell is calculated using available information on past and expected future profitability, valuation multiples for comparable quoted companies (adjusted as required for significant differences) and information on costs of similar transactions. Fair value less costs to sell models are used when trading projections in the strategic plan cannot be adjusted to eliminate the impact of a major restructuring

Goodwill is allocated by division as follows:

	2016 £m	2016 Number of CGUs	2015 £m	2015 Number of CGUs
John Crane	108	3	92	3
Smiths Medical	591	1	508	1
Smiths Detection	410	1	343	1
Smiths Interconnect	381	5	340	5
Flex-Tek	27	2	23	2
	1,517	**12**	**1,306**	**12**

The goodwill allocated to Smiths Interconnect Power has been split, and part of it allocated to Smiths Interconnect Microwave Telecoms, following the transfer of the protection business from Smiths Interconnect Power to Smiths Interconnect Microwave Telecoms to increase synergies from the customer base of these businesses. Goodwill was also reallocated from Smiths Interconnect Microwave Subsystems to Smiths Interconnect Microwave Components when a business was transferred between the two business units. These changes were made to reflect how the businesses were being managed. If goodwill had not been reallocated, the impairment recognised for Smiths Interconnect Microwave Telecoms and Smiths Interconnect Microwave Components would have been smaller.

11 Impairment testing continued

Goodwill continued

Goodwill impairment

John Crane Production Solutions ("JCPS")

JCPS is a business unit of John Crane focused on the servicing and provision of onshore down-hole 'artificial lift' pumping hardware and systems. Goodwill of £nil (2015: £5m) is allocated to JCPS. An impairment test was carried out following completion of the annual strategic planning process because the significant decline in oil prices had adversely affected JCPS customers. JCPS anticipate that customers will continue to scale back expansion plans and reduce running costs. Following this impairment test, the JCPS goodwill has been impaired by £5m (2015: £27m) and property, plant and equipment where the value is expected to be recovered at a CGU level has been impaired by £5m (2015: no impairment). The impairment has occurred because JCPS is now expected to have lower levels of trading activity, operating margins and growth in the future, significantly reducing the value in use of the business.

The impairment loss has been recognised in John Crane administration expenses, and excluded from headline operating profit for the division.

	Year ended 31 July 2016	Year ended 31 July 2015
Impairment loss recognised	**£5m**	**£27m**
Property, plant the equipment impairment loss	**£5m**	
Basis of valuation	value in use	value in use
Discount rate used for impairment test	13.7%	12.9%
Long-term growth rates	2.3%	2.2%

Sales assumptions for JCPS are based on:

- anticipated levels of maintenance and repair activities based on the current forward curve for oil prices; and
- expected North American drilling activity.

The gross margins included in the projections are lower than historical due to lower levels of activity. As required by 'IAS 36: Impairment of assets', margin projections for JCPS are based on the current fixed cost base, and do not incorporate any future restructuring.

At 31 July 2016 the Artificial lift business, comprising the US and Romanian activities of JCPS, was classified as held for sale (see note 27).

Smiths Interconnect Microwave Components

Goodwill of £66m (2015: £52m) is allocated to Smiths Interconnect Microwave Components. The underlying increase in goodwill is due to a reorganisation that moved a business from Smiths Interconnect Microwave Subsystems to Smiths Interconnect Microwave Components. An impairment test was carried out following the completion of the annual strategic planning process, which identified increased execution risks affecting the long-term strategy.

	Year ended 31 July 2016	Year ended 31 July 2015
Impairment loss recognised	**£7m**	
Basis of valuation	value in use	value in use
Discount rate used for impairment test	13.6%	15.6%
Long-term growth rates	2.3%	2.4%

Sales assumptions for Smiths Interconnect Microwave Components are based on:

- the current order book;
- sales projections from major customers; and
- developments in key customer markets including smartphone testing equipment.

Margin projections for Smiths Interconnect Microwave Components incorporate the variable cost structure of the current production capacity.

11 Impairment testing continued

Goodwill continued

Goodwill impairment continued

Smiths Interconnect Microwave Telecoms

Goodwill of £11m (2015: £7m) is allocated to Smiths Interconnect Microwave Telecoms. The underlying increase in goodwill is due to a reorganisation that moved the protection business from Smiths Interconnect Power to Smiths Interconnect Microwave Telecoms. An impairment test was carried out following the completion of the annual strategic planning process, which identified execution risks affecting this CGU. The impairment testing used a fair value less costs to sell model to value the businesses, because the Board approved forecasts for this business fundamentally incorporated significant reorganisation activity.

	Year ended 31 July 2016	Year ended 31 July 2015
Impairment loss recognised	**£11m**	
Basis of valuation	fair value	value in use
Discount rate used for impairment test	n/a	14.1%
Long-term growth rates	n/a	2.2%

The estimate of fair value less costs to sell incorporated projected 2017 revenue and profitability. Sales assumptions for Smiths Interconnect Microwave Telecoms are based on the current order book, sales projections from major customers, technology developments, and competitor strategies.

Fair value was calculated using a level 3 valuation model. Valuation multiples were based on adjusted valuation multiples for listed comparator companies, validated against publically available information on transaction multiples. Costs to sell were estimated based on Group experience of transactions involving businesses of a similar size.

Impairment testing assumptions

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. The discount rates disclosed incorporate risk adjustments where the projected sales and margins are affected by significant delivery risks. Pre-tax rates of 11.0% to 14.3% (2015: 10.7% to 16.2%) 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 2.19% (2015: 2.16%). 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 2016					
	John Crane	Smiths Medical	Smiths Detection	Smiths Interconnect		
	Core Rotating Equipment			Microwave Subsystems	Connectors	Power
Net book value of goodwill (£m)	**104**	**591**	**410**	**75**	**100**	**128**
Discount rate	13.4%	11.0%	13.9%	11.8%	13.5%	11.7%
Period covered by management projections	5 years	5 years	5 years	5 years	5 years	5 years
Long-term growth rates	2.3%	2.1%	2.0%	2.3%	2.0%	2.3%

11 Impairment testing continued

Goodwill continued

Impairment testing assumptions continued

						Year ended 31 July 2015
	John Crane	Smiths Medical	Smiths Detection	Smiths Interconnect		
	Core Rotating Equipment			Microwave Subsystems	Connectors	Power
Net book value of goodwill (£m)	**82**	**508**	**343**	**72**	**85**	**123**
Discount rate	11.9%	10.7%	14.4%	12.6%	15.4%	12.2%
Period covered by management projections	5 years	5 years	5 years	5 years	5 years	5 years
Long-term growth rates	2.0%	2.2%	2.2%	2.5%	1.5%	2.5%

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

Sensitivity analysis

Smiths Interconnect Power

Smiths Interconnect Power's value in use exceeds its carrying value by £1m (2015: £14m). Sensitivity analysis performed around the base case assumptions has indicated that for Smiths Interconnect Power, the following changes in assumptions (in isolation), would cause the value in use to fall below the carrying value. The 2015 sensitivities relate to the combined business of Smiths Interconnect Power and Smiths Interconnect Microwave Telecoms Protection, since they were only split in the current year.

	Year ended 31 July 2016 Change required to trigger impairment	Year ended 31 July 2015 Change required to trigger impairment
Forecast revenue	1% reduction	10% reduction
Forecast margins	10 basis points lower	120 basis points lower
Discount rate	10 basis points higher	100 basis points higher
Long-term growth rates	10 basis points lower	190 basis points lower

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

The directors also reviewed the fair value less costs to sell for the division when considering the results of the impairment testing, which also supported the conclusion that the Smiths Interconnect Power goodwill was not impaired.

Other CGUs

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. Value in use calculations were used to determine the recoverable values of these assets.

No impairment charges have been incurred (2015: £nil).

Property, plant and equipment

Impairment charges of £5m for property, plant and equipment of John Crane Production Solutions have been recognised in the year, principally relating to property. Please see disclosures above under goodwill for an explanation of the circumstances affecting this business.

There are £1m impairment charges for sites affected by the *Fuel for Growth* restructuring (see note 3).

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 2014	184	520	212	916
Exchange adjustments	3	13	(3)	13
Additions	7	37	15	59
Disposals	(13)	(33)	(25)	(71)
Business disposals		(1)		(1)
At 31 July 2015	**181**	**536**	**199**	**916**
Exchange adjustments	31	91	30	152
Additions	19	42	13	74
Disposals	(2)	(35)	(21)	(58)
Transfers to disposal group held for sale at the year end	(6)	(3)	(1)	(10)
At 31 July 2016	**223**	**631**	**220**	**1,074**
Depreciation				
At 1 August 2014	95	393	170	658
Exchange adjustments	2	11	(2)	11
Charge for the year	7	28	14	49
Disposals	(7)	(28)	(25)	(60)
Business disposals		(1)		(1)
At 31 July 2015	**97**	**403**	**157**	**657**
Exchange adjustments	16	68	24	108
Charge for the year	8	31	14	53
Impairments (note 11)	5	1		6
Disposals	(1)	(34)	(20)	(55)
Transfers to disposal group held for sale at the year end	(6)	(3)	(1)	(10)
At 31 July 2016	**119**	**466**	**174**	**759**
Net book value at 31 July 2016	**104**	**165**	**46**	**315**
Net book value at 31 July 2015	84	133	42	259
Net book value at 1 August 2014	89	127	42	258

13 Inventories

	31 July 2016 £m	31 July 2015 £m
Inventories comprise		
Raw materials and consumables	174	157
Work in progress	102	96
Finished goods	202	203
	478	**456**
Less: payments on account		(2)
	478	**454**

The Group consumed £1,319m (2015: £1,293m) of inventories during the period. In the year to 31 July 2016, £16m (2015: £13m) was charged for the write-down of inventory and £4m (2015: £4m) was released from inventory provisions no longer required.

Inventory provisioning

	31 July 2016 £m	31 July 2015 £m
Gross inventory carried at full value	436	415
Gross value of inventory partly or fully provided for	112	113
	548	**528**
Inventory provision	(70)	(72)
Inventory after provisions	**478**	**456**

14 Trade and other receivables

	31 July 2016 £m	31 July 2015 £m
Non-current		
Trade receivables	31	29
Accrued income	3	5
Prepayments	1	
Other receivables	16	6
	51	**40**
Current		
Trade receivables	665	560
Accrued income	18	17
Prepayments	21	14
Other receivables	41	25
	745	**616**

Trade receivables include unbilled balances of £47m (2015: £27m) relating to Smiths Detection contracts, where revenue recognition does not align with the agreed billing schedule. The Group also has cash received of £41m (2015: £38m) deferred in trade and other payables relating to these Smiths Detection contracts.

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 receivables qualifying as financial instruments are classified as 'loans and receivables'. The maximum credit exposure arising from these financial assets is £745m (2015: £611m).

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 5% (2015: less than 5%) of Group revenue.

Ageing of trade receivables

	31 July 2016 £m	31 July 2015 £m
Trade receivables which are not impaired and not yet due	535	468
Trade receivables which are not impaired and less than three months overdue	109	86
Trade receivables which are not impaired and more than three months overdue	45	32
Gross value of partially and fully provided receivables	38	25
	727	**611**
Provision for bad and doubtful debts	(31)	(22)
Trade receivables	**696**	**589**

15 Trade and other payables

	31 July 2016 £m	31 July 2015 £m
Non-current		
Other payables	**29**	**24**
Current		
Trade payables	202	192
Other payables	11	11
Other taxation and social security costs	25	18
Accruals	231	191
Deferred income	67	54
	536	**466**

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

16 Financial assets

The Group invests in early stage businesses that are developing or commercialising related technology. In the current year £2m was invested in Detection businesses. In 2015 £2m was invested in John Crane and £1m was invested in interconnect businesses.

In December 2015, £152m of UK government bonds previously held as available for sale financial assets were contributed to Smiths Industries Pension Scheme. At 31 July 2015, the Group held £147m UK government bonds as part of the deficit-funding plan agreed with the trustee of this pension schemes. See note 8 for additional details.

