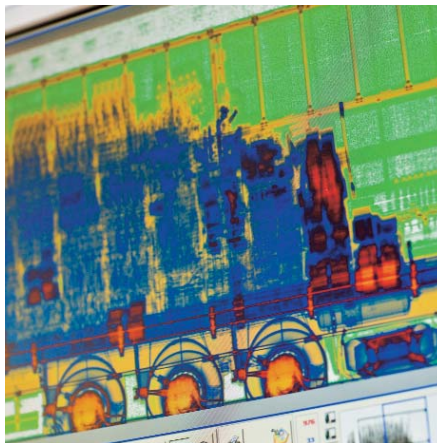


Annual report
Year ended 31 July 2008
Opportunities to create value



Smiths Group plc

Smiths is a global technology company listed on the London Stock Exchange. A world leader in the practical application of advanced technologies, Smiths Group delivers products and services for the threat and contraband detection, energy, medical devices, communications and engineered components markets worldwide. Our products and services make the world safer, healthier and more productive.

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Headline* results for continuing operations

	2008		2007	
	Sales £m	Profits £m	Sales £m	Profit £m
Detection	509	85.6	438	78.6
Medical	703	127.8	691	127.3
Specialty Engineering:				
– John Crane	626	95.9	532	75.3
– Specialty – Other	483	71.3	500	66.4
Total sales	2,321		2,161	
Headline* operating profit		380.6		347.6
Interest		(41.0)		(36.4)
Pensions financing		41.7		33.7
Post-tax loss of associate		(1.0)		(0.5)
Headline* pre-tax profit		380.3		344.4
Headline* earnings per share (basic)		74.5p		47.0p

*Before exceptional items (including impairment of assets), amortisation of acquired intangible assets, profit or loss on disposal of businesses and financing gains or losses from currency hedging.

Statutory results for continuing operations

	2008		2007	
	Sales £m	Profits £m	Sales £m	Profit £m
Detection	509	85.0	438	65.1
Medical	703	106.1	691	106.0
Specialty Engineering:				
– John Crane	626	38.8	532	1.3
– Specialty – Other	483	95.8	500	60.7
Profit on sale of financial assets				24.0
Total sales	2,321		2,161	
Operating profit/(loss)		325.7		257.1
Interest		(41.0)		(36.4)
Pensions financing		41.7		33.7
Share of post-tax loss of associate		(1.0)		(0.5)
Financing gains/(losses)		(6.1)		2.1
Pre-tax profit		319.3		256.0
Earnings per share (basic)		63.0p		36.9p

The purpose of this Report is to provide information to the members of the Company. The Annual Report contains certain forward-looking statements with respect to the operations, performance and financial condition of the Group. 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 Annual Report and the Company undertakes no obligation to update these forward-looking statements. Nothing in this Annual Report should be construed as a profit forecast.

Opportunities to increase value

Smiths has opportunities to create value for shareholders by improving performance and growing our businesses.

Expand our margins through a programme of self help

Taking advantage of opportunities

Self help is taking many forms at Smiths. To improve efficiency and remove a layer of management the Smiths Specialty Engineering division has been disbanded. To improve customer focus, operating divisions' headquarters are relocating from London to be close to their operations. To reduce costs and improve lines of accountability the corporate centre has been halved in size, focusing its activities where it can add value. To improve service levels and deliver the necessary data and information a new Global IT Service Delivery organisation has been created.



Support top-line growth by increasing manufacturing and service capacity

Expanding capacity for airport checkpoint systems

Over the past year, Smiths Detection has deployed new checkpoint X-ray machines that for the first time automatically detect explosives and liquids in carry-on bags. Now located in most major UK airports, these aTiX systems are being rolled out in the USA and globally. To achieve the necessary manufacturing capacity to meet this demand, the Smiths Detection facility in Wiesbaden, Germany, has been expanded substantially. In less than 12 months, the team has designed and completed an extension dedicated to the production of new equipment such as the aTiX system.



Create top-line growth by expanding activity in developing markets

Building capacity in Asia

Flex-Tek is broadening its footprint in Asia, where its existing plant in Malaysia continues to expand. Over the past year it has added to this with new manufacturing facilities in Bangalore, India, in the Clark Special Economic Zone, Philippines and Changzhou, China. The facilities in India and Philippines are aimed at better serving its aerospace customers, following increased demand due to the growth of air traffic in Asia. The facility in Changzhou is focused on the growing HVAC and household appliance market in China.

Deliver efficiencies by restructuring our organisation and using our scale more effectively

Creating one global John Crane

A project launched in June 2008 is bringing together the two geographic John Crane organisations. Unifying John Crane – with a head office located in Morton Grove, US – will enhance performance and improve customer service, while implementing a truly global product portfolio. The leadership team is creating an organisation that can more effectively deliver state-of-the-art solutions anywhere in the world. In this way John Crane has the capacity to provide customers with a global operations platform, assuring rapid delivery of products while improving service support capabilities.



Grow our technology and geographic footprint through bolt-on acquisitions

Expanding in the world's major telecoms market

Some 70% of the world's wireless telecommunications infrastructure equipment is manufactured in China. To expand its footprint in the region, Smiths Interconnect acquired Allrizon, a Shanghai-based communications equipment firm. Allrizon together with Triasx – an Australian based business also with Chinese operations and acquired recently – complement and extend Smiths Interconnect's microwave business. They add not only Chinese manufacturing capacity but also strong design teams and good relationships with key wireless telecoms infrastructure customers.



Drive growth in our technology businesses by investing in targeted R&D

Developing new medical products

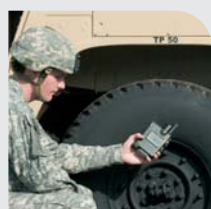
Smiths Medical is increasing R&D in order to boost new product development. With a strong pipeline in place, new products are reaching the market. Recent innovations include UniPerc™, a unique tracheostomy tube designed for patients with larger necks – a problem increasingly faced by clinicians due to rising obesity levels among patients. When it comes to delivering medication, the new Medfusion 4000™ system helps to treat patients with cancer and painful conditions. It features wireless connectivity to enable clinicians to monitor the performance of the machine remotely.

Smiths Group: A global business



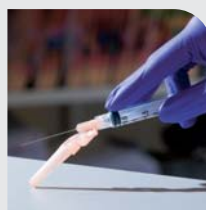
Flex-Tek Piloting a new EHS programme in Tennessee, USA

Flex-Tek business Tutco, based in Cookeville, Tennessee, is piloting a new Environment Health and Safety programme in a drive to become OHSAS 18001 certified. The programme seeks to eliminate injuries and reduce hazards in the workplace. The results are already encouraging as the number of recordable injuries has been reduced to zero and recordable incidents have reduced by 25%, while operating costs at the facility have also been cut.



Smiths Detection Manufacturing expansion in Maryland, USA

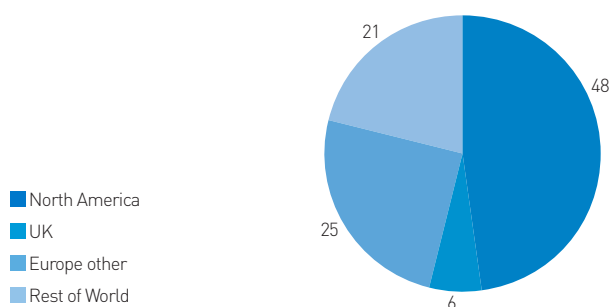
Smiths Detection has expanded its manufacturing capacity at its Edgewood site by 50% to fulfil increased demand from the US Department of Defense Chemical Biological Protection Shelters (CBPS) programme. CBPS provides contamination free, environmentally controlled working areas for medical and combat services personnel in operational circumstances.



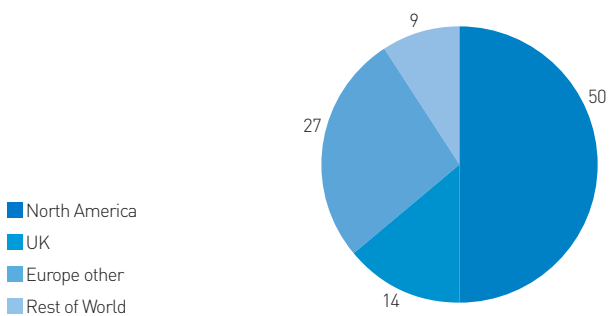
Smiths Medical Automation in New Hampshire, USA

Each year around 150 million safety needles are produced at our Smiths Medical manufacturing facility in Keene. This is largely thanks to an investment in advanced high-speed automated robotics which has yielded record production rates, helping to reduce back orders at the facility to zero.

Group sales by destination %



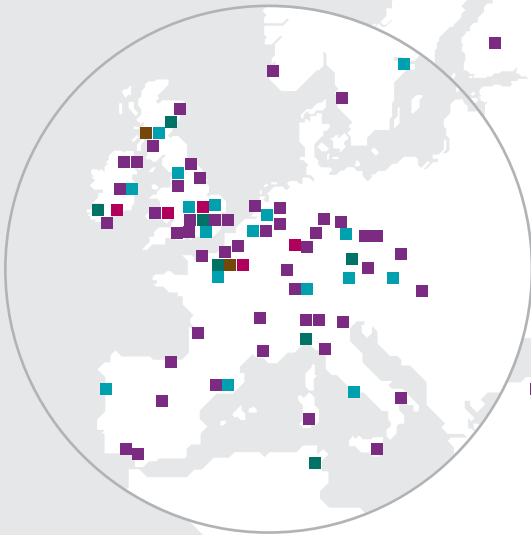
Location of assets %



Analysis excludes cash and cash equivalents

Smiths Group major manufacturing and service locations by division

- Smiths Detection
- John Crane
- Smiths Medical
- Smiths Interconnect
- Flex-Tek



Smiths Interconnect Opening up in Tunisia

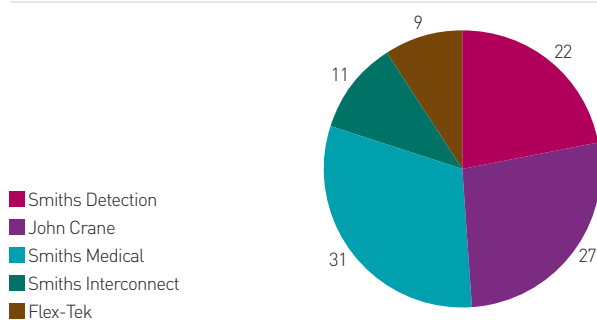
Smiths Interconnect recently opened a new low-cost manufacturing facility in Tunisia to serve its European customers. The facility consolidates and expands manufacturing capacity for connectors which are deployed in military, commercial avionics, medical, space, and test and measurement applications.



John Crane Servicing customers in Saudi Arabia

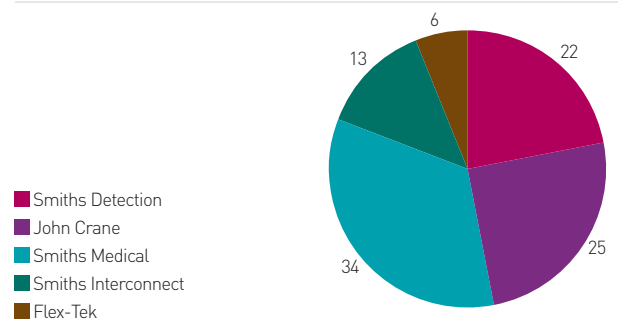
John Crane is expanding its global service and support network. In addition to opening new facilities in Finland, Dubai and Morocco, it has inaugurated a new service centre and training facility in Saudi Arabia for Middle East customers.

Divisional sales %



Analysis is based on revised operating structure for 2008/09 (see page 72)

Divisional headline operating profit %



Analysis is based on revised operating structure for 2008/09 (see page 72)
Percentage relates to headline operating profit before corporate costs

Smiths divisions

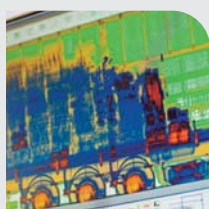
Smiths Group has five divisions: Smiths Detection, John Crane, Smiths Medical, Smiths Interconnect and Flex-Tek. Our businesses are highly competitive, with strong technology positions, and operate in sectors with excellent opportunities for growth.

Smiths has evolved substantially since its foundation. Now employing over 22,000 people in more than 50 countries, we serve a diverse range of global customers including governments and their agencies, petrochemical companies, hospitals, telecommunications companies and manufacturers in a variety of sectors around the world.

We bring technology to life.

Smiths Detection

Smiths Detection is a world-leading designer and manufacturer of sensors that detect and identify explosives, narcotics, weapons, chemical agents, biohazards and contraband.



Contribution to 2008 sales*

22%

Contribution to 2008 headline operating profit**

22%

Growth opportunities

- Bring new technologies to market
- Develop biological and millimetre wave detection technology
- Seek acquisitions
- Deliver efficiencies: implement single enterprise wide software system and smarter sourcing initiative

Customers

Our technology is deployed at nearly 80% of the world's commercial airports. Some 85% of sales are influenced by more than 100 governments and their agencies globally, including homeland security authorities, customs authorities, emergency responders and the military. This includes the US Department of Defense, US Transportation Security Administration (TSA), UK Ministry of Defence, and airport operators such as BAA in the UK.

Key strengths

- Global market growth
- Strong technology positions
- Good access to growing markets
- Investment in R&D increasing

Employees

2,300

With governments seeking more advanced ways to counter terror threats, our world leading X-ray screening equipment is continuously evolving to help keep passengers safe across the globe.

John Crane

John Crane is a world-leading provider of products and services for the major process industries, these include the oil and gas, chemical, pharmaceutical, pulp and paper, and mining sectors.



Contribution to 2008 sales*

27%

Contribution to 2008 headline operating profit**

25%

Growth opportunities

- Creation of a single John Crane customer-facing organisation
- Expand technology footprint through acquisitions
- Build new upstream services business that uses existing global customer service network
- Increase original equipment sales and manufacturing capacity and extend global customer service network

Customers

John Crane serves oil and gas companies, refineries, pump and compressor manufacturers, chemical and other process industries. Its main customers include BP, Chevron, China Petroleum, ConocoPhillips, ExxonMobil, Gazprom, Qatargas, Saudi Aramco, Shell, Total, Dresser, Elliot, Flowserve, GE Nuovo Pignone, ITT, Mitsubishi, Siemens, Solar turbines, Sulzer, York, BASF, Bayer, Dow, Koch Industries and Lyondell.

Key strengths

- Two-thirds of revenue from after-market service
- Market leader in its field, blue chip customer base
- Largest segment is fast-growing petrochemical industry
- Good positions in key growth markets

Employees

6,400

In the petrochemical industry, our advanced mechanical seals are deployed on oil and gas pipelines and refineries, helping to deliver energy efficiently to millions of homes and businesses around the world.

*Analysis is based on revised operating structure for 2008/09 (see page 72)

#Percentage relates to headline operating profit before corporate costs

Smiths Medical

Smiths Medical is a leading supplier of specialist medical devices and equipment for global markets. Our products are focused in the medication delivery, vital care and safety devices market segments.



Customers

We estimate that around three-quarters of our end customers are hospitals with the remainder comprising the alternate care market such as home care and other surgery centres. We have a direct sales presence in 20 countries with distribution arrangements in many others.

Key strengths

- Consistent market growth
- Global sales & marketing network
- Established brands with practitioner loyalty
- Increasing roll-out of new products
- Focusing increased R&D investment on higher growth segments and markets

Employees
8,400

Contribution to 2008 sales*
31%

Contribution to 2008 headline operating profit**
34%

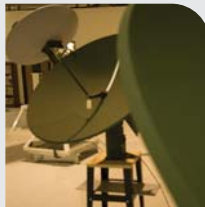
Growth opportunities

- Ageing population and increasing prosperity
- Safety legislation and regulation
- Healthcare industry productivity needs and increasing use of IT
- Leverage global product development process and increase percentage of sales from products under three years old
- Scope to reduce costs and improve margins

In healthcare, our products help prevent needlestick injuries and reduce the risk of cross infections, while our revolutionary medication delivery equipment helps to ease patients' pain and prevent accidental overdoses.

Smiths Interconnect

Smiths Interconnect designs and manufactures specialised electronic and radio frequency products that connect, protect and control critical systems for the global wireless telecommunications, aerospace, defence, space and medical markets.



Customers

Smiths Interconnect supplies to multiple levels of the supply chain and its blue chip customers include primes and service providers, OEMs and system suppliers, and sub-system manufacturers. Amongst our largest customers are Raytheon, Finmeccanica, BAE Systems, AAI/Textron, Northrop Grumman, Ericsson, Motorola, Sprint Nextel, ZTE, GE Medical and Alstom.

Key strengths

- Technical differentiation providing barriers to entry for competition
- Strong brands recognised by customers as partners and solution providers
- Excellent military programme positions
- Positive market dynamics in wireless infrastructure and defence

Employees
3,100

Contribution to 2008 sales*
11%

Contribution to 2008 headline operating profit**
13%

Growth opportunities

- Expand globally from US base
- Leverage market knowledge and customer relationships throughout the business
- Add new technologies and territories through bolt-on acquisitions from fragmented sector
- Rationalise manufacturing and accelerate move to lower costs

In communications, our sophisticated technology helps to keep people and systems connected and protected.

Flex-Tek

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



Customers

Flex-Tek serves mainly domestic appliance manufacturers and the US construction industry. Its large customers include Whirlpool, Trane, Pratt & Whitney, Carrier, Boeing, Electrolux, Respiroics, GE Aerospace, Airbus, Panasonic, Hoover and Dyson.

Key strengths

- Lean manufacturing culture
- Good performance in markets other than US construction market, civil and military aircraft demand rising

Employees
2,400

Contribution to 2008 sales*
9%

Contribution to 2008 headline operating profit**
6%

Growth opportunities

- Expand non-construction market activities eg aerospace and medical
- Exploit growth potential in Asian industrial and appliance markets
- Further rationalise sites

Our engineered components heat and move fluids in a wide range of different industries from aircraft and racing cars to medical devices.

Summary performance

Sales +7%

£2,321m

Headline pre-tax profit +10%

£380m

Statutory pre-tax profit

£319.3m

Headline earnings per share

74.5p

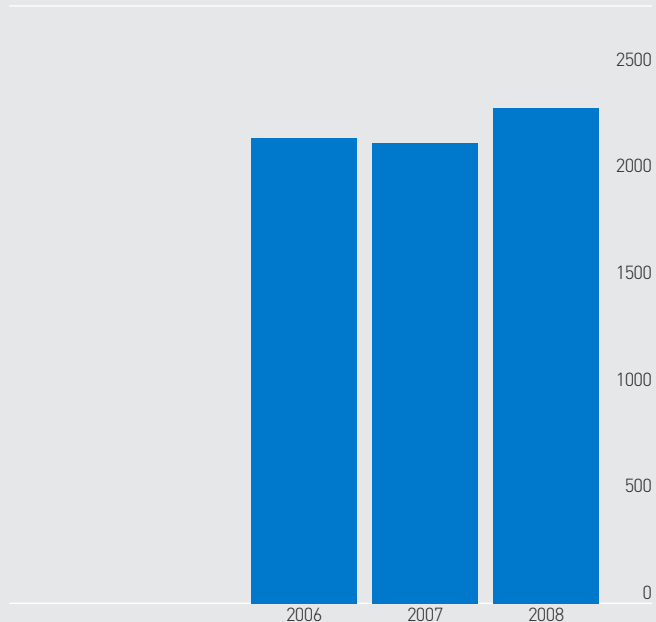
Dividend per share

34.0p

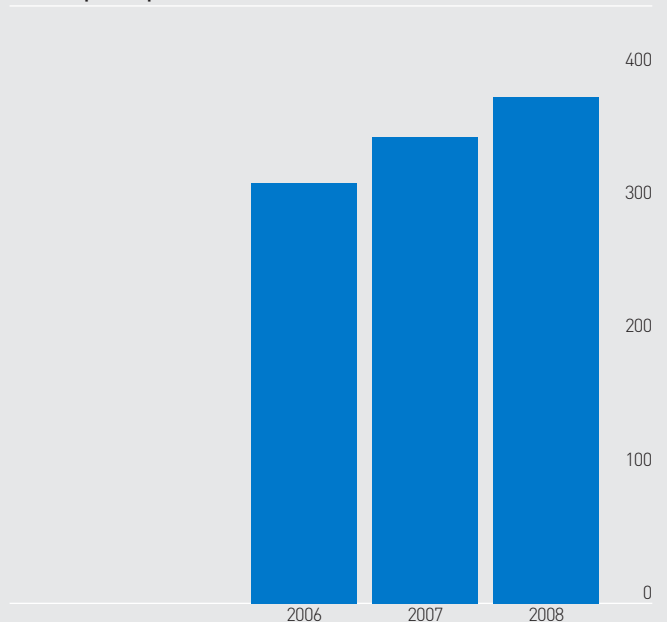
Statutory earnings per share

63.0p

Sales £m



Headline pre-tax profit £m



Chairman's statement

As I indicated in last year's report, the Board appointed Philip Bowman as Chief Executive of the Group in December 2007. Philip brings a new energy to the Group and already some significant changes to the operation of the Group have been announced following his initial review at all levels. All businesses benefit from fresh eyes and the Board has been delighted by the way in which Philip has further energised the management team.

Each of the Group's businesses brings technology based products and solutions to a range of highly sophisticated customers. The Board has continued to ensure that these customers are to be found in areas of significant and profitable growth opportunity including security, oil & gas, medical devices and wireless communications. These opportunities have to be turned into value for our shareholders and to this end the Chief Executive has instigated major changes that are aimed at substantially increasing value creation across the Group's portfolio of businesses.

The programme of changes set out in the Chief Executive's statement and the other narrative in this report explain these opportunities and how they will be exploited. The Board has encouraged the new approach to ensure that operationally the Group develops its potential to the full. At the forefront of this structure is clear delegated accountability for achievement in each of our businesses with executive reward clearly linked to value creating performance.

The smaller corporate centre of the Group guides the strategy and leverages benefits of scale across the Group. It retains the task, on behalf of the Board, of ensuring that the divisions comply with all of the systems and processes that protect shareholders' interests. Each division will now hold monthly Divisional Board Meetings: included on these boards will be an Investor Director from one of the Chief Executive's direct reports who will have a mandate that includes monitoring compliance with Group policies.

The business leadership teams deliver the operational performance which translates into improved shareholder returns. This clarity is important in developing a more performance-driven culture in Smiths. There is a corresponding increase in the demands made of all management to perform.

On 28 July, an Extraordinary General Meeting of shareholders adopted proposals that substantially change how the senior teams both at the centre and in each of the divisions are rewarded. These changes place a premium on the creation of shareholder value. They strengthen the link between pay and performance, they link remuneration to long-term value creation at divisional level and they provide exceptional reward only if there is exceptional performance.

In the past year there have been notable operational projects across the business as a whole addressing new customers and generating new products. Examples from across the businesses of these are to be found in this report; but it would be wrong at this time, when everyone is focused on safety, not to mention the major breakthrough achieved by our Detection business with its new aTix system security machines which are now being rolled out from Heathrow Airport in the UK to airports all around the world. It is a relief not to have to take out laptops where these machines are installed!

I have said in past reports that the Board is mindful of its role as guardian of shareholders' money. As well as ensuring operating excellence the Board remains restless in its hunt for shareholder value and will continue to monitor each of our businesses to ensure that the Group is their most appropriate owner.

The past year has seen a number of changes to the composition of the Board. On the executive side, the arrival of Philip Bowman in December 2007 was preceded by the retirement of Keith Butler-Wheelhouse, as I discussed last year. In addition, David Lillycrop resigned from the Board in June 2008, standing down from his role as General Counsel and Company Secretary. David had been a member of the Board since the merger with TI Group and I would like to thank him for his major contribution to Smiths Group and for the help he has given me.

On the non-executive side, in April 2008 Peter Loescher resigned as a non-executive director at his own request so that he could concentrate on his responsibilities as Chief Executive of Siemens AG. The Board benefitted from his wisdom and wish him well in his executive role.

At the half year we explained that in light of the prevailing market conditions and the scope for investment in organic growth and acquisitions, the Board intends to grow dividends consistent with increasing cover to around 2.5 times in the medium term. As a result the interim dividend was unchanged year-on-year.

The Board has considered the final dividend in the light of this policy and has decided to propose a dividend of 23.5p, making a total of 34.0p for the year, unchanged from last year.

The final dividend will be paid on 21 November to shareholders registered at the close of business on 24 October. The ex-dividend date is 22 October.

This report is being published at a time of turmoil in financial markets and anxieties for world growth. This is putting pressure on sales and margins for many businesses. It is not by chance that Smiths Group is positioned in markets that the Board believes are better equipped to resist the pressures of a global downturn. Neither the Board nor management are complacent and the businesses have embarked on an extensive programme of self-help that aims over the course of the next 24 months not only to withstand any effects from the downturn but also to deliver increased value to shareholders. The Group remains therefore both strong and dynamic.

Donald Brydon
Chairman



Chief Executive's statement

We have delivered strong sales and profit growth driven by good performances from John Crane, Smiths Detection and Smiths Interconnect. A performance improvement programme is underway to address the operational issues that have held back Smiths Medical over the past two years.

The portfolio has been strengthened this year through one divestment and seven acquisitions which bring new technologies and extend Smiths geographic footprint – particularly in developing markets.

Our focus is on top-line growth and margin enhancement while there are significant opportunities to improve performance and generate value across the Group. We have begun a substantial restructuring programme that will deliver operating efficiencies and improve customer service. The scale of the opportunities is demonstrated by the new divisional targets set out here for the first time.

The sustained upheaval in the world economy is creating uncertainty in many markets and may disrupt government spending patterns – particularly in the US and India where there are forthcoming elections. However, Smiths Group is well placed among global businesses to meet these challenges.

Looking at this year's results, sales rose by 7% and the headline pre-tax profit increased by 10%; after adjusting for currency translation and acquisitions and disposals the underlying improvement was 6% and 8% respectively. The headline numbers exclude various exceptional items which are detailed in the Business Review; one of these is a charge of £40m in respect of John Crane, Inc. litigation, a full explanation of which is on page 29.

Since joining Smiths some nine months ago, I have undertaken a thorough review of operations. It is a Group with a strong set of technology-based businesses applying some of the world's most advanced industrial sciences – from airport X-ray scanning machines to mechanical seals for the oil industry. In addition, the businesses operate in markets sustained by long-term secular growth: Smiths Medical's market is growing as populations age and increase in prosperity, John Crane by energy consumption, and Interconnect by the need for increased bandwidth and upgraded wireless infrastructure. Smiths Detection is driven by demand for increased security and protection. Although Flex-Tek is exposed to more cyclical markets such as US housing, it has a portfolio of high-performance products that supply the aerospace market.

My review of operations identified significant opportunities to improve performance progressively over a two-year period and maximise value for shareholders. To deliver these benefits, the Board has already taken some key decisions:

- manage the Group as five divisions from 1 August 2008 and restructure each to improve customer service and deliver efficiencies;
- restructure and reduce the corporate centre to cut cost and focus it on delivering returns from the business;
- improve business systems and data-flow which, over time, will support data-driven decision-making and enable the Group to be more responsive to changing market conditions and opportunities;
- build the business through acquisitions which will add complementary technologies, expand the geographic footprint or leverage existing scale;
- increase investment in research and development and focus it more intensely on higher growth areas that will deliver greater returns; and
- introduce an incentive scheme for senior management that reinforces our new culture of performance improvement and delivery against recently established divisional targets.

In June, we announced that the Specialty Engineering division would be disbanded so that its three constituent businesses – John Crane, Interconnect and Flex-Tek – report directly to me. This reduces cost and gives greater accountability to each of the businesses. In addition, all Smiths divisions will now be managed from divisional headquarters that are closer to their operations, key markets and customers.

We also aim to realise value by restructuring the divisions themselves. For example, John Crane which had historically been managed as two separate operations from the UK and US, is now combined under the leadership of Paul Cox and headquartered at Morton Grove, near Chicago. In Medical, the management structure in the US will be simplified and we will introduce a global approach to R&D. There are also further opportunities to re-organise Flex-Tek's portfolio of businesses to drive efficiencies and improve operational effectiveness.

At the same time, we have defined more clearly the roles of the divisions and their interface with the corporate centre. These changes will reduce substantially the size of the corporate office and improve the way we work by introducing better defined governance and decision-making. The small head office will concentrate on three areas: setting the Group's strategic direction and capital allocation; leveraging the Group's scale where appropriate; and ensuring compliance as a UK-listed company. In future, we will report the corporate centre costs separately which will give greater clarity to the underlying margins of the divisions and provide a clear incentive to minimise corporate costs.

Taken together, these restructuring programmes are expected to deliver annual cost savings of £47m once they are complete in three years time. The cost of delivering these programmes will be £48m which will be treated as an exceptional item. Further details are given in the divisional reviews.

We are also investing more to improve data-flow and speed up decision-making through the implementation of better information systems. For example, ERP systems are currently being deployed in Detection, John Crane and Medical. At a Group level, a new information platform is being introduced which will help capture operational data from the divisions. This creates opportunities to leverage the scale of the Group for the first time by group-wide procurement of travel, IT, and other services. We have already launched a programme to consolidate IT service delivery across the Group, improving service quality and cutting costs. We have also signed a deal with AT&T to supply a range of communication services such as mobile telephones, remote access, etc. which will deliver annual savings of at least \$5m.

Our management team has also been strengthened. Reflecting the importance of the IT investment, Brian Jones has joined us as Chief Information Officer. He brings many years' experience in implementing ERP systems and improving information flow within large organisations. Michael Herlihy has been appointed General Counsel and is also a member of the Executive Committee and Peter Durman has joined to lead an invigorated investor relations programme. The mix of talent at Smiths will continue to be refreshed and reinforced with external appointments bringing different competencies and innovative ideas to the Group.

There are valuable opportunities to build Smiths through bolt-on acquisitions – particularly in John Crane, Interconnect and Detection. Such acquisitions bring complementary technologies, support geographic expansion or leverage existing infrastructure. John Crane acquired Indufil, a specialist in filtration systems, and Sartorius Bearing Technology, a leading provider of high performance rotating equipment for the oil and gas industry; both have added valuable new technologies that can be leveraged through John Crane's global network of more than 220 sales and service centres. John Crane also acquired Fiberod which further extends our upstream energy services capability and complements the CDI acquisition made last year. In addition, John Crane expanded its presence in Japan, the world's second largest market for OEM pump manufacturers, by increasing its ownership share of John Crane Japan from 49% to 70%. In Interconnect, the acquisitions of Shanghai-based Allrizon Tongguang and Brisbane-based Triasx Pty Ltd have strengthened its position in the growing Asian market. Flex-Tek's acquisition of Fast Heat has extended its range of specialty heating solutions.

We are also driving higher levels of revenue growth organically through an increase in research and development (R&D) investment focused more tightly on growth areas that can deliver the most attractive returns. R&D investment for the Group increased by 8%, or £7m, to £86m. In Detection, our spend has been focused on X-ray detection systems for both airports and cargo screening, while we have extended our portfolio of chemical and trace detectors. We are at the cutting edge of a number of technologies – X-ray screening, millimetre wave imaging and biological detection. In Medical, we have launched a number of new products during the year as we begin to benefit from the introduction of a streamlined product development process. It has resulted in a 50% increase in the number of product launches this year.

To reinforce our new culture of performance improvement, we have established targets for sales growth and margins for each of the divisions. These are the ranges we anticipate the divisions will operate within over the next three years, based on organic growth at constant currency and assume a financial and macro-economic environment consistent with that of recent years. Alongside this, we have introduced a new incentive plan for senior management and divisional leadership. It more closely links remuneration with performance and, ultimately, value creation and places much greater accountability on the divisional leadership for the performance of their businesses. The new incentive plan means that each division will have its own targets to meet, reward will be bound together by one common currency, the Smiths share price. In that way we will reflect the value-creating performance of each division.

Sales

	2008* £m	2008 growth [#]	Target growth range [#]
Detection	509	12%	10-12%
John Crane	626	8%	6-8%
Medical	703	0%	3-5%
Interconnect	261	13%	6-10%
Flex-Tek	206	[4%]	0-7%
Total	2,305		

Headline operating profit

	2008* £m	2008 margin	Target margin range [#]
Detection	93	18%	17-20%
John Crane	104	17%	17-22%
Medical	140	20%	20-24%
Interconnect	54	21%	21-23%
Flex-Tek	24	12%	11-16%
Corporate centre	(35)		
Total	380		

*The above analysis reflects the revised operating structure for 2008/09, see page 72, and excludes three months of trading for Marine Systems which was sold in November 2007.

[#]Organic growth at constant currency

Delivering these returns will be a team effort and I would like to thank our 22,000 employees around the world for their hard work and support during a time of very real change both within Smiths Group and the wider economy.

In summary, I believe that most divisions have the opportunity to improve margins significantly. The greater responsibility, accountability and incentivisation of the divisional management teams, combined with the availability of better data to underpin management decisions, should progressively unlock value for the benefit of shareholders.

Philip Bowman
Chief Executive



Business review

Group activities

Smiths is a global technology business serving the detection, medical devices mechanical seals, electronic product and engineered component markets.

Strategy

Smiths is committed to creating long-term value for shareholders by building and sustaining strong businesses in growth sectors.

The Group's objective is to create value from organic growth and from reinvestment of self-generated cash-flow. Adjustments are made to the business mix through both acquisitions and disposals to enhance value for shareholders.

Performance of continuing operations

The continuing operations comprise the Detection and Medical divisions together with John Crane, Smiths Interconnect and Flex-Tek which until 31 July 2008 made up the Specialty Engineering division.

Following the restructuring of the roles of the divisions and the corporate centre set out in the Chief Executive's statement and the adoption of IFRS8 from 1 August 2008, the divisional information in this review will largely reflect the new operating arrangements in order to assist shareholder understanding.

The key Smiths performance indicators, which are closely monitored throughout the year and measured against pre-set targets, are:

- sales and headline profits;
- cash generation; and
- return on investment.

The table below shows the overall performance of continuing operations.

	2008 £m	2007 £m	Movement
Sales	2,321	2,161	7%
Headline:			
– operating profit	381	348	10%
– pre-tax profit	380	344	10%
– earnings per share	74.5p	47.0p	
Statutory:			
– operating profit	326	257	
– pre-tax profit	319	256	
– earnings per share	63.0p	36.9p	
Cash conversion	72%	75%	
Return on shareholders' funds (page 27)	16.7%	14.9%	

Sales

Sales increased by £160m to £2,321m. Currency translation on overseas sales contributed £46m of this increase while the net impact of acquisitions and disposals lowered sales by £6m.

On an underlying basis, excluding the effects of currency translation and acquisitions and disposals, sales increased by £120m or 6%. This £120m increase was driven by:

- Smiths Detection (£55m) reflecting the new contracts for airport checkpoint detection systems; high energy cargo screening and the Joint Chemical Agent Detector (JCAD);
- John Crane (£43m) as a result of strong demand from the petrochemical industry;

- Specialty – Other (£23m) – driven by Smiths Interconnect and its new contracts for USA 4G wireless broadband and new military programmes; and

- A decline of £1m in Smiths Medical reflects the operational challenges of supply chain disruption and product recalls.

Profit

Headline operating profit increased by £33m to £381m. Headline operating margin increased to 16.4% (2007: 16.1%). The £33m increase in headline operating profit comprises £7m from favourable currency translation, £3m from the net impact of acquisitions and disposals made during the year and a £23m, or 6%, increase in underlying headline operating profit.

The main drivers of the £23m underlying growth in operating profit are:

- John Crane (£10m) reflecting strong volume growth and price increases;
- Specialty – Other – comprising Interconnect and Flex-Tek (£9m) driven by volume and price;
- Smiths Medical (£2m) benefited from positive mix partly offset by higher costs as a result of supply chain problems and product recalls; and
- Detection (£2m) as a result of strong volume growth offset by adverse currency transaction and mix.

Operating profit on a statutory basis, after taking account of the items excluded from the headline figures was £326m (2007: £256m).

The net interest charge increased from £36m to £41m reflecting the prior year benefit of £18m of interest income from the proceeds of the Aerospace sale. There was a pensions financing gain of £42m (2007: £34m) which reflected the funding position of the company's retirement benefit schemes at July 2007.

Headline profit before tax increased by £36m to £380m. The Group's tax rate on headline profit for the period was 24.0% (2007: 25.1%). Headline earnings per share were 74.5p (2007: 47.0p). The comparison in earnings per share is distorted by the share consolidation carried out in June last year as part of the Aerospace disposal; on a pro-forma basis, earnings per share grew by 15%.

Cash generation

Headline operating cash flow totalled £273m, representing 72% of headline operating profit, and reflects investment in capital projects and increased working capital to support business growth. The working capital investment was particularly driven by the timing and nature of contracts in Detection and John Crane. Net debt has increased since July 2007 by £181m to £771m as a result of acquisitions and investment in fixed and working capital to support growth.

Outlook

Although the world economy is facing sustained upheaval and continued uncertainties, Smiths Group is well placed among global businesses to meet the challenges. Smiths Detection is expected to deliver growth although there is likely to be some variability in the timing and pattern of order flow – particularly in the US and India where there are forthcoming elections. John Crane and Smiths Interconnect will continue to benefit from their strong market positions. The creation of a unified John Crane also offers cost benefits and enhanced customer service in the future. The performance improvement programme in Smiths Medical is a key part of delivering better results. Flex-Tek will be held back by the recession in the US construction market.

Business review: Smiths Detection

Smiths Detection is a world leading designer and manufacturer of sensors that detect and identify explosives, weapons, chemical agents, biohazards, narcotics and contraband.

Our technology helps customers in the global transportation, ports and borders, critical infrastructure, military and emergency responder markets. We have the most comprehensive range of detection technologies in the world, including trace detection, millimetre-wave, infra-red, biological detection and diagnostics.

Employees
2,300

Principal operating regions

Our eight manufacturing centres are concentrated in North America, Germany, France and the UK. We sell to over 100 markets around the world either through a sales and marketing company or a third party distributor.

Customers

Our technology is deployed at nearly 80% of the world's commercial airports. Some 85% of sales are influenced by more than 100 governments and their agencies, including homeland security authorities, customs authorities, emergency responders and the military. These include the US Department of Defense, US Transportation Security Administration (TSA), UK Ministry of Defence, and airport operators such as BAA in the UK.

#Based on revised operating structure for 2008/09 (see page 72)

+Percentage relates to headline operating profit before corporate costs



Stephen Phipson
President

Contribution to 2008 Group sales#
22%

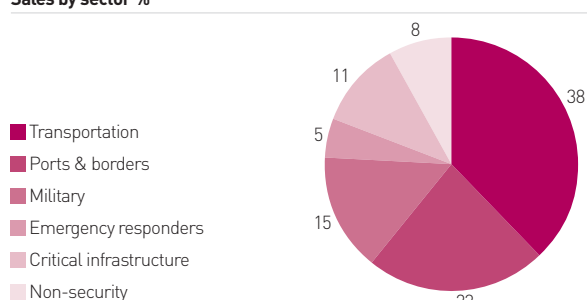
Contribution to 2008 Group headline operating profit#+
22%

Competitors

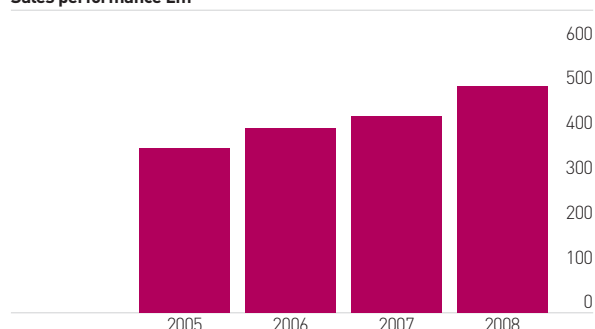
Data published by IMS Research* shows that, in the combined Transportation, Critical infrastructure and Ports & Borders sectors, Smiths Detection has a 29% market share, with GE Security (15.5%), L3 Security & Detection Systems (12.5%), Rapiscan Systems (8.5%) and Nuctech (8%) the main competitors. In the Military and Emergency responder markets (not included in this data), the main competitors are General Dynamics, Bruker, Environics and Canberra.

*The World Market for Explosives, Weapons & Contraband Detection Equipment 2007 Edition

Sales by sector %



Sales performance £m



Markets

Homeland security is a top priority in western countries, with 11% per annum market growth expected. The worldwide market for Smiths Detection products and services is estimated to be worth £3.5 billion.

Smiths Detection's products serve the transportation, critical infrastructure, ports and borders, military and emergency responder markets. The Group also adapts technology developed for these markets for carefully selected industrial applications in life sciences, food quality and safety.

The transportation sector, which includes airports, is the largest representing 38% of total sales. The airport security market is expected to grow in response to:

- projected growth in air traffic;
- new security threats; and
- customer pressure for faster throughput at checkpoints and an improved passenger experience.

The critical infrastructure market is diversified with varying growth rates in the different segments. Smiths Detection focuses on three key areas: mass transit, sports and events and government and military facilities. Smiths Detection has a growing involvement in helping protect a number of important metro systems in both the US and Europe.

The ports and borders market is a rapidly expanding sector driven by government objectives of enhancing security screening and protecting tax revenues. Customers require mobile and fixed units capable of detecting explosives, weapons, radioactive materials, narcotics and contraband.

