

# Smiths Group plc Annual Results for the year ended 31 July 2020

London, Thursday 24 September 2020

## Strong now and for the future

- A robust FY2020 performance despite the disrupted second half, reflecting the Group's market-leading positions and flexible business model
- FY2021 focus continues to be on safeguarding employees and optimising performance
- The strategic restructuring programme is well underway, £70m benefits expected by FY2022
- Strategic intent to separate Smiths Medical unchanged
- Maintaining resilience in the short term, but investing for long-term value creation

**Andy Reynolds Smith**, Group Chief Executive, commented:

*"The strength and flexibility we have built into the business, and the benefits of the Group's strategic positioning, underpinned a robust performance in challenging market conditions.*

*Our priorities remain the safety of our people and keeping the business running flawlessly to support customers. I'm incredibly grateful to our amazing people for their dedication in difficult times, which ensured we delivered in the year and continue to maximise opportunities for future growth.*

*The strength of performance during the year and our confidence in the future support the proposed total dividend. We remain prudent as we continue to navigate the ongoing uncertainty.*

*We have continued to enhance the Group's strategic positioning, through execution of the restructuring programme, completion of three further bolt-on acquisitions and our unchanged commitment to separate Smiths Medical.*

*We are seeing a stabilisation of recent trends; but we are not complacent and are continuing to strengthen the business to deliver sustainable outperformance in the future."*

	Headline <sup>1</sup>				Statutory		
	FY2020 £m	FY2019 £m	Reported growth	Underlying growth <sup>2</sup>	FY2020 £m	FY2019 £m	Reported growth
<b>Smiths continuing operations<sup>3</sup></b>							
Revenue	2,548	2,498	+2%	(1)%	2,548	2,498	+2%
Operating profit ex. restructuring & write-downs <sup>4,6</sup>	382	427	(11)%	(13)%			
Operating profit	327	427	(23)%	(13)%	241	326	(26)%
<b>Smiths Medical - discontinued operations<sup>3</sup></b>							
Revenue	918	874	+5%	+4%			
Profit after tax	139	112	+24%	(3)%	200	85	+135%
<b>Total Group<sup>5</sup></b>							
Profit for the year	338	385	(12)%		267	227	+18%
Basic EPS	84.8p	96.8p	(12)%	(12)%	66.9p	56.8p	+18%
Free Cash-Flow <sup>6</sup>	273	234	+17%				
Dividend	35.0p	45.9p	(24)%		35.0p	45.9p	(24)%

The differences between headline and statutory operating profit are non-headline items as defined in note 3 to the accounts, of which the largest constituents are the amortisation of acquisition related intangible assets and provision for asbestos litigation in John Crane, Inc.

## Operational resilience

- Robust topline performance despite significant market disruption
- Strong business continuity and exemplary customer service maintained during the pandemic with temporarily higher costs
- Rewarded with further contract wins

## Financial strength

- Headline cash conversion<sup>6</sup> at 123% (FY2019: 83%)
- Net debt<sup>6</sup> of £1.1bn (including leases) and EBITDA<sup>6</sup> (Continuing and Discontinued) of £610m; a ratio of 1.7x (1.9x including restructuring and write-downs)
- Cash of c.£390m and undrawn RCF of c.£610m; total liquidity headroom of £1bn
- Total dividend of 35 pence per share reflecting delayed interim dividend of 11 pence per share and proposed final dividend of 24 pence per share

## Attractive strategic fundamentals

- Resilient characteristics: highly-differentiated, market-leading products and services; significant aftermarket activity serving critical industries; flexible cost base and strong cash generation
- Well-positioned in long-term, attractive growth markets
- A culture of innovation, entrepreneurship and relentless execution
- Organic growth complemented by disciplined M&A and portfolio optimisation

## Outlook

- Guidance remains withdrawn, given the uncertain depth and duration of the COVID-19 pandemic
- Current trading reflects market conditions, with revenue for the four months to end of August stabilising at (5)% for the Group (continuing operations (8)%) against pre-COVID comparators
- Continued focus on optimising performance, including the strategic restructuring programme which is well underway and expected to deliver £70m of benefits by FY2022
- Strategic intent to separate Smiths Medical unchanged
- Maintaining resilience in the short term, but investing for long-term value creation

### Statutory reporting

Statutory reporting takes account of all items excluded from headline performance. On a statutory basis, total Group profit for the year was £267m (FY2019: £227m) and basic earnings per share were 66.9p (FY2019: 56.8p).

See accounting policies for an explanation of the presentation of results and note 3 to the financial statements for an analysis of non-headline<sup>6</sup> items.

### Definitions

The following definitions are applied throughout the document and are Alternative Performance Measures (APMs) as defined in note 30 to the financial statements:

<sup>1</sup>Headline: In addition to statutory reporting, the Group reports on a headline basis. Definitions of headline metrics, and information about the adjustments to statutory measures, are provided in note 3 to the financial statements.

<sup>2</sup>Underlying modifies headline performance to adjust prior year to reflect an equivalent period of ownership for divested businesses, exclude the effects of foreign exchange, acquisitions, restructuring costs and write-downs, and add back the depreciation and amortisation of discontinued operations for comparability purposes.

<sup>3</sup>Continuing operations exclude Smiths Medical which is accounted for as 'Discontinued operations – businesses held for distribution to owners'. Discontinued operations are defined in note 28 to the financial statements.

<sup>4</sup>Restructuring and write-downs as defined in note 2 to the financial statements.

<sup>5</sup>Total Group comprises continuing operations and discontinued operations.

<sup>6</sup>APMs are defined as in note 30 to the financial statements

## Contact details

### Investor enquiries

Jemma Spalton, Smiths Group  
+44 (0)20 7004 1637  
+44 (0)78 6739 0350  
jemma.spalton@smiths.com

Marion Le Bot, Smiths Group  
+44 (0)20 7004 1672  
+44 (0)75 8315 4386  
marion.lebot@smiths.com

### Media enquiries

Richard Mountain, FTI Consulting  
+44 (0)20 3727 1374  
+44 (0)790 968 4466  
smiths@fticonsulting.com

Alex Le May, FTI Consulting  
+44 (0)20 3727 1308  
+44 (0)770 244 3312  
smiths@fticonsulting.com

Legal Entity Identifier (LEI): 213800MJL6IPZS3ASA11

### Presentation

The presentation slides and a live webcast of the analyst presentation will be available at <https://smiths.com/investors/results-reports-and-presentations> at 09.00 (UK time) today. A recording of the webcast will be made available from 13.00 (UK time).

### Photography

Original high-resolution photography is available to the media from the media contacts above or from <http://www.smiths-images.com/>

This document contains certain statements that are forward-looking statements. They appear in a number of places throughout this document and include statements regarding the intentions, beliefs and/or current expectations of Smiths Group plc (the "Company") and its subsidiaries (together, the "Group") and those of their respective officers, directors and employees concerning, amongst other things, the results of operations, financial condition, liquidity, prospects, growth, strategies and the businesses operated by 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 document and, unless otherwise required by applicable law, the Company undertakes no obligation to update or revise these forward-looking statements. Nothing in this document should be construed as a profit forecast. The Company and its directors accept no liability to third parties. This document contains brands that are trademarks and are registered and/or otherwise protected in accordance with applicable law.

	FY2019	Foreign exchange	Acquisitions & disposals*	Restructuring costs & write-downs	Underlying	FY2020
<b>Continuing operations (£m)</b>						
<b>Revenue</b>	2,498	15	61	-	(26)	2,548
<b>Headline operating profit</b>	427	2	9	(55)	(56)	327
<b>Headline operating margin</b>	17.1%				15.0%	

\* Includes disposals and FY2020 performance from acquisitions that do not have comparators for the prior year

<b>FY2020 – Headline underlying revenue growth</b>	H1	H2	FY
<b>John Crane</b>	+6%	(2)%	+2%
<b>Smiths Detection</b>	+4%	(3)%	-
<b>Flex-Tek</b>	+3%	(13)%	(6)%
<b>Smiths Interconnect</b>	(7)%	(3)%	(5)%
<b>Continuing operations</b>	+3%	(4)%	(1)%

## Smiths (continuing operations)

The commentary below refers to continuing operations (excluding Smiths Medical), unless otherwise stated.

### Revenue

The Group delivered a robust overall performance for the year. Underlying revenue for continuing operations was down (1)%, comprising +3% in the first half and (4)% in the second half. In a period of unprecedented global disruption, the Group's overall performance reflects its resilience founded on its market-leading positions and a high proportion of aftermarket revenues.

Reported revenue increased +2% to £2,548m (FY2019: £2,498m). This included +£15m of favourable foreign exchange translation and +£61m from the acquisition of United Flexible.

### Operating profit and margin

Underlying headline operating profit was down (13)% driven by lower volumes in the second half as well as additional costs to support business continuity and uninterrupted customer service during the pandemic. Central costs were flat year-on-year at £(51)m.

Reported headline operating profit decreased (23)% to £327m (FY2019: £427m). This included +£2m of favourable foreign exchange translation, +£9m contribution from the United Flexible acquisition, £(31)m of restructuring costs and £(24)m of write-downs relating to trade receivables and impairment of capitalised development projects.

Headline operating margin decreased (210)bps to 15.0% on an underlying basis and (430)bps on a reported basis including the impact of restructuring and write-downs.

The £(86)m difference between headline and statutory operating profit is non-headline items as defined in note 3 to the financial statements. The largest constituents relate to amortisation of acquisition related intangible assets and provision for asbestos litigation in John Crane, Inc. On a statutory basis, after taking into account all items excluded from headline performance, operating profit of £241m was £(85)m lower than last year (FY2019: £326m), reflecting the lower headline profit.

### Finance costs

Headline finance costs of £(49)m (FY2019: £(51)m) were £2m lower than last year. This reflects the impact of early repayment of higher coupon debt in the prior year, which more than offset the inclusion of lease interest of £(4)m following the adoption of IFRS 16. Statutory finance costs were £(108)m (FY2019: £(22)m) mainly due to a £(62)m foreign exchange loss on an intercompany loan with Smiths Medical; the matching credit in discontinued operations nets out to zero in total Group earnings.

### Taxation

The headline tax charge for the year of £(79)m (FY2019: £(103)m) represents an effective rate of 28% (FY2019: 27%). The Total Group headline effective tax rate was 26% (FY2019: 26%).

Non-headline taxation items of £13m (FY2019: £(59)m) related to tax on the non-headline loss. The statutory effective tax rate was 50% (FY2019: 53%) due to the non-headline items. Please refer to notes 3 and 6 of the financial statements for further details.

### R&D and capex

The income statement cost of R&D (excluding restructuring and write-downs) of £(89)m was broadly in line with last year (FY2019: £(93)m), excluding R&D write-downs. The cash cost increased to £(119)m or 4.7% of sales (FY2019: £(111)m or 4.5%), as the Group continues to invest for future growth.

Our Vitality Index measures the effectiveness of organic investment, tracking revenue from new products launched in the last three years. Our Total Group Vitality Index was 20% (FY2019: 13%), driven by new products in Smiths Detection (CTiX) and in Flex-Tek (Flashshield+™).

Capex of £(67)m (FY2019: £(68)m) represented 1.2x depreciation and amortisation (FY2019: 1.3x), excluding the impact of additional depreciation following the adoption of IFRS 16.

## **Portfolio**

The Group continues to invest in disciplined, complementary acquisitions.

In October 2019, Smiths Interconnect completed the acquisition of Reflex Photonics (“Reflex”) for an enterprise value of CAD\$40m. Reflex’s technological leadership in ruggedised fibre optics significantly strengthens Smiths Interconnect’s product offering in defence, space, aerospace and industrial market segments. For more information, please see note 27 of the financial statements.

In August 2020, Smiths Detection completed the acquisition of PathSensors Inc, which complements and accelerates its biological capability to detect pathogens for broad end market applications.

## **Smiths Medical (discontinued operations)**

As disclosed on 31 March 2020, the Board decided to delay the previously announced separation of Smiths Medical due to the uncertain market conditions. The strategic intent and rationale remain unchanged.

Accounting standards require the Group to stop charging depreciation and amortisation within Smiths Medical, since it has been reclassified as discontinued operations. For comparability purposes, depreciation and amortisation of £(45)m have been included in the calculation of underlying measures.

Smiths Medical continued its return to growth with underlying revenue up +4%. This growth accelerated in the second half to +7%, including +5% from participation in Ventilator Challenge UK. During the year, Smiths Medical signed a c.\$20m investment agreement from the U.S Government to expand syringe and needle device production to support COVID-19 vaccine efforts. Reported revenue was up +5% with +£12m of favourable foreign exchange translation and a £(3)m revenue impact from prior year disposals.

Headline operating profit of £184m was down (3)% on an underlying basis, with increased volumes offset by margin dilution from Ventilator Challenge UK, a one-off legal settlement and COVID-19 costs (including expedited freight, labour incentives and protective equipment). Reported headline operating profit was up +25% thanks to the exclusion of £(45)m of depreciation and amortisation, and +£2m of favourable foreign exchange, partially offset by £(1)m from prior year disposals and £(4)m of restructuring costs. Restructuring costs include delayering and decentralisation to increase efficiency and effectiveness. Reported headline operating margin was up +330bps to 20.1%, mainly driven by the exclusion of depreciation and amortisation, but was down (120)bps on an underlying basis.

The difference between statutory and headline operating profit comprised separation costs.

In May 2020, Smiths Medical acquired the business of Access Scientific LLC. The acquisition extends Smiths Medical’s vascular access portfolio and enhances its infection prevention capabilities.

## **Total Group**

The commentary below refers to Total Group, unless otherwise stated.

### **COVID-19**

The health and safety of our people and our operations have always been our number one priority. We have put in place measures to ensure our colleagues keep themselves and others safe while continuing to operate and serve our customers. We have maintained business continuity throughout with no interruption to our aftermarket support, albeit with higher operating costs.

We are seeing generally weaker demand across our markets with the exception of our products and services serving the medical market. For some of our markets the impact of COVID-19 was temporary, such as US construction, but in areas such as commercial aerospace we are seeing a more prolonged impact.

The Group has put measures in place to contain costs and preserve cash, including hiring freezes, cancellation of discretionary expenditure and postponement of non-critical capex. We have reinforced controls around receivables and payables, including cash tax (corporate, indirect and payroll).

**Restructuring and write-down costs**

FY2020 £m	Restructuring		Total income	
	cash costs	Write-downs	statement costs	Cash outflow
John Crane	(14)	(4)	(18)	(4)
Smiths Detection	(14)	(17)	(31)	(2)
Smiths Interconnect	(2)	(3)	(5)	(1)
Centre	(1)	-	(1)	(1)
<b>Group – continuing operations</b>	<b>(31)</b>	<b>(24)</b>	<b>(55)</b>	<b>(8)</b>
Smiths Medical	(4)	-	(4)	(4)
<b>Total Group</b>	<b>(35)</b>	<b>(24)</b>	<b>(59)</b>	<b>(12)</b>

The Group announced on 30 June that it is undertaking a strategic restructuring programme which brings together a number of pre-COVID initiatives to ensure that it is better positioned for long-term growth and consistent outperformance. The programme will support the achievement of our goal to deliver operating margins of 18-20%.

It impacts all divisions and is now well underway, with costs of £(35)m and a cash outflow of £(12)m in FY2020. Of the £(35)m charged, £(30)m related to headcount reduction and £(5)m related to footprint optimisation. Flex-Tek recorded £(2)m of restructuring for its commercial aerospace business which has been accounted for in the non-headline integration costs of the United Flexible acquisition.

The total cost of the programme is anticipated to be c.£(65)m spread across FY2020 and FY2021. Savings are expected to offset costs in FY2021; £(30)m of remaining costs will be spread evenly through the year, whilst the matching savings will be 70% weighted to the second half. We expect to deliver full annualised benefits of approximately £70m from FY2022 onwards.

The Group recorded £(24)m of write-downs, which are unrelated to restructuring. £(12)m relates to the cancellation of capitalised development projects in Smith Detection that are no longer deemed commercially viable. The balance of £(12)m of write-downs comprises trade receivables that were written off in John Crane, Smiths Detection and Smiths Interconnect.

**Total profit and EPS**

Total headline profit after tax decreased by (12)% on a reported basis. Headline basic EPS was down (12)% on an underlying basis and reported basis. Total statutory profit after tax increased by +18% to £267m (FY2019: £227m), driven by lower non-headline items. Statutory basic EPS was also up +18% to 66.9p (FY2019: 56.8p).

**Cash-flow**

Strong cash generation is a key characteristic of our business. Headline operating cash-flow was £575m (FY2019: £474m). This strong performance was achieved despite the disruption associated with the COVID-19 pandemic. Operating headline cash conversion was 123% (FY2019: 83%), including a benefit from IFRS 16, restructuring and write-downs.

Free cash-flow of £273m (FY2019: £234m) increased by £39m, underpinned by the strong operating cash-flow. Tax payments have increased to £113m in the year due to timing differences and the the repatriation of foreign dividends. Statutory net cash inflow from operating activities was £429m (FY2019: £346m). See note 29 to the financial statements for a reconciliation of headline operating cash-flow to statutory cash-flow.

**Debt**

Net debt at 31 July 2020 was £1,141m, a decrease of £(56)m in the period, despite the £148m impact of capitalised operating leases under IFRS16. EBITDA from continuing and discontinued operations was £610m. Net debt to EBITDA was 1.7x after inclusion of leases (1.9x including restructuring costs and write-downs).

Gross debt\* was £1,609m (FY2019: £1,512m), including the impact of leases. There are no covenants associated with this debt. The weighted average maturity was 4.2 years and there are no maturities before October 2022. Cash balances were £386m (FY2019: £315m).

An \$800m (c.£610m at the period-end exchange rate) revolving credit facility ('RCF') remains undrawn. \$110m of the RCF extends until November 2023 and \$690m until November 2024. The only covenant relates to interest cover which must be greater than or equal to 3 times, compared with 11 times at the year end. Taking cash and the RCF together, total liquidity was approximately £1bn at the year end.

Strong cash conversion and a conservative balance sheet enable us to face the challenges of the present crisis with our eyes firmly fixed on creating sustainable, long-term shareholder value.

\* APMs are defined in note 30 to the financial statements

## Pension

The net accounting pension surplus increased to £372m (FY2019: £311m), principally driven by higher returns on assets and life expectancy decreases, partially offset by a lower discount rate. Taken together, the two UK schemes were fully funded on a technical provisions basis as at their last formal updates.

Pension contributions for the year were £(33)m (FY2019: £(36)m). For FY2021, we expect total cash contributions of up to £(38)m across all schemes.

The two main UK pension schemes are well positioned to withstand a volatile market environment. They are well hedged, so that a movement in liabilities is largely offset by the movement in assets. As at 31 July 2020, approximately 35% of the liabilities had been de-risked through the purchase of annuities from third party insurers. Approximately 90% of assets are invested in third-party annuities, government bonds and investment grade credit. Only around 2% of assets is invested in equities.

On 10 September 2020, the TIGPS Trustee secured a further bulk annuity, which has insured the benefits of a further 1,200 pensioners. Across the two UK schemes, approximately 65% of pensioner liability (37% of total liabilities) is now de-risked through bulk annuities.

## Dividend

The Group maintains a progressive dividend policy, aiming to increase dividends in line with long-term underlying growth in earnings and cash-flow. The policy enables us to retain sufficient cash-flow to finance investment in the drivers of growth and meet our financial obligations. In setting the level of dividend payments, the Board considers prevailing economic conditions and future investment plans, along with the objective to maintain minimum dividend cover\* of around 2 times.

In March the Board considered it prudent not to declare an interim dividend for HY2020 until such time as trading conditions became clearer and there was less uncertainty. Reflecting the Group's strong performance and financial position, the Board is now recommending a total dividend of 35.0p per share for the year. This reflects a delayed interim dividend of 11.0p and a proposed final dividend of 24.0p.

The Company offers a Dividend Reinvestment Plan (DRIP) - see our website for details. To participate in the DRIP shareholders must submit their election notice to be received by 6 November 2020 – the Election Date. Elections received after the Election Date will apply to dividends paid after 20 November 2020. Purchases under the DRIP are made on or as soon as practicable after the dividend payment date and at prevailing market prices.

## Return on Capital Employed (ROCE)\*

ROCE was 11.8% (FY2019: 14.4%). The decrease reflects lower profitability, including restructuring costs and write-downs, recent investments (such as the acquisition of United Flexible, which are expected to generate superior returns over the longer-term) and the adoption of IFRS 16, partially offset by the absence of depreciation and amortisation in discontinued operations. For further detail of its calculation, please refer to note 30 to the financial statements.

