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News release

London, Wednesday 28 September 2011
For immediate release

Annual results for the year ended 31 July 2011

	Headline*				Statutory	
	2011 £m	2010 £m	Growth	Underlying#	**2011 £m**	2010 £m
Continuing activities						
Sales	**2,842**	2,770	3%	1%	**2,842**	2,770
Operating profit	**517**	492	5%	4%	**438**	436
Operating margin	**18.2%**	17.8%	40 bps	–	**15.4%**	15.7%
Pre-tax profit	**486**	435	12%	11%	**398**	373
Basic EPS	**92.7p**	84.6p	10%		**77.8p**	75.3p
Free cash-flow	**236**	331				
Dividend	**36.25p**	34.0p	7%		**36.25p**	34.0p
Return on capital employed	**17.0%**	16.6%	40 bps			

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

#Organic growth at constant currency.

Highlights

- Sales up 3%; headline operating profit up 5%
- Headline operating margin up 40 basis points to 18.2%
- Company funded R&D increased by 5% to £99m
- Restructuring programme savings of £15m; £56m to date from £70m target
- Cash conversion strong – with free cash flow of £236m and year end net debt of £729m
- Dividend up 7%
- Return on capital employed up 40 basis points to 17.0%

"Smiths Group has made good progress against a deteriorating economic backdrop. We continue to build a solid foundation for future growth through further operational efficiencies and greater investment in new product development, sales and marketing effectiveness, expansion of our emerging market exposure and targeted acquisitions. The results again demonstrate the significant benefits delivered by our sustained focus on operational improvement that have driven margins to new highs. At the same time, we increased investment in future growth drivers, such as company-funded research and development, up 5%, and spent more on sales and marketing. We have again delivered strong cash conversion in line with guidance, and increased the annual dividend ahead of inflation.

"The economic outlook remains uncertain and continued pressures on government spending, which particularly impacted Smiths Detection, Medical and Interconnect are likely to continue to constrain revenue opportunities of some of our businesses during fiscal 2012. However, we still see further potential to drive operational improvements, enhance margins and deliver strong cash conversion."

Philip Bowman
Chief Executive
Smiths Group plc

Divisional highlights*

	% of Group sales	Underlying sales growth*	Headline operating profit margin		Headline return on capital employed	
			2011	2010	**2011**	2010
Smiths Detection	18%	**(13)%**	**12.8%**	15.7%	**9.8%**	13.3%
John Crane	31%	**13%**	**21.1%**	20.7%	**25.4%**	22.2%
Smiths Medical	30%	**(3)%**	**23.4%**	21.5%	**16.9%**	15.1%
Smiths Interconnect	13%	**3%**	**17.8%**	18.2%	**15.7%**	17.3%
Flex-Tek	8%	**6%**	**12.5%**	11.1%	**21.9%**	18.4%
Group	100%	**1%**	**18.2%**	17.8%	**17.0%**	16.6%

Smiths Detection

- Revenue and margins declined as a result of order delays in most sectors, particularly military and ports & borders
- A performance improvement programme is expected to deliver £40m of annualised savings by the end of FY2014
- Announced the appointment of Mal Maginnis as divisional President, with effect from 1 January 2012
- Acquisitions have strengthened sales presence in key emerging markets: Brazil and India
- Sales will be affected by government budgets and regulations, margins will benefit from the restructuring initiatives

John Crane

- Sales driven by growth in original equipment and aftermarket revenue, particularly in the oil and gas sector
- Margins improved by 40 basis points to 21.1%, benefiting from increased volumes and efficiency initiatives
- Restructuring initiatives delivered £6m savings in the period, with the total to date of £23m
- A strong order book supports first half growth; expanding bearings aftermarket service through TCE acquisition

Smiths Medical

- Margins enhanced 190 basis points to 23.4% through a range of cost management initiatives
- These initiatives include portfolio profitability reviews, value engineering and restructuring
- Tough operating environment with pressure on healthcare spend from government budgets and unemployment
- New product launches benefiting from increased investment in R&D

Smiths Interconnect

- Sales and margins affected by lower military sales offsetting growth in other sectors
- Several new contract wins and further roll-out of broadband antenna for commercial aircraft
- Integration of Interconnect Devices, Inc. complete, and agreed to acquire Power Holdings, Inc.
- Sales growth will be held back by declines in the military sectors, other sectors are expected to see further growth

Flex-Tek

- Improved volumes and continued cost efficiencies contributed to a 140 basis point increase in margins
- Sales growth driven primarily by the aerospace and US residential construction sectors
- Fluid management is expected to see continued growth while construction and appliances markets are uncertain
- An upturn in these markets will generate positive earnings growth

**Sales and profit are at constant currency and exclude the impact of acquisitions and disposals*

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Presentation

The presentation slides and a live webcast of the presentation to analysts are available at www.smiths.com/results at 09.00 (UK time) on Wednesday 28 September. A recording of the webcast is available later that day. A live audio broadcast of the presentation is also available by dialling (no access code required):

UK toll free: 0800 368 1985

International: +44 (0)20 3140 0820

US/Canada toll free: 1 866 978 9967

An audio replay is available for seven days on the following numbers (access PIN 378701#):

UK toll free: 0800 368 1890

International: +44 (0)20 3140 0698

US/Canada toll free: 1 877 846 3918

Photography

Original high-resolution photography is available to the media from http://www.smiths.com/images.aspx.

Statutory reporting

Statutory reporting takes account of all items excluded from headline performance. On a statutory basis, pre-tax profit from continuing operations was £398m (2010: £373m) and earnings per share were 77.8p (2010: 75.3p). The items excluded from headline performance comprise amortisation and impairment of acquired intangible assets of £50m (2010: £42m); £34m in connection with John Crane, Inc. asbestos litigation (2010: £25m); £16m of exceptional restructuring costs (2010: £8m); £10m of gains in respect of post retirement liabilities (2010: £4m); £4m profit on disposal of businesses (2010: £3m); £2m release of a diabetes-related provision (2010: nil); acquisition costs of £1m (2010: £1m) and financing losses of £3m (2010: £1m gain).

This document contains certain statements that are forward-looking statements. They appear in a number of places throughout this document and include statements regarding our intentions, beliefs or current expectations and those of our officers, directors and employees concerning, amongst other things, our results of operations, financial condition, liquidity, prospects, growth, strategies and the business we operate. By their nature, these statements involve uncertainty since future events and circumstances can cause results and developments to differ materially from those anticipated. The forward-looking statements reflect knowledge and information available at the date of preparation of this document and, unless otherwise required by applicable law, the Company undertakes no obligation to update or revise these forward-looking statements. Nothing in this document should be construed as a profit forecast. The Company and its directors accept no liability to third parties in respect of this document save as would arise under English law.

Chief Executive's review

We have delivered across all our key financial metrics: sales growth, margins, cash generation and return on capital. Sales benefited from organic growth in John Crane, Interconnect and Flex-Tex and recent acquisitions, partly offset by a disappointing performance from Smiths Detection and a tougher trading environment and continuing portfolio rationalisation at Smiths Medical. A detailed performance improvement programme has begun in Smiths Detection and its delivery is a key priority. Group margins have advanced as a result of volume leverage, better pricing and our continued focus on operational improvement and restructuring. Cash conversion remains strong and return on capital employed increased 40 basis points to 17.0%.

John Crane's revenues grew strongly with robust demand from its end markets, particularly the oil and gas sector, for its aftermarket services and original equipment. Margins advanced as a result of the higher volumes and further savings from its various cost reduction programmes, more than offsetting some adverse mix effects from the acceleration in growth in sales of original equipment and the lower margin upstream energy services business. Smiths Medical delivered further profit improvement to raise margins to 10-year highs, while also increasing investment in the future growth drivers, such as new product development and sales and marketing. This has been achieved in a tough operating environment, particularly the mature markets in the US and Europe, where budget pressures have constrained capital purchases and unemployment has reduced procedure rates. A focus on product profitability and SKU rationalisation benefited margins but adversely affected sales. As previously guided, Smiths Detection experienced delays to orders across a number of sectors which caused sales declines and adversely impacted margins. However, we launched a performance improvement programme to deliver cost savings and operational improvements. Smiths Interconnect delivered overall sales growth despite declines in its military sales as a result of lower defence spending; this was more than offset by strong sales of specialist connector components to the medical, rail, automation and test markets, as well as growth in components and subsystems for wireless telecoms and commercial aerospace markets. The acquisition of IDI last year also benefited sales and margins. Flex-Tek delivered revenue growth across the aerospace and construction markets, which in turn supported higher margins as a result of its strong operational gearing.

Strategy

Our strategy is to continue to grow shareholder value by:

- Delivering sales growth through investment in organic drivers including new product development, expansion in high growth markets and sales and marketing effectiveness
- Enhancing margins through a relentless drive for operational improvement across all our businesses.
- Generating strong cash flows with efficient balance sheet management
- Implementing a rigorous approach to allocating capital across the businesses through active and disciplined portfolio management and a targeted acquisition strategy
- Promoting a culture of corporate responsibility.

We made good progress towards these goals during the last year, with some key examples set out below. Clear opportunities remain, however, for Smiths Group to improve performance progressively and generate further value for shareholders.

Investing in sales growth

We have maintained technology leadership in many areas through a firm commitment to new product development and innovation, which in turn is a key driver of future sales and margin growth as new products typically command higher margins and deliver superior returns. We raised company-funded investment in R&D by 5% to £99m and secured a further £12m of customer-funded investment to bring our total spend to £111m, or 3.9% of sales (2010: 3.9%). This long-term investment is delivering results. In Canada, Smiths Medical launched a new syringe pump with wireless networking, Medfusion™ 4000, as well the new CADD®-Solis VIP pump which targets the growing alternate site and homecare markets. The Medfusion™ 4000 recently received FDA 510(k) clearance for sale in the US and we expect to extend both products to other markets subject to regulatory clearances. In Smiths Detection, the development of a next generation explosives detection system for screening airport checked baggage, in co-operation with Analogic Corporation, is meeting our programme milestones. John Crane has continued to make progress on its portfolio of environmentally focused zero and low emission seals and on extending the high pressure capabilities of its compressor dry gas seals.

To support growth opportunities in emerging markets, we established a direct sales and marketing team in India for Smiths Medical. This builds on an existing distributor presence and supports further direct investment to drive accelerated growth in this rapidly growing market. We also made two acquisitions during the period, buying Smiths Detection's existing distributors in India and Brazil, to create a direct sales presence in these important fast growing markets. Smiths Detection is already prominent in India with its equipment operating at more than 125 sites, while in

Brazil, Smiths Detection's systems are deployed throughout the vast country, from airports and ports in major cities such as Sao Paulo and Rio de Janeiro to remote border crossings in the Amazon.

Enhancing margins

Margins have continued to benefit from the major restructuring programme that began in 2008, delivering further savings of £15m in the period. To date, we have generated savings of £56m against our total planned savings of £70m when completed in 2012/13.

We have also launched a performance improvement programme in Smiths Detection which is expected to deliver annualised savings of £40m by the end of financial year 2014, at a cost of £40m. It is expected that £15m of these savings will be delivered in the first year. This will lower the fixed cost base and make the business better able to respond to variations in demand while improving customer service.

Strong cash generation and financing

We have achieved strong free cash-flow which has reduced net debt by £108m to £729m. The Group benefits from high cash conversion and a sound balance sheet. During the year, we refinanced our bank facility with a new US$800m revolving credit facility. The new facility, which matures in December 2015, is currently un-drawn. Over the past three years, we have progressively refinanced all our facilities, giving us an average maturity of almost five years and a strong balance sheet to finance our plans.

Allocating capital to maximise returns

The Group continues to focus on improving returns on capital across all divisions by enhancing margins while operating an efficient capital base. This has increased headline return on capital employed by 40 basis points to 17.0%.

Subject to suitable market conditions, we will undertake more active management of our portfolio through a combination of acquisitions that satisfy our strategic and financial objectives and disposals that realise additional value for our shareholders. This will be undertaken in the context of continuing to manage the legacy issues of the significant actuarial deficits on the defined benefit pension plans and the ongoing historic product liability litigation against John Crane, Inc.

There are attractive opportunities to invest in our businesses to deliver superior returns. After the year end, Smiths Interconnect agreed to acquire Power Holdings, Inc., a leading designer and manufacturer of specialist power distribution, conditioning and monitoring systems for $235m, subject to regulatory approvals. This acquisition will transform Smiths Interconnect's existing power protection group with a complementary range of products and technologies, as well as new growth opportunities. In August 2011, John Crane agreed, conditional upon regulatory approvals, to acquire the business of Turbo Components and Engineering Inc. which services, repairs and builds replacement bearings and seals used in critical rotating equipment. This will accelerate the development of John Crane's aftermarket services offering for bearings.

Targeting performance improvement

In September 2008, we set out ranges for sales growth and margins for each of the divisions based on what we believed the businesses could achieve over the medium term in an economic environment consistent with the immediately preceding period. However, the downturn in world economies since then has made it harder to operate within these targets in the near term; particularly sales growth, which is harder to deliver than improved margins, where we have greater control over delivering cost savings and efficiencies.

We are planning to review these targets during the course of the 2012 financial year, although the current economic uncertainty and risk of a further recession has made this more challenging in the near term. In the meantime, we will continue to strive to deliver improvements in sales growth and margins against our targets.

Managing our legacy liabilities

We manage two areas of material historic liabilities: actuarial deficits on our defined benefit pension plans and ongoing product liability litigation in connection with John Crane, Inc.

The net funding position for the pension schemes has deteriorated in recent years as a result of increased liabilities caused by low bond yields and increased longevity, and poor asset performance in weak equity markets. Over this time, the Group has taken steps to minimise this liability by closing the defined benefit schemes and capping our obligations for post-retirement health benefits. In addition, the Group has agreed 10-year funding plans with the UK Trustees. Steps have also been taken to improve the matching of the Schemes' assets and liabilities. In September 2011, the Trustee of the TI Group Pension Scheme invested approximately £147m in a bulk annuity policy as a match for specific pensioner liabilities, thereby mitigating the longevity risk in the Scheme. This follows similar annuity purchases in 2008 involving assets of around £500m.

The product liability litigation relates to various sealing products containing asbestos that John Crane, Inc. ("JCI"), a US subsidiary of John Crane, ceased making in 1985. JCI resists these claims based on a "safe product" defence because the asbestos was encapsulated in such a manner that, based on tests conducted on its behalf, the products were safe. In our accounts, we disclose details of recent claims experience and of the provisions established for these liabilities. During the year, the provisioning approach for both the adverse judgments and legal defence costs

was harmonised by using the same asbestos valuation experts and the same 10-year rolling period for both, compared with up to 16-years for previous estimates of legal costs. We will continue to update these provisions every six months. During the year, the number of claims in which JCI is a defendant continued to fall. Further details are given in note 23 to the accounts.

Dividend

Having reached our target dividend cover of around 2.5 times last year, the Board has adopted a progressive dividend policy for future payouts while maintaining this prudent level of cover. This policy will enable us to retain sufficient cash-flow to meet our legacy liabilities and finance our investment in the drivers of growth.

The Board has recommended a final dividend of 25.0p per share giving a total for the year of 36.25p, an increase of 7%. The final dividend will be paid on 25 November to shareholders registered at the close of business on 28 October. The ex-dividend date is 26 October.

Outlook

The economic outlook remains uncertain and continued pressures on government spending, which particularly impacted Smiths Detection, Medical and Interconnect are likely to continue to constrain revenue opportunities of some of our businesses during fiscal 2012. However, we still see further potential to drive operational improvements, enhance margins and deliver strong cash conversion. Outlook statements for the divisions are provided in the Business review.

Business review

Sales

Sales increased by 3%, or £72m, to £2,842m. The net impact of acquisitions and disposals contributed £45m, partly offset by adverse currency translation on overseas sales of £3m. On an underlying basis, excluding currency translation and acquisitions, sales grew £30m. This increase was driven primarily by strong growth at John Crane (up £104m), Flex-Tek (up £12m) and Smiths Interconnect (up £9m) partly offset by underlying sales declines in Smiths Detection (£73m) and Smiths Medical (£22m).

Profit

Headline operating profit rose £25m to £517m. Headline operating margin increased by 40 basis points to 18.2% (2010: 17.8%). The growth comprises a £19m, or 4%, underlying increase in headline operating profit and £8m benefit from the net impact of acquisitions and disposals, partly offset by £2m from adverse currency translation. The main drivers of this £19m underlying improvement were higher volumes and cost savings at John Crane (up £25m), manufacturing and overhead efficiencies at Smiths Medical (up £13m), and higher volumes and prices at Flex-Tek (£5m), partly offset by lower volumes at Smiths Detection (down £24m) and adverse mix and price at Smiths Interconnect (down £1m). Corporate centre costs were down £1m on last year reflecting lower bonus payments.

Operating profit on a statutory basis, after taking account of the items excluded from the headline figures, was £438m (2010: £436m).

The net interest charge on debt declined to £59m (2010: £62m) which reflects reduced average levels of debt. The pensions financing credit increased to £23m (2010: £2m), reflecting the improved funding level at 1 August 2010. Contribution from associates increased by £2m to £4m. As a result, headline profit before tax increased by £51m to £486m (2010: £435m). On an underlying basis, headline profit before tax grew by 11%.

On a statutory basis, after taking account of items excluded from the headline figure, profit before tax increased £25m to £398m (2010: £373m).

The Group's tax rate on headline profit for the period was 25% (2010: 24%). Headline earnings per share increased by 10% to 92.7p (2010: 84.6p).

Cash generation

Operating cash generation remained strong, albeit below the high levels of the previous years. Headline operating cash of £489m (2010: £565m) represented 95% (2010: 115%) of headline operating profit. Cash conversion benefited in 2010 from reduced working capital arising from certain one-off initiatives. Free cash-flow declined £95m to £236m (2010: £331m). Free cash-flow is stated after interest and tax but before acquisitions, financing activities and dividends (see note 28 to the accounts for a reconciliation of headline operating cash and free cash-flow to statutory cash-flow measures).

On a statutory basis, net cash inflow from continuing operations was £322m (2010: £410m).

Dividends paid in the year on ordinary shares amounted to £136m (2010: £133m).

Net debt at 31 July was £729m, down from £837m at 31 July 2010. The decrease in net debt reflects the strong free cash-flow and outflows of £136m for dividends and £21m for the net effect of acquisitions and disposals.