The military market for UK and US technology is restricted by export controls, and these two governments form a large part of the market which is characterised by tendering opportunities for large individual contracts that typically run for several years. Smiths Detection intends to develop new business by expanding systems integration activity, offering improved functionality in protective shelters and introducing new technologies through government funded partnerships.

The emergency responder market is smaller than the others, with US sales accounting for more than 50% of global demand. This market is characterised by more localised purchasing decisions and steadier growth.

A possible future market is with biological detection and its application to veterinary diagnostics. Smiths Detection's expertise in producing rugged portable sensor equipment has enabled the development of a field-based device which can detect a range of animal infections such as foot-and-mouth and avian flu. It could also be developed for clinical applications.

The markets served by Smiths Detection are particularly influenced by specific events and the perception of the threat of terrorist activity or other security issues. This perception itself has been and is likely to remain variable.

Business review: Smiths Detection continued

Performance

	2008 £m	2007 £m	Reported growth	Underlying growth
Sales	509	438	16%	12%
Headline operating profit	86	79	9%	2%
Headline operating margin	16.8%	18.0%		
Statutory operating profit	85	65		

Reported sales grew by 16% and headline operating profit increased by 9%. Currency translation benefited sales by £17m and headline operating profit by £5m. On an underlying basis, excluding the impact of currency translation, sales grew by 12% and headline operating profit increased by 2%. The key drivers of growth were contract wins for airport checkpoint explosive detection systems, for cargo screening systems and for JCAD, the advanced chemical point detector. Headline operating margin declined from 18.0% to 16.8% reflecting the impact of currency transaction and the timing and mix of new contracts compared to last year. We also incurred additional costs associated with the scaling-up of our manufacturing to meet the strong customer demand for new products. The year-on-year impact of adverse currency transaction amounted to some £9m which, if excluded, would give an underlying operating profit margin of 18%.

The year had a very strong start with underlying sales growth of 21% compared with 6% in the second half. This is a result of winning some particularly large contracts in the first half of the year and some delays to contracts at the year end. It demonstrates the increasingly volatile nature of the order flow of this government contracting business. In addition, the strong growth in Detection, coupled with the increasing size and changing payment terms of the new contracts, has raised its working capital requirements.

In transportation, we have benefited from the introduction of a new generation of airport checkpoint explosive detection systems. Unlike conventional X-ray systems, this equipment captures multiple views of carry-on bags in a single sweep. The system also includes powerful software that helps the system operator detect potential threats and it can easily be upgraded to meet future threats. Smiths Detection has won substantial contracts in the UK and US for this new equipment which is helping airports to speed up passenger security checks. To support future demand, a new 4,000 square metre high-tech production plant was completed in Wiesbaden, Germany, in July. Overall, Wiesbaden produced a record 5,000 X-ray scanning units during the year.

Our results also benefited from strong demand in the ports and borders segment for advanced, high-energy cargo screening solutions to inspect inbound and outbound shipping containers and trucks. Deliveries to the Russian authorities from the St Petersburg facility were completed in December, while a major order from US Customs and Border Protection is now being fulfilled.

In the military segment, the recently developed JCAD programme has begun to roll-out with further orders received from the US Department of Defense. Orders totalling \$52.3m were received during the year. The JCAD is an advanced chemical point detector designed to help safeguard troops by automatically detecting, identifying and quantifying both chemical warfare agents and toxic industrial chemicals. We have begun to expand production in the US with an extension of our facility at Edgewood. Construction began in 2008 and is expected to be completed by January 2009.

The implementation of a new ERP system began during the second half following 18 months of planning and preparation. This single system will replace 14 legacy business software systems and provide a common information platform to support data-driven decision making. Nine sites in the military and emergency responder area went live with the new system in May 2008. The project is expected to conclude by the end of calendar year 2009. Investment to date has been £15m, with a total budget of £22m. We anticipate that once complete the project will generate efficiencies in working capital of £11m and annual cost savings of £8m.

Research and development

Smiths leadership in the sector is maintained by ongoing product innovation developed by in-house R&D, government-funded research and through partnerships and licences. Company-funded R&D increased by 10% to some £29m or 5.6% of sales (2007: 5.9% of sales). This includes £8m of capitalised projects. Smiths Detection actively seeks customer and government support for R&D which totalled £9m in the period (2007: £7m). Total R&D spend was £38m (2007: £33m) or 7% of sales.

Key R&D projects

X-ray screening continues to be a focus for our investment. This has supported the development of a new generation of cargo screening which will be launched in the coming year. We have also continued to invest in the development of our airport checkpoint explosive detection systems particularly to address new threats.

We have continued to invest heavily in chemical and trace detection. In September 2008, we launched two new handheld detectors for the military and emergency responder markets. High-Performance Radioisotope Identifier (HPRID) is our first portable handheld radiation detector which can be used for highly enriched uranium, plutonium and other radioactive substances. We also launched the Multi-Mode Threat Detector (MMTD), a portable device that detects a range of explosives including the materials most commonly used in homemade bombs.

Smiths Detection is developing technology that detects weapons, explosives and other potentially dangerous items concealed under layers of clothing without physical contact. The new system is based on patented millimetre-wave technology and creates video images that reveal a far wider range of concealed weapons and hazards than is possible with traditional people screening technologies. With trials and testing underway, the system will offer a fast and efficient way of scanning people as they enter airport checkpoints, high profile buildings or other facilities that require protection.

Diagnostics has also been an area of focus with the development of a portable biological detection system that enables veterinarians to carry out on-site diagnosis of animal diseases such as foot-and-mouth and avian flu. The technology is now being developed for clinical applications such as the detection and identification of MRSA, sepsis or other medical conditions.

Outlook

Looking ahead, the sector is set for continued growth and Smiths Detection should benefit from its leadership position and the roll-out of new technologies. We are well-positioned for future growth although the increasing size of contracts coupled with the irregular timing of government contracting – particularly where there are elections – may cause variability in the pattern of contract wins and working capital requirements from period to period.



New technology enhances cargo scanning

Our investment in R&D continues to drive advances in cargo screening. The HCV series of high-energy screening equipment identifies both contraband and security hazards hidden in trucks and other freight. The HCV Passthru, recently sold in the US, features advanced high throughput technology which can scan 200 trucks per hour, enabling customers to implement 100% cargo screening processes. The new Datasets Management System (DMS) enables customs officers to analyse images and information taken at the container's departure point remotely, allowing them to clear the container before its arrival in the destination country.

Business review: John Crane

John Crane is a world-leading provider of products and services for the major process industries, these include the oil and gas, chemical, pharmaceutical, pulp and paper, and mining sectors.

We help to enhance customer productivity by providing advanced technology mechanical products backed by an exceptional global service network.

Employees
6,400

Principal operating regions

John Crane is a global business with a presence in more than 50 countries.

Customers

John Crane serves oil & gas companies, refineries, pump and compressor manufacturers, chemical and other process industries. Its main customers include BP, Chevron, China Petroleum, ConocoPhillips, ExxonMobil, Gazprom, Qatargas, Saudi Aramco, Shell, Total, Dresser, Elliot, Flowserve, GE Nuovo Pignone, ITT, Mitsubishi, Siemens, Solar Turbines, Sulzer, York, BASF, Bayer, Dow, Koch Industries and Lyondell.

#Based on revised operating structure for 2008/09 (see page 72)

*Percentage relates to headline operating profit before corporate costs



Paul Cox
President

Contribution to 2008 Group sales#
27%

Contribution to 2008 Group headline operating profit#*
25%

Competitors

For rotating technologies in oil & gas, John Crane's main competitors are, Flowserve and EagleBurgmann Industries (mechanical seals), Kingsbury, Osborne Engineering & Waukesha (engineered bearings), Pall, Hydac and Boll (filtration systems), Thomas, Turboflex and Kopflex (couplings). For equipment in upstream energy John Crane's principal competitors include Weatherford, Norris, UPCO, Cameron and Quinn.

Markets

John Crane sustains the effective operation of customers' rotating equipment and other machinery with products that include mechanical seals, seal support systems, engineered bearings, power transmission couplings and specialist filtration systems. John Crane also helps maintain oil and gas productivity through the provision of down-hole pumping hardware. All this technology is supported by a global sales and service network that provides performance enhancing services. Using expertise developed from decades of experience, service teams in more than 50 countries maintain and support customer assets throughout their economic lifetime.

John Crane is experiencing strong demand for its products and services, particularly in the oil, gas and petrochemical sector, which is its largest market. John Crane's robust business model stems largely from the aftermarket, which represents two-thirds of revenue. At this stage in the capital investment cycle, the growth is in the sale of original equipment for new production facilities. This will provide aftermarket opportunities in the future, which are expected to generate attractive margins. Global capital spending in the energy sector is projected to continue growing in the long term in response to increasing energy demand.

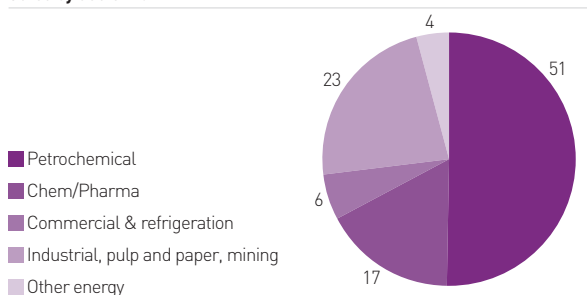
John Crane already has a global presence, with local service centres in more than 50 countries and hardware installed throughout the supply chain: for example, liquefied natural gas (LNG) produced in Qatar and ultimately drawn from the UK gas grid by consumers will have passed through John Crane seals and other technology at every point in its journey. It is building on this platform in two ways.

First, it is increasing its technological footprint by adding new product lines. These products typically also have a similar customer profile and have strong aftermarkets.

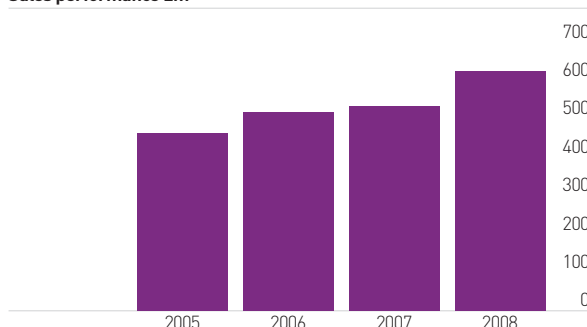
Second, there are approximately 850,000 wells around the world and many of these require oil and gas reserves to be brought to the surface using artificial lift. John Crane is broadening into upstream energy services which address a segment of this £700m per annum market and leverage John Crane's strong global service and support infrastructure.

Over the past 12 months there have been significant developments in both these areas. The markets for these products are experiencing significant growth resulting from the increasing consumption of oil. This growth is coming in both International and Domestic markets. In addition, we are also experiencing strong growth in the gas markets, as artificial lift systems are being used to de-water gas wells.

Sales by sector %



Sales performance £m



Performance

	2008 £m	2007 £m	Reported growth	Underlying growth
Sales	626	532	18%	8%
Headline operating profit	96	75	27%	12%
Headline operating margin	15.3%	14.1%		
Statutory operating profit	39	1		

John Crane grew reported sales by 18% and headline operating profit by 27%. Sales benefited from currency translation (£20m) and from acquisitions (£30m) giving underlying sales growth of 8%. Similarly, headline operating profit benefited from currency translation (£4m) and from acquisitions (£7m) leaving an underlying growth rate of 12%. Margins increased by 120 basis points to 15.3%. This strong growth has been driven by high levels of investment by the petrochemical industry, reflecting the strong global demand for oil and gas.

The growth in the petrochemical sector has increased original equipment orders to record levels. To help meet these requirements John Crane has invested over £5m worldwide to increase manufacturing capacity by over 20%.

The provision of maintenance and repair services to customers through the aftermarket represents two-thirds of John Crane's sales. The sale of original equipment for new production facilities creates subsequent aftermarket service opportunities that are delivered via John Crane's network of service centres, and the business has continued to build its global service base. Local service centres are now sited in 52 countries worldwide. This capability allows us to provide a range of added value services including repair, root cause analysis, alignment and condition monitoring, all designed to improve the performance of our customers' rotating equipment and reduce downtime. Current developments are focused on key growth markets. For example, in Saudi Arabia, we have a new service centre in Jubail and are building a new service, sales, training and manufacturing facility in Dammam. The Dammam facility features an upgraded gas seals test capability and adds significant service capacity in an area where extensive investment is planned by the petrochemical industry over the next 10 years.

Production capacity has been increased by the creation of a new 5,600 square metre, 60 person manufacturing facility in Mexico. This factory provides machining of seal parts, seal welding and assembly in support of the markets throughout the Americas. The increased capacity takes advantage of the low cost base and availability of skilled machinists in the Mexico City area, and is well positioned for future expansion.

Another growth opportunity is China where we expect to complete a new facility in Tianjin by the end of 2009. This will support further growth and enable the relocation and consolidation of two existing businesses to a single site. This new facility will accommodate sophisticated manufacturing including assembly, testing and enhanced product development, as well as providing a sales and service centre for the vast domestic Chinese market.

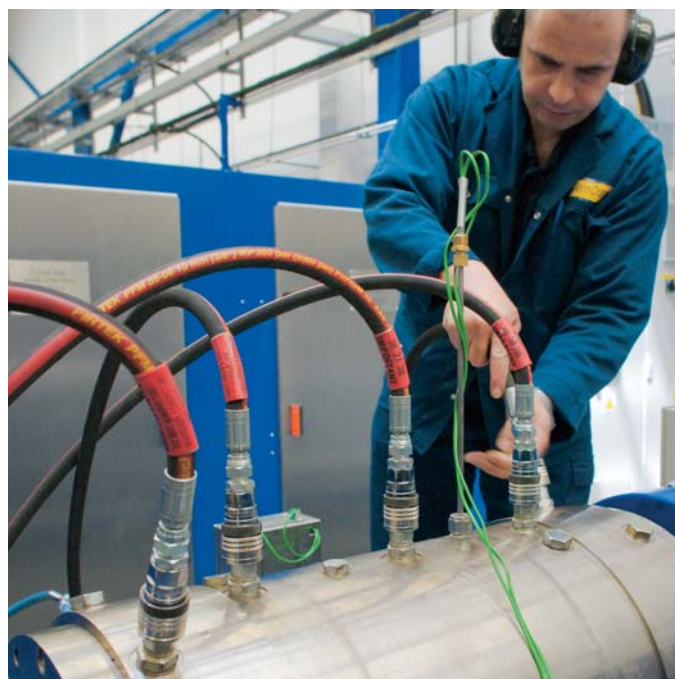
Major oil companies are making significant investments to develop the Canadian oil sands in northern Alberta and Saskatchewan, where the oil reserves are thought to equal those of Saudi Arabia. John Crane continues to add manufacturing capacity and support capabilities throughout its Canadian operations, particularly in Edmonton, to service the construction and maintenance of the refineries that bring this oil to market.

Helping ensure the world's oil and gas keeps flowing

John Crane invested £2.4m in a world-leading high pressure seal testing facility at its manufacturing site in Slough, UK. One of the most advanced of its kind in the world, the facility can test high specification mechanical seals under near-field conditions at pressures of up to 800 bar.

Using a new remote web-link the facility enables customers to witness their seals being tested in real-time from wherever they are in the world.

The facility is also being used by the John Crane R&D team to help develop new technologies, such as high-pressure seals that are increasingly requested by customers.



Business review: John Crane continued

Business developments

Our customers are increasingly demanding larger and higher pressure gas seals so we have invested in dry gas seal facilities in Slough, UK and Morton Grove, USA to support our customers' objectives. At the same time one of the world's most advanced high-pressure test rigs has come onstream.

In pursuit of its policy to increase its technological footprint, John Crane completed a number of bolt-on acquisitions. The acquisition of Sartorius Bearing Technology in November 2007 expands John Crane's offering into the area of rotating bearings for turbo machinery, while the acquisition of Indufil in March 2008 adds specialist filtration systems.

The bearing business is a leading provider of engineered bearings for high performance rotating equipment for the oil and gas industry based in Goettingen, Germany. The acquisition cost of £13m was satisfied in cash. Indufil was acquired for £71m and had sales of £25m in the financial year ending 31 December 2007. It designs and manufactures filtration systems for rotating equipment in the oil and gas, chemical and power sectors. Both businesses serve similar customers to John Crane with a strong aftermarket for their products, a combination which fits well with John Crane's business model.

The acquisition of CDI Energy Services in March 2007 expanded John Crane's upstream energy services capability. This was boosted in December 2007 with the acquisition of FiberComposite Company Inc (Fiberod) for £46m. In calendar year 2007, Fiberod reported sales of £12m. It is the world's leading manufacturer of fibreglass sucker rods, complementing the CDI service offering.

As a sign of our solid commitment to both the Japanese and the wider Asia Pacific markets, in December 2007 we increased our shareholding in John Crane Japan, a venture with Starlite Co Limited, to become the majority shareholder. The increased shareholding and operational control gives John Crane a greater presence in what is the second largest market after the United States. Our new majority shareholding will help us accelerate the levels of growth and investment in new technologies which we are able to make in Japan.

The implementation of a new ERP system is underway across Europe with 10 markets now successfully online. The project will be rolled out across Europe and then into the Middle East and Asia. Investment to date has been £17m out of a total project cost of £22.5m. The project is due for completion in June 2010 after which it should generate annual cost savings of £9.5m.

During the second half, we began a restructuring programme to create a global John Crane business by merging the two existing regional businesses. Through the creation of a global operations platform, we can provide better capacity and rapid delivery of products and services. We will also improve our service centre support capabilities and provide distributed global account management teams for greater co-ordination around the world. Going forward, the product line will be managed globally which will enhance service delivery to customers. The project is expected to cost £24m and deliver annual savings of £26m once complete. This initiative comes at a time when John Crane is strong and performing well, an ideal time to build for greater success.

Outlook

Looking ahead, sustained growth in demand for oil and gas is likely to continue to drive investment by petrochemical companies and original equipment manufacturers into new technology and facilities. The addition of adjacent technologies to the portfolio will also support growth.

Investment in equipment for new facilities not only provides short term growth, but provides the foundation for long term aftermarket business. With over 60% of our business derived from the aftermarket, and new equipment having an installed life of over 30 years, we are well placed for continued growth in this area.

Business review: Smiths Medical

Smiths Medical is a leading supplier of specialist medical devices and equipment for global markets.

In medication delivery, our devices help to treat cancer patients, deliver insulin to diabetics and provide relief to those in pain. Our vital care products reduce hospital acquired infections, manage patients' airways before, during and after surgery, maintain body temperature and assist reproduction through IVF therapy. Our safety products keep health workers safe by helping to prevent needlestick injuries and reduce cross infections.

Employees
8,400

Principal operating regions
Manufacturing is concentrated in Mexico, the US, the UK, Italy and Germany. We sell to over 100 markets worldwide with the US being our largest single market with 49% of sales.

Customers
We estimate that around three-quarters of our end customers are hospitals with the remainder comprising the alternate care market such as home care, clinics and other surgery centres. We have a direct sales presence in 20 countries with distribution arrangements in many others.

#Based on revised operating structure for 2008/09 (see page 72)

*Percentage relates to headline operating profit before corporate costs



Srini Seshadri
President

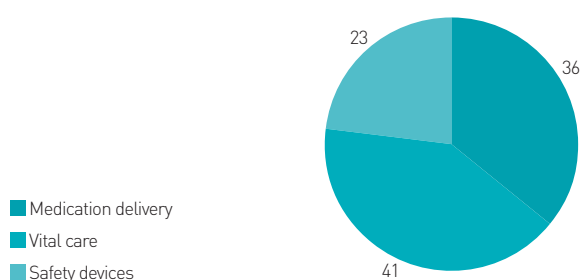
Contribution to 2008 Group sales#
31%

Contribution to 2008 Group headline operating profit#+
34%

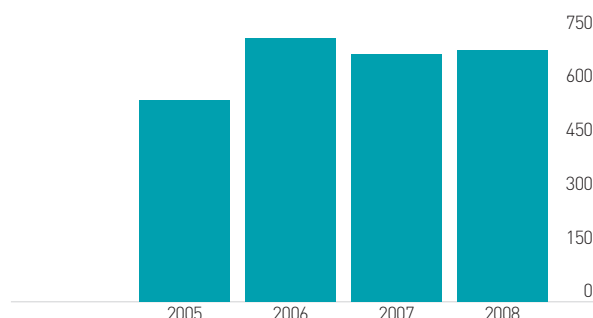
Competitors

The competitive landscape for Medical is complex as we compete with different businesses across the wide range of product areas. Our competitors include Covidien, Teleflex/Arrow, B Braun, Becton Dickinson, Hospira, Cardinal (Alaris), Vital Signs, Medtronic among many others. In many of these examples, we only compete with a small portion of their medical businesses so comparison between peers is complex.

Sales by sector %



Sales performance £m



Markets

Healthcare spending continues to increase worldwide, driven by demographics – aging populations and increasing prosperity, particularly in Asia. The overall world market for devices and equipment of the type supplied by Smiths Medical is estimated to be worth £3.5 billion and is growing consistently. Smiths Medical has a global reach in the design, production and distribution of medical device products, with sales and marketing activities in over 100 countries. Its product ranges serve three main markets – medication delivery, vital care and safety.

Medication delivery

Smiths Medical designs and manufactures drug delivery systems that relieve acute and chronic pain (CADD and Medfusion), chemotherapy delivery systems to treat cancer patients (CADD) and patient-friendly pumps to deliver insulin to diabetics (Cozmore). The global market for medication delivery products is estimated to be worth £1.5 billion and growing at around 4-7% per annum. This growth is due to the increase in treatment of chronic conditions, integrating medication delivery devices with hospital IT systems, and the move to treating patients outside hospitals. We are a leader in ambulatory infusion, with a strong position in hospital infusion particularly in the syringe pump market.

Vital care

Smiths Medical's products manage patient airways during and after surgery (Portex), aid patients with breathing difficulties (Portex, Pneupac), help to maintain body temperature (Level 1), monitor vital signs such as blood pressure and heart rate (BCI, Medex) and assist reproduction through IVF therapy (Wallace). The market for vital care products is showing annual growth of around 2-4%, partly due to a steady increase in the incidence of chronic respiratory diseases and obesity. Demand is increasing for single use devices such as Portex airway management products. The market is expected to continue growing as the number of operations and intensive care beds both increase. This market is currently worth about £1.5 billion a year. We are a market leader in airway products.

Safety devices

Smiths Medical makes effective safety devices that prevent needlestick injuries and reduce cross infections. These cover a range of functions including drawing blood samples (Jelco) administering injections and vaccinations (Jelco) and delivering intravenous drugs (Deltec). The global market for safety products is estimated to be worth £500m and growing at 3-5% per annum. Smiths Medical is one of the world's leading suppliers of safety needles and catheters.

In the US, Smiths Medical is benefiting from the move towards treatment of illnesses in their chronic, rather than acute stages. A number of airway management products and ambulatory pumps already address this trend – such as the CADD ambulatory infusion pump range and the Portex Acapella respiratory therapy system – and it is becoming a focus for our vital care products.

The advantages of using safety devices are well understood in the US, and there is now greater recognition of the contribution safety devices make to improving the safety and productivity of healthcare employees. In other geographic markets, conversion to safety products is in its infancy, with opportunities for rapid future growth. Safety products are also being introduced into other areas of healthcare, such as dentistry.

Business review: Smiths Medical continued

Performance

	2008 £m	2007 £m	Reported growth	Underlying growth
Sales	703	691	2%	0%
Headline operating profit	128	127	0%	2%
Headline operating margin	18.2%	18.4%		
Statutory operating profit	106	106		

At reported exchange rates, Smiths Medical's sales grew 2% while headline operating profit remained in line with last year. Excluding the impact of currency translation, the underlying growth in profit was 2% on flat sales. Operating profit margins reduced slightly by 20 basis points. Performance has been severely affected by three product recalls and by supply chain disruption caused by several long-term initiatives. The simultaneous relocation of manufacturing to lower cost regions, the integration of the Medex acquisition, and the implementation of a new ERP system have all posed operational challenges over the past two years. These factors combined to disrupt deliveries which in turn have had an adverse impact on relationships with major customers. A 24-month performance improvement programme has begun and a new global operations team recruited to address these issues. Unfulfilled customer orders peaked in June 2007 but, as a result of the performance improvement initiatives, have since fallen by 90% back to normal levels. Our immediate priority is the rebuilding of relationships with customers and the delivery of the performance improvement programme.

While overall underlying sales growth was flat, Medication Delivery grew by 3.4% but was offset by declines in Vital Care of 1% and Safety Devices of 2.9%.

Medication Delivery benefited from good growth in its infusion product range, particularly outside the US. Its performance in the US was held back temporarily ahead of the launch of CADD Solis which began in April. The access franchise, which includes some new product launches such as POWER ports and Gripper Micro, grew well. Cozmore, which serves the diabetes market, delivered strong growth outside the US but sales were held back in the US by a product recall caused by a faulty motor from a supplier. The pain management franchise grew well outside the US but supply chain problems and restructuring in the US constrained overall growth.

Vital Care's performance was affected by supply chain disruption and by a product recall in temperature management. The airway franchise grew well in spite of supply chain problems and the assisted reproduction area also delivered strong growth reflecting the growing global demand. However, these performances were offset by declines in temperature management, caused by a product recall and aggressive competitor pricing; and declines in pressure monitoring caused by supply chain disruption.

The performance of Safety Devices was affected by declines in our peripheral intravenous catheter franchise. These declines were caused largely by disruption to production schedules as a result of a problem with resin from a supplier. The problem was quickly identified and no faulty products entered the supply chain, but supplies to our customers were interrupted. Sales of safety needles also fell within the US market but saw growth outside the US. The decline in US sales was caused by the conclusion of some large OEM contracts during the year.

On a geographic basis, our largest market is the US which accounts for 49% of sales, and has experienced a 2.6% fall in sales as a result of the supply chain disruption and product recall issues. In Europe, sales have grown by 2.4%. We have seen double digit growth, albeit from a low base, in emerging markets served via our distributors, particularly in Latin America, and Saudi Arabia. Last year's investment in new infrastructure for Greater China contributed to a 30% growth in sales in that territory.

In the US, a number of significant two- or three-year contracts were agreed across the product portfolio during the period. These include a three-year Group Purchasing Organisation (GPO) contract with Premier Purchasing Partners, to supply PORT-A-CATH® implantable access systems to Premier's 1,700 hospitals and almost 50,000 other healthcare sites across the US. A new three-year agreement has also been signed with MedAssets for five categories of anaesthesia products and a contract has been secured with Amerinet, for respiratory products. We secured major GPO contracts with HPG and Broadlane for syringe pumps. In addition, we signed a number of agreements from across the portfolio with Cardinal Health which includes a ground-breaking initiative for the co-branding of Smiths EDGE safety needles. Over the past year, these and other GPO contracts totalling \$32m have been secured.

There is an ongoing focus on margin improvement through cost control and efficiencies. The manufacturing rationalisation programme has resulted in site closures at Hythe, UK; and Duluth, Georgia, USA. Over the past two years, the proportion of all employees working in low-cost countries has increased from 24% in July 2006 to 35%. Of our direct manufacturing employees, 62% are now working in Mexico, compared with 44% in July 2006.

The implementation of an ERP system was restarted in June 2008 after a period of stabilisation since the project was halted in 2007. The Benelux markets successfully went live in August 2008 such that more than 50% of global sites are now operating on the new system. The project, due for completion in March 2010, will improve the quality of management information and support inventory reductions, global sourcing and deliver savings. The total budget is £32m, of which £18m has been spent to date. Once complete, the project is expected to deliver annual cost saving of £15m.

Business developments

We have announced a restructuring programme that will merge the two existing operational units in the US. This will create a more efficient organisational structure and a single route to market, giving a more coherent customer-facing organisation. The project is expected to cost £4m and, once complete, generate annualised savings of £2m.

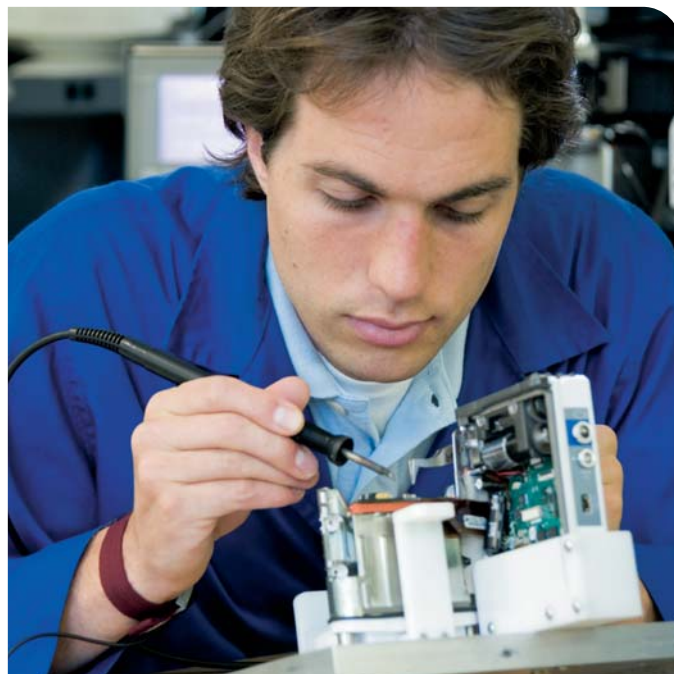
Research and development

Total R&D investment has risen by 6%, and as a proportion of sales has increased from 3.5% to 3.7%. Looking forward, we expect this commitment to increase further. We are now focusing our investment more tightly on product areas and segments which will deliver higher growth. For example, the largest increase benefited Medication Delivery where our R&D investment in infusion pumps is typically much higher at around 7% of sales. In contrast, our R&D investment in Safety remained constant at 1.5% of sales which is in line with many of competitors. However, we have invested in automated machinery to drive capacity. In summary, we have increased the number of new product launches by about 50% in the current year.

We have increased the rate of product launches with an improved new product development process. Over the past year, we have launched several new products. CADD®-Solis, a next generation ambulatory pump system, replaces a 10 year old platform and features error detection software and data connectivity to hospital IT systems. We also launched the Saf-T Closed Blood Collection System® Devices, the dual-lumen implantable access systems (P.A.S. PORT® T2 POWER P.A.C. and PORT-A-CATH® II POWER P.A.C), the Theraheat heated humidification system and the GRIPPER® Micro Safety Needle. A full range of EDGE safety needles was also launched, together with the latest closed blood sampling product, Hemodraw, which is already winning market share in the US. Since the year end, we have launched SmartX®, a wireless blood pressure monitoring system; UniPerc™, a tracheostomy tube for patients with large necks; SACETT, which helps to reduce hospital acquired infections and two lower cost intubation devices for the Chinese market.

Outlook

The key priority for Smiths Medical is to improve customer service and implement the performance improvement programme. The division will focus on growth in developing markets and globally through the launch of new products. The performance improvement programme will support a return to sales growth in line with its end markets. The focus in the short term will be on margin improvement through restructuring and operating efficiencies. A planned review of portfolio profitability may lead to the rationalisation of certain product lines and a short term impact on revenue growth.



Revolutionising portable medication delivery

Smiths Medical's revolutionary CADD®-Solis portable medication delivery system eases patients' pain enabling them to stay mobile whilst undergoing treatment. CADD®-Solis is a clinically and technologically advanced system that administers pain relief medication, including narcotics, to post-surgery, trauma, cancer and labour patients. Its innovative safety software allows hospitals to input their own standardised pain management protocols for their patients, helping to prevent accidental overdoses.

CADD®-Solis was developed in cooperation with expert clinicians and the University Health Network in Toronto.

Business review: Smiths Interconnect

Smiths Interconnect is an electronic components and sub-systems business providing signal, power and microwave solutions that are application specific and incorporate innovative technologies to help our customers achieve ultimate system performance.

We design and manufacture specialised electronic and radio frequency products that connect, protect and control critical systems for the global wireless telecommunications, aerospace, defence, space and medical markets.

Employees
3,100

Principal operating regions
Smiths Interconnect operates globally and has locations in the US, Mexico, Costa Rica, Ireland, UK, France, Germany, Italy, Tunisia, India, China and Australia.

Customers

Smiths Interconnect supplies to multiple levels of the supply chain and its blue chip customers include primes and service providers, OEMs and system suppliers, and sub-system manufacturers. Amongst our largest customers are Raytheon, Finmeccanica, BAE Systems, AAI/Texttron, Northrop Grumman, Ericsson, Motorola, Sprint Nextel, ZTE, GE Medical and Alstom.

#Based on revised operating structure for 2008/09 (see page 72)

+Percentage relates to headline operating profit before corporate costs



Ralph Phillips
President

Contribution to 2008 Group sales#
11%

Contribution to 2008 Group headline operating profit#+
13%

Competitors

Smiths Interconnect operates in a fragmented market with many small and medium-sized competitors. In Connectors, the competitors include Amphenol, Deutsch, Radiall and Souriau. Microwave Components competes with, amongst others, Anaren, Spectrum Control and parts of M/A-Com and Dover. The competitors of Microwave Sub-Systems include Cobham, EMS Teledyne and L3. Protection competes with Huber & Suhner, Dehn and parts of SL Industries.

Markets

The two largest markets for Smiths Interconnect are defence and wireless telecommunications.

Typical military applications for Smiths Interconnect technology include unmanned aerial systems (UAS), next-generation ground vehicles, communications systems, surveillance systems and self-protection systems. Its rugged connectors and radio frequency products are deployed in the most extreme environments, such as keeping military personnel and systems connected in areas of conflict.

In the evolving field of mobile telecommunications, Smiths Interconnect supplies niche microwave components used in the base stations and cell sites as well as protection solutions to safeguard the high value infrastructure from the effects of lightning strikes and power surges and maintain network integrity.

Other applications for Smiths Interconnect products include medical equipment such as MRI scanners, space and satellites, commercial aerospace and mass transit.

Smiths Interconnect comprises four focused technology areas:

- Connectors provides application-specific, high-reliability electrical interconnect solutions from highly integrated assemblies to micro-miniature connectors.
- Microwave Components provides passive microwave products used within the building blocks that generate, transmit, receive and process high frequency signals for communication systems.
- Microwave Sub-Systems provides microwave and millimetre-wave sub-assemblies, antennas and systems solutions for both defence and commercial applications.
- Protection provides signal and power integrity components that protect high value electrical systems from surges caused by power spikes and lightning strikes.

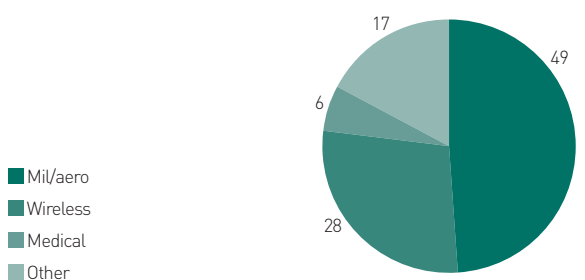
Performance

Smiths Interconnect delivered strong underlying sales and profit growth. Sales growth was driven primarily by three technology areas: Protection, Microwave Sub-Systems and Connectors.

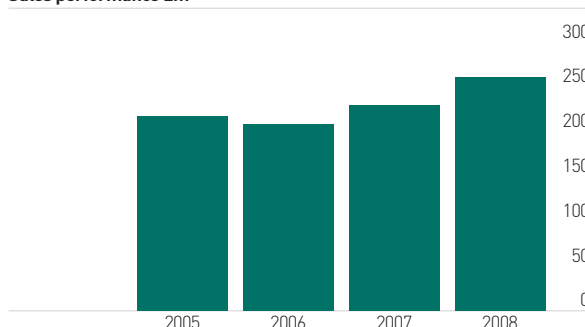
The performance of the Protection technology group was enhanced by sales of lightning and surge protection solutions supplied to major US 4G wireless broadband providers for mobile internet access. It benefited from sales of protection solutions to medical and telecommunications customers. The division has also made key wins in the defence sector for protection of ground mobile communication systems.

Microwave Sub-Systems saw strong sales growth through several US military programmes including the three-frequency band data link (MDAS) which supports multiple unmanned aircraft systems. Positions on three new satellite communications programmes for US forces were also secured: one is a shipboard communications programme and the other two are Satellite Communications On The Move (SOTM) programmes and Warfighter Information Network-Tactical (WIN T), the US army system for reliable, secure and seamless high bandwidth mobile communications in areas of conflict.

Sales by sector %



Sales performance £m



The Connector group delivered good sales growth but profit was held back by a slowdown in Italy. Key wins were secured on several major defence programmes and our connectors were selected as the high reliability standard for future NASA space applications. Major product orders were also received for medical MRI scanners, civil aerospace and rail traction.

The Microwave Components group delivered a small underlying increase in sales as a result of a lower than expected demand from Chinese and North American telecom operators. However, we have seen continued strong demand for filters used to combat improvised explosive devices and other components for a variety of applications including commercial satellite programmes.

Smiths Interconnect successfully expanded its global capacity, particularly in lower manufacturing cost environments. During the year operations were opened in Tunisia and India while we continued to build our operating base in China, Mexico and Costa Rica. Over the last year, the proportion of Smiths Interconnect products manufactured in low cost countries has more than doubled.

Business developments

Over the course of the past six months Smiths Interconnect has acquired Shanghai-based Allrizon Tongguang and Brisbane-based Triasx Pty Ltd. These strengthen our position in the growing Asian market. Allrizon offers first-class technology, providing new channels to market and enhanced relationships with the rapidly growing Chinese telecoms manufacturers. In the 2007 calendar year, Allrizon posted sales of £5.3m. Triasx has in-depth knowledge of the telecommunications radio frequency market and an excellent R&D capability. Its strong filter capabilities complement our existing products, particularly those from Allrizon, while the Triasx interference testing devices fit well with our existing Summitek test and measurement business. In the year to 30 June 2008, Triasx reported sales of £12.5m.

Outlook

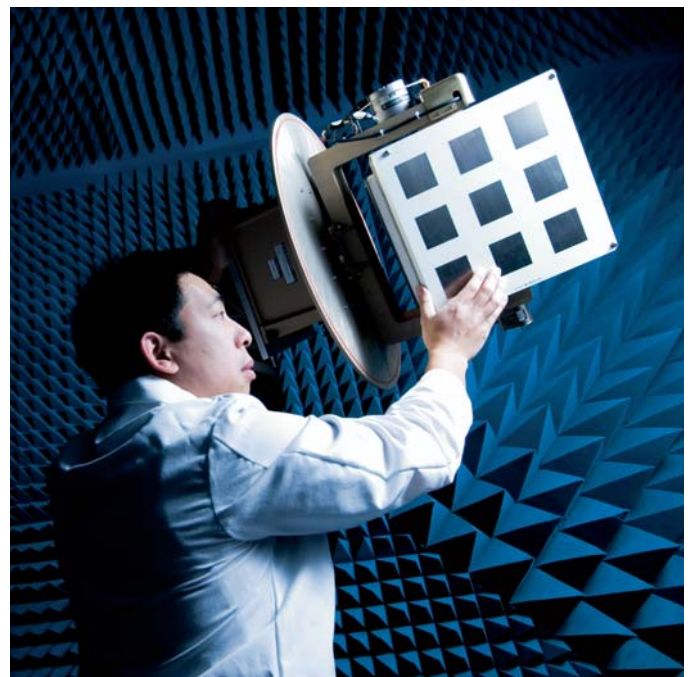
There are good opportunities for Smiths Interconnect to grow organically – particularly in developing markets – and scope exists to improve the portfolio and extend its geographic reach through bolt-on acquisitions. Military communications is anticipated to be an area of continued investment by governments and the further roll-out of wireless networks is expected with the highest growth in developing markets. Smiths Interconnect's markets remain robust and are set for continued growth.

Keeping soldiers connected and protected in extreme environments

The advanced Mobile Directional Antenna System (MDAS) is a sophisticated, multi-band communication system that facilitates communications with Unmanned Aerial Vehicles (UAVs). Designed and built by Smiths Interconnect business Tecom Industries, MDAS is a rugged, portable antenna, which is typically mounted on vehicles.

UAVs are commonly used in reconnaissance missions to scout an area for threats when the environment is too dangerous for it to be patrolled.

The MDAS system enables tracking and communications with multiple UAVs relaying real time pictures and video to the soldier and command forces.



Business review: Flex-Tek

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

Our flexible hosing and rigid tubing is deployed on commercial aircraft as well as in motorsport for fuel and hydraulic applications. In the home our technology can be found in domestic equipment including vacuum cleaners and HVAC systems support.

Employees

2,400

Principal operating regions

Flex-Tek conducts a majority of business in the US but also has manufacturing in the UK, France, Malaysia, India, China and Mexico.

Customers

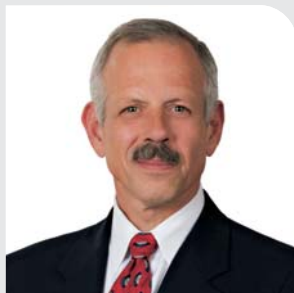
Flex-Tek serves mainly domestic appliance manufacturers and the US construction industry. Its large customers include Whirlpool, Trane, Pratt & Whitney, Carrier, Boeing, Electrolux, Respiroics, GE Aerospace, Airbus, Panasonic, Hoover and Dyson.