17 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 2016 £m	31 July 2015 £m
Cash and cash equivalents		
Net cash and deposits	**431**	**495**
Short-term borrowings		
Bank overdrafts	(1)	
£150m 7.25% Sterling Eurobond 2016		(150)
€300m 4.125% Eurobond 2017	(255)	
Bank and other loans	(1)	(1)
Interest accrual	(13)	(12)
	(270)	**(163)**
Long-term borrowings		
€300m 4.125% Eurobond 2017		(214)
$175m 7.37% US$ Private placement 2018	(132)	(112)
$250m 7.20% US$ Guaranteed notes 2019	(189)	(159)
$400m 3.625% US$ Guaranteed notes 2022	(304)	(253)
€600m 1.25% Eurobond 2023	(512)	(410)
Bank and other loans	(2)	(2)
	(1,139)	**(1,150)**
Borrowings	**(1,409)**	**(1,313)**
Net debt	**(978)**	**(818)**

Borrowings are accounted for at amortised cost and are categorised as other financial liabilities. See note 18 for a maturity analysis of borrowings.

Interest of £47m (2015: £42m) was charged to the consolidated income statement in this period in respect of public bonds.

Net cash and cash equivalents

	31 July 2016 £m	31 July 2015 £m
Cash at bank and in hand	161	104
Short-term deposits	270	391
Cash and cash equivalents	**431**	**495**
Bank overdrafts	(1)	
Net cash and cash equivalents	**430**	**495**

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

Netting

Cash and overdraft balances in interest compensation cash pooling systems are reported gross on the balance sheet. The cash pooling agreements incorporate a legally enforceable right of net settlement. However, there is no intention to settle the balances net, so these arrangements do not qualify for net presentation. At 31 July 2016 and 31 July 2015 the total value of overdrafts on accounts in interest compensation cash pooling systems was less than £1m.

The balances held in zero balancing cash pooling arrangements have daily settlement of balances, so netting is not relevant.

17 Borrowings and net debt continued

Movements in net debt

	Net cash and cash equivalents £m	Other short-term borrowings £m	Long-term borrowings £m	Net debt £m
At 31 July 2015	495	(163)	(1,150)	(818)
Foreign exchange gains and losses	33		(220)	(187)
Net cash outflow	(98)			(98)
Repayment of borrowings		151		151
Drawdown of borrowings			(1)	(1)
Capitalisation, interest accruals and unwind of capitalised fees		(1)	(1)	(2)
Fair value movement from interest rate hedging			(23)	(23)
Change in maturity analysis		(256)	256	
At 31 July 2016	**430**	**(269)**	**(1,139)**	**(978)**

Secured loans

Loans amounting to £3m (2015: £3m) were secured on plant and equipment with a book value of £3m (2015: £3m).

18 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 14.

(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 2016				
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Financial assets and liabilities					
Financial instruments included in trade and other receivables	38	391	136	180	745
Financial instruments included in trade and other payables	(48)	(203)	(72)	(79)	(402)
Cash and cash equivalents	189	129	41	72	431
Borrowings not designated as net investment hedges	1	(12)	(5)	(1)	(17)
	180	305	100	172	757
Exclude balances held in operations with the same functional currency	(180)	(188)	(101)	(167)	(636)
Exposure arising from intra-group loans		(165)	(70)	(77)	(312)
Forward foreign exchange contracts	(286)	112	119	55	
	(286)	**64**	**48**	**(17)**	**(191)**

18 Financial risk management continued

(a) Foreign exchange risk continued

Transactional currency exposure continued

					At 31 July 2015
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Financial assets and liabilities					
Financial instruments included in trade and other receivables	34	316	111	150	611
Financial instruments included in trade and other payables	(41)	(185)	(55)	(55)	(336)
Cash and cash equivalents	311	115	20	49	495
Borrowings not designated as net investment hedges	(151)	(11)	(3)		(165)
	153	235	73	144	605
Exclude balances held in operations with the same functional currency	(155)	(149)	(72)	(138)	(514)
Exposure arising from intra-group loans		(101)	(28)	(49)	(178)
Forward foreign exchange contracts	(163)	48	79	36	
	(165)	**33**	**52**	**(7)**	**(87)**

Financial instruments included in trade and other receivables comprise trade receivables, accrued income and other receivables which qualify as financial instruments. Similarly, financial instruments included in trade and other payables comprise trade payables, accrued expenses and other payables that 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 2016 £m	Gain/(loss) recognised in reserves 31 July 2016 £m	Impact on profit for the year 31 July 2015 £m	Gain/(loss) recognised in reserves 31 July 2015 £m
US dollar	3	2	4	(2)
Euro	(6)	(3)		4
Sterling	16	(2)	1	

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 2016 contracts with a nominal value of £393m (2015: £317m) were designated as hedging instruments. In addition, the Group had outstanding foreign currency contracts with a nominal value of £529m (2015: £314m) 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 19.

The majority of hedged transactions will be recognised in the consolidated income statement in the same period that the cash flows are expected to occur, with the only differences arising because of normal commercial credit terms on sales and purchases. Of the foreign exchange contracts designated as hedging instruments 91% are for periods of 12 months or less (2015: 92%).

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

	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Brought forward cash-flow hedge reserve at start of year	3	
Gains/(losses) on effective cash-flow hedges recognised in equity	(10)	2
Amounts removed from the hedge reserve and recognised in the following lines on the income statement		
– revenue	(1)	
– cost of sales	1	1
Carried forward cash-flow hedge reserve at end of year	**(7)**	**3**

18 Financial risk management continued

(a) Foreign exchange risk 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 using 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 2016
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges		(625)	(767)		(1,392)
Cross-currency swap contracts		(358)	373		15
Currency swap contracts	111			(111)	
	111	**(983)**	**(394)**	**(111)**	**(1,377)**

					At 31 July 2015
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges		(524)	(624)		(1,148)
Cross-currency swap contracts		(306)	302		(4)
Currency swap contracts	90			(90)	
	90	**(830)**	**(322)**	**(90)**	**(1,152)**

At 31 July 2016 swap contracts hedged the Group's exposure to Canadian dollars, Japanese yen and Chinese renminbi (31 July 2015: Canadian dollars, Japanese yen and Chinese renminbi).

All the currency swap contracts designated as net investment hedges are current (2015: current). The cross-currency swap contracts will mature in April 2023.

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

	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Brought forward net investment hedge reserve at start of year	(66)	(58)
Amounts deferred in the period on effective net investment hedges	(228)	(8)
Carried forward net investment hedge reserve at end of year	**(294)**	**(66)**

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 2016 £m	Loss recognised in hedge reserve 31 July 2015 £m
US dollar	98	80
Euro	35	35

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.

18 Financial risk management continued

(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 through fixed rate borrowings and interest rate swaps. At 31 July 2016 59% (2015: 57%) 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 2016, after interest rate swaps, is 3.68% (2015: 3.98%).

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 2016 £m	Cash and cash equivalents 31 July 2016 £m	Borrowings 31 July 2016 £m	Fair value of borrowings 31 July 2016 £m	Available for sale investments 31 July 2015 £m	Cash and cash equivalents 31 July 2015 £m	Borrowings 31 July 2015 £m	Fair value of borrowings 31 July 2015 £m
Fixed interest								
Less than one year			(153)	(158)			(151)	(158)
Between one and five years			(322)	(362)			(399)	(443)
Greater than five years			(353)	(362)	147		(296)	(290)
Total fixed interest financial assets/(liabilities)			**(828)**	**(882)**	**147**		**(846)**	**(891)**
Floating rate interest financial assets/(liabilities)		390	(581)	(581)		467	(467)	(467)
Total interest-bearing financial assets/(liabilities)		**390**	**(1,409)**	**(1,463)**	**147**	**467**	**(1,313)**	**(1,358)**
Non-interest-bearing assets/(liabilities) in the same category	9	41			9	28		
Total	**9**	**431**	**(1,409)**	**(1,463)**	**156**	**495**	**(1,313)**	**(1,358)**

Interest rate hedging

At 31 July 2016 and 31 July 2015 the Group has designated the following fair value hedges:

- US$150m interest rate swap which matures on 12 October 2022 partially hedging the US$ 2022 Guaranteed notes;
- €120m interest rate swaps which mature on 5 May 2017 partially hedging the € 2017 Eurobond; and
- the fixed/floating element of €400m of €/US$ interest rate swaps which mature on 28 April 2023 partially hedging the € 2023 Eurobond.

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 19. The effect of the swaps is to convert £552m (2015: £462m) 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 2016, 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 £2.1m (2015: £0.2m) impact on the Group's profit before tax.

Following the contribution of the UK Gilts to the pension scheme, the sensitivity of investments to changes in interest rates is no longer material.

18 Financial risk management continued

(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 £440m at 31 July 2016 (2015: £651m).

	31 July 2016 £m	31 July 2015 £m
UK government bonds with at least a AA credit rating (note 16)		147
Cash at banks with at least a AA- credit rating	215	268
Cash at banks with a A+ credit rating	126	194
Cash at other banks	90	33
Other investments	9	9
	440	**651**

At 31 July 2016 the maximum exposure with a single bank for deposits and cash is £97m (2015: £108m), whilst the maximum mark to market exposure for derivatives is £10m (2015: £4m). These banks have AA- and AA- credit rating, respectively (2015: AA- and AA-).

(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, which is provided by a multi-currency revolving credit facility.

On 19 February 2014 Smiths completed the refinancing of its existing $800m Revolving Credit Facility. The two uncommitted extension options have been exercised on 4 February 2015 and 3 February 2016. The facility now matures on 19 February 2021. At the balance sheet date, the Group had the following undrawn credit facilities:

	31 July 2016 £m	31 July 2015 £m
Expiring within one year		
Expiring between one and two years		
Expiring after more than two years	605	512
	605	**512**

Cash deposits

As at 31 July 2016, £270m (2015: £391m) of cash and cash equivalents was on deposit with various banks of which £119m (2015: £301m) was on deposit in the UK.

Gross contractual cash-flows for borrowings

	Borrowings (Note 17) 31 July 2016 £m	Fair value adjustments 31 July 2016 £m	Contractual interest payments 31 July 2016 £m	Total contractual cash-flows 31 July 2016 £m	Borrowings (Note 17) 31 July 2015 £m	Fair value adjustments 31 July 2015 £m	Contractual interest payments 31 July 2015 £m	Total contractual cash-flows 31 July 2015 £m
Less than one year	(270)	2	(39)	(307)	(163)	(1)	(41)	(205)
Between one and two years	(133)		(41)	(174)	(215)	3	(43)	(255)
Between two and three years	(190)	(1)	(32)	(223)	(113)		(34)	(147)
Between three and four years			(18)	(18)	(159)	(1)	(26)	(186)
Between four and five years			(18)	(18)			(15)	(15)
Greater than five years	(816)	8	(30)	(838)	(663)	(16)	(39)	(718)
Total	**(1,409)**	**9**	**(178)**	**(1,578)**	**(1,313)**	**(15)**	**(198)**	**(1,526)**

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.

18 Financial risk management continued

(d) Liquidity risk continued

Gross contractual cash-flows for derivative financial instruments

	Receipts 31 July 2016 £m	Payments 31 July 2016 £m	Net cash-flow 31 July 2016 £m	Receipts 31 July 2015 £m	Payments 31 July 2015 £m	Net cash-flow 31 July 2015 £m
Assets						
Less than one year	425	(415)	10	326	(304)	22
Greater than one year	378	(374)	4	20	(18)	2
Liabilities						
Less than one year	467	(485)	(18)	470	(483)	(13)
Greater than one year	28	(29)	(1)	326	(320)	6
Total	**1,298**	**(1,303)**	**(5)**	**1,142**	**(1,125)**	**17**

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 19.

Gross contractual cash-flows for other financial liabilities

The contractual cash-flows for financial liabilities included in trade and other payables are: £388m (2015: £324m) due in less than one year, £9m (2015: £7m) due between one and five years and £5m (2015: £5m) due after more than five years.

19 Derivative financial instruments

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 2016
	Contract or underlying nominal amount		Fair value	
	£m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	393	8	(15)	(7)
Foreign exchange contracts (not hedge accounted)	529	3	(4)	(1)
Total foreign exchange contracts	**922**	**11**	**(19)**	**(8)**
Currency swaps (net investment hedges)	**111**		**(1)**	**(1)**
Cross currency swaps (fair value and net investment hedges)	326	25		25
Interest rate swaps (fair value hedges)	214	6		6
Total financial derivatives	**1,573**	**42**	**(20)**	**22**
Balance sheet entries				
Non-current	473	29	(1)	28
Current	1,100	13	(19)	(6)
Total financial derivatives	**1,573**	**42**	**(20)**	**22**

19 Derivative financial instruments continued

				At 31 July 2015
	Contract or underlying nominal amount			Fair value
	£m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	317	8	(5)	3
Foreign exchange contracts (not hedge accounted)	314	2	(2)	
Total foreign exchange contracts	**631**	**10**	**(7)**	**3**
Currency swaps (net investment hedges)	97	7		7
Currency swaps (not hedge accounted)	157	3	(5)	(2)
Total currency swaps	**254**	**10**	**(5)**	**5**
Cross currency swaps (fair value and net investment hedges)	276		(4)	(4)
Interest rate swaps (fair value hedges)	180	4	(2)	2
Total financial derivatives	**1,341**	**24**	**(18)**	**6**
Balance sheet entries				
Non-current		4	(6)	(2)
Current		20	(12)	8
Total financial derivatives		**24**	**(18)**	**6**

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.