Smiths Detection

	2011 £m	2010 £m	Reported growth	Underlying growth
Sales	**510**	574	(11)%	(13)%
Headline operating profit	**66**	90	(27)%	(27)%
Headline operating margin	**12.8%**	15.7%	(290) bps	
Statutory operating profit	**64**	89		
Return on capital employed	**9.8%**	13.3%	(350) bps	

Reported sales declined 11%, or £64m, reflecting an underlying revenue fall of £73m and an adverse currency effect of £3m, partly offset by a benefit from acquisitions of £12m. The decrease in underlying sales was driven primarily by lower sales to the military market, reflecting the timing of a number of large military programmes, with smaller declines in other sectors, offsetting strong growth in the critical infrastructure segment. Excluding military sales, underlying sales fell 4%, reflecting uncertainty in government budgets and regulatory delays in aviation security.

Operating margins fell by 290 basis points to 12.8% as headline operating profit declined by £24m on an underlying basis. The fall in sales volumes and its effect on operational gearing was the principal driver for the lower margins.

As a result, there was a change in management and a performance improvement programme was initiated at the end of the year, targeting annualised savings of at least £40m by the end of the 2014 financial year. The programme will cost £40m, of which £33m will be treated as an exceptional item over three years and a £7m charge against headline operating profit in 2012 financial year. It is expected that this programme will deliver savings of £15m in the first year. The programme will comprise a number of different workstreams. A reduction in the size of the workforce has begun and discretionary spending has been severely curtailed and remains a focus as part of tighter budget control. A site rationalisation programme has commenced, as the manufacturing base is realigned to match the business needs. It will build on the global reorganisation that took place during the past year.

Specific initiatives have also been implemented in materials sourcing and a value engineering project to reduce scrap, rework and warranty liabilities. We will also leverage our investment in our global ERP system by maximising revenue and cash collection through the adoption of consistent and timely processes, as well as reduce costs.

Underlying sales in transportation fell 4% as a result of various budget and regulatory delays. For example, the uncertainty in the US federal budget caused procurement delays and the regulatory delays in Europe on air cargo and on the relaxation of liquids in passenger hand baggage affected order flow. Major orders included a US$43.5 million contract from the Transportation Security Administration (TSA) for Advanced Technology X-ray systems to be deployed at airport checkpoints across the United States. We also received a C$19m order from the Canadian Air Transportation Security Authority (CATSA) to provide advanced X-ray systems for use at airport baggage checkpoints. At Frankfurt International Airport we are fulfilling a requirement for around 50 aTiX systems for security checkpoints. At Berlin's new Brandenburg International Airport, we delivered checked baggage screening systems and secured an exclusive supply contract for checkpoint security systems, to be delivered in the next financial year. The Berlin contracts will together be worth some £19m. Lufthansa Cargo added to its extensive installation of Smiths Detection systems with multiple X-ray inspection and trace detection units to support air cargo screening throughout the Americas. We also secured contracts during the year from international airports in Doha, Mumbai, Munich, Yemen, Turkey and London Gatwick. Technology upgrades and investment in enhanced security screening continue to fuel demand for advanced X-ray scanners for hold and carry-on baggage. Governments are also assessing a multi-layered approach to aviation security that combines the deployment of detection technologies for screening passengers, baggage and cargo with other measures, such as the training of airport security staff in behavioural analysis techniques and increased cooperation between international intelligence agencies to improve the sharing of information.

Underlying sales in the ports and borders market declined 17% as a result of order delays. During the period we delivered an order from Japan for five high-energy cargo inspection systems. The German Federal Ministry of Finance ordered three high-energy X-ray systems for mobile customs checkpoints and at the start of the new financial year a contract was placed by the Cayman Islands Customs Department for similar equipment to improve border security. The market sector will continue to be influenced in the short term by global economic conditions, with government customers reviewing their expenditure plans. Governments are committed to improve their border security and customs revenue protection but are being forced to adopt more cost-effective approaches, layered with different levels of technological support.

Our military business saw underlying sales fall 42% as a result of a cyclical transition between mature and new programmes, as well as the return of US government military expenditure to more normal funding levels following the easing of recent conflicts. Nevertheless, opportunities for military programmes in the US, Europe and Asia remain strong, with new contract wins in Canada, Sweden and Germany. During the period we delivered a $30 million order to the United States Department of Defense under the long-running Joint Chemical Agent Detector (JCAD) programme. This latest order was for enhanced JCAD detectors which are based on Smiths Detection's

LCD 3.3, an advanced, detect-to-warn device that protects troops by sampling the air for chemical warfare agents. This latest contract takes the total awarded to Smiths Detection under the JCAD program to more than $350 million, with the continuing programme presenting further contract opportunities.

Critical infrastructure grew 37% as a result of a number of contracts including supplying equipment for the Commonwealth Games in India, and for US Government Services including the FBI, Federal Protective Services and Federal Bureau of Prisons. We see considerable opportunities in the critical infrastructure market in the immediate future and will be focusing strongly on this sector.

Research and development

Smiths Detection is continuing to invest heavily in a new product pipeline while sharpening the focus and effectiveness of the product development process. We seek to meet customers' needs through a consistent commitment to product innovation using in-house R&D, government-funded research, partnerships and licences.

Company-funded R&D declined 1% to £35m (2010: £36m), although increased as a percentage of sales to 6.9% (2010: 6.2% of sales). This includes £17m of capitalised projects. Smiths Detection actively seeks customer and government support for R&D which totalled £8m in the period (2010: £8m). Total R&D spend was £43m (2010: £44m) or 8.5% of sales.

In a significant product launch, Smiths Detection moved directly into the market for the detection and identification of radiological and nuclear threats. The handheld RadSeeker detector was developed in collaboration with the US Domestic Nuclear Detection Office, which subsequently approved its production and deployment, leading to the award of an initial delivery contract. RadSeeker fulfils a number of applications, such as assisting civil defence and first responders in search operations and helping port and border personnel with cargo, container and vehicle screening.

The main focus for R&D investment continues to be on X-ray for a variety of applications, including checkpoint and baggage scanning at airports and cargo screening at ports and borders. Our next-generation explosives detection system project with Analogic leverages the complementary expertise of each company in multienergy X-ray technology and three-dimensional computed tomography (CT). Prototype machines have been placed in airports for preliminary data collection.

Following an evaluation of projects, it was decided to terminate the programme to develop the diagnostics instrument platform for use in a medical environment as a result of extended development times and unfavourable market conditions. We will sustain assay development, including continuing to work with Novartis under the existing agreement, while determining how best to develop the relationship to support the long-term goals of both companies.

We have a strong pipeline of new product launches planned during the next year. These will be spread across the key product groups.

Business developments

To support growth opportunities in the Indian market, Smiths Detection acquired the detection sales, distribution and service business of Veecon IPA Gastchnik Limited. This business has acted as a distributor for Smiths Detection and helped build a market-leading presence in this important market.

Smiths Detection also purchased its Brazilian distributor from EBCO Systems Limited, taking direct control over product sales in one of the world's fastest-growing economies. EBCO, based in Sao Paulo, had been the exclusive distributor for Smiths Detection in Brazil since 1994, with a wide customer base that included customs authorities, airports, and prisons. The new company, Smiths Detection Brazil, employs about 55 people, managing a well-established sales and service network.

Outlook

Smiths Detection is focused on delivering a performance improvement programme under its new leadership. This will reduce fixed costs, improve operational efficiency and customer service; its delivery is a key priority. However, this is principally a government contracting business, directly affected by terror incidents, security regulations and government budgets. The sales environment is likely to remain challenging in the near term. Longer term, we believe the sector is set for sustained growth and Smiths Detection is well placed to benefit from its leadership position and strong technologies.

John Crane

	2011 £m	2010 £m	Reported growth	Underlying growth
Sales	**894**	786	14%	13%
Headline operating profit	**189**	163	16%	15%
Headline operating margin	**21.1%**	20.7%	40 bps	
Statutory operating profit	**143**	124		
Return on capital employed	**25.4%**	22.2%	320 bps	

John Crane grew sales by 14%, or £108m, reflecting an underlying increase in revenue of £104m (13%) against a relatively weak comparator period, as well as a currency benefit of £4m. The underlying growth reflects higher orders for first-fit original equipment and increased aftermarket sales across all end markets, particularly from the oil, gas and petrochemical sectors.

Reported headline operating profit grew by 16% driven by a 15%, £25m, increase in underlying profit, and a £1m gain from currency translation. Margins increased to new highs of 21.1%. The underlying improvement in profitability stems from increased volumes, benefits from our cost-saving initiatives and improved pricing on aftermarket sales. These positive margin effects were partly offset by adverse mix as a result of faster growth in first-fit original equipment sales and from John Crane Production Solutions (JCPS), our upstream energy services business. Return on capital employed improved 320 basis points to 25.4% as a result of the improved profitability.

The restructuring programme launched in August 2008 to create one global John Crane division is delivering improved customer service, quicker delivery, and lower costs. In the period, we spent £3m and delivered savings of £6m so that annualised savings to date now total £23m. Overall, the project is on track to deliver annualised savings of £25m during the coming financial year.

Overall aftermarket sales grew 13% on an underlying basis which benefited from strong demand in the oil and gas sector, particularly from JCPS. Sales for JCPS advanced 68% as a result of higher activity levels in US onshore gas and oil production and the full year effect of a contract to upgrade and maintain Petrom's 9000-plus wells in Romania. Aftermarket sales of rotating equipment (seals, seal support systems, couplings, bearings and filtration) increased 5% with growth across all sectors.

First-fit original equipment sales rose 14% on an underlying basis as customers increased their capital expenditure in new projects. We saw strong activity in the oil, gas and petrochemical sectors in the Middle East, Latin America and Asia. Some of this activity has been the start-up of previously delayed projects and a number of these have experienced some competitive pricing pressure. In the short term, investment in these capital projects may constrain margin improvement but will support aftermarket sales growth, as well as market share gains and margin strength longer term.

We continued to invest in infrastructure enhancement to expand our market-leading sales and service network. During this past year a new 'state of the art' manufacturing and service centre was opened in Dammam, Saudi Arabia and the Middle East HQ located in Dubai is being significantly expanded to increase manufacturing, service and training capabilities. In China, manufacturing of the well-known 'Safematic' product line has been introduced in response to key pulp and paper customer requirements. Expansion of manufacturing in China continued with the introduction of a new metal bellows seal line which is meeting specific needs of the local market. In the US, a new Indufil capability was added in the Deer Park facility in Texas, providing users of Indufil filtration equipment in the Americas with local technical and commercial support.

Research and development

Our investment in research and development continues to progress on several fronts: environmentally focused zero and low emission seals, rotating equipment condition monitoring with responsive control, advanced materials for seals and couplings, expansion of the performance range limit for compressor dry gas seals to extreme high pressures and engineered point solutions to target specific application services. Recent new product introductions include the launch of a non-contacting supercritical CO_2 pump seal used in enhanced oilfield recovery and a line of high-duty American Petroleum Institute (API) compliant couplings.

In keeping with our commitment to leading-edge product technology development, over the past year John Crane has invested more than £1m in the expansion of test capabilities including the establishment of a dedicated bearings test facility in Göttingen, Germany, and a state of the art high duty couplings test rig in Manchester, UK.

John Crane Production Solutions has also introduced to the market a high-temperature version of its fibreglass sucker rods for lifting oil from wells. This advanced product design will provide a more cost-effective pumping solution for customers and open new market opportunities for JCPS previously inaccessible due to well temperature.

Business developments
John Crane has also pursued a strategy to expand its addressable market by making targeted acquisitions that add complementary technologies and products while also leveraging its extensive network of sales and service centres. In August 2011, we advanced this strategy through the agreement to acquire, subject to regulatory approvals, the business of Houston-based Turbo Components and Engineering Inc., which services, repairs and builds replacement bearings and seals used in critical rotating equipment. This acquisition is complementary to our existing engineered bearings business which was formed through acquisitions in 2007 and 2009. It will accelerate our plans to develop an aftermarket services business to support our existing engineered bearings offering. This acquisition also provides more technically differentiated solutions which will improve the scale and overall profitability of the bearings product line in the immediate future. Further progress was made within the year to advance the penetration of our expanded product line with several new accounts achieved for bearings and filtration.

Outlook
John Crane's order rate has continued at strong levels. This visibility should support sales growth in the first half of the coming year. The full year sales growth will be subject to a sustained expansion in market economies and further customer investment in capital projects. Margins will benefit from the full year impact of the cost saving initiatives in the coming year. However this will be offset by strategic investments in longer term growth opportunities such as the expansion of our sales and service network, targeted large projects and increasing our presence in growth markets. John Crane will capitalise on its market leadership in mechanical seals and continue to leverage its global sales and service network to promote the full product line while continuing to build the JCPS business.

Smiths Medical

	2011 £m	2010 £m	Reported growth	Underlying growth
Sales	**838**	858	(2)%	(3)%
Headline operating profit	**196**	184	7%	7%
Headline operating margin	**23.4%**	21.5%	190 bps	
Statutory operating profit	**178**	172		
Return on capital employed	**16.9%**	15.1%	180 bps	

Headline operating profit rose 7% (£12m), and headline operating margin increased 190 basis points to 23.4%, the highest achieved for more than 10 years. This reflects underlying profit growth of £13m and adverse currency translation of £1m. Margins benefited from our ongoing initiatives to reduce overheads and manufacturing costs, as well as our portfolio profitability review. Underlying sales were down 3%. Our portfolio management initiatives accounted for the majority of sales declines, including our diabetes business exit (£3m), and declines in other product lines (£9m) such as patient monitoring, kitting and interventional imaging. The rest of the decline reflects the difficult trading conditions, driven by economic pressures, unemployment and a slowdown in procedure growth rates in the US and Europe. At reported exchange rates, Smiths Medical sales declined 2% (£20m), including positive impact from currency translation (£2m).

We have seen strong growth in some hardware products, which has driven sales of related disposable products. The performance of our other disposable lines continues to reflect the trading pressures described, especially in developed markets.

We have reorganised to create a global organisation for all functions. The new structure has reduced costs and enhanced communication, while integrated global processes have improved customer focus and service levels. The business reorganised field sales and marketing structures in most regions during the year, investing in building key account management, sales force effectiveness and training tools. Our new sales structure will promote sales effectiveness and our ability to prioritise sales opportunities by product category and market.

In medication delivery, excluding diabetes, underlying revenue grew 1% from increased sales of our CADD ambulatory pumps, which grew at 5%. We have seen share gains due to the superior capabilities of the CADD®-Solis smart pump and through the efforts of our dedicated sales and clinical teams. Sales of CADD®-Solis HPCA pumps grew in North America and continue to expand into Europe following the introduction of a multi-language platform. CADD®-Solis VIP, which is the Company's first smart multi-therapy pump targeted at the alternate site and homecare segment, was successfully launched into the Canadian market this year. The launch of Medfusion™ 4000, our innovative wireless syringe pump, into the Canadian acute care market was received well. Pending appropriate market regulatory clearances, we anticipate launching CADD®-Solis VIP and Medfusion™ 4000 globally. The Medfusion™ 4000 recently received FDA 510(k) clearance in the US and will be launched during our 2012 fiscal year. The collaboration with Hospira to co-promote infusion pump systems continued to gain some ground in the year. As part of this agreement, the two companies have started the development of software for managing infusion medication, designed to enhance patient safety and simplify how clinicians work. This agreement will allow us to extend the use of our Medfusion syringe pumps with PharmGuard Medication Safety Software to more hospitals and care areas in the US and Canada.

Vital care underlying sales declined by 3%, primarily due to a weaker flu season than the prior year, the H1N1 sales in 2010 and reduced sales in areas such as patient monitoring, interventional imaging and kitting, which have been a focus of our SKU rationalisation initiative. Our temperature management business grew slightly in challenging markets where we continue to show particular strength in convective warming and temperature probes. We have seen good growth in bronchial hygiene products and humidification systems driven by our Ventilator Associated Pneumonia (VAP) reduction campaigns. Our tracheostomy business also grew, benefiting from our award-winning UniPerc® tracheostomy kit as well as strong Bivona silicone tracheostomy sales. Our assisted reproduction products also grew strongly as we benefit from our leading presence in this niche market.

Underlying sales of safety devices declined 4%, driven by a tough competitive environment, procedure trends and reduced demand versus H1N1 needs in the prior year. Although our safety catheter business grew, our overall PIVC and sharps safety businesses were slightly down during for the year. Vascular access was also down, reflecting difficult market conditions. Interest in safety products remains high in developed markets, and is growing in developing markets like India and China. We anticipate improved safety market performance given our strong product line.

Emerging markets continue to be a source of growth as the quality of, and access to, healthcare improves. We continue to expand our efforts and presence in emerging markets which now represent approximately 9% of sales and are growing at greater than 10% per annum, depending on the market. While we have had a presence in India for many years, we recently established an operating entity which includes a direct sales and marketing team to complement our distributor business and will continue to invest in emerging market opportunities.

We have continued to manage our product portfolio aggressively to boost profitability and reduce complexity. We have eliminated around 4,000 SKUs in the last two years and in many cases have successfully converted customers to alternative higher margin products, which has contributed to our significantly improved profitability. There are further opportunities for margin improvement through portfolio management.

We have also optimised our footprint to deliver a more efficient supply chain. During the year, we merged a distribution centre in Milan, Italy into our central European distribution centre in Nijmegen, Netherlands. We also in-sourced the Nijmegen distribution centre operations, to reduce costs and improve performance. Additional initiatives to optimise our manufacturing and distribution network are currently in progress, with a focus on migrating the footprint closer to our markets, as well as cutting costs. We have aggressively pursued productivity initiatives and significantly reduced variable costs by some 4-5% in each of the last three years.

Research and development

Investment in R&D continues to be a priority with an increase of 3%. Our total R&D spend of £31m (2010: £30m) comprised 3.7% of sales (2010: 3.5%). At the same time, we significantly reduced the number of pipeline projects thereby increasing the investment on the highest impact products. This is enabling a higher level of project execution and will increase overall R&D effectiveness.

Sales from products launched in the last three years represent some 10% of sales and, with the strength of our pipeline, we expect this to improve in 2012 and beyond. During the year, we launched two significant new medication delivery products into Canada: the CADD®-Solis VIP ambulatory pump and Medfusion™ 4000 wireless syringe pump, generating new business and strengthening existing customer relationships. In addition, we released the CT Marker in our PORT-A-CATH® and P.A.S. PORT® POWER P.A.C. systems, Gripper®Micro Extension, and Pneupac® paraPAC™ plus, expanding our offerings in vascular access and mobile ventilation. We also continued to extend the reach of a number of existing products into new regions, broadening our offering particularly in emerging markets.

Outlook

Developed markets are likely to remain challenging in the short term as healthcare cost controls and unemployment put pressure on price and volumes. Against these trading conditions, our R&D pipeline is strong and we will seek to drive sales growth through new product introductions in 2012 and beyond, coupled with an increased emphasis on customer-facing resources and sales effectiveness. Our investments in China, India and other emerging markets will also serve as a source of growth. Additional opportunities exist to drive operational improvements to support continued margin expansion success. We will reinvest some of these savings into sales and marketing and new product development efforts to accelerate long-term growth.