#Based on revised operating structure for 2008/09 (see page 72)

+Percentage relates to headline operating profit before corporate costs

Contribution to 2008 Group sales#
9%

Contribution to 2008 Group headline operating profit#+
6%



Tedd Smith
President

Competitors

Smiths Tubular Systems Aerospace competitors include Parker-Hannifin and Eaton as well as outsourced capacity from its key customers. Flexible Solutions competes globally with a number of smaller privately owned businesses which manufacture specialty hoses. Heat Solutions domestic appliance and specialty heating element competitors include Emerson, Watlow and Chromalox. Whilst the construction related products competitors are comprised of Hitachi, Atco, Omega-Flex, Hart & Cooley and Goodman.

Markets

Flex-Tek designs and manufactures engineered components which heat and move fluids and gases for aerospace, consumer products and construction applications. Its products include proprietary hose and tubing technology, engineered thermal systems and heating elements.

Flex-Tek manufactures specialised high-performance tubing for the civil and military aerospace industry and supplies most major aircraft and engine manufacturers. Flex-Tek's customers also include leading domestic appliance manufacturers and the US construction industry. In addition, it supports specialised original equipment manufacturers (OEMs) with a wide range of solutions for equipment used to treat sleep disorders, semi-conductor manufacture, and temperature control in extrusion and large commercial heating and ventilation.

Demand is normally a function of overall economic growth, the air transport market, and the strength of the US construction industry.

Flex-Tek goes to market via three distinct technology areas:

Smiths Tubular Systems Aerospace

Meeting the aircraft industry's need for rigid and flexible hydraulic and fuel hose, STS Aerospace delivers high performance airframe fluid management systems that are also deployed in the world of motorsport.

Flexible Solutions

Focusing on flexible hose assemblies for a range of domestic appliance manufacturers, the Flexible Solutions group makes both high and low pressure hose assemblies for OEMs. It also supplies ducting for purposes ranging from chemical transfer to grain handling.

Heat Solutions

Comprising specialised heating elements and thermal systems, HVAC ducting and gas delivery tubing, the Heat Solutions group's products serve customers that manufacture tumble dryers, HVAC equipment and specialized OEM customers described above. Ducting and gas delivery tubing is largely supplied to the construction industry via distributors.

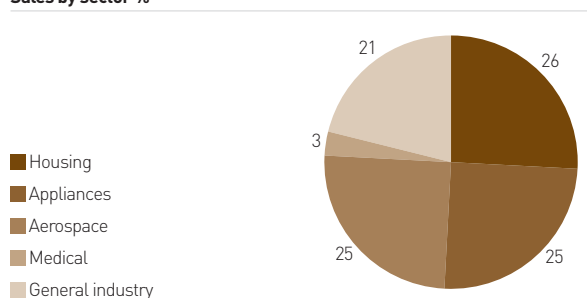
Performance

Flex-Tek experienced declines in sales and profit as a result of the recession in the US residential construction markets and household appliances market. However, these declines were offset in part by the strong growth in sales of components and services to the aerospace market and by the benefit from the acquisition of Fast Heat in January.

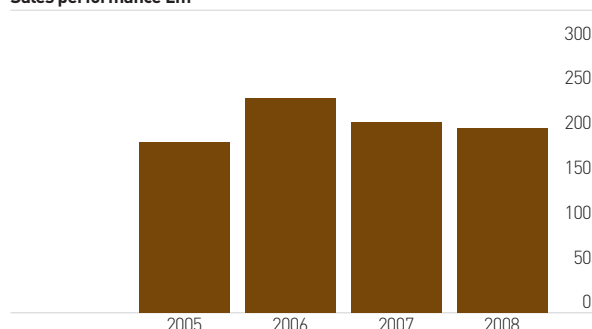
Smiths Tubular Systems Aerospace delivered strong growth in sales and profit. This technology group benefited from the high demand for fluid distribution components and services for commercial and military aircraft. For example, Flex-Tek secured an \$18m contract for the provision of flexible and rigid fuel and hydraulic hoses on the Boeing 787 Dreamliner. Through a combination of price rises to offset raw material cost increases and a focus on cost management, we were able to improve margins.

Flexible Solutions experienced declines in sales and profit as a result of continued pressure in the household appliance and general industrial sectors. The domestic appliance market has fallen by some 6% over the past year while the general industrial market is tied to GDP.

Sales by sector %



Sales performance £m



The Heat Solutions group supplies heating components for tumble dryers and HVAC ducting and related equipment to the US construction market, primarily to the residential sector. The recession in the US construction market saw a 30% decline year-on-year in building permits and a 28% fall in housing starts. Similarly, the US electric dryer appliance market declined by around 6%. Against this background, sales and profit fell – although the impact on profit was partly mitigated through careful cost management. At the beginning of the year, the group completed a reorganisation and consolidation of manufacturing in Tennessee which has cut costs and improved customer service.

Business developments

In January 2008, to extend Flex-Tek's range of specialty heating solutions, Smiths acquired Fast Heat for \$18m. Now integrated into the Heat Solutions group, this business manufactures heating elements and controls used for plastic injection moulding and packaging equipment employed in the manufacture of medical products and semi-conductors.

Flex-Tek is broadening its global footprint particularly in Asia, where its existing plant in Malaysia continues to expand. Over the past year it has added new manufacturing facilities in Bangalore, India, the Clark Freeport Zone, Philippines, and Changzhou, China. The facilities in India and Philippines are aimed at better serving its aerospace customers, following increased demand due to the growth of air traffic in Asia. The facility in Changzhou is focused on the growing HVAC and household appliance market in China.

As part of the Group restructuring, Flex-Tek has also announced a programme to reorganise its operations to drive efficiency improvements. The programme will cost £5m in total and once complete will deliver annualised savings of £7m.

Outlook

Flex-Tek is facing continued uncertainty in the US residential construction and household appliance markets. It will continue to rationalise its portfolio of sites and reduce costs in order to deliver future value when these markets improve. The growth opportunities in aerospace and developing markets will also be a focus.



Racing ahead in world motorsport

In the competitive world of motorsport, Flex-Tek's advanced technology is helping the winning teams to achieve optimal performance. Flex-Tek's highly specialised tubing, which provides fuel to engines and hydraulic control for landing gear and reverse engine thrusters on aircraft including the Boeing 787 Dreamliner, is also deployed on the winning cars in high performance motorsport.

Our highly engineered components – manufactured at our facility in Laconia, New Hampshire, USA, and Paris, France – are designed for fuel and braking in these very demanding applications and are used by the major F1 and NASCAR teams.

Financial review

Changes in Group composition

We continued to improve the portfolio and business mix through a number of acquisitions and disposals during the year. In November, Sartorius Bearing Technology, a leading provider of high performance rotating equipment for the oil and gas industry, was acquired for £13m. In November, Smiths sold its Marine Systems business for £44m, after a working capital adjustment. In December, Smiths acquired the majority ownership of the John Crane business in Japan for a consideration of £5m, increasing its ownership share from 49% to 70%. In February, the Heating Element division of Fast Heat was acquired for £9m: it manufactures a wide range of specialty heating elements for HVAC, industrial and medical applications. In April, John Crane acquired Indufil BV for £71m, a Dutch-based specialist in filters for the petrochemical and process industries. In May, Smiths Interconnect acquired Allrizon Tongguang, a communications equipment firm based in Shanghai which designs and manufactures radio frequency filters and products for the wireless telecommunications market. The acquisition of Fiber Composite Company Inc. (Fiberod), a Texas-based specialist provider of lifting equipment for the oil and gas industry, was completed in May. In July, Smiths Interconnect acquired Triasx Pty Ltd, a firm based in Brisbane that designs and manufactures complex radio frequency filter products for the wireless communications market.

Earnings per share

Basic headline earnings per share from continuing activities were 74.5p (2007: 47.0p) a rise of 59%.

On a statutory basis, the basic earnings per share from continuing activities were 63.0p (2007: 36.9p).

These comparisons are distorted by the effect of the share consolidation in June 2007 following the disposal of the Aerospace business. The average number of shares in issue during that year was a reflection of the capital structure appropriate to both the continuing and the discontinued business.

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

These items amounted to £59m, compared to £88m in 2007. They comprised:

- £4m in respect of restructuring corporate and divisional headquarters; this cost is the initial part of a programme expected to cost approximately £48m;
- £9m for integration costs associated with the Medex acquisition (2007: £9m);
- £54m (2007: £101m) in connection with John Crane, Inc. asbestos litigation, including a £40m provision for adverse judgments (see litigation paragraph on page 29);
- Amortisation of intangible assets acquired in business combinations of £19m (2007: £15m). The amortisation relates principally to technology and customer relationships; and
- Profit on disposal of businesses of £27m (2007: loss of £5m).

Exceptional items in 2007 included insurance commutation proceeds (£43m); profit on sales of TI Automotive shares (£24m) and other costs of £26m.

Financing losses amounted to £2m (2007: gain of £1m). These represent the results of derivatives and other financing instruments which are not hedge accounted under IFRS. Of this sum, nil (2007: £1.5m) was charged to operating profit.

Cash generation

Headline operating cash-flow was £273m, representing 72% of headline operating profit. This compares to operating cash of £259m in 2007 and cash generation of 75%. The cash generation outcome this year reflects investment in capital projects and increased working capital to support business growth in the new year.

On a statutory basis, net cash inflow from continuing operations was £198m (2007: £205m).

Cash expenditure on exceptional items was £26m, compared with an £8m inflow in the previous year. The Group made special pension contributions of £34m (2007: £56m). Free cash-flow from continuing operations (after interest and tax but before acquisitions and dividends) was £91m.

Dividends paid in the year on ordinary shares amounted to £131m, compared with £182m in 2007.

Interest and other financing costs

For continuing operations, interest payable on debt, less interest on cash deposits, was £41m, compared with £36m in 2007. Net interest costs were 9.3 times covered 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 income for continuing operations was £42m in 2008, compared with £34m in 2007. As a result of the reduction in pension surplus, the amount in the coming year is likely to be approximately £35m lower.

Net debt

Net debt at year end was £771m, up from £590m at the start.

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.

Smiths invested a total of £86m in R&D on continuing operations, equivalent to 4% of sales. Of that total, £13m was funded by customers. The comparative figures for 2007 were £79m and £8m. Under IFRS, certain of these development costs are capitalised. 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.

Accounting policies

The accounts in this report are prepared under International Financial Reporting Standards (IFRS), as adopted by the European Union (EU). The accounting policies used in preparing these accounts are set out on pages 63 to 68.

Significant judgements, key assumptions and estimates

Applying accounting policies requires the use of certain judgements, assumptions and estimates. The most important of these are set out on page 63.

The uncertainty affecting the estimation of provisions has increased following the commutation of certain insurance policies in respect of product liability. See legal issues section (page 29) for details.

Taxation

The tax charge for the year represented an effective rate for continuing operations of 24.0% on the headline profit before taxation, compared to 25.1% in 2007. The rate reduced due to taking advantage of global tax incentives, the tax-efficient use of capital and active tax compliance management. On a statutory basis, the tax charge on continuing activities was £75m.

The fundamental tenets of the Smiths approach to taxation are to enhance the Company's competitive position on a global basis, while engaging with tax authorities around the world on a basis of full disclosure, full co-operation and full legal compliance. The Board considers and approves the management of the Company's tax affairs in the context of the Company's commercial objectives.

Accordingly, Smiths seeks to build open relationships with tax authorities to bring about timely agreement of tax affairs and to remove uncertainty on business transactions.

In summary, the Company's taxation strategy is to mitigate the burden of taxation in a responsible manner for competitive advantage, and, in this way, to enhance long-term shareholder value.

Cost of capital and return on shareholders' funds

Smiths uses its weighted average cost of capital as one measure to appraise both internally-generated investment opportunities and acquisitions. During 2007, the Company's weighted average cost of capital (WACC) decreased from 9% to 8% as a result of the lower cost of equity.

The after-tax headline return on shareholders' funds for continuing operations, including goodwill set-off against reserves, was 16.7% (2007: 14.9%).

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 2008 and evaluating liabilities at year-end AA corporate bond interest rates.

The year-end retirement benefit position was:

	2008	2007
Funded plans:		
UK plans – funding status	106%	113%
US plans – funding status	89%	92%
Other plans – funding status	81%	83%

	2008 £m	2007 £m
Surplus/(deficit):		
Funded plans	102	297
Unfunded plans	(113)	(114)
Total surplus/(liability)	(11)	183

Company contributions to the funded pension plans were £56m (2007: £103m including discontinued operations). In 2008, special contributions were made totalling £17m, including £4m in respect of the Aerospace disposal. In 2007, special payments of £56m were made including £21m in respect of the Aerospace disposal. During the year, the trustees of the TI Group Pension Scheme invested £250m in annuities from Legal & General which are matched with specific liabilities of the Scheme thereby mitigating the longevity risk in respect of specific pensioners.

Full details of the retirement benefits are shown in note 10.

Exchange rates

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

	2008	2007	
Average rates:			
US Dollar	2.00	1.95	Dollar weakened 2.5%
Euro	1.35	1.48	Euro strengthened 8.8%
Year-end rates:			
US Dollar	1.98	2.04	Dollar strengthened 2.9%
Euro	1.27	1.49	Euro strengthened 14.7%

Dividend policy

An interim dividend of 10.5p per share was paid on 25 April 2008. A final dividend of 23.5p per share is proposed.

The Board intends to grow dividends consistent with increasing cover to around 2.5 times in the medium term. Dividend cover relative to headline earnings for the year ending 31 July 2008 was 2.2 times.

Financial review continued

Goodwill and intangibles

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

The goodwill balance was tested for impairment in 2008 and 2007.

Treasury

Smiths decentralises treasury management over its financial risks to its subsidiary businesses, within a strong control environment. The Board has approved a Treasury Policy, which governs the financial risk profile, and Treasury permits appropriate delegated authorities across the subsidiary companies. The Company uses financial instruments to raise money for its operations and to manage the related financial risks. Smiths neither speculates nor trades in derivative financial instruments and all financial instruments are properly recognised on the balance sheet. A treasury report is presented annually to the Audit Committee to confirm compliance with policy.

The objectives of the treasury function are to:

1. To deliver the liquidity requirements of the businesses cost-effectively.

The Group aims to minimise the level of surplus cash but, where surpluses arise, tight controls apply to ensure that they are securely placed with highly-rated counterparties and are available for redeployment at short notice. The Company is required under IFRS to show gross borrowings and cash under its cash pooling arrangements, despite these balances being netted for interest purposes, which exaggerates the Company's surplus cash balance. Liquidity is provided to the Group by a committed revolving credit facility to 2012 which at 31 July 2008 was £450m undrawn. Local working capital needs and capital expenditure requirements are typically funded by local bank facilities.

2. To manage the central funding demands and provide a low cost of debt.

The Company's funding requirements are largely driven by acquisition activity and met by centrally arranged debt finance. Smiths has net debt as at 31 July 2008 of £771m (2007: £590m) with average maturity of 4 years (2007: 5 years) and at an average effective interest rate after interest and currency swaps of 5.1% (2007: 5.8%). Through the use of interest rate swaps, Smiths maintains a broadly even mix of fixed and floating rate debt. Credit ratings have been held at BBB+/Baa2 (stable) with Standard & Poor's and Moody's respectively. Accordingly, this approach aims to reduce the cost of capital by optimising financial liabilities

3. To develop and maintain strong and stable banking relationships and services.

Smiths has a core group of 11 leading global banks and financial institutions that competitively tender for treasury business. Credit exposures to any one bank are carefully controlled.

4. To provide reasonable protection from foreign currency volatility.

Smiths has adopted hedge accounting for the majority of the Group's business at its larger sites, thereby mitigating the impact of transactional exposures in the income statement. Material cross-border sales or purchase contracts in foreign currencies are hedged at their inception by appropriate derivative financial instruments, principally forward foreign exchange contracts and swaps, with the Group's core banks as counterparties. Whilst the trends of foreign currency movements cannot be eliminated, this hedging programme reduces volatility, protecting cash-flow and margins.

Smiths protects its reserves from foreign currency fluctuations by ensuring that at least 75% of the total net overseas operational assets are offset either by borrowings in the respective currency or by currency swaps. This excludes goodwill which is only partly hedged. Overseas earnings are translated at average currency rates for the year, which smoothes the effect of currency volatility.

Therefore, treasury management in Smiths ensures a robust and prudent financial profile while driving value for shareholders, with the support of world-class banks.

Financial controls

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

The internal audit department reviews all units over a rolling three-year cycle, and its findings are reported to the Audit Committee. All acquisitions are reviewed within 12 months of acquisition, to verify compliance with Group procedures.

Further information regarding the Group's procedures to maintain strict controls over all aspects of risk, including financial risk, are set out in the Corporate governance report on pages 43 to 46.

Legal issues

Smiths is committed to operating within the law in all applicable jurisdictions, and seeks to benefit from the rights and protections afforded by relevant laws. The Company aims to anticipate and meet the changing requirements of the markets it serves, as legal and regulatory reforms impact those markets.

Smiths faces different types of legal issues in different jurisdictions. The high level of activity in the US, for example, exposes the Company to the likelihood of various types of litigation commonplace in that country, such as 'mass tort' and 'class action' litigation, 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.

In addition, contracting with the US Government subjects a company to numerous stringent regulatory obligations, calling for an active programme of compliance, reporting and communication. By contrast, the Company's activities in some countries with less developed legal systems pose challenges for the protection of corporate assets such as real estate and intellectual property rights.

In order to address the challenges and exploit the opportunities arising from these and other legal issues, Smiths employs experienced lawyers in head office and certain operations, and retains the services of law firms around the world.

John Crane, Inc. litigation

John Crane, Inc. (JCI) an indirect subsidiary of the Company, is one of many co-defendants in numerous lawsuits pending in the USA in which plaintiffs are claiming damages arising from alleged exposure to, or use of, products containing asbestos. The JCI products generally referred to in these cases consist of industrial sealing products, primarily packing and gaskets. The asbestos was encapsulated within these products in such a manner that, according to tests conducted on behalf of JCI, the products were safe. John Crane ceased manufacturing products containing asbestos in 1985.

JCI has resisted every case in which it has been named and intends to continue its robust defence of asbestos-related claims based upon this 'safe product' defence. As a result of its defence policy, JCI has been dismissed before trial from cases involving approximately 159,000 claims over the last 29 years. JCI is currently a defendant in cases involving approximately 136,000 claims. Despite these large numbers of claims, JCI has had final judgments against it, after appeals, in only 70 cases, amounting to awards of some US\$70m over the 29 year period.

The 2007 Annual Report noted that JCI had secured the commutation of certain liability insurance policies, resulting in proceeds of £43m. While substantial excess liability insurance remains in place the exact scope of the cover is currently the subject of litigation in the United States in the Circuit Court of Cook County, Illinois. In the meantime JCI has begun to meet defence costs directly, and intends to recover appropriate contribution from insurers in accordance with the terms of the remaining policies in due course. The 2007 Annual report noted that JCI has made a provision for defence costs of £101m based upon an assessment of the probable costs of defending known and expected future claims. In establishing this provision no account has been taken of recoveries from insurers as their nature and timing are not yet sufficiently certain to permit recognition.

During the current year, JCI has charged £5m in respect of adverse legal judgments delivered. Despite JCI's commitment to its safe product defence, history shows that juries will occasionally return adverse verdicts which can be difficult to overturn on appeal. A further £40m has, therefore, been charged to establish a provision for future adverse judgments. In deciding upon this amount, JCI has relied on expert advice from a specialist in asbestos liability estimation.

Risks and uncertainties

Smiths is exposed to the following principal risks. If any of these risks, or other significant unforeseen risks, materialise, they could have a significant adverse effect on not only our business and financial condition but also our reputation and the trading prices and liquidity of our securities. This could lead to a loss for investors of part or, in a worst case all, of their investment.

Smiths seeks to mitigate significant identified risks through risk management processes, appropriate Group policies and other measures (including insurance where we regard it as appropriate and economic) but there can be no assurance that such measures will be effective in any particular case.

Competition, innovation and major projects

Smiths operates in highly competitive markets where some competitors may have greater resources than we do and where the entry of new competitors, the consolidation of competitors and changed or irrational behaviour by competitors could all have a significant adverse impact on our business.

Continued development of new products and improvements to existing products is critical to the future of the business and competitors may innovate in these areas more effectively than we do with significant adverse consequences for Smiths.

Smiths develops new technologies and introduces new products, in some cases contracting to supply the products to the customer before the design is established or proven. All new technologies and products involve risk, including possible abortive expenditure, reputational risk, and potential customer claims or onerous contracts. The same is true for investment in new facilities and other major projects. Such risks, if they materialise, may have significant adverse consequences for Smiths.

Raw materials and inability to supply

Smiths products contain various raw materials or purchased components including electronic components, metals and plastics. Increases or volatility in prices and shortages in supply could have a significant adverse effect.

Inability to supply against contractual commitments is a risk, which could materialise in a number of different scenarios and which could have a significant adverse effect.

Given the competitive nature of the markets in which Smiths operates, any loss of customer confidence resulting from failure to supply may be difficult or impossible to recover.

Global political and economic conditions

Operating in over 50 countries, Smiths is exposed to political and economic risks, including possible terrorist action.

Some 43% of total sales are to customers in the US, and the Group is therefore particularly affected by US economic conditions.

Smiths may be impacted by adverse changes in general economic conditions including interest rates, and the availability of credit, exchange rates and inflation, and the effect of these could be significant. In addition, demand for products from the Detection and Interconnect divisions is significantly dependent on spending by governments and government agencies, and aside from the impact of general economic conditions, these businesses may suffer significant adverse effects if these customers reduce their spending.

Information technology

Smiths is dependent on information technology systems for both internal and external communications and for the day to day management of its operations with a number of key enterprise resource planning projects in the course of implementation across the Group. Any disruption to these systems, or delays or failures in the implementation of these projects, could have significant adverse consequences for the Group.

Acquisitions and disposals

Smiths is an active acquirer of other businesses and companies: acquisitions may involve risks that might have a material impact on the Group.

The sale and purchase agreement governing the sale of the Aerospace business to GE Aviation UK in 2007 contains certain warranties and indemnities in favour of GE Aviation UK. If costs should be incurred under any of these warranties or indemnities (or similar such provisions in other agreements for the disposal of businesses) these could have a significant adverse effect.

Controls

Smiths information systems, personnel and facilities are subject to security risk, and failures in security systems or processes could have significant adverse consequences as could failures in the Group's various corporate governance and internal controls or non compliance with the Smiths Code of Business Ethics.

Legislative and regulatory

Smiths is subject to a broad range of laws, regulations and standards in the jurisdictions in which it operates. Unexpected changes in these laws or regulations or failure to comply with them could have significant adverse consequences.

The Detection, Interconnect and Medical divisions are particularly subject to regulation, with certain customers and regulatory or other enforcement bodies routinely inspecting the Group's practices, processes and premises. A compliance problem arising in one of these (or any other of Smiths) Divisions could have significant adverse consequences for the Group as a whole.

Litigation and product liability

Smiths is subject to litigation risk including but not limited to product liability risks. Many Smiths products are used in critical applications where the consequences of a failure could be extremely serious and, in some cases, potentially catastrophic, with significant adverse consequences for the Group.

Remediation of design, manufacturing or other product defects could require Smiths to recall products with significant adverse consequences for the Group.

John Crane, Inc., a subsidiary of Smiths, is currently one of many defendants in litigation relating to products previously manufactured which contained asbestos.

The outcome of legal action is always uncertain and there is always the risk that it may prove more costly and time consuming than expected. Both current and potential future litigation could have significant adverse impact on the Group.

Environmental and external

The environmental laws of the jurisdictions in which Smiths operates impose actual and potential obligations to remediate contaminated sites, including some sites no longer owned by Smiths. There is a risk that remediation could prove more costly than expected or that further contamination could be discovered with significant adverse consequences for the Group. Because of the location of its operations, Smiths is also exposed to a number of natural catastrophe risks, such as earthquakes, floods, hurricanes and other types of storm, which like other external events, such as terrorist attacks or a disease pandemic could have significant adverse consequences for the Group.

Financial

Smiths is exposed to two types of currency risk: transaction risk in respect of products manufactured in one currency region and sold in another currency; and translation risk in that the results of non-UK businesses will translate into differing pounds sterling values depending on the exchange rate.

Smiths is exposed to credit risk particularly in relation to customers, banks and insurers. Both currency and credit risk could result in significant adverse consequences for the Group.

In addition, whilst in recent times Smiths has had an effective tax rate of approximately 24%, there can be no guarantee that this rate will remain below the prevailing tax rate applicable in the territories in which Smiths operates.

Pension funding

The Group operates significant pension plans as a result of which Smiths is subject to various funding risks, including poor performance of the investments (particularly equity investments), increased longevity of members and changes in valuation and funding assumptions, any of which could have significant adverse effects.

Human resources

Smiths employs approximately 22,000 people around the world and faces considerable competition in recruiting and retaining the talented individuals it needs to ensure that it is successful. Failure to recruit these staff and/or a loss of key personnel could have significant adverse consequences.

Corporate responsibility

Smiths Code of Business Ethics ('the Code') is based on 12 principles:

- 1 Compliance with all applicable laws and regulations
- 2 Fair and vigorous competition in the marketplace
- 3 Integrity and ethical conduct as the standard of individual and corporate business behaviour
- 4 Fair and honest treatment of suppliers, business partners and customers
- 5 Proper and respectful treatment of employees
- 6 High standards for health, safety and security in the workplace
- 7 Respect for the environment
- 8 Contributing to the communities in which we live and work
- 9 Engaging appropriately with government departments and agencies
- 10 Respect for human rights
- 11 Prudent and transparent public accounting and reporting
- 12 A culture of compliance throughout the entire Smiths organisation embracing all employees

The Code applies to all Smiths businesses and employees worldwide and provides the framework for policies, programmes and procedures for a range of corporate responsibility issues. It is endorsed and fully supported by the Board.

Compliance support to Smiths businesses is provided through legal counsel serving the businesses and other experts who provide advice, export control policies, education, training, guidance materials and risk assessment tools.

During the financial year ended 31 July 2008, Smiths retained the consultancy URS to benchmark the Code against those of peer companies and a gap analysis was completed. This work found that there were no major omissions to the Code but a revised version has been produced to more fully reflect the current challenges facing a global company. The revised Code, although expanded, retains the 12 core principles that were central to its predecessor's structure and has the simplified title 'Code of Business Ethics'. It has been produced in all of the main Smiths operating languages, and is being made available to each employee in both hard copy format and on the Smiths intranet.

Managing corporate responsibility

The Code is monitored by the Business Ethics Compliance Council, which reports to the Audit Committee of the Board and has representation from each of the divisions. Responsibility for managing specific areas of activity depends on the nature of the issue and how it can most effectively be managed:

- environment, health and safety issues are managed through a Group-wide steering committee, a technical implementation committee and local co-ordinators;
- security is managed in each business by line management;
- employee issues are managed by line management and through the human resources function;
- supplier and customer programmes are managed by each business; and
- community programmes are principally managed locally, although there is also some Group-level activity.

Health and safety

Smiths is committed to conducting all its activities in a manner which achieves the highest practicable standards of health and safety.

In 2007 Smiths made the commitment to achieve certification to the occupational health and safety management system standard OHSAS18001 by July 2010 at all of its facilities with more than 50 employees. This financial year has seen pilot programmes, the development of standard materials and training workshops to support this programme. The success of OHSAS18001, together with other targeted initiatives is measured against the recordable incident rate performance where a rate of better than 1.5 recordable incidents per 100 employees is expected.

Performance against targets

Target (August 2007 - July 2010)	2008 result
Recordable incident rate Better than 1.5 per 100 employees	1.27
Lost time incident rate No target set	0.57
OHSAS18001 certification Certification at all sites with more than 50 employees by July 2010	17 out of 83 certified

Recordable incident rate

Lost time incident rate

OHSAS18001 certification

Last year we reported on three incidents that resulted in extended hospital stays for the injured parties. We are pleased to report that we have had no incidents of the same severity this year.

Following a concerted effort, driven from the highest levels of the organisation, our safety performance, as measured through recordable incident and lost time incident rates, continues to improve. The improvements are supported by enhanced incident investigation and return to work programmes. The financial year that we have just completed has been the safest on record for Smiths.

Environment

Smiths is committed to ensuring that, as far as is reasonably practicable, any detrimental effects of its activities, products and services upon the environment are minimised. In practice, this means using performance-based environmental management systems to drive improvement throughout the business.

The environmental management system ISO14001 has been implemented at all Smiths manufacturing sites with more than 50 employees. New acquisitions, or businesses that grow above the 50 employee threshold, are required to seek certification. ISO14001 ensures that a culture of continual improvement is embedded throughout the organisation.

Three-year targets were set in August 2007 to be achieved by July 2010 for greenhouse gas emissions, waste disposal and water consumption. Progress is reported below.

Performance against targets

Target (August 2007 - July 2010)	2008 result
ISO14001 certification for all sites with more than 50 employees	All targeted sites have been certified
Greenhouse gas emissions No absolute increase over the 2007 baseline	3% reduction
Total non-recycled waste 9% reduction over three years normalised against turnover	25% reduction
Water consumption 9% reduction over three years normalised against turnover	12% reduction

Each of our key indicators shows improvement during the year and we will report on further progress and initiatives to ensure that this progress is maintained.

Corporate responsibility continued

High level investigation may help improve breathing

Smiths Medical is increasing its R&D investment to boost the number of new product launches and drive sales. It is currently developing a revolutionary breathing circuit which was tested on Mount Everest as part of a ground breaking medical study that Smiths Medical supported in collaboration with Great Ormond Street Hospital and University College London. The system is undergoing clinical trials and regulatory assessments. If approved, it will for the first time enable patients with chronic breathing difficulties to stay active whilst receiving treatment, greatly improving their chances of recovery.

Employees

It is the Company's policy to provide equal opportunities for employment. Smiths recruits, selects and promotes employees on the basis of their qualifications, skills, aptitude and attitude. In employment-related decisions, Smiths complies with all applicable anti-discrimination requirements in the relevant jurisdictions including concerning matters of race, colour, national origin, gender, marital status, sexual orientation, religious belief, age, or physical or mental disability. Disabled people are given full consideration for employment and subsequent training, career development and promotion on the basis of their aptitudes and abilities.

All Smiths employees are treated with respect and dignity. Accordingly, any harassment or bullying is unacceptable. Smiths respects the right of each employee to join or not to join a trade union or other bona fide employee representative organisation. Smiths believes in good communications with employees and in promoting consultation, co-operation and teamwork on matters of mutual concern.

Smiths offers employees in the US and the UK opportunities to participate in share plans that enable employees to benefit from increases to the company's share price and to align their interests more closely with those of shareholders.

Reaching full potential

Smiths invests in employees' skills and capabilities, which in turn helps the Company and its businesses to succeed. Current priorities for Smiths are talent development, succession planning and employee engagement.

Developing talent

Smiths has a number of development programmes designed to evaluate and enhance core leadership competencies. These development programmes are designed and tailored to address a wide range of learning styles, incorporating workshops, experiential learning, mentoring, team working and project experience.

Smiths continues to be actively involved in training and developing young people, including initiatives designed to ease the transition from school or study to work. For example, Horizons is a two-year programme for newly and recently appointed graduates and those early in their career. It provides an understanding of the Group and the business world in general, and develops personal and team working skills.



Succession management

Smiths operates a systematic succession management process for leadership roles. Our businesses identify leadership talent and development needs using common tools and a consistent language. Development plans are monitored by senior management to optimise effective succession opportunities.

Employee engagement

Smiths provides information to and communicates with employees as an important part of doing business. Employees are regularly provided with a wide range of information concerning the performance and prospects of the business in which they are involved by means of employee councils, information and consultation forums, and other consultative bodies that allow their views to be taken into account.

Communities

Smiths contributes positively to the communities in which we operate. In addition to providing employment opportunities and playing a beneficial role in local economies, we support community involvement through charitable giving and education initiatives.

This activity is primarily managed at a divisional level. However, Smiths does offer some support to community and charitable organisations from a central budget. Consideration is given to charities and organisations that demonstrate how a donation will enhance the wellbeing of people through improved education, health and welfare or environment. Projects local to our operational facilities or connected to the industries in which we operate are the primary focus of Smiths support.

Education is a major recipient of our support. For example together with the Royal Academy of Engineering in the UK, the Smiths Technology Education Programme is now in its second year. Through the programme, school students are offered the opportunity to participate in summer school courses in engineering and technology. Those students who then go on to take an engineering or technology degree course at university are eligible to receive Smiths bursaries. Smiths also supports the Centre for the Study of Terrorism and Political Violence at St Andrews University by funding a research assistant.

Smiths divisions also deliver significant support. The Smiths Medical Chair of Anaesthesia and Critical Care at University College London is an important example of long-term funding that has enhanced medical care.

In addition to donations, Smiths people devote time to local community projects around the world. For further information, please see the 2008 Corporate Responsibility Report at www.smiths.com/responsibility.

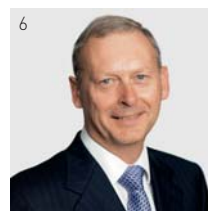
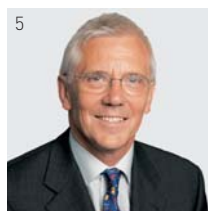
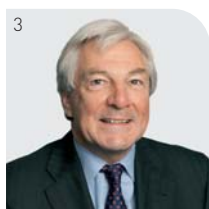
Controls on defence sales

All sales of defence equipment are undertaken in accordance with government export and approval procedures and regulations, such as the International Traffic in Arms Regulation and the Export Administration Regulations in the USA. These laws prohibit export of certain items to specific countries. Smiths adheres to all relevant government guidelines designed to ensure that products are not incorporated into weapons or other equipment used for the purposes of terrorism or abuse of human rights, with internal controls to ensure compliance with these guidelines.

FTSE4Good

In 2008, Smiths was awarded membership of the FTSE4Good Index which recognises companies that meet globally recognised corporate responsibility standards. Whilst we are not complacent about the ongoing work required, we were pleased to receive this external recognition of our corporate responsibility initiatives and business ethics programme.

Board of directors



1 Donald Brydon, CBE Chairman †#

Aged 63. British. Donald Brydon was appointed to the Board in April 2004, becoming Chairman in September 2004. He was previously Chief Executive of AXA Investment Managers SA and prior to that had been Chairman and Chief Executive of BZW Investment Management. He is Chairman of the London Metal Exchange, Chairman of Taylor Nelson Sofres plc and a Member of the Board of AXA Investment Managers SA. He was formerly Chairman of Amersham plc.

Chairman of the Nomination Committee.

2 Philip Bowman Chief Executive

Aged 55. Australian. Philip Bowman was appointed Chief Executive in December 2007. He is currently the senior independent director of Burberry Group plc and is a non-executive director of Berry Brothers and Rudd Limited, as well a member of the Advisory Board of Alchemy Partners. He previously held the positions of Chief Executive at Scottish Power plc from early 2006 until mid 2007 and Chief Executive at Allied Domecq plc between 1999 and 2005. Past board appointments include Scottish & Newcastle plc, British Sky Broadcasting Group plc and Coles Myer Limited as well as Chairman of Liberty plc and Coral Eurobet plc. His earlier career includes five years as a director of Bass plc (now Mitchells & Butler plc and Intercontinental Hotel Group plc), where he held the roles of Chief Financial Officer and subsequently Chief Executive of Bass Taverns.

3 David Challen, CBE Non-executive director *†

Aged 65. British. David Challen was appointed to the Board in September 2004. He is Vice-Chairman of Citigroup European Investment Bank and former Chairman of J Henry Schroder & Co Ltd. He is Senior Independent Director at Anglo American and Deputy Chairman of the Takeover Panel.

Chairman of the Audit Committee.

4 Stuart Chambers Non-executive director †

Aged 52. British. Stuart Chambers was appointed to the Board in November 2006. He was Chief Executive of Pilkington plc and became Group Chief Executive of Nippon Sheet Glass in June 2008. Prior to joining Pilkington plc in 1996, he spent ten years at Mars Corporation, latterly as Vice President, Sales & Marketing – Mars Electronics International. A chemical engineer by training, he previously spent ten years at Shell in a variety of European roles. He is also Chairman of the North West Business Leadership Team.

Chairman of the Remuneration Committee.

5 Peter Jackson Non-executive director †*#

Aged 61. British. Peter Jackson was appointed to the Board as a non-executive director in December 2003 and as senior independent director in September 2004. He was formerly Chief Executive of Associated British Foods plc. He is Chairman of Kingfisher plc and chair of the Disabilities Trust.

Senior independent director.

6 John Langston Finance Director

Aged 58. British. John Langston was appointed to the Board in December 2000 on the Company's merger with TI Group plc. A Chartered Accountant, he was appointed Finance Director in September 2006. He previously held positions as head of Sealing Solutions, Group Managing Director of Detection and Group Managing Director of Specialty Engineering. He joined TI Group in 1993, becoming Chief Executive of Bundy Automotive in 1996 and Chief Executive of TI Specialty Polymer Products in 1998. He was appointed a director of TI Group plc in October 1998. He formerly worked for Lucas Industries.

7 Sir Kevin Tebbit, KCB, CMG Non-executive director †*#

Aged 61. British. Sir Kevin Tebbit was appointed to the Board in June 2006. He served widely in policy, management and finance posts in the Foreign & Commonwealth Office, NATO and finally the Ministry of Defence, where he was Permanent Under-Secretary of State from July 1998 to his retirement in November 2005. He is Chairman of Finmeccanica UK. He is also Visiting Professor at Queen Mary, University of London.

Committees

* Audit Committee

† Remuneration Committee

Nomination Committee

Group directors' report

Principal activities

The principal activities of the Company and its subsidiaries (the Group) are and, during the year ended 31 July 2008, were the development, manufacture, sale and support of:

- advanced security equipment, including trace detection, millimetre-wave, infra-red, biological detection and diagnostics, that detect and identify explosives, narcotics, weapons, chemical agents, biohazards and contraband;
- mechanical seals, seal support systems, engineered bearings, power transmission couplings, specialist filtration systems and other hardware for the oil & gas, chemical, pharmaceutical, pulp & paper and mining sectors;
- medical devices aligned to specific therapies, principally airway, pain and temperature management, infusion, needle protection, critical care monitoring and vascular access;
- specialised electronic and radio frequency products that connect, protect and control critical systems for the global wireless telecommunications, aerospace, defence, space and medical markets; and
- engineered components including ducting, hose assemblies and heating elements that move and heat fluids for the aerospace, medical, industrial, construction and domestic markets.

The main manufacturing operations are in the UK, the Americas, Continental Europe and China.

Business review/future development/research and development

The business review is on pages 12 to 35 and is incorporated by reference, forming part of this directors' report. This is a review of the development and performance of the business of the Group, including the financial performance during the financial year ended 31 July 2008; key performance indicators; and the principal risks and uncertainties facing the Group. It also includes information on likely future developments and activities in the field of research and development. The cautionary statement set out on the inside front cover of this Annual Report forms part of this Annual Report and is incorporated by reference into the business review.

Results and dividends

The results for the financial year ended 31 July 2008 are set out in the Consolidated income statement on page 59. Sales for the year amounted to £2,321m (2007: £2,161m). The profit for the year after taxation amounted to £268.8m (2007: £1,728.1m).

An interim dividend of 10.5p per ordinary share of 37.5p was paid on 25 April 2008. The directors recommend for payment on 21 November 2008 a final cash dividend of 23.5p on each ordinary share of 37.5p, making a total dividend of 34p for the financial year.

The retained profit of £268.8m was transferred to Reserves.

Changes in the Company and its interests during the financial year

On 19 September 2007 the Company announced that it was no longer proceeding with the conditional agreement with GE to form Smiths GE Detection, due to differences over a strategic vision for the combined businesses.

On 3 November 2007 the Company sold the issued share capital of Kelvin Hughes Limited and its associated companies for £44m in cash, after a working capital adjustment.

On 15 October 2007 the Company acquired the issued share capital of Sartorius Bearing Technology GmbH for £19m in cash.

On 21 December the Company acquired a further 21% of the issued share capital of John Crane Japan Limited for ¥862m in cash, bringing its interest in John Crane Japan to 70%.

On 4 February 2008 the Company acquired the business and assets of Fast Heat, Inc. for US\$18m in cash.

On 17 April 2008 the Company completed the purchase of 4,467,437 B shares for 365p per share, in cash, and cancelled the shares. 459,157 B shares currently remain in issue.

On 28 April 2008 the Company acquired the issued share capital of Indufil BV for €90m in cash.

On 2 May 2008 the Company acquired the business and assets of The Fiber Composite Company, Inc. (known as Fiberod) for US\$91m in cash.

On 7 May 2008 the Company acquired the issued share capital of Allrizon Tongguang Communication Equipment (Shanghai) Co Ltd for RMB 135m in cash.

On 1 July 2008 the Company acquired the issued share capital of Triasx Pty Ltd for Aus\$29m in cash.