Netting
International Swaps and Derivatives Association (ISDA) master netting agreements are in place with derivative counterparties except for contracts traded on a dedicated international electronic trading platform used for operational foreign exchange hedging. Under these agreements if a credit event occurs, all outstanding transactions under the ISDA are terminated and only a single net amount per counterparty is payable in settlement of all transactions. The ISDA agreements do not meet the criteria for offsetting, since the offsetting is enforceable only if specific events occur in the future, and there is no intention to settle the contracts on a net basis.

	Assets 31 July 2016 £m	Liabilities 31 July 2016 £m	Assets 31 July 2015 £m	Liabilities 31 July 2015 £m
Gross value of assets and liabilities	42	(20)	24	(18)
Related assets and liabilities subject to master netting agreements	(2)	2	(4)	4
Net exposure	**40**	**(18)**	**20**	**(14)**

20 Fair value of financial instruments

	Notes	Carrying value 31 July 2016 £m	Fair value 31 July 2016 £m	Carrying value 31 July 2015 £m	Fair value 31 July 2015 £m
Level 1 valuations					
Financial assets – other investments	16			147	147
Level 2 valuations					
Financial derivatives – assets	19	42	42	24	24
Borrowings	17	(1,409)	(1,463)	(1,313)	(1,358)
Financial derivatives – liabilities	19	(20)	(20)	(18)	(18)
Level 3 valuations					
Financial assets – other investments	16	9	9	9	9

Investments with level 1 valuations at 31 July 2015 comprise quoted government bonds.

Derivatives, including forward exchange contracts, currency swaps, interest rate instruments, and embedded derivatives, are valued at the net present value of the future cash-flows calculated using market data at the balance sheet date (principally exchange rates and yield curves).

Borrowings are valued at the net present value of the future cash-flows using credit spreads and yield curves derived from market data. 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.

Cash, trade receivables and trade payables are excluded from this table because carrying value is a reasonable approximation to fair value for all these assets and liabilities.

21 Commitments

Operating lease commitments – minimum lease payments

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

	31 July 2016		31 July 2015	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Payments due				
– not later than one year	35	7	31	7
– later than one year and not later than five years	76	6	57	7
– later than five years	22		22	
	133	**13**	**110**	**14**

Other commitments

At 31 July 2016, commitments, comprising bonds and guarantees arising in the normal course of business, amounted to £174m (2015: £159m), including pension commitments of £54m (2015: £54m).

22 Provisions and contingent liabilities

	Trading	Non-headline and legacy			Total
	£m	John Crane, Inc. litigation £m	Titeflex Corporation litigation £m	Other £m	£m
Current liabilities	21	27	17	14	79
Non-current liabilities	5	189	54	5	253
At 31 July 2015	**26**	**216**	**71**	**19**	**332**
Exchange adjustments	5	39	14	2	60
Provision charged	21	16	12	15	64
Provision released	(4)	(1)	(1)	(2)	(8)
Unwind of provision discount		4	1		5
Utilisation	(16)	(22)	(3)	(13)	(54)
At 31 July 2016	**32**	**252**	**94**	**21**	**399**
Current liabilities	26	32	20	16	94
Non-current liabilities	6	220	74	5	305
At 31 July 2016	**32**	**252**	**94**	**21**	**399**

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

Trading

Warranty provision and product liability

At 31 July 2016 there are warranty and product liability provisions of £29m (2015: £24m). 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.

Commercial disputes and litigation in respect of 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. Trading provisions include £1m (2015: £1m) in connection with ongoing price audits of overhead cost recovery charges associated with certain historical supply arrangements and royalty claims linked to customer funded development projects.

Contingent liabilities

In the ordinary course of its business, the Group is subject to commercial disputes and litigation such as government price audits, 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.

The Group operates in some markets where the risk of unethical or corrupt behaviour is material and has procedures, including an employee 'Ethics Alertline', to help it identify potential issues. Such procedures will, from time to time, give rise to internal investigations, sometimes conducted with external support, to ensure that Smiths Group properly understands risks and concerns and can take steps both to manage immediate issues and to improve its practices and procedures for the future. The Group also co-operates with relevant authorities in investigating business conduct issues whenever requested to. The Group is not aware of any issues which are expected to generate material financial exposures.

Non-headline 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. 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.

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.

22 Provisions and contingent liabilities continued

Non-headline and legacy continued

John Crane, Inc. continued

John Crane, Inc. litigation provision

While JCI has excess liability insurance, the availability of such insurance and scope of the cover are currently the subject of litigation in the United States. Pending the outcome of that litigation, JCI has met defence costs directly. JCI has recognised the recovery of £16m through a settlement with an insurer (see note 3) but this agreement does not provide any cover for future costs. The calculation of the provision does not take account of any potential recoveries from insurers.

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 247,000 claims (2015: 242,000 claims) against JCI have been dismissed before trial over the last 37 years. JCI is currently a defendant in cases involving approximately 74,000 claims (2015: 76,000 claims). Despite the large number of claims brought against JCI, since the inception of the litigation it has had final judgments against it, after appeals, in 137 cases (2015: 133 cases) over the period, and has had to pay awards amounting to approximately US$158m (2015: US$153m). JCI has also incurred significant additional defence costs. The litigation involves claims for a number of allegedly asbestos related diseases, with awards, when made, for mesothelioma tending to be larger than those for the other diseases JCI's ability to defend mesothelioma cases successfully is, therefore, likely to have a significant impact on its annual aggregate adverse judgment and defence costs. The provision is based on past history and 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.

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; and the average amount of judgments awarded.

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 2016 £m	31 July 2015 £m
Gross provision	267	236
Discount	(15)	(20)
Discounted pre-tax provision	**252**	**216**
Deferred tax	(84)	(72)
Discounted post-tax provision	**168**	**144**

John Crane, Inc. litigation provision sensitivities

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.

Statistical analysis of the provision indicates that there is a 50% probability that the total future spend will fall between £250m and £280m (2015: between £221m and £248m), compared to the gross provision value of £267m (2015: £236m).

The projections use a 10 year time horizon. Reducing the time horizon by one year would reduce the provision by £18m (2015: £15m) and reducing it by five years would reduce the provision by £107m (2015: £91m).

John Crane, Inc. contingent liabilities

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

Although the methodology used to calculate the JCI litigation provision can in theory be applied to show claims and costs for longer periods, the Directors consider, based on advice from Bates White, that the level of uncertainty regarding the factors used in estimating future costs is too great to provide for reasonable estimation of the numbers of future claims, the nature of such claims or the cost to resolve them for years beyond the 10 year time horizon.

22 Provisions and contingent liabilities continued

Non-headline and legacy continued

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 claims have been settled on an individual basis without admission of liability. Equivalent third-party products in the US marketplace face similar challenges.

Titeflex Corporation litigation provision

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; and the impact of statutes of repose and safe installation initiatives on the expected number of future claims. This is the first year that the company has had sufficient evidence of the impact of statutes of repose and safe installation initiatives to incorporate them into the provision calculation. Reflecting work completed in the year on streamlining the settlement process, and dismissing claims covered by statutes of repose, the Directors consider that the pattern of resolution of future potential claims by Titeflex Corporation is now more predictable. As a result, the provision model has been extended. Incorporating the two additional assumptions and extending the time period generated a net £16m increase in the provision.

The provision of £94m (2015: £71m) 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).

	31 July 2016 £m	31 July 2015 £m
Gross provision	140	77
Discount	(46)	(6)
Discounted pre-tax provision	**94**	**71**
Deferred tax	(36)	(27)
Discounted post-tax provision	**58**	**44**

Titeflex Corporation litigation provision sensitivities

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 projections incorporate a long-term assumption about the impact of safe installation initiatives on the level of future claims. If the assumed annual benefit of bonding and grounding initiatives was 0.5% higher the provision would be £6m lower, and if the benefit was 0.5% lower, the provision would increase by £7m.

Other non-headline and legacy

Legacy provisions comprise provisions relating to former business activities and properties no longer used by Smiths. Non-headline provisions comprise all provisions that were disclosed as non-headline items when they were charged to the consolidated income statement.

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

Reorganisation and property

At 31 July 2016 there were provisions of £11m (2015: £6m) related to *Fuel for Growth*, £3m (2015: £6m) related to onerous leases and dilapidations provisions, and £2m (2015: £1m) related to actual and potential environmental issues for sites which were no longer occupied by Smiths operations.

The *Fuel for Growth* provisions are expected to be utilised in 2017.

Disposal

Other provisions include disposal provisions of £3m (2015: £3m) 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 three years.

23 Share capital

	Number of shares	Issued capital £m	Consideration £m
Ordinary shares of 37.5p each			
Total share capital at 31 July 2014	394,456,135	148	
Exercise of share options	403,869		3
Total share capital at 31 July 2015	**394,860,004**	**148**	
Exercise of share options	363,068		3
Total share capital at 31 July 2016	**395,223,072**	**148**	

At 31 July 2016 all of the issued share capital was in free issue. All issued shares are fully paid.

24 Dividends

The following dividends were declared and paid in the period:

	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Ordinary final dividend of 28.00p for 2015 (2014: 27.50p) paid 20 November 2015	111	108
Ordinary interim dividend of 13.25p for 2016 (2015: 13.00p) paid 22 April 2016	52	52
	163	**160**

The final dividend for the year ended 31 July 2016 of 28.75p per share was recommended by the Board on 27 September 2016 and will be paid to shareholders on 18 November 2016, 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 21 October 2016.

25 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 (2015: nil) shares to the Trust, and the Trust purchased 760,218 shares (2015: 838,032 shares) in the market. At 31 July 2016 the Trust held 852 (2015: 852) 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 non-headline 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 15.3% (2015: 16.0%), see note 28.

The capital structure is based on the directors' judgement of the balance required to maintain flexibility while achieving an efficient cost of capital.

The ratio of net debt to headline EBITDA of 1.6 (2015: 1.4) is within the Group's stated policy of less than 2.0 over the medium term. 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.

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 2016 the Group had a credit rating of BBB+/Baa2 (2015: BBB+/Baa2) with Standard & Poor's and Moody's respectively.

The Board has a progressive dividend policy for future payouts, with the aim of increasing dividends in line with the long-term underlying growth in earnings. In setting the level of dividend payments, the Board will take into account prevailing economic conditions and future investment plans, along with the objective to maintain minimum dividend cover of around 2.0.

25 Reserves continued

Hedge reserve

	31 July 2016 £m	31 July 2015 £m
The hedge reserve on the balance sheet comprises		
– cash-flow hedge reserve	(7)	3
– net investment hedge reserve	(294)	(66)
	(301)	**(63)**

See transactional currency exposure risk management disclosures in note 18 for additional details of cash-flow hedges, and translational currency exposure risk management disclosure also in note 18 for additional details of net investment hedges.

26 Cash-flow

Cash-flow from operating activities

	Year ended 31 July 2016			Year ended 31 July 2015		
	Headline £m	Non-headline £m	Total £m	Headline £m	Non-headline £m	Total £m
Operating profit	510	(123)	387	511	(117)	394
Amortisation of intangible assets	43	15	58	38	33	71
Impairment of intangible assets		23	23		27	27
Impairment of trade investments		2	2			
Depreciation of property, plant and equipment	53		53	49		49
Impairment of property, plant and equipment		6	6			
Loss on disposal of property, plant and equipment	2		2	1		1
Loss/(profit) on disposal of business					1	1
Share-based payment expense	9		9	8		8
Retirement benefits	1	(104)	(103)	2	(87)	(85)
Decrease/(increase) in inventories	30		30	(30)		(30)
(Increase)/decrease in trade and other receivables	(21)	(16)	(37)	11		11
Increase/(decrease) in trade and other payables	1		1	(4)		(4)
Increase/(decrease) in provisions	(1)	3	2	(15)	(7)	(22)
Cash generated from operations	**627**	**(194)**	**433**	**571**	**(150)**	**421**
Interest paid	(61)		(61)	(56)	(10)	(66)
Interest received	3	45	48	2		2
Tax paid	(62)		(62)	(91)		(91)
Net cash inflow from operating activities	**507**	**(149)**	**358**	**426**	**(160)**	**266**

Retirement benefit contributions comprise cash contributions of £123m and a non-cash transaction where £152m of financial assets were contributed to the Smiths Industries Pension Scheme. See note 8 for details.