Smiths Interconnect

	2011 £m	2010 £m	Reported growth	Underlying growth
Sales	**379**	340	12%	3%
Headline operating profit	**68**	62	9%	(2)%
Headline operating margin	**17.8%**	18.2%	(40) bps	
Statutory operating profit	**49**	53		
Return on capital employed	**15.7%**	17.3%	(160) bps	

Reported sales for Smiths Interconnect grew 12%, or £39m. Acquisitions contributed £33m and there was a currency translation headwind of £3m. Underlying growth was 3% (£9m), primarily due to strong growth in the medical, rail, automation and test markets offsetting a decline in military and aerospace sales, particularly in the second half as the US Department of Defense budgetary cutbacks and the associated Continuing Resolution impacted demand.

Reported headline operating profit increased 9%, or £6m. Excluding the impact of currency translation and acquisitions, underlying headline operating profit decreased by 2% (£1m) with headline operating margin reducing by 40 basis points to 17.8%. The decrease was primarily driven by the difficulty of adjusting the cost base to address the lower military sales caused by the Continuing Resolution and slightly weaker gross margins due to sales mix and pricing pressure. These were partially offset by restructuring savings, procurement initiatives and of the benefit of moving manufacturing to lower cost economies. Fixed costs continued to be tightly controlled.

On an underlying basis, sales into the military, aerospace and space markets fell 5% for the full year. Despite a 3% increase in the first half, budget cuts at the US Department of Defense caused the market to weaken in the second half. The effect of the Continuing Resolution was substantial, particularly at the components and sub-systems level in the supply chain, as funding uncertainty delayed several programmes incorporating our microwave and connector technologies.

Despite these underlying conditions, our Protection technology experienced significant growth in military markets as the potential threat from an electromagnetic pulse (EMP) weapon or solar flare gains further recognition and raises demand for our transient voltage protection devices. Specifically, we completed a $4.6m contract from the US Air Force Global Strike Command to supply our advanced hardened technology to protect Minuteman Weapon Systems.

Demand from the military market slowed considerably for our connectors and microwave technologies. In Europe, the Eurofighter programme continued to be strong but other programmes such as soldier-based electronics have been slow. Similarly, upgrade programmes for counter-IED systems incorporating our microwave technology experienced delays.

The SatCom, UAV (unmanned aerial vehicles) and ISR (intelligence, surveillance and reconnaissance) sectors are focus areas for our microwave business and remain more robust than other parts of the military budget. During the year we were awarded several new contracts including radar components for multiple UAV programmes and a major contract for millimetre-wave instruments to be used on the next-generation US weather satellites. Most notably, in December 2010, our Millitech business was awarded a $16m contract to supply the Antenna Pedestal for the US Navy Multiband Terminal (NMT) satellite communication programme which provides a powerful and reliable new capability at up to five times the current bandwidth while using smaller, lighter and more energy-efficient systems.

The commercial aerospace market remained strong, with increased demand for our connector products as production rates increased at both Boeing and Airbus. We also won positions on the new Chinese commercial aircraft currently in development, the Comac C919. Our KuStream broadband satellite antenna system has now been selected by three airlines, including Southwest, and is undergoing trials with several others. It will be installed on over 500 aircraft enabling in-flight connectivity and applications such as live-TV, movies and internet. We have also been selected to provide a military variant of the system.

Underlying sales to the wireless communications market increased 3%. Infrastructure spend was focused on new technology deployments within specific geographies such as LTE 4G in the US and WCDMA 3G in India, and hotspots of activity such as network improvement projects in Australasia. However, growth remained constrained by network operators controlling capital expenditures and consolidation within the equipment manufacturers sector.

The need for network operators to drive improved performance from existing assets resulted in significant growth in portable passive intermodulation test equipment and filter products to enhance signal performance, including sales in China and India where network quality is poor after large rapid deployments over the last five years.

Wireless telecommunications demand for our RF and power protection products remained relatively flat. Reductions in government budgets also adversely affected sales of our timing products used in public safety and first responder network applications. However, microwave components and cable assembly sales grew as a result of new contract

wins with Chinese equipment manufacturers. Furthermore, increased data traffic from smart phones and tablet computers created opportunities for new products for backhaul infrastructure.

Underlying sales to the medical, rail, test and automation markets remained strong in the second half and for the full year increased 20%. In medical, sales of high reliability connectors grew significantly, particularly during the first half, with strong demand from cardiac mapping and MRI systems, and a range of new applications. Power protection product volumes increased for radiotherapy and radiosurgery systems. The rail market provided modest growth as rolling stock and train control system projects started to transition from development into production and generated demand for high-speed and reliable connection systems and surge protection devices. In the test market, our spring probe connector acquisition, IDI, continued to perform strongly, and two important new product ranges were developed which are expected to offset softening market conditions experienced at the end of the year. The industrial market has been positive this year with particular growth in connectors for machine automation and sensor applications.

Research and development

Total R&D spend increased 19% to £25m or 6.6% of sales (2010: £21m or 6.3% of sales). The customer-funded portion, predominantly within the Microwave Defence group, reduced by £1m to £4m or 1.1% of sales (2010: £5m) reflecting US Department of Defense budget cuts and the completion of some programmes.

Investment was targeted across all technology areas and we continued to develop non-US based technical resources. In Connectors, we have focused on developing smaller, higher speed and higher power products. Microwave developments included improvements in our industry-leading capabilities in airborne broadband antenna systems and passive intermodulation test equipment, and new filtering products to address broader geographic markets. Protection's technical advancements included high performance RF protectors with improved reflection loss and new power protection configurations for the military and rail markets. More than a third of sales now come from products or technologies developed during the past three years.

Business developments

In September 2011, Smiths Interconnect announced its intention, subject to regulatory approvals, to acquire Power Holdings Inc. (PDI), a leading designer and manufacturer of specialist power distribution, conditioning and monitoring systems. Based in Richmond, Virginia, PDI is the parent company for Power Distribution, Inc., Marelco Power Systems, Inc. and Onyx Power, Inc. It produces power distribution units, static transfer switches, remote power panels, power conditioning units, medium and low voltage transformers and patented power monitors used mainly in data centre and alternative energy applications.

The acquisition of PDI transforms the existing power protection group with a new range of products and growth opportunities. It strengthens Smiths Interconnect's offering of technically differentiated solutions for applications requiring ultra-reliable and precise power performance broadening our high reliability power quality capabilities to include conditioning, protection, distribution, filtering and monitoring to ensure the optimum function of advanced electrical systems.

PDI, which also has facilities in Santa Ana, California and Howell, Michigan, employs around 370 people and more than 90% of revenues come from non-government funded markets.

We remain focused on cost control and further improving margin performance. During the year, we consolidated our Protection activities in China into one facility and also began restructuring our European connector businesses by concentrating manufacturing into a centre of excellence in a lower cost geography. We also brought together a number of our microwave wireless telecommunications businesses under a single management team which culminated with the launch of a new brand, Kaelus, providing a single face to customers and simplifying our business interactions in this fast-moving sector.

Outlook

Government-funded sectors, particularly the defence market in the US, are expected to remain challenging. However, we are relatively well positioned on some long-term programmes and strategically important sectors such as communications and ISR. Investment by wireless network operators in higher speed next-generation technologies will increase demand for our network optimisation products, test solutions and protection devices. Market conditions in medical, rail, test and automation are expected to be mixed with the semiconductor and circuit-board test markets tightening as consumers hold back on purchases of electronic devices. Margins are expected to face some pressure as volumes decline in some sectors, although this will be offset in part by restructuring benefits and operational efficiencies.

Flex-Tek

	2011 £m	2010 £m	Reported growth	Underlying growth
Sales	**221**	212	4%	6%
Headline operating profit	**28**	24	18%	19%
Headline operating margin	**12.5%**	11.1%	140 bps	
Statutory operating profit	**26**	21		
Return on capital employed	**21.9%**	18.4%	350 bps	

Reported sales grew 4%, or £9m, reflecting underlying sales growth of 6% that was offset by £3m of adverse currency translation. Underlying sales were boosted primarily by an increase in sales of components to the OEM aerospace market and US residential construction sector, and were partly offset by declines in sales in Flexible Solutions.

Headline operating profit margins increased by 140 basis points to 12.5% as a result of increased sales, operational gearing from prior restructuring, and price increases which helped to offset raw material inflation. The underlying increase in operating profit was £5m. Return on capital employed improved by 350 basis points driven both by profitability improvement and reductions in working capital.

As reported at the half year results, we now manage the business as four technology groups: Fluid Management; Construction Products; Heat Solutions, and Flexible Solutions.

In Fluid Management, sales of components to aerospace customers rose 16% on an underlying basis, helped by higher volumes on major airframe platforms from Airbus and Boeing. The order book for our commercial aviation OEM business remains strong and we have gained market share in our overhaul & repair service segment. In addition our sales to the US automotive market for both fuel and brake applications remains robust.

Sales to the construction market improved 10% on an underlying basis, with growth mainly coming from the first half of the year. The second half sales underlying growth rate slowed to 6% as uncertainty still clouds the US housing market. The latest US Bureau of the Census forecast is for housing starts to remain relatively flat with prior year, with no expectation of a measurable upturn in the near term. We have gained market share by bundling our ducting, flexible gas piping and HVAC heating element product lines to the US distribution market.

Heat Solutions underlying sales were in line with the prior year. In 2010, the US federal government offered rebates to consumers who traded in their old appliances for new. This programme benefited first half underlying sales, up 11%, but resulted in reduced demand in the second half, down 8%. Consumer confidence remains cautious in the US and OEM appliance manufacturers continue to project low single growth rates in the US markets.

The Flexible Solutions division sales were down 7% for the year. Continued weak demand in the US for floorcare products and industrial goods was only slightly offset by higher sales for our respiratory care hoses for sleep apnoea.

The final stages of Flex-Tek's restructuring programme were completed in the year as we continued to rationalise our manufacturing portfolio, refurbish facilities, and deliver productivity improvements. The programme, part of the wider Group restructuring, has achieved annualised savings of £9m in line with our plans, as we delivered a further £1m of savings in the year, including the rationalisation of two facilities in the north eastern US.

Flex-Tek has increased R&D spend and investment in our Asian manufacturing facilities in China and India. We continue to seek new investments to grow our market share, expand our product portfolio, and target potential bolt-on acquisitions to build on the strength of the management team.

Outlook

The momentum of the Fluid Management business should continue well into the coming year as our order book reflects a positive environment supported by a new generation of aeroplanes with better fuel efficiency and lower cost per passenger mile. The US residential construction and household appliance markets are expected to remain uncertain with no significant growth projected. Any upturn in these markets will generate positive earnings for the business.

Financial review

Earnings per share

Basic headline earnings per share from continuing activities were 92.7p (2010: 84.6p), a growth of 10%. This reflects an increased headline operating profit and a higher pensions financing credit which have been partly offset by a higher tax rate.

On a statutory basis, the basic earnings per share from continuing activities were 77.8p (2010: 75.3p).

Exceptional and other items relating to continuing activities excluded from headline profits

These items amounted to a charge of £88m compared to a charge of £62m in 2010. They comprised:

- Amortisation and impairment of intangible assets acquired in business combinations of £50m (2010: £42m). The charge relates principally to technology and customer relationships;
- A charge of £34m (2010: £25m) in connection with John Crane, Inc. asbestos litigation;
- A charge of £16m (2010: £8m) in respect of restructuring. This is part of a programme which is expected to cost approximately £62m by the end of 2012, of which £52m has now been charged;
- Release of a diabetes-related provision of £2m (2010: nil) which was part of an exceptional cost when established;
- £10m gain in relation to changes to certain early retirement terms (2010: £4m gain arising from the closure of the principal UK defined benefit pension schemes);
- £4m profit on disposal of businesses (2010: £9m including profit on disposal of property);
- Acquisition costs of £1m (2010: £1m); and
- Financing loss of £3m (2010: £1m gain). These represent exchange movements on derivatives and other financing instruments not hedge accounted under IFRS.

Cash generation and net debt

Operating cash generation remained strong, albeit below the high levels of the previous years. Headline operating cash-flow of £489m (2010: £565m) represented 95% (2010: 115%) of headline operating profit. Cash conversion benefited in 2010 from reduced working capital arising from certain one-off initiatives. Free cash-flow declined £95m to £236m (2010: £331m). Free cash-flow is stated after interest and tax but before acquisitions, financing activities and dividends (see note 28 to the accounts for a reconciliation of headline operating cash-flow and free cash-flow to statutory cash-flow measures).

On a statutory basis, net cash inflow from continuing operations was £322m (2010: £410m).

Dividends paid in the year on ordinary shares amounted to £136m (2010: £133m).

Net debt at 31 July was £729m, down from £837m at 31 July 2010. The decrease in net debt reflects the strong free cash-flow and outflows of £136m for dividends and £21m for the net effect of acquisitions and disposals.

Interest and other financing costs

Interest payable on debt, net of interest earned on cash deposits, was £59m compared with £62m in 2010. This reduction reflects lower average levels of debt. Interest costs were covered 8.8 times by headline operating profits.

The Group accounts for pensions using IAS19. As required by this standard, a finance credit is recognised reflecting the expected return on pension scheme assets and a finance charge is recognised reflecting the unwinding of the discount on the future pension liability. The net financing credit was £23m (2010: £2m). With effect from 1 August 2011, we propose to report headline pre-tax profit excluding this item (see note 3 to the accounts for pro-forma 2011 figures). The headline measures are intended to report the underlying performance of the Group excluding factors which are outside management control.

Research and development

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

We invested a total of £111m in R&D (2010: £107m) on continuing operations, equivalent to 3.9% of sales (2010: 3.9%). Of that total, £99m was funded by the Company compared with £93m in 2010, an increase of 5%. We actively seek funding from customers to support R&D and this amounted to £12m (2010: £13m). Under IFRS, certain development costs are capitalised, and this amounted to £31m in the period (2010: £24m). The gross capitalisation is shown as an intangible asset. Where customers contribute to the costs of development, the contribution is included as deferred income and disclosed within trade and other payables.

Taxation

The headline tax charge of £121m (2010: £104m) represented an effective rate of 25% on the headline profit before taxation (2010: 24%). The tax rate has increased by 1% in the year reflecting underlying changes in the profit mix

across our countries of operations and the net impact of effective compliance management including the favourable conclusion of recent tax audits. On a statutory basis, the tax charge on continuing activities was £92m (2010: £79m).

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. However, our increased profitability in areas with higher tax rates will cause the headline tax rate to increase over time with a rate of between 26-28% expected in the year ending 31 July 2012.

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

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, net post-retirement benefit assets and liabilities and net debt (see note 1 to the accounts). The ROCE was 17.0% (2010: 16.6%).

Retirement benefits

As required by IFRS the balance sheet reflects the net surplus or deficit in retirement benefit plans, taking assets at their market values at 31 July 2011 and evaluating liabilities at period-end AA corporate bond interest rates.

The tables below disclose the net status across a number of individual plans. Where any individual plan shows a surplus under IAS 19, this is disclosed on the balance sheet as a retirement benefit asset. The IAS 19 surplus of any one plan is not available to fund the IAS 19 deficit of another plan.

The net pension deficit has reduced to £199m at 31 July 2011 from £305m at 31 July 2010. The reduction reflects asset returns in respect of UK funded schemes and cash contributions to the schemes.

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

The retirement benefit position was:

	31 July 2011	29 January 2011	31 July 2010
Funded plans			
UK plans – funding status	**101%**	104%	98%
US plans – funding status	**76%**	78%	71%
Other plans – funding status	**77%**	70%	69%

	31 July 2011 £m	29 January 2011 £m	31 July 2010 £m
Surplus/(deficit)			
Funded plans	**(108)**	(29)	(216)
Unfunded plans	**(91)**	(90)	(89)
Total deficit	**(199)**	(119)	(305)
Retirement benefit assets	**141**	151	80
Retirement benefit liabilities	**(340)**	(270)	(385)
	(199)	(119)	(305)

In the coming year, cash contributions to the schemes are expected to total approximately £110m (2011: £64m), including a conditional £50m to the TI Group Pension Scheme. In addition, the Group will invest £24m in an escrow account as part of the 10-year funding plan agreed with the Smiths Industries Pension Scheme.

Exchange rates

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

	31 July 2011	**31 July 2010**		29 January 2011
Average rates:				
US dollar	**1.60**	1.57	Dollar weakened 2%	1.57
Euro	**1.16**	1.14	Euro weakened 2%	1.18
Period end rates:				
US dollar	**1.64**	1.57	Dollar weakened 4%	1.58
Euro	**1.14**	1.20	Euro strengthened 5%	1.16

Financial information

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

The statutory accounts for the year ended 31 July 2010 have been filed with the Registrar of Companies. The auditors have reported on those accounts and on the statutory accounts for the year ended 31 July 2011, which will be filed with the Registrar of Companies following the Annual General Meeting. Both the audit reports were unqualified and did not contain any statement under section 498 of the Companies Act 2006.