## IFRS 16 – Leases

The Group has adopted IFRS 16 from 1 August 2019 and elected to apply the modified retrospective transition approach, requiring no restatement of the comparative period. The main changes include recognition of right of use assets and lease liabilities with a value of £144m (of which £48m relates to discontinued operations), and a marginal increase in operating profit due to reclassification of the financing charges inherent in operating lease costs to finance costs.

## Foreign exchange

The results of overseas operations are translated into sterling at average exchange rates. The net assets are translated at period-end rates. The Group is exposed to foreign exchange movements, mainly the US Dollar and the Euro. The principal exchange rates, expressed in terms of the value of sterling, are shown in the following table.

	Average rates		Period-end rates	
	31 July 2020 (12 months)	31 July 2019 (12 months)	31 July 2020	31 July 2019
USD	1.26	1.29	1.31	1.22
EUR	1.14	1.13	1.11	1.10

## Brexit

With over 95% of revenue originating outside the UK, the Group expects limited impact from Brexit but monitors the ongoing negotiations between the UK and the EU as part of its risk management process. Preparations have been made and mitigation measures have been put in place to meet potential scenarios.

\* APMs are defined in note 30 to the financial statements

**Outlook**

Guidance remains withdrawn, given the uncertain depth and duration of the COVID-19 pandemic.

We are seeing a stabilisation of recent trends, with Total Group underlying revenue of (5)% for the last four months to end of August (continuing operations (8)%). The first half of FY2021 will continue to cycle against pre-COVID comparators. The Group's seasonality normally results in a second-half weighted revenue profile. It is anticipated that the restructuring programme will incur £(30)m of costs spread evenly through the year, whilst the matching savings will be 70% weighted to the second half.

This is all underpinned by the Group's strong financial framework and robust balance sheet, and supports confidence that we will deliver long-term sustainable outperformance.

**Financial information**

The financial information set out above does not constitute the company's statutory accounts for the years ended 31 July 2020 or 2019 but is derived from those accounts. Statutory accounts for FY2019 have been delivered to the registrar of companies, and those for FY2020 will be delivered in due course. The auditor has reported on those accounts; their reports were (i) unqualified, (ii) did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under section 498 (2) or (3) of the Companies Act 2006.

# Business review

9 Smiths Group plc Annual Results 2020

## John Crane

John Crane is a leading provider of mission-critical engineered solutions for global energy and process industries. c.63% of revenue is derived from the energy sector (downstream and midstream oil & gas and power generation) and c.37% comes from other process industries (including chemical, pharmaceutical, mining, water treatment, and pulp & paper). 67% of John Crane revenue comes from aftermarket sales. John Crane represents 37% of continuing Group revenue.

	FY2020 £m	FY2019 £m	Reported growth	H1 underlying growth	H2 underlying growth	FY underlying growth
Revenue	955	945	1%	+6%	(2)%	+2%
Original Equipment	314	313		+8%	(6)%	-
Aftermarket	641	632		+5%	-	+2%
Headline operating profit	187	220	(15)%	+4%	(15)%	(6)%
Statutory operating profit	154	191	(19)%			
Return on capital employed	19.0%	23.4%	(440)bps			
R&D cash costs % sales	1.9%	1.7%	+20bps			

## Revenue

(£m)	FY2019 reported	Foreign exchange	Acquisitions & disposals	Underlying	FY2020 reported
Revenue	945	(6)	-	16	955

John Crane's market-leading positions and the strength of its global service network supported its robust performance, despite the challenges in the energy market and COVID-19 disruptions. Revenue was up +2% on an underlying basis. Reported revenue was up +1% as foreign exchange had a £(6)m adverse impact.

Underlying revenue from John Crane's Energy segment was up c.4%. After a strong first half with growth of c.11%, underlying revenue from Energy declined c.(2)% in the second half, impacted by the downturn in the energy sector and COVID-19 disruptions. Underlying revenue from Industrial activities was down c.(2)%, throughout the year due to strong comparators and COVID-19 disruptions.

Underlying revenue from Original Equipment ('OE') was flat year-on-year as the very strong start to the year (+8%) reversed in the second half ((6)%). Despite a slower rate of tenders, John Crane secured multiple new contracts, many of which were in the higher-growth regions of Asia-Pacific and the Middle East. These contract wins reflect John Crane's exemplary customer service and focus on business continuity despite the difficult operating conditions. John Crane's large installed base and leading service offering position it well to support the demand for aftermarket repairs, maintenance and upgrades. Underlying aftermarket revenue was resilient and grew +2% during the year, representing 67% of John Crane's revenue (FY2019: 66%).

## Operating profit

(£m)	FY2019 reported	Foreign exchange	Acquisitions & disposals	Restructuring & write-down costs	Underlying	FY2020 reported
Headline operating profit	220	(1)	-	(18)	(14)	187
Headline operating margin	23.3%				21.5%	19.6%

Headline operating profit of £187m decreased by (6)% on an underlying basis, with higher volumes being more than offset by the increased costs associated with COVID-19 disruptions. Reported headline operating profit declined (15)% due to £(14)m of restructuring costs and £(4)m of receivables write-downs. The restructuring actions in John Crane are focused on enhancing its flexibility to withstand the cyclical nature of its end markets and improve its efficiency.

Reported headline operating margin was 19.6%, down (370)bps on a reported basis but down only (180)bps to 21.5% on an underlying basis, excluding the impact of the restructuring costs and write-downs. The difference between statutory and headline operating profit includes the net cost in relation to the provision for John Crane, Inc. asbestos litigation.

## ROCE

ROCE was down (440)bps at 19.0%, due to the lower profitability and the adverse impact of IFRS 16 adoption.

## R&D

Cash R&D expenditure during the year represented 1.9% of sales, +20bps higher than last year. John Crane's innovation is primarily focused on enhancing efficiency, performance and sustainability by using materials science advancements, coatings and additive manufacturing. John Crane is also leveraging the Group's digital expertise to support the development of predictive diagnostic platforms and other innovative digital technologies.

During the year, John Crane introduced several new technologies, including a booster and filter to support dry gas seals on turbo compressors and further product developments to reduce the effects of friction and extreme pressure on pipeline applications.

## Smiths Detection

Smiths Detection is a global leader in the detection and identification of safety and security threats and contraband. It produces equipment for customers in the Aviation market and Other Security Systems for ports & borders, defence and urban security markets. 45% of Smiths Detection's sales are derived from the aftermarket. Smiths Detection represents 32% of continuing Group revenue.

	FY2020 £m	FY2019 £m	Reported growth	H1 underlying growth	H2 underlying growth	FY underlying growth
Revenue	806	798	+1%	+4%	(3)%	-
Aviation	577	522		+5%	+8%	+6%
Other Security Systems	229	276		+3%	(26)%	(13)%
Headline operating profit	82	127	(36)%	+4%	(24)%	(12)%
Statutory operating profit	57	91	(37)%			
Return on capital employed	7.2%	11.5%	(430)bps			
R&D cash costs % sales	9.2%	8.4%	+80bps			

## Revenue

(£m)	FY2019 reported	Foreign exchange	Acquisitions & disposals	Underlying	FY2020 reported
Revenue	798	8	-	-	806

The strength of Smiths Detection's market position and its leading technology supported its resilient performance with underlying revenue flat year-on-year.

The delivery of previously announced contract wins drove Original Equipment ('OE') up +2% on an underlying basis, with strong first half growth of +8% moderating to (2)% in the second half. Aftermarket revenue declined (2)% on an underlying basis, with first half growth of +1% being offset by (5)% in the second half as service and maintenance levels reduced during the COVID-19 pandemic. Reported revenue was up +1%, including +£8m of favourable foreign exchange translation.

Revenue from Aviation activities increased +6% on an underlying basis. Aviation is Smiths Detection's largest segment, representing 72% of total revenue. We continued to see demand for hold baggage systems ('HBS') across Europe, as a result of the ECAC standard-3 regulation, and globally, as airports upgrade their fleets. Demand is also driven by Computed Tomography ('CT') based screening systems for cabin baggage, which allow laptops and liquids to remain in bags. Deliveries included part of the previously announced contracts with Aena in Spain, Airports Authority India (AAI) and with the TSA in the US. Despite a slower rate of new tenders, Smiths Detection continues to secure contract wins, including for Kuwait International Airport and Singapore Changi Airport.

Underlying revenue from Other Security Systems declined by (13)%. This performance reflects both the strong comparator and the impact of COVID-19. Smiths Detection continues to respond to the pandemic by driving its digital portfolio and investing selectively in chemical and biological detection capabilities that will support a safer post COVID-19 world. New contract wins include an order from U.S Customs and Border Protection for high-energy X-ray inspection scanners used to screen moving rail carriages for dangerous or illegal cargo, and with the US Department of Defence (US DoD) for Solid Liquid Adaptors which add new capabilities to Joint Chemical Agent Detectors (JCADs), securing Smiths Detection as a global supplier of JCADs to the US DoD for several more years to come.

## Operating profit

(£m)	FY2019 reported	Foreign exchange	Acquisitions & disposals	Restructuring & write-down costs	Underlying	FY2020 reported
Headline operating profit	127	1	-	(31)	(15)	82
Headline operating margin	16.0%				13.9%	10.2%

Headline operating profit decreased (12)% on an underlying basis, reflecting a higher proportion of OE - at competitive pricing and COVID-19 related costs including reduced aftermarket services. Reported headline operating profit of £82m was down (36)% year-on-year, including £(14)m of restructuring and £(17)m of R&D and receivables write-down costs. Restructuring costs consist of headcount reduction combined with footprint optimisation. Reported headline operating margin was 10.2%, down (580)bps on a reported basis but only down (210)bps to 13.9% on an underlying basis, excluding the impact of the restructuring costs and write-downs. The difference between statutory and headline operating profit primarily reflects amortisation of acquired intangibles.

## Portfolio

In August 2020, Smiths Detection completed the bolt-on acquisition of PathSensors Inc, which enhances its biological capability to detect pathogens for broad end market applications.

**ROCE**

ROCE decreased by (430)bps to 7.2%, impacted by reduced profitability.

**R&D**

Cash R&D expenditure during the year was 9.2% of sales, +80bps higher than last year. R&D excluding customer funding was 6.9% for FY2020 (FY2019: 6.6%). Our new checkpoint scanner (CTiX) contributed positively to the Group's Vitality Index. We continue to invest in the development of the next generation of detection devices for the defence market, new algorithms to improve the detection of dangerous goods for cargo applications and operational efficiency, and digital solutions to strengthen our aftermarket proposition to make people and infrastructure safer. Certain programmes are co-funded by strategic customers seeking next-generation solutions to security challenges. In the year, Smiths Detection launched its new ultraviolet (UVC) light kits, capable of destroying up to 99.9% of microorganisms present on baggage trays at the security checkpoint. Demonstrating heightened hygiene standards will be important, as airports seek to restore the confidence of travellers and staff during and after the COVID-19 pandemic.

## Flex-Tek

Flex-Tek provides innovative components to heat and move fluids and gases for aerospace and industrial applications. 72% of Flex-Tek's revenue is derived from Industrials and 28% from the Aerospace sector. 51% of Flex-Tek's revenue comes from aftermarket sales. Flex-Tek represents 19% of continuing Group revenue.

	FY2020 £m	FY2019 £m	Reported growth	H1 underlying growth	H2 underlying growth	FY underlying growth
Revenue	478	436	+10%	+3%	(13)%	(6)%
Industrials	345	315		+2%	(5)%	(2)%
Aerospace	133	121		+5%	(31)%	(18)%
Headline operating profit	83	84	(1)%	+9%	(29)%	(14)%
Statutory operating profit	52	68	(24)%			
Return on capital employed	17.5%	23.3%	(580)bps			
R&D cash costs % sales	0.5%	0.6%	(10)bps			

## Revenue

(£m)	FY2019 reported	Foreign exchange	Acquisitions & disposals*	Underlying	FY2020 reported
Revenue	436	8	61	(27)	478

\* Includes disposals and FY2020 performance from acquisitions that do not have comparators for the prior year

Flex-Tek's underlying revenue decreased (6)%. After a good first half, underlying revenue declined (13)% in the second half, reflecting the downturn in commercial aerospace as well as a temporary disruption to US construction - which has since recovered. On a reported basis, revenue increased +10%, including +£61m incremental revenue associated with the acquisition of United Flexible, and +£8m favourable foreign exchange translation.

Industrials revenue was down (2)% despite increased sales of medical hoses and strong customer conversions to Flashshield+™, an innovative new flexible gas tubing product, which contributed positively to the Group's Vitality Index. Aerospace revenue was down (18)% on an underlying basis for the year, driven by the downturn in commercial aerospace in the second half. However defence aerospace was more resilient.

## Operating profit

(£m)	FY2019 reported	Foreign exchange	Acquisitions & disposals*	Restructuring & write-down costs	Underlying	FY2020 reported
Headline operating profit	84	2	9	-	(12)	83
Headline operating margin	19.2%				17.6%	17.3%

\* Includes disposals and FY2020 performance from acquisitions that do not have comparators for the prior year

Headline operating profit decreased (14)% on an underlying basis, impacted by lower volumes partially offset by strong cost controls. Reported headline operating profit was down (1)% at £83m, benefiting from £2m favourable foreign exchange and £9m from the United Flexible acquisition. Reported headline operating margin was 17.3%, down (190)bps. The difference between statutory and headline operating profit is due to amortisation of acquired intangible assets, provision for Titeflex Corporation subrogation claims, and integration costs for the United Flexible acquisition.

## ROCE

ROCE decreased (580)bps to 17.5%, mainly driven by the impact of lower volumes on profit and the acquisition of United Flexible in the prior year.

## R&D

Cash R&D expenditure remained broadly consistent at 0.5% of sales. R&D is focused on new products for HVAC line sets, duct innovation in Thermaflex, and an expanded product offering in aerospace.

## Smiths Interconnect

Smiths Interconnect designs solutions for high-speed, secure connectivity in demanding applications for various end markets including defence, semiconductor test, medical, space, commercial aerospace, and rail. Smiths Interconnect represents 12% of continuing Group revenue.

	FY2020 £m	FY2019 £m	Reported growth	H1 underlying growth	H2 underlying growth	FY underlying growth
Revenue	309	319	(3)%	(7)%	(3)%	(5)%
Headline operating profit	26	47	(45)%	(50)%	(25)%	(35)%
Statutory operating profit	23	45	(49)%			
Return on capital employed	6.4%	12.8%	(640)bps			
R&D cash costs % sales	7.7%	7.2%	+50bps			

### Revenue

(£m)	FY2019 reported	Foreign exchange	Acquisitions & disposals	Underlying	FY2020 reported
Revenue	319	5	-	(15)	309

Smiths Interconnect revenue declined (5)% on an underlying basis, primarily reflecting the pre-COVID slowdown in its end markets. After a challenging first half with underlying revenue down (7)%, the trajectory improved in the second half with underlying revenue of (3)% and an increase in orders supporting the division's return to growth in the fourth quarter. On a reported basis, revenue decreased by (3)%, including +£5m favourable foreign exchange translation.

The volume decline reflects a general slowdown in Interconnect's markets, which were impacted by the China-US trade dispute from the start of the financial year. The commercial aerospace and general industrial market segments were particularly badly impacted by the COVID-19 pandemic. Sales in the defence and space market segments also declined due to programme delays. Partly offsetting these declines was cyclical growth in semiconductor test as customers increased production of graphics cards for games consoles, and one-off orders for ventilator components in the medical segment.

During the year, Smiths Interconnect received significant orders for its space applications including for NASA projects and commercial satellite constellations.

### Operating profit

(£m)	FY2019 reported	Foreign exchange	Acquisitions & disposals	Restructuring & write-down costs	Underlying	FY2020 reported
Headline operating profit	47	1	-	(5)	(17)	26
Headline operating margin	14.7%				10.1%	8.4%

Headline operating profit decreased (35)% on an underlying basis, reflecting lower volumes and the cost of relocating and rationalising production capacity. Reported headline operating profit was down (45)% in the year to £26m, including £1m favourable foreign exchange and £(2)m of restructuring costs to optimise the operational footprint, and £(3)m of receivables write-downs. Reported headline operating margin was 8.4%, down (630)bps on a reported basis and (460)bps to 10.1% on an underlying basis, excluding the impact of the restructuring costs. The difference between statutory and headline operating profit reflects adjustments for amortisation of acquired intangibles and acquisition costs.

### Portfolio

In October 2019, Smiths Interconnect completed the acquisition of Reflex Photonics ("Reflex") for an enterprise value of CAD\$40m. Reflex's technological leadership in shock-resistant fibre optics significantly strengthens Smiths Interconnect's product offering in the defence, space, aerospace and industrial market segments.

### ROCE

ROCE decreased (640)bps to 6.4%, driven by lower profitability.

### R&D

Cash R&D expenditure increased to 7.7% of sales (7.0% excluding customer funded R&D, FY2019: 6.4%), as we continued to invest in technology-led growth. R&D is focused on bringing to market new products that improve connectivity in difficult operating environments. Product launches included connectors for power transmission in harsh environments and efficient probe heads for the semiconductor packaging industry. Smiths Interconnect opened a new Qualification and Test laboratory in Dundee, offering a one-stop shop for critical qualification and testing for space applications.

## Smiths Medical - discontinued operations

Smiths Medical supplies high-quality, cost-effective medical devices and consumables vital to patient care globally. Its portfolio incorporates established brands, with strong positions in select segments of the Infusion Systems, Vascular Access, and Vital Care markets. 80% of Smiths Medical's sales are from consumable and disposable products.

	FY2020 £m	FY2019 £m	Reported growth	H1 underlying growth	H2 underlying growth	FY underlying growth
Revenue	918	874	+5%	+1%	+7%	+4%
Headline operating profit	184	147	+25%	+1%	(7)%	(3)%
Statutory operating profit	161	151	+7%			
Return on capital employed	13.8%	11.7%	+210bps			
R&D cash costs % sales	5.9%	6.0%	(10)bps			

Accounting standards require the Group to stop charging depreciation and amortisation within Smiths Medical, since it has been reclassified as discontinued operations. For comparability purposes, depreciation and amortisation of £(45)m have been included in the calculation of underlying measures.

## Update on separation

As disclosed on 31 March 2020, the Board decided to delay the previously announced separation of Smiths Medical due to the uncertain market conditions. The strategic rationale remains unchanged.

## Revenue

(£m)	FY2019 reported	Foreign exchange	Acquisitions & disposals*	Underlying	FY2020 reported
Revenue	874	12	(3)	35	918

\* Includes disposals and FY2020 performance from acquisitions that do not have comparators for the prior year

Smiths Medical continued its return to growth with underlying revenue up +4%. This growth accelerated in the second half to +7%, including +5% from participation in Ventilator Challenge UK. Reported revenue was up +5% with +£12m favourable foreign exchange translation and a £(3)m revenue impact from prior year disposals.

Revenue from Infusion Systems was up +4% on an underlying basis driven by COVID-19 related demand. Vascular Access underlying revenue decreased by (5)% driven by the reduction of elective procedures as a result of COVID-19. During the year, Smiths Medical signed a c.\$20m investment agreement from the U.S Government to expand syringe and needle device production to support COVID-19 vaccine efforts. Underlying revenue from Vital Care and Specialty Products grew +13%, with exceptional growth in ventilators and tracheostomy tubes due to the pandemic, and good growth in the COPD product line, which is now being sold directly to customers.

## Operating profit

(£m)	FY2019 reported	Foreign exchange	Acquisitions & disposals*	Restructuring costs	Depreciation & amortisation	Underlying	FY2020 reported
Operating profit	147	2	(1)	(4)	45	(5)	184
Operating margin	16.8%					15.5%	20.1%

\* Includes disposals and FY2020 performance from acquisitions that do not have comparators for the prior year

Headline operating profit of £184m was down (3)% on an underlying basis, with increased volumes offset by margin dilution from Ventilator Challenge UK, a one-off legal settlement and COVID-19 costs, including expedited freight, labour incentives and protective equipment. Reported headline operating profit was up +25% thanks to the exclusion of £(45)m of depreciation and amortisation and +£2m of favourable foreign exchange, partially offset by £(1)m from prior year disposals and £(4)m of restructuring costs. Restructuring costs include layering and decentralisation to increase efficiency and effectiveness. Reported headline operating margin was up +330bps to 20.1%, mainly driven by the exclusion of depreciation and amortisation, but was down (120)bps on an underlying basis.