On 28 July 2008 the shareholders in general meeting approved the adoption of new Articles of Association, which take effect on 1 October 2008; a new share incentive plan, the Smiths Group Value Sharing Plan; and amendments to the Smiths Group Co-Investment Plan. Details of the Value Sharing Plan and the amendments to the Co-Investment Plan are included in the Directors' Remuneration Report on pages 47 to 56.

Group directors' report continued

Post balance sheet event

On 1 September 2008 the Company completed the sale of land in Basingstoke for £16m in cash. A further amount of up to £12m will be paid depending on the final terms of such amended planning permission as may be granted.

Charitable and political donations

During the financial year the Company made donations of £469,000 for charitable purposes including payments totalling £150,000 for the Smiths Medical Chair of Anaesthesia and Critical Care and other donations made by the Company's businesses worldwide to miscellaneous charities. No political donations were made.

Directors

On 10 December 2007 Mr K.O. Butler-Wheelhouse retired as a director and Chief Executive and Mr P. Bowman was appointed in his stead. Mr P.H. Loescher resigned as a non-executive director on 4 April 2008 and Mr D.P. Lillycrop resigned as an executive director and Company Secretary on 3 June 2008. Messrs D.H. Brydon; D.J. Challen; S.J. Chambers; P.J. Jackson; J. Langston; and Sir Kevin Tebbit all served throughout the year.

Reappointment of director

Mr P. Bowman will retire from office at the Annual General Meeting (AGM), having been appointed by the Board since the AGM in 2007. Mr Bowman is willing and eligible to stand for re-election and a resolution will be proposed at the AGM to re-elect him.

Directors' remuneration report

The Directors' remuneration report is on pages 47 to 56.

An ordinary resolution to approve the report will be put to shareholders at the AGM.

Directors' interests in contracts

Details of the executive directors' service contracts are as disclosed in the service contracts section of the Directors' remuneration report on pages 52 and 53. Details of the interests of the executive directors in the Company's share option schemes and plans are shown in the Directors' remuneration report on pages 54 to 56.

Qualifying third party indemnity provisions (as defined by section 309B of the Companies Act 1985) have remained in force for the directors during the financial year ended 31 July 2008 and, at the date of this report, are in force for the benefit of the current directors in relation to certain losses and liabilities which they may incur (or may have incurred) to third parties in the course of their professional duties.

Apart from the exceptions referred to above, no director had an interest in any contract to which the Company or its subsidiaries was a party during the year.

Interests in voting rights

As at 19 September 2008 the Company had been notified, pursuant to the FSA's Disclosure & Transparency Rules, of the following notifiable voting rights in its issued share capital:

	No. of shares	Percentage of issued ordinary share capital*
AXA S.A.	21.3m	5.5%
Legal & General Group plc	15.7m	4.1%
Massachusetts Financial Services Company	19.1m	4.9%
Newton Investment Management Limited	15.2m	3.9%

*Percentage of ordinary share capital in issue on 19 September 2008.

The Company has not acquired or disposed of any interests in its own shares other than in connection with the 2007 Return of Cash scheme. Details of shares purchased and cancelled pursuant to that scheme are shown on page 41.

The interests of the directors, their families and any connected persons in the issued share capital of the Company are shown on page 52.

Corporate governance

The report on corporate governance is on pages 43 to 46. PricewaterhouseCoopers LLP has reviewed the Company's statements as to compliance with the June 2006 issue of the Combined Code, to the extent required by the UK Listing Authority Listing Rules. The results of its review are set out on page 58.

Financial instruments

The financial risk management objectives and policies of the Group; the policy for hedging each major type of forecasted transaction for which hedge accounting is used; and the exposure of the Group to price risk, credit risk, liquidity risk and cash-flow risk are outlined in note 21 of the Group financial statements.

Going concern

The Board's review of the accounts, budgets and forward plans, together with the internal control system, lead the directors to believe that the Company has sufficient resources to continue in operation for the foreseeable future. The accounts are therefore prepared on a going concern basis.

Policy on payment of creditors

The Company's policy and practice is to pay creditors promptly in accordance with agreed terms of business. The average time taken to pay an invoice was 33 days (2007: 35) for the parent Company and 43 days (2007: 43) for the Group as a whole.

Share capital and control

As at 31 July 2008, the Company's authorised share capital was £200,228,879.995, divided into 533,333,333 ordinary shares of 37.5p each nominal value (ordinary shares), representing 99.9% of the total share capital, and 22,888,012 non-cumulative preference shares of 1p (preference shares), representing 0.1% of the total share capital. On 31 July 2008 there were 387,879,181 ordinary shares and 459,157 preference shares in issue. The ordinary shares and the preference shares are listed on the London Stock Exchange.

The holders of ordinary shares are entitled to receive the Company's reports and accounts; to attend and speak at General Meetings of the Company; to appoint proxies and to exercise voting rights. The holders of preference shares are entitled to attend, speak and vote at a General Meeting only if the business of the meeting includes the winding-up of the Company or if, at the date of the notice of the meeting, the B share Continuing Dividend under Article 126* has remained unpaid for at least six months. Preference shareholders are entitled to receive the B share Continuing Dividend and have priority over ordinary shareholders on a return of capital on a winding-up of 365p per preference share. The Company has the right to purchase and thereafter cancel preference shares or to convert them into ordinary shares at any time after 30 April 2008.

There are no restrictions on transfer or limitations on the holding of any class of shares and no requirements for prior approval of any transfers. None of the shares carries any special rights with regard to control of the Company. The only restrictions on voting rights are those that apply to the preference shares, as described in the preceding paragraph. There are no known arrangements under which financial rights are held by a person other than the holder of the shares and no known agreements or restrictions on share transfers or on voting rights.

Shares acquired through Company share schemes and plans rank *pari passu* with the shares in issue and have no special rights. The Company operates an employee benefit trust, with an independent trustee, to hold shares pending employees becoming entitled to them under the Company's share schemes and plans. On 31 July 2008 the trust held 1,095,965 ordinary shares in the Company. The trust waives all but 0.1p per share of each dividend entitlement on its holding and abstains from voting the shares at general meetings.

The table on page 38 sets out the notifications received by the Company pursuant to the FSA's Disclosure & Transparency Rules, as at 19 September 2008, from persons with significant direct or indirect holdings in the Company's share capital.

The rules about the appointment and replacement of directors are contained in the Company's Articles of Association. Changes to the Articles of Association must be approved by the shareholders in accordance with the legislation in force from time to time. New Articles of Association were approved by the Company in general meeting on 28 July 2008. These take effect on 1 October 2008 and have been adopted primarily to take account of changes in English company law brought about by certain provisions of the Companies Act 2006 which have already come into force or which will come into force on 1 October 2008.

The powers of the directors are determined by English law and the Memorandum and Articles of Association of the Company in force from time to time. The directors have been authorised to issue and allot ordinary shares, pursuant to Articles 6, 7 and 126*, and preference shares, pursuant to Article 126*. The directors have authority to make market purchases of ordinary and preference shares. The powers under Articles 6 and 7 are referred to the shareholders at the AGM for renewal. At the AGM the shareholders are also requested to renew the power to make market purchases of ordinary shares. Any ordinary shares so purchased may be cancelled or held in treasury. Article 126* authorises the purchase of preference shares.

The Company has in place credit facility agreements under which a change in control would trigger prepayment clauses and has bonds in issue the terms of which would allow bondholders to exercise put options and require the Company to buy back the bonds at their principal amount plus interest if a rating downgrade occurs at the same time as a change of control takes effect. The Company's share schemes and plans contain clauses which cause options and awards to vest on a change in control. The Company is not party to any other significant agreements that would take effect, alter or terminate upon a change of control following a takeover bid.

Group directors' report continued

If there is a change in control of the Company prior to 10 December 2010, the terms of Mr Bowman's service contract allow him, at any time during the three months following the change in control, to resign and treat himself as redundant. In this event, (i) Mr Bowman would be entitled to receive the sum payable on a Company-elected termination of his employment, as described on page 52, save that his bonus entitlement for the period from the start of the bonus year in which the termination falls to the end of any unserved notice period would be a minimum of 75% of base salary (less any amount already paid to him in respect of the bonus year) and (ii) all available discretions will be exercised under the Company's share schemes and in default the Company must indemnify Mr Bowman for the value of any awards that do not vest on the change in control.

No other director or employee is contractually entitled to compensation for loss of office or employment as a result of a change in control except that provisions of the Company's share schemes may cause options and awards granted to employees under such schemes to vest on a change in control.

*Article 126 is renumbered as Article 129 from 1 October 2008 when the new Articles of Association, approved by the Company in general meeting on 28 July 2008, take effect.

Corporate responsibility

The Company has Group policies on environmental, health and safety matters and operates a Code of Business Ethics. The Company seeks to minimise, as far as is reasonably practicable, any detrimental effects on the environment of its operations and products. The Group HR director has responsibility for environmental, health and safety matters, which are subject to preventative, investigatory and consultative systems, overseen by the Group Environment, Health and Safety Committee, and reports regularly to the Board on these matters. Issues relevant to the Company pension schemes are likewise covered by means of structured committees, including representation from recognised trade unions.

Further information on environmental and employee health and safety matters, including key performance indicators, is contained in the Corporate responsibility summary in the business review on pages 32 to 35. The full Corporate responsibility report is available online at www.smiths.com/responsibility.

Annual General Meeting

The 2008 AGM will be held at The Thomas Lord Suite, Lord's Cricket Ground, Grace Gate, St John's Wood Road, London NW8 8QN on Tuesday 18 November 2008 at 2:30 p.m.

Authority to issue shares

At the AGM shareholders will be asked to renew the authority, given to the directors at the last AGM, to allot relevant securities for the purposes of Section 80 of the Companies Act 1985. The authority proposed will expire at the conclusion of the next Annual General Meeting of the Company or, if earlier, on 17 February 2010. The amount of relevant securities to which this authority relates (£48,510,168 nominal of ordinary share capital) represents one third of the ordinary share capital in issue on 19 September 2008. The ordinary resolution is set out in the Notice of AGM.

Also in the Notice is the special resolution to renew the power granted to directors under Section 95 of the Companies Act 1985. The new authority sought will be on substantially similar terms to those attaching to the existing authority and will expire at the conclusion of the next AGM of the Company or, if earlier, on 17 February 2010. It will permit the directors to allot equity securities for cash:

- in connection with a rights issue pro rata to the rights of the existing shareholders;
- pursuant to the terms of any share scheme or plan approved by the shareholders in General Meeting; and
- for any other purpose (including the sale on a non pre-emptive basis of any shares the Company may hold in treasury for cash) provided that the aggregate nominal value of such allotments does not exceed £7,276,525 (approximately 5% of the issued ordinary share capital on 19 September 2008).

The directors intend seeking renewal of these authorities annually.

The directors have no present intention of exercising these authorities, except for allotments of shares pursuant to the Company's share option schemes, and would not seek to issue more than 7.5% of the issued share capital in the Company in any rolling three year period without prior consultation with the Investment Committees of the Association of British Insurers and National Association of Pension Funds.

During the financial year ended 31 July 2008, the following shares in Smiths Group plc were issued:

- 2,268,348 ordinary shares of 37.5p pursuant to the terms of the Company's shareholder-approved share option schemes; and
- 112,560 ordinary shares of 37.5p pursuant to the terms of TI Group share option schemes.

Authority to purchase shares

At the AGM the Company will seek to renew the authority, granted at the last AGM to the directors, to purchase the Company's ordinary shares in the market. The authority will be limited to 10% of the ordinary share capital in issue on 19 September 2008 and will be renewed annually. The price that may be paid for the shares will be not less than the nominal amount of 37.5p per share and not more than the higher of 5% above the average of the middle market quotations of the Company's ordinary shares, as derived from the London Stock Exchange Daily Official List, for the five business days prior to any purchase and the amount stipulated by Article 5(1) of the Buy-back and Stabilisation Regulation 2003. On 19 September 2008 options over approximately 8.4m shares were outstanding under the Company's share option schemes, representing approximately 2.2% of the then issued share capital. If the existing authority to purchase shares and the new authority being sought at the AGM were to be used in full and the purchased shares were cancelled, then the outstanding options would represent approximately 2.7% of the reduced issued share capital.

Under the Companies Act 1985, any shares purchased under this authority may be cancelled or held as treasury shares. Treasury shares may be subsequently sold or used to satisfy applications under share schemes.

The directors will exercise the authority only if they are satisfied that any purchase will increase the earnings per share of the ordinary share capital in issue and will be in the interests of the shareholders. The directors will also give careful consideration to the gearing levels of the Company and its general financial position. It is the Company's present intention that, in the event that any shares were to be purchased under this authority, such shares would be cancelled. The directors will, however, have regard to any guidelines issued by investor groups which may be published at the time of any such purchase regarding the merits of the cancellation of such shares as against holding them as treasury shares.

Purchase of shares

In accordance with the authorities given at the Extraordinary General Meeting held on 11 June 2007 in connection with the Return of Cash to shareholders from the sale of the Aerospace division, on 17 April 2008 the Company purchased 4,467,437 non-cumulative preference shares of 1p each (90.7% of the then issued preference share capital) for an aggregate consideration of £16,306,145.05 and immediately cancelled them.

Political donations

A resolution will be proposed at the AGM to renew and revise the authority, granted by the shareholders in 2004 to the Company and its subsidiaries, to make donations to EU political organisations and to incur EU political expenditure. The new authority will follow the provisions of Part 14 of the Companies Act 2006 (the 2006 Act) and permit the Company and its subsidiaries, present and future, to make donations (i) to political parties; (ii) to other political organisations or independent election candidates; and (iii) to incur political expenditure. The authority will expire at the conclusion of the next AGM of the Company or, if earlier, on 17 February 2010 and will be limited to £50,000 in respect of each of items (i) to (iii) above. As was the case in 2004, the proposal of this resolution is a precautionary measure in the light of the wide definitions of political donations and expenditure contained in the 2006 Act. The resolution proposed is in general terms and does not purport to authorise particular donations. The Company has not made any political donations in the past under the expiring resolution and it is not the present intention of the Company to make any political donations or incur any political expenditure in the foreseeable future. The directors intend seeking renewal of this authority annually.

Auditor

Resolutions will be proposed at the AGM to reappoint PricewaterhouseCoopers LLP as auditor and to authorise the directors to determine the auditor's remuneration.

Disclosure of information to the auditor

As at the date of this report, as far as each director is aware, there is no relevant audit information of which the Company's auditor is unaware. Each director has taken all the steps as he should have taken as a director in order to make himself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Electronic communications at www.smiths.com

The Companies Act 2006 recognises the growing importance of electronic communication ("e-communication") and enables companies to provide documentation and communications to shareholders via their websites, except to those shareholders who elect to receive hard (printed paper) copies by post. E-communication allows shareholders faster access to important information about the Company; saves the Company considerable overheads, by reducing its print production costs and postage; and helps the environment by saving the energy and raw materials that would otherwise be used in producing and dispatching printed documents. At the Extraordinary General Meeting held on 11 June 2007 shareholders approved the adoption of electronic communications.

Electronic copies of the Annual Report 2008 and the Notice of AGM are posted on the Company's website, www.smiths.com. The Company's announcements to the Stock Exchange and press releases are available online through the website. Shareholding details and practical help on share transfers and changes of address can be found at www.shareview.co.uk.

Shareholders wishing to change their election and receive documents in hard copy form can do so at any time by contacting the Company's Registrar (see the inside back cover for contact details) or by logging on to www.shareview.co.uk.

Group directors' report continued

Electronic proxy voting

The Company continues to provide electronic proxy voting for this year's AGM. Shareholders who are not Crest members can appoint a proxy and vote online for or against (or consciously not vote on) the resolutions to be proposed at the AGM by visiting the website www.sharevote.co.uk. The onscreen instructions will give details on how to complete the appointment and voting process. Crest members, Crest personal members and other Crest sponsored members should consult the Crest Manual or their sponsor or voting service provider for instructions on electronic proxy appointment and voting. The Company may treat as invalid a Crest proxy voting instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.

Paper proxy cards have been distributed with the Notice of AGM to all shareholders other than those who have elected for notification by e-mail.

Shareholders who will not be able to attend the AGM on 18 November 2008 in person are encouraged to vote their shares by appointing a proxy and issuing voting instructions (either electronically or by completing and returning their proxy cards). Electronic and paper proxy appointments and voting instructions must be received by the Company's Registrar not later than 48 hours before the AGM in order to be valid.

In order to facilitate voting by corporate representatives at the meeting, arrangements will be put in place at the meeting so that (i) if a corporate shareholder has appointed the chairman of the meeting as its corporate representative with instructions to vote on a poll in accordance with the directions of all of the other corporate representatives for that shareholder at the meeting, then on a poll those corporate representatives will give voting directions to the chairman and the chairman will vote (or withhold a vote) as corporate representative in accordance with those directions; and (ii) if more than one corporate representative for the same corporate shareholder attends the meeting but the corporate shareholder has not appointed the chairman of the meeting as its corporate representative, a designated corporate representative will be nominated from those corporate representatives who attend to vote on a poll and the other corporate representatives will give voting directions to that designated corporate representative. Corporate shareholders are referred to the guidance issued by the Institute of Chartered Secretaries and Administrators on proxies and corporate representatives (www.icsa.org.uk) for further details of this procedure. The guidance includes a sample form of representation letter if the chairman is being appointed as described in (i) above.

Registrar

On 1 October 2007 Advent International acquired Lloyds TSB Registrars and changed its name to Equiniti Limited. Equiniti Limited continues to act as the Company's Registrar and to provide shareholder services to the members of Smiths Group plc. The address and contact details of Equiniti Limited are listed on the inside back cover of this report. Individual shareholders' access to their personal shareholder information continues to be available online, through the www.shareview.co.uk website. Dividend payments will continue to be made through Lloyds TSB Bank. The shareholder helpline telephone number has changed to 0871 384 2943. (Note: calls to this number are charged at 8p per minute from a UK BT landline. Other telephony providers' costs may vary.)

Important information

If you are in any doubt as to what action you should take in relation to the resolutions being proposed at the AGM, you are recommended to consult your stockbroker, bank manager, solicitor, accountant or other independent professional adviser authorised under the Financial Services and Markets Act 2000. If you received this document in printed form from the Company and have recently sold or transferred all your shares in Smiths Group plc, please pass this document to the purchaser or transferee or to the agent through whom the sale or transfer was effected for transmission to the purchaser or transferee.

Recommendation

Your directors believe that all the proposals to be considered at the AGM are in the best interests of the Company and its shareholders as a whole and recommend shareholders to vote in favour of the resolutions. The directors intend to vote in favour of the resolutions in respect of their own beneficial holdings.

By Order of the Board

Sarah Cameron
Secretary

765 Finchley Road
London NW11 8DS

23 September 2008

Corporate governance report

Compliance with the Combined Code

Throughout the period 1 August 2007 to 31 July 2008 the Company has been in full compliance with the June 2006 issue of the Combined Code on Corporate Governance (the Code) except that the value of any fees received by executive directors in respect of external non-executive directorships is not disclosed in the Remuneration Report, as this is not considered relevant to the Company.

Directors

The Board

The Board is collectively responsible for the Company's success. The Board's role is to provide entrepreneurial leadership within a framework of controls that allow risk to be assessed and managed. The Board sets strategic aims and the Company's values, ensuring that obligations to shareholders are met. Non-executive directors have a particular role in overseeing the development of strategy, scrutinising management performance and ensuring the integrity of financial information and systems of risk management. The Board is satisfied that it has met these requirements.

During the last financial year the membership of the Board has changed. Mr K.O. Butler-Wheelhouse retired as Chief Executive on 10 December 2007 and was succeeded on that date by Mr P. Bowman. Mr P.H. Loescher, who had been a non-executive director since 1 June 2007, resigned on 4 April 2008. Mr D.P. Lillycrop, who was appointed as an executive director on 4 December 2000 and as Company Secretary on 11 December 2000, resigned from both offices on 3 June 2008. Ms S.L. Cameron was appointed as the Company Secretary on 1 July 2008.

As at 19 September 2008, the Board comprises Mr Brydon (Chairman), Mr Bowman (Chief Executive), one other executive director and four independent non-executive directors. Mr Jackson is the senior independent director. Biographies of these directors, giving details of their experience and other main commitments, are set out on page 36. The wide-ranging experience and backgrounds of the non-executive directors ensure that they can debate and constructively challenge management in relation to both the development of strategy and the evaluation of performance against the goals set by the Board.

The Board normally holds formal meetings at least six times a year to make and review major business decisions and monitor current trading against plans which it has approved. It additionally exercises control by determining matters specifically reserved to it in a formal schedule which only the Board may change: these matters include the acquisition of significant companies, the issue of shares, significant contractual commitments, the review of the effectiveness of risk management processes and major capital expenditure. Once a year, the Board meets with a particular focus on long-term strategy and developments affecting the Company. Additional meetings are arranged as necessary to deal with urgent items.

The Board sets the Company's values and standards and has adopted a Code of Business Ethics which is referred to on page 32.

The Chairman meets the non-executive directors without the executive directors present at least three times per annum. The senior independent director meets the other non-executive directors without the Chairman present at least annually.

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

The following table shows the number of scheduled Board and Board Committee meetings held during the financial year ended 31 July 2008 and opposite each director's name the number of meetings they were eligible to attend and the number actually attended. However, directors attend many other meetings and make site visits during the year. The Board views directors' contributions as measured beyond meeting attendance records.

Name	Board Meetings		Audit Committee		Remuneration Committee		Nomination Committee	
	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended
D H Brydon	7	7	–	–	5	5	4	4
P Bowman (appointed 10/12/2007)	5	5	–	–	–	–	–	–
D J Challen	7	7	3	3	5	5	–	–
S J Chambers	7	7	–	–	5	5	–	–
P J Jackson	7	7	3	3	3	3	4	4
J Langston	7	7	–	–	–	–	–	–
Sir Kevin Tebbit	6	6	2	2	3	2	3	3
K O Butler-Wheelhouse (retired 10/12/2007)	2	2	–	–	–	–	–	–
D P Lillycrop (resigned 03/06/2008)	6	6	–	–	–	–	–	–
P H Loescher (resigned 08/04/2008)	4	2	–	–	2	1	–	–

– indicates not a member of that Committee in 2007/08

Chairman and Chief Executive

The Board has established clearly defined roles for the Chairman and the Chief Executive, in writing. The Chairman is responsible for leadership of the Board, ensuring its effectiveness and setting its agenda. Once agreed by the Board as a whole, it is the Chief Executive's responsibility to ensure delivery of the strategic and financial objectives.

Corporate governance report continued

Board balance and independence

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

In deciding the chairmanship and membership of the Board Committees, the need to refresh membership of the Committees is taken into account.

All the non-executive directors are considered to be independent and Mr Brydon was considered independent at the time of his appointment as Chairman.

Appointments to the Board

The Nomination Committee has a formal, rigorous and transparent procedure for the appointment of new directors, which are made on merit and against objective criteria.

Information and professional development

The Board is provided with detailed information several days in advance on matters to be considered at its meetings and non-executive directors have ready access to the executive directors. Regular site visits are arranged and non-executive directors are encouraged to visit sites independently. During site visits, briefings are arranged and the Board is free to discuss aspects of the business with employees at all levels.

Newly-appointed directors undergo an induction programme to ensure that they have the necessary knowledge and understanding of the Company and its activities. They undertake briefing sessions on corporate governance, strategy, stakeholder issues, finance and risk management and HR strategy, as well as meetings and site visits to business locations in the UK and overseas. Each director's individual experience and background is taken into account in developing a programme tailored to his own requirements.

Ongoing training is provided as and when necessary. The suitability of external courses is kept under review by the Company Secretary who is charged with facilitating the induction of new directors and with assisting in the ongoing training and development of directors.

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

Performance evaluation

The Board undertakes a formal and rigorous annual evaluation of its own performance and that of its Committees and the directors. It is confirmed that all the non-executive directors have sufficient time to fulfil their commitments to the Company, that the Chairman does not hold the office of chairman of another FTSE 100 company and that no executive director holds more than one non-executive directorship of another FTSE 100 company.

A formal evaluation of the performance of the Board, its Committees and the directors was conducted by means of detailed questionnaires completed by each director. The answers to the questionnaires formed the basis of a review by the whole Board, led by the Chairman.

The performance evaluation of the Chairman was led by the senior independent director who obtained the views of both the executive and non-executive directors.

Re-election

Non-executive directors are appointed for a specified term of three years and re-election for a second term is not automatic. In exceptional circumstances and only after rigorous review, a non-executive director may serve for a third term. Any non-executive director who has served for more than nine years is subject to annual re-election. Directors stand for re-election by the shareholders at the first Annual General Meeting (AGM) following their appointment and subsequently at least every three years.

Remuneration

Information regarding the Remuneration Committee is set out on page 46 and the Directors' remuneration report is on pages 47 to 56.

Accountability and audit

Financial reporting

The Board is required to present a balanced and understandable assessment of the Company's position and prospects in the Annual Report and in interim and other public reports. The Board is satisfied that it has met this obligation. A summary of the directors' responsibilities for the financial statements is set out on page 57.

The 'going concern' statement required by the Code is set out in the Group directors' report on page 39.

Internal control

The Board maintains a sound system of internal control to safeguard shareholders' investment and the Company's assets. The effectiveness of the internal control system is reviewed at least annually, covering all material controls, including financial, operational and compliance controls and risk management systems, and the Board reports to shareholders that it has done so. The Financial Reporting Council's report, "Internal Control: Revised Guidance for Directors on the Combined Code (October 2005)" provides guidance.

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

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

The Group has an embedded process for the identification, evaluation and management of significant business risks. The process is reviewed through the Audit Committee and monitored by the Group Internal Audit Department. The Company has during the year identified and evaluated the key risks under three categories – Strategic; Operational; and Corporate Responsibility, including ethical matters and information provision – and has ensured that effective controls and procedures are in place to manage these risks.

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

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

Throughout the financial year the Board, through the Audit Committee, reviews the effectiveness of internal control and the management of risks. In addition to financial and business reports, the Board has reviewed medium and longer-term strategic plans; capital expenditure and development programmes; management and product development programmes; reports on key operational issues; tax; treasury; risk management; insurance; legal matters; and Audit Committee reports, including internal and external auditor reports.

Audit Committee and Auditor

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

Relations with shareholders

Dialogue with shareholders

The Chief Executive, Finance Director and the Director, Investor Relations communicate with institutional investors through analysts' briefings and extensive investor roadshows in the UK, US and continental Europe, as well as timely Stock Exchange announcements, meetings with management and site visits. Members of the Board, and in particular non-executive directors, are kept informed of investors' views in the main through distribution of analysts' and brokers' briefings. At least twice a year a report is made to the Board on the number and types of meetings held with institutional shareholders. The Chairman and the non-executive directors are available in the event of shareholder concerns which cannot be addressed through management. On appointment, new non-executive directors are available to meet shareholders on request.

Constructive use of the AGM

All directors normally attend the Company's AGM and shareholders are invited to ask questions during the meeting and to meet directors after the formal proceedings have ended. It is intended that there shall be a poll vote on each resolution at the 2008 AGM. Shareholders will be advised as to the provisional results of the poll vote on each resolution immediately after each poll is taken. The audited, final results of the poll votes will be released to the London Stock Exchange and published on the Company's website, www.smiths.com, as soon as is practicable after the conclusion of the AGM.

The Chairmen of the Audit and Nomination Committees were available at the 2007 AGM to answer shareholders' questions. Mr Chambers, the Chairman of the Remuneration Committee, was not able to attend the meeting: Mr Brydon, a member of the Committee, was available to answer shareholders' questions in his stead. All the directors, apart from Mr Chambers, were in attendance. The notice of the AGM and related papers were sent to shareholders 20 working days before the meeting.

Board Committees

The full terms of reference of the following Board Committees are available upon request and on the Company's website, www.smiths.com.

Audit Committee

The members of the Committee during the financial year were Mr Challen (Chairman), Mr Jackson and Sir Kevin Tebbit.

The Board has determined that the Committee members have the skills and experience necessary to contribute meaningfully to the Committee's deliberations. In addition, the Chairman of the Committee has requisite experience in accounting and financial management.

The Committee meets at least three times per year to monitor the integrity of the Company's financial statements and the effectiveness of the external audit process, Corporate Governance issues and, in particular, the implementation of the Company's Code of Business Ethics and the arrangements for employees to raise confidentially (and anonymously, if they so choose) concerns about possible wrongdoing in financial reporting and other matters. It is responsible for ensuring that an appropriate relationship between the Company and the external auditor is maintained, including reviewing non-audit services and fees and implementing the Company's audit partner rotation policy. The Committee has primary responsibility for making recommendations to the Board on the appointment, reappointment and removal of the external auditor.

The Committee also reviews annually the Group's systems of internal control; the processes for monitoring and evaluating the risks facing the Group; and the effectiveness of the internal audit function: it is responsible for approving the appointment and removal of the Director, Internal Audit. The Committee reviews annually its terms of reference and its effectiveness and recommends to the Board any changes required as a result of such review.

In July 2008 the annual review of the Committee's terms of reference resulted in a number of largely clarificatory changes.

Corporate governance report continued

In the year to 31 July 2008, the Audit Committee discharged its responsibilities by reviewing:

- the Group's financial statements and interim results statement prior to Board approval and the external auditor's detailed reports thereon;
- the audit fee and non-audit fees payable to the Group's external auditor;
- the external auditor's effectiveness and plan for the audit of the Group's 2007/08 accounts, which included confirmations of auditor independence and the proposed audit fee, and approving the terms of engagement for the audit;
- an annual report on the Group's systems of internal control and their effectiveness, reporting to the Board on the results of the review and receiving regular updates on key risk areas of financial control;
- the risks associated with major business programmes; and
- the internal audit function's terms of reference, its 2007/08 work programme and regular reports on its work during the year.

The Committee has authority to investigate any matters within its terms of reference, to access resources, to call for information and to obtain external professional advice at the cost of the Company.

No one other than the members of the Committee is entitled to be present at meetings. However, the Chairman and the non-executive directors who are not members of the Committee, the Chief Executive, Finance Director, Group Financial Controller, Director, Internal Audit and external auditor are normally invited to attend. Others may be invited to attend by the Committee. The papers for and Minutes of each Committee Meeting are sent to all directors. At least once a year, there is an opportunity for the external auditor, the Director, Internal Audit and the Director of Business Ethics to discuss matters with the Committee without any executive management being present. The Director, Internal Audit, the Director of Business Ethics and the external auditor have direct access to the Chairman of the Committee outside formal Committee meetings.

The Committee reviews the nature and extent of non-audit services provided by the external auditor in order to ensure that objectivity and independence are maintained. Under the audit independence policy, approved by the Committee, certain non-audit services may not be provided by the external auditor, certain services require the approval of the Finance Director and other services require the approval of the Chairman of the Committee. Where the cost of the services is expected to exceed £100,000, the engagement will normally be subject to competitive tender. The external auditor has in place processes to ensure that its independence is maintained including safeguards to ensure that where it does provide non-audit services, its independence is not threatened. The external auditor has written to the Audit Committee confirming that, in its opinion, it is independent.

Remuneration Committee

Mr Brydon and Mr Challen were members of the Committee throughout the financial year. Mr Chambers served as Chairman of the Committee throughout the year. Mr Loescher was a member of the Committee until his resignation as a director on 4 April 2008. Mr Jackson and Sir Kevin Tebbit were appointed as members of the Committee on 16 April 2008.

The Committee's responsibilities and terms of reference are described in the Directors' remuneration report on page 47.

Nomination Committee

During the financial year the members of the Committee were: Mr Brydon, as Chairman of the Committee, Mr Jackson and Sir Kevin Tebbit.

The Committee leads the process for identifying, and makes recommendations to the Board regarding, candidates for appointment as directors of the Company and as Company Secretary, giving full consideration to succession planning and the leadership needs of the Group. It also makes recommendations to the Board on the composition of the Nomination Committee and the composition and chairmanship of the Audit and Remuneration Committees. It reviews regularly the structure, size and composition of the Board, including the balance of skills, knowledge and experience and the independence of the non-executive directors, and makes recommendations to the Board with regard to any changes.

The Committee meets periodically when required. No one other than members of the Committee is entitled to be present at meetings but the non-executive directors who are not members of the Committee and the Chief Executive are normally invited to attend and external advisers may be invited by the Committee to attend.

The Committee has access to such information and advice both from within the Group and externally, at the cost of the Company, as it deems necessary. This may include the appointment of external search consultants, where appropriate. The Committee reviews annually its terms of reference and effectiveness and recommends to the Board any changes required as a result of such review. In July 2008 the annual review of the Committee's terms of reference resulted in a number of revisions.

The procedures referred to above, including the use of an external search consultant, were used by the Nomination Committee in recommending the appointment of Mr Bowman as the Chief Executive on 10 December 2007.

Directors' remuneration report

The Directors' remuneration report is presented to shareholders by the Board. The report complies with the Directors' Remuneration Report Regulations 2002 (the Regulations). A resolution will be put to shareholders at the Annual General Meeting on 18 November 2008 inviting them to approve this report.

Remuneration policy and arrangements

The Remuneration Committee

Responsibilities of the Committee include making recommendations to the Board on the Group's executive remuneration policy and determining, on behalf of the Board, specific remuneration packages for the executive directors and Chairman. The Committee operates within agreed terms of reference which are available for inspection on the Company's website. The Company complied with the provisions of the Combined Code 2006 on Corporate Governance relating to directors' remuneration throughout the financial year except as is disclosed on page 43.

In 2007/08 the Committee consisted of: Mr S.J. Chambers (Chairman of the Committee); Mr D.H. Brydon; Mr D.J. Challen; Mr P.J. Jackson (member from 16 April 2008); Mr P.H. Loescher (resigned on 4 April 2008); and Sir Kevin Tebbit (member from 16 April 2008).

Mr Brydon is absent when his own remuneration as Chairman of the Company is under consideration. The Chief Executive attends meetings of the Committee by invitation; he is absent when his own remuneration is under consideration.

During the year, the Committee received material assistance and advice from the Chief Executive, the General Counsel (who was also Secretary to the Committee until 3 June 2008) and the HR Director (who was also Secretary to the Committee from 3 June 2008).

During the year, the Committee received advice from Kepler Associates, who succeeded Towers Perrin as the independent executive remuneration advisers to the Committee in March 2008, and Freshfields Bruckhaus Deringer LLP. Kepler Associates did not provide any other advice to the Group. Freshfields Bruckhaus Deringer LLP, who were appointed by the Company, also advised the Group on various legal matters during the year.

Remuneration policy

The Committee applies a remuneration policy which has at its core the following objectives:

- to align the interests of executives with those of shareholders
- to focus on top line growth, improving margins and capital discipline
- to link a significant proportion of remuneration to financial and individual performance, both in the short-term and long-term
- to provide strong linkage between remuneration and performance
- to ensure remuneration is market-competitive and helps attract and retain executives of the highest calibre.

Remuneration arrangements

The remuneration of senior executives balances fixed, variable, short-term and long-term remuneration, and is reviewed each year to ensure that they are appropriately incentivised to achieve the Group's objectives.

For 2007/08, executive directors' remuneration comprised basic salary, benefits in kind, annual bonus and pension benefits. In addition, executive directors and senior executives participated in share-based incentive schemes, which in 2007/08 included the Smiths Group Sharesave Scheme, the Smiths Group Performance Share Plan (PSP) and the Smiths Group Co-Investment Plan (CIP).

During the year, the Remuneration Committee reviewed the Group's senior executive remuneration arrangements with a view to ensuring that they support the new strategy of focusing on value creation at both Group and Divisional levels.

On 28 July 2008, shareholders approved the Value Sharing Plan (VSP), a one-off long-term incentive plan rewarding executives for value creation at Group and Divisional levels over three-year and four-year periods commencing with the financial year 2008/09. The two executive directors and any other 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. The CIP will continue to operate with some amendments, also approved by shareholders. The participants in the VSP (including executive directors) will not be eligible for awards under the Performance Share Plan in 2008/09 or 2009/10.

Directors' remuneration report continued

The main elements of remuneration for executive directors in 2007/08 and 2008/09 are summarised below:

Element	Objective	2007/08 policy	2008/09 policy
Base salary (see page 49)	<ul style="list-style-type: none"> Reflects individual performance and experience; size and nature of the role 	<ul style="list-style-type: none"> Reviewed annually 2007/08 annual base salaries for current executive directors range from £400,000 to £800,000 p.a. 	<ul style="list-style-type: none"> Frozen at current levels for at least 2 years
Annual bonus (see page 49)	<ul style="list-style-type: none"> Incentivises short-term operational and financial performance 	<ul style="list-style-type: none"> Rewards Group and Divisional profit, cashflow and individual performance Maximum opportunity of 120% of salary for the Chief Executive and 100% of salary for other executive directors 	<ul style="list-style-type: none"> Increased weighting on individual performance Tougher performance targets Opportunity increased to 180% of salary for the Chief Executive and 150% of salary for any other executive director
Co-Investment Plan (CIP) (see page 49)	<ul style="list-style-type: none"> Encourages executives to build a shareholding in the Company Helps align interests of executives and shareholders 	<ul style="list-style-type: none"> Voluntary investment opportunity of up to 100% of net bonus earned (or 25% of salary, if higher) into Smiths shares 1-for-1 matching opportunity on any invested shares if average 3-year ROCE exceeds WACC+1% p.a. 	<ul style="list-style-type: none"> Mandatory investment in Smiths shares of 50% of any net bonus earned in respect of 2008/09 2-for-1 matching opportunity on invested shares after 3 years if average ROCE exceeds WACC+3% p.a. (1-for-1 match for ROCE between WACC+1% and WACC+3% p.a.)
Performance Share Plan (PSP) (see page 50)	<ul style="list-style-type: none"> Incentivises executives to achieve superior long-term performance and commitment to the goals of the Group Aligns executives' interests with those of shareholders Helps retain key talent 	<ul style="list-style-type: none"> Annual conditional share awards vesting 1/3rd on 3 year TSR relative to the FTSE100 (excluding financial services companies) and 2/3rds on 3-year EPS growth Awards worth 133.3% of salary for the Chief Executive and 112.5% of salary for other executive directors 	<ul style="list-style-type: none"> Replaced by VSP (see below)
Value Sharing Plan (VSP) (see page 49)	<ul style="list-style-type: none"> Incentivises senior executives to drive value creation Reinforces and rewards delivery of strategic goals 	<ul style="list-style-type: none"> Not applicable 	<ul style="list-style-type: none"> One-off incentive rewarding value creation over 3 years and 4 years Executives receive a pre defined number of shares per £5m of 'surplus value created'. For executive directors, 1/3rd of an award is based on growth in TSR relative to the FTSE100 (excluding financial services companies) and 2/3rds on the growth in internal value above the cost of equity
Pension (see page 50)	<ul style="list-style-type: none"> Provides competitive retirement benefits 	<ul style="list-style-type: none"> Varies between executive directors according to what was agreed at time of appointment 	<ul style="list-style-type: none"> As for 2007/08
Share ownership guidelines (see page 50)	<ul style="list-style-type: none"> Requires executives to build and maintain a significant shareholding in Smiths Supports alignment with shareholder interests 	<ul style="list-style-type: none"> 150% of salary for executive directors 	<ul style="list-style-type: none"> Increase share ownership guideline for the Chief Executive to 200% of salary 150% of salary for other executive directors

The executive directors' remuneration packages in 2007/08 and 2008/09 include fixed and variable elements. The fixed element is salary, which remains unchanged for both the Chief Executive and Finance Director, as described above: the variable elements assume that target annual bonuses will be achieved in respect of each year and include fair-value assessments of the long term incentive components of the packages awarded in each year. Approximately 60% of the executive directors' total remuneration for 2007/08 is expected to come from the variable elements of their packages: the changes outlined above for 2008/09 are anticipated to increase the proportion of their remuneration that is derived from variable elements to approximately 70%.

Elements of Remuneration

Base salary and benefits

Executive directors' salaries have typically been reviewed annually, taking into account individual performance and experience, the size and nature of the role, the relative performance of the Company, remuneration policy within the Company and salaries at comparator companies. The salaries for all participants in the Value Sharing Plan, including executive directors, will be frozen at current levels until 2010. Executive directors' base salaries for 2008/09 are, therefore, unchanged from 2007/08 at the following levels:

Executive director	Salary last reviewed	2008/09 salary
Mr P Bowman	10 December 2007	£800,000
Mr J Langston	1 August 2007	£424,000

Benefits include a fully expensed company car, or an allowance in lieu, and health insurance.

Annual bonus

2007/08

Executive directors were eligible to participate in an annual bonus plan based on a combination of corporate financial goals (Group and Divisional profit and cashflow) and individual performance. The maximum annual bonus opportunity for the Chief Executive was 120% of salary and for other executive directors was 100% of salary. Bonuses to be paid to executive directors in respect of the 2007/08 financial year are set out in the emoluments table on page 51.

2008/09

Maximum annual bonus opportunities will be increased to 180% of salary for the Chief Executive and 150% of salary for any other executive director. Targets will be made commensurately more demanding, and one-third of the bonus opportunity will be linked to the achievement of personal objectives. 50% of any net bonus earned must be invested in Smiths shares under the rules of the CIP.