Consolidated income statement

	Notes	**Year ended 31 July 2011 £m**	Year ended 31 July 2010 £m
Continuing operations			
Revenue	1	**2,842.0**	2,769.6
Cost of sales		**(1,534.0)**	(1,476.3)
Gross profit		**1,308.0**	1,293.3
Sales and distribution costs		**(384.3)**	(369.7)
Administrative expenses		**(490.1)**	(491.0)
Profit on disposal of businesses	4	**4.4**	3.3
Operating profit	2	**438.0**	435.9
Comprising			
– headline operating profit	3	**516.9**	492.4
– exceptional items, amortisation of acquired intangibles	3	**(78.9)**	(56.5)
		438.0	435.9
Interest receivable		**1.8**	3.6
Interest payable		**(60.3)**	(65.1)
Other financing losses		**(9.2)**	(5.4)
Other finance income – retirement benefits		**23.3**	2.3
Finance costs	5	**(44.4)**	(64.6)
Share of post-tax profits of associated companies	14	**4.3**	1.8
Profit before taxation		**397.9**	373.1
Comprising			
– headline profit before taxation	3	**486.0**	435.0
– exceptional items, amortisation of acquired intangibles and other financing gains and losses	3	**(88.1)**	(61.9)
		397.9	373.1
Taxation	6	**(91.8)**	(78.9)
Profit after taxation – continuing operations		**306.1**	294.2
Profit – discontinued operations	7	**79.0**	16.4
Profit for the year		**385.1**	310.6
Attributable to			
Smiths Group shareholders		**383.8**	310.0
Non-controlling interests		**1.3**	0.6
		385.1	310.6
Earnings per share	9		
Basic		**98.0p**	79.5p
Basic – continuing operations		**77.8p**	75.3p
Diluted		**97.1p**	78.9p
Diluted – continuing operations		**77.1p**	74.8p

Consolidated statement of comprehensive income

	Notes	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Profit for the period		**385.1**	310.6
Exchange (losses)/gains		**(9.3)**	81.4
Actuarial losses on retirement benefits	10	**(0.2)**	(15.2)
Taxation recognised on actuarial movements	6	**10.9**	12.2
Fair value gains/(losses)			
– on available for sale financial assets		**4.1**	0.2
– deferred in the period on cash-flow and net investment hedges		**8.3**	(41.6)
– reclassified to income statement		**(0.2)**	(0.3)
Total other comprehensive income		**13.6**	36.7
Total comprehensive income		**398.7**	347.3
Attributable to			
Smiths Group shareholders		**397.0**	345.9
Non-controlling interests		**1.7**	1.4
		398.7	347.3

Consolidated balance sheet

	Notes	31 July 2011 £m	31 July 2010 £m
Non-current assets			
Intangible assets	12	**1,610.2**	1,638.6
Property, plant and equipment	13	**282.8**	302.7
Investments accounted for using the equity method	14	**18.5**	13.6
Financial assets – other investments	15	**31.6**	27.0
Retirement benefit assets	10	**140.6**	80.3
Deferred tax assets	6	**174.8**	194.2
Trade and other receivables	17	**33.6**	33.8
Financial derivatives	22	**6.4**	10.8
		2,298.5	2,301.0
Current assets			
Inventories	16	**432.5**	390.0
Current tax receivable		**16.4**	
Trade and other receivables	17	**612.8**	578.9
Cash and cash equivalents	18	**261.1**	172.9
Financial derivatives	22	**5.7**	15.5
		1,328.5	1,157.3
Total assets		**3,627.0**	3,458.3
Non-current liabilities			
Financial liabilities			
– borrowings	20	**(978.4)**	(995.0)
– financial derivatives	22	**(1.5)**	(1.1)
Provisions for liabilities and charges	23	**(174.1)**	(230.8)
Retirement benefit obligations	10	**(339.6)**	(385.6)
Deferred tax liabilities	6	**(77.6)**	(77.8)
Trade and other payables	19	**(45.1)**	(27.3)
		(1,616.3)	(1,717.6)
Current liabilities			
Financial liabilities			
– borrowings	20	**(11.7)**	(14.7)
– financial derivatives	22	**(8.9)**	(14.9)
Provisions for liabilities and charges	23	**(74.7)**	(70.4)
Trade and other payables	19	**(454.2)**	(428.2)
Current tax payable		**(81.3)**	(112.7)
		(630.8)	(640.9)
Total liabilities		**(2,247.1)**	(2,358.5)
Net assets		**1,379.9**	1,099.8
Shareholders' equity			
Share capital	24	**147.1**	146.5
Share premium account		**329.1**	315.3
Capital redemption reserve		**5.8**	5.8
Revaluation reserve		**1.7**	1.7
Merger reserve		**234.8**	234.8
Retained earnings	25	**775.6**	519.5
Hedge reserve	25	**(120.6)**	(128.8)
Total shareholders' equity		**1,373.5**	1,094.8
Non-controlling interest equity		**6.4**	5.0
Total equity		**1,379.9**	1,099.8

Consolidated statement of changes in equity

	Notes	Share capital and share premium £m	Other reserves £m	Retained earnings £m	Hedge reserve £m	Equity shareholders' funds £m	Non-controlling Interest £m	Total equity £m
At 31 July 2010		461.8	242.3	519.5	(128.8)	1,094.8	5.0	1,099.8
Profit for the year				383.8		383.8	1.3	385.1
Other comprehensive income								
Exchange (losses)/gains				(9.8)	0.1	(9.7)	0.4	(9.3)
Actuarial losses on retirement benefits and related tax				10.7		10.7		10.7
Fair value gains/(losses)				4.1	8.1	12.2		12.2
Total comprehensive income for the year				388.8	8.2	397.0	1.7	398.7
Transactions relating to ownership interests								
Exercises of share options	24	14.4				14.4		14.4
Taxation recognised on share options	6			(1.8)		(1.8)		(1.8)
Purchase of own shares	25			(8.6)		(8.6)		(8.6)
Dividends								
– equity shareholders	8			(136.1)		(136.1)		(136.1)
– non-controlling interest							(0.3)	(0.3)
Share-based payment	30			13.8		13.8		13.8
At 31 July 2011		**476.2**	**242.3**	**775.6**	**(120.6)**	**1,373.5**	**6.4**	**1,379.9**

	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 2009		452.5	242.3	251.3	(87.1)	859.0	3.8	862.8
Profit for the year				310.0		310.0	0.6	310.6
Other comprehensive income								
Exchange gains				80.4	0.2	80.6	0.8	81.4
Actuarial losses on retirement benefits net of tax				(3.0)		(3.0)		(3.0)
Fair value gains/(losses)				0.2	(41.9)	(41.7)		(41.7)
Total comprehensive income for the year				387.6	(41.7)	345.9	1.4	347.3
Transactions relating to ownership interest								
Exercises of share options		9.1		0.6		9.7		9.7
Taxation recognised on share options	6			2.4		2.4		2.4
Purchase of own shares		0.2		(0.2)				
Dividends								
– equity shareholders	8			(132.5)		(132.5)		(132.5)
– non-controlling interest							(0.2)	(0.2)
Share-based payment	30			10.3		10.3		10.3
At 31 July 2010		**461.8**	**242.3**	**519.5**	**(128.8)**	**1,094.8**	**5.0**	**1,099.8**

Consolidated cash-flow statement

	Notes	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Net cash inflow from operating activities	28	**321.7**	410.5
Cash-flows from investing activities			
Expenditure on capitalised development		**(30.6)**	(24.3)
Expenditure on other intangible assets		**(10.2)**	(7.6)
Purchases of property, plant and equipment		**(49.3)**	(47.0)
Disposals of property, plant and equipment		**4.5**	24.8
Investment in financial assets		**(0.3)**	(25.3)
Acquisition of businesses		**(18.5)**	(132.7)
Disposal of Aerospace	7	**(6.2)**	19.9
Disposals of businesses		**3.9**	1.1
Net cash-flow used in investing activities		**(106.7)**	(191.1)
Cash-flows from financing activities			
Proceeds from exercise of share options	24	**14.4**	9.7
Purchase of own shares		**(8.6)**	
Dividends paid to equity shareholders	8	**(136.1)**	(132.5)
Dividends paid to non-controlling interests		**(0.3)**	(0.2)
Cash inflow/(outflow) from matured derivative financial instruments		**1.0**	(1.5)
Increase in new borrowings		**1.6**	466.8
Reduction and repayment of borrowings		**(1.2)**	(408.4)
Net cash-flow used in financing activities		**(129.2)**	(66.1)
Net increase in cash and cash equivalents		**85.8**	153.3
Cash and cash equivalents at beginning of year		**172.2**	19.7
Exchange differences		**2.7**	(0.8)
Cash and cash equivalents at end of year	18	**260.7**	172.2
Cash and cash equivalents at end of year comprise			
– cash at bank and in hand		**232.0**	136.3
– short-term deposits		**29.1**	36.6
– bank overdrafts		**(0.4)**	(0.7)
		260.7	172.2
Included in cash and cash equivalents per the balance sheet		**261.1**	172.9
Included in overdrafts per the balance sheet		**(0.4)**	(0.7)
		260.7	172.2

The consolidated cash-flow statement includes cash-flows relating to discontinued operations. See note 7 for details of these cash-flows.

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 (IFRIC) interpretations, as adopted by the European Union in response to the IAS regulation (EC 1606/2002), under the historical cost convention modified to include revaluation of certain financial instruments, share options and pension assets and liabilities, held at fair value as described below.

The accounting policies adopted are consistent with those of the previous financial year except that the Group has adopted:

- Amendment to 'IAS 32: Financial instruments: Presentation' on classification of rights issues
- 'IFRIC 19: Extinguishing financial liabilities with equity instruments'
- 'IFRS 2: Share-based payment' – Group cash-settled share-based payment transactions

These changes have not materially affected reported financial position or performance.

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 long-term funded 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 £27.9m (2010: £23.6m) has been recognised in respect of contracts in progress at the year end with a total expected value of £129.3m (2010: £116.2m). A 5% increase in the proportion of the contract activity recognised in the current year would have increased operating profit by an estimated £1.1m (2010: £0.4m).

Impairment
Goodwill is tested at least annually for impairment in accordance with the accounting policy for goodwill set out below. The recoverable amounts of cash generating units are determined based on value in use calculations. These calculations require the use of estimates including projected future cash-flows and other future events. See note 12 for details of the critical assumptions made and disclosures on the sensitivity of the impairment testing to these key assumptions.

Provisions for liabilities and charges
The consolidated financial statements include a provision for litigation of £196.1m (2010: £191.4m).

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 has been made for the future defence costs which the Group is expected to incur and the expected costs of future adverse judgments against John Crane, Inc. However, because of the significant uncertainty associated with the future level of asbestos claims and of the costs arising out of the related litigation, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred and, as a result, the provision may be subject to potentially material revisions from time to time if new information becomes available as a result of future events. John Crane, Inc. takes account of the advice of an expert in asbestos liability estimation in quantifying the expected costs. In the current period the method used to calculate the expected costs of defending claims has been conformed to the approach used to calculate the expected cost of adverse judgments following the appointment of Bates White LLC to value both elements of John Crane, Inc.'s exposure. See note 23 for details.

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

Retirement benefits
The consolidated financial statements include costs in relation to, and provision for, retirement benefit obligations. The costs and the present value of any related pension assets and liabilities depend on such factors as life expectancy of the members, the returns that plan assets generate and the discount rate used to calculate the present value of the liabilities. The Group uses previous experience and impartial actuarial advice to select the values of critical estimates. The estimates, and the effect of variances in key estimates, are disclosed in note 10.

At 31 July 2011 there is a retirement benefit asset of £140.6m (2010: £80.3m) which arises from the rights of the employers to recover the surplus at the end of the life of the scheme. If the pension schemes were wound up while they still had members, the schemes would need to buy out the benefits of all members. The buy outs would cost significantly more than the present value of the scheme liabilities calculated in accordance with IAS 19: Employee benefits.

Taxation
The Group has recognised deferred tax assets of £26.0m (2010: £31.9m) relating to losses and £50.6m (2010: £47.4m) relating to the John Crane, Inc. litigation provision. The recognition of assets pertaining to these items involves judgement by management as to the likelihood of realisation of these deferred tax assets and this is based on a number of factors, which seek to assess the expectation that the benefit of these assets will be realised, including appropriate taxable temporary timing differences and it has been concluded that there are sufficient taxable profits in future periods to support recognition. Further detail on the Group's deferred taxation position is included in note 6.

Accounting policies

Basis of consolidation

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

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

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

Foreign currencies

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

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

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

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

Revenue

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

Sale of goods

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

Services

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

Construction contracts

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

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

Employee benefits

Share-based compensation

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

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

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

Pension obligations and post-retirement benefits

The Group has 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 high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised in full in the period in which they occur, outside of the income statement and are presented in the statement of comprehensive income. Past service costs are recognised immediately in the income statement, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs are amortised on a straight-line basis over the vesting period.

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

The Group also has certain post-retirement healthcare schemes which are accounted for on a similar basis to the defined benefit plans.

Exceptional items

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

- profits/(losses) on disposal of businesses and costs of acquisitions;
- spend on the integration of significant acquisitions and other major restructuring programmes;
- significant goodwill or other asset impairments;
- income and expenditure relating to John Crane, Inc. asbestos litigation; and
- other particularly significant or unusual items.

Exceptional items are excluded from the headline profit measures used by the Group. The basis of calculation of these measures is explained in note 3.

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.

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 re-measurements 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.

Intangible assets

Goodwill

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

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

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

Research and development

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

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

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

Intangible assets acquired in business combinations

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

The estimated useful lives are as follows:

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

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

Software, patents and intellectual property

The estimated useful lives are as follows:

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

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

Property, plant and equipment

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

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

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

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

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.

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.

Taxation

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

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

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

Deferred tax liabilities and assets are not discounted.

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.

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.

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.

Fair value of financial assets and liabilities

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

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

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

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

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

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

Financial guarantees

Financial guarantees are initially recognised at the fair value of the consideration received.

At each subsequent balance sheet date an estimate is made of the payments which will be required under the guarantee in accordance with 'IAS 37: Provisions, contingent liabilities and contingent assets'. The guarantee is then valued at the higher of its initial value less revenue recognised to date and the best estimate of the total payments which will be required under the contract.

Any gains or losses on the contract are recognised in the income statement.

Dividends

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

Recent accounting developments

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

- Amendment to IFRIC 14, IAS 19 – Prepayments of a minimum funding requirement
- Amendment to 'IAS 24: Related party disclosures'
- Amendment to 'IFRS 7: Financial instruments: Disclosures' on derecognition
- 'IFRS 9: Financial instruments'
- 'IFRS 10: Consolidated financial statements'
- 'IAS 27 (Revised 2011): Separate financial statements'
- 'IFRS 11: Joint arrangements'
- 'IAS 28 (Revised 2011): Associates and joint ventures'
- 'IFRS 12: Disclosure of interests in other entities'
- 'IFRS 13: Fair value measurement'
- 'IAS 19: Employee benefits (revised 2011)'

A review of the impact of these standards and interpretations is being undertaken, and the impact of adopting them will be determined once this review has been completed. Based on the work completed to date, the changes are not expected to have a material impact on the Group's reported position or performance, except for the implementation of IAS 19: Employee benefits (revised 2011). This standard, which is expected to be implemented in the year ending 31 July 2014, subject to EU approval, may then result in the recognition of a financing charge in respect of retirement benefits. For the year ended 31 July 2011, calculating the finance charge in accordance with the new requirements would have increased finance costs by £39.2m. Under the current accounting policies the Group recognises actuarial gains and losses directly in Other comprehensive income, as required by the new standard.

Notes to the accounts

1 Segment information

Analysis by operating segment

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

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

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

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

						Year ended 31 July 2011
	Smiths Detection £m	**John Crane £m**	**Smiths Medical £m**	**Smiths Interconnect £m**	**Flex-Tek £m**	**Total £m**
Revenue	**509.9**	**893.9**	**838.4**	**379.0**	**220.8**	**2,842.0**
Divisional headline operating profit	**65.5**	**188.7**	**196.2**	**67.6**	**27.6**	**545.6**
Corporate headline operating costs						**(28.7)**
Headline operating profit	**65.5**	**188.7**	**196.2**	**67.6**	**27.6**	**516.9**
Divisional exceptional operating items (note 4)	**(0.3)**	**(30.9)**	**(1.6)**	**(1.4)**	**(1.8)**	**(36.0)**
Corporate exceptional operating items (note 4)						**6.6**
Amortisation of acquired intangible assets	**(1.2)**	**(14.5)**	**(16.6)**	**(17.2)**		**(49.5)**
Operating profit	**64.0**	**143.3**	**178.0**	**49.0**	**25.8**	**438.0**
Exceptional finance costs – adjustment to discounted provision (note 4)		**(6.1)**				**(6.1)**
Net finance costs – other						**(38.3)**
Share of post-tax profits of associate companies	**4.3**					**4.3**
Profit before taxation						**397.9**

						Year ended 31 July 2010
	Smiths Detection £m	John Crane £m	Smiths Medical £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Revenue	574.1	786.1	857.6	339.9	211.9	2,769.6
Divisional headline operating profit	89.9	162.7	184.2	61.9	23.5	522.2
Corporate headline operating costs						(29.8)
Headline operating profit	89.9	162.7	184.2	61.9	23.5	492.4
Divisional exceptional operating items (note 4)	(0.3)	(22.3)	5.4	(0.9)	(2.3)	(20.4)
Corporate exceptional operating items (note 4)						6.0
Amortisation of acquired intangible assets	(0.4)	(16.2)	(17.3)	(8.2)		(42.1)
Operating profit	89.2	124.2	172.3	52.8	21.2	435.9
Exceptional finance costs – adjustment to discounted provision (note 4)		(7.0)				(7.0)
Net finance costs – other						(57.6)
Share of post-tax profits of associate companies	1.8					1.8
Profit before taxation						373.1

1 Segment information continued

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

	Year ended 31 July 2011						
	Smiths Detection £m	**John Crane £m**	**Smiths Medical £m**	**Smiths Interconnect £m**	**Flex-Tek £m**	**Reconciling items £m**	**Total £m**
Depreciation	**9.1**	**14.5**	**25.9**	**8.0**	**4.9**	**1.0**	**63.4**
Amortisation	**12.6**	**2.9**	**11.1**	**0.6**	**0.1**	**45.0**	**72.3**
Other non-cash items							
– share-based payment	**(1.2)**	**5.6**	**3.3**	**0.5**	**0.7**	**4.9**	**13.8**
– asset impairments						**5.5**	**5.5**

	Year ended 31 July 2010						
	Smiths Detection £m	John Crane £m	Smiths Medical £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
Depreciation	9.7	14.9	27.6	7.8	4.8	0.9	65.7
Amortisation	11.2	3.0	10.0	0.5	0.2	42.7	67.6
Other non-cash items							
– share-based payment	2.5	(0.2)	3.3	0.6	0.5	4.6	11.3
– asset impairments						(2.1)	(2.1)

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

The capital expenditure for each division is:

	Smiths Detection £m	John Crane £m	Smiths Medical £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
Capital expenditure year ended 31 July 2011	**22.7**	**16.2**	**31.2**	**8.1**	**3.5**	**8.8**	**90.5**
Capital expenditure year ended 31 July 2010	21.4	16.2	28.1	10.3	2.6	0.3	78.9

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

	31 July 2011					
	Smiths Detection £m	**John Crane £m**	**Smiths Medical £m**	**Smiths Interconnect £m**	**Flex-Tek £m**	**Total £m**
Property, plant, equipment, development projects and other intangibles	**104.8**	**99.8**	**158.4**	**34.1**	**22.3**	**419.4**
Investments in associates	**18.5**					**18.5**
Working capital assets	**304.1**	**327.9**	**246.5**	**129.6**	**63.5**	**1,071.6**
Operating assets	**427.4**	**427.7**	**404.9**	**163.7**	**85.8**	**1,509.5**
Derivatives, tax and retirement benefit assets						**343.9**
Goodwill and acquired intangibles						**1,464.1**
Corporate assets						**48.4**
Cash						**261.1**
Total assets						**3,627.0**
Working capital liabilities	**(152.2)**	**(160.1)**	**(93.6)**	**(61.5)**	**(34.8)**	**(502.2)**
Corporate and non-headline liabilities						**(245.9)**
Derivatives, tax and retirement benefit liabilities						**(508.9)**
Borrowings						**(990.1)**
Total liabilities						**(2,247.1)**
Average divisional capital employed	**664.8**	**742.5**	**1,159.4**	**431.2**	**126.1**	**3,124.0**
Average corporate capital employed						**(86.3)**
Average total capital employed						**3,037.7**

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

Capital employed is a non-statutory measure of invested resources. It comprises statutory net assets adjusted to add goodwill recognised directly in reserves in respect of subsidiaries acquired before 1 August 1998 of £815.2m (2010: £815.2m) and eliminate post-retirement benefit assets and liabilities, net of related tax, and net debt.