The difference between statutory and headline operating profit mainly comprised separation costs.

## Portfolio

In May 2020, Smiths Medical acquired the business of Access Scientific LLC. The acquisition extends Smiths Medical's vascular access portfolio and enhances its infection prevention capabilities.

## ROCE

ROCE increased by +210bps to 13.8% due to the absence of depreciation and amortisation, partially offset by the adoption of IFRS 16.

**R&D**

Cash R&D expenditure was 5.9% of sales, down (10)bps year on year. Smiths Medical continues to invest in the development of innovative, commercially focused products across the portfolio to support long-term, sustainable growth. Product launches in the year included: a pain management connection system designed to promote patient safety; anaesthesia breathing masks designed to better fit senior patients; a needle and catheter system that allows full visualisation under ultrasound to provide certainty of placement, and a non-invasive ventilation product for the Indian market.

# CONSOLIDATED INCOME STATEMENT

	Year ended 31 July 2020				Year ended 31 July 2019		
	Notes	Headline £m	Non- headline (note 3) £m	Total £m	Headline £m	Non- headline (note 3) £m	Total £m
<b>CONTINUING OPERATIONS</b>							
Revenue	1	2,548	-	2,548	2,498	-	2,498
Cost of sales		(1,559)	-	(1,559)	(1,429)	-	(1,429)
Gross profit		989	-	989	1,069	-	1,069
Sales and distribution costs		(270)	-	(270)	(267)	-	(267)
Administrative expenses		(392)	(86)	(478)	(375)	(101)	(476)
<b>OPERATING PROFIT</b>	2	<b>327</b>	<b>(86)</b>	<b>241</b>	<b>427</b>	<b>(101)</b>	<b>326</b>
Interest receivable		6	-	6	11	-	11
Interest payable		(55)	-	(55)	(62)	-	(62)
Other financing gains/(losses)		-	(66)	(66)	-	18	18
Other finance income – retirement benefits	8	-	7	7	-	11	11
Finance costs	4	(49)	(59)	(108)	(51)	29	(22)
<b>Continuing operations – profit before taxation</b>		<b>278</b>	<b>(145)</b>	<b>133</b>	<b>376</b>	<b>(72)</b>	<b>304</b>
Taxation	6	(79)	13	(66)	(103)	(59)	(162)
<b>Continuing operations – profit for the year</b>		<b>199</b>	<b>(132)</b>	<b>67</b>	<b>273</b>	<b>(131)</b>	<b>142</b>
<b>Discontinued operations</b>							
Profit from discontinued operations	28	139	61	200	112	(27)	85
<b>PROFIT FOR THE YEAR</b>		<b>338</b>	<b>(71)</b>	<b>267</b>	<b>385</b>	<b>(158)</b>	<b>227</b>
<b>Profit for the year attributable to:</b>							
Smiths Group shareholders – continuing operations		197	(132)	65	271	(131)	140
Smiths Group shareholders – discontinued operations		139	61	200	112	(27)	85
Non-controlling interests		2	-	2	2	-	2
		<b>338</b>	<b>(71)</b>	<b>267</b>	<b>385</b>	<b>(158)</b>	<b>227</b>
<b>EARNINGS PER SHARE</b>							
	5						
Basic				66.9p			56.8p
Basic – continuing				16.4p			35.4p
Diluted				66.4p			56.5p
Diluted – continuing				16.3p			35.1p

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Notes	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
<b>PROFIT FOR THE YEAR</b>		<b>267</b>	<b>227</b>
<b>Other comprehensive income:</b>			
Re-measurement of post-retirement benefits assets and obligations	8	19	(76)
Taxation thereon	6	(2)	13
<b>Other comprehensive income and expenditure which will not be reclassified to the consolidated income statement</b>		<b>17</b>	<b>(63)</b>
<b>Other comprehensive income which will be reclassified and reclassifications:</b>			
Exchange (losses)/gains		(205)	191
Fair value gains/(losses) and reclassification adjustments:			
– on financial asset at fair value through other comprehensive income		2	2
– deferred in the period on cash-flow and net investment hedges		73	(77)
– reclassified to income statement on cash-flow and net investment hedges		(2)	(4)
<b>Total other comprehensive income</b>		<b>(115)</b>	<b>49</b>
<b>Total comprehensive income</b>		<b>152</b>	<b>276</b>
<b>Attributable to:</b>			
Smiths Group shareholders		151	272
Non-controlling interests		1	4
		<b>152</b>	<b>276</b>
<b>Total comprehensive income attributable to Smiths Group shareholders arising from:</b>			
Continuing operations		59	148
Discontinued operations		92	124
		<b>151</b>	<b>272</b>

# CONSOLIDATED BALANCE SHEET

	Notes	31 July 2020 £m	31 July 2019 £m
<b>NON-CURRENT ASSETS</b>			
Intangible assets	10	1,564	1,684
Property, plant and equipment	12	218	232
Right of use assets	13	94	-
Financial assets – other investments	19	19	19
Retirement benefit assets	8	516	469
Deferred tax assets	6	102	115
Trade and other receivables	15	52	52
Financial derivatives	20	82	47
		<b>2,647</b>	<b>2,618</b>
<b>CURRENT ASSETS</b>			
Inventories	14	446	417
Current tax receivable	6	46	11
Trade and other receivables	15	627	764
Cash and cash equivalents	18	366	289
Financial derivatives	20	2	3
Assets held for distribution to owners	28	1,279	1,216
		<b>2,766</b>	<b>2,700</b>
<b>TOTAL ASSETS</b>		<b>5,413</b>	<b>5,318</b>
<b>CURRENT LIABILITIES</b>			
Financial liabilities			
– borrowings	18	(10)	(9)
– lease liabilities	18	(31)	-
– financial derivatives	20	(4)	(5)
Provisions	23	(55)	(66)
Trade and other payables	16	(527)	(569)
Current tax payable	6	(79)	(56)
Liabilities held for distribution to owners	28	(295)	(213)
		<b>(1,001)</b>	<b>(918)</b>
<b>NON-CURRENT LIABILITIES</b>			
Financial liabilities			
– borrowings	18	(1,455)	(1,500)
– lease liabilities	18	(65)	-
– financial derivatives	20	-	(1)
Provisions	23	(276)	(285)
Retirement benefit obligations	8	(139)	(152)
Corporation tax payable	6	(5)	(6)
Deferred tax liabilities	6	(27)	(45)
Trade and other payables	16	(51)	(30)
		<b>(2,018)</b>	<b>(2,019)</b>
<b>TOTAL LIABILITIES</b>		<b>(3,019)</b>	<b>(2,937)</b>
<b>NET ASSETS</b>		<b>2,394</b>	<b>2,381</b>
<b>SHAREHOLDERS' EQUITY</b>			
Share capital	24	149	148
Share premium account		361	360
Capital redemption reserve	26	6	6
Revaluation reserve	26	1	1
Merger reserve	26	235	235
Cumulative translation adjustments		674	878
Retained earnings		1,259	1,115
Hedge reserve	26	(312)	(383)
Total shareholders' equity		<b>2,373</b>	<b>2,360</b>
Non-controlling interest equity		21	21
<b>TOTAL EQUITY</b>		<b>2,394</b>	<b>2,381</b>

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Notes	Share capital and share premium £m	Other reserves £m	Cumulative translation adjustments £m	Retained earnings £m	Hedge reserve £m	Equity shareholders' funds £m	Non-controlling Interest £m	Total equity £m
At 31 July 2019	508	242	878	1,115	(383)	2,360	21	2,381
Impact of adopting IFRS 16	-	-	-	(1)	-	(1)	-	(1)
Impact of adopting IFRIC 23	-	-	-	(4)	-	(4)	-	(4)
Profit for the year	-	-	-	265	-	265	2	267
Other comprehensive income:								
– re-measurement of post-retirement benefits after tax	-	-	-	17	-	17	-	17
– exchange losses net of recycling	-	-	(204)	-	-	(204)	(1)	(205)
– fair value gains and related tax	-	-	-	2	71	73	-	73
<b>Total comprehensive income for the year</b>	-	-	<b>(204)</b>	<b>284</b>	<b>71</b>	<b>151</b>	<b>1</b>	<b>152</b>

## Transactions relating to ownership interests:

Exercises of share options	24	2	-	-	-	2	-	2
Purchase of own shares	26	-	-	(18)	-	(18)	-	(18)
Dividends:								
– equity shareholders	25	-	-	(126)	-	(126)	-	(126)
– non-controlling interest	-	-	-	-	-	-	(1)	(1)
Share-based payment	9	-	-	9	-	9	-	9
<b>At 31 July 2020</b>	<b>510</b>	<b>242</b>	<b>674</b>	<b>1,259</b>	<b>(312)</b>	<b>2,373</b>	<b>21</b>	<b>2,394</b>

Notes	Share capital and share premium £m	Other reserves £m	Cumulative translation adjustments (represented) £m	Retained earnings (represented) £m	Hedge reserve £m	Equity shareholders' funds £m	Non-controlling Interest £m	Total equity £m
At 31 July 2018	506	242	689	1,137	(302)	2,272	16	2,288
Profit for the year	-	-	-	225	-	225	2	227
Other comprehensive income:								
– re-measurement of post-retirement benefits after tax	-	-	-	(63)	-	(63)	-	(63)
– exchange losses net of recycling	-	-	189	-	-	189	2	191
– fair value gains/(losses) and related tax	-	-	-	2	(81)	(79)	-	(79)
<b>Total comprehensive income for the year</b>	-	-	<b>189</b>	<b>164</b>	<b>(81)</b>	<b>272</b>	<b>4</b>	<b>276</b>

## Transactions relating to ownership interests:

Exercises of share options	24	2	-	-	-	2	-	2
Purchase of own shares	26	-	-	(19)	-	(19)	-	(19)
Dividends:								
– equity shareholders	25	-	-	(178)	-	(178)	-	(178)
– non-controlling interest	-	-	-	-	-	-	(1)	(1)
Receipt of capital from non-controlling interest	-	-	-	-	-	-	2	2
Share-based payment	9	-	-	11	-	11	-	11
<b>At 31 July 2019</b>	<b>508</b>	<b>242</b>	<b>878</b>	<b>1,115</b>	<b>(383)</b>	<b>2,360</b>	<b>21</b>	<b>2,381</b>

Retained earnings in the comparatives for the year to 31 July 2019 have been represented to show the cumulative foreign exchange translation differences as a separate component of equity.

# CONSOLIDATED CASH-FLOW STATEMENT

	Notes	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
<b>Net cash inflow from operating activities</b>	29	<b>429</b>	<b>346</b>
<b>Cash-flows from investing activities</b>			
Expenditure on capitalised development	10	(35)	(27)
Expenditure on other intangible assets	10	(14)	(12)
Purchases of property, plant and equipment	12	(61)	(79)
Disposals of property, plant and equipment		1	4
Capital returned by/(investment in) financial assets		-	2
Acquisition of businesses	27	(24)	(277)
Acquisition of businesses - discontinued operations	28	(12)	-
Disposal of businesses – discontinued operations		1	30
Tax paid on disposal of businesses – discontinued operations		-	(8)
<b>Net cash-flow used in investing activities</b>		<b>(144)</b>	<b>(367)</b>
<b>Cash-flows from financing activities</b>			
Proceeds from exercise of share options	24	2	2
Purchase of own shares	26	(18)	(19)
Settlement of cash settled share awards		-	(2)
Dividends paid to equity shareholders	25	(126)	(178)
Payment of lease liabilities		(47)	-
Cash inflow/(outflow) from matured derivative financial instruments		1	-
Reduction and repayment of borrowings	18	-	(194)
<b>Net cash-flow used in financing activities</b>		<b>(188)</b>	<b>(391)</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>97</b>	<b>(412)</b>
Cash and cash equivalents at beginning of year		289	717
Movement in net cash held in disposal group		6	(26)
Foreign exchange rate movements		(26)	10
<b>Cash and cash equivalents at end of year</b>	18	<b>366</b>	<b>289</b>
<b>Cash and cash equivalents at end of year comprise:</b>			
– cash at bank and in hand		173	153
– short-term deposits		193	136
		<b>366</b>	<b>289</b>

# ACCOUNTING POLICIES

## Basis of preparation

The accounts have been prepared in accordance with the Companies Act 2006 applicable to companies reporting under International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee (IFRIC) interpretations, as adopted by the European Union.

The consolidated financial statements have been prepared under the historical cost convention modified to include revaluation of certain financial instruments, share options and pension assets and liabilities, held at fair value as described below.

## Going concern

The Directors are satisfied that the Group has adequate resources to continue to operate for a period not less than 12 months from the date of approval of the financial statements and that there are no material uncertainties around their assessment. Accordingly, the Directors continue to adopt the going concern basis of accounting.

Given the significant impact of COVID-19 on the macroeconomic conditions in which the Group is operating, the Directors have placed a particular focus on the appropriateness of adopting the going concern basis in preparing the financial statements for the year ended 31 July 2020.

In concluding that the going concern basis is appropriate, the Directors have modelled the impact of a severe but plausible downside scenario for COVID-19 whereby the Group experiences:

(i) Demand decline:

- a significant revenue decline in the first half of FY2021, resulting in a 25% year-on-year fall in revenue for FY2021. The decline being driven by a drop in demand in John Crane and Detection due to customer circumstances, weak demand in Flex-Tek and a reduction in Interconnect revenues due to a market slowdown and supply disruptions; and
- a further period of continued dampened demand for 12 months with a slow recovery beginning towards the end of FY2021 and into the first half of FY2022.

(ii) Supply chain disruption:

- supply chain disruptions assuming a closure of all manufacturing sites in November and December (with the exception of Medical);
- split shifts and inefficiency due to staff shortage thereafter; and
- ongoing supply chain disruption due to both ability of suppliers to continue to service and availability of freight forwarding to ship supplies.

This scenario assumes no additional mitigation than currently being enacted in terms of staff reductions, restructuring or government subsidies.

Throughout this severe but plausible downside scenario, the Group continues to have significant liquidity headroom on existing facilities and against the RCF financial covenant.

Other factors considered by the Board as part of their going concern assessment included the potential impact of Brexit trade talks, alongside inherent uncertainties in cash flow forecasts. Based on the above, the Directors have concluded that the Group is well placed to manage its financing and other business risks satisfactorily, and they have a reasonable expectation that the Group will have adequate resources to continue in operation for at least 12 months from the signing date of these financial statements. They therefore consider it appropriate to adopt the going concern basis of accounting in preparing the financial statements.

## Key estimates and significant judgements

The preparation of the accounts in conformity with generally accepted accounting principles requires management to make estimates and judgements 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 sources of estimation uncertainty together with the significant judgements and assumptions used for these consolidated financial statements are set out below.

## Sources of estimation uncertainty

### Impairment reviews of intangible assets

In carrying out impairment reviews of intangible assets, a number of significant assumptions have to be made when preparing cash-flow projections to determine the value in use of the asset or cash generating unit (CGU). These include the future rate of market growth, discount rates, the market demand for the products acquired, the future profitability of acquired businesses or products, levels of reimbursement and success in obtaining regulatory approvals. If actual results differ or changes in expectations arise, impairment charges may be required which would adversely impact operating results.

Critical estimates, and the effect of variances in these estimates, are disclosed in note 11 and note 28.

### Retirement benefits

Determining the value of the future defined benefit obligation involves significant estimates in respect of the assumptions used to calculate present values. These include future mortality, discount rate and inflation. The Group uses previous experience and independent actuarial advice to select the values for critical estimates.

The Group's principal defined benefit pension plans are in the UK and the US and these have been closed so that no future benefits are accrued. Critical estimates for these plans, and the effect of variances in these estimates, are disclosed in note 8.

### Provisions for liabilities and charges

John Crane, Inc. (JCI), a subsidiary of the Group, is one of many co-defendants in litigation relating to products previously manufactured which contained asbestos. Provision of £231m (FY2019: £237m) has been made for the future defence costs which the Group is expected to incur and the expected costs of future adverse judgments against JCI. Whilst well-established incidence curves can be used to estimate the likely future pattern of asbestos-related disease, JCI's claims experience is significantly impacted by other factors which influence the US litigation environment. These can include: changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels; and legislative and procedural changes in both the state and federal court systems. Because of the significant uncertainty associated with the future level of asbestos claims and of the costs arising out of the related litigation, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that will be incurred.

In quantifying the expected costs JCI takes account of the advice of an expert in asbestos liability estimation. The following estimates were made in preparing the provision calculation:

- the period over which the expenditure can be reliably estimated is judged to be ten years, based on past experience regarding significant changes in the litigation environment that have occurred every few years and on the amount of time taken in the past for some of those changes to impact the broader asbestos litigation environment. See note 23 for a sensitivity showing the impact on the provision of reducing or increasing this time horizon;
- the future trend of legal costs, the rate of future claims filed, the rate of successful resolution of claims, and the average amount of judgments awarded have been projected based on the past history of JCI claims and well-established tables of asbestos incidence projections, since this is the best available evidence. Claims history from other defendants is not used to calculate the provision because JCI's defence strategy generates a significantly different pattern of legal costs and settlement expenses. See note 23 for a sensitivity showing the range of expected future spend.

Titeflex Corporation, a subsidiary of the Group in the Flex-Tek division, has received a number of claims from insurance companies seeking recompense on a subrogated basis for the effects of damage allegedly caused by lightning strikes in relation to its flexible gas piping product. It has also received a number of product liability claims regarding this product, some in the form of purported class actions. Titeflex Corporation believes that its products are a safe and effective means of delivering gas when installed in accordance with the manufacturer's instructions and local and national codes; however some claims have been settled on an individual basis without admission of liability. Provision of £66m (FY2019: £74m) has been made for the costs which the Group is expected to incur in respect of these claims. In preparing the provision calculation, key estimates have been made about the impact of safe installation initiatives on the level of future claims. See note 23 for a sensitivity showing the impact on the provision of reducing or increasing the expected impact. However, because of the significant uncertainty associated with the future level of claims, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred.

All provisions may be subject to potentially material revisions from time to time if new information becomes available as a result of future events.

### Taxation

The Group has recognised deferred tax assets of £128m (FY2019: £106m) relating to losses and £75m (FY2019: £68m) relating to the John Crane, Inc. and Titeflex Corporation litigation provisions. The recognition of assets pertaining to these items requires management to make significant estimates as to the likelihood of realisation of these deferred tax assets and the phasing and attribution of future taxable profits. This is based on a number of factors, which management use to assess the expectation that the benefit of these assets will be realised, including expected future levels of operating profit, expenditure on litigation, pension contributions and the timing of the unwind of other tax positions.

## Significant judgements made in applying accounting policies

### Business combinations

On the acquisition of a business, the Group has to make judgements on the identification of specific intangible assets which are recognised separately from goodwill and then amortised over their estimated useful lives. These include items such as brand names and customer lists, to which value is first attributed at the time of acquisition. The capitalisation of these assets and the related amortisation charges are based on judgments about the value and economic life of such items.

Where acquisitions are significant, appropriate advice is sought from professional advisers before making such allocations.

### Retirement benefits

At 31 July 2020 the Group has recognised a retirement benefit asset of £516m (FY2019: £469m), principally relating to UK schemes, which arises from the rights of the employers to recover the surplus at the end of the life of the scheme.

The recognition of this surplus is a significant judgement. There is judgement required in determining whether an unconditional right of refund exists based on the provisions of the relevant trust deed and rules. Having taken legal advice with regards to the rights of the Group under the relevant Trust deed and rules, it has been determined that the surplus is recoverable by the Group and therefore can be recognised. If the pension schemes were wound up while they still had members, the schemes would need to buy out the benefits of all members. The buyouts would cost significantly more than the carrying value of the scheme liabilities within these financial statements which are calculated in accordance with IAS 19: Employee benefits.

### Capitalisation of development costs

Expenditure incurred in the development of major new products is capitalised as internally generated intangible assets only when it has been judged that strict criteria are met, specifically in relation to the products' technical feasibility and commercial viability (the ability to generate probable future economic benefits).

The assessment of technical feasibility and the future commercial viability of development projects requires significant judgement and the use of assumptions. Key judgements made in the assessment of future commercial viability include:

- Scope of work to achieve regulatory clearance (where required) - including the level testing evidence and documentation;
- Competitor activity - including the impact of potential competitor product launches on the market place and customer demand; and
- Launch timeline - including time and resource required to establish and support the commercial launch of a new product.