Interest received in the period includes £41m cash inflows (2015: interest paid includes £10m cash outflows) on foreign exchange contracts hedging exposures on intra-group loans, and £4m exchange gains realised on internal interest.

The split of tax payments between headline and non-headline only considers the nature of payments made. No adjustment has been made for reductions in tax payments due to tax relief received on non-headline items.

26 Cash-flow continued

Headline cash measures

The Group measure of headline operating cash excludes interest and tax and includes capital expenditure supporting organic growth.

	Year ended 31 July 2016			Year ended 31 July 2015		
	Headline £m	Non-headline £m	Total £m	Headline £m	Non-headline £m	Total £m
Net cash inflow from operating activities	**507**	**(149)**	**358**	**426**	**(160)**	**266**
Include						
Expenditure on capitalised development, other intangible assets and property, plant and equipment	(108)		(108)	(95)		(95)
Disposals of property, plant and equipment	1		1	8	3	11
Investment in financial assets relating to pensions financing		(8)	(8)		(24)	(24)
Headline free cash-flow	**400**	**(157)**	**243**	**339**	**(181)**	**158**
Exclude						
Interest paid	61		61	56	10	66
Interest received	(3)	(45)	(48)	(2)		(2)
Tax paid	62		62	91		91
Headline operating cash-flow	**520**	**(202)**	**318**	**484**	**(171)**	**313**

Reconciliation of headline free cash-flow to total movement in cash and cash-equivalents

	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Headline free cash-flow	**400**	**339**
Non-headline free cash-flows	(157)	(181)
Investment in other financial assets	(1)	(3)
Acquisition of businesses	(8)	
Disposal of businesses		2
Net cash-flow used in financing activities	(332)	147
Net (decrease)/increase cash and cash equivalents	**(98)**	**304**

27 Business held for sale

At 31 July 2016 the Group had invited offers for the purchase of the John Crane Artificial lift business. Agreement to sell the business was announced on 23 September 2016 and, subject to regulatory clearance, the disposal is expected to complete in the first half of 2016/17. In the year ended 31 July 2016 the business had headline losses of $10m (2015: $2m) on sales of $53m (2015: $91m).

As required by IFRS 5, the assets and liabilities to be sold have been disclosed as held for sale in the consolidated balance sheet as at 31 July 2016. No impairment loss was recognised on writing assets down to fair value less disposal costs although impairments were recognised earlier in the year relating to this business, see notes 11 and 12.

	31 July 2016 £m
Current assets	
Inventories	17
Trade and other receivables	7
Total assets of business held for sale	**24**
Current liabilities	
Trade and other payables	(5)
Total liabilities of business held for sale	**(5)**

28 Non-statutory capital and credit metrics

In addition to the non-statutory profit measures explained in note 3, the Company calculates credit metrics and return on capital employed incorporating the same adjustments. See the disclosures on presentation of results in accounting policies for an explanation of the excluded items.

Return on capital employed (ROCE)
Smiths ROCE is calculated over a rolling 12-month period and is the percentage that headline operating profit comprises of monthly average capital employed.

See note 1 for the divisional headline operating profit and average divisional capital employed used to calculate divisional ROCE.

Capital employed

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 £815m (31 July 2015: £815m) and eliminate post-retirement benefit assets and liabilities and litigation provisions relating to non-headline items, both net of related tax, and net debt.

	Notes	31 July 2016 £m	31 July 2015 £m
Net assets		**1,660**	**1,428**
Adjust for			
Goodwill recognised directly in reserves		815	815
Post-retirement benefit assets and liabilities	8	(80)	108
Tax related to post retirement benefit assets and liabilities		(4)	(55)
Investments related to post retirement benefit assets and liabilities			(147)
John Crane, Inc. litigation provisions and related tax	22	168	144
Titeflex Corporation litigation provisions and related tax	22	58	44
Net debt	17	978	818
Capital employed		**3,595**	**3,155**

Return on capital employed

	Notes	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Headline operating profit for previous twelve months		510	511
Average capital employed	1	3,324	3,197
ROCE		**15.3%**	**16.0%**

Credit metrics
Smiths Group monitors the ratio of net debt to Headline EBITDA as part of its management of credit ratings, see note 25 for details. This ratio is calculated as follows.

Headline earnings before interest, tax, depreciation and amortisation (Headline EBITDA)

	Notes	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Headline operating profit		**510**	**511**
Exclude			
– depreciation	12	53	49
– amortisation of development costs	10	26	23
– amortisation of software, patents and intellectual property	10	17	15
Headline EBITDA		**606**	**598**

Ratio of net debt to headline EBITDA

	Notes	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m
Headline EBITDA		606	598
Net debt	17	978	818
Ratio of net debt to headline EBITDA		**1.6**	**1.4**

Unaudited Group financial record 2012-2016

	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m	Year ended 31 July 2013 £m	Year ended 31 July 2012 £m
Income statement metrics – headline					
Revenue	2,949	2,897	2,952	3,109	3,038
Headline operating profit	510	511	504	560	554
Headline profit before tax	451	459	445	498	497
Income statement metrics – statutory					
Operating profit	387	394	378	487	407
Profit before taxation	346	325	302	396	366
Profit after taxation	261	248	235	317	258
Balance sheet metrics					
Net borrowings	(978)	(818)	(804)	(744)	(791)
Shareholders' equity	1,646	1,419	1,237	1,486	973
Average capital employed	3,324	3,197	3,218	3,362	3,349
Ratios					
Headline operating profit: revenue (%)	17.3	17.6	17.1	18.0	18.2
Headline effective tax rate (%)	25.0	25.5	27.0	26.5	26.5
Return on capital employed (%)	15.3	16.0	15.7	16.6	16.5
Return on shareholders' funds (%)	14.3	15.8	14.9	17.8	18.3
Cash-flow					
Headline operating cash	520	484	490	548	549
Headline operating cash conversion (%)	102	95	97	98	99
Headline free cash-flow	400	339			
Headline free cash-flow per share (p)	101.2	85.9			
Earnings per share					
Headline earnings per share (p)	85.2	86.1	81.8	92.7	92.6
Dividends					
Pence per share	42.00	41.00	40.25	39.50	38.00
Special dividend				30.00	
Headline dividend cover	2.0	2.1	2.0	2.3	2.4
Number of employees (000s)					
United Kingdom	1.5	1.7	1.8	1.9	1.9
Overseas	20.5	21.6	21.4	21.4	21.3
	22.0	23.3	23.2	23.3	23.2

*The year ending 2012 has not been restated for the adoption of IAS 19 (revised 2011). As a result, the statutory operating profit is higher, since it does not include administration costs for retirement benefit schemes, and statutory finance costs are lower, since they benefit from higher interest credits on pension assets. There is no impact on figures reported on a headline basis.

Unaudited supplementary consolidated income statement – US dollar translation

	Notes	Year ended 31 July 2016 Headline $m	Year ended 31 July 2016 Non-headline (note 3) $m	Year ended 31 July 2016 Total $m	Year ended 31 July 2015 Headline $m	Year ended 31 July 2015 Non-headline (note 3) $m	Year ended 31 July 2015 Total $m
Continuing operations							
Revenue	1	4,315		4,315	4,525		4,525
Cost of sales		(2,342)		(2,342)	(2,443)		(2,443)
Gross profit		1,973		1,973	2,082		2,082
Sales and distribution costs		(589)		(589)	(634)		(634)
Administrative expenses		(637)	(203)	(840)	(650)	(182)	(832)
Other operating income			23	23			
Operating profit	2	**747**	**(180)**	**567**	**798**	**(182)**	**616**
Interest receivable		5		5	5		5
Interest payable		(91)		(91)	(86)		(86)
Other financing gains/(losses)			21	21		(14)	(14)
Other finance charges – retirement benefits	8		4	4		(12)	(12)
Finance costs	4	(86)	25	(61)	(81)	(26)	(107)
Profit before taxation		**661**	**(155)**	**506**	**717**	**(208)**	**509**
Taxation	6	(165)	41	(124)	(183)	62	(121)
Profit for the period		**496**	**(114)**	**382**	**534**	**(146)**	**388**
Attributable to							
Smiths Group shareholders		493	(114)	379	531	(146)	385
Non-controlling interests		3		3	3		3
		496	**(114)**	**382**	**534**	**(146)**	**388**
Earnings per share	5						
Basic				95.9c			97.5c
Diluted				95.1c			96.5c

Assets and liabilities have been translated into US dollars at the exchange rate at the date of that balance sheet and income, expenses and cash-flows are translated at average exchange rates for the period. This reflects the accounting approach that Smiths Group plc would use if the Group moved to reporting in US dollars without making any changes to its Group structure or financing arrangements.

Unaudited supplementary consolidated statement of comprehensive income – US dollar translation

	Notes	Year ended 31 July 2016 $m	Year ended 31 July 2015 $m
Profit for the period		**382**	**388**
Other comprehensive income			
Actuarial (losses)/gains on retirement benefits	8	(59)	95
Taxation recognised on actuarial movements	6	15	31
Other comprehensive income and expenditure which will not be reclassified to the consolidated income statement		**(44)**	**126**
Other comprehensive income which will be reclassified and reclassifications			
Exchange gains/(losses)		240	(143)
Fair value gains/(losses) and reclassification adjustments			
– deferred on available for sale financial assets		(3)	
– reclassified to income statement on available for sale financial assets	4	(28)	17
– deferred in the period on cash-flow and net investment hedges		(348)	(9)
– reclassified to income statement on cash-flow and net investment hedges			1
Total other comprehensive income		**(183)**	**(8)**
Total comprehensive income		**199**	**380**
Attributable to			
Smiths Group shareholders		192	380
Non-controlling interests		7	
		199	**380**

Unaudited supplementary consolidated balance sheet – US dollar translation

	Notes	31 July 2016 $m	31 July 2015 $m
Non-current assets			
Intangible assets	10	2,304	2,371
Property, plant and equipment	12	417	404
Financial assets – other investments	16	12	244
Retirement benefit assets	8	434	266
Deferred tax assets	6	326	341
Trade and other receivables	14	67	63
Financial derivatives	19	38	7
		3,598	**3,696**
Current assets			
Inventories	13	632	710
Current tax receivable	6	82	47
Trade and other receivables	14	986	962
Cash and cash equivalents	17	571	774
Financial derivatives	19	16	31
		2,287	**2,524**
Assets of businesses held for sale	27	31	
Total assets		**5,916**	**6,220**
Non-current liabilities			
Financial liabilities			
– borrowings	17	(1,506)	(1,797)
– financial derivatives	19	(1)	(10)
Provisions for liabilities and charges	22	(403)	(395)
Retirement benefit obligations	8	(329)	(433)
Deferred tax liabilities	6	(126)	(112)
Trade and other payables	15	(38)	(38)
		(2,403)	**(2,785)**
Current liabilities			
Financial liabilities			
– borrowings	17	(359)	(255)
– financial derivatives	19	(23)	(19)
Provisions for liabilities and charges	22	(124)	(123)
Trade and other payables	15	(708)	(728)
Current tax payable	6	(95)	(78)
		(1,309)	**(1,203)**
Liabilities of businesses held for sale	27	(7)	
Total liabilities		**(3,719)**	**(3,988)**
Net assets		**2,197**	**2,232**
Shareholders' equity			
Share capital	23	196	231
Share premium account		466	546
Capital redemption reserve		7	9
Revaluation reserve		2	3
Merger reserve		311	367
Retained earnings		1,594	1,161
Hedge reserve	25	(398)	(98)
Total shareholders' equity		**2,178**	**2,219**
Non-controlling interest equity		19	13
Total equity		**2,197**	**2,232**

Unaudited supplementary consolidated statement of changes in equity – US dollar translation