1 Segment information continued

						31 July 2010
	Smiths Detection £m	John Crane £m	Smiths Medical £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Property, plant, equipment, development projects and other intangibles	103.8	101.4	170.1	35.6	25.0	435.9
Investments in associates	13.6					13.6
Working capital assets	269.0	288.0	256.6	117.9	65.8	997.3
Operating assets	386.4	389.4	426.7	153.5	90.8	1,446.8
Derivatives, tax and retirement benefit assets						300.8
Goodwill and acquired intangibles						1,502.4
Corporate assets						35.4
Cash						172.9
Total assets						3,458.3
Working capital liabilities	(136.5)	(139.4)	(100.5)	(47.9)	(34.2)	(458.5)
Corporate and non-headline liabilities						(298.2)
Derivatives, tax and retirement benefit liabilities						(592.1)
Borrowings						(1,009.7)
Total liabilities						(2,358.5)
Average divisional capital employed	674.8	733.3	1,219.0	358.0	127.4	3,112.5
Average corporate capital employed						(154.0)
Average total capital employed						2,958.5

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

Analysis of revenue

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

Smiths Detection	Transportation £m	Ports and borders £m	Military £m	Emergency responders £m	Critical infrastructure £m	Non-security £m	Total £m
Revenue year ended 31 July 2011	**218.6**	**75.7**	**79.5**	**25.4**	**86.9**	**23.8**	**509.9**
Revenue year ended 31 July 2010	220.7	90.9	138.0	24.7	59.0	40.8	574.1

	Original equipment manufacture				Aftermarket	Total
John Crane	£m	Oil, gas and petrochemical £m	Chemical and pharmaceutical £m	Distributors £m	General industry £m	£m
Revenue year ended 31 July 2011	**330.1**	**344.0**	**74.0**	**62.6**	**83.2**	**893.9**
Revenue year ended 31 July 2010	287.5	298.6	69.4	52.0	78.6	786.1

Smiths Medical	Medication delivery £m	Vital care £m	Safety devices £m	Total £m
Revenue year ended 31 July 2011	**233.1**	**345.6**	**259.7**	**838.4**
Revenue year ended 31 July 2010	235.0	351.8	270.8	857.6

Smiths Interconnect	Telecom £m	Military and Aerospace £m	Rail, Medical Automation, Test £m	Total £m
Revenue year ended 31 July 2011	**94.6**	**163.9**	**120.5**	**379.0**
Revenue year ended 31 July 2010	91.1	170.2	78.6	339.9

Flex-Tek	Fluid Management £m	Flexible Solutions £m	Heat Solutions £m	Construction Products £m	Total £m
Revenue year ended 31 July 2011	**70.3**	**35.9**	**60.1**	**54.5**	**220.8**
Revenue year ended 31 July 2010 (restated)	61.9	38.5	60.9	50.6	211.9

The analysis of Flex-Tek revenue for the year ended 31 July 2010 has been restated to reflect their current operating structure.

1 Segment information continued

Analysis of revenue continued

The Group's statutory revenue is analysed as follows:

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Sale of goods	**2,630.9**	2,535.4
Services	**178.3**	162.4
Contracts	**32.8**	71.8
	2,842.0	2,769.6

Analysis by geographical areas

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

	Revenue		Intangible assets, property plant and equipment and investments accounted for using the equity method	
	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m	31 July 2011 £m	31 July 2010 £m
United Kingdom	**124.5**	118.4	**146.2**	150.4
Germany	**161.0**	149.7	**333.9**	317.9
France	**93.1**	97.6	**17.8**	16.5
Other European	**357.5**	323.6	**86.1**	89.8
United States of America	**1,275.4**	1,274.1	**1,135.5**	1,211.8
Canada	**119.6**	142.2	**12.9**	15.4
Mexico	**25.2**	20.1	**9.9**	7.5
Japan	**149.4**	120.0	**22.2**	20.9
China	**82.0**	82.9	**63.6**	73.5
Rest of the World	**454.3**	441.0	**83.4**	51.2
	2,842.0	2,769.6	**1,911.5**	1,954.9

2 Operating profit is stated after charging

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Research and development expense	**68.0**	69.2
Operating leases		
– land and buildings	**25.3**	24.4
– other	**10.9**	10.2

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Audit services		
Fees payable to the Company's auditors for the audit of the parent company and consolidated accounts	**0.5**	0.5
Fees payable to the Company's auditors and its associates for other services		
– the audit of the Company's subsidiaries, pursuant to legislation	**3.5**	3.4
– other services pursuant to legislation	**0.1**	0.1
	4.1	4.0
Tax services		
– advisory services	**0.5**	0.3
All other services	**0.5**	0.3

Other services relate to one-off projects.

3 Headline profit measures

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

The following items have been excluded from the headline measure:

- exceptional items, including income and expenditure relating to John Crane, Inc. asbestos litigation;
- amortisation and impairment of intangible assets acquired in a business combination – the charge is a non-cash item, and the directors believe that it should be added back to give a clearer picture of underlying performance; and
- other financing gains and losses, which represent the potentially volatile gains and losses on derivatives and other financial instruments which do not fall to be hedge accounted under IAS 39.

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

	Notes	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Operating profit		**438.0**	435.9
Exclude			
– exceptional operating items	4	**29.4**	14.4
– amortisation and impairment of acquired intangible assets	12	**49.5**	42.1
Non-headline items in operating profit		**78.9**	56.5
Headline operating profit		**516.9**	492.4
Finance costs		**(44.4)**	(64.6)
Exclude			
– exceptional finance costs	4	**6.1**	7.0
– other financing gains and losses	5	**3.1**	(1.6)
Non-headline items in finance costs		**9.2**	5.4
Headline finance costs		**(35.2)**	(59.2)
Profit before taxation		**397.9**	373.1
Non-headline items in operating profit		**78.9**	56.5
Non-headline items in finance costs		**9.2**	5.4
Headline profit before taxation		**486.0**	435.0
Profit after taxation – continuing operations		**306.1**	294.2
Exclude			
– non-headline items in profit before taxation		**88.1**	61.9
– tax on excluded items	6	**(29.6)**	(25.4)
		58.5	36.5
Headline profit after taxation – continuing operations		**364.6**	330.7

From 1 August 2011 the definition of headline profit will be amended to exclude financing credits and charges relating to retirement benefits. For the year ended 31 July 2011 the retirement benefit credit included in finance costs is £23.3m (2010: £2.3m). The 2011 profit measures under the new definition are:

- Headline finance costs £58.5m (2010: £61.5m),
- Headline profit before taxation £462.7m (2010: £432.7m),
- Headline profit after taxation £340.0m (2010: £325.9m), and
- Headline earnings per share 86.5p (2010: 83.4p) basic and 85.7p (2010: 82.8p) diluted.

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

4 Exceptional items

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

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Operating items		
Restructuring of corporate headquarters and divisional reorganisation	**(15.7)**	(8.2)
Release of diabetes provision	**1.5**	
Gains on changes to post-retirement benefits (note 10)	**10.2**	3.9
Profit on disposal of businesses	**4.4**	3.3
Profit on disposal of property		5.5
Costs of acquisitions	**(1.5)**	(1.3)
Litigation		
– provision for John Crane, Inc. asbestos litigation (note 23)	**(28.3)**	(17.6)
	(29.4)	(14.4)
Financing items		
Exceptional finance costs – adjustment to discounted provision (note 23)	**(6.1)**	(7.0)
	(35.5)	(21.4)

Year ended 31 July 2011

The restructuring of corporate headquarters and divisional reorganisation was announced in 2008, and a second phase of this project was introduced in 2010. The total cost of this restructuring, including redundancy, relocation and consolidation of manufacturing, was considered exceptional by virtue of its size. Costs of £15.7m have been recognised in the year for the project, out of an expected total cost of £62m, of which £52m has been recognised to date.

The profit on disposal of businesses includes £2.7m in respect of the disposal of a small Detection operation.

Costs of acquisition comprise costs directly attributable to the work undertaken during the year to investigate and complete acquisitions.

The operating charge of £28.3m in respect of John Crane, Inc. asbestos litigation comprises £6.1m in respect of increased provision for adverse legal judgments, £9.3m in respect of increased provision for legal defence costs, £11.9m arising from movements in the discounting and £1.0m in respect of legal fees in connection with litigation against insurers and defence strategy.

Year ended 31 July 2010

On 3 June 2008 the Company announced a number of changes to its corporate centre and divisional organisation. In the year ended 31 July 2010 £8.2m was charged in respect of the restructuring of corporate centre and divisional reorganisation. This cost was reduced by a partial reversal of the impairment loss recognised in 2009.

The UK defined benefit pension schemes were closed with effect from 31 October 2009, and a curtailment gain of £3.6m was recognised. There was also a net gain of £0.3m due to the closure of a small US scheme.

The profit on disposal of businesses included £3.8m in respect of additional consideration relating to the Group’s disposal of its automotive seals manufacturing business to Cyclam Holdings LLC on 31 July 2007. This consideration was contingent on the acquirer successfully restructuring the business.

Profit on property disposals comprised £5.5m arising from the grant of planning permission in respect of a property sold in the previous year.

Costs of acquisition comprise costs directly attributable to the work undertaken during the year to investigate and complete acquisitions.

The operating charge of £17.6m in respect of John Crane, Inc. asbestos litigation comprised £8.1m in respect of increased provision for adverse legal judgments, £5.2m arising from movements in the discounting due to changes in US interest rates and £4.3m in respect of legal fees in connection with litigation against insurers and defence strategy.

5 Net finance costs

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Interest receivable	**1.8**	3.6
Interest payable		
– bank loans and overdrafts	**(6.6)**	(7.7)
– other loans	**(53.7)**	(57.4)
Interest payable	**(60.3)**	(65.1)
Other financing gains/(losses)		
– fair value gains/(losses) on hedged debt	**3.6**	(2.9)
– fair value (losses)/gains on fair value hedge	**(3.6)**	2.9
– net foreign exchange (losses)/gains	**(3.1)**	1.6
– exceptional finance costs – adjustment to discounted provision	**(6.1)**	(7.0)
Other financing losses	**(9.2)**	(5.4)
Retirement benefits		
– return on plan assets	**198.4**	183.7
– interest cost	**(175.1)**	(181.4)
Retirement benefits	**23.3**	2.3
Net finance costs	**(44.4)**	(64.6)

6 Taxation

	Continuing Year ended 31 July 2011 £m	Continuing Year ended 31 July 2010 £m	Discontinued Year ended 31 July 2011 £m	Discontinued Year ended 31 July 2010 £m
The taxation charge for the year comprises				
– current taxation	**67.0**	81.1	**(25.0)**	
– deferred taxation	**24.8**	(2.2)		
Total taxation expense in the income statement	**91.8**	78.9	**(25.0)**	
Current taxation				
– UK corporation tax				
– foreign tax	**67.0**	81.1		
– discontinued tax			**(25.0)**	
	67.0	81.1	**(25.0)**	

Reconciliation of the total tax charge

The tax expense on the profit for the period is different from the standard rate of corporation tax in the UK of 27.3% (2010: 28.0%). The difference is reconciled as follows:

	Continuing Year ended 31 July 2011 £m	Continuing Year ended 31 July 2010 £m	Discontinued Year ended 31 July 2011 £m	Discontinued Year ended 31 July 2010 £m
Profit before tax	**397.9**	373.1	**54.0**	16.4
Notional taxation expense at UK rate of 27.3% (2010: 28.0%)	**108.6**	104.5	**14.7**	4.6
Effect of overseas taxation	**15.1**	14.7		
Compliance benefits	**(16.1)**	(15.2)		
Local incentives	**(10.1)**	(16.9)		
Tax effect of other non-headline items	**(5.7)**	(8.2)		
Tax effect of Aerospace sale			**(39.7)**	(4.6)
	91.8	78.9	**(25.0)**	
Comprising				
– taxation on headline profit	**121.4**	104.3		
– tax on non-headline profit/(loss)	**(29.6)**	(25.4)		
– tax on sale of discontinued operations			**(25.0)**	
Total taxation expense in the income statement	**91.8**	78.9	**(25.0)**	

6 Taxation continued

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Tax on items (charged)/credited to equity		
Deferred tax charge/(credit)		
– retirement benefit schemes	**(10.9)**	(12.2)
– share options	**1.8**	(2.4)
	(9.1)	(14.6)

Of the net £10.9m credited to equity for retirement benefits, £11.6m relates to UK schemes. The UK schemes have now closed and this amount represents tax relief on payments that is being set off against previous amounts charged to equity to write off the deferred tax asset.

Deferred taxation

	Excess tax depreciation on fixed assets and goodwill £m	Share-based payment £m	Retirement benefit obligations £m	Capitalised development expenditure £m	Other £m	Total £m
At 31 July 2009	(68.4)	3.9	51.0	(17.6)	129.3	98.2
Credit/(charge) to income statement	22.0	2.8	0.7	(3.8)	(19.5)	2.2
Credit/(charge) to equity		2.4	12.2			14.6
Business combinations	(3.5)					(3.5)
Exchange adjustments	(3.7)		3.2	(1.0)	6.4	4.9
At 31 July 2010	(53.6)	9.1	67.1	(22.4)	116.2	116.4
Deferred tax assets	18.0	9.1	65.2	(2.3)	104.2	194.2
Deferred tax liabilities	(71.6)		1.9	(20.1)	12.0	(77.8)
At 31 July 2010	(53.6)	9.1	67.1	(22.4)	116.2	116.4
Credit/(charge) to income statement	(1.7)	1.5	(22.9)	(5.6)	3.9	(24.8)
Credit/(charge) to equity		(1.8)	10.9			9.1
Business combinations	(1.4)					(1.4)
Exchange adjustments	1.8		(2.4)	1.1	(2.6)	(2.1)
At 31 July 2011	**(54.9)**	**8.8**	**52.7**	**(26.9)**	**117.5**	**97.2**
Deferred tax assets	9.6	8.6	52.0	(5.6)	110.2	174.8
Deferred tax liabilities	(64.5)	0.2	0.7	(21.3)	7.3	(77.6)
At 31 July 2011	**(54.9)**	**8.8**	**52.7**	**(26.9)**	**117.5**	**97.2**

Included in other deferred tax balances above is:

- no deferred tax liability relating to unremitted overseas earnings has been recognised this year (2010: £4.0m) because the Group is in a position to control the timing of other temporary differences and it is probable that such differences will not reverse in the future;
- a deferred tax asset of £26.0m (2010: £31.9m) relating to losses carried forward; and
- a deferred tax asset of £65.0m (2010: £60.3m) relating to provisions where current tax relief is only available as payments are made. Of this asset, £50.6m (£47.4m) relates to the John Crane, Inc. litigation provision. See note 23 for additional information on provisions.

The Group has not recognised deferred tax assets relating to tax losses of £225.4m (2010: £92.4m) and pensions and other long term liabilities of £96.9m (2010: £194.5m) due to uncertainty as to their recoverability.

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 restrictions apply is set out below.

Restricted losses

	2011 £m	Expiry of losses	2010 £m	Expiry of losses
Territory				
– Americas	**13.3**	**2019-2025**	13.9	2019-2025
– Asia	**3.2**	**2014-2018**	2.5	2014-2017
Total restricted losses	**16.5**		16.4	
Unrestricted losses:				
– operating losses	**208.9**	**No expiry**	76.0	No expiry
Total	**225.4**		92.4	

7 Discontinued operations

On 5 May 2007, the Group sold its Aerospace operations to General Electric Company. The Aerospace operations sold comprised the previously reported Aerospace business segment and a US microwave company. The disposal group was treated as a discontinued operation in the 2007 Annual Report and Accounts.

Profit/(loss) on disposal of operation

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Consideration		19.9
Provisions and disposal costs	**54.0**	(3.5)
Pre-tax profit on disposal	**54.0**	16.4
Cash received from disposal of Aerospace operations		19.9
Disposal costs	**(6.2)**	
Net cash (outflow)/inflow on disposal	**(6.2)**	19.9

The profit on disposal in 2011 arises from the resolution and time barring of certain disposal indemnities. The further consideration of £19.9m recognised in 2010 was received following settlement of prior year tax filings.

Financial information for the Aerospace operations after Group eliminations is presented below.

Results from discontinued operations

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Profit on disposal	**54.0**	16.4
Tax credit (note 6)	**25.0**	
Profit for the period	**79.0**	16.4
Earnings per share from discontinued operations – pence		
Basic	**20.2p**	4.2p
Diluted	**20.0p**	4.1p

The tax credit of £25.0m reflects the resolution of the tax treatment of the disposal profits.

Cash-flows from discontinued operations

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Profit before taxation (including profit on disposal of Aerospace operations)	**54.0**	16.4
Profit on disposal of discontinued operations	**(54.0)**	(16.4)
Net cash inflow from operating activities		

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Investing activities	**(6.2)**	19.9
Net cash (outflow)/inflow from investing activities	**(6.2)**	19.9

8 Dividends

The following dividends were declared and paid in the period:

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Ordinary final dividend of 23.50p for 2010 (2009: 23.50p) paid 19 November 2010	**91.9**	91.6
Ordinary interim dividend of 11.25p for 2011 (2010: 10.5p) paid 21 April 2011	**44.2**	40.9
	136.1	132.5

The final dividend for the year ended 31 July 2011 of 25.0p per share was recommended by the Board on 27 September 2011 and will be paid to shareholders on 25 November 2011, 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 28 October 2011.

9 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 2011 £m	Year ended 31 July 2010 £m
Profit attributable to equity shareholders for the year		
– continuing	**304.8**	293.6
– total	**383.8**	310.0
Average number of shares in issue during the year	**391,718,941**	390,034,777

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 395,240,785 (2010: 392,773,151) 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 2011 options over no shares (2010: 1,729,551) were excluded from this calculation because their effect was anti-dilutive for continuing operations.