### Revenue recognition

Revenue is recognised as the performance obligations to deliver products or services are satisfied and revenue is recorded based on the amount of consideration expected to be received in exchange for satisfying the performance obligations.

Smiths Detection and Smiths Interconnect have multi-year contractual arrangements for the sale of goods and services. Where these contracts have separately identifiable components with distinct patterns of delivery and customer acceptance, revenue is accounted for separately for each identifiable component. Judgement is applied in the identification of the performance obligations of the contract and the allocation of contract revenue to each performance obligation.

The Group enters into certain contracts for agreed fees that are performed across more than one accounting period and revenue is recognised over time. Judgement is required to assess the stage of completion of the contract activity at the balance sheet date. This assessment requires the expected total costs of the contract and the costs to complete to be determined.

### Taxation

As stated in the previous section 'Sources of estimation uncertainty'. The Group has recognised deferred tax assets of £128m (FY2019: £106m) relating to losses and £75m (FY2019: £68m) relating to the John Crane, Inc. and Titeflex Corporation litigation provisions. The decision to recognise deferred tax assets requires judgement and it has been concluded that there are sufficient taxable profits in future periods to support recognition.

### Presentation of the Smiths Medical demerger

Following the Group's decision to pursue a demerger of the Smiths Medical business, judgement is required to determine the most appropriate financial reporting presentation of the division and its performance.

The key judgement for this classification is that the following conditions were met at the balance sheet date:

- The Group is committed to distribute the assets;
- The assets are available for immediate sale in their present condition;
- Actions to complete the distribution have been initiated and shareholder approval is highly probable;
- The distribution must be expected to be completed within one year from the date of classification; and
- It should be unlikely that any significant changes will be made to the plan or that it will be withdrawn.

The IFRS 5 requirement above for the expected completion of the transaction within 12 months of the date of classification was not achieved in FY2020, as the demerger project was paused in March 2020 due to unprecedented circumstances of the second half of FY2020.

However management has determined that, as the Group remains demonstrably committed to the demerger project for Smiths Medical, the criteria for classification as discontinued and held for distribution to owners continue to be met.

As a result of this classification, the results of Smiths Medical are presented as profit from discontinued operations and the Smiths Medical assets and liabilities are reported in assets and liabilities held for distribution to owners in FY2020 and FY2019.

### Presentation of headline profits and underlying growth

In order to provide users of the accounts with a clear and consistent presentation of the performance of the Group's ongoing trading activity, the income statement is presented in a three column format with 'headline' profits shown separately from non-headline items. In addition, the Group reports underlying growth rates for sales and profit measures.

See note 1 for disclosures of headline operating profit and note 30 for more information about the alternative performance measures ('APMs') used by the Group.

Judgement is required in determining which items should be included as non-headline. The amortisation/impairment of acquired intangibles, legacy liabilities, material one-off items and certain re-measurements are included in a separate column of the income statement. See note 3 for a breakdown of the items excluded from headline profit.

Calculating underlying growth also requires judgement. Underlying growth excludes the effects of foreign exchange, acquisitions and disposals, restructuring charges, impairment of capitalised development and COVID related balance sheet write-downs.

## Significant accounting policies

### Basis of consolidation

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

Subsidiaries are all entities controlled by the Company. Subsidiaries are fully consolidated from the date on which control is obtained by the Company to the date that control ceases.

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

### Foreign currencies

The Company's presentational currency and functional currency is sterling. The financial position of all subsidiaries and associates that have a functional currency different from sterling are translated into sterling at the rate of exchange at the date of that balance sheet, and the income and expenses are translated at average exchange rates for the period. All resulting foreign exchange rate movements are recognised as a separate component of equity.

On consolidation, foreign exchange rate movements 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 foreign exchange rate movements is recognised in the income statement as part of the gain or loss on sale.

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

## Revenue

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

When the Group enters into complex contracts with multiple, separately identifiable components, the terms of the contract are reviewed to determine whether or not the elements of the contract should be accounted for separately. If a contract is being split into multiple components, the contract revenue is allocated to the different components at the start of the contract. The basis of allocation depends on the substance of the contract. The Group considers relative stand-alone selling prices, contractual prices and relative cost when allocating revenue.

The Group has identified the following different types of revenue:

### **Sale of goods (i) – generic products manufactured by Smiths**

Generic products are defined as either;

- Products that are not specific to any particular customer;
- Products that may initially be specific to a customer but can be reconfigured at minimal cost, i.e. retaining a margin, for sale to an alternative customer; or
- Products that are specific to a customer but are manufactured at Smiths' risk, i.e. we have no right to payment of costs plus margin if the customer refuses to take control of the goods.

For established products with simple installation requirements, revenue is recognised when control of the product is passed to the customer. The point in time that control passes is defined in accordance with the agreed shipping terms and is determined on a case by case basis. The time of despatch or delivery of the goods to the customer is normally the point at which invoicing occurs. However for some generic products, revenue is recognised when the overall performance obligation has been completed, which is often after the customer has completed its acceptance procedures and has assumed control.

Products that are sold under multiple element arrangements, i.e. contracts involving a combination of products and services, are bundled into a single performance obligation unless the customer can benefit from the goods or services either on their own, or together with other resources that are readily available to the customer and are distinct within the context of the contract.

For contracts that pass control of the product to the customer only on completion of installation services, revenue is recognised upon completion of the installation.

An obligation to provide a refund for faulty products under the standard warranty terms is recognised as a provision. If the contract includes terms that either extend the warranty beyond the standard term or imply that maintenance is provided to keep the product working, these are service warranties and revenue is deferred to cover the performance obligation in an amount equivalent to the stand-alone selling price of that service.

### **Sale of goods (ii) – customer-specific products where the contractual terms include rights to payment for work performed to date**

Customer-specific products are defined as being:

- Products that cannot be reconfigured economically such that it remains profitable to sell to another customer;
- Products that cannot be sold to another customer due to contractual restrictions; and
- Products that allow Smiths to charge for the work performed to date in an amount that represents the costs incurred to date plus a margin, should the customer refuse to take control of the goods.

For contracts that meet the terms listed above, revenue is recognised over the period that the Group is engaged in the manufacture of the product, calculated using the input method based on the amount of costs incurred to date compared to the overall costs of the contract. The time of despatch or delivery of the goods to the customer is normally the point at which invoicing occurs.

An obligation to provide a refund for faulty products under the standard warranty terms is recognised as a provision. If the contract includes terms that either extend the warranty beyond the standard term or imply that maintenance is provided to keep the product working, these are service warranties and revenue is deferred to cover the performance obligation in an amount equivalent to the stand-alone selling price of that service.

### **Services relating to the installation, repair and ongoing maintenance of equipment**

Services include installation, commissioning, testing, training, software hosting & maintenance, product repairs and contracts undertaking extended warranty services.

For complex installations where the supply of services cannot be separated from the supply of product, revenue is recognised upon acceptance of the combined performance obligation (see Sale of goods (i) above).

For services that can be accounted for as a separate performance obligation, revenue is recognised over time, assessed on the basis of the actual service provided as a proportion of the total services to be provided.

Depending on the nature of the contract, revenue is recognised as follows:

- Installation, commissioning and testing services (when neither linked to the supply of product nor subject to acceptance) is recognised rateably as the service is provided;
- Training services are recognised on completion of the training course;
- Software hosting & maintenance services are recognised rateably over the life of the contract;
- Product repair services, where the product is returned to Smiths premises for remedial action, are recognised when the product is returned to the customer and they regain control of the asset;
- On-site ad hoc product repair services are recognised rateably as the services are performed;
- Long-term product repair and maintenance contracts are recognised rateably over the contract term; and
- Extended service warranties are recognised rateably over the contract term.

Invoicing for services depends on the nature of the service provided with some services charged in advance and others in arrears.

Where contracts are accounted for under the revenue recognised over time basis, the proportion of costs incurred is used to determine the percentage of contract completion.

Contracts for the construction of substantial assets, which normally last in excess of one year, are accounted for under the revenue recognised over time basis, using an input method.

For fixed-price contracts, revenue is recognised based upon an assessment of the amount of cost incurred under the contract, compared to the total expected costs that will be incurred under the contract. This calculation is applied cumulatively with any over/under recognition being adjusted in the current period.

For cost-plus contracts, revenue is recognised based upon costs incurred to date plus any agreed margin.

For both fixed-price and cost-plus contracts, invoicing is normally based on a schedule with milestone payments.

#### **Contract costs**

The Group has taken the practical expedient of not capitalising contract costs as they are expected to be expensed within one year from the date of signing.

#### **Leases**

The Group has adopted IFRS 16: Leases in the current year. The impact of adopting this new accounting standard on the Group's results, accounting policies and key judgements is set out below.

#### **Taxation**

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

Current income tax assets and liabilities are measured at the amount expected to be recovered from or paid to taxation authorities. Tax benefits are not recognised unless it is likely that the tax positions are sustainable. Once considered to be likely, tax benefits are reviewed to assess whether a provision should be made based on prevailing circumstances. Tax provisions are included in current tax liabilities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted, at the reporting date in the countries where the Group operates and generates taxable income.

The Group operates and is subject to taxation in many countries. Tax legislation is different in each country, is often complex and is subject to interpretation by management and government authorities. These matters of judgement give rise to the need to create provisions for uncertain tax positions which are recognised when it is considered more likely than not that there will be a future outflow of funds to a taxing authority. Provisions are made against individual exposures and take into account the specific circumstances of each case, including the strength of technical arguments, recent case law decisions or rulings on similar issues and relevant external advice.

The amounts are measured using one of the following methods, depending on which of the methods the Directors expect will better reflect the amount the Group will pay to the tax authority:

- The single best estimate method is used where there is a single outcome that is more likely than not to occur. This will happen, for example, where the tax outcome is binary or the range of possible outcomes is very limited;
- Alternatively, a probability weighted expected value is used where, on the balance of probabilities, there will be a payment to the tax authority but there are a number of possible outcomes. In this case, a probability is assigned to each of the outcomes

and the amount provided is the sum of these risk-weighted amounts. In assessing provisions against uncertain tax positions, management uses in-house tax experts, professional firms and previous experience of the taxing authority to evaluate the risk.

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

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

Deferred tax liabilities and assets are not discounted.

## Employee benefits

### Share-based compensation

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

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

### Pension obligations and post-retirement benefits

The Group has defined benefit plans, defined contribution plans and post-retirement healthcare schemes.

For defined benefit plans and post-retirement healthcare schemes the liability for each scheme recognised in the balance sheet is the present value of the obligation at the balance sheet date less the fair value of any plan assets. The obligation is calculated annually by independent actuaries using the projected unit credit method. The present value is determined by discounting the estimated future cash outflows using interest rates of AA-rated corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related liability. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised in full in the period in which they occur, outside of the income statement, and are presented in the statement of comprehensive income. Past service costs are recognised immediately in the income statement. Where relevant, the assets are valued on a fair value basis. The insured liabilities are valued by an external qualified actuary equal to the accounting valuation of corresponding liabilities insured.

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.

## 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.

The 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. The goodwill arising from acquisitions of subsidiaries before 1 August 1998 was set against reserves in the year of acquisition.

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

### Research and development

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

- Amounts recoverable from third parties; and
- Expenditure incurred in respect of the development of major new products where the outcome of those projects is assessed as being reasonably certain as regards viability and technical feasibility. Such expenditure is capitalised and amortised over the estimated period of sale for each product, commencing in the year that the product is ready for sale. Amortisation is charged straight line or based on the units produced, depending on the nature of the product and the availability of reliable estimates of production volumes.

The cost of development projects which are expected to take a substantial period of time to complete includes attributable borrowing costs.

### Intangible assets acquired in business combinations

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

Patents, licences and trademarks	up to 20 years
Technology	up to 13 years
Customer relationships	up to 11 years

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

### Software, patents and intellectual property

The estimated useful lives are as follows:

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

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

### Property, plant and equipment

Property, plant and equipment are 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% per annum
Short leasehold property	over the period of the lease
Plant, machinery, etc.	10% to 20% per annum
Fixtures, fittings, tools and other equipment	10% to 33% per annum

The cost of any assets which are expected to take a substantial period of time to complete includes attributable borrowing costs.

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

### Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in, first-out (FIFO) method. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). The cost of items of inventory which take a substantial period of time to complete includes attributable borrowing costs.

The net realisable value of inventories is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. Provisions are made for any slow-moving, obsolete or defective inventories.

### Trade and other receivables

Trade receivables and contract assets are initially recognised at fair value and subsequently measured at amortised cost, less any appropriate provision for expected credit losses.

A provision for expected credit losses is established when there is objective evidence that it will not be possible to collect all amounts due according to the original payment terms. Expected credit losses are determined using historical write-offs as a basis with a default risk multiplier applied to reflect country risk premium. The Group applies the IFRS 9 simplified lifetime expected credit loss approach for trade receivables and contract assets which do not contain a significant financing component.

### Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Where the Group expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

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 is a number of similar obligations, for example where a warranty has been given, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

### Businesses held for distribution to owners

Businesses classified as held for distribution to owners are measured at the lower of carrying amount and fair value less costs to distribute. Impairment losses on initial classification as held for distribution and gains or losses on subsequent remeasurements are included in the income statement. No depreciation is charged on assets and businesses classified as held for distribution.

Businesses are classified as held for distribution to owners if their carrying amount will be settled principally through a demerger transaction rather than through continuing use and the following criteria are met:

- The business must be a separate major line of business, available for immediate distribution in its present condition;
- Management is committed to the plan, shareholder approval is highly probable and the plan is unlikely to be significantly changed or withdrawn; and
- Distribution is expected to be completed within 12 months of the balance sheet date.

The assets and liabilities of businesses held for distribution to owners are presented as separate lines on the balance sheet.

### Discontinued operations

A discontinued operation is either:

- 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 distribution to owners; or
- A business acquired solely for the purpose of selling it.

Discontinued operations are presented on the income statement as a separate line and are shown net of tax.

In accordance with IAS 21, gains and losses on intragroup monetary assets and liabilities are not eliminated. Therefore foreign exchange rate movements on intercompany loans with discontinued operations are presented on the income statement as non-headline finance cost items.

### Cash and cash equivalents

Cash and cash equivalents include cash at bank and in hand and highly liquid interest-bearing securities with maturities of three months or less.

In the cash-flow statement, cash and cash equivalents are shown net of bank overdrafts, which are included as current borrowings in liabilities on the balance sheet.

### Financial assets

The classification of financial assets depends on the purpose for which the assets were acquired. Management determines the classification of an asset at initial recognition and re-evaluates the designation at each reporting date. Financial assets are classified as: measured at amortised cost, fair value through other comprehensive income or fair value through profit and loss.

Financial assets primarily include trade receivables, cash and cash equivalents (comprising cash at bank, money market funds and short term deposits), short term investments, derivatives (foreign exchange contracts and interest rate derivatives) and unlisted investments.

- Trade receivables are classified either as 'held to collect' and measured at amortised cost or as 'held to collect and sell' and measured at fair value through other comprehensive income (FVOCI). The Group may sell trade receivables due from certain customers before the due date. Any trade receivables from such customers that are not sold at the reporting date are classified as 'held to collect and sell'.
- Cash and cash equivalents (consisting of balances with banks and other financial institutions, money-market funds, short-term deposits) and short-term investments are subject to low market risk. Cash balances and short-term investments are measured at amortised cost. Money market funds and short-term deposits are measured at fair value through profit and loss (FVPL).
- Derivatives are measured at FVPL.
- Unlisted investments are measured at FVOCI.

Financial assets are derecognised when the right to receive cash-flows from the assets has expired, or has been transferred, and the Company has transferred substantially all of the risks and rewards of ownership. When securities classified as available for sale are sold or impaired, the accumulated fair value adjustments previously taken to reserves are included in the income statement.

Financial assets are classified as current if they are expected to be realised within 12 months of the balance sheet date.

### **Financial liabilities**

Borrowings are initially recognised at the fair value of the proceeds, net of related transaction costs. These transaction costs, and any discount or premium on issue, are subsequently amortised under the effective interest rate method through the income statement as interest over the life of the loan and added to the liability disclosed in the balance sheet. Related accrued interest is included in the borrowings figure.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least one year after the balance sheet date.

### **Derivative financial instruments and hedging activities**

The Group uses derivative financial instruments to hedge its exposures to foreign exchange and interest rates arising from its operating and financing activities.

Derivative financial instruments are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value. The method of recognising any resulting gain or loss depends on whether the derivative financial instrument is designated as a hedging instrument and, if so, the nature of the item being hedged.

Where derivative financial instruments are designated into hedging relationships, the Group formally documents the following:

- the risk management objective and strategy for entering the hedge;
- the nature of the risks being hedged and the economic relationship between the hedged item and the hedging instrument; and
- whether the change in cash-flows of the hedged item and hedging instrument are expected to offset each other.

Changes in the fair value of any derivative financial instruments that do not qualify for hedge accounting are recognised immediately in the income statement.

### **Fair value hedge**

The Group uses derivative financial instruments to convert part of its fixed rate debt to floating rate in order to hedge the risks arising from its external borrowings.

The Group designates these as fair value hedges of interest rate risk. Changes in the hedging instrument 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 to the extent that the hedge is effective. Gains or losses relating to any ineffectiveness are immediately recognised in the income statement.

### **Cash-flow hedge**

Cash-flow hedging is used by the Group to hedge certain exposures to variability in future cash-flows.

The effective portions of changes in the fair values of derivatives that are designated and qualify as cash-flow hedges are recognised in equity. The gain or loss relating to any ineffective portion is recognised immediately in the income statement. Amounts accumulated in the hedge reserve are recycled in the income statement in the periods when the hedged items will affect profit or loss (for example, when the forecast sale that is hedged takes place).

If a forecast transaction that is hedged results in the recognition of a non-financial asset (for example, inventory) or a liability, the gains and losses previously deferred in the hedge reserve are transferred from the reserve and included in the initial measurement of the cost of the asset or liability. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in the hedge reserve at that time remains in the reserve and is recognised when the forecast transaction is ultimately recognised in the income statement.

When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in other comprehensive income is immediately transferred to the income statement.

### **Net investment hedge**

Hedges of net investments in foreign operations are accounted for similarly to cash-flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in other comprehensive income; the gain or loss relating to any ineffective portion is recognised immediately in the income statement. When a foreign operation is disposed of, gains and losses accumulated in equity related to that operation are included in the income statement for that period.

### Fair value of financial assets and liabilities

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

'IFRS 13: Fair value measurement' requires fair value measurements to be classified according to the following hierarchy:

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

See note 21 for information on the methods which the Group uses to estimate the fair values of its financial instruments.

### Dividends

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

### New accounting standards effective 2020

The accounting policies adopted in the preparation of these consolidated financial statements are consistent with those followed in the previous financial year, except for the adoption of the new standards and policies applicable for the year ended 31 July 2020. The significant accounting policies adopted are set out below.

#### IFRS 16: Leases

The Group adopted IFRS 16 – Leases with effect from 1 August 2019. The standard fundamentally changed the accounting treatment of leased assets, requiring that all material lease liabilities and corresponding 'right of use' assets are recognised on the balance sheet. The operating lease rental expense previously charged to operating profit in the income statement has been replaced by a depreciation charge for the 'right of use' assets recognised in operating profit and an interest charge on the lease liabilities recognised in finance costs.

The Group has adopted IFRS 16 using the modified retrospective transition approach, which allows the matching of the opening right of use assets with the opening lease liabilities on 1 August 2019. Under this approach, no restatement of comparative figures is required. On adoption of IFRS 16, the Group recognised lease liabilities in relation to leases which had previously been classified as 'operating leases' under the principles of IAS 17, 'Leases'. These liabilities have been measured at the present value of the remaining lease payments, discounted using a weighted average incremental borrowing rate (IBR) on initial recognition at 1 August 2019 of 4.0%.

On transition the Group applied the following available practical expedients permitted by the standard:

- the exclusion of leases relating to low-value assets (less than £5,000 when new);
- the exclusion of short-term leases, being those with a lease term of 12 months or less; and
- applying the new definition of a lease only to contracts entered into after the transition date.