Co-Investment Plan (CIP)

2007/08

Executive directors and selected senior executives were invited to participate in the CIP. Participants were able to invest up to 100% of their net earned annual bonus (or, if greater, 25% of salary) into Smiths shares. Invested amounts were eligible for a 1-for-1 matching share award after three years (based on the pre-tax amount of salary or deferred bonus in question), subject to continued employment in the Group and the Company's average return on capital employed (ROCE) over the performance period exceeding the Company's weighted average cost of capital (WACC) over the same period by an average margin of at least 1% per annum.

2008/09

Executive directors and selected senior executives will be required to invest 50% of any net bonus earned in respect of 2008/09 in Smiths shares. The maximum matching opportunity will be increased to 2-for-1, subject to the average ROCE exceeding the WACC by at least 3% p.a. over three years (with a 1-for-1 match if ROCE is between WACC+1% and WACC+3% p.a.). As a change to 2007/08, notional dividends will be paid on matching shares that vest.

The Committee continues to regard ROCE as an appropriate performance condition for reflecting the operating efficiency of the Company.

Value Sharing Plans (VSPs)

The Group and Divisional VSPs are one-off, long-term incentive plans, designed to reinforce Smiths' strategy of focusing on shareholder value creation at the Group and Divisional levels.

Group VSP

Messrs Bowman and Langston are participants in the Group VSP, which rewards executive directors and selected senior executives with a pre determined number of shares for every £5m of value created above a hurdle over the three-year and four-year performance periods from 1 August 2008 (or until a vesting event, if earlier). On 28 July 2008 Mr Bowman was granted an award under which he will be entitled to receive 1,250 Smiths Group shares for each £5m of surplus value created in respect of each performance period. On the same date Mr Langston was granted an award under which he will be entitled to receive 500 Smiths Group shares for each £5m of surplus value created in respect of each performance period.

– TSR Element

One-third of the award will depend on the growth, over each performance period, in Smiths' market capitalisation plus net equity cashflows to shareholders (i.e. dividends plus share buybacks less share issues) over and above the median total shareholder return of the FTSE100 companies (excluding financial services companies).

– Earnings Element

The remaining two thirds of each award will be determined by the growth, over each performance period, in adjusted Profit Before Tax (PBT) (2007/08: £338.6m) times a fixed multiple of 12 plus net equity cashflows to shareholders over and above a cost of equity hurdle return of 9.5% p.a.

Participants will only be entitled to a vesting of shares under the TSR Element if the Committee is satisfied that this is justified by the underlying financial performance of the Company over the Performance Period.

No retesting of either performance condition is permitted.

Directors' remuneration report continued

Divisional VSPs

In addition to the Group VSP, the Committee has introduced Divisional plans for each of the five divisions (Smiths Detection, Smiths Medical, John Crane, Smiths Interconnect, and Flex-Tek). The plans are along the same lines as the Group VSP to help focus the most senior Divisional executives on maximising the value of their divisions and returning surplus cash. Further details on the Divisional VSPs are contained in the Circular Letter to Shareholders dated 4 July 2008.

Performance Share Plan (PSP)

No awards will be made under the PSP to executive directors or any other participants in the VSP in 2008/09 and 2009/10. Grants to executive directors in 2007/08 were between 112.5% and 133.3% of salary. An award of 150% of salary was made to Mr Bowman on his appointment.

Awards vest after three years, subject to performance conditions. One-third of the award vests based on the Company's TSR performance relative to the FTSE100 companies (excluding financial services companies); the remaining two-thirds of the award vests subject to an earnings per share (EPS) growth target (measured before exceptional items).

Sharesave Scheme

The Smiths Group Sharesave Scheme, which is open to all UK employees with at least 12 months' service, is subject to UK legislation as to the amount that can be saved. Participants save a fixed sum per month for three or five years and may use the sum generated by their savings contracts to exercise the options which are usually granted at a 20% discount to the market price.

Share ownership guidelines

It is the Committee's policy that executive directors should, over time, acquire a shareholding with a value equal to at least one and a half years' gross salary and retain at least 50% of any net vested share awards (after sales to meet tax liabilities) until those values are achieved. In 2008/09, the share ownership guideline will be increased to two years' gross salary for the Chief Executive.

Share scheme dilution limits

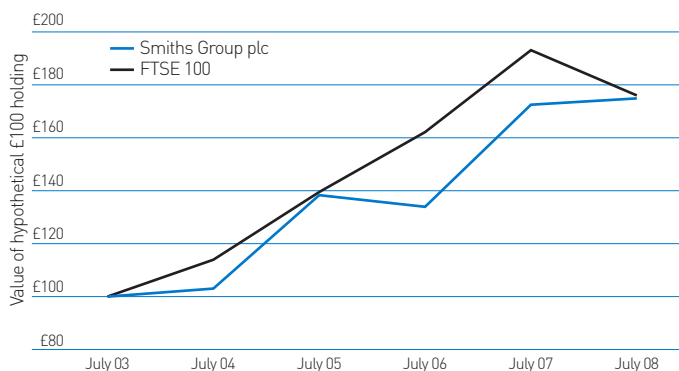
The Company follows the guidelines laid down by the Association of British Insurers. These restrict the issue of new shares under all the Company's share schemes in any 10-year period to 10 per cent of the issued ordinary share capital and under the Company's discretionary schemes to 5 per cent in any 10-year period. As at 31 July 2008, the headroom available under these limits was 3.8% and 0.1%, respectively (excluding the conditional share awards granted under the VSP on 28 July 2008).

Pension

The Company operates appropriate pension arrangements for executive directors. In the case of Mr Bowman, the Company pays a monthly salary supplement of a percentage of salary approved by the Committee to enable him to make his own pension provision. In the case of Mr Langston, a final salary scheme provides a pension of up to two-thirds of final pensionable salary. The Company continues to apply an earnings cap, on a basis similar to the pre-2006 statutory limit, to determine the proportion of overall pension payable by the regulated pension scheme, with the balance of pension provided by the Company. This arrangement substantially represents a continuation of pre-2006 practice and involves no additional cost for the Company. In appropriate cases, the Company permits the waiver of salary and pension supplement entitlements where the arrangement does not involve additional cost for the Company. Where such waivers are made, incentives and pension entitlements continue to be calculated by reference to salaries prior to these reductions. Details of the salary supplements, waiver and other pension provisions are set out in the tables on pages 51 and 52.

Five-year historical TSR performance

The following graph shows the Company's total shareholder return (TSR) performance over the past five years compared to the FTSE100 Index. The FTSE100 Index, of which the Company has been a member throughout the period, has been selected to reflect the TSR performance of other leading UK-listed companies. The values of hypothetical £100 investments in the FTSE100 Index and Smiths Group plc shares (after adjustment for the Return of Cash in June 2007) were £165 and £166 respectively.



Remuneration

The total remuneration of directors, excluding the value of shares to which certain directors may become entitled under the Performance Share Plan and Co-Investment Plan and also defined benefit pension arrangements, was as follows:

	2008 £000	2007 £000
Fees, salaries and benefits, compensation for loss of office	4,098	2,740
Performance-related bonuses	1,232	1,943
Aggregate gain from exercise of share options and vesting of share awards	2,026	3,479
Incremental gain from deferred share scheme exercises	109	363
Payments in lieu of pension contribution	362	544
	7,827	9,069

The emoluments of the directors are set out below:

	Fees/salary		Compensation for loss of office	Benefits	Bonus	Payments in lieu of pension contribution	Total emoluments	
	2008 £000	2007 £000	2008 £000	2008 £000	2008 £000	2008 £000	2008 £000	2007 £000
Chairman								
D H Brydon	295	273	–	22	–	–	317	293
Chief Executive								
P Bowman (appointed 10/12/07)	516	–	–	14	608	217	1,355	–
Executive director								
J Langston	424	400	–	38	346	–	808	788
Non-executive directors								
D J Challen	67	65	–	–	–	–	67	65
S J Chambers (appointed 27/11/06)	62	40	–	–	–	–	62	40
P J Jackson	67	65	–	–	–	–	67	65
Sir Kevin Tebbit (appointed 14/06/06)	52	50	–	–	–	–	52	50
Directors who resigned in 2007/08								
K O Butler-Wheelhouse (retired 10/12/07 – note 4)	310	840	1,748	46	–	145	2,249	2,132
D P Lillycrop (resigned 03/06/08 – note 5)	337	359	–	70	278	–	685	787
P H Loescher (appointed 01/06/07; resigned 08/04/08)	36	8	–	–	–	–	36	8
Directors who resigned in 2006/07 (in aggregate)	–	412	–	–	–	–	–	999
	2,166	2,512	1,748	190	1,232	362	5,698	5,227

1. Shares which may be awarded under the Performance Share Plan; Co-Investment Plan; and the Group Value Sharing Plan are as set out in the directors' share options and awards table on pages 54 to 56.

2. Under the arrangements approved by the Remuneration Committee, Mr Butler-Wheelhouse waived entitlements to certain of his emoluments in return for the Company making equivalent amounts of contributions to the Smiths Industries Pension Scheme to provide money purchase benefits, which does not involve additional cost for the Company. Under these arrangements, Mr Butler-Wheelhouse waived £38,905.79 during the year. The amounts waived would otherwise have been paid to Mr Butler-Wheelhouse as payments in lieu of pension contributions and are included in the table above.

3. In common with other UK employees participating in the relevant pension schemes, the salaries of Messrs Langston and Lillycrop were each reduced by £8,580 and the Company paid the same amount directly to the pension schemes during the year. The salaries shown in the table above for these directors are the amounts they would have been paid if they had not given up these salary entitlements.

4. Mr Butler-Wheelhouse retired on 10 December 2007. The salary, benefits and pension contribution information in the table above relates to his employment from 1 August 2007 to 10 December 2007. Further information on Mr Butler-Wheelhouse's termination arrangements, including his bonus payment for 2007/08, is set out below.

5. Mr Lillycrop remained in service on his existing terms and conditions following his resignation from the board. The information in the table reflects salary and benefits up to his resignation and the proportion of the 2007/08 bonus attributable to his period of service as a director within that year. During the period 4 June to 31 July 2008, Mr Lillycrop received £63,388 in salary and benefits to the value of £13,164 as an employee: the proportion of his 2007/08 bonus attributable to that period was £53,395. Further information on Mr Lillycrop's termination arrangements is set out below.

Directors' remuneration report continued

Directors' pension entitlements

Accrued annual pension under defined benefit schemes

	Age at 31 July 2008	Accrued entitlement at 31 July 2007 £000	Additional pension earned during the year (excluding any increase for inflation) £000	Transfer value of accrued benefits at 31 July 2008 (New basis) (A) £000	Transfer value of accrued benefits at 31 July 2007 (MFR basis) (B) £000	Transfer value of accrued benefits at 31 July 2007 (New basis) (C) £000	The amount of (A – B) less contributions made by the director in 2008 £000	Accrued entitlement at 31 July 2008 £000 p.a.
J Langston	58	212	20	5,670	3,656	4,183	2,014	241
D P Lillycrop (resigned 03/06/08)	52	156	24	3,414	2,058	2,267	1,356	186

1. An executive director's normal retirement age is 60. An early retirement pension, based on actual service completed, may be paid after age 50 and may be subject to a reduction on account of early payment. On death, a spouse's pension of two-thirds of the director's pension (or for death-in-service his prospective pension at age 60) is payable. All pensions in excess of the Guaranteed Minimum Pension (GMP) are guaranteed to increase at the lesser of (i) 7% per annum compound and (ii) the annual increase in the Retail Prices Index. There has, however, been a long-standing practice of granting additional discretionary increases on pensions in excess of the GMP to bring them into line with price inflation.

2. See Note 3 above. The benefits provided under the relevant pension schemes were not affected by these arrangements.

3. Transfer values of the accrued benefits have been calculated in accordance with actuarial guidance (GN11), and represent the amount that the pension scheme would pay to another pension provider if the member elects to transfer all of his benefits out of the scheme. The transfer values do not represent sums payable or due to the individual directors and therefore cannot be added meaningfully to annual remuneration.

4. The transfer basis changed with effect from August 2007 and therefore the transfer value at 31 July 2007 is shown on the revised basis for comparison purposes (see Column (C) in the table above).

Directors' interests in the Company's shares

	Ordinary shares of 37.5p each 31 July 2008	Ordinary shares of 37.5p each 1 August 2007
D H Brydon	8,000	8,000
P Bowman (appointed 10/12/07)	20,000	3,000†
D J Challen	1,333	1,333
S J Chambers	1,333	1,333
P J Jackson	0	0
J Langston	175,650	112,824
Sir Kevin Tebbit	0	0
K O Butler-Wheelhouse (retired 10/12/07)	317,368*	400,732
D P Lillycrop (resigned 03/06/08)	91,598*	80,623
P H Loescher (resigned 04/04/08)	0*	0

*Indicates holding of ordinary shares of 37.5p each at date of resignation.

†Indicates holding of ordinary shares of 37.5p each at date of appointment

These interests include beneficial interests of the directors and their families in the Company's shares held in trusts and holdings through nominee companies. None of the directors has disclosed any non-beneficial interests in the Company's shares.

The Company has not been notified of any changes to the holdings of the current directors, their families and any connected persons between 1 August and 19 September 2008.

Service contracts

The Company's policy is that executive directors are normally employed on terms which include a one-year rolling period of notice and provision for the payment of a predetermined sum in the event of termination of employment in certain circumstances (but excluding circumstances where the Company is entitled to dismiss without compensation).

Mr Bowman is employed under a service contract with the Company dated 15 November 2007 and effective from 10 December 2007. The service contract is for an indefinite term expressed to end automatically on his anticipated normal retirement date (age 60), but may be terminated by 12 months' notice given by the Company (save that during the first 12 months of employment, the notice period shall expire on the second anniversary of the effective date) or six months' notice given by Mr Bowman. The Company may elect to terminate the contract by making a payment in lieu of notice equal to 150% of Mr Bowman's basic salary in respect of the unserved notice period. In this event, the contract provides that Mr Bowman's bonus entitlement for the financial year in which termination occurs and for the unserved notice period will be the subject of a separate, good faith discussion between Mr Bowman and the Chairman; the contract also specifies that Mr Bowman will be treated as a "good leaver" for the purposes of relevant share plans. In certain constructive dismissal events, Mr Bowman is entitled to resign and be treated in the manner set out above.

Mr Langston is employed under a service contract with the Company dated 26 September 2001. The service contract is for an indefinite term expressed to end automatically on the anticipated normal retirement date (age 60), but may be terminated by 12 months' notice given by the Company or six months' notice given by Mr Langston. The Company may at its discretion elect to terminate the contract by making a payment in lieu of notice on the following terms:

1. the salary receivable during the notice period;
2. an amount equal to 50% of the maximum bonus potential receivable under the executive bonus scheme for the then current bonus year;
3. the annual cost to the Company of providing all other benefits to which Mr Langston is entitled under his contract, which has been pre-agreed as 10% of basic salary; and
4. an amount equal to the cost of securing one year's pensionable service in the appropriate pension scheme(s). In addition, the Company has given its irrevocable consent to early payment of Mr Langston's pension from age 50 and without actuarial reduction from age 55.

Mr Lillycrop, who resigned as a director on 3 June 2008, remains employed under a service contract dated 26 September 2001. Under a compromise agreement dated 14 August 2008, it has been agreed that Mr Lillycrop will remain in service until 30 November 2008 (serving six months of his notice period), continuing to receive normal salary and benefits until that date. In accordance with the termination provisions in his service contract (which reflect those of Mr Langston's service contract, as described above), he will on termination become entitled to a payment of £332,000 and the credit of six months' additional pensionable service. The Company has agreed to the continuation of private healthcare cover for Mr Lillycrop's and his spouse's lifetimes and to approximately £50,000 of educational benefits for his children for the current academic year: he will also be entitled to outplacement counselling and to payment of legal fees relating to the termination. In accordance with Mr Lillycrop's service contract, his share awards under the PSP and matching share awards under the CIP will be preserved and will be capable of vesting on the normal vesting dates without application of time prorating.

Mr Butler-Wheelhouse, who resigned as a director on 10 December 2007, was employed under a service contract with the Company dated 26 September 2001, as varied by a letter dated 31 July 2007. Although it had been anticipated that Mr Butler-Wheelhouse would be retiring on 31 July 2008, such that no compensation would have been payable to him under his service contract on retirement, his employment was, in fact, terminated on 10 December 2007 in order to facilitate handover arrangements to his successor as Chief Executive. He was accordingly entitled under his contract to receive a termination payment of £833,055, representing his entitlement to salary, pension allowance and benefits in kind for the period from 11 December 2007 to 31 July 2008, and a cash bonus of £915,363 (being an amount equal to the average of the annual bonuses paid to him over the three financial years 2004/05, 2005/06 and 2006/07). He was also entitled to the continuation of private healthcare for his and his spouse's lifetimes and to life cover and car benefits until 31 July 2008. In relation to Mr Butler-Wheelhouse's share awards under the PSP and matching share awards under the CIP, the Committee agreed to provide him with the most favourable treatment under the rules, so that his awards will be preserved and capable of vesting on the normal vesting dates without application of time prorating.

External appointments

Subject to the overriding requirements of the Company, the Committee is prepared to allow executive directors to accept external appointments where it considers that such appointments will contribute to the director's breadth of knowledge and experience. Directors are permitted to retain fees associated with such appointments.

Chairman and non-executive directors

Non-executive directors (which term excludes the Chairman) were paid fees totalling £284,000 in the financial year ended 31 July 2008. Their remuneration is determined by the Board in accordance with the Articles of Association, with the non-executive directors abstaining from voting. During the year, the basic fee was £52,000 per annum. The Chairman and the non-executive directors are not eligible for bonuses or participation in share schemes and no pension contributions are made on their behalf. The Chairman and the non-executive directors serve the Company under letters of appointment and do not have contracts of service or contracts for services.

Auditable part

The directors' remuneration tables and accompanying notes on page 51; the directors' pensions table and accompanying notes on page 52; and the directors' share options and awards table on pages 54 to 56 have been audited.

The Directors' remuneration report has been approved by the Board and signed on its behalf by:

S J Chambers

23 September 2008

Directors' remuneration report continued

Directors' share options and long-term share plans

Director and Scheme	Options and awards held on 31 July 2008	Options and awards held on 31 July 2007	Option and award data					Options exercised and awards vested 2007/08				
	Number	Number	Performance test	Exercise price	Grant date	Vesting date*	Expiry date**	Exercise date	Number	Exercise price	Market price at date of grant***	Market price at date of exercise†
P Bowman – appointed 10/12/07												
PSP	75,543	0 x	C	n/a	11/12/07	13/11/10	13/11/10					
	37,771	0 x	D	n/a	11/12/07	13/11/10	13/11/10					
J Langston												
95 ESOS	38,462	38,462	A	806.00p	09/04/02	09/04/05	09/04/12					
	38,461	38,461	B	806.00p	09/04/02	09/04/05	09/04/12					
PSP	0	44,547	C	n/a	07/12/04	07/12/07		07/12/07	44,547	n/a	781.50p	1,059.00p
	0 #	22,274	D	n/a	07/12/04	07/12/07		<i>lapsed 07/12/07</i>				
	38,269	38,269	C	n/a	07/10/05	20/10/08	20/10/08					
	19,135	19,135	D	n/a	07/10/05	20/10/08	20/10/08					
	44,618	44,618	C	n/a	29/09/06	25/10/09	25/10/09					
	22,309	22,309	D	n/a	29/09/06	25/10/09	25/10/09					
	38,243	0	C	n/a	13/11/07	13/11/10	13/11/10					
	19,121	0	D	n/a	13/11/07	13/11/10	13/11/10					
CIP	51,680	51,680	E	n/a	25/10/05	24/09/08	24/09/08					
	31,881	31,881	E	n/a	02/02/07	30/09/09	30/09/09					
	22,202	0	E	n/a	13/11/07	29/09/10	29/09/10					
SAYE	0	1,795		525.00p	05/05/04	01/08/07		01/08/07	1,795	525.00p	525.00p	1,025.00p
	1,088	1,088		868.00p	18/05/07	01/08/10	01/02/11					
DSS	0	17,922		0.10p	07/12/04	07/12/07		07/12/07	17,922	0.10p	784.17p	1,059.00p
TI 90 ESOS	0 #	18,691		1,219.80p	08/09/97	08/09/00		<i>lapsed 08/09/07</i>				
D P Lillycrop – resigned 03/06/08												
95 ESOS	37,221 z	37,221	A	806.00p	09/04/02	09/04/05	01/05/09					
	37,220 z	37,220	B	806.00p	09/04/02	09/04/05	01/05/09					
PSP	0	42,491	C	n/a	07/12/04	07/12/07		07/12/07	42,491	n/a	781.50p	1,059.00p
	0 #	21,246	D	n/a	07/12/04	07/12/07		<i>lapsed 07/12/07</i>				
	36,503 z	36,503	C	n/a	07/10/05	20/10/08	20/10/08					
	18,252 z	18,252	D	n/a	07/10/05	20/10/08	20/10/08					
	40,060 z	40,060	C	n/a	29/09/06	25/10/09	25/10/09					
	20,030 z	20,030	D	n/a	29/09/06	25/10/09	25/10/09					
	36,057 z	0	C	n/a	13/11/07	13/11/10	13/11/10					
	18,029 z	0	D	n/a	13/11/07	13/11/10	13/11/10					
CIP	45,362 z	45,362	E	n/a	25/10/05	24/09/08	24/09/08					
	29,994 z	29,994	E	n/a	02/02/07	30/09/09	30/09/09					
	19,934 z	0	E	n/a	13/11/07	29/09/10	29/09/10					
SAYE	0	1,539		645.00p	09/05/02	01/08/07		01/08/07	1,539	645.00p	645.00p	1,025.00p
	1,185 z	1,185		554.00p	08/05/03	01/08/08		<i>exercised 01/08/08</i>				
	1,131 z	1,131		868.00p	18/05/07	01/08/10	01/05/09					
	899 z	0		724.00p	15/05/08	01/08/13	01/05/09					
DSS	0	21,750		0.10p	07/12/04	07/12/07		07/12/07	21,750	0.10p	784.17p	1,059.00p
TI 90 ESOS	0 #	19,675		1,219.80p	08/09/97	08/09/00		<i>lapsed 08/09/07</i>				
	0	23,364		1,026.66p	13/03/98	13/03/01		29/10/07	23,364	1,026.66p	1,026.66p	1,122.90p

Director and Scheme	Options and awards held on 31 July 2008	Options and awards held on 31 July 2007	Option and award data					Options exercised and awards vested 2007/08				
	Number	Number	Performance test	Exercise price	Grant date	Vesting date*	Expiry date**	Exercise date	Number	Exercise price	Market price at date of grant***	Market price at date of exercise†
K O Butler-Wheelhouse – retired 10/12/07												
95 ESOS	86,849 z	86,849	A	806.00p	09/04/02	09/04/05	10/06/09					
	86,848 z	86,848	B	806.00p	09/04/02	09/04/05	10/06/09					
PSP	0	100,746	C	n/a	07/12/04	07/12/07		07/12/07	100,746	n/a	781.50p	1,059.00p
	0 #	50,373	D	n/a	07/12/04	07/12/07		lapsed 07/12/07				
	86,548 z	86,548	C	n/a	07/10/05	20/10/08	20/10/08					
	43,274 z	43,274	D	n/a	07/10/05	20/10/08	20/10/08					
	93,698 z	93,698	C	n/a	29/09/06	25/10/09	25/10/09					
	46,849 z	46,849	D	n/a	29/09/06	25/10/09	25/10/09					
	82,308 z	0	C	n/a	13/11/07	13/11/10	13/11/10					
	41,154 z	0	D	n/a	13/11/07	13/11/10	13/11/10					
CIP	125,937 z	125,937	E	n/a	25/10/05	24/09/08	24/09/08					
	75,213 z	75,213	E	n/a	02/02/07	30/09/09	30/09/09					
	51,655 z	0	E	n/a	13/11/07	29/09/10	29/09/10					
SAYE	2,964 z	2,964		554.00p	08/05/03	01/08/08		exercised 01/08/08				
DSS	58,987 z	58,987		0.10p	07/12/04	07/12/07		exercised 20/03/08				

Value Sharing Plan

Director and Scheme	VSP awards held on 31 July 2008	VSP awards held on 31 July 2007	Award data						Awards vested 2007/08			
	Shares per £5m surplus value†	Shares per £5m surplus value‡	Performance test	Exercise price	Grant date	Vesting date*	Expiry date**	Exercise date	Number	Exercise price	Market price at date of grant***	Market price at date of exercise¹
P Bowman – appointed 10/12/07												
VSP	417	0 x	F	n/a	28/07/08	Oct 2011	Oct 2011					
	833	0 x	G	n/a	28/07/08	Oct 2011	Oct 2011					
	417	0 x	F	n/a	28/07/08	Oct 2012	Oct 2012					
	833	0 x	G	n/a	28/07/08	Oct 2012	Oct 2012					
J Langston												
VSP	167	0	F	n/a	28/07/08	Oct 2011	Oct 2011					
	333	0	G	n/a	28/07/08	Oct 2011	Oct 2011					
	167	0	F	n/a	28/07/08	Oct 2012	Oct 2012					
	333	0	G	n/a	28/07/08	Oct 2012	Oct 2012					

Key

95 ESOS The Smiths Industries 1995 Executive Share Option Scheme

PSP The Smiths Group Performance Share Plan

CIP The Smiths Group Co-Investment Plan

SAYE The Smiths Group Sharesave Scheme

DSS The Smiths Industries Senior Executive Deferred Share Scheme

TI 90 ESOS The TI Group (1990) Executive Share Option Scheme

VSP The Smiths Group Value Sharing Plan

* The Vesting Dates shown above in respect of options granted under the 95 ESOS and awards made under the PSP, CIP and VSP are subject to the relevant performance test being passed.

** Market price of a Smiths share at date of grant (if different from exercise price). The exercise price of an option under the Smiths Group Sharesave Scheme is set at 20% less than the mid-market closing price of a Smiths share on the business day preceding the date on which employees are invited to participate in the grant. The market prices for DSS options are actual prices paid for the matching shares purchased by the optionholders.

*** The expiry dates shown above apply in normal circumstances. No expiry date is shown if the option or award was exercised or vested or lapsed prior to 19 September 2008. In the case of the two former directors, the expiry dates shown are specific to their particular circumstances.

† Mid-market closing quotation from the London Stock Exchange Daily Official List or actual sale price, if applicable.

Denotes an option that lapsed on the 10th anniversary of its date of grant or a conditional award that lapsed on the 3rd anniversary of the date of its grant.

x Options and awards held at date of appointment as a director of the Company.

z Options and awards held at date of cessation of appointment as a director of the Company.

‡ Indicates the number of shares that will be awarded for each £5m of surplus value created, subject to the performance test and hurdle. The operation of the VSP is explained in detail above.

Directors' remuneration report continued

Performance tests

- A EPS growth versus UK RPI Index + 3% p.a.
- B EPS growth versus UK RPI Index + 4% p.a.
- C PSP Earnings Per Share growth test (see below)
- D PSP Total Shareholder Return rank test (see below)
- E CIP Return on Capital Employed test (see above)
- F Surplus Shareholder Value – VSP TSR Test (see above)
- G Surplus Internal Value – VSP PBT Test (see above)

Notes

The high and low market prices of the ordinary shares during the period 1 August 2007 to 31 July 2008 were 1151p and 891.5p respectively.

The mid-market closing price on 31 July 2007 was 1047p and on 31 July 2008 was 1047p.

The mid-market closing price of a Smiths share on the date of awards made to directors under the PSP and CIP in the 2007/08 financial year was 1057p.

Of the 78,011 shares under options granted to and held by directors under 95 ESOS and SAYE at 31 July 2008, all shares were granted at exercise prices below the market price of a Smiths Group share on 19 September 2008 (1108p).

None of the options or awards listed above was subject to any payment on grant.

Options and awards which lapsed during the financial year ended 31 July 2008 are indicated in the table above by a hash mark (#): no other options or awards held by any director lapsed during the period 1 August 2007 to 31 July 2008.

No other Director held any options over the Company's shares during the period 1 August 2007 to 31 July 2008.

No options or awards have been granted to or exercised by directors or have lapsed during the period 1 August to 19 September 2008.

Executive directors received their final grants of options under the 95 ESOS in October 2003. From 2004 to 2007, senior executives, including directors, received awards under the PSP. The final grant of options under the DSS was issued in December 2004: the DSS has been replaced by the CIP.

PSP awards will be released after three years to the extent a performance condition is met. One-third of the award is subject to a TSR target relative to other FTSE 100 companies (excluding financial companies and investment trusts). For full vesting, the Company's TSR must be at or above the 75th percentile over the three year performance period. 25% of the award will vest if the Company's TSR is at median. Awards will vest on a straight-line pro rata basis between median and 75th percentile. The remaining two-thirds of the award will be subject to an earnings per share (EPS) growth target (measured before exceptional items). For each of the three year cycles commencing in 2005/06, 2006/07 and 2007/08 full vesting will occur if the compound annual growth in EPS is equivalent to 12% per annum. 25% vesting will occur if the compound annual growth in EPS is equivalent to 5% per annum, with vesting on a straight-line basis between 5% and 12%. The Committee considered the use of two measures, in these proportions, to be appropriate. The TSR performance measure is dependent on the Company's relative long-term share price performance and, therefore, brings a market perspective to the Performance Share Plan. This is balanced by a key internal measure, EPS growth, which is critical to our long-term success and ties in with the Group's strategic goals. The Committee determined the threshold and maximum vesting levels operated to date after considering the Company's historic performance and future plans, and on the basis of external advice. There will be no retesting of the TSR and EPS performance measures. The VSP had replaced the PSP and no awards will be made under the PSP in 2008/09 or 2009/10.

The performance criterion for EPS-element of the PSP Awards granted on 7 December 2004 was exceeded and the PSP-element of the Awards vested in full on 7 December 2007. The performance criterion for the TSR-element of the 2004 PSP Awards was not passed and the TSR-element of all those Awards lapsed on 7 December 2007.

The performance tests for options granted the 95 ESOS up to and including December 2004 have all been passed with the sole exception of the grant on 9 April 2002, which failed its initial test and two annual retests. No further retests of the April 2002 grant will be undertaken. The April 2002 grant can now only be exercised in the event of a change in control of the Company or by certain good leavers, in which circumstances the performance tests will be waived.

Under the DSS executive directors were able to use their after tax bonus to purchase the Company's shares at the prevailing market price. At the end of a three year period, if the Director is still in office, he can exercise an option granted to him over matching shares, in respect of any shares retained for that period. The number of matching shares awarded was determined by the Committee at the end of the year in which the bonus was earned by reference to annual bonus, and other corporate financial criteria. The last grant under the DSS was made on 7 December 2004, in respect of bonus earned in the year to 31 July 2004, and matched shares purchased in the market by the grantee on that day.

At 31 July 2008 the trustee of the Employee Share Trust held 1,095,965 shares of which 18,582 shares were held for the benefit of senior executives with extant DSS options (none of the directors had an interest in these shares at 31 July 2008, as disclosed above). The market value of the shares held by the trustee on 31 July 2008 was £11.47m and dividends of approximately £291,114 were waived in the year in respect of the shares held by the trustee during the year.

There are no performance criteria for the SAYE, DSS or the TI 90 ESOS.

Special provisions permit early exercise of options and vesting of awards in the event of redundancy, death, etc.

Statement of directors' responsibilities

Company law requires the directors to prepare accounts for each financial year which give a true and fair view of the state of affairs of the Company and the Group at the end of the year, and of the profit or loss of the Group for that period. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state that the consolidated financial statements comply with International Financial Reporting Standards, and the Parent Company Financial Statements comply with UK GAAP;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts; and
- prepare the accounts on the going concern basis unless it is inappropriate to assume that the Company and the Group will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the accounts comply with the relevant provisions of the Companies Acts 1985 to 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention of fraud and other irregularities.

Independent auditors' report to the members of Smiths Group plc

We have audited the group financial statements of Smiths Group plc for the year ended 31 July 2008 which comprise the consolidated income statement, the consolidated statement of recognised income and expense, the consolidated balance sheet, the consolidated cash-flow statement, the Accounting policies and the related notes. These Group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of Smiths Group plc for the year ended 31 July 2008 and on the information in the Directors' remuneration report that is described as having been audited.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of directors' responsibilities.

Our responsibility is to audit the group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the group financial statements give a true and fair view and whether the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Group directors' report is consistent with the group financial statements. The information given in the Group directors' report includes that specific information presented in the Business review that is cross referred from the Group directors' report.

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the Corporate governance report reflects the company's compliance with the nine provisions of the Combined Code 2006 specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited group financial statements. The other information comprises only the Summary performance, Group at a glance, Chairman's statement, the Chief Executive's statement, the Business review, Board of directors, the Group directors' report, the unaudited part of the Directors' remuneration report, the Statement of directors' responsibilities, the Group financial record and the Financial calendar. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the group financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the group financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the group financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the group financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the group financial statements.

Opinion

In our opinion:

- the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 July 2008 and of its profit and cash flows for the year then ended;
- the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Group directors' report is consistent with the group financial statements.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors
London

23 September 2008

Notes

(a) The maintenance and integrity of the Smiths Group plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

(b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Consolidated income statement

	Notes	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Continuing operations			
Revenue	1	2,321.2	2,160.9
Cost of sales		(1,265.5)	(1,159.1)
Gross profit		1,055.7	1,001.8
Sales and distribution costs		(311.8)	(311.5)
Administrative expenses			
– normal activities		(396.4)	(394.2)
– provision for John Crane, Inc. litigation	4	(49.0)	(100.7)
Other operating income	2		66.9
Profit/(loss) on disposal of businesses	4	27.2	(5.2)
Operating profit	2	325.7	257.1
Interest receivable		2.2	21.4
Interest payable		(43.2)	(57.8)
Other financing (losses)/gains	3	(6.1)	2.1
Other finance income – retirement benefits		41.7	33.7
Finance costs	5	(5.4)	(0.6)
Share of post-tax losses of associated companies	14	(1.0)	(0.5)
Profit before taxation		319.3	256.0
Comprising			
– headline profit before taxation	3	380.3	344.4
– exceptional items	4		
• profit/(loss) on disposal of businesses		27.2	(5.2)
• commutation of insurance policies			42.9
• provision for John Crane, Inc. litigation		(53.7)	(100.7)
• other		(13.6)	(35.2)
– amortisation of acquired intangible assets		(19.2)	(14.8)
– other financing (losses)/gains		(1.7)	0.6
– profit on sale of financial asset			24.0
		319.3	256.0
Taxation	6	(75.0)	(53.1)
Profit after taxation – continuing operations		244.3	202.9
Profit after taxation – discontinued operations	7	24.5	1,525.2
Profit for the period		268.8	1,728.1
Attributable to:			
Smiths Group shareholders		268.5	1,728.1
Minority interests		0.3	
		268.8	1,728.1
Earnings per share	9		
Basic		69.3p	314.7p
Basic – continuing operations		63.0p	36.9p
Diluted		68.5p	310.3p
Diluted – continuing operations		62.3p	36.4p

References in the consolidated income statement, consolidated statement of recognised income and expense, consolidated balance sheet and consolidated cash-flow statement relate to notes on pages 69 to 108, which form an integral part of the consolidated financial statements.

Consolidated statement of recognised income and expense

	Notes	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Exchange gain/(loss)		89.5	(72.2)
Cumulative exchange losses recycled on disposals			49.2
Fair value gain on acquisition of former associate		0.4	
Taxation recognised on exchange losses			
– current			2.4
Taxation recognised on share-based payment			
– current	6	5.2	10.3
– deferred	6	(3.8)	(9.4)
Actuarial (losses)/gains on retirement benefits	10	(254.5)	70.3
Taxation recognised on actuarial (losses)/gains – deferred	6	75.5	(30.1)
Fair value (losses)/gains:			
– on cash-flow hedges	21	(0.5)	(11.9)
– on net investment hedges	21	(47.5)	8.2
Net (expense)/income recognised directly in equity		(135.7)	16.8
Profit for the period		268.8	1,728.1
Total recognised income and expense	27	133.1	1,744.9
Attributable to:			
Smiths Group shareholders		132.8	1,744.9
Minority interests		0.3	
		133.1	1,744.9

Consolidated balance sheet

	Notes	2008 £m	2007 £m
Non-current assets			
Intangible assets	12	1,253.2	1,021.3
Property, plant and equipment	13	296.3	260.9
Investments accounted for using the equity method	14	9.1	12.0
Financial assets – other investments		3.6	0.7
Retirement benefit assets	10	174.2	333.7
Deferred tax assets	6	96.2	94.0
Trade and other receivables	16	14.6	14.7
Financial derivatives	22	1.4	0.4
		1,848.6	1,737.7
Current assets			
Inventories	15	380.3	319.7
Trade and other receivables	16	565.4	489.8
Cash and cash equivalents	17	132.5	186.2
Financial derivatives	22	6.5	13.5
		1,084.7	1,009.2
Assets of businesses held for sale	18		31.3
Total assets		2,933.3	2,778.2
Non-current liabilities			
Financial liabilities:			
– borrowings	20	(720.7)	(567.1)
– financial derivatives	22	(0.1)	(2.5)
Provisions for liabilities and charges	23	(200.6)	(143.4)
Retirement benefit obligations	10	(184.7)	(150.1)
Deferred tax liabilities	6	(64.3)	(118.0)
Trade and other payables	19	(27.5)	(22.5)
		(1,197.9)	(1,003.6)
Current liabilities			
Financial liabilities:			
– borrowings	20	(182.4)	(212.1)
– financial derivatives	22	(21.5)	(2.8)
Provisions for liabilities and charges	23	(70.0)	(90.1)
Trade and other payables	19	(420.7)	(412.6)
Current tax payable		(122.6)	(137.5)
		(817.2)	(855.1)
Liabilities of businesses held for sale	18		(16.2)
Total liabilities		(2,015.1)	(1,874.9)
Net assets		918.2	903.3
Shareholders' equity			
Share capital	26	145.5	144.6
Share premium account	27	303.6	289.0
Capital redemption reserve	27	5.8	5.7
Revaluation reserve	27	1.7	1.7
Merger reserve	27	234.8	234.8
Retained earnings	27	253.7	208.9
Hedge reserve	27	(29.2)	18.6
Total shareholders' equity		915.9	903.3
Minority interest equity		2.3	
Total equity		918.2	903.3

The accounts on pages 59 to 108 were approved by the Board of Directors on 23 September 2008 and were signed on its behalf by:

Philip Bowman
Chief Executive

John Langston
Finance Director

Consolidated cash-flow statement

	Notes	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Net cash inflow from operating activities	28	198.1	246.0
Cash-flows from investing activities			
Expenditure on capitalised development		(19.8)	(87.4)
Expenditure on other intangible assets		(16.1)	(29.6)
Purchases of property, plant and equipment		(64.2)	(118.3)
Disposals of property, plant and equipment		2.7	25.6
Investment in financial assets		(3.4)	
Proceeds from sale of financial asset		1.1	15.0
Acquisition of businesses	29	(149.7)	(34.9)
Disposal of Aerospace	7	(6.3)	2,495.0
Disposals of businesses	30	43.2	9.1
Net cash-flow (used)/generated in investing activities		(212.5)	2,274.5
Cash-flows from financing activities			
Proceeds from exercise of share options	27	21.0	77.7
Purchase of own shares		(20.7)	(7.0)
Dividends paid to equity shareholders	8	(131.4)	(182.4)
Cash paid to shareholders under B share scheme		(16.4)	(2,090.9)
Increase in new borrowings		135.9	19.0
Reduction and repayment of borrowings		(11.0)	(284.7)
Net cash-flow used in financing activities		(22.6)	(2,468.3)
Net (decrease)/increase in cash and cash equivalents		(37.0)	52.2
Cash and cash equivalents at beginning of period		3.1	(51.1)
Exchange differences		(6.1)	2.0
Cash and cash equivalents at end of period	17	(40.0)	3.1
Cash and cash equivalents at end of period comprise:			
– cash at bank and in hand		122.5	148.5
– short-term deposits		10.0	40.8
– bank overdrafts		(172.5)	(186.2)
		(40.0)	3.1
Included in cash and cash equivalents per the balance sheet	17	132.5	186.2
Included in overdrafts per the balance sheet	17	(172.5)	(186.2)
Included in the assets of the disposal group	18		3.1
	17	(40.0)	3.1

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 1985 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 historic cost convention modified to include revaluation of certain financial instruments, share options and pension assets and liabilities, held at fair value as described below. For Smiths Group plc there are no differences between IFRS as adopted for use in the European Union and full IFRS as published by the International Accounting Standards Board.

The accounting policies adopted are consistent with those of the previous financial period except that the Group has adopted 'IFRS 7: Financial instruments: Disclosures' and the amendment to 'IAS 1: Presentation of financial statements'. Adoption of these standards has required additional disclosures on the credit quality of trade receivables and capital management.

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 £63.3m (2007: £58.1m) has been recognised in respect of contracts in progress at the year end with a total expected value of £197.5m (2007: £141.5m). A 5% increase in the proportion of the contract activity recognised in the current year would have increased operating profit by an estimated £0.6m (2007: £0.5m).

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 £163.7m (2007: £121.2m).