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

	Year ended 31 July 2011		Year ended 31 July 2010	
	£m	EPS (p)	£m	EPS (p)
Profit attributable to equity shareholders of the Parent Company	**304.8**	**77.8**	293.6	75.3
Exclude				
Non-headline items and related tax (note 3)	**58.5**	**14.9**	36.5	9.3
Headline	**363.3**	**92.7**	330.1	84.6
Headline EPS – diluted (p)		**91.9**		84.0

10 Post-retirement benefits

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

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

Pension costs are assessed in accordance with the advice of independent, professionally-qualified actuaries. The most recent actuarial valuations of the two principal UK schemes were performed using the Projected Unit Method as at 31 March 2009. The most recent valuations of the six principal US pension and post-retirement healthcare plans were performed at 1 January 2010. These valuations have been updated by independent qualified actuaries in order to assess the liabilities of the schemes as at 31 July 2011. Scheme assets are stated at their market values. Contributions to the schemes are made on the advice of the actuaries.

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

			2011			2010
	UK	US	Other	UK	US	Other
Rate of increase in salaries	**n/a**	**n/a**	**2.9%**	n/a	n/a	3.0%
Rate of increase for active deferred members	**4.4%**	**n/a**	**n/a**	4.1%	n/a	n/a
Rate of increase in pensions in payment	**3.5%**	**n/a**	**1.3%**	3.2%	n/a	1.4%
Rate of increase in deferred pensions	**3.5%**	**n/a**	**0.6%**	3.2%	n/a	0.6%
Discount rate	**5.3%**	**5.1%**	**5.3%**	5.4%	5.2%	5.2%
Inflation rate	**3.5%**	**n/a**	**1.8%**	3.2%	n/a	1.8%
Healthcare cost increases	**5.0%**	**n/a**	**2.5%**	5.0%	n/a	3.0%

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

The mortality assumptions used in the principal UK schemes are based on the SAPS All Birth year tables with relevant scaling factors based on recent actual mortality experience of members within each. They allow for future improvements in life expectancy in line with 80% and 60% of the long cohort for males and females respectively with an annual 1% underpin. The mortality assumptions used in the principal US schemes are based on the most recent mortality study table produced for retired pensioners in the US (RP 2000 table). The table selected allows for future mortality improvements and applies an adjustment for job classification (blue collar versus white collar). The assumptions give the following:

Expected further years of life		UK		US
	Male	Female	Male	Female
Member who retires next year at age 65	22	24	19	21
Member, currently 45, when they retire in 20 years time	24	25	19	21

The assets in the scheme and the expected rates of return as at 31 July 2011 were:

							31 July 2011
		UK schemes		US schemes		Other countries	Total
	Long-term rate of return	Value £m	Long-term rate of return	Value £m	Long-term rate of return	Value £m	£m
Equities	**7.9%**	**1,349.9**	**8.8%**	**224.1**	**9.5%**	**21.0**	**1,595.0**
Government bonds	**3.9%**	**300.8**	**3.8%**	**47.5**	**5.8%**	**6.0**	**354.3**
Corporate bonds	**5.3%**	**173.8**	**5.1%**	**141.2**	**4.7%**	**3.8**	**318.8**
Insured liabilities	**5.3%**	**491.3**					**491.3**
Property	**7.5%**	**176.4**			**3.8%**	**0.3**	**176.7**
Other	**4.1%**	**321.4**			**2.0%**	**15.1**	**336.5**
Total market value		**2,813.6**		**412.8**		**46.2**	**3,272.6**
Present value of funded scheme liabilities		**(2,775.7)**		**(543.8)**		**(60.2)**	**(3,379.7)**
Surplus/(deficit)		**37.9**		**(131.0)**		**(14.0)**	**(107.1)**
Unfunded pension plans		**(40.2)**		**(5.9)**		**(22.1)**	**(68.2)**
Post-retirement healthcare		**(8.5)**		**(13.0)**		**(1.0)**	**(22.5)**
Present value of unfunded obligations		**(48.7)**		**(18.9)**		**(23.1)**	**(90.7)**
Unrecognised asset due to surplus restriction						**(1.2)**	**(1.2)**
Net pension liability		**(10.8)**		**(149.9)**		**(38.3)**	**(199.0)**
Post-retirement assets		**140.6**					**140.6**
Post-retirement liabilities		**(151.4)**		**(149.9)**		**(38.3)**	**(339.6)**
Net pension liability		**(10.8)**		**(149.9)**		**(38.3)**	**(199.0)**

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

10 Post-retirement benefits continued

							31 July 2010
	UK schemes		US schemes		Other countries		Total
	Long-term rate of return	Value £m	Long-term rate of return	Value £m	Long-term rate of return	Value £m	£m
Equities	8.2%	1,361.2	8.8%	222.7	9.4%	16.1	1,600.0
Government bonds	4.2%	268.9	3.8%	91.5	5.8%	8.1	368.5
Corporate bonds	5.4%	272.7	5.2%	58.5	3.7%	0.9	332.1
Insured liabilities	5.4%	488.0	5.2%	2.0			490.0
Property	7.2%	155.9			3.7%	0.4	156.3
Other	4.6%	69.6	3.0%	11.9	4.0%	14.7	96.2
Total market value		2,616.3		386.6		40.2	3,043.1
Present value of funded scheme liabilities		(2,658.0)		(543.4)		(57.1)	(3,258.5)
Deficit		(41.7)		(156.8)		(16.9)	(215.4)
Unfunded pension plans		(37.3)		(6.1)		(22.6)	(66.0)
Post-retirement healthcare		(8.0)		(14.4)		(0.8)	(23.2)
Present value of unfunded obligations		(45.3)		(20.5)		(23.4)	(89.2)
Unrecognised asset due to surplus restriction						(0.7)	(0.7)
Net pension liability		(87.0)		(177.3)		(41.0)	(305.3)
Post-retirement assets		80.3					80.3
Post-retirement liabilities		(167.3)		(177.3)		(41.0)	(385.6)
Net pension liability		(87.0)		(177.3)		(41.0)	(305.3)

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

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

Amounts recognised in the income statement

	Year ended 31 July 2011				Year ended 31 July 2010			
	Funded defined benefit pension schemes			**Unfunded pension/post-retirement healthcare plans**	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans
	UK £m	**US £m**	**Other £m**	**£m**	**UK £m**	**US £m**	Other £m	£m
Amounts (credited)/charged to operating profit								
Current service cost	**0.4**	**0.2**	**2.1**	**0.9**	2.8	0.3	1.6	1.4
Past service (gain)/cost	**(10.2)**	**0.1**				0.1		0.3
Curtailment (gains)/losses		**(0.9)**	**(0.1)**	**0.1**	(3.7)	(0.3)		0.1
Total (credit)/charge	**(9.8)**	**(0.6)**	**2.0**	**1.0**	(0.9)	0.1	1.6	1.8
Amounts (credited)/charged to finance costs								
Expected return on pension scheme assets	**(169.9)**	**(26.0)**	**(2.5)**		(156.4)	(25.0)	(2.3)	
Interest on pension scheme liabilities	**140.1**	**27.2**	**3.2**	**4.6**	144.8	28.8	3.0	4.8
Net return	**(29.8)**	**1.2**	**0.7**	**4.6**	(11.6)	3.8	0.7	4.8
Total (credit)/charge to income statement	**(39.6)**	**0.6**	**2.7**	**5.6**	(12.5)	3.9	2.3	6.6

The UK past service gain of £10.2m in 2011 relates to changes in certain early retirement terms. The curtailment gains in 2010 related to the closure of the UK and US defined benefit schemes. The actual return on scheme assets was a profit of £337.8m (2010: profit of £351.2m).

The operating cost is charged/(credited) as follows:

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Cost of sales	**0.5**	3.4
Sales and distribution costs	**0.4**	2.6
Administrative expenses	**1.9**	0.5
Exceptional operating items	**(10.2)**	(3.9)
	(7.4)	2.6

10 Post-retirement benefits continued

Amounts recognised directly in the consolidated statement of comprehensive income

Net actuarial losses of £0.2m (2010: losses of £15.2m) have been reported in the statement of comprehensive income. This includes a loss of £0.5m (2010: gain of £1.3m) in respect of unrecognised assets owing to surplus restriction. Cumulative actuarial losses from 1 August 2004 reported in the statement of comprehensive income are £558.5m (2010: cumulative losses of £558.3m).

Changes in present value of defined benefit obligations

	Year ended 31 July 2011				Year ended 31 July 2010			
	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans
	UK £m	US £m	Other £m	£m	UK £m	US £m	Other £m	£m
At beginning of period	**(2,658.0)**	**(543.4)**	**(57.1)**	**(89.2)**	(2,531.8)	(462.6)	(33.2)	(84.5)
Reclassification of Irish pension scheme					11.6		(11.6)	
Current service cost	**(0.4)**	**(0.2)**	**(2.1)**	**(0.9)**	(2.8)	(0.3)	(1.6)	(1.4)
Interest on obligations	**(140.1)**	**(27.2)**	**(3.2)**	**(4.6)**	(144.8)	(28.8)	(3.0)	(4.8)
Employee contributions			**(0.4)**				(0.4)	
Past service gain/(cost)	**10.2**	**(0.1)**				(0.1)		(0.3)
Actuarial (loss)/gain on liabilities	**(116.6)**	**(22.9)**	**2.7**	**(2.3)**	(126.7)	(46.3)	(6.4)	(4.7)
Curtailment gain/(cost)		**0.9**	**0.1**	**(0.1)**	3.7	0.3		(0.1)
Exchange adjustments		**25.3**	**(2.5)**	**(0.3)**		(29.5)	(2.2)	(1.2)
Benefits paid	**129.2**	**23.8**	**2.3**	**6.7**	132.8	23.9	1.3	7.8
At end of period	**(2,775.7)**	**(543.8)**	**(60.2)**	**(90.7)**	(2,658.0)	(543.4)	(57.1)	(89.2)

Changes in present value of scheme assets

	Year ended 31 July 2011				Year ended 31 July 2010			
	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans
	UK £m	US £m	Other £m	£m	UK £m	US £m	Other £m	£m
At beginning of period	**2,616.3**	**386.6**	**40.2**		2,413.7	334.5	26.9	
Reclassification of Irish pension scheme					(6.7)		6.7	
Expected return on assets	**169.9**	**26.0**	**2.5**		156.4	25.0	2.3	
Actuarial gain/(loss) on scheme assets	**115.8**	**22.6**	**1.0**		150.6	16.9		
Employer contributions	**40.8**	**20.0**	**2.9**	**6.7**	35.1	12.7	3.0	7.8
Employee contributions			**0.4**				0.4	
Exchange adjustments		**(18.6)**	**1.5**			21.4	2.2	
Benefits paid	**(129.2)**	**(23.8)**	**(2.3)**	**(6.7)**	(132.8)	(23.9)	(1.3)	(7.8)
At end of period	**2,813.6**	**412.8**	**46.2**		2,616.3	386.6	40.2	

Cash contributions

Company contributions to the funded defined benefit pension plans for 2011 totalled £63.7m (2010: £50.8m).

Following completion of the triennial actuarial valuation of the principal UK defined benefit schemes (SIPS and TIGPS) as at 31 March 2009 and 5 April 2009, the Group agreed 10 year funding plans which require the following contributions:

- Cash contributions to SIPS of £36m a year for 10 years.
- An initial investment of £25m in index-linked gilts - held in an escrow account - with further ongoing monthly investments of £2m for nine years. The first such instalment was paid in August 2011. The escrow account remains an asset of the Group (see note 15) until 2020. At that time the assets in escrow are allocated subject to the funding position of SIPS. In addition, the escrow account may revert to the Group, should there be a surplus at an intervening triennial review.
- A conditional cash contribution to the TIGPS of up to £50m is payable in May 2012, with further biannual payments of £8m thereafter. These payments may not be made, or paid only in part, subject to the funding position of the Scheme in the six months ending 5 April 2012.

In addition to the funding plans referred to above, the Group agreed to make cash contributions in respect of any future service cost based on actuarial advice. In 2012 the following cash contributions to the Group's principal defined benefit schemes are expected: £36m to SIPS; a conditional £50m to TIGPS; and approximately £20m to the US defined benefit scheme. Including payments to smaller schemes around the world; expected cash payments for 2012 total approximately £110m.

10 Post-retirement benefits continued

History of schemes

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Balance sheet					
Present value of defined benefit obligation	**(3,470.4)**	(3,347.7)	(3,112.1)	(2,968.9)	(3,132.9)
Fair value of scheme assets	**3,272.6**	3,043.1	2,775.1	2,959.9	3,318.9
Unrecognised asset due to surplus restriction	**(1.2)**	(0.7)	(2.0)	(1.5)	(2.4)
(Deficit)/surplus	**(199.0)**	(305.3)	(339.0)	(10.5)	183.6
Post-retirement assets	**140.6**	80.3	39.2	174.2	333.7
Post-retirement liabilities	**(339.6)**	(385.6)	(378.2)	(184.7)	(150.1)
(Deficit)/surplus	**(199.0)**	(305.3)	(339.0)	(10.5)	183.6

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m	Year ended 31 July 2009 £m	Period ended 31 July 2008 £m	Period ended 5 August 2007 £m
Experience gains/(losses)					
Experience gains/(losses) on scheme liabilities	**(25.5)**	31.5	100.5	(6.4)	(57.6)
Experience gains/(losses) on scheme assets	**139.4**	167.5	(345.4)	(350.0)	95.7
Movement on restricted surplus	**(0.5)**	1.3	(0.5)	0.9	(1.9)

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

Sensitivity

The valuation of post-retirement schemes involves judgements about uncertain future events. Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 July 2011 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions. While each of these sensitivities holds all other assumptions constant, in practice such assumptions rarely change in isolation and the impacts may offset to some extent.

	Profit before tax for year ended 31 July 2011 £m	Increase/ (decrease) in scheme assets £m	(Increase)/ decrease in scheme liabilities £m
Rate of mortality – 1 year increase in life expectancy	(4.0)	25.4	(101.2)
Rate of mortality – 1 year decrease in life expectancy	4.0	(26.1)	102.4
Rate of inflation – 0.25% increase	(4.0)	8.6	(85.6)
Discount rate – 0.25% increase	(0.8)	(10.7)	127.0
Expected return on scheme assets – 0.25% increase	5.8		
Market value of scheme assets – 2.5% increase	4.4	68.7	(0.1)
Healthcare cost trends – 1% increase			(0.1)
Healthcare cost trends – 1% decrease			0.1

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

Investment

In September 2011, the Trustees of the TIGPS invested approximately £147m in annuities which are matched with specific liabilities in the Scheme.

Defined contribution plans

The Group operates a number of defined contribution plans across many countries. In the UK a defined contribution plan has been offered since the closure of the UK defined benefit pension plans. In the US a 401k defined contribution plan operates. The total expense recognised in the income statement in respect of all these plans was £29.6m (2010: £27.1m).

11 Employees

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Staff costs during the period		
Wages and salaries	**698.4**	686.1
Social security	**82.4**	82.0
Share-based payment (note 30)	**13.8**	11.3
Pension costs (including defined contribution schemes) (note 10)	**32.9**	33.8
	827.5	813.2

The average number of persons employed was:

	Year ended 31 July 2011	Year ended 31 July 2010
Smiths Detection	**2,500**	2,400
John Crane	**6,800**	6,700
Smiths Medical	**7,550**	8,400
Smiths Interconnect	**4,000**	4,000
Flex-Tek	**2,000**	2,000
Corporate	**50**	50
	22,900	23,550

Key management

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

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Key management compensation		
Salaries and short-term employee benefits	**9.2**	10.3
Cost of post-retirement benefits	**0.1**	0.1
Cost of share-based incentive plans	**4.0**	2.4

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 2011		Year ended 31 July 2010	
	Number of instruments '000	Weighted average price	Number of instruments '000	Weighted average price
CIP	**540**		315	
ESOS	**194**	**£8.81**	220	£8.73
PSP			241	
VSP	**852**		753	
SAYE	**4**	**£6.81**	5	£6.45

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

Related party transactions

The Group has a service contract with a company connected to a member of the Executive Committee. Costs of £0.2m (2010: £0.2m) were incurred in respect of this arrangement.

12 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 2009	1,266.5	106.2	290.2	116.3	1,779.2
Exchange adjustments	48.7	5.4	13.8	3.0	70.9
Business combinations	64.1		51.5		115.6
Adjustments to prior year business combinations	0.2				0.2
Additions		24.3		7.6	31.9
Disposals		(0.7)		(2.0)	(2.7)
At 31 July 2010	1,379.5	135.2	355.5	124.9	1,995.1
Exchange adjustments	(12.2)	(3.7)	(7.7)	(0.7)	(24.3)
Business combinations	22.4		4.1		26.5
Additions		31.0		10.2	41.2
Disposals				(2.2)	(2.2)
At 31 July 2011	**1,389.7**	**162.5**	**351.9**	**132.2**	**2,036.3**
Amortisation					
At 1 August 2009	92.0	32.4	91.2	63.3	278.9
Exchange adjustments	3.1	2.0	4.2	2.3	11.6
Charge for the year		13.8	42.1	11.7	67.6
Disposals				(1.6)	(1.6)
At 31 July 2010	95.1	48.2	137.5	75.7	356.5
Exchange adjustments	(1.2)	(1.0)	(3.4)	(0.5)	(6.1)
Charge for the year		16.2	44.0	12.1	72.3
Impairment charge			5.5		5.5
Disposals				(2.1)	(2.1)
At 31 July 2011	**93.9**	**63.4**	**183.6**	**85.2**	**426.1**
Net book value at 31 July 2011	**1,295.8**	**99.1**	**168.3**	**47.0**	**1,610.2**
Net book value at 31 July 2010	1,284.4	87.0	218.0	49.2	1,638.6
Net book value at 1 August 2009	1,174.5	73.8	199.0	53.0	1,500.3

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 2009	64.3	94.4	131.5	290.2
Exchange adjustments	4.4	5.3	4.1	13.8
Business combinations (note 29)		22.8	28.7	51.5
At 31 July 2010	68.7	122.5	164.3	355.5
Exchange adjustments	(2.1)	(5.1)	(0.5)	(7.7)
Business combinations (note 29)			4.1	4.1
At 31 July 2011	**66.6**	**117.4**	**167.9**	**351.9**
Amortisation				
At 1 August 2009	13.8	32.3	45.1	91.2
Exchange adjustments	0.9	2.0	1.3	4.2
Charge for the year	5.3	11.7	25.1	42.1
At 31 July 2010	20.0	46.0	71.5	137.5
Exchange adjustments	(0.7)	(2.2)	(0.5)	(3.4)
Charge for the year	5.1	13.3	25.6	44.0
Impairment charge	0.8		4.7	5.5
At 31 July 2011	**25.2**	**57.1**	**101.3**	**183.6**
Net book value at 31 July 2011	**41.4**	**60.3**	**66.6**	**168.3**
Net book value at 31 July 2010	48.7	76.5	92.8	218.0
Net book value at 1 August 2009	50.5	62.1	86.4	199.0

12 Intangible assets continued

Impairment testing

Goodwill

Goodwill is allocated by division as follows:

	2011 £m	2011 Number of CGUs	2010 £m	2010 Number of CGUs
Smiths Detection	**406.9**	**1**	372.9	2
John Crane	**132.9**	**6**	130.8	6
Smiths Medical	**497.2**	**1**	512.5	2
Smiths Interconnect	**237.5**	**4**	245.9	4
Flex-Tek	**21.3**	**2**	22.3	2
	1,295.8	**14**	1,284.4	16

As discussed in the business review, both Smiths Detection and Smiths Medical adopted global organisations at the beginning of this year. The divisions now have global management and reporting for sales and marketing, product management and operations. Both divisions now report and review performance using these global structures. As required by IAS 36, following these reorganisations, the allocation of goodwill to CGUs for impairment testing was reviewed, and it was established that goodwill is now monitored, and should be tested for impairment, at a divisional level.