The impact of adoption of IFRS 16 on the Group's financial results is set out below:

Year ended 31 July 2020	Proforma IAS 17 £m	IFRS 16 adjustment £m	As reported £m
<b>Consolidated income statement (extract)</b>			
Headline operating profit	326	1	327
Headline finance costs	(45)	(4)	(49)
<b>Continuing operations – headline profit before tax</b>	<b>281</b>	<b>(3)</b>	<b>278</b>
Non-headline items (pre-tax)	(145)	-	(145)
Taxation	(66)	-	(66)
Profit from discontinued operations	189	11	200
<b>Profit for the financial year</b>	<b>259</b>	<b>8</b>	<b>267</b>

As at 1 August 2019 Consolidated balance sheet (extract)	Proforma IAS 17 £m	IFRS 16 adjustment £m	As reported £m
<b>Non-current assets</b>			
Right of use assets	-	106	106
<b>Current assets</b>			
Assets held for distribution to owners	1,216	41	1,257
<b>Current liabilities</b>			
Lease liabilities	(3)	(26)	(29)
Liabilities held for distribution to owners	(210)	(43)	(253)
<b>Non-current liabilities</b>			
Lease liabilities	-	(79)	(79)
Other	(1,378)	-	(1,378)
<b>Net assets</b>	<b>2,381</b>	<b>(1)</b>	<b>2,380</b>
<b>Total equity</b>	<b>2,381</b>	<b>(1)</b>	<b>2,380</b>

Within continuing operations during the year, lease interest of £4m has been recognised within finance costs and £33m of depreciation has been charged to the income statement. In total, payments of £34m were made under leasing contracts, of which £30m was made to repay the principal portion of the lease. Additionally, administrative expenses include £1m in respect of lease payments for short term and low value leases which are not included in the lease liabilities and payments disclosed above.

The impact of adopting IFRS 16 on discontinued operations is to increase profit by £11m. IFRS 16 has a greater impact on profits from discontinued operations than continuing operations, as in accordance with the requirements of IFRS 5, no depreciation is charged on assets classified as held for distribution.

Discounting the operating lease commitments at 31 July 2019 at the IBR reduced the lease liabilities by £21m, £20m of which was offset by increases in the lease liability arising from revised lease extension and termination assumptions.

#### IFRS 16: Accounting policy and key judgements

Having adopted IFRS 16, the Group applies the following approach. At the commencement date of the lease, the Group recognises lease liabilities measured at the present value of lease payments to be made over the lease term, which includes periods covered by renewal options the Group is reasonably certain to exercise. In calculating the present value of lease payments, the Group uses the incremental borrowing rate at the lease commencement date.

The Group recognises right of use assets at the commencement date of the lease. Right of use assets are measured at cost including the amount of lease liabilities recognised and initial direct costs incurred, less any incentives granted by the lessor. Right of use assets are subject to impairment. Right of use assets are depreciated over the shorter of the lease term and the useful life of the right of use assets, unless there is a transfer of ownership or purchase option which is reasonably certain to be exercised at the end of the lease term, in which case depreciation is over the useful life of the underlying asset.

Leases of buildings typically have lease terms between 1 and 6 years, while plant and machinery generally have lease terms between 1 and 3 years. The Group also has certain leases of machinery with lease terms of 12 months or less and leases of office equipment with low value (typically below £5,000). The Group applies the 'short-term lease' and 'lease of low-value assets' recognition exemptions for these leases and recognises the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

#### IFRIC 23: Uncertainty over income tax treatments

The Group adopted IFRIC 23 – Uncertainty over Income Tax Treatments on 1 August 2019. This interpretation is to be applied to the determination of taxable profit, tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments under IAS 12.

The interpretation specifically addresses the following:

- Whether an entity considers uncertain tax treatments separately;
- The assumptions an entity makes about the examination of tax treatments by taxation authorities;
- How an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates; and
- How an entity considers changes in facts and circumstances.

The Group already provides for tax uncertainties and following a detailed assessment the Group has determined that the adoption of this interpretation has not had a material impact on the Group's financial statements.

## New standards and interpretations not yet adopted

No other new standards, new interpretations or amendments to standards or interpretations have been published which are expected to have a significant impact on the Group's financial statements.

## NOTES TO THE ACCOUNTS

### 1 SEGMENT INFORMATION

#### Analysis by operating segment

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

- **John Crane** – mechanical seals, seal support systems, power transmission couplings and specialised filtration systems;
- **Smiths Detection** – sensors and systems that detect and identify explosives, narcotics, weapons, chemical agents, biohazards and contraband;
- **Flex-Tek** – engineered components, flexible hosing and rigid tubing that heat and move fluids and gases;
- **Smiths Interconnect** – specialised electronic and radio frequency board-level and waveguide devices, connectors, cables, test sockets and sub-systems used in high-speed, high reliability, secure connectivity applications; and
- **Smiths Medical** – infusion systems, vascular access products, patient airway and temperature management equipment and specialised devices in areas of diagnostic and emergency patient transport.

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

The Smiths Medical business is classified as a discontinued operation and the segmental information of the Smiths Medical division is disclosed in note 28.

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

#### Segment trading performance

	Year ended 31 July 2020					
	John Crane £m	Smiths Detection £m	Flex-Tek £m	Smiths Interconnect £m	Corporate costs £m	Total £m
Revenue	955	806	478	309	-	2,548
Headline operating profit	187	82	83	26	-	378
Corporate headline operating costs	-	-	-	-	(51)	(51)
<b>Headline operating profit/(loss)</b>	<b>187</b>	<b>82</b>	<b>83</b>	<b>26</b>	<b>(51)</b>	<b>327</b>
Items excluded from headline measures (note 3)	(33)	(25)	(31)	(3)	6	(86)
<b>Operating profit/(loss)</b>	<b>154</b>	<b>57</b>	<b>52</b>	<b>23</b>	<b>(45)</b>	<b>241</b>

	Year ended 31 July 2019					
	John Crane £m	Smiths Detection £m	Flex-Tek £m	Smiths Interconnect £m	Corporate costs £m	Total £m
Revenue	945	798	436	319	-	2,498
Divisional headline operating profit	220	127	84	47	-	478
Corporate headline operating costs	-	-	-	-	(51)	(51)
<b>Headline operating profit/(loss)</b>	<b>220</b>	<b>127</b>	<b>84</b>	<b>47</b>	<b>(51)</b>	<b>427</b>
Items excluded from headline measures (note 3)	(29)	(36)	(16)	(2)	(18)	(101)
<b>Operating profit/(loss)</b>	<b>191</b>	<b>91</b>	<b>68</b>	<b>45</b>	<b>(69)</b>	<b>326</b>

Headline operating profit is stated after charging the following items:

	Year ended 31 July 2020					
	John Crane £m	Smiths Detection £m	Flex-Tek £m	Smiths Interconnect £m	Corporate and non-headline £m	Total £m
Depreciation - property, plant and equipment	15	12	7	6	1	41
Depreciation - right of use assets	15	7	4	5	2	33
Amortisation of capitalised development costs	-	6	-	-	-	6
Amortisation of software, patents and intellectual property	4	-	-	2	1	7
Amortisation of acquired intangibles	-	-	-	-	57	57
Share-based payment	3	2	1	1	3	10
Strategic restructuring costs	14	14	-	2	1	31
Impairment of capitalised development costs	-	12	-	-	-	12
Balance sheet write-downs - trade receivables	4	5	-	3	-	12

	Year ended 31 July 2019					
	John Crane £m	Smiths Detection £m	Flex-Tek £m	Smiths Interconnect £m	Corporate and non-headline £m	Total £m
Depreciation - property, plant and equipment	14	10	5	6	2	37
Amortisation of capitalised development costs	-	9	-	-	-	9
Amortisation of software, patents and intellectual property	3	2	-	2	2	9
Amortisation of acquired intangibles	-	-	-	-	42	42
Share-based payment	4	3	1	1	5	14

The corporate and non-headline column comprise central information technology, human resources and headquarters costs and non-headline expenses (see note 3).

## Segment assets and liabilities

### Segment assets

	31 July 2020					
	John Crane £m	Smiths Detection £m	Flex-Tek £m	Smiths Interconnect £m	Corporate and non-headline £m	Total £m
Property, plant, equipment, right of use assets, development projects, other intangibles and investments	143	125	64	49	26	407
Inventory, trade and other receivables	395	438	144	136	11	1,124
<b>Segment assets</b>	<b>538</b>	<b>563</b>	<b>208</b>	<b>185</b>	<b>37</b>	<b>1,531</b>

	31 July 2019					
	John Crane £m	Smiths Detection £m	Flex-Tek £m	Smiths Interconnect £m	Corporate and non-headline £m	Total £m
Property, plant, equipment, development projects, other intangibles and investments	113	106	52	38	20	329
Inventory, trade and other receivables	428	485	171	132	17	1,233
<b>Segment assets</b>	<b>541</b>	<b>591</b>	<b>223</b>	<b>170</b>	<b>37</b>	<b>1,562</b>

Non-headline assets comprise receivables relating to non-headline items, acquisitions and disposals. Further details of the assets held for distribution to owners are disclosed in note 28.

**Segment liabilities**

	31 July 2020					
	John Crane £m	Smiths Detection £m	Flex-Tek £m	Smiths Interconnect £m	Corporate and non-headline £m	Total £m
Divisional liabilities	(142)	(288)	(60)	(55)	-	(545)
Corporate and non-headline liabilities	-	-	-	-	(364)	(364)
<b>Segment liabilities</b>	<b>(142)</b>	<b>(288)</b>	<b>(60)</b>	<b>(55)</b>	<b>(364)</b>	<b>(909)</b>

  

	31 July 2019					
	John Crane £m	Smiths Detection £m	Flex-Tek £m	Smiths Interconnect £m	Corporate and non-headline £m	Total £m
Divisional liabilities	(158)	(287)	(63)	(56)	-	(564)
Corporate and non-headline liabilities	-	-	-	-	(386)	(386)
<b>Segment liabilities</b>	<b>(158)</b>	<b>(287)</b>	<b>(63)</b>	<b>(56)</b>	<b>(386)</b>	<b>(950)</b>

Non-headline liabilities comprise provisions and accruals relating to non-headline items, acquisitions and disposals. Further details of the liabilities held for distribution to owners are disclosed in note 28.

**Reconciliation of segment assets and liabilities to statutory assets and liabilities**

	Assets		Liabilities	
	31 July 2020 £m	31 July 2019 £m	31 July 2020 £m	31 July 2019 £m
<b>Segment assets and liabilities</b>	<b>1,531</b>	<b>1,562</b>	<b>(909)</b>	<b>(950)</b>
Goodwill and acquired intangibles	1,489	1,606	-	-
Derivatives	84	50	(4)	(6)
Current and deferred tax	148	126	(111)	(107)
Retirement benefit assets and obligations	516	469	(139)	(152)
Cash and borrowings	366	289	(1,561)	(1,509)
Assets and liabilities held for distribution to owners	1,279	1,216	(295)	(213)
<b>Statutory assets and liabilities</b>	<b>5,413</b>	<b>5,318</b>	<b>(3,019)</b>	<b>(2,937)</b>

**Segment capital expenditure**

The capital expenditure on property, plant and equipment, capitalised development and other intangible assets for each division is:

	John Crane £m	Smiths Detection £m	Flex-Tek £m	Smiths Interconnect £m	Corporate and non-headline £m	Total £m
Capital expenditure year ended 31 July 2020	18	29	8	8	3	<b>66</b>
Capital expenditure year ended 31 July 2019*	29	23	6	10	1	<b>69</b>

\*represented to exclude amounts of capital expenditure relating to businesses held for distribution, which are disclosed in note 28.

**Segment capital employed**

Capital employed is a non-statutory measure of invested resources. It comprises statutory net assets adjusted to add goodwill recognised directly in reserves in respect of subsidiaries acquired before 1 August 1998 of £787m (FY2019: £787m) and eliminate post-retirement benefit assets and liabilities and litigation provisions relating to non-headline items, both net of related tax, and net debt. See note 30 for a reconciliation of net assets to capital employed.

The 12-month rolling average capital employed by division, which Smiths use to calculate divisional return on capital employed, is:

	31 July 2020				
	John Crane £m	Smiths Detection £m	Flex-Tek £m	Smiths Interconnect £m	Total £m
Average divisional capital employed	989	1,144	474	405	3,012
Average capital employed – business held for distribution to owners					1,335
Average corporate capital employed					(32)
<b>Average total capital employed</b>					<b>4,315</b>

  

	31 July 2019				
	John Crane £m	Smiths Detection £m	Flex-Tek £m	Smiths Interconnect £m	Total £m
Average divisional capital employed	938	1,113	359	368	2,778
Average capital employed – business held for distribution to owners					1,253
Average corporate capital employed					(59)
<b>Average total capital employed</b>					<b>3,972</b>

The Smiths Medical division has been accounted for as a business held for distribution to owners. Further details of the segmental assets and liabilities of the Smiths Medical division are disclosed in note 28.

## Analysis of revenue

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

<b>John Crane</b>	Original equipment £m	Aftermarket £m	Total £m
Revenue year ended 31 July 2020	314	641	<b>955</b>
Revenue year ended 31 July 2019	313	632	<b>945</b>

  

<b>Smiths Detection</b>	Aviation security £m	Other security systems £m	Total £m
Revenue year ended 31 July 2020	577	229	<b>806</b>
Revenue year ended 31 July 2019	522	276	<b>798</b>

  

<b>Flex-Tek</b>	Aerospace £m	Industrials £m	Total £m
Revenue year ended 31 July 2020	133	345	<b>478</b>
Revenue year ended 31 July 2019	121	315	<b>436</b>

  

<b>Smiths Interconnect</b>	Components, Connectors & Subsystems £m
Revenue year ended 31 July 2020	<b>309</b>
Revenue year ended 31 July 2019	<b>319</b>

The Group's statutory revenue is analysed as follows:

	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
Sale of goods recognised at a point in time	2,027	1,984
Sale of goods recognised over time	52	41
Services recognised over time	469	473
	<b>2,548</b>	<b>2,498</b>

### Analysis by geographical areas

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

	Revenue		Intangible assets, right of use assets and property plant and equipment	
	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m	31 July 2020 £m	31 July 2019 £m
Americas	1,263	1,243	1,231	1,299
Europe	580	558	553	533
Asia-Pacific	460	409	72	69
Rest of the World	245	288	20	15
	<b>2,548</b>	<b>2,498</b>	<b>1,876</b>	<b>1,916</b>

Revenue by destination attributable to the United Kingdom was £85m (FY2019: £100m). Revenue earned in the United States of America is noteworthy totalling £1,068m (FY2019: £1,030m). Revenue by destination has been selected as the basis for attributing revenue to geographical areas as this is the geographic attribution of revenue used by management to review business performance.

Non-current assets located in the United Kingdom total £88m (FY2019: £67m). Significant non-current assets are held in the United States of America £1,177m (FY2019: £1,271m) and Germany £383m (FY2019: £397m).

## 2 OPERATING PROFIT IS STATED AFTER CHARGING

	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
Research and development expense	83	84
Depreciation of property, plant and equipment	41	37
Depreciation of right of use assets	33	-
Amortisation of intangible assets	70	60
Strategic restructuring programme and write-downs	55	-

Research and development (R&D) cash costs were £119m (FY2019: £111m) comprising £83m (FY2019: £84m) of R&D expensed to the income statement, £16m (FY2019: £9m) of capitalised costs and £20m (FY2019: £18m) of customer funded R&D.

Administrative expenses include £1m in respect of lease payments for short term and low value leases which are not included within right of use assets and lease liabilities.

### Strategic restructuring programme and write-downs

In June 2020 the Group announced a strategic restructuring programme that will ensure it emerges stronger from the COVID-19 crisis and better able to deliver consistent outperformance. The programme is Group-wide and has an operating cash cost of c.£65m which will be spread across FY2020 and FY2021. Programme costs of £31m were recognised in continuing operations and £4m in discontinued operations during FY2020.

The table below shows the analysis of the costs recognised for the restructuring programme and asset write-downs and the calculation basis for headline operating profit excluding restructuring and write-downs:

	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
Restructuring costs - severance costs and footprint rationalisation	31	-
Impairment of capitalised development costs	12	-
Balance sheet write-downs - trade receivables	12	-
<b>Total strategic restructuring costs and write-downs</b>	<b>55</b>	<b>-</b>
Operating profit – see note 30 for definition	241	326
Non-headline operating profit items – see note 3	86	101
Headline Operating Profit	327	427
Strategic restructuring costs and write-downs – see above	55	
<b>Headline operating profit excluding restructuring and write-downs</b>	<b>382</b>	<b>427</b>

### Auditors' remuneration

The following fees were paid or are payable to the company's auditors, KPMG LLP and other firms in the KPMG network, for the year ended 31 July 2020. Figures in the table and notes below for the year ended 31 July 2019 are in respect of fees paid to the company's previous auditor, PricewaterhouseCoopers LLP ('PwC').

	Payable to KPMG Year ended 31 July 2020 £m	Payable to PwC Year ended 31 July 2019 £m
Audit services		
Fees payable to the Company's auditors for the audit of the Company's annual financial statements	2.3	4.0
Fees payable to the Company's auditors and its associates for other services:		
– the audit of the Company's subsidiaries	3.6	1.5
	<b>5.9</b>	<b>5.5</b>
All other services	0.5	0.2

Other services comprise audit-related assurance services £0.3m (FY2019: £0.2m) and fees for reporting accountant services in connection with a class 1 disposal £0.2m (FY2019: £nil). Total fees for non-audit services comprise 9% (FY2019: 4%) of audit fees. Audit-related assurance services include the review of the Interim Report.

## 3 NON-STATUTORY PROFIT MEASURES

### Headline profit measures

The Group has identified and defined a 'headline' measure of performance which is not impacted by material non-recurring items or items considered non-operational/trading in nature. This non-GAAP measure of profit is not intended to be a substitute for any IFRS measures of performance, but is a key measure used by management to understand and manage performance. See the disclosures on presentation of results in accounting policies for an explanation of the adjustments. The items excluded from 'headline' are referred to as 'non-headline' items.

**Non-headline operating profit items**

The non-headline items included in statutory operating profit for continuing operations are as follows:

	Notes	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
<b>Post-acquisition integration costs and fair value adjustment unwind</b>			
Integration programme costs		(4)	(17)
Unwind of acquisition balance sheet fair value uplift		-	(6)
<b>Acquisition and disposal related transaction costs and provision releases</b>			
Business acquisition/disposal costs		(3)	(10)
Release of acquisition related provisions		-	4
<b>Legacy pension scheme arrangements</b>			
Settlement gain/(loss) on post-retirement benefit schemes	8	7	(1)
Guaranteed Minimum Pension (GMP) equalisation	8	-	(29)
<b>Non-headline litigation provision movements</b>			
Movement in provision held against Titeflex Corporation subrogation claims	23	(1)	6
Provision for John Crane, Inc. asbestos litigation	23	(31)	(17)
Cost recovery for John Crane, Inc. asbestos litigation		3	11
<b>Other items</b>			
Amortisation of acquisition related intangible assets	10	(57)	(42)
<b>Non-headline items in operating profit – continuing operations</b>		<b>(86)</b>	<b>(101)</b>

**Post-acquisition integration costs and fair value adjustment unwind**

The £4m (FY2019: £17m) of integration programme costs relate to defined projects for the integration of United Flexible into the existing Flex-Tek business and Morpho Detection into the existing Smiths Detection business. Integration programme costs include the direct costs of organisational change, site rationalisation and entity closure costs. The United Flexible integration programme is due to conclude in 2021 whilst the Morpho Detection integration programme concluded in the current year. Integration costs are recognised as non-headline items because they are considered material and bear no relation to the ongoing performance of the acquired businesses.

The impact of unwinding the acquisition balance sheet fair value adjustments required by IFRS 3 'Business combinations' is recognised as non-headline as the charge does not relate to trading activity. The FY2019 charge of £6m was due to the unwind of fair value uplifts on the United Flexible and Morpho Detection acquisitions.

**Acquisition and disposal transaction costs and provision releases**

The £3m of business acquisition/disposal costs (FY2019: £10m) represents incremental transaction costs on the acquisition of Reflex Photonics and additional payments now due on the acquisition of United Flexible following COVID-19 related changes to the US tax code. These costs do not include the cost of employees working on transactions and are reported as non-headline because they are dependent on the level of acquisition and disposal activity in the year.

The release of acquisition related provisions in FY2019 of £4m represented the release of excess accruals for deferred consideration on business acquisitions. These were reported as non-headline as the initial provision accrual was not recognised as a headline expense.

**Legacy pension scheme arrangements**

The £7m settlement gain (FY2019: £1m settlement loss) is principally due to changes to the Group's US post-retirement healthcare plans as a result of the US Patient Protection and Affordable Care Act. In FY2019 £29m of past service costs were recognised following the UK High Court ruling that GMP equalisation is required. These items are included in non-headline as they are non-recurring and relate to legacy pension liabilities.