As previously reported, John Crane, Inc., a subsidiary of the Company, is one of many co-defendants in litigation relating to products previously manufactured which contain asbestos. Provision has been made for the future legal defence costs which the Group is expected to incur and the expected costs of potential future judgments against John Crane, Inc. The actual future costs could be materially higher or lower than this estimate, depending on the progress of the claims that are ongoing. See note 23 for details.

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 salary progression of current employees, 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.

Taxation

The Group has recognised deferred tax assets relating to UK losses of £94m. The recognition of assets pertaining to these losses 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 deferred tax 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.

The accounts have been prepared in accordance with the accounting policies, as described below.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of 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. They are de-consolidated from 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.

Accounting policies continued

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 from the sale of goods is recognised when the risks and rewards of ownership have been transferred to the customer, which is usually when title passes.

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.

Revenue is measured at the fair value of the consideration received, net of trade discounts and sales taxes.

Long-term funded contracts

Where the outcome of a 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

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 recognised income and expense. 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.

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.

In accordance with the transitional provisions of 'IFRS 2: Share-based Payment', no charge has been recognised for grants of equity instruments made before 7 November 2002.

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 separately on the face of the income statement. The separate reporting of exceptional items helps provide a better picture of the Company's underlying performance. Items which may be included within the exceptional category include:

- profits/(losses) on disposal of businesses;
- 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.

Other intangible assets

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	7 to 12 years
Customer relationships	up to 7 years

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

Accounting policies continued

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%; Motor vehicles – 25%; Tools and other equipment – 10% to 33%.

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.

No borrowing costs are capitalised as part of property, plant and equipment.

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). It excludes borrowing costs. 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.

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.

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 provision 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.

Where a leasehold property is vacant, or sub-let under terms such that the rental income is insufficient to meet all outgoings, provision is made for the anticipated future shortfall up to termination of the lease, or the termination payment, if smaller.

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.

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 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.

Financial assets continued

The subsequent measurement of financial assets depends on their classification. Loans and receivables are measured at amortised cost using the effective interest method. 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.

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 yield 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 equity 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 equity are transferred from equity reserves 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 equity at that time remains in equity 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 equity 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 equity; 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.

Embedded derivatives

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not carried at their fair value. Unrealised gains and losses on these embedded derivatives are recognised 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.

The following methods are used to estimate the fair values of the financial instruments:

- cash, trade receivables and payables and floating rate borrowings – the carrying value is a good approximation of the fair value;
- fixed rate borrowings – quoted market prices of equivalent instruments; 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).

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.

Accounting policies continued

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 are likely to affect future annual reports and accounts.

'IFRS 8: Operating Segments' was issued in February 2007 and will be adopted by Smiths from 1 August 2008. The new standard requires segment information to be prepared on the same basis as information reported to management for decision-making purposes. Following the restructuring of internal reporting from 1 August 2008, five divisions will be reported in the 2009 Annual report. In addition, the operating profit reported will be calculated on the basis used for management reporting and some detailed disclosures will change.

Smiths will determine an appropriate implementation date for the following standards, amendments and interpretations after they have been adopted by the European Union:

An amendment to 'IAS 23: Borrowing costs' was issued in March 2007. This eliminates the option, currently used by the Group, of expensing all borrowing costs when they are incurred. As retrospective adoption is not required, there will be no changes to the information previously reported when this standard is adopted. The impact of the new policy on future reported performance is expected to be limited because the only qualifying assets have short construction periods.

'IFRIC 12: Service concession arrangements' was issued in December 2006 and 'IFRIC 13: Customer Loyalty Programmes' was issued in June 2007. Neither interpretation is expected to have a material impact on the Group because it does not have any material contracts or programmes within the scope of these interpretations.

'IFRIC 14: The limit on a defined benefit asset, minimum funding requirements and their interaction' was issued on 6 July 2007. This interpretation provides guidance on the extent to which a pension scheme surplus should be recognised as an asset. Based on current actuarial advice, this interpretation is not expected to reduce the assets recognised at 31 July 2008 in respect of pension schemes.

'IFRIC 15: Agreements for the construction of real estate' was issued on 3 July 2008. The Group is not involved in the construction or sale of residential real estate. However a review of contract accounting is being undertaken to establish whether or not the same principles apply to any transactions undertaken by the Group. The impact of adopting this interpretation will be determined once this review has been completed.

'IFRIC 16: Hedges of a net investment in a foreign operation' was issued on 3 July 2007. An initial review of the Group's net investment hedging indicated that this interpretation is not likely to affect their accounting treatment. A detailed review of the impact of this interpretation is still in progress.

'IFRS 3: (Revised) business combinations' and 'IAS 27: (Revised) consolidated and separate financial statements' were issued in January 2008. Implementing IFRS 3 (revised) will significantly change the recognition of goodwill, acquisition costs and contingent consideration relating to acquisitions. However it only applies to acquisitions made after it has been adopted. IAS 27 (revised) requires different accounting treatment for minority interest but it is not expected to affect the Group's financial results or position materially.

An amendment to 'IFRS 2: Share based payment' was issued in January 2008. This provides a definition of vesting conditions and specifies the accounting treatment for non-vesting conditions. It is not expected to materially affect the share based payment charge recognised in the Group accounts because only a small proportion of awards under employee share schemes are affected by failures to comply with non-vesting conditions.

'IAS 1: (Revised) Presentation of financial statements' was issued in January 2008. This changes the presentation requirements for other comprehensive income and transactions with shareholders, and requires increased disclosures when there is a restatement of comparatives. Adopting this standard will not affect the recognition, measurement or disclosure of any transactions or events.

In February 2008 amendments to 'IAS 32: Financial Instruments: Presentation' and 'IAS 1: (Revised) Presentation of financial statements' were issued clarifying the treatment of puttable financial instruments. The adoption of these amendments is not expected to have any impact on the Group.

Parent company

The accounts of the parent company, Smiths Group plc, have been prepared in accordance with UK GAAP. The Company accounts are presented in separate financial statements on pages 111 to 120.

The principal subsidiaries of the parent company are listed in the above accounts.

The ultimate parent company of the Group is Smiths Group plc, a company incorporated in England, and listed on the London Stock Exchange.

Notes to the accounts

1 Segment information

Analysis by business segments

For management purposes, the Group has been organised into three business segments – Detection, Medical and Specialty Engineering. These business segments are the basis on which the Group reported its primary segment information. For reporting purposes Specialty Engineering is analysed into two segments: John Crane and Specialty – Other.

Year ended 31 July 2008					
	Detection £m	Medical £m	Specialty Engineering		Total £m
			John Crane £m	Specialty – Other £m	
Revenue	509.3	703.4	625.8	482.7	2,321.2
Headline operating profit	85.6	127.8	95.9	71.3	380.6
Exceptional operating items (note 4)	(0.3)	(10.0)	(51.5)	26.4	(35.4)
Amortisation of acquired intangible assets	(0.4)	(11.3)	(5.5)	(2.0)	(19.2)
Financing losses	0.1	(0.4)	(0.1)	0.1	(0.3)
Operating profit	85.0	106.1	38.8	95.8	325.7
Exceptional finance costs – adjustment to discounted provision (note 4)			(4.7)		(4.7)
Net finance costs – other					(0.7)
Share of post-tax (losses)/profits of associated companies	(1.4)		0.4		(1.0)
Profit before taxation					319.3
Taxation					(75.0)
Profit for the period – continuing operations					244.3

Period ended 31 July 2007					
	Detection £m	Medical £m	Specialty Engineering		Total £m
			John Crane £m	Specialty – Other £m	
Revenue	437.5	690.6	532.4	500.4	2,160.9
Headline operating profit	78.6	127.3	75.3	66.4	347.6
Exceptional operating items (note 4)	(13.0)	(9.6)	(73.2)	(2.4)	(98.2)
Amortisation of acquired intangible assets	(0.4)	(11.5)	(0.6)	(2.3)	(14.8)
Financing losses	(0.1)	(0.2)	(0.2)	(1.0)	(1.5)
Profit on sale of financial assets	65.1	106.0	1.3	60.7	233.1
Operating profit					257.1
Net finance costs					(0.6)
Share of post-tax (losses)/profits of associated companies	(1.1)		0.6		(0.5)
Profit before taxation					256.0
Taxation					(53.1)
Profit for the period – continuing operations					202.9

The Group's revenue is analysed as follows:

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Sale of goods	2,077.8	1,965.2
Contracts	132.1	98.4
Services	111.3	97.3
	2,321.2	2,160.9

Notes to the accounts continued

1 Segment information continued

The non-cash expenditure included in operating costs by division is shown below:

	Year ended 31 July 2008				Period ended 31 July 2007			
	Depreciation £m	Amortisation £m	Goodwill and other asset impairments £m	Other non-cash expenses (excluding impairments) £m	Depreciation £m	Amortisation £m	Goodwill and other asset impairments £m	Other non-cash expenses (excluding impairments) £m
Detection	7.8	4.4		2.7	6.2	2.5		1.8
Medical	26.5	16.6	0.3	4.1	18.3	18.9		3.6
Specialty Engineering:								
John Crane	10.0	7.2		3.5	8.3	2.1		2.6
Specialty – Other	8.9	2.8		2.6	11.0	2.4	10.3	2.4
Continuing operations	53.2	31.0	0.3	12.9	43.8	25.9	10.3	10.4
Discontinued operations					8.4	3.8		3.5
Total	53.2	31.0	0.3	12.9	52.2	29.7	10.3	13.9

Included in goodwill and other asset impairments in 2007 is £8.1m relating to disposal group impairment of assets on re-measurement to fair value less costs of sale.

Capital expenditure

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Detection	32.3	25.9
Medical	37.8	42.5
Specialty Engineering:		
John Crane	21.8	17.3
Specialty – Other	8.2	14.7
Continuing operations	100.1	100.4
Discontinued operations		127.7
	100.1	228.1

Included in discontinued operations for the period ended 31 July 2007 is capital expenditure of £90.9m, incurred during the period after being classified as a disposal group.

1 Segment information continued

Balance sheet

	2008 £m	2007 £m
Assets		
Detection	711.7	604.8
Medical	912.1	899.9
Specialty Engineering:		
John Crane	490.5	336.0
Specialty – Other	375.1	357.6
Operating assets by segment – continuing operations	2,489.4	2,198.3
Unallocated corporate assets	311.4	393.7
Cash and cash equivalents	132.5	186.2
Total assets	2,933.3	2,778.2
Liabilities		
Detection	143.6	164.2
Medical	93.0	136.2
Specialty Engineering:		
John Crane	282.1	253.4
Specialty – Other	77.6	93.2
Operating liabilities by segment	596.3	647.0
Unallocated corporate liabilities	515.7	448.7
Borrowings	903.1	779.2
Total liabilities	2,015.1	1,874.9

Unallocated corporate assets and liabilities include net taxation liabilities of £90.7m, retirement benefit assets of £174.2m, retirement benefit obligations of £184.7m and property, plant and equipment of £16.8m. All these assets and liabilities are not directly attributable to the operating activities.

Analysis by geographical location

The Group's revenue by destination is shown below:

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
United Kingdom	148.3	134.6
North America	1,107.5	1,038.4
Europe	586.3	546.2
Other overseas	479.1	441.7
	2,321.2	2,160.9

The following analysis shows the carrying amounts of the Group's assets, and additions to intangible assets and property, plant and equipment.

	Segment assets		Additions to intangible assets and property, plant and equipment	
	2008 £m	2007 £m	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
United Kingdom	393.8	583.6	16.6	76.9
North America	1,405.5	1,276.4	53.4	118.8
Europe	746.3	554.0	20.0	13.3
Other overseas	255.2	178.0	10.1	19.1
	2,800.8	2,592.0	100.1	228.1
Cash and cash equivalents	132.5	186.2		
	2,933.3	2,778.2	100.1	228.1

Included in additions to intangible assets and property, plant and equipment above were the following in relation to discontinued operations: United Kingdom £nil (2007: £53.4m), North America £nil (2007: £66.7m), Europe £nil (2007: £0.6m), and Other overseas £nil (2007: £7.0m). Of the additions relating to discontinued operations in 2007, the following amounts were incurred during the period after being classified as a disposal group: United Kingdom £37.5m, North America £47.0m, Europe £nil, and Other overseas £6.4m.

Notes to the accounts continued

1 Segment information continued

Additional voluntary segment disclosure of the impact of the restructuring

As set out in the Chief Executive's statement, the roles of the divisions and the corporate centre are being restructured with the new management structure in place from 1 August 2008. The following information, which is presented with no comparatives, illustrates how the result would have been reported if the new structure had been in place for the year ended 31 July 2008.

	Year ended 31 July 2008							
	Detection £m	John Crane £m	Medical £m	Interconnect £m	Flex-Tek £m	Other £m	Corporate £m	Total £m
Revenue	509.3	625.8	703.4	260.6	206.1	16.0		2,321.2
Headline operating profit	93.3	103.8	139.6	54.0	24.3	0.8	(35.2)	380.6
Exceptional operating items (note 4)	0.1	(51.0)	(9.4)	(1.3)	(0.1)	28.3	(2.0)	(35.4)
Amortisation of acquired intangible assets	(0.4)	(5.5)	(11.3)	(2.0)				(19.2)
Financing losses			(0.4)		0.1			(0.3)
Operating profit	93.0	47.3	118.5	50.7	24.3	29.1	(37.2)	325.7
Exceptional finance costs – adjustment to discounted provision (note 4)		(4.7)						(4.7)
Net finance costs – other								(0.7)
Share of post-tax (losses)/profits of associated companies	(1.4)	0.4						(1.0)
Profit before taxation								319.3
Taxation								(75.0)
Profit for the period – continuing operations								244.3

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

	Year ended 31 July 2008							
	Detection £m	John Crane £m	Medical £m	Interconnect £m	Flex-Tek £m	Other unallocated & corporate £m	Cash & borrowings £m	Total £m
Assets	711.7	490.5	912.1	267.4	106.2	312.9	132.5	2,933.3
Liabilities	(143.6)	(282.1)	(93.0)	(47.0)	(29.2)	(517.1)	(903.1)	(2,015.1)
Net assets	568.1	208.4	819.1	220.4	77.0	(204.2)	(770.6)	918.2

2 Operating profit is stated after charging

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Cost of inventories recognised as an expense	1,776.4	1,582.1
Employee costs (note 11)	662.4	645.2
Depreciation of property, plant and equipment including impairment of £0.3m (2007: £8.1m)	53.5	51.9
Amortisation of intangible assets including impairment of £nil (2007: £2.2m)	31.0	28.1
Impairment losses recognised in the period on receivables	0.6	1.3
Research and development expense	52.7	52.3
Operating leases		
– land and buildings	20.2	18.9
– other	7.9	7.2
Fair value movements on derivatives		
– embedded		0.8
– held for trading	0.3	0.7

For the period ending 31 July 2007 other operating income comprises the income received following the commutation of insurance policies (£42.9m – see note 4) and the profit on sale of a financial asset.

2 Operating profit is stated after charging continued

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Audit services		
Fees payable to the Company's auditors for the audit of the parent company and consolidated accounts	0.5	0.4
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	3.6
– other services pursuant to legislation		0.1
	4.0	4.1
Tax services		
– compliance services	0.1	0.1
– advisory services	0.1	0.7
Services in relation to corporate acquisition and disposal transactions		
– sale of Aerospace		1.8
– aborted transaction		1.1
– B-share issue		0.3
– due diligence	0.1	0.9
All other services	0.2	0.2

Other services relate to one-off projects.

3 Headline profit measures

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

The following items have been excluded from the headline measure:

- exceptional items, including income and expenditure relating to John Crane, Inc. asbestos litigation;
- amortisation of intangible assets acquired in a business combination – the amortisation 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.

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Other financing gains and losses		
Financing gains and losses on financial instruments	(1.4)	2.1
Exceptional finance costs – adjustment to discounted provision (note 4)	(4.7)	
	(6.1)	2.1
Financing gains and losses reported in operating profit		
Financing gains and losses on financial instruments	(0.3)	(1.5)
	(6.4)	0.6

Notes to the accounts continued

4 Exceptional items

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

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Operating items		
Restructuring of corporate and divisional headquarters	(4.5)	
Integration of acquisitions	(9.1)	(9.0)
Impairment of goodwill and other assets		(10.3)
Profit/(loss) on disposal of businesses (note 30)	27.2	(5.2)
Aborted transaction costs		(12.7)
Litigation:		
– Commutation of insurance policies (note 23)		42.9
– Provision for John Crane, Inc. asbestos litigation (note 23)	(49.0)	(100.7)
– Provision for other litigation (note 23)		(8.6)
– Class action settlement		5.4
	(35.4)	(98.2)
Financing items		
Exceptional finance costs – adjustment to discounted provision (note 23)	(4.7)	
	(40.1)	(98.2)

Year ended 31 July 2008

On 3 June 2008 the Company announced a number of changes to its corporate centre and divisional headquarters. The total cost of this restructuring, including redundancy, relocation and consolidation of manufacturing, is considered exceptional by virtue of its size. It is expected to amount to approximately £48m over the period to 2010, of which £4.5m has been charged in the current year.

In addition, restructuring costs in connection with the integration of Medex amounting to £9.1m have been incurred in the period. No further costs relating to this restructuring are anticipated.

The operating charge of £49.0m in respect of John Crane, Inc. asbestos litigation comprises a £40.0m provision for the expected costs of future asbestos judgments, £5.2m in respect of adverse legal judgments (net of insurer contributions previously lodged as collateral) and £3.8m arising from movements in the discounting due to changes in US interest rates (see note 23).

Period ended 31 July 2007

Restructuring costs in connection with the integration of Medex amounting to £9.0m were incurred in the period.

Impairment of goodwill and other assets includes £8.1m in respect of the impairment of a disposal group (John Crane Automotive) prior to its eventual sale.

Costs of £12.7m in relation to the proposed joint venture with GE were written off in the light of the decision not to proceed with the joint venture.

John Crane, Inc. commuted certain insurance policies and received £42.9m in cash for the period. At the same time, a provision of £100.7m in respect of legal defence costs for asbestos cases was established (note 23).

The progression of other litigation cases arising in 2007 gave rise to an exceptional charge.

The exceptional charge recognised in 2006 in respect of the class action settlement has now been finalised. That element of the provision which was surplus was therefore released.

5 Net finance costs

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Interest receivable	2.2	21.4
Interest payable		
– bank loans and overdrafts	(19.6)	(28.5)
– other loans	(23.6)	(29.3)
Interest payable	(43.2)	(57.8)
Other financing (losses)/gains		
– fair value losses on hedged debt	(4.0)	(1.0)
– fair value gains on fair value hedge	4.0	1.0
– net foreign exchange (losses)/gains	(1.4)	2.1
– exceptional finance costs – adjustment to discounted provision	(4.7)	
Other financing (losses)/gains	(6.1)	2.1
Retirement benefits		
– return on plan assets	217.3	191.2
– interest cost	(175.6)	(157.5)
Retirement benefits	41.7	33.7
Net finance costs	(5.4)	(0.6)

6 Taxation

	Continuing Year ended 31 July 2008 £m	Continuing Period ended 31 July 2007 £m	Discontinued Year ended 31 July 2008 £m	Discontinued Period ended 31 July 2007 £m
The taxation charge for the year comprises				
– current income taxation	67.0	13.6		87.6
– deferred taxation	8.0	39.5	2.3	0.6
Total taxation expense in the income statement	75.0	53.1	2.3	88.2
Current income taxation				
– UK corporation tax				
– foreign tax	67.0	13.6		62.6
– discontinued tax				25.0
	67.0	13.6		87.6

Notes to the accounts continued

6 Taxation continued

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 29.3% (2007: 30%). The difference is reconciled as follows:

	Continuing Year ended 31 July 2008 £m	Continuing Period ended 31 July 2007 £m	Discontinued Year ended 31 July 2008 £m	Discontinued Period ended 31 July 2007 £m
Profit before tax	319.3	256.0	26.8	1,613.4
Notional taxation expense at UK rate of 29.3% (2007: 30%)	93.7	76.8	7.9	484.0
Effect of overseas taxation	8.2	15.7		5.0
Compliance benefits	(12.4)	(16.5)		(4.0)
Local incentives	(16.1)	(16.1)		(7.0)
Sale of investment		(7.2)		
Tax effect of other non-headline items	1.6	0.4		
Tax effect of Aerospace sale			(5.6)	(389.8)
	75.0	53.1	2.3	88.2
Comprising				
– taxation on headline profit	91.3	86.4		
– tax relief on non-headline loss	(16.3)	(33.3)		
– taxation on discontinued profit				36.9
– tax on sale of discontinued operations			2.3	51.3
Total taxation expense in the income statement	75.0	53.1	2.3	88.2

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Tax on items charged/(credited) to equity		
Current tax credit		
– share-based payment	(5.2)	(10.3)
– exchange gains		(2.4)
	(5.2)	(12.7)
Deferred tax (credit)/charge		
– retirement benefit schemes	(75.5)	30.1
– share-based payment	3.8	9.4
	(76.9)	26.8

6 Taxation continued

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 5 August 2006	(45.9)	24.5	32.7	(11.8)	43.1	42.6
(Charge)/credit to income statement	(41.3)	2.3	(55.6)	22.8	31.7	(40.1)
Charge to equity		(9.4)	(30.1)			(39.5)
Other					(1.5)	(1.5)
Disposals	12.0			(22.0)	27.4	17.4
Exchange adjustments	3.1	(1.7)	(2.2)	0.8	(2.9)	(2.9)
At 31 July 2007	(72.1)	15.7	(55.2)	(10.2)	97.8	(24.0)
Deferred tax assets	11.1		12.7	(4.4)	74.6	94.0
Deferred tax liabilities	(83.2)	15.7	(67.9)	(5.8)	23.2	(118.0)
At 31 July 2007	(72.1)	15.7	(55.2)	(10.2)	97.8	(24.0)
Credit/(charge) to income statement	9.7	0.3	(31.3)	(1.6)	12.6	(10.3)
Charge to equity		(3.8)	75.5			71.7
Other					6.0	6.0
Disposals					(12.8)	(12.8)
Exchange adjustments	(1.9)		0.5	(0.2)	2.9	1.3
At 31 July 2008	(64.3)	12.2	(10.5)	(12.0)	106.5	31.9
Deferred tax assets	(2.6)	0.3	19.7	(4.6)	83.4	96.2
Deferred tax liabilities	(61.7)	11.9	(30.2)	(7.4)	23.1	(64.3)
At 31 July 2008	(64.3)	12.2	(10.5)	(12.0)	106.5	31.9

Included in Other above is a deferred tax liability of £9.3m (2007: £10m) relating to unremitted overseas earnings. No additional tax liabilities have been recognised 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. Other deferred tax also includes the tax benefits of losses carried forward amounting to £26.7m (2007: £15.4m).

The Group has not recognised deferred tax assets relating to tax losses of £102.2m (2007: £17.9m), 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

	2008 £m	Expiry of losses	2007 £m	Expiry of losses
Territory				
– Americas	10.7	2019–2025	10.6	2019–2025
– Europe			5.0	2014
Total restricted losses	10.7		15.6	
Unrestricted losses:				
– operating losses	91.5	No expiry	2.3	No expiry
Total	102.2		17.9	

Notes to the accounts continued

7 Discontinued operations

On 5 May 2007, the Company sold its Aerospace operations to General Electric Company. The Aerospace operations sold comprised the Aerospace business segment as reported in previous annual reports and accounts plus the US microwave company previously reported in Specialty – Other. The revenue and profit before taxation of the US microwave company in the period ended 31 July 2007 were £32.2m and £7.6m respectively. As the Aerospace operations represented a separate business segment, the disposal group was treated as a discontinued operation in the 2007 Annual report and accounts. The post-tax result of the Aerospace operations was disclosed as a discontinued operation in the consolidated income statement. In the cash-flow statement, the operating cash-flows of the Aerospace Group for the period ended 31 July 2007 were aggregated with those of the continuing operations, but are shown separately in the note below.

Profit on disposal of operation

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Total consideration	6.1	2,585.4
Foreign exchange recycled to the income statement on disposal		(48.4)
Provisions and disposal costs	17.1	(76.0)
Pension curtailment gains		63.3
Provision for settlement loss	3.6	(24.3)
	26.8	2,500.0
Net assets disposed		(1,030.4)
Pre-tax profit on disposal	26.8	1,469.6
		£m
Cash received from disposal of Aerospace operations	3.0	2,585.4
Disposal costs	(9.3)	(31.9)
Cash and cash equivalents of subsidiaries disposed		(62.5)
Borrowings of subsidiaries disposed		4.0
Net cash (outflow)/inflow on disposal	(6.3)	2,495.0

The £6.1m consideration recognised in the year ended 31 July 2008 arises from the finalisation of the working capital adjustment.

The provisions and disposal costs movement for the year ended 31 July 2008 include £4.3m other finance income relating to retirement benefits and £12.7m relating to the reassessment of the carrying value of other assets and liabilities

Assets and liabilities of discontinued operations at the date of disposal

	£m
Assets	
Intangible assets	553.0
Property, plant and equipment	256.1
Retirement benefit assets	6.8
Inventories	297.0
Trade and other receivables	1,357.1
Inter-company receivables	1,024.5
Cash and cash equivalents	62.5
Financial derivatives	12.1
Total assets	3,569.1
Liabilities	
Financial liabilities	
– borrowings	(4.0)
– financial derivatives	(2.5)
Provisions for liabilities and charges	(20.6)
Retirement benefit obligations	(0.5)
Deferred tax liabilities	(17.4)
Trade and other payables	(2,493.7)
Total liabilities	(2,538.7)
Net assets	1,030.4

7 Discontinued operations continued

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

Results from discontinued operations

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Revenue		955.6
Cost of sales		(667.9)
Gross profit		287.7
Sales and distribution costs		(29.9)
Administrative expenses		(116.6)
Loss on disposal of business		
Operating profit		141.2
Interest payable		(1.2)
Other financing gains		0.7
Other finance income – retirement benefits		3.1
Profit before taxation		143.8
Taxation relating to performance of discontinued operations (note 6)		(36.9)
Profit on disposal	26.8	1,469.6
Attributable tax charge (note 6)	(2.3)	(51.3)
Profit for the period	24.5	1,525.2
Earnings per share from discontinued operations – pence		
Basic	6.3p	277.8p
Diluted	6.2p	273.9p

The profit before taxation for the period ended 31 July 2007 represents the results of the operations for the period to the date of disposal.

Analysis by geographical location

The Group's revenue from discontinued operations by destination is shown below:

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Revenue		
United Kingdom		125.7
North America		688.6
Europe		95.0
Other overseas		46.3
		955.6

The Group operating profit from discontinued operations was after charging:

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Cost of inventories recognised as an expense		594.6
Employee costs (note 11)		342.5
Depreciation of property, plant and equipment		8.4
Amortisation of intangible assets		3.8
Impairment losses recognised in the period on receivables		0.1
Research and development costs		29.4
Operating leases		
– land and buildings		4.1
– other		1.0
Fair value movements on derivatives		
– embedded		(0.1)
– held for trading		0.7

Notes to the accounts continued

7 Discontinued operations continued

Cash-flows from discontinued operations

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Profit before taxation (including profit on disposal of Aerospace operations)	26.8	1,613.4
Net interest payable		1.2
Financing (gains)/losses		
– charged to financing		(0.7)
Other finance income – retirement benefits		(3.1)
Profit on disposal of discontinued operations	(26.8)	(1,469.6)
		141.2
Amortisation of intangible assets		3.8
Profit on disposal of property, plant and equipment		0.2
Profit on disposal of business		
Depreciation of property, plant and equipment		8.4
Share-based payment expense		3.5
Retirement benefits		(22.6)
Increase in inventories		(51.0)
(Increase)/decrease in trade and other receivables		(17.3)
(Decrease)/increase in trade and other payables		(16.4)
(Decrease)/increase in provisions		(1.1)
Cash generated from operations		48.7
Interest		(1.2)
Tax paid		(6.9)
Net cash inflow from operating activities		40.6

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Operating activities		40.6
Investing activities	(6.3)	2,373.1
Financing activities		14.2
	(6.3)	2,427.9

8 Dividends

The following dividends were declared and paid in the period:

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Ordinary final dividend of 23.5p for 2007 (2006: 21.5p) paid 23 November 2007	90.8	122.3
Ordinary interim dividend of 10.5p for 2008 (2007: 10.5p) paid 25 April 2008	40.6	60.1
	131.4	182.4

The final dividend for the year ended 31 July 2008 of 23.5p per share was declared by the Board on 23 September 2008 and will be paid to shareholders on 21 November 2008. 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 24 October 2008.

9 Earnings per share

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

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Profit attributable to equity shareholders for the year		
– continuing	244.0	202.9
– total	268.5	1,728.1
Average number of shares in issue during the year	387,446,186	549,153,733

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 391,851,712 (2007: 556,934,401) ordinary shares, being the average number of ordinary shares in issue during the period adjusted by the dilutive effect of employee share schemes. For the year ended 31 July 2008 options over 1,376,331 (2007: 847,762) shares were excluded from this calculation because their effect was anti-dilutive for continuing operations.

The average number of shares in issue has reduced as a result of the share consolidation in June 2007 following the disposal of the Aerospace business. The average number of shares in issue during the period ended 31 July 2007 was a reflection of the capital structure appropriate to both the continuing and the discontinued business.

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

	Year ended 31 July 2008		Period ended 31 July 2007	
	£m	EPS (p)	£m	EPS (p)
Profit attributable to equity shareholders of the Parent Company	244.0	63.0	202.9	36.9
Exclude				
– exceptional operating items (note 4)	35.4		98.2	
– (profit on sale)/impairment of financial asset			(24.0)	
– amortisation of acquired intangible assets	19.2		14.8	
– financing gains – charged to administrative expenses	0.3		1.5	
– exceptional finance cost – adjustment to discounted provision (note 4)	4.7			
– charged to financing	1.4		(2.1)	
	61.0		88.4	
– less tax	(16.3)		(33.3)	
	44.7	11.5	55.1	10.1
Headline	288.7	74.5	258.0	47.0
Headline EPS – diluted (p)		73.7		46.3

Notes to the accounts continued

10 Post-retirement benefits

Smiths operates a number of defined benefit plans throughout the world. The principal schemes are in the United Kingdom and in the United States and assets held in separate trustee-administered funds. The Group also provides a defined contribution (401K) plan for its US employees.

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 2006. The most recent valuations of the six principal US pension and post-retirement healthcare plans were performed at 1 January 2008. These valuations have been updated by independent qualified actuaries in order to assess the liabilities of the schemes as at 31 July 2008. Scheme assets are stated at their market values.

Contributions to the schemes are made on the advice of the actuaries with the objective that the benefits be fully funded during the scheme members' average working lives.

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

	UK	US	2008 Other	UK	US	2007 Other
Rate of increase in salaries	4.1%	3.8%	3.7%	4.1%	3.8%	3.0%
Rate of increase in pensions in payment	3.6%	n/a	1.4%	3.1%	n/a	1.0%
Rate of increase in deferred pensions	3.5%	n/a	0.7%	3.1%	n/a	0.6%
Discount rate	6.6%	6.8%	6.0%	5.8%	6.4%	5.1%
Inflation rate	3.6%	3.3%	2.5%	3.1%	2.8%	1.6%
Healthcare cost increases	5.0%	*	3.8%	5.0%	**	2.7%

*8% p.a. reducing 0.5% p.a. to 5% in 2014

**9% p.a. reducing 1% p.a. to 5% in 2012

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 UK schemes are based on the recent actual mortality experience of members within each scheme. The assumptions are based on the PA92 birth year tables with relevant scaling factors based on the experience of the schemes. The assumption also allows for future improvements in life expectancy in line with the medium cohort and a 1% underpin. The assumptions are that a member who retires next year at age 65 will live on average for a further 22 years after retirement if they are male and for a further 25 years if they are female. For a member who is currently 45, when they retire in 20 years' time they are assumed to live on average for a further 23 years after retirement if they are male and for a further 27 years if they are female.

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 are that a member who retires at age 65 will live on average for a further 18 years after retirement if they are male and for a further 20 years after retirement if they are female. For a member who is currently 45, when they retire in 20 years time they are assumed to live on average for a further 19 years after retirement if they are male and for a further 21 years if they are female.

The assets in the scheme and the expected rates of return as at 31 July 2008 were:

	2008					
	UK schemes		US schemes		Other countries	
	Long-term rate of return	Value £m	Long-term rate of return	Value £m	Long-term rate of return	Value £m
Equities	8.2%	1,165.8	8.8%	187.5	8.8%	7.1
Government bonds	4.8%	445.1	5.3%	83.8	6.6%	4.9
Corporate bonds	6.6%	258.4	6.8%	25.8	7.1%	1.8
Insured liabilities	6.6%	271.4	6.8%	1.5	n/a	
Property	7.2%	188.7	7.2%		3.2%	0.2
Other	5.8%	289.0	6.0%	17.9	5.0%	11.0
Total market value		2,618.4		316.5		25.0
Present value of funded scheme liabilities		(2,468.8)		(357.0)		(30.7)
Surplus/(deficit)		149.6		(40.5)		(5.7)
Unfunded pension plans		(34.3)		(3.7)		(16.4)
Post-retirement healthcare		(15.2)		(42.0)		(0.8)
Unrecognised asset due to surplus restriction						(1.5)
Net pension asset/(liability)		100.1		(86.2)		(24.4)

During the year, the Trustees of the TI pension scheme invested £250.0m in annuities which are matched with specific liabilities of the fund. As a result, this investment category is separately analysed.

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

10 Post-retirement benefits continued

	2007					
	UK schemes		US schemes		Other countries	
	Long-term rate of return	Value £m	Long-term rate of return	Value £m	Long-term rate of return	Value £m
Equities	8.2%	1,624.1	8.8%	202.9	8.2%	7.1
Government bonds	4.9%	591.6	5.0%	94.9	6.5%	3.6
Corporate bonds	5.8%	364.9	6.4%	23.8	7.7%	2.5
Property	7.2%	201.8	n/a		n/a	
Other	6.0%	186.7	5.0%	6.0	4.1%	9.0
Total market value		2,969.1		327.6		22.2
Present value of funded scheme liabilities		(2,637.6)		(355.0)		(26.6)
Surplus/(deficit)		331.5		(27.4)		(4.4)
Unfunded pension plans		(33.6)		(3.8)		(14.1)
Post-retirement healthcare		(15.9)		(45.4)		(0.9)
Unrecognised asset due to surplus restriction						(2.4)
Net pension asset/(liability)		282.0		(76.6)		(21.8)

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 scheme's investment portfolios.

Amounts recognised in the income statement – continuing and discontinued operations

	Year ended 31 July 2008				Period ended 31 July 2007			
	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
Current service cost	11.3	7.6	1.3	2.4	28.2	10.6	1.2	2.6
Past service cost		1.0	0.1		0.7	0.2		0.4
Settlement losses/(gains)	20.7				(0.4)	2.8		
Curtailment gains	(1.1)				(36.5)	(20.6)		(9.3)
Total charge/(credit)	30.9	8.6	1.4	2.4	(8.0)	(7.0)	1.2	(6.3)
Expected return on pension scheme assets	(199.5)	(24.5)	(1.5)		(179.6)	(24.2)	(1.2)	
Interest on pension scheme liabilities	148.3	23.0	1.5	6.7	136.3	23.5	1.4	7.0
Net return	(51.2)	(1.5)		6.7	(43.3)	(0.7)	0.2	7.0
Total (credited)/charged to income statement	(20.3)	7.1	1.4	9.1	(51.3)	(7.7)	1.4	0.7

The actual return on scheme assets was a loss of £124.5m (2007: gain of £300.7m).

Notes to the accounts continued

10 Post-retirement benefits continued

The operating cost is charged as follows:

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Cost of sales	6.6	7.3
Sales and distribution costs	5.0	4.4
Administrative expenses	12.1	11.3
Discontinued operations	20.7	20.5
Exceptional operating items		(0.3)
Profit on disposal of business/curtailment gain	(1.1)	(63.3)

Actuarial losses of £254.5m (2007: gains of £70.3m) have been reported in the statement of recognised income and expense. This includes a gain of £0.9m (2007: loss of £1.9m) in respect of unrecognised assets owing to surplus restriction. Cumulative actuarial losses from 1 August 2004 reported in the statement of recognised income and expense are £113.1m (2007: cumulative gain of £141.4m).

During the year, the pension settlement relating to the active Aerospace employees was completed, resulting in a £20.7m settlement charge to discontinued operations. In 2007 a provision of £24.3m was made to cover the expected costs of this settlement. The balance of the provision has been released in the current year.

Amounts recognised in the balance sheet

	Year ended 31 July 2008				Period ended 31 July 2007			
	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
Present value of funded obligations	(2,468.8)	(357.0)	(30.7)		(2,637.6)	(355.0)	(26.6)	
Fair value of scheme assets	2,618.4	316.5	25.0		2,969.1	327.6	22.2	
	149.6	(40.5)	(5.7)		331.5	(27.4)	(4.4)	
Present value of unfunded obligations				(112.4)				(113.7)
Irrecoverable surplus			(1.5)				(2.4)	
Net asset/(liability) recognised in the balance sheet	149.6	(40.5)	(7.2)	(112.4)	331.5	(27.4)	(6.8)	(113.7)

Changes in present value of defined benefit obligations

	Year ended 31 July 2008				Period ended 31 July 2007			
	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	(2,637.6)	(355.0)	(26.6)	(113.7)	(2,630.1)	(394.3)	(11.4)	(126.8)
Transfers in of territories outside UK and USA				(0.1)			(5.2)	(7.1)
Liabilities assumed on acquisitions			(0.1)	(1.3)				(0.2)
Liabilities transferred on disposal				0.3				
Current service cost	(11.3)	(7.6)	(1.3)	(2.4)	(28.2)	(10.6)	(1.2)	(2.6)
Interest on obligations	(148.3)	(23.0)	(1.5)	(6.7)	(136.3)	(23.5)	(1.4)	(7.0)
Employee contributions	(0.2)		(0.2)		(0.4)		(0.2)	
Past service cost		(1.0)	(0.1)		(0.7)	(0.2)		(0.4)
Actuarial gain/(loss) on liabilities	66.7	20.3	0.9	6.7	(14.0)	(10.4)	(9.3)	10.2
Curtailment gain	1.1				36.5	20.6		9.3
Liabilities extinguished on settlements	131.3				12.7	23.6		
Exchange adjustments	(1.3)	(9.7)	(2.7)	(3.8)		24.0	0.8	3.7
Benefits paid	130.8	19.0	0.9	8.6	122.9	15.8	1.3	7.2
At end of period	(2,468.8)	(357.0)	(30.7)	(112.4)	(2,637.6)	(355.0)	(26.6)	(113.7)

10 Post-retirement benefits continued

Changes in present value of scheme assets

	Year ended 31 July 2008				Period ended 31 July 2007			
	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	2,969.1	327.6	22.2		2,770.4	332.8	7.8	
Transfers in of territories outside UK and USA							5.1	
Expected return on assets	199.5	24.5	1.5		179.6	24.2	1.2	
Actuarial (losses)/gains on scheme assets	(312.1)	(35.4)	(2.5)		67.2	20.4	8.1	
Employer contributions	43.5	10.0	2.6	8.6	86.7	13.9	1.9	7.2
Employee contributions	0.2		0.2		0.4		0.2	
Assets distributed on settlements	(152.0)				(12.3)	(26.4)		
Exchange adjustments	1.0	8.8	1.9			(21.5)	(0.8)	
Benefits paid	(130.8)	(19.0)	(0.9)	(8.6)	(122.9)	(15.8)	(1.3)	(7.2)
At end of period	2,618.4	316.5	25.0		2,969.1	327.6	22.2	

Cash contributions

Company contributions to the funded defined benefit pension plans for 2008 totalled £56.1m (2007: £102.5m). 2008 included special UK contributions of £17.1m (2007: £55.9m) including: £13.1 (2007: £13.1m) for special covenant payments; £4.0m (2007: £20.6m) arising from the sale of Aerospace; and Enil (2007: £22.2m) in respect of back-dated payments resulting from trustee valuations. Cash payments in 2009 are expected to be £51.7m.

History of schemes

	2008 £m	2007 £m	2006 £m	2005 £m
Balance sheet				
Present value of defined benefit obligation	(2,968.9)	(3,132.9)	(3,162.6)	(3,127.4)
Fair value of scheme assets	2,959.9	3,318.9	3,111.0	2,890.8
Unrecognised asset due to surplus restriction	(1.5)	(2.4)	(0.5)	
(Deficit)/surplus	(10.5)	183.6	(52.1)	(236.6)
Post-retirement assets	174.2	333.7	183.7	134.6
Post-retirement liabilities	(184.7)	(150.1)	(235.8)	(371.2)
(Deficit)/surplus	(10.5)	183.6	(52.1)	(236.6)

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m	Period ended 5 August 2006 £m	Year ended 31 July 2005 £m
Experience gains/(losses)				
Experience gains/(losses) on scheme liabilities	(6.4)	(57.6)	17.6	0.5
Experience (losses)/gains on scheme assets	(350.0)	95.7	76.6	242.9
Movement on restricted surplus	0.9	(1.9)	(0.5)	

The disclosures above are determined prospectively from 2005. The experience gains and losses on scheme liabilities have been represented to exclude gains and losses arising from changes in actuarial assumptions.