	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 2015		777	379	1,161	(98)	2,219	13	2,232
Profit for the period				379		379	3	382
Other comprehensive income								
Exchange gains		(120)	(59)	367	48	236	4	240
Actuarial gains on retirement benefits and tax				(44)		(44)		(44)
Fair value gains/(losses)				(31)	(348)	(379)		(379)
Total comprehensive income for the period		**(120)**	**(59)**	**671**	**(300)**	**192**	**7**	**199**
Transactions relating to ownership interests								
Exercises of share options	23	5				5		5
Taxation recognised on share options	6							
Purchase of own shares	25			(12)		(12)		(12)
Dividends								
– equity shareholders	24			(239)		(239)		(239)
– non-controlling interests							(1)	(1)
Share-based payment	9			13		13		13
At 31 July 2016		**662**	**320**	**1,594**	**(398)**	**2,178**	**19**	**2,197**

	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 2014		835	409	943	(97)	2,090	14	2,104
Profit for the year				385		385	3	388
Other comprehensive income								
Actuarial losses on retirement benefits and related tax				126		126		126
Exchange (losses)/gains		(63)	(30)	(54)	7	(140)	(3)	(143)
Fair value gains/(losses) and related tax				17	(8)	9		9
Total comprehensive income for the year		**(63)**	**(30)**	**474**	**(1)**	**380**		**380**
Transactions relating to ownership interests								
Exercises of share options	23	5				5		5
Taxation recognised on share options	6			(2)		(2)		(2)
Purchase of own shares	25			(17)		(17)		(17)
Dividends								
– equity shareholders	24			(250)		(250)		(250)
– non-controlling interest							(1)	(1)
Share-based payment	9			13		13		13
At 31 July 2015		**777**	**379**	**1,161**	**(98)**	**2,219**	**13**	**2,232**

Unaudited supplementary consolidated cash-flow statement – US dollar translation

	Notes	Year ended 31 July 2016 $m	Year ended 31 July 2015 $m
Net cash inflow from operating activities	26	**524**	**416**
Cash-flows from investing activities			
Expenditure on capitalised development		(34)	(28)
Expenditure on other intangible assets		(16)	(28)
Purchases of property, plant and equipment	12	(108)	(92)
Disposals of property, plant and equipment		1	17
Investment in financial assets		(13)	(42)
Acquisition of businesses		(12)	
Disposals of businesses			3
Net cash-flow used in investing activities		**(182)**	**(170)**
Cash-flows from financing activities			
Proceeds from exercise of share options	23	4	5
Purchase of own shares		(12)	(17)
Dividends paid to equity shareholders	24	(239)	(250)
Dividends paid to non-controlling interests		(1)	(1)
Cash (outflow)/ inflow from matured derivative financial instruments		(19)	7
Increase in new borrowings		1	887
Reduction and repayment of borrowings		(221)	(402)
Net cash-flow used in financing activities		**(487)**	**229**
Net increase/(decrease) in cash and cash equivalents		**(145)**	**475**
Cash and cash equivalents at beginning of year		774	319
Exchange differences		(60)	(20)
Cash and cash equivalents at end of year	17	**569**	**774**
Cash and cash equivalents at end of year comprise			
– cash at bank and in hand		213	163
– short-term deposits		358	611
– bank overdrafts		(2)	
		569	**774**
Included in cash and cash equivalents per the balance sheet		571	774
Included in overdrafts per the balance sheet		(2)	
		569	**774**

Reconciliation of net cash-flow to movement in net debt

	Notes	Year ended 31 July 2016 $m	Year ended 31 July 2015 $m
Net debt at start of year	17	**(1,278)**	**(1,358)**
Net (decrease)/increase in cash and cash equivalents		(145)	475
Increase in borrowings		(1)	(887)
Reduction and repayment of borrowings		221	402
Movement in net debt resulting from cash-flows		**75**	**(10)**
Capitalisation, interest accruals and unwind of capitalisation fees		(3)	(2)
Movement from fair value hedging		(33)	12
Exchange differences		(55)	80
Movement in net debt in the year		**(16)**	**80**
Net debt at end of year	17	**(1,294)**	**(1,278)**

Unaudited Group US dollar financial record 2013-2016

	Year ended 31 July 2016 $m	Year ended 31 July 2015 $m	Year ended 31 July 2014 $m	Year ended 31 July 2013 $m
Income statement metrics – headline				
Revenue	4,315	4,525	4,849	4,866
Headline operating profit	747	798	828	876
Headline profit before tax	661	717	730	780
Income statement metrics – statutory				
Operating profit	567	616	620	762
Profit before taxation	506	509	496	620
Profit after taxation	382	388	385	496
Balance sheet metrics				
Net borrowings	(1,294)	(1,278)	(1,358)	(1,129)
Shareholders' equity	2,178	2,219	2,090	2,255
Average capital employed	4,864	4,994	5,287	5,263
Ratios				
Headline operating profit: revenue (%)	17.3	17.6	17.1	18.0
Headline effective tax rate (%)	25.0	25.5	27.0	26.5
Return on capital employed (%)	15.3	15.9	15.8	16.7
Return on shareholders' funds (%)	14.6	15.3	15.1	18.1
Cash-flow				
Headline operating cash	760	756	804	858
Headline operating cash conversion (%)	102	95	97	98
Headline free cash-flow	585	530		
Headline free cash-flow per share (c)	148.2	134.2		
Earnings per share				
Headline earnings per share (c)	124.6	134.5	134.4	145.1
Dividends				
Cents per share (c)	61.5	64.0	66.1	61.8
Special dividend (c)				49.3
Headline dividend cover	2.0	2.1	2.0	2.3
Number of employees (000s)				
United States of America	7.9	8.4	8.3	8.5
Rest of World	14.1	14.9	14.9	14.8
	22.0	23.3	23.2	23.3

Independent auditors' report to the members of Smiths Group plc

Report on the Company financial statements

Our opinion

In our opinion, Smiths Group plc's Company financial statements (the "financial statements"):

- give a true and fair view of the state of the Company's affairs as at 31 July 2016;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

What we have audited

The financial statements comprise:

- the Company balance sheet as at 31 July 2016;
- the Company statement of changes in equity for the year then ended;
- the accounting policies; and
- the notes to the financial statements, which include other explanatory information.

Certain required disclosures have been presented elsewhere in the Annual Report, rather than in the notes to the Company accounts. These are cross-referenced from the financial statements and are identified as audited.

The financial reporting framework that has been applied in the preparation of the financial statements is United Kingdom Accounting Standards, comprising FRS 101 "Reduced Disclosure Framework", and applicable law (United Kingdom Generally Accepted Accounting Practice).

Other required reporting

Consistency of other information

Companies Act 2006 opinion

In our opinion, the information given in the Strategic Report and the Group directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

ISAs (UK & Ireland) reporting

Under International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)") we are required to report to you if, in our opinion, information in the Annual Report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Company acquired in the course of performing our audit; or
- otherwise misleading.

We have no exceptions to report arising from this responsibility.

Adequacy of accounting records and information and explanations received

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

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Directors' remuneration

Directors' remuneration report – Companies Act 2006 opinion

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Other Companies Act 2006 reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the Statement of directors responsibilities set out on page 124, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

What an audit of financial statements involves

We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Other matter

We have reported separately on the Group financial statements of Smiths Group plc for the year ended 31 July 2016.

Andrew Kemp (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London

27 September 2016

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

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

Company balance sheet

	Notes	31 July 2016 £m	31 July 2015 (restated) £m
Fixed assets			
Intangible assets	2		
Tangible assets	3	1	
Investments and advances	4	3,487	3,486
Available for sale financial assets	5		147
		3,488	**3,633**
Current assets			
Retirement benefit assets			
– amounts falling due after more than one year	11	327	169
Debtors			
– amounts falling due within one year	6	59	60
Cash at bank and on deposit	8	207	330
Financial derivatives			
– amounts falling due within one year	9	4	12
– amounts falling due after more than one year	9	29	4
		626	**575**
Creditors: amounts falling due within one year	7	(363)	(229)
Financial derivatives: amounts falling due within one year	9	(3)	(7)
Net current assets		**260**	**339**
Total assets less current liabilities		**3,748**	**3,972**
Creditors: amounts falling due after more than one year	8	(1,137)	(1,148)
Provisions for liabilities and charges	10	(2)	(2)
Retirement benefit liabilities	11	(65)	(90)
Financial derivatives: amounts falling due after more than one year	9		(6)
Net assets including pension liabilities		**2,544**	**2,726**
Capital and reserves			
Called up share capital	12	148	148
Share premium account	12	352	349
Capital redemption reserve	12	6	6
Other reserves	12	181	181
Profit and loss account	12	1,857	2,042
Shareholders' equity		**2,544**	**2,726**

The accounts on pages 194 to 205 were approved by the Board of Directors on 27 September 2016 and were signed on its behalf by:

Andy Reynolds Smith
Chief Executive

Chris O'Shea
Chief Financial Officer

Smiths Group plc – registered number 137013

Company statement of changes in equity

	Share capital £m	Share premium £m	Capital redemption reserve £m	Other reserves £m	Retained profit £m	Shareholders' equity £m
At 31 July 2015	148	349	6	181	2,042	2,726
Profit for the period					17	17
Other comprehensive income						
Actuarial loss on retirement benefits					(21)	(21)
Taxation recognised on retirement benefits					4	4
Fair value losses on available for sale financial assets					(4)	(4)
Fair value gains reclassified to the income statement on available for sale financial assets					(19)	(19)
Total comprehensive income					**(23)**	**(23)**
Transactions with owners						
Exercise of share options		3				3
Purchase of own shares					(8)	(8)
Dividends paid to equity shareholders					(163)	(163)
Share-based payment					9	9
Total transactions with owners recognised in equity		**3**			**(162)**	**(159)**
At 31 July 2016	**148**	**352**	**6**	**181**	**1,857**	**2,544**

	Share capital £m	Share premium £m	Capital redemption reserve £m	Other reserves £m	Retained profit £m	Shareholders' equity £m
At 31 July 2014	148	346	6	181	1,886	2,567
Profit for the period					194	194
Other comprehensive income						
Actuarial gain on retirement benefits					113	113
Fair value gains on available for sale financial assets					11	11
Total comprehensive income					**318**	**318**
Transactions with owners						
Exercise of share options		3				3
Purchase of own shares					(11)	(11)
Dividends paid to equity shareholders					(160)	(160)
Share-based payment					9	9
Total transactions with owners recognised in equity		**3**			**(162)**	**(159)**
At 31 July 2015	**148**	**349**	**6**	**181**	**2,042**	**2,726**

Company accounting policies

Basis of preparation
The accounts have been prepared in accordance with the Companies Act 2006 and Financial Reporting Standard 101, "Reduced Disclosure Framework" (FRS 101).

These accounts have been prepared on a going concern basis and under the historical cost convention modified to include revaluation of certain financial instruments, share options and pension assets and liabilities held at fair value.

As permitted by Section 408(3) of the Companies Act 2006, the Company's income statement and statement comprehensive income have not been presented. As permitted by Section 408(2), information about the Company's employee numbers and costs is not presented.

This is the Company's first year reporting under FRS 101. All comparative amounts have been restated from the previously applicable accounting standards in the United Kingdom. The impact of this restatement is disclosed in more detail in note 16. Tables are marked restated where the comparative numbers presented under FRS 101 are different from the amounts previously reported, to highlight the impact of adopting FRS 101.

Exemptions from the requirements of IFRS applied in accordance with FRS 101
The following exemptions from the requirements of IFRS have been applied in the preparation of these financial statements, in accordance with FRS 101:

- Paragraphs 45(b) and 46 to 52 of IFRS 2, 'Share-based payment' (details of the number and weighted-average exercise prices of share options, and how the fair value of goods or services received was determined)
- IFRS 7, 'Financial Instruments: Disclosures'
- Paragraphs 91 to 99 of IFRS 13, 'Fair value measurement' (disclosure of valuation techniques and inputs used for fair value measurement of assets and liabilities)
- Paragraph 38 of IAS 1, 'Presentation of financial statements' comparative information requirements in respect of:
  - paragraph 79(a)(iv) of IAS 1;
  - paragraph 73(e) of IAS 16 'Property, plant and equipment';
- The following paragraphs of IAS 1, 'Presentation of financial statements':
  - 10(d), (statement of cash flows),
  - 16 (statement of compliance with all IFRS),
  - 38A (requirement for minimum of two primary statements, including cash flow statements),
  - 38B-D (additional comparative information),
  - 111 (cash flow statement information), and
  - 134-136 (capital management disclosures)
- IAS 7, 'Statement of cash flows'
- Paragraph 30 and 31 of IAS 8 'Accounting policies, changes in accounting estimates and errors' (requirement for the disclosure of information when an entity has not applied a new IFRS that has been issued but is not yet effective)
- Paragraph 17 of IAS 24, 'Related party disclosures' (key management compensation)
- The requirements in IAS 24, 'Related party disclosures' to disclose related party transactions entered into between two or more members of a group.