**Non-headline litigation provision movements**

The following litigation costs and recoveries have been treated as non-headline items because the provisions were treated as non-headline when originally recognised and the subrogation claims and litigation relate to products that the Group no longer sells in these markets:

- The £1m net charge (FY2019: £6m credit) recognised by Titeflex Corporation in respect of changes to the estimated cost of future claims is principally due to discount rate movements following a reduction in US treasury bond yields. See note 22 for further details; and
- The £31m (FY2019: £17m) increase in John Crane, Inc. asbestos litigation provision is principally due to discount rate movements following a reduction in US treasury bond yields. The costs recovered via insurer settlements in the current year were £3m (FY2019: £11m). See note 22 for further details.

#### Other items

Acquisition related intangible asset amortisation costs of £57m (FY2019: £42m) were recognised in the current year. This is considered to be a non-headline item on the basis that these charges result from acquisition accounting and are non-operational in nature.

#### Non-headline finance costs items

The non-headline items included in finance costs for continuing operations are as follows:

	Notes	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
Unwind of discount on provisions	23	(5)	(8)
Other finance income – retirement benefits	8	7	11
Foreign exchange (loss)/gain on intercompany loan with discontinued operations		(62)	39
Other financing gains/(losses)		1	(13)
<b>Non-headline items in finance costs – continuing operations</b>		<b>(59)</b>	<b>29</b>
<b>Continuing operations – non-headline loss before taxation</b>		<b>(145)</b>	<b>(72)</b>

The financing elements of non-headline legacy liabilities, including the £5m (FY2019: £8m) unwind of discount on provisions, are excluded from headline finance costs because these provisions were originally recognised as non-headline and this treatment has been maintained for ongoing costs and credits.

Other finance income comprises £7m (FY2019: £11m) of financing credits relating to retirement benefits. These are excluded from headline finance costs because the ongoing costs and credits are a legacy of previous employee pension arrangements.

Foreign exchange gains or losses on intercompany financing between Smiths Medical and the continuing group are recognised on the face of the income statement as a non-headline item due to the classification of Smiths Medical division as a discontinued operation. The £62m foreign exchange loss in continuing operations (FY2019: £39m gain) matches the foreign exchange gain in discontinued operations. This is excluded from headline net finance costs as these fair value movements are non-operational in nature and are purely a consequence of the presentational requirements for discontinued operations.

Other financing gains represent the fair value movements on financial instruments, foreign exchange movements on borrowings and other financing activities which the Group excludes from headline net finance costs. The current year gain of £1m (FY2019: £13m) is due to the partial reversal of the prior year fair value and net investment hedge ineffectiveness, partially offset by foreign exchange revaluation losses on surplus currency cash balances and intercompany financing - see note 4 for a further breakdown of this balance. These fair value movements are excluded from headline net finance costs when the following requirements are met:

- Fair value gains and losses on the interest element of derivative financial instruments hedging the Group's net debt exposures are excluded from headline as they will either reverse over time or be matched in future periods by interest charges.
- Fair value gains and losses on the currency element of derivative financial instruments hedging the Group's net debt and exposures, and exchange gains and losses on borrowings are excluded as the relevant foreign exchange gains and losses on the commercially hedged items are recognised as a separate component of other comprehensive income in accordance with the Group's foreign currencies accounting policy.

**Non-headline taxation items**

The non-headline items included in taxation for continuing operations are as follows:

	Notes	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
Tax on non-headline loss	6	15	12
Tax on the repatriation of treasury legacy cash pools	6	-	(17)
US deferred tax asset derecognition	6	(5)	(18)
UK deferred tax asset re-recognition/(derecognition)	6	3	(36)
<b>Non-headline items in taxation – continuing operations</b>		<b>13</b>	<b>(59)</b>
<b>Continuing operations – non-headline loss for the year</b>		<b>(132)</b>	<b>(131)</b>

**Tax on the repatriation of treasury legacy cash pools**

A £17m tax charge was recognised in FY2019 on prior year undistributed overseas earnings following the adoption of a new Treasury cash repatriation policy. This cost was reported as non-headline because the impact of the policy change was material and non-recurring.

**US deferred tax asset derecognition**

In FY2019 £18m of tax losses were derecognised following changes in US tax legislation which affected the Group's ability to utilise the losses. The losses equated to non-headline amortisation of intangibles and their derecognition was therefore treated as non-headline. Further net derecognition adjustments were made this year resulting in a charge of £5m following reassessment of future profitability.

**UK deferred tax asset derecognition**

In FY20 £3m of deferred tax was re-recognised due to movements in UK pension schemes and deferred tax thereon and is matched by a £3m deferred tax charge in equity. In FY2019 £36m of deferred tax was derecognised following the decision to separate Smiths Medical, which reduces the Group's profitability in the UK. These movements are reported as non-headline because recognition arises to match a non-headline deferred tax liability related to the UK legacy pension scheme surplus.

**Non-headline items for discontinued operations**

The non-headline items for discontinued operations are as follows:

	Notes	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
<b>Acquisition and disposal related transaction costs and provision releases</b>			
Business acquisition/disposal costs		-	(2)
Medical separation costs		(23)	(8)
<b>Other items</b>			
Amortisation of acquisition related intangible assets		-	(3)
Profit on disposal of businesses		-	17
<b>Non-headline finance costs items</b>			
Foreign exchange gain/(loss) on intercompany loan with parent		62	(39)
Other financing gains		-	1
<b>Non-headline taxation items</b>			
Tax on non-headline loss	28	22	8
Tax on the repatriation of treasury legacy cash pools		-	(1)
<b>Non-headline items in profit from discontinued operations</b>		<b>61</b>	<b>(27)</b>
<b>Profit for the year – non-headline items for continuing and discontinued operations</b>		<b>(71)</b>	<b>(158)</b>

The £2m of business acquisition/disposal costs recognised in FY2019 comprised incremental deal costs and were reported as non-headline because they are dependent on the level of activity in the year.

The incremental costs incurred by the Group on the transaction to demerge the Smiths Medical business amounted to £23m (FY2019: £8m). This cost has been reported as non-headline as the full year effect of the transaction on the Group's financial statements is both material and non-recurring.

The £62m foreign exchange gain on intercompany loan with parent (FY2019: £39m loss) matches the foreign exchange loss in continuing operations. This is excluded from headline net finance costs as these fair value movements are non-operational in nature and are purely a consequence of the presentational requirements for discontinued operations.

The FY2019 profit on disposal of businesses of £17m related to the sale of Smiths Medical's sterile water bottling and EMEA kitting businesses. These are considered to be non-headline items since the profit and cash impacts are material and non-recurring arising from the sale of a business.

## 4 NET FINANCE COSTS

	Notes	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
<b>Interest receivable</b>		6	11
Interest payable:			
– bank loans and overdrafts, including associated fees		(8)	(7)
– other loans		(43)	(55)
– interest on leases		(4)	-
<b>Interest payable</b>		<b>(55)</b>	<b>(62)</b>
<b>Headline net finance costs</b>		<b>(49)</b>	<b>(51)</b>
Other financing gains/(losses):			
– valuation movements on fair value hedged debt		10	(52)
– valuation movements on fair value derivatives		(4)	42
– foreign exchange and ineffectiveness on net investment hedges		(1)	(1)
– retranslation of foreign currency bank balances		(3)	-
– other items including counterparty credit risk adjustments and non-hedge accounted derivatives		(1)	(2)
<b>Other financing gains/(losses)</b>	3	1	(13)
Foreign exchange gain on intercompany loan with discontinued operations	3	(62)	39
Unwind of discount on provisions	3	(5)	(8)
Net interest income on retirement benefit obligations	8	7	11
<b>Non-headline finance cost items</b>		<b>(59)</b>	<b>29</b>
<b>Net finance costs</b>		<b>(108)</b>	<b>(22)</b>

## 5 EARNINGS PER SHARE

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

	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
Profit attributable to equity shareholders for the year:		
– continuing	65	140
– discontinued	200	85
Total	265	225
Average number of shares in issue during the year	396,193,310	395,936,520
Statutory earnings per share total – basic	66.9p	56.8p
Statutory earnings per share total – diluted	66.4p	56.5p
Statutory earnings per share continuing operations – basic	16.4p	35.4p
Statutory earnings per share continuing operations – diluted	16.3p	35.1p

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 398,814,030 (FY2019: 398,375,376) ordinary shares, being the average number of ordinary shares in issue during the year adjusted by the dilutive

effect of employee share schemes. For the year ended 31 July 2020, zero options (FY2019: zero) were excluded from this calculation because their effect was anti-dilutive for continuing operations.

A reconciliation of statutory and headline earnings per share is as follows:

	Year ended 31 July 2020			Year ended 31 July 2019		
	£m	Basic EPS (p)	Diluted EPS (p)	£m	Basic EPS (p)	Diluted EPS (p)
Total profit attributable to equity shareholders of the Parent Company	265	66.9	66.4	225	56.8	56.5
Exclude: Non-headline items (note 3)	71			158		
Headline earnings per share	336	84.8	84.2	383	96.8	96.1
Profit from continuing operations attributable to equity shareholders of the Parent Company	65	16.4	16.3	140	35.4	35.1
Exclude: Non-headline items (note 3)	132			131		
Headline earnings per share - continuing operations	197	49.7	49.4	271	68.4	68.0

## 6 TAXATION

This note only provides information about corporate income taxes under IFRS. Smiths companies operate in over 50 countries across the world. They pay and collect many different taxes in addition to corporate income taxes including: payroll taxes; value added and sales taxes; property taxes; product-specific taxes and environmental taxes. The costs associated with these other taxes are included in profit before tax.

	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
The taxation charge in the consolidated income statement for the year comprises:		
<b>Continuing operations</b>		
– current income tax charge	77	93
– current tax adjustments in respect of prior periods	2	5
<b>Current taxation</b>	<b>79</b>	<b>98</b>
Deferred taxation	(13)	64
<b>Total taxation expense – continuing operations</b>	<b>66</b>	<b>162</b>
<b>Discontinued operations</b>		
– current income tax charge	11	36
– deferred taxation	8	(11)
<b>Total taxation expense – discontinued operations</b>	<b>19</b>	<b>25</b>
<b>Total taxation expense in the consolidated income statement</b>	<b>85</b>	<b>187</b>

	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
<b>Tax on items charged/(credited) to equity</b>		
Deferred tax:		
– retirement benefit schemes	2	(13)
– foreign exchange	(3)	-
– share-based payments	1	3
	-	<b>(10)</b>

Of the net £2m charge to equity for retirement benefits, a £3m charge relates to UK retirement schemes.

**Current taxation liabilities**

	Current tax £m
At 31 July 2018	(34)
Foreign exchange losses	(1)
Charge to income statement	(132)
Reclassified to businesses held for distribution to owners (note 28)	9
Tax paid	107
<b>At 31 July 2019</b>	<b>(51)</b>
Current tax receivable	11
Current tax payable within one year	(56)
Corporation tax payable after more than one year	(6)
<b>At 31 July 2019</b>	<b>(51)</b>
Charge to income statement	(79)
Business acquired (note 27)	(3)
Tax paid	95
<b>At 31 July 2020</b>	<b>(38)</b>
Current tax receivable	46
Current tax payable within one year	(79)
Corporation tax payable after more than one year	(5)
<b>At 31 July 2020</b>	<b>(38)</b>

Taxation liabilities include provisions of £29m (FY2019: £26m), the majority of which relates to the risk of challenge to the geographic allocation of profits by tax authorities.

In addition to the risks provided for, the Group faces a variety of other tax risks, which result from operating in a complex global environment, including the ongoing reform of both international and domestic tax rules, new and ongoing tax audits in the Group's larger markets and the challenge to fulfil ongoing tax compliance filing and transfer pricing obligations given the scale and diversity of the Group's global operations.

The Group anticipates that a number of tax audits are likely to conclude in the next 12 to 24 months. Due to the uncertainty associated with such tax items, it is possible that the conclusion of open tax matters, the final outcome may vary significantly from the amounts noted above.

## Reconciliation of the tax charge

The tax charge on the profit for the year for continuing operations is different from the standard rate of corporation tax in the UK of 19% (FY2019: 19.0%). The difference is reconciled as follows:

	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
<b>Profit before taxation</b>	<b>133</b>	<b>304</b>
Notional taxation expense at UK corporate rate of 19.0% (FY2019: 19.0%)	25	58
Different tax rates on non-UK profits and losses	10	22
Non-deductible expenses	16	18
Tax credits and non-taxable income	7	(14)
Non-headline (re-recognition)/derecognition of UK deferred tax asset	(3)	36
Other adjustments to unrecognised deferred tax	(6)	3
Non-headline derecognition of US deferred tax asset	5	18
Provision for prior year deferred tax on unremitted overseas earnings	-	17
Tax on Medical consolidation adjustments	11	7
Prior Year true-up	1	(3)
Tax on continuing operations	66	162
Tax on discontinued operations	19	25
<b>Total taxation expense in the consolidated income statement</b>	<b>85</b>	<b>187</b>
Comprising:		
Taxation on headline profit	79	103
Non-headline taxation items:		
– Tax on non-headline loss	(15)	(12)
– (Recognition)/derecognition of UK deferred tax asset	(3)	36
– Derecognition of US deferred tax asset	5	18
– Provision for prior year deferred tax on unremitted overseas earnings	-	17
Taxation on non-headline items	(13)	59
Taxation on discontinued operations	19	25
<b>Total taxation expense in the consolidated income statement</b>	<b>85</b>	<b>187</b>

The head office of Smiths Group is domiciled in the UK; so the tax charge has been reconciled to UK tax rates.

### Deferred taxation assets/(liabilities)

	Property, plant, equipment and intangible assets £m	Employment benefits £m	Losses carried forward £m	Provisions £m	Other £m	Total £m
At 31 July 2018	(84)	(50)	121	84	32	103
Reallocation	-	-	1	3	(4)	-
Charge to income statement – continuing operations	(19)	(9)	(21)	(2)	(2)	(53)
Credit to equity	-	10	-	-	-	10
Business combinations	(31)	-	2	1	(1)	(29)
Reclassified to businesses held for distribution to owners (note 28)	61	-	(1)	(2)	(23)	35
Foreign exchange rate movements	(11)	1	4	7	3	4
<b>At 31 July 2019</b>	<b>(84)</b>	<b>(48)</b>	<b>106</b>	<b>91</b>	<b>5</b>	<b>70</b>
Deferred tax assets	(20)	(57)	103	66	23	115
Deferred tax liabilities	(64)	9	3	25	(18)	(45)
<b>At 31 July 2019</b>	<b>(84)</b>	<b>(48)</b>	<b>106</b>	<b>91</b>	<b>5</b>	<b>70</b>
Charge to income statement – continuing operations	6	(12)	21	-	(2)	13
Credit to equity	-	(3)	3	-	-	-
Foreign exchange rate movements	4	(3)	(2)	(5)	(2)	(8)
<b>At 31 July 2020</b>	<b>(74)</b>	<b>(66)</b>	<b>128</b>	<b>86</b>	<b>1</b>	<b>75</b>
Deferred tax assets	(5)	(75)	106	63	13	102
Deferred tax liabilities	(69)	9	22	23	(12)	(27)
<b>At 31 July 2020</b>	<b>(74)</b>	<b>(66)</b>	<b>128</b>	<b>86</b>	<b>1</b>	<b>75</b>

Businesses held for distribution to owners had net deferred tax liabilities of £39m at 31 July 2020 (FY2019: £35m).

Of the amounts included within "Other" in the table above as at 31 July 2020, liabilities relating to tax on unremitted earnings were £11m (FY2019: £18m). The aggregate amount of temporary differences associated with investments in subsidiaries for which deferred tax liabilities have not been recognised is immaterial.

The deferred tax asset relating to losses has been recognised on the basis of strong evidence of future taxable profits against which the unutilised tax losses can be relieved or it is probable that they will be recovered against the reversal of deferred tax liabilities. Deferred tax relating to provisions includes £59m (FY2019: £50m) relating to John Crane Inc. litigation provision, and £16m (FY2019: £18m) relating to Titeflex Corporation litigation provision. See note 22 for additional information on provisions.

Included in other deferred tax balances above is a deferred tax asset related to inventory of £5m (FY2019: £6m) and deferred revenue of £1m (FY2019: £9m).

### Unrecognised Deferred Tax

The Group, including Smiths Medical, has unrecognised deferred tax relating to losses amounting to £94m (FY2019: £243m).

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 the unrecognised deferred tax on losses is set out below:

	2020 £m	Expiry of losses	2019 £m	Expiry of losses
Restricted losses – Asia	27	2021-2026	29	2020-2026
Restricted losses – Americas	1	2021-2022	53	2020-2032
Unrestricted losses – operating losses	66	No expiry	161	No expiry
<b>Total unrecognised deferred tax on losses</b>	<b>94</b>		<b>243</b>	

### Franked Investment Income Group Litigation Order (FII GLO)

Smiths Group plc is one of the companies enrolled in the FII GLO litigation against HMRC. The court actions first filed in 2003 are nearing an end and some claimants with different fact patterns have received payments. Smiths' recoveries are estimated at circa £25m (computed on a simple interest basis and after deducting 45% withholding tax). However there are further relevant legal actions that may impact this estimate.

The Group has not recognised any of this potential tax credit to the financial statements in the current period or the prior year.

### EU Commission Investigation re Claims for Partial (75%) Exemption for Profits from qualifying loan relationships

In April 2019, the European Commission issued its decision in respect of a state aid investigation into the Group Financing Exemption in the UK controlled foreign company ("CFC") rules. The European Commission's decision found that part of the Group Financing Exemption constitutes state aid. The Group Financing Exemption was introduced in legislation by the UK Government in 2013. In common with other UK-based international companies whose arrangements were in line with the then UK CFC legislation, Smiths Group may be affected by the ultimate outcome of this decision.

In December 2019, HMRC issued general guidance on reliefs which can be taken into account in computing the amount of State Aid. If the European Commission's decision is ultimately upheld, Smiths should be able to use other tax attributes, including tax losses, such that it is expected that there will be no material cash outlay for Smiths. Nevertheless, the use of these attributes is not certain and the estimated maximum potential liability (which includes both tax and interest) remains at £15m. Based on our current assessment, no provision is being made in respect of this issue.

## 7 EMPLOYEES

	Year ended 31 July 2020			Year ended 31 July 2019		
	Continuing operations £m	Discontinued operations £m	Total £m	Continuing operations £m	Discontinued operations £m	Total £m
<b>Staff costs during the period</b>						
Wages and salaries	695	257	952	645	245	890
Social security	84	25	109	80	25	105
Share-based payments (note 9)	10	1	11	14	1	15
Pension costs (including defined contribution schemes) (note 8)	28	12	40	27	13	40
	<b>817</b>	<b>295</b>	<b>1,112</b>	<b>766</b>	<b>284</b>	<b>1,050</b>

The average number of persons employed, rounded to the nearest 50 employees, was:

	Year ended 31 July 2020	Year ended 31 July 2019
John Crane	6,450	6,200
Smiths Detection	3,000	2,850
Flex-Tek	2,850	2,550
Smiths Interconnect	2,450	2,350
Corporate (including central/shared IT services)	300	300
<b>Continuing operations</b>	<b>15,050</b>	<b>14,250</b>
Discontinued operations – Smiths Medical	8,050	7,750
<b>Total</b>	<b>23,100</b>	<b>22,000</b>

## Key management

The key management of the Group comprises Smiths Group plc Board Directors and Executive Committee members. Their aggregate compensation is shown below. Details of Directors' remuneration are contained in the report of the Remuneration Committee within the Annual Report 2020.

	Year ended 31 July 2019 £m	Year ended 31 July 2018 £m
<b>Key management compensation</b>		
Salaries and short-term employee benefits	10.3	10.2
Cost of post-retirement benefits	0.8	0.3
Cost of share-based incentive plans	3.0	5.0

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 2020		Year ended 31 July 2019	
	Number of instruments '000	Weighted average exercise price	Number of instruments '000	Weighted average exercise price
SEP	270		231	
LTIP	1,494		1,463	
Restricted stock	96		178	
SAYE	13	£10.58	12	£10.63

## Related party transactions

The only related party transactions in FY2020 were key management compensation (FY2019: key management compensation).

## 8 POST-RETIREMENT BENEFITS

Smiths provides post-retirement benefits to employees in a number of countries. This includes defined benefit and defined contribution plans and, mainly in the United Kingdom (UK) and United States of America (US), post-retirement healthcare.