Goodwill is not amortised but is tested for impairment at least annually. Value in use calculations are used to determine the recoverable amount of goodwill held allocated to each group of cash generating units (CGU). Value in use is calculated as the net present value of the projected risk-adjusted cash-flows of the CGU. These forecast cash-flows are based on the 2012 budget and the three year divisional strategic plan, which have both been approved by the Board.

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 developments in key markets.
- Margins: projected margins reflect historical performance and the impact of all completed projects to improve operational efficiency and leverage scale. The projections do not include the impact of future restructuring projects to which the Group is not yet committed.
- Discount rate: the discount rates have been calculated based on the Group’s weighted average cost of capital and risks specific to the CGU being tested. Pre-tax rates of 11.1% to 14.1% (2010: 9.8% to 12.8%) 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 2.42% (2010: 2.25%). These rates do not reflect the long-term assumption used by the Group for investment planning.

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

	Smiths Medical		Smiths Detection	
	2011	2010 (restated)	2011	2010 (restated)
Net book value of goodwill (£m)	**497.2**	512.5	**406.9**	372.9
Discount rate	**11.2%**	11.5%	**11.2%**	11.7%
Period covered by management projections	**5 years**	5 years	**5 years**	5 years
Long-term growth rates	**2.47%**	2.25%	**2.00%**	2.25%

The 2010 information has been restated to reflect the new CGU structure. The 2010 discount and growth rates are weighted averages of the rates used for testing in that year. The remaining balance of the goodwill represents smaller individual amounts which have been allocated to smaller 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.

Impairment charges of £5.5m have been incurred on intangible assets acquired in two business combinations. Value in use calculations were used to determine the recoverable values of these assets. The impairment charges have arisen because current and forecast profitability is below the levels originally projected.

13 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 2009	191.3	454.6	202.9	848.8
Exchange adjustments	8.0	23.5	8.3	39.8
Business combinations		3.4	0.8	4.2
Additions	6.5	26.9	13.6	47.0
Disposals	(18.8)	(14.8)	(15.6)	(49.2)
At 31 July 2010	187.0	493.6	210.0	890.6
Exchange adjustments	(1.8)	(9.0)	1.2	(9.6)
Business combinations		0.2	0.1	0.3
Additions	7.8	26.6	14.9	49.3
Disposals	(2.7)	(15.7)	(16.7)	(35.1)
At 31 July 2011	**190.3**	**495.7**	**209.5**	**895.5**
Depreciation				
At 1 August 2009	79.5	302.7	148.6	530.8
Exchange adjustments	3.8	15.9	6.2	25.9
Charge for the year	7.7	39.1	18.9	65.7
Reversal of impairment	(2.1)			(2.1)
Disposals	(6.4)	(12.7)	(13.3)	(32.4)
At 31 July 2010	82.5	345.0	160.4	587.9
Exchange adjustments	(1.3)	(6.8)	0.7	(7.4)
Charge for the year	7.8	38.9	16.7	63.4
Disposals	(1.9)	(14.4)	(14.9)	(31.2)
At 31 July 2011	**87.1**	**362.7**	**162.9**	**612.7**
Net book value at 31 July 2011	**103.2**	**133.0**	**46.6**	**282.8**
Net book value at 31 July 2010	104.5	148.6	49.6	302.7
Net book value at 1 August 2009	111.8	151.9	54.3	318.0

14 Investments accounted for using the equity method

	31 July 2011 £m	31 July 2010 £m
Investments in associated companies		
At start of period	**13.6**	11.2
Exchange adjustment	**0.8**	0.7
Share of results after tax	**4.3**	1.8
Dividend received	**(0.2)**	(0.1)
At end of period	**18.5**	13.6

The Group’s share of the revenue of associates was £23.7m (2010: £22.5m). The total assets of associates are £59.9m (2010: £43.1m) and liabilities are £13.5m (2010: £17.6m). These figures principally represent the performance, assets and liabilities of Cross Match Technologies, Inc., incorporated in the United States. The share of these assets and liabilities attributable to Smiths Group is 35.6% (2010: 35.6%).

15 Financial assets

Available for sale financial assets include £29.1m (2010: £25.2m) UK government bonds. This investment forms part of the deficit funding plan agreed with the trustee of one of the principal UK pension schemes. See note 10 for additional details.

16 Inventories

	31 July 2011 £m	31 July 2010 £m
Inventories comprise		
Raw materials and consumables	**145.1**	129.3
Work in progress	**94.7**	72.4
Finished goods	**197.2**	190.5
	437.0	392.2
Less: payments on account	**(4.5)**	(2.2)
	432.5	390.0

The Group consumed £1,332.6m (2010: £1,262.2m) of inventories during the period. £11.3m (2010: £19.0m) was recognised as an expense resulting from the write-down of inventory and £3.0m (2010: £5.6m) was released to the income statement from inventory provisions charged in earlier years but no longer required.

17 Trade and other receivables

	31 July 2011 £m	31 July 2010 £m
Non-current		
Trade receivables	**23.7**	22.8
Prepayments and accrued income	**5.3**	6.0
Other debtors	**4.6**	5.0
	33.6	33.8
Current		
Trade receivables	**564.2**	535.3
Prepayments and accrued income	**32.9**	30.5
Other debtors	**15.7**	13.1
	612.8	578.9

Trade receivables do not carry interest. Management considers that the carrying value of trade and other receivables approximates to the fair value. Trade and other receivables, including prepayments, accrued income and other debtors qualifying as financial instruments are classified as ‘loans and receivables’. The maximum credit exposure arising from these financial assets is £606.5m (2010: £575.8m).

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 6% (2010: 8%) of Group revenue.

Ageing of trade receivables

	31 July 2011 £m	31 July 2010 £m
Trade receivables which are not impaired and not yet due	**472.4**	447.3
Trade receivables which are not impaired and less than three months overdue	**84.2**	75.7
Trade receivables which are not impaired and more than three months overdue	**28.5**	31.8
Gross value of partially and fully provided debtors	**16.8**	17.9
	601.9	572.7
Provision for bad and doubtful debts	**(14.0)**	(14.6)
Trade receivables	**587.9**	558.1

18 Cash and cash equivalents

	31 July 2011 £m	31 July 2010 £m
Cash at bank and in hand	**232.0**	136.3
Short-term deposits	**29.1**	36.6
Cash and cash equivalents	**261.1**	172.9
Bank overdrafts	**(0.4)**	(0.7)
Net cash and cash equivalents	**260.7**	172.2

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

19 Trade and other payables

	31 July 2011 £m	31 July 2010 £m
Non-current		
Other creditors	**45.1**	27.3
Current		
Trade creditors	**190.3**	151.6
Bills of exchange payable	**0.7**	0.5
Other creditors	**19.4**	35.2
Other taxation and social security costs	**22.5**	21.2
Accruals and deferred income	**221.3**	219.7
	454.2	428.2

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

20 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 2011 £m	31 July 2010 £m
Cash and cash equivalents		
Net cash and deposits (note 18)	**261.1**	172.9
Short-term borrowings		
Bank overdrafts	**(0.4)**	(0.7)
Bank and other loans	**(1.2)**	(1.3)
Interest accrual	**(10.1)**	(12.7)
	(11.7)	(14.7)
Long-term borrowings		
$250m 5.45% US$ Private placement 2013	**(158.3)**	(169.1)
$250m 6.05% US$ Guaranteed notes 2014	**(151.4)**	(158.3)
£150m 7.25% Sterling Eurobond 2016	**(149.3)**	(149.1)
€300m 4.125% Eurobond 2017	**(260.2)**	(247.6)
$175m 7.37% US$ Private placement 2018	**(106.4)**	(111.4)
$250m 7.20% US$ Guaranteed notes 2019	**(151.0)**	(158.0)
Bank and other loans	**(1.8)**	(1.5)
	(978.4)	(995.0)
Borrowings	**(990.1)**	(1,009.7)
Net debt	**(729.0)**	(836.8)

Borrowings are accounted for at amortised cost and are categorised as other financial liabilities. See note 21 for a maturity analysis of borrowings. The repayment dates on borrowings repayable after five years range from 2017 to 2019.

Interest of £42.3m (2010: £43.2m) was charged to the consolidated income statement in this period in respect of public bonds.

20 Borrowings and net debt continued
Movements in net debt

	Net cash and cash equivalents £m	Other short-term borrowing £m	Long-term borrowings £m	Net debt £m
At 31 July 2010	172.2	(14.0)	(995.0)	(836.8)
Foreign exchange gains and losses	2.7	0.1	13.3	16.1
Net cash inflow/(outflow)	85.8			85.8
Repayment of borrowings		1.2		1.2
Drawdown of borrowings			(1.6)	(1.6)
Capitalisation, interest accruals and unwind of capitalised fees		2.6	0.1	2.7
Fair value movement from interest rate hedging			3.6	3.6
Change in maturity analysis		(1.2)	1.2	
At 31 July 2011	**260.7**	**(11.3)**	**(978.4)**	**(729.0)**

Secured loans

Loans amounting to £3.0m (2010: £2.8m) were secured on plant and equipment with a book value of £2.9m (2010: £2.6m).

21 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 17.

(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 2011
	Sterling £m	**US$ £m**	**Euro £m**	**Other £m**	**Total £m**
Financial assets and liabilities					
Financial instruments included in trade and other receivables	**35.3**	**290.7**	**144.2**	**136.3**	**606.5**
Financial instruments included in trade and other payables	**(50.3)**	**(141.4)**	**(78.8)**	**(64.6)**	**(335.1)**
Cash and cash equivalents	**55.8**	**58.5**	**32.9**	**113.9**	**261.1**
Borrowings not designated as net investment hedges	**(149.0)**	**(10.8)**	**(3.0)**		**(162.8)**
	(108.2)	**197.0**	**95.3**	**185.6**	**369.7**
Exclude balances held in operations with the same functional currency	**108.5**	**(147.8)**	**(98.4)**	**(183.4)**	**(321.1)**
Exposure arising from intra-group loans		**(93.5)**	**(8.8)**	**8.7**	**(93.6)**
Forward foreign exchange contracts	**(104.4)**	**65.1**	**62.9**	**(23.6)**	
	(104.1)	**20.8**	**51.0**	**(12.7)**	**(45.0)**

21 Financial risk management continued

	At 31 July 2010				
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Financial assets and liabilities					
Financial instruments included in trade and other receivables	34.5	280.3	138.8	122.2	575.8
Financial instruments included in trade and other payables	(36.3)	(143.1)	(66.2)	(51.1)	(296.7)
Cash and cash equivalents	30.4	30.6	19.0	92.9	172.9
Borrowings not designated as net investment hedges	(151.6)	(11.5)	(2.6)	(0.3)	(166.0)
	(123.0)	156.3	89.0	163.7	286.0
Exclude balances held in operations with the same functional currency	124.7	(103.9)	(87.1)	(159.0)	(225.3)
Exposure arising from intra-group loans		(36.0)	12.8	6.2	(17.0)
Forward foreign exchange contracts	(2.6)	30.0	11.2	(38.6)	
	(0.9)	46.4	25.9	(27.7)	43.7

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

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

	Impact on profit for the year 31 July 2011 £m	**Gain/(loss) recognised in reserves 31 July 2011 £m**	Impact on profit for the year 31 July 2010 £m	Gain/(loss) recognised in reserves 31 July 2010 £m
US dollar	**5.9**	**(3.4)**	1.5	(1.8)
Euro	**(1.8)**	**4.2**	1.0	2.9
Sterling	**0.5**	**1.6**	1.3	1.8

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 2011 contracts with a nominal value of £217.7m (2010: £292.7m) were designated as hedging instruments. In addition, the Group had outstanding foreign currency contracts with a nominal value of £241.0m (2010: £152.1m) 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 22.

The majority of hedged transactions will be recognised in the income statement in the same period that the cash-flows are expected to occur, with the only differences arising as a result of normal commercial credit terms on sales and purchases. Of the foreign exchange contracts designated as hedging instruments 99.9% are for periods of 12 months or less (2010: 99.6%).

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

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Brought forward cash-flow hedge reserve at start of year	**(0.6)**	1.8
Exchange adjustments	**0.1**	0.2
Gains and losses on effective cash-flow hedges recognised in equity	**0.4**	(2.3)
Amounts removed from the hedge reserve and recognised in the following lines on the income statement		
– revenue	**0.2**	0.1
– cost of sales	**(0.4)**	0.9
– administrative expenses		(1.3)
Carried forward cash-flow hedge reserve at end of year	**(0.3)**	(0.6)

21 Financial risk management continued

Translational currency exposure

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

Net investment hedges

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

					At 31 July 2011
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges		**(567.2)**	**(260.1)**		**(827.3)**
Currency swap contracts	**192.6**	**(45.6)**	**(39.2)**	**(107.8)**	
	192.6	**(612.8)**	**(299.3)**	**(107.8)**	**(827.3)**

					At 31 July 2010
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges		(587.0)	(248.1)		(835.1)
Currency swap contracts	206.7	(32.4)	(39.2)	(135.1)	
	206.7	(619.4)	(287.3)	(135.1)	(835.1)

At 31 July 2011 and 31 July 2010 swap contracts in other currencies hedged the Group's exposure to Australian dollars, Canadian dollars, Japanese yen and Chinese renminbi.

Of the contracts designated as net investment hedges, 54% (2010: 56%) are current and the balance matures over the next three years (2010: three years).

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

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Brought forward net investment hedge reserve at start of year	**(128.2)**	(88.9)
Amounts deferred in the period on effective net investment hedges	**7.9**	(39.3)
Carried forward net investment hedge reserve at end of year	**(120.3)**	(128.2)

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 2011 £m	Loss recognised in hedge reserve 31 July 2010 £m
US dollar	**60.4**	61.8
Euro	**27.6**	26.0

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

21 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 60% of the level of net debt. This is achieved primarily through fixed rate borrowings, and also through the use of interest rate swaps. At 31 July 2011 98.5% (2010: 91.5%) of the Group's net 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 weighted average interest rate on borrowings and cross-currency swaps at 31 July 2011, after interest rate swaps, is 5.5% (2010: 5.4%).

Interest rate profile of financial assets and liabilities and the fair value of borrowings
The following table shows the interest rate risk exposure of cash and borrowings. 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.

	Cash and cash equivalents 31 July 2011 £m	Borrowings 31 July 2011 £m	Fair value of borrowings 31 July 2011 £m	Cash and cash equivalents 31 July 2010 £m	Borrowings 31 July 2010 £m	Fair value of borrowings 31 July 2010 £m
Fixed interest (adjusted for interest rate hedging)						
Less than one year		**(1.2)**	**(1.2)**		(1.3)	(1.3)
Between one and five years		**(363.4)**	**(403.6)**		(223.5)	(244.3)
Greater than five years		**(414.2)**	**(463.0)**		(566.9)	(643.7)
Total fixed interest financial assets/(liabilities) (adjusted for interest rate hedging)		**(778.8)**	**(867.8)**		(791.7)	(889.3)
Floating rate interest financial assets/(liabilities)	**243.1**	**(211.3)**	**(211.3)**	156.4	(218.0)	(218.0)
Total interest bearing financial assets/(liabilities)	**243.1**	**(990.1)**	**(1,079.1)**	156.4	(1,009.7)	(1,107.3)
Non-interest bearing assets/(liabilities) in the same category	**18.0**			16.5		
Total	**261.1**	**(990.1)**	**(1,079.1)**	172.9	(1,009.7)	(1,107.3)

Interest rate hedging
The Group has designated US$150.0m interest rate swaps which mature on 28 January 2013 and €120.0m interest rate swaps which mature on 5 May 2017 as fair value hedges on the US Private placement and the Eurobond respectively which mature on the same dates. 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 22. The effect of the swaps is to convert £196.3m (2010: £195.3m) 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 2011, 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 £nil (2010: £0.2m) impact on the Group's profit before tax.

(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 selecting counterparties with a strong investment grade long-term credit rating for cash deposits and assigning financial limits to individual counterparties. 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 £292.7m at 31 July 2011 (2010: £199.9m).

	31 July 2011 £m	31 July 2010 £m
Cash at banks with at least a AA- credit rating	**236.6**	120.9
Cash at banks with a A+ credit rating	**21.1**	47.4
Cash at other banks	**3.4**	4.7
UK government bonds with a AAA credit rating (note 15)	**29.1**	25.2
Other investments	**2.5**	1.7
	292.7	199.9

At 31 July 2011 the maximum exposure with a single bank for deposits and cash is £57.1m (2010: £41.6m), whilst the maximum mark to market exposure for derivatives is £5.3m (2010: £6.8m). These banks have AA- and AA credit rating, respectively (2010: AA and AA).

21 Financial risk management continued

(d) Liquidity risk

Borrowing facilities

The Board policy specifies the maintenance of unused committed credit facilities of at least £200m at all times to ensure it has sufficient available funds for operations and planned development. On 14 December 2010 the £660m Revolving Credit Facility 2012 was refinanced with a new US$800m multi-currency revolving credit facility. The new facility, which matures in December 2015, is undrawn. At the balance sheet date the Group had the following undrawn credit facilities:

	31 July 2011 £m	31 July 2010 £m
Expiring within one year		
Expiring between one and two years		660.0
Expiring after two years	**486.8**	
	486.8	660.0

Cash deposits

As at 31 July 2011, £29.1m (2010: £36.6m) of cash and cash equivalents was on deposit with various banks of which £4.5m (2010: £20.8m) was on deposit in the UK.