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 parent company financial statements are set out below.

Taxation
The Company has not recognised deferred tax assets of £nil (2015: £27m) relating to losses and £19m (2015: £3m) relating to other temporary differences. The Company derecognised UK tax assets relating to revenue losses brought forward and other temporary differences due to the impact of the pension contributions on the outlook for the UK tax base. The treatment of these assets is reviewed regularly and is dependent on the ability to recover them against forecast UK taxable profits of the tax group. Further detail on the Company's deferred taxation position is included in note 13.

Retirement benefits
The 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 Company uses previous experience and independent actuarial advice to select the values of critical estimates. The estimates, and the effect of variances in key estimates, are disclosed in note 8 to the consolidated accounts.

At 31 July 2016 there is a retirement benefit asset of £327m (2015: £169m) 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 buyouts would cost significantly more than the present value of the scheme liabilities calculated in accordance with IAS 19: Employee benefits.

Investment carrying value
Investments in subsidiary undertakings and loans due from subsidiaries are reviewed regularly, and tested if there are any indications of impairment, or problems with recoverability. The recoverable amounts of investments are determined based on valuations of the underlying trading operations. The recoverability of loans is assessed by looking at the credit quality of the subsidiary and any support available to the subsidiary. These calculations require the use of estimates including projected future cash-flows and other future events.

Foreign currencies
Foreign currency transactions are recorded at the exchange rate ruling on the date of transaction. Foreign exchange gains and losses resulting from the settlement of such transactions, and from the retranslation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies, are recognised in the profit and loss account.

Operating leases
Payments made under operating leases are charged to the profit and loss account as incurred over the term of the lease.

Where a leasehold property is vacant, or sub-let under terms such that the rental income is insufficient to meet all outgoings, provision is made for the anticipated future shortfall up to termination of the lease.

Property, plant and equipment
Depreciation is provided at rates estimated to write off the relevant assets by equal annual amounts over their expected useful lives. In general, the rates used are: Freehold and long leasehold property – 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%.

Investments in shares in Group companies
The Company's investments in shares in Group companies are stated at cost less provision for impairment. Any impairment is charged to the profit and loss account as it arises.

Financial instruments
The policies disclosed in the Group accounting policies on pages 139 to 143 for recognition, measurement and presentation of financial instruments are applied in the Company accounts.

Taxation
Deferred tax is provided 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.

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

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

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

Post-retirement benefits
The Company has both defined benefit and defined contribution plans.

For defined benefit plans the liability for each scheme recognised in the balance sheet is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of AA corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised in full when they occur and presented in the statement of other comprehensive income.

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

The Company also has post-retirement healthcare schemes that are accounted for on a similar basis to the defined benefit plans.

Share-based payment
The Company operates a number of equity-settled and cash-settled share-based compensation plans.

The fair value of the shares or share options granted is recognised over the vesting period to reflect the value of the employee services received. The charge relating to grants to employees of the Company is recognised as an expense in the profit and loss account and the charge for grants to employees of other group companies is recognised as an investment in the relevant subsidiary.

The fair value of options granted, excluding the impact of any non-market vesting conditions, is calculated using established option pricing models, principally binomial models. The probability of meeting non-market vesting conditions, which include profitability targets, is used to estimate the number of share options that are likely to vest.

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

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

Notes to the Company accounts

1 Audit fee

The audit fee for the Parent Company was £0.1m (2015: £0.1m).

2 Intangible assets

	Software £m
Cost or valuation	
At 31 July 2015 and 31 July 2016	**5**
Depreciation	
At 31 July 2015 and 31 July 2016	**5**
Net book value at 31 July 2016	
Net book value at 31 July 2015	

Intangible assets comprise computer software.

3 Tangible assets

	Plant and equipment £m
Cost or valuation	
At 31 July 2015	2
Additions	1
At 31 July 2016	**3**
Depreciation	
At 31 July 2015	2
Disposals	
At 31 July 2016	**2**
Net book value at 31 July 2016	**1**
Net book value at 31 July 2015	

Plant and equipment comprises plant, machinery, fixtures, fittings, tools and equipment, including computer hardware.

4 Investments and advances

	Shares in subsidiary undertakings £m	Loans due from subsidiaries £m	Total £m
Cost or valuation			
At 31 July 2015	2,391	1,106	3,497
Exchange adjustments		207	207
Contribution through share options	6		6
Increases in advances due from/(due to) subsidiaries		(212)	(212)
At 31 July 2016	**2,397**	**1,101**	**3,498**
Provision for impairment			
At 31 July 2015 and 31 July 2016	**10**	**1**	**11**
Net book value at 31 July 2016	**2,387**	**1,100**	**3,487**
Net book value at 31 July 2015	2,381	1,105	3,486

Loans due to subsidiaries are offset against loans due from subsidiaries to the extent that there is a legal right of set off and an intention to settle the balances net. At 31 July 2016, £1,372m of loans payable are offset against loans receivable (2015: £996m). The Company has large offsetting loan balances because it uses loans to reduce its foreign currency exposures and separately monitor net cash generated from trading activities.

The Company's subsidiaries are largely held according to business lines by the following holding companies, which are incorporated in England:

Smiths Group International Holdings Limited
Smiths Detection Group Limited
John Crane Group Limited
Smiths Medical Group Limited
Smiths Interconnect Group Limited

The principal subsidiaries and their countries of incorporation are:

England
Smiths Detection – Watford Ltd
Smiths Medical International Limited
John Crane UK Limited

Europe
Smiths Heimann SAS (France)
Smiths Heimann GmbH (Germany)
Smiths Medical France SA (France)
Smiths Medical Deutschland GmbH (Germany)
John Crane Italia SpA (Italy)

Other
Smiths Detection (Asia-Pacific) Pte Ltd (Singapore)
Smiths Medical Japan Limited (Japan)
John Crane Middle East FZE (UAE)

United States
Smiths Detection, Inc.
Smiths Medical ASD, Inc.
John Crane, Inc.
Titeflex Corporation
Flexible Technologies, Inc.
Tutco, Inc.
Hypertronics Corporation
Transtector Systems, Inc.
Interconnect Devices, Inc.
Power Distribution, Inc.
JC Production Solutions, Inc.

Of the companies above, Smiths Group International Holdings Limited is 100% owned directly by the Company. The others are 100% owned through intermediate holding companies. Shareholdings are of ordinary shares or common stock. All subsidiaries operate in their country of incorporation.

See pages 206 to 209 for a complete list of subsidiary undertakings.

5 Available for sale financial assets

In December 2015, £152m of UK government bonds previously held as available for sale financial assets were contributed to Smiths Industries Pension Scheme. At 31 July 2015, the Group held £147m UK government bonds as part of the deficit-funding plan agreed with the trustee of this pension scheme. See note 8 of the Group accounts for additional details.

6 Trade and other receivables

	31 July 2016 £m	31 July 2015 £m
Amounts falling due within one year		
Amounts owed by subsidiaries	55	56
Other receivables	4	4
	59	**60**

7 Creditors: amounts falling due within one year

	31 July 2016 £m	31 July 2015 £m
Amounts falling due within one year		
Term loans due within one year (note 8)	255	150
Amounts owed to subsidiaries	80	55
Other creditors	18	16
Accruals and deferred income	10	8
	363	**229**

8 Borrowings and net debt

	31 July 2016 £m	31 July 2015 £m
Cash at bank	7	2
Short term deposits	200	328
Cash and cash equivalents	**207**	**330**
Term loans due within one year (note 7)	(255)	(150)
Term loans due after more than one year	(1,137)	(1,148)
Borrowings	**(1,392)**	**(1,298)**
Net debt	**(1,185)**	**(968)**

Term loans

The currency and coupons for the term loans are disclosed in note 17 of the Group accounts.

	31 July 2016 £m	31 July 2015 £m
Less than one year	255	150
Between one and two years	132	214
Between two and three years	189	112
Between three and four years		159
Between four and five years		
Greater than five years	816	663
Smiths Group plc term loans	**1,392**	**1,298**

See the liquidity risk disclosures in note 18 in the Group accounts for information on the cash and borrowing facilities available to the Group. The Company can borrow an additional $800m under the US$800m multi-currency revolving credit facility, which matures in February 2021.

9 Derivatives

The tables below set out the nominal amount and fair value of derivative contracts held by the Company:

	Contract or underlying nominal amount £m	Fair value Assets £m	Fair value Liabilities £m	Fair value Net £m
				At 31 July 2016
Foreign exchange contracts (not hedge accounted)	437	2	(2)	
Currency swaps (net investment hedges)	111		(1)	(1)
Cross currency swaps (fair value and net investment hedges)	326	25		25
Interest rate swaps (fair value hedges)	214	6		6
Total financial derivatives	**1,088**	**33**	**(3)**	**30**
Balance sheet entries				
Non-current		29		29
Current		4	(3)	1
Total financial derivatives		**33**	**(3)**	**30**

	Contract or underlying nominal amount £m	Fair value Assets £m	Fair value Liabilities £m	Fair value Net £m
				At 31 July 2015
Foreign exchange contracts (not hedge accounted)	254	2	(2)	
Currency swaps (net investment hedges)	97	7		7
Currency swaps (not hedge accounted)	157	3	(5)	(2)
Cross currency swaps (fair value and net investment hedges)	276		(4)	(4)
Interest rate swaps (fair value hedges)	180	4	(2)	2
Total financial derivatives	**964**	**16**	**(13)**	**3**
Balance sheet entries				
Non-current		4	(6)	(2)
Current		12	(7)	5
Total financial derivatives		**16**	**(13)**	**3**

10 Provisions for liabilities and charges

	At 31 July 2015 £m	Charged against profit £m	Utilisation £m	At 31 July 2016 £m
Disposals	2			2
	2			**2**

The closing disposal provision relates to warranties and other obligations in respect of a past disposal and is expected to be utilised within the next five years.

11 Post-retirement benefits

The Company is the principal employer for the two major defined benefit plans in the UK. Following the adoption of FRS 101, the Company is accounting for all the UK defined benefit schemes (funded and unfunded) and virtually all of the post-retirement healthcare schemes.

The retirement benefit assets and liabilities comprise:

	31 July 2016 £m	31 July 2015 (restated) £m
Market value of scheme assets	4,034	3,523
Present value of funded scheme liabilities	(3,709)	(3,385)
Surplus	325	138
Unfunded pension plans	(56)	(52)
Post-retirement healthcare	(7)	(7)
Present value of unfunded obligations	(63)	(59)
Net pension asset/(liability)	**262**	**79**
Retirement benefit assets	327	169
Retirement benefit liabilities	(65)	(90)
Net pension asset/(liability)	**262**	**79**

See the disclosures for UK schemes in note 8 to the consolidated accounts for the circumstances of the major schemes, risk management, principal assumptions, assets and liabilities and the funding position of the two major schemes.

12 Share capital and reserves

Share capital

	Number of shares	Issued capital £m	Consideration £m
Ordinary shares of 37.5p each			
At 31 July 2015	394,860,004	148	
Exercise of share options	363,068		3
Total share capital at 31 July 2016	**395,223,072**	**148**	

At 31 July 2016, all of the issued share capital was in free issue. All issued shares are fully paid.

See note 9 to the consolidated accounts for information about share schemes, including total shares under options and options exercisable at the balance sheet date.

During the year, the Company received £3m (2015: £3m) on the issue of shares in respect of the exercise of options awarded under various share option schemes.

Smiths Industries Employee Benefit Trust

The retained earnings include the purchase of Smiths Group plc shares by the Smiths Industries Employee Benefit Trust, and the issue of these shares upon the exercise of share options. The consideration paid was £8m (2015: £11m) and £nil (2015: £nil) was received as a result of the issue of shares. At 31 July 2016 the Trust held 852 (2015: 852) ordinary shares.

Distributable profits

The Company's profit and loss reserve of £1,857m (2015: £2,042m) comprised £913m (2015: £908m) not available for distribution as a dividend and £944m (2015: £1,134m) available for distribution. See note 25 in the Group accounts for a discussion of capital management and the factors the Board consider when proposing dividends.

Other reserves

Other reserves arose from the cancellation of the share premium arising from an equity-funded acquisition in the year ended 30 July 1988.