### Defined contribution plans

The Group operates defined contribution plans across many countries. In the UK a defined contribution plan has been offered since the closure of the UK defined benefit pension plans. In the US a 401(k) defined contribution plan operates. The total expense recognised in the consolidated income statement in respect of all these plans was £38m (FY2019: £37m).

### Defined benefit and post-retirement healthcare plans

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

For all schemes, pension costs are assessed in accordance with the advice of independent, professionally qualified actuaries. These valuations have been updated by independent qualified actuaries in order to assess the liabilities of the schemes as at 31 July 2019. Contributions to the schemes are made on the advice of the actuaries, in accordance with local funding requirements.

**The changes in the present value of the net pension asset in the period were:**

	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
At beginning of period	311	381
Foreign exchange rate movements	2	(4)
Current service cost	(3)	(3)
Scheme administration costs	(5)	(4)
Past service cost, curtailments, settlements	8	(30)
Finance income – retirement benefits	7	11
Contributions by employer	33	36
Actuarial gain/(loss)	19	(76)
<b>Net retirement benefit asset</b>	<b>372</b>	<b>311</b>

The £372m net retirement benefit asset includes £5m (FY2019: £6m) of pension obligations disclosed as liabilities held for distribution to owners.

**UK pension schemes**

Smiths funded UK pension schemes are subject to a statutory funding objective, as set out in UK pension legislation. Scheme trustees need to obtain regular actuarial valuations to assess the scheme against this funding objective. The trustees and sponsoring companies need to agree funding plans to improve the position of a scheme when it is below the acceptable funding level.

The UK Pensions Regulator has extensive powers to protect the benefits of members, promote good administration and reduce the risk of situations arising which may require compensation to be paid from the Pension Protection Fund. These include imposing a schedule of contributions or the calculation of the technical provisions, where a trustee and company fail to agree appropriate calculations.

**Smiths Industries Pension Scheme ('SIPS')**

This scheme was closed to future accrual effective 1 November 2009. SIPS provides index-linked pension benefits based on final earnings at date of closure. SIPS is governed by a corporate trustee (S.I. Pension Trustees Limited, a wholly owned subsidiary of Smiths Group plc). The board of trustee directors currently comprises four company-nominated trustees and four member-nominated trustees, with an independent chairman selected by Smiths Group plc. Trustee Directors are responsible for the management, administration, funding and investment strategy of the scheme.

The most recent formal actuarial valuation of this Scheme has been performed using the Projected Unit Method as at 31 March 2017. As part of the 2017 valuation process, a long-term funding objective to reach full funding on a 'gilts + 0%' basis by 31 December 2028 was agreed with the Scheme's Trustee. Under the funding plan for SIPS agreed in June 2018, Smiths will pay cash contributions of £1m a month until the long-term funding objective is achieved.

Work on the valuation of the scheme as at 31 March 2020 has commenced and experience gains and losses identified during the work on the 2020 valuation have been incorporated into the IAS 19 valuation. Any changes to the funding plan agreed after the 2020 valuation has been completed will be reported in next year's annual report. Under the governing documentation of SIPS, any future surplus would be returnable to Smiths Group plc by refund, assuming gradual settlement of the liabilities over the lifetime of the scheme.

The duration of SIPS liabilities is around 23 years (FY2019: 23 years) for active deferred members, 22 years (FY2019: 23 years) for deferred members and 12 years (FY2019: 12 years) for pensioners and dependants. In FY2019 SIPS purchased a buy-in annuity policy with Canada Life for a premium of £176m. An actuarial loss of £14m was recognised in FY2019 as a result of this buy-in agreement.

**TI Group Pension Scheme ('TIGPS')**

This scheme was closed to future accrual effective 1 November 2009. TIGPS provides index-linked pension benefits based on final earnings at the date of closure. TIGPS is governed by a corporate trustee (TI Pension Trustee Limited, an independent company). The board of trustee directors comprises four company-nominated trustees and four member-nominated trustees, with an independent trustee director selected by the Trustee. The Trustee is responsible for the management, administration, funding and investment strategy of the scheme.

The most recent actuarial valuation of this scheme has been performed using the Projected Unit Method as at 5 April 2017. As part of the 2017 valuation process, a long-term funding objective to reach full funding on a solvency (or "buy-out") basis by 31

December 2028 was agreed with the Scheme's Trustee. Under the funding plan for TIGPS agreed in June 2018, Smiths will pay cash contributions of £1m a month until the long-term funding objective is achieved.

Work on the valuation of the scheme as at 5 April 2020 has commenced and experience gains and losses identified during the work on the 2020 valuation have been incorporated into the IAS 19 valuation. Any changes to the funding plan agreed after the 2020 valuation has been completed will be reported in next year's annual report. Under the governing documentation of TIGPS, any future surplus would be returnable to Smiths Group plc by refund, assuming gradual settlement of the liabilities over the lifetime of the scheme.

The duration of the TIGPS liabilities is around 25 years (FY2019: 25 years) for active deferred members, 22 years (FY2019: 22 years) for deferred members and 11 years (FY2019: 11 years) for pensioners and dependants. After the financial year-end, in September 2020, the TIGPS Trustee secured a further bulk annuity policy which has insured the benefits of a further 1,200 pensioners. The premium paid was £142m.

### **US pension plans**

The valuations of the principal US pension and post-retirement healthcare plans were performed using census data at 1 January 2018.

The pension plans were closed with effect from 30 April 2009 and benefits were calculated as at that date and are not revalued. Governance of the US pension plans is managed by a Settlor Committee appointed by Smiths Group Services Corp, a wholly-owned subsidiary.

The duration of the liabilities for the largest US plan is around 19 years (FY2019: 18 years) for active deferred members, 19 years (FY2019: 18 years) for deferred members and 12 years (FY2019: 11 years) for pensioners and dependants.

### **Risk management**

The pensions schemes are exposed to risks that:

- investment returns are below expectations, leaving the scheme with insufficient assets in future to pay all their pension obligations;
- members and dependants live longer than expected, increasing the value of the pensions the schemes have to pay;
- inflation rates are higher than expected, causing amounts payable under index-linked pensions to be higher than expected; and
- increased contributions are required to meet funding targets if lower interest rates increase the current value of liabilities.

These risks are managed separately for each pension scheme. However the Group has adopted a common approach of closing defined benefit schemes to cap members' entitlements and supporting trustees in adopting investment strategies which aim to hedge the value of assets against changes in the value of liabilities caused by changes in interest and inflation rates.

### **TIGPS**

TIGPS has covered roughly 50% of liabilities with matching annuities, eliminating investment return, longevity, inflation and funding risks in respect of those liabilities. It has also adopted a Liability Driven Investment strategy to hedge interest and inflation risks of the scheme's uninsured liabilities by investment in gilts together with the use of gilt repurchase arrangements. The strategy also takes into account the scheme's corporate bond investments.

### **SIPS**

SIPS has covered roughly 30% of liabilities with matching annuities, eliminating investment return, longevity, inflation and funding risks in respect of those liabilities. It has also adopted a Liability Driven Investment strategy to hedge interest and inflation risks of the scheme's uninsured liabilities by investment in gilts together with the use of gilt repurchase arrangements, total return swaps, inflation swaps and interest rate swaps. The strategy also takes into account the scheme's corporate bond investments.

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

	2020 UK	2020 US	2020 Other	2019 UK	2019 US	2019 Other
Rate of increase in salaries	n/a	n/a	3.7%	n/a	n/a	3.3%
Rate of increase for active deferred members	3.8%	n/a	n/a	4.2%	n/a	n/a
Rate of increase in pensions in payment	2.9%	n/a	3.2%	3.3%	n/a	3.1%
Rate of increase in deferred pensions	2.9%	n/a	n/a	3.3%	n/a	n/a
Discount rate	1.4%	2.4%	3.0%	2.1%	3.5%	2.8%
Inflation rate	2.9%	n/a	2.9%	3.3%	n/a	2.6%
Healthcare cost increases	4.4%	n/a	n/a	4.7%	n/a	n/a

The assumptions used in calculating the costs and obligations of the Group's defined benefit pension plans are set by the Group after consultation with independent professionally qualified actuaries. The assumptions used are estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily occur in practice. For countries outside the UK and USA, assumptions are disclosed as a weighted average.

**Inflation rate assumptions**

The UK PRI assumption is based on an underlying 'break even' RPI assumption of 3.1% pa, derived consistently with the discount rate using the Aon UK Government RPI Curve with an Inflation Risk Premium of 0.2% pa. In September 2019, the UK Chancellor set out proposals to replace RPI with CPIH (Consumer Pricing Index, including housing costs), at some time from 2025-2030, and a consultation process was run until 21 August 2020. The Government and UKSA are expected to respond to the consultation during the Autumn. No specific allowance (beyond anything already priced into markets) has been factored into the RPI assumptions for potential changes. This approach will be kept under review, taking into account future market developments and further announcements from the Government and UKSA. The assumption for the long term gap between RPI and CPI has been reduced by 0.3% p.a. (from 1.0% p.a. last year to 0.7% p.a.) to reflect the Group's view on the market pricing of this gap over the lifetime of the UK schemes' liabilities. This has increased SIPS liabilities by £10m and TIGPS liabilities by £8m at the balance sheet date.

**Discount rate assumptions**

The UK schemes use a discount rate based on the annualised yield on the Aon GBP Select AA Curve, using the expected cash-flows from a notional scheme with obligations of the same duration as that of the UK schemes.

**Mortality assumptions**

The mortality assumptions used in the principal UK schemes are based on the "SAPS S3" birth year tables with relevant scaling factors based on the recent experience of the schemes. The assumption allows for future improvements in life expectancy in line with the 2019 CMI projections, with a smoothing factor of 7.0 and 'A' parameter of 0.5%/0.25% (SIPS/TIGPS) and blended to a long-term rate of 1.25%. The mortality assumptions used in the principal US schemes are based on the RP-2014 table for healthy employees and healthy annuitants, removing MP-2014 improvement projections from 2006-2014 and applying scale MP-2018 mortality improvements from 2006 on a generational basis.

Expected further years of life	UK schemes				US schemes			
	Male 31 July 2020	Female 31 July 2020	Male 31 July 2019	Female 31 July 2019	Male 31 July 2020	Female 31 July 2020	Male 31 July 2019	Female 31 July 2019
Member who retires next year at age 65	22	23	22	24	21	22	21	23
Member, currently 45, when they retire in 20 years' time	23	24	23	25	22	24	22	24

## Sensitivity

Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 July 2020 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions. In practice, such assumptions rarely change in isolation.

	Profit before tax for year ended 31 July 2020 £m	Increase/(decrease) in scheme assets 31 July 2020 £m	(Increase)/decrease in scheme liabilities 31 July 2020 £m	Profit before tax for year ended 31 July 2019 £m	Increase/(decrease) in scheme assets 31 July 2019 £m	(Increase)/decrease in scheme liabilities 31 July 2019 £m
Rate of mortality – 1 year increase in life expectancy	(2)	85	(216)	(2)	86	(195)
Rate of mortality – 1 year decrease in life expectancy	2	(84)	212	2	(85)	193
Rate of inflation – 0.25% increase	(1)	26	(107)	(2)	26	(109)
Discount rate – 0.25% increase	4	(33)	156	4	(33)	152
Market value of scheme assets – 2.5% increase	1	81	-	2	76	-

The effect on profit before tax reflects the impact of current service cost and net interest cost. The value of the scheme assets is affected by changes in mortality rates, inflation and discounting because they affect the carrying value of the insurance assets.

## Asset valuation

The pension schemes hold assets in a variety of pooled funds, in which the underlying assets are invested in equities, diversified growth, credit and cash assets. These funds are valued. The price of the funds is set by administrators/custodians employed by the investment managers and based on the value of the underlying assets held in the funds. Details of pricing methodology is set out within internal control reports provided for each fund. Prices are updated daily, weekly or monthly depending upon the frequency of the fund's dealing.

Bonds are valued using observable broker quotes. Gilt repurchase obligations are valued by the relevant manager, which derives the value using an industry recognised model with observable inputs.

Property is valued by specialists applying recognised property valuation methods incorporating current market data on rental yields and transaction prices. In light of the negative impact of the COVID-19 pandemic on financial markets, the valuer included material uncertainty clauses in respect of the UK property asset valuations. These valuations are still considered to be the best estimate of the valuation of the Property investments, but there is a higher degree of uncertainty compared to previous years.

Total return, interest and inflation swaps and forward FX contracts are bilateral agreements between counterparties and do not have observable market prices. These derivative contracts are valued using observable inputs.

Insured liabilities comprise annuity policies broadly matching the scheme obligation to identified groups of pensioners. These assets are valued by an external qualified actuary at the actuarial valuation of the corresponding liability, reflecting this matching relationship. The insurance policies are treated as qualifying insurance policies as none of the insurers are related parties of Smiths Group, and the proceeds of the policies can only be used to pay or fund employee benefits for the respective schemes, are not available to Smiths Group's creditors and cannot be paid to Smiths Group.

**Retirement benefit plan assets**

	31 July 2020 – £m				31 July 2019 – £m			
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
Cash and cash equivalents	106	1	1	108	45	1	1	47
Pooled funds:								
– Pooled equity	38	-	2	40	60	-	1	61
– Pooled Diversified Growth	48	-	-	48	91	-	-	91
– Pooled credit	607	-	-	607	668	-	-	668
Corporate bonds	797	212	-	1,009	704	196	3	903
Government bonds/LDI	1,257	98	3	1,358	1,074	85	3	1,162
Insured liabilities	1,300	-	1	1,301	1,343	-	1	1,344
Property	78	-	-	78	103	-	1	104
Other	9	-	24	33	18	-	26	44
<b>Total market value</b>	<b>4,240</b>	<b>311</b>	<b>31</b>	<b>4,582</b>	<b>4,106</b>	<b>282</b>	<b>36</b>	<b>4,424</b>

The assets are unquoted. Government bonds/LDI portfolios contain £2,343m (FY2019:£2,229m) of UK Government bonds (Gilts), £1,063m (FY2019:£1,159m) of Gilt Repurchase obligations and £23m (FY2019:£4m) of interest and inflation swaps held by SIPS.

The UK bond portfolios include forward FX contracts with a net value of £11m (FY2019:£9m). These are held to hedge against foreign currency risk in respect of overseas bonds.

The scheme assets do not include any property occupied by, or other assets used by, the Group. Pooled equity funds include investments in broad-based equity indices, some of which may hold ordinary equity shares in Smiths Group plc as part of the underlying assets.

**Present value of funded scheme liabilities and assets for the main UK and US schemes**

	31 July 2020 – £m			31 July 2019 – £m		
	SIPS	TIGPS	US schemes	SIPS	TIGPS	US schemes
Present value of funded scheme liabilities:						
– Active deferred members	(44)	(61)	(95)	(42)	(60)	(95)
– Deferred members	(961)	(593)	(138)	(930)	(587)	(123)
– Pensioners	(1,178)	(866)	(81)	(1,142)	(857)	(72)
Present value of funded scheme liabilities	<b>(2,183)</b>	<b>(1,520)</b>	<b>(314)</b>	<b>(2,114)</b>	<b>(1,504)</b>	<b>(290)</b>
Market value of scheme assets	2,466	1,754	311	2,377	1,710	282
<b>Surplus/(deficit)</b>	<b>283</b>	<b>234</b>	<b>(3)</b>	<b>263</b>	<b>206</b>	<b>(8)</b>

**Net retirement benefit obligations**

	31 July 2020 – £m				31 July 2019 – £m			
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
Market value of scheme assets	4,240	311	31	4,582	4,106	282	36	4,424
Present value of funded scheme liabilities	(3,724)	(314)	(40)	(4,078)	(3,637)	(291)	(45)	(3,973)
Surplus/(deficit)	<b>516</b>	<b>(3)</b>	<b>(9)</b>	<b>504</b>	<b>469</b>	<b>(9)</b>	<b>(9)</b>	<b>451</b>
Unfunded pension plans	(55)	(8)	(60)	(123)	(56)	(8)	(59)	(123)
Post-retirement healthcare	(5)	(1)	(3)	(9)	(5)	(10)	(2)	(17)
Present value of unfunded obligations	<b>(60)</b>	<b>(9)</b>	<b>(63)</b>	<b>(132)</b>	<b>(61)</b>	<b>(18)</b>	<b>(61)</b>	<b>(140)</b>
<b>Net pension asset/(liability)</b>	<b>456</b>	<b>(12)</b>	<b>(72)</b>	<b>372</b>	<b>408</b>	<b>(27)</b>	<b>(70)</b>	<b>311</b>
Post-retirement assets	516	-	-	516	469	-	-	469
Post-retirement liabilities	(60)	(12)	(67)	(139)	(61)	(27)	(64)	(152)
Liabilities held for distribution to owners	-	-	(5)	(5)	-	-	(6)	(6)
<b>Net pension asset/(liability)</b>	<b>456</b>	<b>(12)</b>	<b>(72)</b>	<b>372</b>	<b>408</b>	<b>(27)</b>	<b>(70)</b>	<b>311</b>

Liabilities held for distribution to owners comprises £4m of unfunded pension plans and £1m deficit on defined benefit schemes within the Smiths Medical division.

Where any individual scheme shows a recoverable surplus under IAS 19, this is disclosed on the balance sheet as a retirement benefit asset. The IAS 19 surplus of any one scheme is not available to fund the IAS 19 deficit of another scheme. The retirement benefit asset disclosed arises from the rights of the employers to recover the surplus at the end of the life of the scheme.

**Amounts recognised in the consolidated income statement**

	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
<b>Amounts charged to operating profit</b>		
Current service cost		3
Past service costs – Guaranteed Minimum Pension (GMP) equalisation		-
Settlement (gain)/loss		(8)
Scheme administration costs		5
		<b>37</b>
<b>The operating cost is charged as follows:</b>		
Cost of sales		1
Sales and distribution costs		-
Headline administrative expenses		6
Non-headline settlement (gain)/loss		(7)
Non-headline administrative expenses		-
		<b>37</b>
<b>Amounts credited to finance costs</b>		
Non-headline other finance income – retirement benefits		(7)
		<b>(11)</b>

**Amounts recognised directly in the consolidated statement of comprehensive income**

	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
<b>Re-measurements of the net defined benefit liability</b>		
Difference between interest credit and return on assets	274	355
Experience gains/(losses) on scheme liabilities	28	(4)
Actuarial gains arising from changes in demographic assumptions	22	25
Actuarial losses arising from changes in financial assumptions	(305)	(452)
	<b>19</b>	<b>(76)</b>

**Changes in present value of funded scheme assets**

	31 July 2020 – £m				31 July 2019 – £m			
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
At beginning of period	4,106	282	36	4,424	3,867	239	33	4,139
Interest on assets	86	9	1	96	105	10	1	116
Actuarial movement on scheme assets	222	54	(2)	274	332	24	(1)	355
Employer contributions	24	-	2	26	24	5	1	30
Scheme administration costs	(4)	(1)	-	(5)	(3)	(1)	-	(4)
Foreign exchange rate movements	-	(21)	(3)	(24)	-	18	3	21
Benefits paid	(194)	(12)	(3)	(209)	(219)	(13)	(1)	(233)
<b>At end of period</b>	<b>4,240</b>	<b>311</b>	<b>31</b>	<b>4,582</b>	<b>4,106</b>	<b>282</b>	<b>36</b>	<b>4,424</b>

**Changes in present value of funded defined benefit obligations**

	31 July 2020 – £m				31 July 2019 – £m			
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
At beginning of period	(3,637)	(291)	(45)	(3,973)	(3,342)	(250)	(41)	(3,633)
Current service cost	-	-	(1)	(1)	-	-	(1)	(1)
Past service costs	-	-	-	-	(29)	-	-	(29)
Interest on obligations	(75)	(10)	(1)	(86)	(91)	(9)	(2)	(102)
Actuarial movement on liabilities	(206)	(47)	2	(251)	(394)	(24)	-	(418)
Foreign exchange rate movements	-	22	2	24	-	(21)	(2)	(23)
Benefits paid	194	12	3	209	219	13	1	233
<b>At end of period</b>	<b>(3,724)</b>	<b>(314)</b>	<b>(40)</b>	<b>(4,078)</b>	<b>(3,637)</b>	<b>(291)</b>	<b>(45)</b>	<b>(3,973)</b>

**Changes in present value of unfunded defined benefit pensions and post-retirement healthcare plans**

	Assets		Obligations	
	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
At beginning of period	-	-	(140)	(125)
Current service cost	-	-	(2)	(2)
Interest on obligations	-	-	(3)	(3)
Actuarial movement	-	-	(4)	(13)
Employer contributions	7	6	-	-
Foreign exchange rate movements	-	-	2	(3)
Liabilities extinguished on settlements	-	-	8	-
Benefits paid	(7)	(6)	7	6
<b>At end of period</b>	<b>-</b>	<b>-</b>	<b>(132)</b>	<b>(140)</b>

**Cash contributions**

Company contributions to the defined benefit pension plans and post-retirement healthcare plans totalled £33m (FY2019: £36m). This comprised regular contributions to funded schemes of £12m (FY2019: £12m) to SIPS, £12m (FY2019: £12m) to TIGPS, no contributions (FY2019: £5m) to funded US schemes and contributions to other schemes of £2m (FY2019: £1m). In addition, £7m (FY2019: £6m) was spent on providing benefits under unfunded defined benefit pension and post-retirement healthcare plans.