Notes to the accounts continued

10 Post-retirement benefits continued

Balance sheet reconciliation

The balance sheet records the retirement assets and liabilities as follows:

	2008 £m	2007 £m
UK surplus	149.6	331.5
US deficit	(40.5)	(27.4)
Other countries deficit	(7.2)	(6.8)
Unfunded	(112.4)	(113.7)
(Deficit)/surplus	(10.5)	183.6
Post-retirement assets	174.2	333.7
Post-retirement liabilities	(184.7)	(150.1)
(Deficit)/surplus	(10.5)	183.6

At 31 July 2008 the net UK funded pension surplus of £149.6m (2007: £331.5m) represented individual plan surpluses of £174.2m (2007: £333.7m) and deficits of £24.6m (2007: £2.2m).

Sensitivity

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 2008 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 such as salary increases. 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 2009 £m	Increase/ (decrease) in scheme assets £m	(Increase)/ decrease in scheme liabilities £m
Rate of mortality – 1 year increase in life expectancy	(6.0)		(86.8)
Rate of mortality – 1 year decrease in life expectancy	6.3		89.8
Rate of inflation – 0.25% increase	(5.0)		(65.8)
Discount rate – 0.25% increase	1.3		100.7
Expected return on scheme assets – 0.25% increase	7.4		
Market value of scheme assets – 2.5% increase	5.0	73.9	
Healthcare cost trends – 1% increase	(0.6)		(5.4)
Healthcare cost trends – 1% decrease	0.5		4.7

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

Defined contribution plans

The Group operates a number of defined contribution plans. The total expense recognised in the income statement in respect of these plans was £13.7m (2007: £19.1m).

11 Employees

	Year ended 31 July 2008		Period ended 31 July 2007	
	Total (all continuing) £m	Continuing £m	Discontinued £m	Total £m
Staff costs during the period				
Wages and salaries	545.8	528.1	295.6	823.7
Social security	67.3	62.4	25.4	87.8
Share-based payment (note 31)	12.9	10.4	3.5	13.9
Pension costs (including defined contribution schemes) (note 10)	36.4	44.3	18.0	62.3
	662.4	645.2	342.5	987.7

The average number of persons employed was:

	Year ended 31 July 2008	Period ended 31 July 2007
Detection	2,300	2,100
Medical	8,400	8,000
Specialty Engineering:		
John Crane	6,400	5,600
Specialty – Other	5,500	5,100
Continuing operations	22,600	20,800
Discontinued operations		8,300
	22,600	29,100

Key management

The key management of the Group comprises Smiths Group plc Board directors and Group Managing Directors who are not Board members during the year and their aggregate compensation is shown below. Details of directors' remuneration are contained in the report of the Remuneration Committee on pages 47 to 56.

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Key management compensation		
Salaries and short-term employee benefits	7.6	6.6
Cost of post-retirement benefits	1.0	1.2
Cost of share-based incentive plans	5.6	2.8

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 2008		Period ended 31 July 2007	
	Number of instruments '000	Weighted average price	Number of instruments '000	Weighted average price
CIP	306	£0.00	425	£0.00
DSS			109	£0.00
ESOS	177	£8.06	413	£8.57
PSP	795	£0.00	1,067	£0.00
SAYE	9	£8.32	14	£6.96

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

Notes to the accounts continued

12 Intangible assets

	Goodwill £m	Development costs £m	Acquired intangibles (see table on next page) £m	Other £m	Total £m
Cost					
At 6 August 2006	1,241.6	293.7	139.1	112.5	1,786.9
Exchange adjustments	(39.2)	(1.9)	(8.5)	(1.7)	(51.3)
Business combinations	16.8		12.1		28.9
Adjustments to prior year business combinations	0.9		(0.9)		
Additions*	2.2	44.1		18.0	64.3
Transfers to disposal group held for sale at year end		(1.2)		(1.1)	(2.3)
Transfer to disposal group sold by the year end	(301.0)	(283.5)	(10.4)	(50.2)	(645.1)
Disposals			(0.1)	(1.2)	(1.3)
At 31 July 2007	921.3	51.2	131.3	76.3	1,180.1
Exchange adjustments	65.4	2.5	5.7	3.3	76.9
Business combinations	87.0		74.5	0.7	162.2
Adjustments to prior year business combinations	(1.7)		1.3	(1.3)	(1.7)
Additions		19.8		16.1	35.9
Disposals	(0.2)			(0.8)	(1.0)
At 31 July 2008	1,071.8	73.5	212.8	94.3	1,452.4
Amortisation					
At 6 August 2006	133.7	39.5	20.2	62.9	256.3
Exchange adjustments	(2.9)	(0.4)	(1.3)	(1.6)	(6.2)
Charge for the period*		6.6	15.0	8.1	29.7
Impairment	2.2				2.2
Transfers to disposal groups held for sale at year end				(0.4)	(0.4)
Transfer to disposal group sold by the year end	(56.0)	(33.2)	(4.8)	(28.7)	(122.7)
Disposals				(0.1)	(0.1)
At 31 July 2007	77.0	12.5	29.1	40.2	158.8
Exchange adjustments	5.3	0.7	1.8	2.5	10.3
Adjustments to prior year business combinations			0.5	(0.5)	
Charge for the year		5.6	19.2	6.2	31.0
Disposals	(0.2)			(0.7)	(0.9)
At 31 July 2008	82.1	18.8	50.6	47.7	199.2
Net book value at 31 July 2008	989.7	54.7	162.2	46.6	1,253.2
Net book value at 31 July 2007	844.3	38.7	102.2	36.1	1,021.3
Net book value at 6 August 2006	1,107.9	254.2	118.9	49.6	1,530.6

*For the period ending 31 July 2007 the additions and amortisation include the respective costs and charge for discontinued operations and disposal groups for the period prior to becoming a disposal group.

12 Intangible assets continued

In addition to goodwill, the acquired intangible assets comprise:

	Patents, licences and trademarks £m	Technology £m	Customer relationships £m	Total acquired intangibles £m
Cost				
At 6 August 2006	38.9	58.6	41.6	139.1
Exchange adjustments	(2.8)	(3.7)	(2.0)	(8.5)
Business combinations	3.6		8.5	12.1
Adjustments to prior year business combinations	0.6	0.2	(1.7)	(0.9)
Transfer to disposal group sold by the year end			(10.4)	(10.4)
Disposals	(0.1)			(0.1)
At 31 July 2007	40.2	55.1	36.0	131.3
Exchange adjustments	1.1	1.9	2.7	5.7
Business combinations (note 29)	12.0	18.8	43.7	74.5
Adjustments to prior year business combinations		1.3		1.3
At 31 July 2008	53.3	77.1	82.4	212.8
Amortisation				
At 6 August 2006	3.4	6.9	9.9	20.2
Exchange adjustments	(0.1)	(0.6)	(0.6)	(1.3)
Charge for the period	2.3	5.6	7.1	15.0
Transfer to disposal group sold by the year end			(4.8)	(4.8)
At 31 July 2007	5.6	11.9	11.6	29.1
Exchange adjustments	0.2	0.7	0.9	1.8
Adjustments to prior year business combinations		0.5		0.5
Charge for the year	2.7	6.1	10.4	19.2
At 31 July 2008	8.5	19.2	22.9	50.6
Net book value at 31 July 2008	44.8	57.9	59.5	162.2
Net book value at 31 July 2007	34.6	43.2	24.4	102.2
Net book value at 6 August 2006	35.5	51.7	31.7	118.9

Significant cash generating units

Goodwill is not amortised but is tested for impairment at least annually. Value in use calculations are utilised to determine the recoverable amount of goodwill held within each cash generating unit (CGU). Value in use is calculated as the net present value of the projected risk-adjusted post-tax cash-flows of the CGU in which the goodwill is contained, applying a discount rate based on the Group's post-tax weighted average cost of capital of 8% adjusted where appropriate for risks specific to the CGU. This approximates to applying a pre-tax discount rate to pre-tax cash-flows. These forecast cash-flows are based on approved budgets and represent a best estimate of future performance.

The goodwill held in the Smiths Medical Critical Care and Smiths Detection Civil CGUs, with net book values of £291.5m (2007: £283.7m) and £288.8m (2007: £252.0m) respectively, is considered significant in comparison to the total carrying value of goodwill. Following a reorganisation of the management of the Detection business the allocation of goodwill to CGUs was updated. The Detection Civil CGU incorporates the business activities reported as Smiths Detection Imaging Systems in 2007. The comparative net book value has been restated to reflect the new allocation.

The following key assumptions were used in the discounted cash-flow projections for the Critical Care and Detection Civil CGUs:

- growth rates of 2.25% (2007: 2.00%) have been used for the Critical Care and Detection Civil CGUs to extrapolate beyond the most recent forecasts, representing a view of the long-term average growth rates for the industries in which the businesses operate. The growth rates used to estimate future performance beyond the periods covered by our annual planning and strategic planning processes do not exceed the long-term average growth rates for similar projects and do not reflect long-term planning assumptions used by the Group for investment planning; and
- in addition to discount rates and long-term growth rates, the key assumptions used to determine the recoverable amounts of the Critical Care and Detection Civil CGUs include future sales prices and volumes (with reference to specific customer relationships and product lines), operating margins, the cost structure of each CGU and the ability to realise planned productivity improvements.

The assumptions used in the discounted cash-flow forecasts incorporate past performance and historical growth rates and margins achievable in our key markets as a guide.

Sensitivity analysis performed around the base case assumptions has indicated that no reasonable changes in key assumptions would cause the carrying amount of the Critical Care and Detection Civil CGUs to exceed their respective recoverable amount.

The balance of the goodwill represents smaller individual amounts which have been allocated to specific operating companies and smaller CGUs. These amounts are tested for impairment at this level.

Notes to the accounts continued

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 6 August 2006	245.1	653.0	337.3	1,235.4
Exchange adjustments	(5.0)	(13.8)	(4.6)	(23.4)
Reclassification		14.6	(14.6)	
Business combinations		1.0	1.0	2.0
Additions*	9.4	40.3	23.2	72.9
Transfers to disposal groups held for sale at year end	(0.7)		(6.6)	(7.3)
Transfer to disposal group sold by the year end	(89.1)	(338.5)	(161.5)	(589.1)
Disposals	(4.2)	(13.7)	(14.7)	(32.6)
At 31 July 2007	155.5	342.9	159.5	657.9
Exchange adjustments	8.4	18.1	10.8	37.3
Reclassification	1.0	(1.8)	0.8	
Business combinations	2.8	2.9	2.2	7.9
Additions	9.9	31.2	23.1	64.2
Disposals	(4.8)	(10.1)	(7.2)	(22.1)
Adjustments to acquisitions and disposals in prior years	(1.4)	6.7		5.3
At 31 July 2008	171.4	389.9	189.2	750.5
Depreciation				
At 6 August 2006	78.3	407.0	252.3	737.6
Exchange adjustments	(2.3)	(8.2)	(3.5)	(14.0)
Reclassification		10.4	(10.4)	
Charge for the period*	5.4	28.6	18.2	52.2
Impairment charge	5.9	2.2		8.1
Transfers to disposal groups held for sale at year end	(0.2)		(4.2)	(4.4)
Transfer to disposal group sold by the year end	(23.7)	(210.7)	(128.5)	(362.9)
Disposals	(0.3)	(10.1)	(9.2)	(19.6)
At 31 July 2007	63.1	219.2	114.7	397.0
Exchange adjustments	2.6	12.1	7.7	22.4
Reclassification	0.8	(1.1)	0.3	
Charge for the year	5.4	28.9	18.9	53.2
Impairment charge	0.3			0.3
Disposals	(3.7)	(7.3)	(6.6)	(17.6)
Adjustments to acquisitions and disposals in prior years	(7.8)	6.7		(1.1)
At 31 July 2008	60.7	258.5	135.0	454.2
Net book value at 31 July 2008	110.7	131.4	54.2	296.3
Net book value at 31 July 2007	92.4	123.7	44.8	260.9
Net book value at 6 August 2006	166.8	246.0	85.0	497.8

*For the period ending 31 July 2007 the additions and the depreciation charge include the respective costs and charge for discontinued operations and disposal groups for the period prior to becoming a disposal group.

The impairment charge of £8.1m in the period ended 31 July 2007 arose when property, plant and equipment was written down to fair value less costs to sell prior to being classified as being held for sale. The charge has been recognised in the results of John Crane.

	2008 £m	2007 £m
Capital expenditure commitments – contracted but not provided for	11.5	16.9

14 Investments accounted for using the equity method

	2008 £m	2007 £m
Investments in associated companies		
At start of period	12.0	14.0
Exchange adjustment	2.3	(0.3)
Share of results after tax	(1.0)	(0.5)
Dilution of interest	(0.9)	(1.2)
Acquisition of a controlling interest	(3.3)	
At end of period	9.1	12.0

The Group acquired a controlling interest in an associate on 21 December 2007, and it has been consolidated as a subsidiary since that date.

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Group share of results of associated companies		
Revenue	17.6	25.3
Operating costs and other income	(18.8)	(25.0)
Profit/(loss) before taxation	(1.2)	0.3
Taxation	0.2	(0.8)
Share of post-tax result from associated companies	(1.0)	(0.5)

Net assets and liabilities of associated companies

	2008 £m	2007 £m
Non-current assets	20.1	9.9
Current assets	24.8	36.9
Total assets	44.9	46.8
Non-current liabilities	(6.2)	(5.0)
Current liabilities	(7.9)	(16.5)
Total liabilities	(14.1)	(21.5)
Net assets	30.8	25.3

The above table principally represents the assets and liabilities of Cross Match Technologies, Inc. The Group share of those assets and liabilities attributable to Smiths Group is 34% (2007: 37%).

In 2007 the interest in Cross Match Technologies, Inc. was diluted as a result of warrants and options being exercised in the period.

15 Inventories

	2008 £m	2007 £m
Inventories comprise		
Raw materials and consumables	149.7	114.2
Work in progress	68.0	58.0
Finished goods	173.5	158.5
	391.2	330.7
Less: payments on account	(10.9)	(11.0)
	380.3	319.7

The Group consumed £1,776.4m (2007: £2,176.7m) of inventories during the period. £11.8m (2007: £13.4m) was recognised as an expense resulting from the write-down of inventory and £1.5m (2007: £4.0m) was released to the income statement from inventory provisions charged in earlier years but no longer required.

Notes to the accounts continued

16 Trade and other receivables

	2008 £m	2007 £m
Non-current		
Trade receivables	8.8	8.9
Prepayments and accrued income	1.6	0.8
Other debtors	4.2	5.0
	14.6	14.7
Current		
Amounts due from customers for contract work		5.3
Trade receivables	509.1	427.2
Other debtors	19.8	16.6
Prepayments and accrued income	36.5	40.7
	565.4	489.8

Trade receivables do not carry interest. Management considers that the carrying value of trade and other receivables approximates 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 £536.7m (2007: £450.1m).

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.

Provision for bad and doubtful debts

Trade receivables are disclosed net of a provision for bad and doubtful debts. Movement on the provision is as follows:

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Balance at the beginning of the period	10.5	16.3
Exchange differences	0.8	(0.3)
Charged	4.4	3.0
Utilised	(1.4)	(2.8)
Released	(3.1)	(2.9)
Disposal of businesses		(2.8)
Balance at the end of the period	11.2	10.5

The provision for bad and doubtful debts is based on specific risk assessment and reference to past default experience.

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 7% (2007: 4%) of group turnover.

Ageing of trade receivables

	2008 £m	2007 £m
Trade receivables which are not impaired and not yet due	412.4	313.1
Ageing analysis of trade receivables which are overdue but not impaired:		
– less than three months	79.2	93.4
– more than three months	22.6	24.1
Gross value of partially and fully provided debtors	14.9	16.0
	529.1	446.6
Provision for bad and doubtful debts	(11.2)	(10.5)
Trade receivables	517.9	436.1

17 Cash and cash equivalents

	2008 £m	2007 £m
Cash at bank and in hand – including impact of cash pooling gross up: £100.6m (2007: £123.2m)	122.5	148.5
Short-term deposits	10.0	40.8
Cash and cash equivalents	132.5	189.3
Cash included in assets of disposal group (note 18)		(3.1)
Cash and cash equivalents per balance sheet	132.5	186.2
Cash and cash equivalents	132.5	189.3
Bank overdrafts	(172.5)	(186.2)
Net cash and cash equivalents	(40.0)	3.1

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

18 Disposal group

During the second half of 2007, the Company invited offers for the purchase of its marine operations, which formed part of Specialty Engineering – Other. These operations were disposed of on 8 November 2007. The assets and liabilities of this operation were disclosed as held for sale in the consolidated balance sheet as at 31 July 2007. No impairment loss was recorded when the assets were revalued to fair value less disposal costs.

	2008 £m	2007 £m
Non-current assets		
Intangible assets		1.9
Property, plant and equipment		2.9
Deferred tax assets		0.1
		4.9
Current assets		
Inventories		7.4
Trade and other receivables		15.7
Cash and cash equivalents		3.1
Financial derivatives		0.2
Total assets of disposal group		31.3
Non-current liabilities		
Financial derivatives		(0.8)
Provisions for liabilities and charges		(0.6)
		(1.4)
Current liabilities		
Financial liabilities:		
– financial derivatives		(0.5)
Provisions for liabilities and charges		(0.6)
Trade and other payables		(12.7)
Current tax payable		(1.0)
Total liabilities of disposal group		(16.2)

Notes to the accounts continued

19 Trade and other payables

	2008 £m	2007 £m
Non-current		
Other creditors	27.5	22.5
Current		
Trade creditors	156.7	164.8
Bills of exchange payable	1.1	1.7
Other creditors	51.0	38.0
Other taxation and social security costs	23.1	20.5
Accruals and deferred income	188.8	187.6
	420.7	412.6

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, a measure considered important in explaining our financing position. The net debt figure includes accrued interest and the fair value adjustments relating to hedge accounting.

	2008 £m	2007 £m
Cash and cash equivalents		
Net cash and deposits including assets of disposal group (note 17)	132.5	189.3
Short-term borrowings		
Bank overdrafts including impact of cash pooling gross up: £100.6m (2007: £123.2m)	(172.5)	(186.2)
Bank loans	(0.3)	(0.2)
Other loans	(3.5)	(3.1)
B shares (note 26)	(1.7)	(18.1)
Interest accrual	(4.4)	(4.5)
	(182.4)	(212.1)
Long-term borrowings		
7.875% Sterling Eurobond 2010	(149.6)	(149.5)
7.25% Sterling Eurobond 2016	(148.8)	(148.7)
5.45% US\$ Private Placement 2013	(127.4)	(120.0)
Floating Rate Revolving Credit Facility 2012 (multi-currency)	(210.2)	(67.2)
EIB Sterling R. & D. Loan 2010	(70.0)	(70.0)
Bank and other loans	(14.7)	(11.7)
	(720.7)	(567.1)
Borrowings	(903.1)	(779.2)
Net debt	(770.6)	(589.9)

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 2014 to 2022.

Interest of £22.5m (2007: £22.5m) was charged to the consolidated income statement in this period in respect of public bonds.

Secured loans

Loans amounting to £13.2m (2007: £11.5m) were secured by charges on freehold properties with a book value of £11.0m (2007: £9.8m).

21 Financial risk management

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

Risk management policies are set by the Board. The treasury 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 risk exposures include foreign currency derivatives, debt and other interest rate derivatives. The central treasury function monitors financial risks and compliance with risk management policies using regular reports from all the businesses.

The management of operational credit risk is discussed in note 16.

(a) Foreign exchange risk

Transactional currency exposure

The Group is exposed to foreign currency risks arising from sales or purchases by businesses in currencies other than their functional currency. It is Group policy that, when such a sale or purchase is certain or highly probable, the net foreign exchange 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. At 31 July 2008 the Group had outstanding foreign currency contracts with a nominal value of £130m (2007: £131m) which were being used to manage transactional foreign exchange exposures, but were not accounted for as cash-flow hedges.

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

	At 31 July 2008				
	Sterling £m	US\$ £m	Euro £m	Other £m	Total £m
Financial assets and liabilities					
Financial instruments included in trade and other receivables	40.6	237.4	162.2	96.5	536.7
Financial instruments included in trade and other payables	(49.9)	(121.4)	(86.9)	(40.1)	(298.3)
Cash and cash equivalents	32.7	16.5	48.0	35.3	132.5
Borrowings not designated as net investment hedges	(412.1)	(163.2)	(13.8)	(103.8)	(692.9)
	(388.7)	(30.7)	109.5	(12.1)	(322.0)
Exclude balances held in operations with the same functional currency	389.3	56.4	(35.6)	(62.0)	348.1
Exposure arising from intra-group loans		(15.5)		(11.2)	(26.7)
Forward foreign exchange contracts	48.9	(50.0)	(1.9)	3.0	
	49.5	(39.8)	72.0	(82.3)	(0.6)

	At 31 July 2007				
	Sterling £m	US\$ £m	Euro £m	Other £m	Total £m
Financial assets and liabilities					
Financial instruments included in trade and other receivables	43.6	198.0	122.5	86.0	450.1
Financial instruments included in trade and other payables	(21.9)	(94.3)	(59.7)	(21.0)	(196.9)
Cash and cash equivalents	68.3	11.6	62.5	46.9	189.3
Borrowings not designated as net investment hedges	(439.2)	(140.2)	(101.6)	(30.9)	(711.9)
	(349.2)	(24.9)	23.7	81.0	(269.4)
Exclude balances held in operations with the same functional currency	350.8	54.8	(22.1)	(73.9)	309.6
Exposure arising from intra-group loans		(5.5)		(18.4)	(23.9)
Forward foreign exchange contracts	(2.4)	(39.6)	14.6	27.4	
	(0.8)	(15.2)	16.2	16.1	16.3

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.

In the period ended 31 July 2007 Smiths entered into a one-off hedge contract to fix the sterling equivalent of the projected net proceeds arising from the Aerospace disposal (note 7). This hedge contract had a nominal value of US\$4.2 billion, a maturity date of 8 May 2007, and an effective exchange rate of 1.9791. The gain of £18.5m realised on this contract was recognised in calculating the fair value of the consideration.

Notes to the accounts continued

21 Financial risk management continued

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 2008 £m	Gain/(loss) recognised in reserves 31 July 2008 £m	Impact on profit for the year 31 July 2007 £m	Gain/(loss) recognised in reserves 31 July 2007 £m
US dollar	(0.1)	(3.3)	1.5	(1.7)
Euro	4.8	(1.0)	(0.7)	2.6
Sterling	2.1	2.8	1.1	2.3

These sensitivities were calculated before adjusting for tax and do not include the effect of intra-group loans which have been designated as quasi-equity.

Cash-flow hedging

The Group uses foreign currency contracts to hedge future foreign currency sales and purchases. At 31 July 2008 contracts with a nominal value of £222.2m (2007: £211.0m) were designated as hedging instruments. The fair value of the hedging instruments 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% are for periods of 12 months or less (2007: 93%).

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

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Brought forward cash-flow hedge reserve at start of period	1.4	13.3
Exchange adjustments	0.2	
Gains and losses on effective cash-flow hedges recognised in equity	(1.0)	4.8
Amounts removed from the hedge reserve and recognised in the following lines on the income statement:		
– Revenue	0.2	(2.7)
– Cost of sales	0.3	1.1
– Profit after taxation – discontinued operations		(15.1)
Carried forward cash-flow hedge reserve at end of period	1.1	1.4

21 Financial risk management continued**Translational currency exposure**

The Group has a significant investment in overseas operations, particularly in America and Europe. As a result, the sterling value of the Group's balance sheet can be 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 either directly in the local currency or indirectly through the use of rolling annual forward foreign exchange contracts.

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

	At 31 July 2008				
	Sterling £m	US\$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges		(139.6)	(70.6)		(210.2)
Cross currency swap contracts	371.4	(150.6)	(163.0)	(57.8)	
	371.4	(290.2)	(233.6)	(57.8)	(210.2)

	At 31 July 2007				
	Sterling £m	US\$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges			(67.3)		(67.3)
Cross currency swap contracts	255.9	(89.5)	(125.0)	(41.4)	
	255.9	(89.5)	(192.3)	(41.4)	(67.3)

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 a 10% increase in the value of the US dollar while all other market rates remained constant would lead to a fair value loss of £14.9m (2007: £8.2m) and a 10% increase in the value of the euro while all other market rates remained constant would lead to a fair value loss of £17.4m (2007: £19.0m). These movements would be recognised in equity and 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.

Net investment hedges

Cross-currency swap contracts for US dollars, Euros, Yen, Renminbi and Canadian dollars with a nominal value of £371m (2007: £238m) and foreign currency borrowings of US \$277m (2007: \$nil) and ¥90m (2007: ¥100m) have been designated as net investment hedges in respect of the currency translation risk arising on foreign operations. The contracts mature within twelve months. See note 22 for the fair value of the contracts.

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

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Brought forward net investment hedge reserve at start of period	17.2	13.2
Amounts deferred in the period on effective net investment hedges	(47.5)	8.2
Amounts removed from the hedge reserve and recognised in the income statement		(4.2)
Carried forward net investment hedge reserve at end of period	(30.3)	17.2

Notes to the accounts continued

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 normal policy is to require interest rates to be fixed for 30% to 70% of the level of underlying borrowings forecast to arise over a three-year horizon. This is achieved partly through fixed rate borrowings, and partly through the use of interest rate swaps. Excluding the cash pool gross up, at 31 July 2008 46% (2007: 55%) of the Group's borrowings were at fixed interest rates, after adjusting for interest rate swaps.

The weighted average interest rate on borrowings and cross currency swaps at 31 July 2008, after interest rate swaps, is 4.6% (2007: 5.3%).

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 2008 £m	Borrowings 31 July 2008 £m	Fair value of borrowings 31 July 2008 £m	Cash and cash equivalents 31 July 2007 £m	Borrowings 31 July 2007 £m	Fair value of borrowings 31 July 2007 £m
Fixed interest (adjusted for interest rate hedging):						
Less than one year		(3.8)	(4.0)	14.1	(3.0)	(3.0)
Between one and five years		(203.5)	(207.1)		(151.1)	(157.3)
Greater than five years		(160.1)	(166.2)		(207.9)	(216.8)
Total fixed interest financial assets/(liabilities) (adjusted for interest rate hedging)		(367.4)	(377.3)	14.1	(362.0)	(377.1)
Floating rate interest financial assets/(liabilities)	122.1	(535.7)	(535.7)	165.6	(417.2)	(417.2)
Total interest bearing financial assets/(liabilities)	122.1	(903.1)	(913.0)	179.7	(779.2)	(794.3)
Non-interest bearing assets/(liabilities) in the same category	10.4			9.6		
Total	132.5	(903.1)	(913.0)	189.3	(779.2)	(794.3)

Interest rate hedging

The Group has designated US\$150m interest rate swaps which mature on 28 January 2013 as fair value hedges on the US private placement which matures on the same date. This hedges the risk of variability in the fair value of borrowings arising from interest rate fluctuations. The fair value of the hedging instrument is disclosed in note 22. The effect of the interest rate swap is to convert £75.7m (2007: £73.7m) 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 2008, 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 £4.3m (2007: 3.9m) 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 expect any counterparties to fail to meet their obligations. Credit risk is mitigated by the Group's Board-approved policy of only selecting counterparties with a strong investment graded long-term credit rating for cash deposits, normally at least AA- or equivalent, and assigning financial limits to individual counterparties. In the normal course of business, the Group operates notional 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, totals £132.5m at 31 July 2008 (2007: £189.3m). This includes cash of £100.6m (2007: £123.2m) held in interest compensation pools where Smiths has a legal right of set-off and the net pool balance at the year end was a creditor.

The maximum exposure with a single bank for deposits and cash is £12.4m (2007: £27.8m), whilst the maximum mark to market exposure for foreign exchange contracts at 31 July 2008 to a single bank is £1.5m (2007: £4.6m). These banks had credit ratings of AA and AA+ respectively.

21 Financial risk management continued**(d) Liquidity risk****Borrowing facilities**

The Group actively maintains committed unused credit facilities of at least £200m (or equivalent free cash) at all times to ensure it has sufficient available funds for operations and planned expansions. In 2007 the principal £660m revolving credit facility was extended to 2012. At the balance sheet date the Group had the following undrawn credit facilities:

	2008 £m	2007 £m
Expiring within one year		50.0
Expiring between one and two years		
Expiring after two years	449.8	593.0
	449.8	643.0

Cash deposits

As at 31 July 2008, £10.0m (2007: £40.8m) of cash and cash equivalents was on deposit with various banks and in money market funds of which £7.2m (2007: £32.2m) was on deposit in the UK.

Gross contractual cash-flows for borrowings

	Borrowings (Note 20) 31 July 2008 £m	Fair value adjustments 31 July 2008 £m	Contractual interest payments 31 July 2008 £m	Total contractual cash-flows 31 July 2008 £m	Borrowings (Note 20) 31 July 2007 £m	Fair value adjustments 31 July 2007 £m	Contractual interest payments 31 July 2007 £m	Total contractual cash-flows 31 July 2007 £m
Less than one year	(182.4)		(42.3)	(224.7)	(212.1)		(37.7)	(249.8)
Between one and two years	(150.9)	(0.4)	(41.5)	(192.8)	(0.5)		(37.0)	(37.5)
Between two and three years	(71.3)		(26.4)	(97.7)	(149.9)	(0.5)	(36.3)	(186.7)
Between three and four years	(210.7)	(0.5)	(25.0)	(236.2)	(70.3)		(21.2)	(91.5)
Between four and five years	(127.7)	1.2	(14.6)	(141.1)	(67.6)	(0.6)	(20.4)	(88.6)
Greater than five years	(160.1)	(1.2)	(34.4)	(195.7)	(278.8)	(4.1)	(48.6)	(331.5)
Total	(903.1)	(0.9)	(184.2)	(1,088.2)	(779.2)	(5.2)	(201.2)	(985.6)

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 2008 £m	Payments 31 July 2008 £m	Net cash-flow 31 July 2008 £m	Receipts 31 July 2007 £m	Payments 31 July 2007 £m	Net cash-flow 31 July 2007 £m
Assets						
Less than one year		256.4	(247.7)		398.1	(382.8)
Greater than one year		63.9	(60.1)		44.4	(43.6)
Liabilities						
Less than one year		379.8	(400.6)		109.3	(112.5)
Greater than one year		28.1	(28.4)		42.4	(45.6)
Total		728.2	(736.8)		594.2	(584.5)

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: £285.8m (2007: £192.3m) due in less than one year, £10.9m (2007: £4.6m) due between one and five years and £1.6m (2007: £nil) due after more than five years.

Notes to the accounts continued

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:

	Contract or underlying nominal amount	Fair value		
	£m	Assets £m	Liabilities £m	Net £m
At 31 July 2008				
Foreign exchange contracts (cash-flow hedges)	222.2	3.8	(2.9)	0.9
Foreign exchange contracts (not hedge accounted)	130.1	1.4	(0.7)	0.7
Total foreign exchange contracts	352.3	5.2	(3.6)	1.6
Cross-currency swaps (net investment hedges)	371.4	1.5	(18.0)	(16.5)
Interest rate swaps (fair value hedges)	75.7	1.2		1.2
Total financial derivatives	799.4	7.9	(21.6)	(13.7)
Balance sheet entries:				
Non-current		1.4	(0.1)	1.3
Current		6.5	(21.5)	(15.0)
Total financial derivatives		7.9	(21.6)	(13.7)

	Contract or underlying nominal amount	Fair value		
	£m	Assets £m	Liabilities £m	Net £m
At 31 July 2007				
Foreign exchange contracts (cash-flow hedges)	211.0	2.6	(0.8)	1.8
Foreign exchange contracts (not hedge accounted)	131.4	0.9	(1.7)	(0.8)
Total foreign exchange contracts	342.4	3.5	(2.5)	1.0
Cross-currency swaps (net investment hedges)	238.2	9.0		9.0
Cross-currency swaps (not hedge accounted)	17.7	1.4		1.4
Total cross-currency swaps	255.9	10.4		10.4
Interest rate swaps (fair value hedges)	73.7		(2.8)	(2.8)
Embedded derivatives	15.8	0.2	(1.3)	(1.1)
Total financial derivatives	687.8	14.1	(6.6)	7.5
Balance sheet entries:				
Non-current		0.4	(2.5)	(2.1)
Included in assets/(liabilities) of disposal group		0.2	(1.3)	(1.1)
Current		13.5	(2.8)	10.7
Total financial derivatives		14.1	(6.6)	7.5

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.

Amounts recognised in 2007 in respect of embedded derivatives primarily represent the value of currency terms in commercial contracts between Smiths European subsidiaries and customers and suppliers outside the USA which are denominated in US dollars.

23 Provisions for liabilities and charges

	At 31 July 2007 £m	Exchange adjustments £m	Provisions charged £m	Provisions released £m	Unwind of provision discount £m	Utilisation £m	At 31 July 2008 £m
Warranty provision and product liability	34.5	3.8	30.0	(5.5)		(16.6)	46.2
Reorganisation	10.8	0.3	5.2	(0.2)		(6.3)	9.8
Property	6.7		0.6	(3.3)		(0.5)	3.5
Disposal	60.3		11.4	(3.6)		(20.7)	47.4
Litigation	121.2	3.3	46.8	(2.2)	4.7	(10.1)	163.7
	233.5	7.4	94.0	(14.8)	4.7	(54.2)	270.6

Analysed as:

	2008 £m	2007 £m
Current liabilities	70.0	90.1
Non-current liabilities	200.6	143.4
	270.6	233.5

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

On 3 June 2008 the Company announced a number of changes to its corporate centre and divisional headquarters. The total cost of this restructuring, including redundancy, relocation and consolidation of manufacturing, is expected to amount to approximately £48m over the period to 2010, of which £4.5m has been charged in the current year.

Reorganisation provisions include £4.7m (2007: £6.0m) costs relating to restructuring supply arrangements following the automotive seals disposal. These costs are expected to be spread over the next six years. The residual balance at 31 July 2007 related mainly to Medical, and was utilised during 2008.

Property

Where a property is vacant, or sub-let under terms such that rental income is insufficient to meet all outgoings, the Group provides for the expected future shortfall up to termination of the lease. Provision is also made for the cost of reinstatement work on leased properties where there is an obligation under the lease, and the costs can be reasonably estimated. Where evidence of contamination is found on property in the Group's occupation, provision is made for estimated remedial costs pending action on the affected site. Most of the balance is expected to be utilised within the next five years.

Disposal

A provision has been made in 2008 in respect of obligations arising from the disposal of the Group's Marine Systems business. See note 30 for details of this disposal.

The terms of the disposal of the Aerospace operations included certain obligations for which provision was made in 2007, including £24.3m in respect of costs of transferring aerospace active pensioners. In 2008 the pensioners were transferred, utilising £20.7m of this provision. The balance of £3.6m has been released to the income statement.

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

Notes to the accounts continued

23 Provisions for liabilities and charges continued

Litigation

John Crane, Inc.

John Crane, Inc. ("JCI") is one of many co-defendants in litigation relating to 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 substantial insurance remains in place, JCI has begun to meet defence costs directly, seeking appropriate contribution from insurers thereafter. 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 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. JCI has resisted every case in which it has been named and will continue its robust defence of all asbestos-related claims based upon this 'safe product' defence. As a result of its defence policy, JCI has been dismissed before trial from cases involving approximately 159,000 claims over the last 29 years. JCI is currently a defendant in cases involving approximately 136,000 claims. JCI has had final judgments against it, after appeals, in only 70 cases, amounting to awards of some US\$70m over the 29 year period.

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

- The periods over which the expenditure can be reliably estimated. Projections used range between 10 and 20 years.
- The future trend of legal costs allowing for 3% cost inflation.
- The rate of future claims.
- The rate of successful resolution of claims.
- The average level of judgments.

The provision is based on past history and allows for decreasing costs based on published tables of asbestos incidence projections. In the light of the significant uncertainty associated with asbestos claims, there can be no guarantee that the assumptions used to estimate the provision will be an accurate prediction of the actual costs that may be incurred and, as a result, the provision may be subject to revision from time to time as more information becomes available.

The provision shown in the table above 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:

	2008 £m	2007 £m
Gross provision	185.9	142.2
Discount	(47.0)	(45.8)
Discounted pre-tax provision	138.9	96.4
Deferred tax	(37.5)	(36.6)
Discounted post-tax provision	101.4	59.8

Other litigation

The Group has on occasion been required to take legal action to protect its patents and other business intellectual property rights against infringement, and similarly to defend itself against proceedings brought by other parties. Provision is made for the expected fees and associated costs, based on professional advice as to the likely duration of each case. Provisions totalling £2.2m (2007: £8.9m) were released relating to litigation settled at less than the expected cost. Most of the balance is expected to be utilised within the next five years.

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

24 Operating lease commitments – minimum lease payments

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

	2008		2007	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Payments due				
– not later than one year	20.5	7.8	17.5	7.3
– later than one year and not later than five years	47.0	8.1	43.1	8.0
– later than five years	20.3	0.1	24.7	0.1
	87.8	16.0	85.3	15.4

25 Contingent liabilities and commitments

John Crane, Inc.

As stated in note 23, John Crane, Inc. ("JCI") is involved in numerous law suits 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 the cost of adverse judgements 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 cost of adverse judgments cannot be reliably estimated.

Other contingent liabilities and commitments

At 31 July 2008, contingent liabilities, comprising bonds and guarantees arising in the normal course of business, amounted to £75m (2007: £88m).

The Group is currently co-operating with the relevant authorities in investigating certain allegations of improper business conduct. Based on the work completed to date, these are not expected to give rise to any material financial exposure.

The Parent Company has arranged two letters of credit to support the Group's pension plans, one for £100.0m and one for £50.0m. At 31 July 2008, total usage of the two facilities was £124.9m (2007: £132.8m).

26 Share capital

	Number of shares	Issued capital £m	Consideration £m
Ordinary shares			
At 31 July 2007	385,498,273	144.6	
Exercise of share options	2,380,908	0.9	15.5
At 31 July 2008	387,879,181	145.5	
B shares			
At 31 July 2007	4,926,594	0.1	
Purchased and cancelled	(4,467,437)	(0.1)	
At 31 July 2008	459,157		
Share capital classified as equity at 31 July 2008		145.5	
Share capital classified as debt at 31 July 2008			
Total share capital at 31 July 2008		145.5	

On 17 April 2008 4.5 million B shares were purchased and cancelled. The remaining B shares carry annual interest of 75% of 12 month LIBOR, payable in arrears in April. Smiths may redeem and cancel the remaining B shares up to November 2008 for a consideration of 365p per share in cash or convert them to ordinary shares. B shares have no voting rights.

In 2007 the Group issued 577.6 million B shares with a nominal value of £5.8m. £4.2m of associated costs were charged to the share premium account. Of these shares 572.6 million were redeemed on 25 June 2007 for a consideration of 365p per share including 348.2 million B shares which had been converted into deferred shares.

After the allotment of the B shares in 2007 a capital reorganisation was undertaken. The shareholders received two new 37.5p ordinary shares for every three 25p ordinary shares which they previously held.

The authorised capital at 31 July 2008 consisted of:

- 533,333,333 (2007: 533,333,333) ordinary shares of 37.5p each; and
- 600,000,000 (2007: 600,000,000) non-cumulative B shares of 1p each.

At 31 July 2008 all of the issued share capital was in free issue. All issued shares are fully paid.

Notes to the accounts continued

27 Reconciliation of movements in equity

	Share capital £m	Share premium account £m	Other reserves £m	Hedge reserve £m	Retained earnings £m	Equity shareholders' funds £m	Minority interest £m	Total equity £m
At 5 August 2006	141.8	224.1	236.5	26.5	734.0	1,362.9		1,362.9
Exercises of share options	2.8	74.9				77.7		77.7
Purchase of own shares					(7.0)	(7.0)		(7.0)
Return of capital to shareholders and redemption of B shares		(10.0)	5.7		(2,104.6)	(2,108.9)		(2,108.9)
Total recognised income and expenses for the period				(7.9)	1,752.8	1,744.9		1,744.9
Dividends paid to equity shareholders					(182.4)	(182.4)		(182.4)
Dilution of interest in associated company					(1.2)	(1.2)		(1.2)
Share-based payment					17.3	17.3		17.3
At 31 July 2007	144.6	289.0	242.2	18.6	208.9	903.3		903.3
Exercises of share options	0.9	14.6			5.5	21.0		21.0
Purchase of own shares					(20.7)	(20.7)		(20.7)
Redemption of B shares			0.1		(0.1)			
Acquisition (note 29)							2.0	2.0
Total recognised income and expenses for the period				(47.8)	180.6	132.8	0.3	133.1
Dividends paid to equity shareholders					(131.4)	(131.4)		(131.4)
Dilution of interest in associated company					(0.9)	(0.9)		(0.9)
Share-based payment					11.8	11.8		11.8
At 31 July 2008	145.5	303.6	242.3	(29.2)	253.7	915.9	2.3	918.2

Other reserves comprise a capital redemption reserve of £5.8m (2007: £5.7m), a revaluation reserve of £1.7m (2007: £1.7m) and a merger reserve of £234.8m (2007: £234.8m). The movements in other reserves relate to the recognition of transfers to the capital redemption reserve required following the redemption of the B shares.