13 Deferred tax

The Company has recognised the following deferred tax assets and liabilities:

	Share-based payment £m	Retirement benefit obligations £m	Losses carried forward £m	Other £m	Total £m
At 31 July 2015		(17)	17		
Credit/(charge) to income statement	2	(35)	27	2	(4)
Credit/(charge) to equity		4			4
At 31 July 2016	**2**	**(48)**	**44**	**2**	

The Company is part of a UK tax group including all its UK-based subsidiaries. The Company derecognised UK tax assets relating to revenue losses brought forward and other temporary differences due to the impact of the pension contributions on the outlook for the UK tax base. The treatment of these assets is reviewed regularly and is dependent on the ability to recover them against forecast UK taxable profits of the tax group.

At 31 July 2016 the Company has unrecognised deferred tax assets of £19m (2015: £30m) relating to:

- retirement benefit obligations £19m (2015: £nil)
- losses carried forward £nil (2015: £27m);
- share-based payments £nil (2015: £1m); and
- other timing differences £nil (2015: £2m).

These tax allowances remain available to the Company and can be utilised should the UK tax base improve.

14 Contingent liabilities

The Company has provided guarantees and arranged letter of credit facilities to support the Group's pension plans. The current amount outstanding under letters of credit is £54m (2015: £54m).

The Company has guaranteed the US$800m revolving credit facility available to a subsidiary.

15 Post balance sheet event

The directors propose a final dividend of 28.75p per share (totalling approximately £114m) for the year ended 31 July 2016. The dividend will be submitted for formal approval at the Annual General Meeting to be held on 15 November 2016.

These financial statements do not reflect this dividend payable, which will be accounted for in shareholders' equity as an appropriation of retained earnings in the year ending 31 July 2017. During the year ended 31 July 2016, a final dividend of 28.00p per share (totalling £111m) was paid in respect of the dividends declared for the year ended 31 July 2015.

16 Adoption of FRS 101

Reconciliation of balance sheet at 31 July 2015

	Notes	31 July 2015 (as previously reported) £m	Reclassifying software £m	Applying IAS 19 £m	31 July 2015 (restated) £m
Fixed assets					
Intangible assets	2				
Tangible assets	3				
Investments and advances	4	3,486			3,486
Available for sale financial assets	5	147			147
		3,633			3,633
Current assets					
Debtors					
– amounts falling due within one year	6	60			60
Cash at bank and on deposit		330			330
Financial derivatives					
– amounts falling due within one year	9	12			12
– amounts falling due after more than one year	9	4			4
		406			406
Creditors: amounts falling due within one year	7	(236)			(236)
Net current assets/(liabilities)		170			170
Total assets less current liabilities		3,803			3,803
Creditors: amounts falling due after more than one year	8	(1,148)			(1,148)
Provisions for liabilities and charges	10	(2)			(2)
Financial derivatives		(6)			(6)
Net assets excluding pension liabilities		2,647			2,647
Retirement benefit assets	11			169	169
Retirement benefit liabilities	11	(89)		(1)	(90)
Net assets including pension liabilities		2,558		168	2,726
Capital and reserves					
Called up share capital	12	148			148
Share premium account		349			349
Capital redemption reserve		6			6
Other reserves		181			181
Profit and loss account		1,874		168	2,042
Shareholders' equity		2,558		168	2,726

Reconciliation of total equity

	31 July 2015 £m	31 July 2014 £m
As previously reported	2,558	2,448
Recognition of surplus on additional pension schemes	168	119
In accordance with FRS 101	2,726	2,567

Impact of reclassifying software

Fully amortised software has been reclassified from tangible to intangible assets, with no net impact on the balance sheet.

Impact of applying the recognition and measurement requirements of IAS 19 (revised)

Applying IAS 19 has increased pension assets by £1,710m and liabilities by £1,542m at 31 July 2015, as the Company recognises schemes previously treated as multi-employer schemes. There is a £49m credit to comprehensive income for 2015 comprising:

- a net £21m charge to interest, with the £(26)m reduction in interest income due to using the discount rate and £63m additional interest income and £(58)m additional interest charges for the recognition of additional pension schemes;
- added scheme administration costs of £2m previously included in actuarial gains and losses and £2m for new schemes;
- reduced operating charges for multi-employer schemes accounted for as defined contribution schemes by £17m; and
- increased actuarial gains by £57m, due to recognising additional UK schemes and the change in the treatment of finance income and scheme administration costs.

Smiths Group plc subsidiaries

Subsidiary	Country	Security	Direct (%)	Total (%)
Air Log Limited	United Kingdom	ORD 1p		100
Antares Advanced Test Technologies (Suzhou) Co. Ltd	China	Ord $1		100
Antares China Holdings, Inc	United States	Common shares		100
Ashfield Medical Systems Limited	United Kingdom	Ord £1		100
CDI Oilfield Services Srl	Romania	Ord RON 10		100
Changshu Flex-Tek Thermal Fluid Systems Manufacturer Co. Ltd	China	US$520,800 (reg capital)		100
Compania EMC Tecnologia S.A.	Costa Rica	Ord $1		100
CVE Trustee Limited	United Kingdom	Ord £1	100	100
EIS Group Plc	United Kingdom	ORD 25p	100	100
Flagtown Limited	United Kingdom	Ord £1	100	100
Flexible Ducting Malaysia Sdn Bhd	Malaysia	Ord $1		100
Flexible Ducting, Limited	United Kingdom	Ord £1		100
Flexible Technologies (Canada) Ltd	Canada	Ordinary shares $1		100
Flexible Technologies, Inc	United States	Ordinary shares $0.01		100
Flexibox (Northern Ireland) Limited	United Kingdom	Ord £1		100
Flexibox (Pty) Limited	South Africa	Ord		100
Flexibox International Limited	United Kingdom	Ord £1		100
Flexibox Japan KK	Japan	Ord JPY 1000		100
Flexibox Limited	United Kingdom	Ord £1		100
Flexibox Pty Limited	Australia	Ord AUS$ each		100
Flexschlauch Producktions GmbH	Germany	Ord		100
Flightspares Limited	United Kingdom	Ord £1; Ord 10p	100	100
Francis Shaw And Company (Manchester) Limited	United Kingdom	Ord £1		100
Francis Shaw P L C	United Kingdom	37% 2nd Pref Ord 10p; 5.25% Cum Pref £1; Def 20p; Ord 10p		100
George Maclellan Holdings Limited	United Kingdom	Def Ord 25p; Ord 5p	100	100
Global TI Limited	United Kingdom	Ord £1		100
Graseby Limited	United Kingdom	ORD 25p	100	100
Graseby Medical Ireland Limited	Ireland	Ord €1.269738 each		100
Graseby Medical Limited	United Kingdom	Ord £1		100
Hypertac GmbH	Germany	Ord €1		100
Hypertac Limited	United Kingdom	Ord £1		100
Hypertac S.A.	France	Ord €76		100
Hypertac SpA	Italy	Ord €5		100
Hypertronics Corporation	United States	Common stock		100
Indufil BV	Netherlands	Ord		100
Industrias John Crane Mexico S.A. de C.V.	Mexico	Series A MXN 1; Series B MXN 1		100
Interconnect Devices, Inc.	United States	Common stock		100
John Crane (Angola) Prestacao De Services Ltd	Angola	Ord AOA 1		100
John Crane (Ireland) Limited	Ireland	ORD US$1		100
John Crane (Switzerland) AG	Switzerland	Ord 1 CHF		100
John Crane (Thailand) Limited	Thailand	Ord THB1, Preferred shares		100
John Crane Argentina SA	Argentina	Common $1 ARS		100
John Crane Australia Pty Limited	Australia	Ord AUS$1		100
John Crane Baku LLC	Azerbaijan	Ord US 10		100
John Crane Bearing Technology GmbH	Germany	Ord		100
John Crane Belgium NV	Belgium	No par value		100
John Crane Canada Inc	Canada	Common $1		100
John Crane Caribe Ltd	Puerto Rico	Common shares		100
John Crane Chile SA	Chile	Ord		100
John Crane China Co. Limited	China	ORD CNY1		100
John Crane Colombia SA	Colombia	Ord COP$1		100
John Crane Dominicana SA	Dominican Republic	Ord DP$1		100
John Crane Egypt LLC	Egypt	Ord EGP 1		100
John Crane Egypt Sealing Systems LLC	Egypt	Ord EGP 1		100
John Crane Endustriyel Sizdirmazlik Sistemleri Ltd	Turkey	Ord TRY 25		100
John Crane Flexibox India Private Limited	India	Ord INR 10		100
John Crane France SAS	France	Ord €286		100
John Crane GmbH	Germany	Ord €1		100
John Crane Group Corporation	United States	Ord		100
John Crane Group Limited	United Kingdom	Ord £1		100
John Crane Hellas - Engineered Sealing Systems Monoprosopi EPE	Greece	Ord €1		100
John Crane Holland BV	Netherlands	Ord €1		100
John Crane Hungary Kft	Hungary	Ord €1		100
John Crane Iberica SA	Spain	Ord €6.010121		100
John Crane Inc	United States	Common $0.01; preferred $0.10		100
John Crane International Inc.	United States	Common shares		100
John Crane International Limited	United Kingdom	Ord £1		100
John Crane Investments Limited	United Kingdom	Ord £1		100
John Crane Italia SpA	Italy	Ord €5.16		100
John Crane Japan Inc	Japan	Ord JPY1,000		70

Subsidiary	Country	Security	Direct (%)	Total (%)
John Crane Kazakhstan	Kazakhstan	Ordinary equity		100
John Crane Korea Co Ltd	Korea, Republic of	Ord KWON5,000		100
John Crane Malaysia Sdn. Bhd.	Malaysia	Ord MYR $1		100
John Crane Middle East FZE	United Arab Emirates	Ord AED 1		100
John Crane Peru SAC	Peru	Common shares		100
John Crane Poland Sp Z O.O.	Poland	Ord 50 PLN		100
John Crane Production Solutions Inc	United States	Ord $0.01		100
John Crane Pty Ltd	South Africa	Ord ZAR 1		100
John Crane Safematic Oy	Finland	Ord		100
John Crane Saudi Arabia Ltd	Saudi Arabia	Ord ZAR 1		100
John Crane Sealing Systems India Private Limited	India	Ord INR10		100
John Crane Sigma AS	Czech Republic	Ord CZK 1m		100
John Crane Singapore Pte Limited	Singapore	Ord S$1		100
John Crane Slovakia sro	Slovakia	Ord €1		100
John Crane Sociedad De Responsibilidad Limitada De Capital Variable	Mexico	Ord MXN $1		100
John Crane Sverige AB	Sweden	Ord		100
John Crane Taiwan Co Ltd.	Taiwan Province of China	Ord T$1		100
John Crane Technology (Tianjin) Co Limited	China	Ord US$1		100
John Crane UK Limited	United Kingdom	Ord £1		100
John Crane Venezuela CA	Venezuela	CLASS "A" VEF1; CLASS "B" VEF1; COMMON VEF1		100
Kaelus Communications Equipment (Shanghai) Co. Ltd	China	Ord $1		100
Kaelus Interconnect (Shanghai) Co. Ltd.	China	Ord $1		100
Kaelus Pty Ltd	Australia	E shares AUS $1; ord AUS $1		100
Kaelus, Inc.	United States	Class A common stock $0.01; Class B common stock $0.01		100
Kiinteisto Oy Ainolantie 21	Finland	Ord		100
Kontak Manufacturing Company Limited	United Kingdom	Ord £1		100
Lighthome Limited (in liquidation)	United Kingdom	Ord £1	100	100
LLC John Crane Rus	Russian Federation	Ord RUB 1 each		100
Medex Cardio-Pulmonary, Inc	United States	Common Stock of $0.01		100
Medex Medical Limited	United Kingdom	Ord £1		100
Millitech, Inc.	United States	Common stock		100
OIE Services Limited	United Kingdom	Ord £1		100
Oil Plus Limited	United Kingdom	Ord £1		100
Orion Corporation	United States	Ord 1 cent		100
Plenty India Limited	India	Ord		100
Pneupac Limited	United Kingdom	Ord £0.50		100
Power Distribution, Inc.	United States	Common		100
Powercam-Houdaille, Inc.	United States	Common shares		100
Project Sugar Limited	United Kingdom	Ord £1		100
Pt John Crane Indonesia	Indonesia	Ord IDR1,000		99
Pyzotec Limited	United Kingdom	Ord £1	75	75
Radio Waves, Inc.	United States	Common stock		100
Roof Units (Group) Limited	United Kingdom	ORD 10p	100	100
S.I. Pension Trustees Limited	United Kingdom	Ord £1	100	100
Sabritec	United States	Ordinary shares		100
Sedding (No.3) Limited	United Kingdom	Ord £1		100
Shenzhen Dowin Lightning Protection Engineering Co. Ltd	China	Ord 1RMB		100
Shenzhen Dowin Lightning Technologies Co. Ltd.	China	Ord 1RMB		100
SI Overseas Holdings Limited	United Kingdom	Ord £1		100
SI Properties Limited	United Kingdom	Ord 25p	100	100
SITI 1 Limited	United Kingdom	US$1 shares		100
Smiths Aerospace Components Tyseley Limited	United Kingdom	Ord £1	100	100
Smiths Aerospace Components-Burnley Limited	United Kingdom	Ord £1		100
Smiths Aerospace Gloucester Limited	United Kingdom	Ord 25p; Ord A 25p		100
Smiths Brasil LTDA	Brazil	Ord R$1		100
Smiths Business Information Services Limited	United Kingdom	Ord £10		100
Smiths Business Information Services, Inc.	United States	Ord $0.01		100
Smiths Connectors Asia Pte. Ltd.	Singapore	Ord SGD$1		100
Smiths Connectors Tunisia Sarl	Tunisia	Ord 1 DT		100
Smiths Detection – Toronto Ltd.	Canada	Common shares; Preference shares		100
Smiths Detection (Asia Pacific) Pte. Ltd	Singapore	Ord S$1		100
Smiths Detection (Australia) Pty Ltd	Australia	Ord AUD 1		100
Smiths Detection (Thailand) Limited	Thailand	Ord THB100; Pre THB100		100
Smiths Detection Brasil Comerico De Equipamentos LTDA	Brazil	Common		100
Smiths Detection GmbH	Germany	1 share of € 25,000; 1 share of €183,100; 1 shares of € 791,900		100
Smiths Detection Group Limited	United Kingdom	Ord £1		100
Smiths Detection Inc	United States	Common stock of $0.0001		100
Smiths Detection Investments Limited	United Kingdom	Ord £1		100