Gross contractual cash-flows for borrowings

	Borrowings (Note 20) 31 July 2011 £m	**Fair value adjustments 31 July 2011 £m**	**Contractual interest payments 31 July 2011 £m**	**Total contractual cash-flows 31 July 2011 £m**	Borrowings (Note 20) 31 July 2010 £m	Fair value adjustments 31 July 2010 £m	Contractual interest payments 31 July 2010 £m	Total contractual cash-flows 31 July 2010 £m
Less than one year	**(11.7)**	**(1.1)**	**(46.9)**	**(59.7)**	(14.7)	1.3	(47.9)	(61.3)
Between one and two years	**(159.2)**	**6.2**	**(54.0)**	**(207.0)**	(1.0)		(59.2)	(60.2)
Between two and three years	**(152.3)**	**(0.7)**	**(49.8)**	**(202.8)**	(169.6)	9.8	(54.9)	(214.7)
Between three and four years			**(40.5)**	**(40.5)**	(158.3)	(1.0)	(50.5)	(209.8)
Between four and five years	**(149.3)**	**(0.7)**	**(40.5)**	**(190.5)**			(40.8)	(40.8)
Greater than five years	**(517.6)**	**(3.6)**	**(59.4)**	**(580.6)**	(666.1)	(4.0)	(102.0)	(772.1)
Total	**(990.1)**	**0.1**	**(291.1)**	**(1,281.1)**	(1,009.7)	6.1	(355.3)	(1,358.9)

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

Gross contractual cash-flows for derivative financial instruments

	Receipts 31 July 2011 £m	**Payments 31 July 2011 £m**	**Net cash-flow 31 July 2011 £m**	Receipts 31 July 2010 £m	Payments 31 July 2010 £m	Net cash-flow 31 July 2010 £m
Assets						
Less than one year	**182.3**	**(166.6)**	**15.7**	375.2	(354.0)	21.2
Greater than one year	**102.4**	**(92.5)**	**9.9**	78.7	(60.7)	18.0
Liabilities						
Less than one year	**351.3**	**(359.5)**	**(8.2)**	362.5	(377.8)	(15.3)
Greater than one year	**26.8**	**(27.0)**	**(0.2)**	30.2	(31.3)	(1.1)
Total	**662.8**	**(645.6)**	**17.2**	846.6	(823.8)	22.8

This table presents the undiscounted future contractual cash-flows for all derivative financial instruments. For this disclosure, cash-flows in foreign currencies are translated using the spot rates at the balance sheet date. The fair values of these financial instruments are presented in note 22.

Gross contractual cash-flows for other financial liabilities

The contractual cash-flows for financial liabilities included in trade and other payables are: £309.9m (2010: £284.5m) due in less than one year, £20.9m (2010: £8.2m) due between one and five years and £4.3m (2010: £4.0m) due after more than five years.

22 Financial derivatives

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

				At 31 July 2011
	Contract or underlying nominal amount			Fair value
	£m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	**217.7**	**3.2**	**(4.5)**	**(1.3)**
Foreign exchange contracts (not hedge accounted)	**241.0**	**1.6**	**(2.6)**	**(1.0)**
Total foreign exchange contracts	**458.7**	**4.8**	**(7.1)**	**(2.3)**
Currency swaps (net investment hedges)	**192.6**	**1.9**	**(2.3)**	**(0.4)**
Interest rate swaps (fair value hedges)	**196.3**	**5.4**	**(1.0)**	**4.4**
Total financial derivatives	**847.6**	**12.1**	**(10.4)**	**1.7**
Balance sheet entries				
Non-current		**6.4**	**(1.5)**	**4.9**
Current		**5.7**	**(8.9)**	**(3.2)**
Total financial derivatives		**12.1**	**(10.4)**	**1.7**

				At 31 July 2010
	Contract or underlying nominal amount			Fair value
	£m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	292.7	5.2	(7.0)	(1.8)
Foreign exchange contracts (not hedge accounted)	152.1	1.2	(2.3)	(1.1)
Total foreign exchange contracts	444.8	6.4	(9.3)	(2.9)
Currency swaps (net investment hedges)	206.7	4.9	(0.8)	4.1
Currency swaps (not hedge accounted)	180.7	6.7	(5.6)	1.1
Total currency swap contracts	387.4	11.6	(6.4)	5.2
Interest rate swaps (fair value hedges)	195.3	8.3	(0.3)	8.0
Total financial derivatives	1,027.5	26.3	(16.0)	10.3
Balance sheet entries				
Non-current		10.8	(1.1)	9.7
Current		15.5	(14.9)	0.6
Total financial derivatives		26.3	(16.0)	10.3

Currency swaps not hedge accounted

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

Accounting for other derivative contracts

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

Fair value hierarchy

All derivatives values are calculated using level 2 valuation methodologies.

23 Provisions for liabilities and charges

	Warranty provision and product liability £m	Reorganisation £m	Property £m	Disposal £m	John Crane, Inc. litigation £m	Other litigation £m	**Total £m**
At 31 July 2010	37.5	11.4	4.7	56.2	175.7	15.7	301.2
Exchange adjustments	0.5	(0.2)			(8.3)	(0.4)	(8.4)
Provision charged	22.9	4.8	0.8		27.3	5.0	60.8
Provision released	(5.8)	(2.0)	(0.8)	(43.8)		(2.1)	(54.5)
Unwind of provision discount					6.1		6.1
Utilisation	(17.5)	(6.2)	(1.3)	(8.5)	(19.1)	(3.8)	(56.4)
At 31 July 2011	**37.6**	**7.8**	**3.4**	**3.9**	**181.7**	**14.4**	**248.8**

Analysed as:

	31 July 2011 £m	31 July 2010 £m
Current liabilities	**74.7**	70.4
Non-current liabilities	**174.1**	230.8
	248.8	301.2

Warranty provision and product liability
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.

Reorganisation
The restructuring of corporate and divisional headquarters was announced on 3 June 2008, and a second phase of this project was introduced in 2010. At 31 July 2011 there is a provision of £4.7m (2010: £8.6m) relating to the two phases of this project.

Reorganisation provisions include £1.8m (2010: £2.8m) costs relating to restructuring supply arrangements following the automotive seals disposal. These costs are expected to be spread over the next two years.

Disposal
The disposal provision relates to warranties and other obligations in respect of the disposal of the Marine Systems and Aerospace businesses.

Most of the balance is expected to be utilised within the next five years.

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

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

JCI continues to actively monitor the conduct and effect of its current and expected asbestos litigation, including the most efficacious presentation of its 'safe product' defence, and intends to continue to resist these asbestos claims based upon this defence. Approximately 202,000 claims against JCI have been dismissed before trial over the last 32 years. JCI is currently a defendant in cases involving approximately 101,000 claims. Despite the large number of claims brought against JCI, it has had final judgments against it, after appeals, in only 107 cases over the period, and has had to pay awards amounting to approximately US$103m. JCI has also incurred significant additional defence costs and, whilst the number of claims being filed against JCI and other defendants has been declining, the proportion of mesothelioma claims has increased, and JCI's ability to defend these cases successfully is likely to have a significant impact on its annual aggregate adverse judgment and defence costs.

23 Provisions for liabilities and charges continued
Litigation continued
John Crane, Inc. continued
The assumptions made in assessing the appropriate level of provision include:

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

The provision is based on past history and allows for decreasing levels of new claims based on published tables of asbestos incidence projections and is determined using asbestos valuation experts, Bates White LLC. In the current period the method used to calculate the expected costs of defending claims has been conformed to the approach used to calculate the expected cost of adverse judgments following the appointment of Bates White LLC to value both elements of JCI's exposure. The projections use a 10 year time horizon (see note 26), compared to time horizons of up to 16 years used in previous estimates, 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 Income Statement charge arising from movements in discounting (see note 4) incorporates the impact of the change in the time frame of the projections. The movement in the gross provision reflects the higher expected annual defence costs offset by the change in the time horizon.

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

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

	31 July 2011 £m	31 July 2010 £m
Gross provision	**203.1**	214.5
Discount	**(21.4)**	(38.8)
Discounted pre-tax provision	**181.7**	175.7
Deferred tax	**(50.6)**	(47.4)
Discounted post-tax provision	**131.1**	128.3

Other litigation
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.

Apart from that relating to JCI, none of the other provisions is discounted.

24 Share capital

	Number of shares	Issued capital £m	Consideration £m
Ordinary shares of 37.5p each			
At 31 July 2010	390,728,043	146.5	
Exercise of share options	1,622,360	0.6	14.4
Total share capital at 31 July 2011	**392,350,403**	**147.1**	

At 31 July 2011 all of the issued share capital was in free issue. All issued shares are fully paid.

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 (2010: 558,754) shares to the Trust, and the Trust purchased 700,892 (2010: nil shares) in the market. At 31 July 2011 the Trust held 855 (2010: 32,858) ordinary shares with a market value of £0.0m (2010: £0.4m).

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.

25 Reserves continued

Capital management

Capital employed comprises total equity adjusted for goodwill recognised directly in reserves, net post-retirement benefit assets and liabilities and net debt. The efficiency of the allocation of the capital to the divisions is monitored through the headline 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 17.0% (2010: 16.6%).

The capital structure is based on the directors' judgement of the balance required to maintain flexibility while achieving an efficient cost of capital. The Group has a target gearing, calculated on a market value basis, of approximately 20%. At the balance sheet date the Group had gearing of 15% (2010: 19%).

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 2011 the Group had a credit rating of BBB+/Baa2 (2010: BBB+/Baa2 – negative outlook) with Standard & Poor's and Moody's respectively. The credit rating is managed through the following cash-flow targets: headline operating cash conversion of greater than 80% and a ratio of net debt to headline EBITDA of less than two. For the year ended 31 July 2011 these measures were 95% (2010: 115%) and 1.2 (2010: 1.4).

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

Hedge reserve

	31 July 2011 £m	31 July 2010 £m
The hedge reserve on the balance sheet comprises		
– cash-flow hedge reserve	**(0.3)**	(0.6)
– net investment hedge reserve	**(120.3)**	(128.2)
	(120.6)	(128.8)

See transactional currency exposure risk management disclosures in note 21 for additional details of cash-flow hedges, and translational currency exposure risk management disclosure also in note 21 for additional details of net investment hedges.

26 Contingent liabilities and commitments

John Crane, Inc.

As stated in note 23, John Crane, Inc. ("JCI") is involved in numerous lawsuits pending in the United States in which plaintiffs are claiming damages arising from exposure to, or use of, products containing asbestos. The JCI products generally referred to in these cases are ones in which the asbestos fibres were encapsulated in such a manner that, according to tests conducted on behalf of JCI, the products were safe. JCI ceased manufacturing products containing asbestos in 1985.

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

Other contingent liabilities and commitments

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

At 31 July 2011, contingent liabilities, comprising bonds and guarantees arising in the normal course of business, amounted to £137.8m (2010: £143.5m), including pension commitments of £43.1m (2010: £40.6m).

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

27 Operating lease commitments – minimum lease payments

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

	31 July 2011		31 July 2010	
	Land and buildings £m	**Other £m**	Land and buildings £m	Other £m
Payments due				
– not later than one year	**30.4**	**9.1**	27.3	9.0
– later than one year and not later than five years	**64.1**	**8.8**	63.7	10.7
– later than five years	**22.7**	**0.1**	27.7	0.1
	117.2	**18.0**	118.7	19.8

28 Cash-flow

Cash-flow from operating activities

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Operating profit – continuing	438.0	435.9
Amortisation of intangible assets	72.3	67.6
Impairment of intangible assets	5.5	
Profit on disposal of property, plant and equipment	(0.7)	(3.1)
Profit on disposal of business	(4.4)	(3.3)
Depreciation of property, plant and equipment	63.4	65.7
Impairment of property, plant and equipment		(2.1)
Share-based payment expense	13.8	10.3
Retirement benefits	(77.6)	(56.1)
(Increase)/decrease in inventories	(46.7)	46.1
Increase in trade and other receivables	(33.1)	(16.5)
Increase in trade and other payables	43.7	27.0
Increase/(decrease) in provisions	5.2	(21.8)
Cash generated from operations	479.4	549.7
Interest	(66.8)	(52.8)
Tax paid	(90.9)	(86.4)
Net cash inflow from operating activities	**321.7**	410.5

Smiths Group cash-flow measures

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

Headline operating cash-flow

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Net cash inflow from operating activities	**321.7**	410.5
Exclude:		
Interest	66.8	52.8
Tax paid	90.9	86.4
Cash outflow in respect of exceptional operating items	34.8	45.7
Pension deficit payments	60.1	44.7
Include:		
Expenditure on capitalised development, other intangible assets and property, plant and equipment	(90.1)	(78.9)
Disposals of property, plant and equipment in the ordinary course of business	4.5	3.6
Headline operating cash-flow	**488.7**	564.8

Free cash-flow

	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m
Net cash inflow from operating activities	321.7	410.5
Expenditure on capitalised development, other intangible assets and property, plant and equipment	(90.1)	(78.9)
Disposals of property, plant and equipment	4.5	24.8
Investment in financial assets relating to pensions financing		(25.0)
Free cash-flow	**236.1**	331.4
Investment in other financial assets	(0.3)	(0.3)
Acquisition of businesses	(18.5)	(132.7)
Disposal of Aerospace	(6.2)	19.9
Disposal of businesses	3.9	1.1
Net cash-flow used in financing activities	(129.2)	(66.1)
Net increase in cash and cash equivalents	**85.8**	153.3

29 Acquisitions

During the period ended 31 July 2011, the Group acquired the detection sales, distribution and servicing business of Veecon IPA Gastchnik Limited (August 2010) and the entire issued share capital of SDBR Comercio De Equipamentos De Seguanca LTDA (May 2011) on behalf of Smiths Detection. The acquired businesses are the Indian and Brazilian distributors for Smiths Detection, and this will continue to be their principal business activity. The acquisitions give Smiths Detection direct control over sales of its products in two major fast-growing economies.

The consideration for these acquisitions comprises:

- cash of £12.0m;
- fixed deferred consideration of which £1.5m is outstanding at 31 July 2011. This is due to be paid over the next two years;
- contingent consideration based on the sales the acquired businesses achieve over the next five years. This consideration is denominated in US dollars. The fair value of $14.7m at acquisition has been calculated using probability weighted forecasts of potential future sales by target customers and market sectors. The maximum potential contingent consideration payable is $23.0m; and
- non-equity shares in one of the new subsidiaries, which were valued at £3.5m on acquisition.

From the date of acquisition to 31 July 2011, the acquisitions contributed £15.1m to revenue, £1.6m to headline profit before taxation and £0.1m to profit before taxation. If Smiths had acquired the businesses at the beginning of the financial period, the acquisitions would have contributed £19.4m to revenue and £1.7m to headline profit before taxation.

The intangible assets recognised comprise £4.1m in respect of customer relationships, orders and contractual non-compete arrangements with the vendors. The assets recognised include the current value of the maintenance contracts acquired. Goodwill represents the value of future growth opportunities in these markets. The goodwill recognised is not expected to be deductible for tax purposes.

The values set out below are provisional pending finalisation of the fair values attributable and working capital adjustments, and will be finalised in the year ending 31 July 2012.

	Book value £m	Fair value adjustments £m	Acquisitions Provisional fair value £m
Intangible assets		4.1	**4.1**
Property, plant and equipment	0.3		**0.3**
Current assets	0.9		**0.9**
Non-current liabilities		(1.4)	**(1.4)**
Net assets acquired	1.2	2.7	**3.9**
Goodwill on current year acquisitions			**22.4**
Total consideration			**26.3**
Cash paid during the period – current year acquisitions			**12.0**
Deferred consideration – current year acquisitions			**10.8**
Other financial instruments – current year acquisitions			**3.5**
Total consideration			**26.3**

30 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:

2008 Value Sharing Plan (2008 VSP)

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

2010 Value Sharing Plan (2010 VSP)

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

30 Employee share schemes continued

Smiths Group Co-Investment Plan (CIP)

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

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

	CIP	Long term incentive plans	Other share schemes	Total	Weighted average price for option plans £
Ordinary shares under option ('000)					
1 August 2009	990	3,339	9,020	13,349	£5.83
Granted	412		248	660	£3.32
Update of estimates		(241)		(241)	£0.00
Exercised	(430)	(130)	(1,643)	(2,203)	£6.18
Lapsed	(95)	(1,198)	(1,193)	(2,486)	£5.53
31 July 2010	877	1,770	6,432	9,079	£6.15
Granted	730	785	123	1,638	£0.78
Update of estimates		122		122	£0.00
Exercised	(216)	(517)	(1,744)	(2,477)	£6.28
Lapsed	(51)	(303)	(373)	(727)	£6.46
31 July 2011	**1,340**	**1,857**	**4,438**	**7,635**	**£5.37**

Options were exercised on an irregular basis during the period. The average closing share price over the financial year was 1,240.24p (2010: 1,000.61p). There has been no change to the effective option price of any of the outstanding options during the period.

Range of exercise prices	Total shares under option ('000)	Weighted average remaining contractual life (months)	**Options exercisable at 31 July 2011 ('000)**	Options exercisable at 31 July 2010 ('000)	**Exercisable weighted average exercise price for options exercisable at 31 July 2011**
£0.00 – £2.00	3,197	18			**£0.00**
£2.01 – £6.00	532	27	**2**	2	**£5.69**
£6.01 – £10.00	2,786	40	**2,106**	1,667	**£8.19**
£10.01 – £14.00	1,120	73	**907**	51	**£10.97**

For the purposes of valuing options to arrive at the share-based payment charge, the Binomial option pricing model has been used for most schemes and the Monte Carlo method is used for schemes with total shareholder return performance targets. The key assumptions used in the models for 2011 and 2010 are volatility of 30% (2010: 30%) and dividend yield of 3.33% (2010: 3.75%). Assumptions on expected volatility and expected option term have been made on the basis of historical data, for the period corresponding with the vesting period of the option. These generated a weighted average fair value for CIP of £12.40 (2010: £9.45) and VSP of £13.86 (2010: £11.21). The fair value disclosed for the CIP award treats the two matching shares as separate options.

Included within staff costs is an expense arising from share-based payment transactions of £13.8m (2010: £11.3m), of which £13.8m (2010: £10.3m) relates to equity-settled share-based payment.

At 31 July 2011 the creditor relating to cash-settled schemes is £0.6m (2010: £0.9m).

31 Events after the balance sheet date

On 2 September 2011 Smiths Interconnect agreed to purchase Power Holdings Inc. a leading designer and manufacturer of specialist power distribution, conditioning and monitoring systems. The purchase price of $235m will be subject to post closing adjustments with respect to working capital at completion. The acquisition is subject to regulatory approval.

On 17 August 2011 John Crane agreed to purchase the business and assets of Turbo Components and Engineering Inc. ("TCE") which services, repairs and builds replacement bearings and seals used in critical rotating equipment. The purchase price of $20m will be subject to post closing adjustments. TCE has gross assets of approximately $3.2m and expected sales of $10m for the current calendar year. This acquisition is subject to regulatory approval.