The retained earnings include the purchase of Smiths Group plc shares by the Smiths Industries Employee Benefit Trust. The consideration paid was £20.7m (2007: £7.0m). At 31 July 2008 the trust held 1,095,965 (2007: 634,274) ordinary shares with a nominal value of £0.4m (2007: £0.2m) and a market value of £11.5m (2007: £6.6m).

Capital management

Capital comprises shareholders' equity adjusted for goodwill recognised directly in reserves. For the period ended 31 July 2008 the average Group capital was £1,728.1m (2007: £1,732.3m).

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 18% (2007: 15%). This generated a weighted average cost of capital of 8% (2007: 9%).

As part of this process the Group maintains its target of a solid investment grade credit rating by monitoring the factors utilised by ratings agencies and evaluating the impact of potential distributions and future funding requirements. At the 31 July 2008 the Group had a credit rating of BBB+/Baa2 (2007: BBB+/Baa2) with Standard & Poor's and Moody's respectively.

Hedge reserve

	2008 £m	2007 £m
The hedge reserve on the balance sheet comprises:		
Cash-flow hedge reserve	1.1	1.4
Net investment hedge reserve	(30.3)	17.2
	(29.2)	18.6

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.

28 Cash-flow from operating activities

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Profit before taxation – continuing and discontinued	346.1	1,869.4
Net interest payable	41.0	37.6
Financing losses/(gains)		
– charged to administrative expenses	0.3	1.5
– charged to financing	6.1	(2.8)
Share of post-tax loss from associate	1.0	0.5
Other finance income – retirement benefits	(41.7)	(36.8)
(Profit on sale)/impairment of financial asset		(24.0)
Profit on disposal of discontinued operation	(26.8)	(1,469.6)
	326.0	375.8
Amortisation of intangible assets	31.0	29.7
Impairment of intangible assets		2.2
Profit on disposal of property, plant and equipment	(0.3)	(0.4)
(Profit)/loss on disposal of business	(27.2)	5.2
Depreciation of property, plant and equipment	53.2	52.2
Impairment of property, plant and equipment	0.3	8.2
Share-based payment expense	12.9	13.9
Retirement benefits	(37.0)	(66.2)
Increase in inventories	(21.4)	(84.2)
Increase in trade and other receivables	(10.0)	(84.8)
(Decrease)/increase in trade and other payables	(56.9)	29.7
Increase in provisions	49.9	84.5
Cash generated from operations	320.5	365.8
Interest	(48.6)	(27.0)
Tax paid	(73.8)	(92.8)
Net cash inflow from operating activities	198.1	246.0

29 Acquisitions

During the period ended 31 July 2008, the Group made a number of acquisitions: Sartorius Bearing Technology (15 October 2007), a controlling interest over an associate John Crane Japan Limited (21 December 2007), Indufil BV (28 April 2008) and Fiber Composite Company Inc. ("Fiberod") (2 May 2008), all on behalf of John Crane, Fast Heat (4 February 2008), Allrizon Tongguang (7 May 2008) and Triasx Pty. Ltd. (1 July 2008) on behalf of Specialty – Other.

From the date of acquisition to 31 July 2008, the acquisitions contributed £38.1m to revenue, £5.9m to headline profit before taxation and £1.4m to profit before taxation. If Smiths had acquired the businesses at the beginning of the financial period, the acquisitions would have contributed £92.4m to revenue and £13.8m to headline profit before tax.

The fair value adjustments in respect of intangible assets are due to the recognition of £43.7m in respect of customer relationships, £18.8m in respect of technology and £12.0m in respect of patents, licenses and trademarks. Goodwill represents the value of synergies arising from the acquisitions and the acquirees' assembled workforces. The adjustments to current assets and liabilities relate to valuation adjustments and are provisional, based on management's best estimates.

The values set out below are provisional pending finalisation of the fair values attributable, and will be finalised in the year ending 31 July 2009. Goodwill and other net assets in respect of prior year acquisitions, as previously reported, have been adjusted as a result of finalising their attributable fair values and changes in the estimated value of contingent considerations. Accordingly, goodwill has increased by £0.5m on one transaction and reduced by £2.2m on another.

The minority interest and assets accounted for using the equity method adjustment represents assets not acquired by Smiths Group plc when a controlling interest in an associate was acquired. The asset revaluation surplus represents fair value gains and losses on the associate's net assets.

Notes to the accounts continued

29 Acquisitions continued

	Indufit BV			Other acquisitions			Total
	Book value £m	Fair value adjustments £m	Provisional fair value £m	Book value £m	Fair value adjustments £m	Provisional fair value £m	Provisional fair value £m
Non-current assets							
– intangible assets	0.2	31.2	31.4	0.5	43.3	43.8	75.2
– property, plant and equipment	1.3		1.3	6.8	(0.2)	6.6	7.9
Current assets							
– cash and cash equivalents				4.0		4.0	4.0
– other current assets	14.5		14.5	29.0	(0.6)	28.4	42.9
Non-current liabilities							
– other liabilities		(8.1)	(8.1)	0.1	(5.5)	(5.4)	(13.5)
Current liabilities							
– overdrafts	(2.5)		(2.5)				(2.5)
– other current liabilities	(4.5)		(4.5)	(20.4)	(0.8)	(21.2)	(25.7)
Minority interest and assets accounted for using the equity method					(5.1)	(5.1)	(5.1)
Net assets acquired	9.0	23.1	32.1	20.0	31.1	51.1	83.2
Asset revaluation surplus						(0.4)	(0.4)
Goodwill on current year acquisitions			38.7			48.3	87.0
Goodwill adjustments on prior year acquisitions						(1.7)	(1.7)
Total consideration			70.8			97.3	168.1
Cash paid during the period – current year acquisitions			70.5			76.8	147.3
Direct costs relating to current year acquisitions			0.3			2.5	2.8
Deferred consideration accrued on current year acquisitions						19.7	19.7
Deferred consideration and costs paid/(released) on prior year acquisitions						(1.7)	(1.7)
Total consideration			70.8			97.3	168.1

30 Disposals

The most significant disposal transaction during the year was the sale of the Group's Marine Systems business to K H Finance Limited, a company owned by ECI Partners LLP, on 8 November 2007. In addition to the consideration recognised there is a deferred payment of £4m contingent on the terms of any future disposal of K H Finance Limited by the purchaser. The assets and liabilities held for sale at 31 July 2007 relate to the Marine Systems business.

The Group has adjusted provisions held in respect of disposals made in prior years, following determination of the warranties and other liabilities provided for at the time of disposal.

	£m
Consideration	46.8
Less: transaction costs	(3.2)
Less: disposal provisions	(2.8)
Net consideration received	40.8
Net assets disposed of:	
– intangible assets	2.2
– property, plant and equipment	4.2
– inventory	9.5
– trade and other receivables	15.5
– cash and cash equivalents	0.9
– liabilities	(18.1)
Net assets	14.2
Profit on disposals in the current year	26.6
Other disposal adjustments	0.6
Profit on disposal of businesses	27.2

31 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:

Smiths Group Sharesave Scheme (SAYE)

The SAYE scheme is an HM Revenue & Customs-approved all-employee savings-related share option scheme which is open to all UK employees, including directors, with 12 months' service or more. Participants enter into a contract to save a fixed amount per month of up to £250 in aggregate for three or five years and are granted an option over shares at a fixed option price, set at a 20% discount to market price at the date of invitation to participate. In the case of five-year savings contracts, participants can elect to delay maturity of the contract until its seventh anniversary. The number of shares comprising the option is determined by the monthly amount saved and the bonus paid on maturity of the savings contract. Options granted under the SAYE scheme are not subject to any performance conditions.

Smiths Group US Sharesave Scheme (US Sharesave)

The US Sharesave scheme is a savings-related share appreciation rights scheme which is open to all US employees with 12 months' service or more. Participants enter into a contract to save a fixed amount per month for two years and are granted share appreciation rights based on a fixed initial price determined using the market price and the US dollar exchange rate at the date of invitation to participate. The number of shares used in the calculation is based on the monthly amount saved and the bonus paid on maturity of the savings contract. Rights granted under the US Sharesave scheme are not subject to any performance conditions.

Smiths Industries 1995 Executive Share Option Scheme (95 ESOS)

Options granted under the 95 ESOS can only be exercised after three years if a performance requirement, determined by the Remuneration Committee, has been met. Options granted under the 95 ESOS up to 2001 are subject to performance testing based on total shareholder return of the Group versus the total return of the General Industrials Sector of the FTSE All-Share Index. Options granted from 2002 are subject to a performance test based on growth in the Group's earnings per share. If the performance requirement is not satisfied at the end of the third year, the performance period may be extended for up to two further years so that performance is tested over a four-year period at the end of the fourth year and a five-year period at the end of the fifth year. The performance requirement is that the growth in the Group's normalised earnings per share over the three/four/five financial years beginning immediately prior to the option grant must exceed the increase in the UK Retail Prices Index over the same period by 3% per annum (for options up to one times base salary) and by 4% per annum (for the excess up to two times base salary). Executive directors received their final grants of options under the 95 ESOS in October 2003. From 2004 senior executives, including directors, have received awards under the PSP (see below). Grants under the 95 ESOS continue to be made to other executives.

Smiths Group Performance Share Plan (PSP)

The PSP was introduced in 2004 and replaced the 95 ESOS for executive directors and senior executives. Conditional awards of up to 1.5 times salary (and exceptionally three times salary) are granted annually. The awards will be released following the third anniversary of the date of grant to the extent the PSP's performance tests have been met. One-third of the award is subject to a total shareholder return ('TSR') target relative to other FTSE 100 companies (excluding financial companies and investment trusts). For full vesting, the company's TSR must be at or above the 75th percentile over the three year performance period. 25% of the award will vest if the company's TSR is at median. Awards will vest on a straight-line pro-rata basis between median and 75th percentile. The remaining two-thirds of the award is subject to an earnings per share ('EPS') growth target (measured before exceptional items). Full vesting will occur if the compound annual growth in EPS is equivalent to 12% per annum. 25% vesting will occur if the compound annual growth in EPS is equivalent to 5% per annum, with vesting on a straight-line basis between 5% and 12%. The PSP has been replaced by the VSP (see below).

Value Sharing Plan (VSP)

The VSP is a one-off long-term incentive plan approved by the shareholders in July 2008 rewarding executives for value creation at Group and Divisional levels over three-year and four-year periods commencing with the financial year 2008/09. 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 9.5% a year. 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 participants in the VSP will not be eligible for awards under the Performance Share Plan in 2008/09 or 2009/10.

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, he will be awarded matching shares 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 will be 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.

Notes to the accounts continued

31 Employee share schemes continued

	SAYE and Sharesave	ESOS (inc. SARS)	DSS and CIP	PSP	Total	Weighted average price for option plans £
Ordinary shares under option ('000)						
6 August 2006	4,283	19,307	1,363	1,934	26,887	£6.50
Granted	917	2,795	459	1,070	5,241	£6.23
Exercised	(599)	(11,789)	(363)		(12,751)	£7.03
Lapsed	(573)	(963)	(53)	(72)	(1,661)	£7.18
31 July 2007	4,028	9,350	1,406	2,932	17,716	£5.98
Granted	639	1,838	245	743	3,465	£7.32
Exercised	(2,159)	(1,455)	(235)	(645)	(4,494)	£5.67
Lapsed	(992)	(1,101)	(9)	(369)	(2,471)	£7.32
31 July 2008	1,516	8,632	1,407	2,661	14,216	£6.23

Options were exercised on an irregular basis during the period. The average closing share price over the financial year was 1,014.32p (2007: 1,012.15p). There has been no change to the effective option price of any of the outstanding options during the period.

Range of exercise prices	Total shares under option ('000)	Weighted average remaining contractual life (months)	Options exercisable at 31 July 2008 ('000)	Options exercisable at 31 July 2007 ('000)	Exercisable weighted average exercise price for options exercisable at 31 July 2008
£0.00 – £2.00	4,068	14	19	1	£0.00
£2.01 – £4.00					
£4.01 – £6.00	234	18	2	956	£5.25
£6.01 – £8.00	2,518	57	1,735	2,236	£7.40
£8.01 – £10.00	5,505	73	587	633	£8.77
£10.01 – £12.00	1,891	108	129	185	£2.42
£12.01 – £14.00				175	

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 assumptions used in the models for 2008 and 2007 are as follows:

	Period ended 31 July 2008				Period ended 31 July 2007			
	SAYE	95 ESOS	DSS/CIP	PSP	SAYE	95 ESOS	DSS/CIP	PSP
Weighted average fair value (£)	2.48	1.73	8.60	7.14	2.19	1.94	7.81	6.40
Key assumptions used:								
Weighted average share price	9.14	8.69	9.61	9.51	8.25	8.32	8.72	8.66
Range of exercise prices (£)	5.25-9.12	6.69-10.97			5.25-8.68	6.69-9.01		
Range of expected volatility	17%-33%	18%-30%		17%-20%	17%-36%	18%-34%		16%-18%
Risk-free interest rate	3.9%-5.6%	4.3%-5.2%		4.3%-4.8%	3.7%-5.6%	4.3%-5.5%		4.3%-4.8%
Range of expected option term (life)	2.2-7.2 yrs	5 yrs	3 yrs	3 yrs	2.2-7.2 yrs	5 yrs	3 yrs	3 yrs
Dividend yield	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%

Assumptions on expected volatility and expected option term have been made on the basis of historical data, wherever available, for the period corresponding with the vesting period of the option. Best estimates have been used where historical data is not available in this respect.

Included within staff costs is an expense arising from share-based payment transactions of £12.9m (2007: £19.3m), of which £11.8m (2007: £17.3m) relates to equity-settled share-based payment. The charge in respect of continuing operations is £12.9m (2007: £10.4m). The total share-based payment charge includes £nil (2007: £3.5m) relating to discontinued operations and £nil (2007: £5.4m) relating to the accelerated vesting of share options on business disposals.

At 31 July 2008 the creditor relating to cash-settled schemes is £1.5m (2007: £1.9m).

32 Events after the balance sheet date

On 1 September 2008 the Company completed the sale of land in Basingstoke for £16m in cash. A further amount of up to £12m will be paid depending on the final terms of such amended planning permission as may be granted.

On 8 September 2008 the Trustees of the TI Pension Scheme invested £250m in annuities which are matched with specific liabilities of the fund.

Group financial record under IFRS 2005-2008

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m	Period ended 5 August 2006 £m	Year ended 31 July 2005 £m
Revenue	2,321.2	2,160.9	2,180.3	3,005.4
Headline operating profit	380.6	347.6	344.8	415.7
Amortisation of acquired intangible assets	(19.2)	(14.8)	(13.0)	(5.7)
Exceptional items (including profit on sale/impairment of financial asset)	(35.4)	(74.2)	(337.8)	(28.0)
Financing losses	(0.3)	(1.5)	(1.8)	
Operating profit/(loss)	325.7	257.1	(7.8)	382.0
Net finance costs	(5.4)	(0.6)	(28.4)	(16.1)
Share of post-tax losses of associated companies	(1.0)	(0.5)	(1.1)	
Profit/(loss) before taxation	319.3	256.0	(37.3)	365.9
Taxation	(75.0)	(53.1)	(65.4)	(94.1)
Profit/(loss) after taxation – continuing operations	244.3	202.9	(102.7)	271.8
Profit after taxation – discontinued operations	24.5	1,525.2	126.9	
Shareholders' equity	915.9	903.3	1,362.9	1,483.8
Represented by				
– intangible assets	1,253.2	1,021.3	1,530.6	1,481.7
– property, plant & equipment and investments	309.0	273.6	512.6	831.3
– net current assets/provisions/retirement benefit liabilities	124.3	198.3	246.4	101.6
Net borrowings	(770.6)	(589.9)	(926.7)	(930.8)
Funds employed	915.9	903.3	1,362.9	1,483.8
Ratios				
Operating profit before amortisation of acquired intangible assets: turnover (%)	16.4	16.1	14.8	13.8
Effective tax rate before amortisation of acquired intangible assets and exceptional items (%)	24.0	25.1	25.6	26.4
Return on shareholders' funds (%)	16.7	14.9	13.6	11.2
Cash-flow				
Cash-flow from normal operating activities	280.5	265.9	437.6	277.6
Less capital expenditure (net)	(8.0)	(6.7)	(18.0)	(18.9)
Operating cash after capital expenditure	272.5	259.2	419.6	258.7
Free cash-flow (before acquisitions and dividends, after capital expenditure)	90.6	100.7	170.4	147.0
Free cash-flow per share (p)	23.4	18.3	30.1	26.1
Earnings per share before amortisation of acquired intangible assets and exceptional items (p)	74.5	47.0	64.8	52.8
Dividends				
Pence per share	34.0	34.0	31.3	29.0
Times covered before amortisation of acquired intangible assets and exceptional items	2.2	1.7	2.1	1.8
Number of employees (000s)				
United Kingdom	2.2	2.8	7.3	7.2
Overseas	20.6	18.6	24.5	23.4
	22.8	21.4	31.8	30.6

The return on shareholders' funds for the period ended 31 July 2007 has been calculated using the closing net assets adjusted for movements in goodwill set-off against reserves relating to continuing operations, in order to adjust for the Aerospace disposal.

The income statement for the period ended 5 August 2006 has been restated for discontinued operations; however information on shareholders' equity, ratios, cash-flow, dividends and employee numbers is presented for the entire Group.

Results for the year ended 31 July 2005 have not been restated for discontinued operations.

Independent auditors' report to the members of Smiths Group plc

We have audited the parent company financial statements of Smiths Group plc for the year ended 31 July 2008 which comprise the Company balance sheet, the Accounting policies and the related notes. These parent company financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' remuneration report that is described as having been audited.

We have reported separately on the Group financial statements of Smiths Group plc for the year ended 31 July 2008.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report, the Directors' remuneration report and the parent company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of directors' responsibilities.

Our responsibility is to audit the parent company financial statements and the part of the Directors' remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the parent company financial statements give a true and fair view and whether the parent company financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Group directors' report is consistent with the parent company financial statements. The information given in the Group directors' report includes that specific information presented in the Business review that is cross referred from the Group directors' report.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited parent company financial statements. The other information comprises only the Summary performance, Group at a glance, Chairman's statement, the Chief Executive's statement, the Business review, Board of directors, the Group directors' report, the unaudited part of the Directors' remuneration report, the Statement of directors' responsibilities, the Group financial record and the Financial calendar. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent company financial statements and the part of the Directors' remuneration report to be audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the parent company financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the parent company financial statements and the part of the Directors' remuneration report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the parent company financial statements and the part of the Directors' remuneration report to be audited.

Opinion

In our opinion:

- the parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 July 2008;
- the parent company financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Group directors' report is consistent with the parent company financial statements.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors
London

23 September 2008

Notes

(a) The maintenance and integrity of the Smiths Group plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

(b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Company balance sheet

	Notes	31 July 2008 £m	31 July 2007 (restated) £m
Fixed assets			
Tangible assets	3	16.7	16.7
Investments and advances	4	3,216.1	3,087.8
		3,232.8	3,104.5
Current assets			
Debtors			
– amounts falling due within one year	5	52.2	104.0
– amounts falling due after more than one year	5	5.2	10.3
Cash at bank and on deposit		1.3	32.8
Financial derivatives		2.7	10.4
		61.4	157.5
Creditors: amounts falling due within one year	6	(95.2)	(105.7)
Net current (liabilities)/assets		(33.8)	51.8
Total assets less current liabilities		3,199.0	3,156.3
Creditors: amounts falling due after more than one year	6	(509.0)	(367.6)
Provisions for liabilities and charges	7	(8.3)	(25.1)
Financial derivatives		(18.0)	(2.8)
Net assets excluding pension assets/(liabilities)		2,663.7	2,760.8
Retirement benefit assets	8		29.7
Retirement benefit liabilities	8	(51.7)	
Net assets including pension assets/(liabilities)		2,612.0	2,790.5
Capital and reserves			
Called up share capital	9	145.5	144.6
Share premium account	10	303.6	289.0
Capital redemption reserve	10	5.8	5.7
Merger reserve	10	180.5	180.5
Profit and loss account	10	1,976.6	2,170.7
Shareholders' equity		2,612.0	2,790.5

The accounts on pages 111 to 120 were approved by the Board of Directors on 23 September 2008 and were signed on its behalf by:

Philip Bowman
Chief Executive

John Langston
Finance Director

Accounting policies

Basis of preparation

The accounts have been prepared in accordance with the Companies Act 1985 and all applicable accounting standards in the United Kingdom (UK GAAP).

These accounts have been prepared on a going concern basis and under the historical cost convention modified to include revaluation of certain financial instruments, share options and pension assets and liabilities held at fair value.

As permitted by Section 230(3) of the Companies Act 1985, the Company's entity profit and loss account and statement of total recognised gains and losses have not been presented.

The Company has taken advantage of the exemption in 'FRS 8 Related Party Disclosures' not to disclose transactions with other members of the Smiths Group.

Changes in accounting policies

As required, the Company has adopted UITF 44 'Group and Treasury Share Transactions' ("UITF 44") in these financial statements. UITF 44 requires the fair value of the award of share options to subsidiary company employees to be treated as a capital contribution.

Consequently, the Company has recognised an addition to investments of the aggregate amount of these contributions for all grants of equity instruments made subsequent to 7 November 2002. The addition to investments in 2008 was £3.3m. The adoption of this pronouncement has required the restatement of the comparative balance sheet. An adjustment of £2.6m was made to the 5 August 2006 balance sheet, with a further £3.9m recognised in 2007.

Foreign currencies

Foreign currency transactions are recorded at the exchange rate ruling on the date of transaction. Foreign exchange gains and losses resulting from the settlement of such transactions, and from the retranslation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies, are recognised in the profit and loss account.

Operating leases

Payments made under operating leases are charged to the profit and loss account as incurred over the term of the lease.

Where a leasehold property is vacant, or sub-let under terms such that the rental income is insufficient to meet all outgoings, provision is made for the anticipated future shortfall up to termination of the lease.

Tangible fixed assets

Depreciation is provided at rates estimated to write off the relevant assets by equal annual amounts over their expected useful lives. In general, the rates used are: Freehold and long leasehold buildings – 2%; Short leasehold property – over the period of the lease; Plant, machinery, etc. – 10% to 20%; Motor vehicles – 25%; Tools and other equipment – 10% to 33%.

Fixed asset investments

The Company's investment in shares in group companies are stated at cost less provision for impairment. Any impairment is charged to the profit and loss account as it arises.

Financial instruments

The policies disclosed in the Group accounting policies on pages 63 to 68 for recognition, measurement and presentation of financial instruments are applied in the Company accounts.

Where there are no differences between the disclosures required for the Group and the Company in respect of a class of financial instruments an appropriate cross reference is made to the Group accounts.

Taxation

Deferred tax is recognised in respect of timing differences that have originated but not reversed as at the balance sheet date. Timing differences are differences between the Company's taxable profits and its results as disclosed in the accounts, arising from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the accounts.

Deferred tax is recognised in respect of the retained earnings of overseas subsidiaries and associates only to the extent that, at the balance sheet date, dividends have been declared or an obligation is present to distribute past earnings. Deferred tax is not recognised on any fixed assets that have been revalued unless there is a binding agreement to sell the asset.

Provisions

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

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

Post-retirement benefits

For defined benefit schemes, the cost of benefits accruing during the year in respect of current and past service is charged against operating profit. The expected return on the schemes' assets and the increase in the present value of the schemes' liabilities arising from the passage of time are included in other finance income. Actuarial gains and losses are recognised in the statement of total recognised gains and losses. The balance sheet includes the surplus/deficit in schemes taking assets at their year-end market values and liabilities at their actuarially calculated values discounted at year-end AA corporate bond interest rates.

The Company has adopted the amendment to FRS 17 issued in December 2006.

Share-based Payment

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

The fair value of the shares or share options granted is recognised over the vesting period to reflect the value of the employee services received. The charge relating to grants to employees of the Company is recognised as an expense in the profit and loss account and the charge for grants to employees of other group companies is recognised as an investment in the relevant subsidiary.

The fair value of options granted, excluding the impact of any non-market vesting conditions, is calculated using established option pricing models, principally Binomial models. The probability of meeting non-market vesting conditions, which include profitability targets, is used to estimate the number of share options 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.

In accordance with the transitional provisions of 'FRS 20: Share-based Payment', no charge has been recognised for grants of equity instruments made before 7 November 2002.

Dividends

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

Notes to the Company accounts

1 Employees

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Staff costs during the period		
Wages and salaries	70.1	148.3
Social security	8.1	14.7
Cost of share-based incentive plans	8.5	7.2
Pension costs (note 8)	7.6	21.6
	94.3	191.8

For details of Smiths Group plc's employee share option schemes and other share-based plans refer to note 31 relating to the Group accounts.

The average number of persons employed during the period was 1,736 (2007: 6,555).

2 Audit fee

The audit fee for the parent company was £0.1m (2007: £0.1m).

3 Property, plant and equipment

	Land and buildings £m	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
Cost or valuation				
At 31 July 2007	15.8	1.0	3.7	20.5
Additions	0.3	0.3	0.4	1.0
Disposals		(0.1)	(0.2)	(0.3)
At 31 July 2008	16.1	1.2	3.9	21.2
Depreciation				
At 31 July 2007	1.0	0.4	2.4	3.8
Charge for the period	0.1	0.1	0.6	0.8
Disposals			(0.1)	(0.1)
At 31 July 2008	1.1	0.5	2.9	4.5
Net book value at 31 July 2008	15.0	0.7	1.0	16.7
Net book value at 31 July 2007	14.8	0.6	1.3	16.7

	31 July 2008 £m	31 July 2007 £m
Land and buildings – cost		
Freehold	15.9	15.6
Long leasehold	0.2	0.2
	16.1	15.8

4 Investments and advances

	31 July 2008 £m	31 July 2007 (restated) £m
Investments in subsidiaries		
Shares at cost	2,386.7	2,283.4
Due from subsidiaries	1,470.3	1,789.6
	3,857.0	4,073.0
Due to subsidiaries	(640.9)	(985.2)
	3,216.1	3,087.8

Investments in subsidiaries have been restated following the adoption of UITF 44. Shares at cost at 31 July 2007 have increased by £6.5m from £2,276.9m to £2,283.4m to reflect the value in 2007 and earlier years of share options granted to employees of subsidiaries.

The Company's subsidiaries are largely held according to business lines by the following holding companies, which are incorporated in England unless otherwise stated:

Smiths Medical Group Limited
 Smiths Detection Group Limited
 Smiths Specialty Engineering Group Limited
 Smiths Group International Holdings Limited
 Smiths Group Holdings Netherlands BV (incorporated in The Netherlands)

The principal subsidiaries and their countries of incorporation are:

England

Smiths Detection – Watford Ltd
 Smiths Medical International Limited
 John Crane UK Limited

Europe

Smiths Heimann SAS (France)
 Smiths Heimann GmbH (Germany)
 Smiths Medical France SA (France)
 Smiths Medical Deutschland GmbH (Germany)
 Hypertac SA (France)
 Hypertac GmbH (Germany)

Other

Smiths Detection (Asia-Pacific) Pte Ltd (Singapore)
 Smiths Medical Japan Limited (Japan)
 John Crane Middle East FZE (UAE)

United States

Smiths Detection, Inc.
 Smiths Medical ASD, Inc.
 Smiths Medical MD, Inc.
 Smiths Medical PM, Inc.
 Medex, Inc.
 John Crane, Inc.
 Flexible Technologies, Inc.
 Tutco, Inc.
 Hypertronics Corporation
 PolyPhaser Corporation
 Sabritec, Inc.
 Transtector Systems, Inc.

Of the companies above Smiths Group International Holdings Limited is 100% owned directly by the Company and Smiths Medical Japan Limited is 60% owned directly by the Company. The others are 100% owned through intermediate holding companies. Shareholdings are of ordinary shares or common stock. All subsidiaries operate in their country of incorporation.

5 Debtors

	31 July 2008 £m	31 July 2007 £m
Amounts falling due within one year		
Amounts owed by subsidiaries	45.4	95.1
Other debtors	5.3	6.5
Corporation tax		0.8
Prepayments and accrued income	1.5	1.6
	52.2	104.0
Amounts falling after more than one year		
Deferred taxation	5.2	10.3
	57.4	114.3

Notes to the Company accounts continued

6 Creditors

	31 July 2008 £m	31 July 2007 £m
Amounts falling due within one year		
Overdrafts	38.7	27.8
B shares (note 9)	1.7	18.1
Amounts owed to subsidiaries	32.4	33.6
Other creditors	6.6	10.6
Other taxation and social security costs	1.5	3.0
Accruals and deferred income	14.3	12.6
	95.2	105.7
Amounts falling due after more than one year		
Term loans	508.6	365.4
Other creditors	0.4	2.2
	509.0	367.6

7 Provisions for liabilities and charges

	At 31 July 2007 £m	Provisions charged £m	Provisions released £m	Utilisation £m	At 31 July 2008 £m
Property	1.2		(1.0)	(0.2)	
Disposals	23.9	5.1	(3.1)	(17.6)	8.3
	25.1	5.1	(4.1)	(17.8)	8.3

The opening disposals provisions included £20.7m in respect of the costs of transferring aerospace active pensioners. In 2008 the pensioners were transferred, utilising £17.6m of this provision. The balance of £3.1m has been released.

A provision has been made in 2008 in respect of obligations of the Company arising from the disposal of the Group's Marine Systems business. See note 30 relating to the Group accounts for details of this disposal. Most of the balance is expected to be utilised within the next five years.

8 Post-retirement benefits

The Company operates three defined benefit plans in the UK. The largest of them is a funded scheme with assets held in a separate trustee-administered fund. The Company is the sole employer in that scheme and, accordingly, accounts for it as a defined benefit pension plan, in accordance with FRS 17.

Pension costs are assessed in accordance with the advice of independent, professionally qualified actuaries. The most recent actuarial valuation of the funded scheme was performed using the Projected Unit Method as at 31 March 2006. This has been rolled forward to 31 July 2008.

Contributions to the funded scheme are made on the advice of the actuaries with the objective that the benefits be fully funded during the scheme members' average working lives.

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

	2008	2007
Rate of increase in salaries	4.1%	4.1%
Rate of increase in pensions in payment	3.5%	3.1%
Rate of increase in deferred pensions	3.6%	3.1%
Discount rate	6.6%	5.8%
Inflation rate	3.6%	3.1%
Healthcare cost increases	5.0%	5.0%

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.

The mortality assumptions used in the principal UK schemes are based on the recent actual mortality experience of members within each scheme. The assumptions are based on the PA92 birth tables with relevant scaling factors based on the experience of the schemes. The assumption also allows for future improvements in life expectancy in line with the medium cohort and a 1% underpin. The assumptions are that a member who retires next year at age 65 will live on average for a further 22 years after retirement if they are male and for a further 25 years after retirement if they are female. For a member who is currently 45, when they retire in 20 years' time they are assumed to live on average for a further 23 years after retirement if they are male and for a further 27 years after retirement if they are female.

8 Post-retirement benefits continued

The assets in the scheme and the expected rates of return as at 31 July 2008 were:

	2008 UK schemes		2007 UK schemes	
	Long-term rate of return	Value £m	Long-term rate of return	Value £m
Equities	8.2%	620.2	8.2%	959.8
Government bonds	4.8%	30.9	4.9%	77.4
Corporate bonds	6.6%	242.7	5.8%	169.9
Property	7.2%	188.1	7.2%	201.4
Other	5.8%	229.1	6.0%	119.0
Total market value		1,311.0		1,527.5
Present value of funded pension scheme liabilities		(1,333.5)		(1,443.3)
(Deficit)/surplus		(22.5)		84.2
Unfunded pension plans		(34.3)		(33.6)
Post-retirement healthcare		(15.2)		(15.9)
		(72.0)		34.7
Related deferred tax asset/(liability)		20.3		(5.0)
Net pension (liability)/ asset		(51.7)		29.7

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 scheme's investment portfolios.

History of experience gains and losses

	2008 £m	2007 £m	2006 £m	2005 £m
Actual return less expected return on pension scheme assets	(183.9)	52.6	23.5	
As a percentage of scheme assets	(14%)	3%	2%	
Experience gains and losses arising on the scheme liabilities	(4.5)	(36.7)	1.6	1.9
As a percentage of present value scheme liabilities	0%	(2)%	0%	5%

Changes in present value of defined benefit obligations

	2008 £m	2007 £m
At beginning of the period	(1,492.8)	(1,464.1)
Current service cost	(7.6)	(20.5)
Past service cost		(1.1)
Interest on obligations	(83.9)	(76.1)
Contributions by employees		(0.1)
Actuarial gain/(loss) on liabilities	36.0	(23.6)
Curtailment gain	1.1	32.5
Liabilities extinguished on settlements	97.2	
Benefits paid	67.0	60.2
At end of the period	(1,383.0)	(1,492.8)

Changes in present value of scheme assets

	2008 £m	2007 £m
At beginning of the period	1,527.5	1,380.4
Expected return on assets	109.1	96.5
Contributions by employer	40.1	60.0
Contributions by employees		0.1
Assets distributed on settlements	(114.8)	
Actuarial (loss)/gain on assets	(183.9)	50.7
Benefits paid	(67.0)	(60.2)
At end of the period	1,311.0	1,527.5

Notes to the Company accounts continued

8 Post-retirement benefits continued

Cash contributions

Cash payments in 2009 are expected to be £39.0m.

A one percentage point change in assumed healthcare cost trend rates would have the following effects:

	One percentage point increase £m	One percentage point decrease £m
Effect on the aggregate of service cost and interest cost	0.1	(0.1)
Effect on defined benefit obligations	1.3	(1.2)

9 Share capital

	Number of shares	Issued capital £m	Consideration £m
Ordinary shares			
At 31 July 2007	385,498,273	144.6	
Exercise of share options	2,380,908	0.9	15.5
At 31 July 2008	387,879,181	145.5	
B shares			
At 31 July 2007	4,926,594	0.1	
Purchased and cancelled	(4,467,437)	(0.1)	
At 31 July 2008	459,157		
Share capital classified as equity at 31 July 2008		145.5	
Share capital classified as debt at 31 July 2008			
Total share capital at 31 July 2008		145.5	

On 17 April 2008 4,467,437 B shares were purchased and cancelled. The remaining B shares carry annual interest of 75% of 12 month LIBOR, payable in arrears in April. Smiths may redeem and cancel the remaining B shares up to November 2008 for a consideration of 365p per share in cash or convert them to ordinary shares. B shares have no voting rights.

The authorised capital at 31 July 2008 consisted of:

- 533,333,333 (2007: 533,333,333) ordinary shares of 37.5p each; and
- 600,000,000 (2007: 600,000,000) non-cumulative B shares of 1p each.

At 31 July 2008 all of the issued share capital was in free issue. All issued shares are fully paid.

9 Share capital continued

	31 July 2008		31 July 2007	
Number of ordinary shares issuable under outstanding options	8,777,181		11,585,441	
	Year issued	Number of shares	Subscription prices	Dates normally exercisable
Smiths Sharesave Scheme	2001	30,990	608.00p	2004/2008
	2002	11,851	645.00p	2005/2009
	2003	118,006	554.00p	2006/2010
	2004	115,973	525.00p	2007/2011
	2005	194,283	704.00p	2008/2012
	2006	227,085	798.00p	2009/2013
	2007	189,534	868.00p	2010/2014
	2008	326,309	1,097.00p	2011/2015
Smiths Industries Executive Share Option Schemes	1998	19,244	765.00p	2001/2008
	1999	64,845	858.50p	2002/2009
	2000	69,653	750.00p	2003/2010
	2001	97,076	790.00p	2004/2011
	2002	1,213,113	806.00p	2005/2012
	2002	143,500	654.00p	2005/2012
	2003	214,800	669.00p	2006/2013
	2004	1,007,600	774.00p	2007/2014
	2005	1,146,437	901.00p	2008/2015
	2006	1,845,427	896.50p	2009/2016
	2007	1,610,500	1,097.00p	2010/2017
TI Group Executive Share Option Schemes	1998	8,607	849.79p	2001/2008
	1999	19,183	907.23p	2002/2009
	1999	87,181	1,103.92p	2002/2009
	2000	2,459	661.23p	2003/2010
	2000	13,525	626.16p	2003/2010

Notes to the Company accounts continued

10 Share premium account and reserves

	Share premium £m	Capital redemption reserve £m	Merger reserve £m	Profit and loss account £m
At 31 July 2007 (as previously reported)	289.0	5.7	180.5	2,164.2
UITF 44 adoption				6.5
At 31 July 2007 (as restated)	289.0	5.7	180.5	2,170.7
Exercise of share options	14.6			5.5
Purchase of own shares				(20.7)
Redemption of B shares		0.1		(0.1)
Profit for the period				47.2
Dividends paid to equity shareholders				(131.4)
Actuarial loss on retirement benefits				(147.9)
Deferred tax credit related thereto				41.5
Share-based payment				11.8
At 31 July 2008	303.6	5.8	180.5	1,976.6

The retained profit of the Company represents a profit for the year of £47.2m less dividends paid of £131.4m.

The retained earnings include the purchase of Smiths Group plc shares by the Smiths Industries Employee Benefit Trust, and the issue of these shares upon the exercise of share options. The consideration paid was £20.7m (2007: £7.0m) and £5.5m was received as a result of the issue of shares. At 31 July 2008 the trust held 1,095,965 (2007: 634,274) ordinary shares with a nominal value of £0.4m (2007: £0.2m) and a market value of £11.5m (2007: £6.6m).

The Company's profit and loss reserve of £1,976.6m includes £895.7m (2007: £926.1m) not available for distribution as dividend.

During the year, the Company received £15.5m (2007: £77.7m) on the issue of shares in respect of the exercise of options awarded under various share option schemes.

11 Contingent liabilities

The Company has arranged letter of credit facilities to support the Group's pension plans. The current amount outstanding is £124.9m (2007: £132.8m).

The Company has guaranteed the US\$250m 5.45% Senior Notes 2013 privately placed by a subsidiary and the £660m revolving credit facility used by a subsidiary.

Other contingent liabilities of the Company are not expected to give rise to a material loss.

12 Post balance sheet event

The directors propose a final dividend of 23.5p per share (totalling approximately £91m) for the period ended 31 July 2008. The dividend will be submitted for formal approval at the Annual General Meeting to be held on 18 November 2008.

In accordance with FRS 21, these financial statements do not reflect this dividend payable, which will be accounted for in shareholders' equity as an appropriation of retained earnings in the year ending 31 July 2009. During the period ended 31 July 2008, a final dividend of 23.5p per share (totalling £91m) was paid in respect of the dividend declared for the period ended 31 July 2007.

On 1 September 2008 the Company completed the sale of land in Basingstoke for £16m in cash. A further amount of up to £12m will be paid depending on the final terms of such amended planning permission as may be granted.

13 Deferred tax

	Year ended 31 July 2008 £m	Period ended 31 July 2007 £m
Deferred taxation		
At beginning of period	5.3	41.1
(Charge)/credit to profit and loss account	(21.3)	(27.8)
(Charge)/credit to equity	41.5	(8.0)
At end of period	25.5	5.3
Analysed as follows:		
Post-retirement benefits	20.3	(5.0)
Share-based payments	4.6	3.9
Short-term timing differences	0.6	6.4
	25.5	5.3

Financial calendar

2008	
Preliminary announcement of results for 2007/08	24 September
Ordinary shares final dividend ex-dividend date	22 October
Ordinary shares final dividend record date	24 October
Annual General Meeting	18 November
Ordinary shares final dividend payment date	21 November
2009	
2008/09 interim results announced	25 March (provisional)
Ordinary shares interim dividend ex-dividend date	1 April (provisional)
Ordinary shares interim dividend record date	3 April (provisional)
Ordinary shares interim dividend payment date	24 April (provisional)
Smiths Group financial year end	31 July
Preliminary announcement of results for 2008/09	30 September (provisional)
Ordinary shares final dividend ex-dividend date	21 October (provisional)
Ordinary shares final dividend record date	23 October (provisional)
Annual General Meeting	17 November (provisional)
Ordinary shares final dividend payment date	20 November (provisional)

The market value of an ordinary share of the Company on 31 March 1982 for the purposes of capital gains tax was 136.875p (taking into account the sub-division of 50p shares into 25p shares on 14 January 1985 and the subdivision and consolidation of 25p shares into 37.5p shares on 18 June 2007).

The 2008 Annual General Meeting will be held at The Thomas Lord Suite, Lord's Cricket Ground, Grace Gate, St John's Wood Road, London NW8 8QN on Tuesday 18 November 2008 at 2.30pm.

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Front cover images



- 1 Flex-Tek: Tutco heating elements
- 2 Smiths Medical: Epidural needles being manufactured in Keene, New Hampshire, USA
- 3 John Crane: Dry gas seal
- 4 Smiths Medical: Assembling an ambulatory pump system in St Paul, Minnesota, USA
- 5 Smiths Detection: Cargo scanning image
- 6 Smiths Interconnect: Assembling microwave electronics in TECOM Industries, Thousand Oaks, California, USA
- 7 Smiths Medical: CADD®-Solis ambulatory pump units
- 8 Smiths Detection: Positioning an X-ray source at Wiesbaden, Germany
- 9 Smiths Interconnect: Ground data terminals

smiths

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