Subsidiary	Country	Security	Direct (%)	Total (%)
Smiths Detection Ireland Limited	Ireland	Ord €1.25; Ord B of €1.269738; Ord D €1.25; Series C shares €1.25		100
Smiths Detection Italia Srl	Italy	Quota value of shares		100
Smiths Detection Limited	United Kingdom	Ord £1	100	100
Smiths Detection Malaysia Sdn Bhd	Malaysia	Share of 1 MYR		100
Smiths Detection Middle East FZE	United Arab Emirates	Share of AED 1,000,000		100
Smiths Detection Montreal Inc.	Canada	Class A shares; Class B shares		100
Smiths Detection New Zealand Limited	New Zealand	Ord NZ$1		100
Smiths Detection Saudi Arabia Co. Ltd	Saudi Arabia	Share of 1000 Saudi Riyals		100
Smiths Detection US, LLC	United States	Ord $1		100
Smiths Detection US Holdings LLC	United States	Units of limited liability company interest		100
Smiths Detection Security Systems LLC	Abu Dhabi	AED 1,500		49
Smiths Detection Veecon Systems Private Limited	India	Class A equity shares INR 10; Class B equity shares INR 10		100
Smiths Detection-Watford Limited	United Kingdom	Ord £1		100
Smiths Finance Limited	United Kingdom	Ord £1; Redeemable US$1		100
Smiths Finance Luxembourg Sarl	Luxembourg	Ord US$0.01		100
Smiths Group (Gibraltar) Limited	Gibraltar	Ord US$ 1.56		100
Smiths Group Deutschland GmbH	Germany	1 share of €1,491,400; 1 share of €3,478,400; 1 share of €995,500		100
Smiths Group Holdings Netherlands BV	Netherlands	Ord		100
Smiths Group Insurance Limited	Guernsey	Ord £1		100
Smiths Group International Holdings Limited	United Kingdom	Ord £1	100	100
Smiths Group Italia Srl	Italy	Ord €1		100
Smiths Group Luxembourg Sarl	Luxembourg	Ord US$1.00		100
Smiths Group Services Corp.	United States	Common stock $0.01		100
Smiths Healthcare Limited	United Kingdom	ORD 1p	100	100
Smiths Healthcare Manufacturing, S.A. de C.V.	Mexico	Series B 10 pesos; series B-1 pesos 10		100
Smiths Heimann Del Ecuador SA (in liquidation)	Ecuador	Ordinary shares of $1.00 each		100
Smiths Heimann GmbH	Germany	Ord		100
Smiths Heimann Limited	United Kingdom	Ord £1	100	100
Smiths Heimann Rus LLC	Russian Federation	Ord		100
Smiths Heimann S.A.S.	France	Shares of €1 each		100
Smiths Industries GmbH	Germany	Ordinary	100	100
Smiths Industries Industrial Group Limited	United Kingdom	Ord £1		100
Smiths Industries Limited	United Kingdom	7% non cum pref; Ord £1	100	100
Smiths Interconnect Australia Pty Ltd	Australia	Ord $1 AUS		100
Smiths Interconnect Connectors UK	United Kingdom	Ordinary		100
Smiths Interconnect Connectors, Inc.	United States	Common		100
Smiths Interconnect Group Limited	United Kingdom	Ord £1		100
Smiths Interconnect Microwave Components, Inc.	United States	Common stock		100
Smiths Interconnect Power Management, Inc.	United States	Common stock $0.01		100
Smiths Interconnect Power Management UK	United Kingdom	Ordinary		100
Smiths Interconnect, Inc.	United States	Common stock		100
Smiths Medical (Beijing) Co. Ltd	China	Ordinary shares $1		100
Smiths Medical (Hong Kong) Limited	Hong Kong	Ord HK$1		100
Smiths Medical (Portugal), Unipessoal Lda	Portugal	1 Share of €505,000		100
Smiths Medical (South Africa) (Pty) Ltd	South Africa	Shares of R1 each		100
Smiths Medical ASD Inc.	United States	Common stock of $1		100
Smiths Medical Australasia Pty Ltd	Australia	Ord		100
Smiths Medical Belgium NV	Belgium	Registered shares		100
Smiths Medical Canada Ltd	Canada	Common shares		100
Smiths Medical Czech Republic A.S	Czech Republic	Ordinary		100
Smiths Medical Danmark ApS	Denmark	Shares of DKK100 each		100
Smiths Medical Deutschland GmbH	Germany	1 share of €1,000; 1 share of €27,000; 1 share of €5,000		100
Smiths Medical Distribution Limited	United Kingdom	Ord £1	100	100
Smiths Medical Do Brasil Produtos Hospitalares LTDA	Brazil	Ord R$1		100
Smiths Medical Espana S.L.	Spain	Shares €1		100
Smiths Medical France SAS	France	Shares of €7.7 each		100
Smiths Medical Group Limited	United Kingdom	Ord A £1; Ord B £1; Ord C £1		100
Smiths Medical India Private Limited	India	Ord 1 INR		100
Smiths Medical Instrument (Zhejiang) Co. Ltd	China	Ordinary shares of RMB		100
Smiths Medical International Limited	United Kingdom	Ord £1; Pref €2		100
Smiths Medical Italia Srl	Italy	Ord €1		100
Smiths Medical Japan Ltd	Japan	Common stock		100
Smiths Medical Limited	United Kingdom	Ord £1		100
Smiths Medical Nederland B.V.	Netherlands	Shares NLG100		100
Smiths Medical Osterreich GmbH	Austria	Ord €1		100
Smiths Medical Schweiz AG	Switzerland	Shares of CHF 10.00 each		100
Smiths Medical Singapore Pte. Limited	Singapore	Ordinary shares		100
Smiths Medical Sverige AB	Sweden	Shares of SEK100 each		100

Subsidiary	Country	Security	Direct (%)	Total (%)
Smiths Medical UK	United Kingdom	Ord US$1		100
Smiths Medical US, Inc	United States	Common stock of $0.01		100
Smiths Nominees Limited	United Kingdom	Ord £1	100	100
Smiths Pensions Limited	United Kingdom	Ord £1	100	100
Smiths Power UK Limited	United Kingdom	Ord GBP1		100
Smiths Tubular Systems-Laconia, Inc	United States	Ordinary shares $1		100
Smiths Wolverhampton Limited	United Kingdom	Ord 25p		100
STS Titeflex India Pvt Ltd	India	Ordinary shares INR 100		100
Subvenmar Limited	United Kingdom	Ord £1		100
TECOM Industries, Incorporated	United States	Common stock $1		100
TI Group Automotive Systems (Argentina) SA	Argentina	Ord $1 ARS		100
TI Group Limited	United Kingdom	Ord 25p	100	100
TI Guarantee Company Limited	United Kingdom	Limited by guarantee		100
TI Interest Limited	United Kingdom	Ord A £1, Ord B £1, Floating Rate Cum Red Pref C £1	100	100
TI SA (France)	France	Ord		100
TIGrup No. 14 Limited	United Kingdom	Ord 20p		100
TIGrup No.7 Limited	United Kingdom	Ord £1	100	100
Titeflex Commercial, Inc.	United States	Ord $0.01		100
Titeflex Corporation	United States	Ordinary shares $1		100
Titeflex Europe SAS	France	Ord $1		100
TRAK Microwave Corporation	United States	Common stock		100
TRAK Microwave Limited	United Kingdom	Ordinary shares		100
Transtector Systems, Inc.	United States	Common stock		100
TriasX (Hong Kong) Limited	Hong Kong	Ord HKD $1		100
TriasX (Suzhou) Telecommunications Co. Ltd.	China	Ord $1		100
Turbo Components & Engineering Inc	United States	Common shares		100
Tutco De Mexico S de RL de CV	Mexico	Ordinary shares $1.00		100
Tutco, Inc	United States	Ordinary shares $1		100
Venmar Limited	United Kingdom	A Ord 10p, B Ord 10p., C Ord £1, Pref 10p		100
XD Communications Limited	United Kingdom	Ord £1		100
XDG Limited	United Kingdom	Ord 50p	100	100
XPD8 Solutions Limited	United Kingdom	Ord £1		100
Zamor KG	Germany	Ordinary shares €1		49

Associates	Country	Security	Direct (%)	Total (%)
LLC John Crane Iskra	Russian Federation	Ord 1 RUB		50
STI Security Training International GMBH	Germany	Ordinary shares €1		34

A new company, Gastite Systems Limited, was incorporated in the United Kingdom on 1 August 2016. Smiths Group plc indirectly owns the entire issued share capital and the new company will be consolidated as a subsidiary from the date of incorporation.

Financial calendar

	2016
Announcement of results for 2015/16	28 September
Ordinary shares final dividend ex-dividend date	20 October
Ordinary shares final dividend record date	21 October
Annual General Meeting	15 November
Ordinary shares final dividend payment date	18 November

	2017
2016/17 interim results announced	22 March (provisional)
Ordinary shares interim dividend ex-dividend date	30 March (provisional)
Ordinary shares interim dividend record date	31 March (provisional)
Ordinary shares interim dividend payment date	28 April (provisional)
Smiths Group financial year end	31 July
Announcement of results for 2016/17	20 September (provisional)
Ordinary shares final dividend ex-dividend date	19 October (provisional)
Ordinary shares final dividend record date	20 October (provisional)
Annual General Meeting	14 November (provisional)
Ordinary shares final dividend payment date	17 November (provisional)

The market value of an ordinary share of the Company on 31 March 1982 for the purposes of capital gains tax was 136.875p (taking into account the sub-division of 50p shares into 25p shares on 14 January 1985 and the subdivision and consolidation of 25p shares into 37.5p shares on 18 June 2007).

The 2016 Annual General Meeting will be held at the Northcliffe House Auditorium of the law firm, Freshfields Bruckhaus Deringer, 26-28 Tudor Street, London EC4Y 0BQ on Tuesday 15 November 2016 at 11:00am.

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Glossary of terms

AGM	Annual General Meeting
BIS	Business Information Services
EHS	Environment, Health & Safety
EMEA	Europe, Middle East, Africa
GHG	Greenhouse Gas
HVAC	Heating, Ventilation and Air Conditioning
R&D	Research and Development
STEM	Science, Technology, Engineering and Mathematics

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smiths

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