In 2021, the cash contributions to the Group's schemes are expected to total about £38m, including £12m to SIPS and £12m to TIGPS, with the balance relating to the US scheme, unfunded schemes and post-retirement healthcare.

**9 EMPLOYEE SHARE SCHEMES**

The Group operates share schemes and plans for the benefit of employees. The nature of the principal schemes and plans, including general conditions, is set out below:

**Long-Term Incentive Plan (LTIP)**

The LTIP is a share plan under which an award over a capped number of shares will vest after the end of a three-year performance period if performance conditions are met. LTIP awards are made to selected senior executives, including the Executive Directors.

**LTIP performance conditions**

Each performance condition has a threshold below which no shares vest and a maximum performance target at or above which the award vests in full. For performance between 'threshold' and 'maximum', awards vest on a straight-line sliding scale. The performance conditions are assessed separately; so performance on one condition does not affect the vesting of the other elements of the award. To the extent that the performance targets are not met over the three-year performance period, awards lapse. There is no re-testing of the performance conditions.

LTIP awards have performance conditions relating to underlying revenue growth, growth in headline EPS, ROCE and headline cash conversion.

**Smiths Share Matching Plan (SMP)**

Under the scheme, participants were required to invest between 25% and 50% of their post-tax bonus to purchase the Company's shares at the prevailing market price. Matching shares granted in October 2015 vested during the year at a rate correlating to the performance of the Group LTIP issued for the same performance period. There were no SMP awards outstanding at 31 July 2020 or 31 July 2019 and no future awards will be made under the SMP.

**Smiths Excellence Plan (SEP)**

In September 2016, the Smiths Excellence plan (SEP) was introduced. The SEP is designed to reinforce value creation over the medium term by focusing on specific objectives in key areas of operational performance. Awards vest after two years, depending on performance on the operational objectives during the first year and continued employment with the Group. There is no re-testing of performance. However, the Remuneration Committee has discretion to adjust vesting rates if material misstatements in reported performance are subsequently identified and awards are subject to clawback provisions in the event of misconduct.

Directors are not eligible to participate in the SEP.

## Restricted stock

Restricted stock is used by the Remuneration Committee, as a part of the recruitment strategy, to make awards in recognition of incentive arrangements forfeited on leaving a previous employer. If an award is considered appropriate, the award will take account of relevant factors including the fair value of awards forfeited, any performance conditions attached, the likelihood of those conditions being met and the proportion of the vesting period remaining.

## Save as you earn (SAYE)

The SAYE scheme is an HM Revenue & Customs approved all employee savings related share option scheme which is open to all UK employees. Participants enter into a contract to save a fixed amount per month of up to £500 in aggregate for three or five years and are granted an option over shares at a fixed option price, set at a discount to market price at the date of invitation to participate. The number of shares 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.

	Long-term incentive plans	SMP	SEP	Restricted stock	Save as you earn scheme	Total	Weighted average exercise price £
Ordinary shares under option/award ('000)							
31 July 2018	3,911	413	1,359	304	962	6,949	£1.46
Granted	1,602	-	928	24	315	2,869	£1.30
Exercised	(406)	(331)	(379)	(79)	(193)	(1,388)	£1.27
Lapsed	(1,215)	(82)	(621)	(57)	(72)	(2,047)	£0.41
31 July 2019	3,892	-	1,287	192	1,012	6,383	£1.77
Granted	1,379	-	924	48	695	3,046	£2.08
Exercised	(785)	-	(406)	(95)	(254)	(1,540)	£1.48
Lapsed	(549)	-	(510)	(14)	(246)	(1,319)	£2.22
<b>31 July 2020</b>	<b>3,937</b>	<b>-</b>	<b>1,295</b>	<b>131</b>	<b>1,207</b>	<b>6,570</b>	<b>£1.89</b>

Options and awards were exercised on an irregular basis during the period. The average closing share price over the financial year was 1,490.92p (FY2019: 1,479.21p). 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 options/awards at 31 July 2020 ('000)	Weighted average remaining contractual life at 31 July 2020 (months)	Total shares under options/awards at 31 July 2019 ('000)	Weighted average remaining contractual life at 31 July 2019 (months)
£0.00 – £2.00	5,363	14	5,370	15
£6.01 – £10.00	744	40	312	10
£10.01 – £12.00	463	22	700	36

For the purposes of valuing options to arrive at the share-based payment charge, the Black-Scholes option-pricing model has been used. The key assumptions used in the models for 2020 and 2019 are volatility of 25% to 20% (FY2019: 25% to 20%) and dividend yield of 2.8% (FY2019: 3.0%), based on historical data, for the period corresponding with the vesting period of the option. These generated a weighted average fair value for SEP of £14.39 (FY2019: £14.48), LTIP of £14.60 (FY2019: £14.52), and restricted stock of £14.04 (FY2019: £13.43). Staff costs include £11m (FY2019: £15m) for share-based payments, of which £10m (FY2019: £14m) relates to equity-settled share-based payment.

## 10 INTANGIBLE ASSETS

	Goodwill £m	Development costs £m	Acquired intangibles (see table below) £m	Software, patents and intellectual property £m	Total £m
<b>Cost</b>					
At 31 July 2018	1,704	360	582	207	2,853
Foreign exchange rate movements	110	24	47	9	190
Business combinations	127	-	148	-	275
Additions	-	30	-	12	42
Disposals	-	-	-	(7)	(7)
Business disposals	(7)	-	-	-	(7)
Reclassified to assets held for distribution to owners (note 28)	(622)	(270)	(212)	(50)	(1,154)
<b>At 31 July 2019</b>	<b>1,312</b>	<b>144</b>	<b>565</b>	<b>171</b>	<b>2,192</b>
Foreign exchange rate movements	(69)	(5)	(34)	(6)	(114)
Business combinations (note 27)	11	-	15	-	26
Additions	-	16	-	10	26
Disposals	-	-	-	(1)	(1)
<b>At 31 July 2020</b>	<b>1,254</b>	<b>155</b>	<b>546</b>	<b>174</b>	<b>2,129</b>
<b>Amortisation and impairments</b>					
At 31 July 2018	88	205	331	168	792
Foreign exchange rate movements	5	14	24	6	49
Charge for the year	-	23	45	13	81
Disposals	-	-	-	(6)	(6)
Reclassified to assets held for distribution to owners (note 28)	(27)	(143)	(195)	(43)	(408)
<b>At 31 July 2019</b>	<b>66</b>	<b>99</b>	<b>205</b>	<b>138</b>	<b>508</b>
Foreign exchange rate movements	(4)	(5)	(13)	(2)	(24)
Amortisation charge for the year	-	6	57	7	70
Impairment charge for the year	-	12	-	-	12
Disposals	-	-	-	(1)	(1)
<b>At 31 July 2020</b>	<b>62</b>	<b>112</b>	<b>249</b>	<b>142</b>	<b>565</b>
<b>Net book value at 31 July 2020</b>	<b>1,192</b>	<b>43</b>	<b>297</b>	<b>32</b>	<b>1,564</b>
Net book value at 31 July 2019	1,246	45	360	33	1,684
Net book value at 31 July 2018	1,616	155	251	39	2,061

In addition to goodwill, the acquired intangible assets comprise:

	Patents, licences and trademarks £m	Technology £m	Customer relationships £m	Total acquired intangibles £m
<b>Cost</b>				
At 31 July 2018	57	214	311	582
Foreign exchange rate movements	4	16	27	47
Business combinations	13	-	135	148
Reclassified to assets held for distribution to owners (note 28)	(59)	(90)	(63)	(212)
<b>At 31 July 2019</b>	<b>15</b>	<b>140</b>	<b>410</b>	<b>565</b>
Foreign exchange rate movements	(1)	(9)	(24)	(34)
Business combinations (note 27)	1	8	6	15
<b>At 31 July 2020</b>	<b>15</b>	<b>139</b>	<b>392</b>	<b>546</b>
<b>Amortisation</b>				
At 31 July 2018	39	121	171	331
Foreign exchange rate movements	3	10	11	24
Charge for the year	3	12	30	45
Reclassified to assets held for distribution to owners (note 28)	(42)	(90)	(63)	(195)
<b>At 31 July 2019</b>	<b>3</b>	<b>53</b>	<b>149</b>	<b>205</b>
Foreign exchange rate movements	-	(4)	(9)	(13)
Charge for the year	1	11	45	57
<b>At 31 July 2020</b>	<b>4</b>	<b>60</b>	<b>185</b>	<b>249</b>
<b>Net book value at 31 July 2020</b>	<b>11</b>	<b>79</b>	<b>207</b>	<b>297</b>
Net book value at 31 July 2019	12	87	261	360
Net book value at 31 July 2018	18	93	140	251

Individually material intangible assets comprise £131m of customer related intangibles attributable to United Flexible (remaining amortisation period: 6 years) and £105m of customer relationship intangibles attributable to Morpho Detection (remaining amortisation period: 12 years).

## 11 IMPAIRMENT TESTING

### Goodwill

Goodwill is tested for impairment at least annually or whenever there is an indication that the carrying value may not be recoverable.

Further details of the impairment review process and judgements are included in the "Significant judgements made in applying accounting policies" section of the "Basis of preparation" for the consolidated financial statements.

For the purpose of impairment testing, assets are grouped at the lowest levels for which there are separately identifiable cash flows, known as cash-generating units (CGUs), taking into consideration the commonality of reporting, policies, leadership and intra-divisional trading relationships. Goodwill acquired through business combinations is allocated to groups of CGUs at a divisional (or operating segment) level, being the lowest level at which management monitors performance separately.

The carrying value of goodwill at 31 July is allocated by division as follows:

	2020 £m	2020 Number of CGUs	2019 £m	2019 Number of CGUs
John Crane	136	1	140	1
Smiths Detection	642	1	673	1
Flex-Tek	161	1	171	1
Smiths Interconnect	253	1	261	1
Smiths Medical – classified as an asset held for distribution in 2020 and 2019	-	1	-	1
	<b>1,192</b>	<b>5</b>	<b>1,245</b>	<b>5</b>

Smiths Interconnect acquired Reflex Photonics in October 2019 and a single management team has been established covering the Smiths Interconnect and Reflex Photonics businesses. The integration of the businesses since acquisition has progressed well and is such that they are considered to be a single CGU for impairment testing.

### Key assumptions used in impairment testing

The recoverable amount for impairment testing is determined from the higher of fair value less costs of disposal and value in use of the CGU. In assessing value in use, the estimated future cash flows are discounted to their present value using a post-tax discount rate that reflects current market assessments of the time value of money, from which pre-tax discount rates are determined.

Fair value less costs of disposal is calculated using available information on past and expected future profitability, valuation multiples for comparable quoted companies and similar transactions (adjusted as required for significant differences) and information on costs of similar transactions. Fair value less costs to sell models are used when trading projections in the strategic plan cannot be adjusted to eliminate the impact of a major restructuring.

The value in use of CGUs is calculated as the net present value of the projected risk-adjusted cash-flows of each CGU. These cash-flow forecasts are based on the 2020-21 business plan (as approved by the Board) and the five year detailed divisional strategic projections which have been prepared by divisional management and approved by the Chief Financial Officer.

The key assumptions used in determining the value in use are:

- **Sales:** Projected sales are built up with reference to markets and product categories. They incorporate past performance, historical growth rates and projections of developments in key markets;
- **Margins:** Projected margins reflect historical performance and the impact of all completed projects to improve operational efficiency and leverage scale. The projections do not include the impact of future restructuring projects to which the Group is not yet committed;
- **Projected capital expenditure:** The cash-flow forecasts for capital expenditure are based on past experience and include committed ongoing capital expenditure consistent with the FY21 budget and the divisional strategic projections. The forecast does not include any future capital expenditure that improves/enhances the operation/asset in excess of its current standard of performance;
- **Discount rate:** The discount rates have been calculated based on the Group's weighted average cost of capital and risks specific to the CGU being tested. In determining the risk adjusted discount rate, management has considered the systematic risk to each of the Group's CGUs determined using an average of discount rates used by other companies for the industries that Smiths divisions operate. Pre-tax rates of 9.4% to 12.3% (FY2019: 9.9% to 13.9%) have been used for the impairment testing;
- **Long-term growth rates:** For the purposes of the Group's value in use calculations, a long-term growth rate into perpetuity is applied immediately at the end of the five year forecast period. Growth rates for the period after the detailed forecasts are based on the long-term GDP projections of the primary market for each CGU. The average growth rate used in the testing was 1.9% (FY2019: 2.0%). These rates do not reflect the long-term assumptions used by the Group for investment planning; and
- **COVID-19:** The COVID-19 pandemic developed rapidly during 2020, with many countries requiring businesses to limit or suspend operations whilst implementing travel restrictions and quarantine measures. These virus containment measures have had a significant adverse impact on global economic activity. It remains extremely challenging to predict the full extent and duration of its impact on the Smiths businesses and the countries where Smiths operates. Based on information available as at 31 July 2020, management has made adjustments to the five year forecasts used in the Group's impairment testing in order to reflect the estimated impact.

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

	Year ended 31 July 2020				
	John Crane	Smiths Detection	Flex-Tek	Smiths Interconnect	Smiths Medical
Net book value of goodwill (£m)	136	642	161	253	563

Basis of valuation	Value in use	Value in use	Value in use	Value in use	Value in use
Discount rate - pre-tax	12.3%	10.8%	11.3%	10.7%	9.4%
- post-tax	9.3%	8.0%	8.7%	8.5%	7.5%
Period covered by management projections	5 years	5 years	5 years	5 years	5 years
Revenue - average annual growth rate over projection period	4.3%	2.1%	3.2%	4.2%	2.0%
Average earnings before interest and tax margin	24.1%	13.5%	17.5%	17.0%	18.1%
Long-term growth rates	2.0%	1.7%	1.8%	2.1%	2.0%

	Year ended 31 July 2019				
	John Crane	Smiths Detection	Flex-Tek	Smiths Interconnect	Smiths Medical
Net book value of goodwill (£m)	140	673	171	261	595

Basis of valuation	Value in use	Value in use	Value in use	Value in use	Value in use
Discount rate - pre-tax	13.9%	11.2%	11.3%	12.6%	9.9%
- post-tax	10.4%	8.2%	9.0%	9.9%	7.8%
Period covered by management projections	5 years	5 years	5 years	5 years	5 years
Long-term growth rates	2.1%	2.1%	1.8%	1.8%	1.8%

### Sensitivity analysis

With the exception of the Smiths Detection and Smiths Interconnect CGUs, the recoverable amount of all CGUs exceeded their carrying value, on the basis of the assumptions set out in the table above and any reasonably possible changes thereof.

The estimated recoverable amount of the Smiths Detection CGU exceeded the carrying value by £183m and the estimated recoverable amount the Smiths Interconnect CGU exceeded the carrying value by £285m. Any decline in estimated value-in-use in excess of those amounts would result in the recognition of impairment charges. If the assumptions used in the impairment reviews were changed to a greater extent than as presented in the following table, the changes would, in isolation, lead to impairment losses being recognised for the year ended 31 July 2020:

Change required for carrying value to equal recoverable amount	Smiths Detection	Smiths Interconnect
Forecast earnings before interest and tax	-1,500 bps decrease	-3,800 bps decrease
Post-tax discount rate	+110 bps increase	+400 bps increase
Long-term growth rate	-180 bps decrease	-740 bps decrease

Forecast earnings before interest and tax have been projected using:

- expected future sales based on the strategic plan, which was constructed at a market level with input from key account managers, product line managers, business development and sales teams. An assessment of the market and existing contracts/programmes was made to produce the sales forecast; and
- current cost structure and production capacity. The projections do not include the impact of future restructuring projects to which the Group is not yet committed.

### Property, plant and equipment, right of use assets and finite-life intangible assets

At each reporting period date, the Group reviews the carrying amounts of its property, plant, equipment, right of use assets and finite-life intangible assets to determine whether there is any indication that those assets have suffered an impairment loss.

The Group has no indefinite life intangible assets other than goodwill. During the year, impairment tests were carried out for capitalised development costs that have not yet started to be amortised and acquired intangibles where there were indications

of impairment. Value in use calculations were used to determine the recoverable values of these assets. In FY2020 Smiths Medical conducted a detailed impairment assessment on the Intellifuse programme, a summary of the basis for and conclusion of this assessment is included in note 28 'Discontinued operations and businesses held for distribution to owners'.

£12m of impairment charges have been incurred against capitalised development costs in Smiths Detection (FY2019: £nil), see note 2 for further details.

## 12 PROPERTY, PLANT AND EQUIPMENT

	Land and buildings £m	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
<b>Cost or valuation</b>				
At 31 July 2018	207	637	194	1,038
Foreign exchange rate movements	14	41	4	59
Business combinations	3	8	-	11
Additions	7	57	15	79
Disposals	(2)	(38)	(17)	(57)
Reclassified to assets held for distribution to owners (note 28)	(43)	(309)	(58)	(410)
<b>At 31 July 2019</b>	<b>186</b>	<b>396</b>	<b>138</b>	<b>720</b>
Foreign exchange rate movements	(10)	(25)	(5)	(40)
Business combinations (note 27)	-	2	-	2
Additions	5	27	8	40
Disposals	(6)	(17)	(8)	(31)
<b>At 31 July 2020</b>	<b>175</b>	<b>383</b>	<b>133</b>	<b>691</b>
<b>Depreciation</b>				
At 31 July 2018	107	459	152	718
Foreign exchange rate movements	6	31	2	39
Charge for the year	10	33	13	56
Disposals	-	(36)	(14)	(50)
Reclassified to assets held for distribution to owners (note 28)	(19)	(216)	(40)	(275)
<b>At 31 July 2019</b>	<b>104</b>	<b>271</b>	<b>113</b>	<b>488</b>
Foreign exchange rate movements	(6)	(17)	(4)	(27)
Charge for the year	10	23	8	41
Disposals	(6)	(16)	(7)	(29)
<b>At 31 July 2020</b>	<b>102</b>	<b>261</b>	<b>110</b>	<b>473</b>
<b>Net book value at 31 July 2020</b>	<b>73</b>	<b>122</b>	<b>23</b>	<b>218</b>
Net book value at 31 July 2019	82	125	25	232
Net book value at 31 July 2018	100	178	42	320

## 13 RIGHT OF USE ASSETS

	Properties £m	Vehicles £m	Equipment £m	Total £m
<b>Cost or valuation</b>				
Right of use assets on transition	95	10	1	106
Foreign exchange rate movements	(6)	(1)	-	(7)
Business combinations (note 27)	1	-	-	1
Recognition of right of use asset	21	5	-	26
Derecognition of right of use asset	(1)	-	-	(1)
<b>At 31 July 2020</b>	<b>110</b>	<b>14</b>	<b>1</b>	<b>125</b>
<b>Depreciation</b>				
Foreign exchange rate movements	(2)	-	-	(2)
Charge for the year	28	5	-	33
<b>At 31 July 2020</b>	<b>26</b>	<b>5</b>	<b>-</b>	<b>31</b>
<b>Net book value at 31 July 2020</b>	<b>84</b>	<b>9</b>	<b>1</b>	<b>94</b>

## 14 INVENTORIES

	31 July 2020 £m	31 July 2019 £m
<b>Inventories comprise</b>		
Raw materials and consumables	122	146
Work in progress	119	111
Finished goods	205	160
	<b>446</b>	<b>417</b>

In FY2020 continuing operations consumed £1,244m (FY2019: £1,174m) of inventory, £20m (FY2019: £16m) was charged for the write-down of inventory and £9m (FY2019: £7m) was released from provisions no longer required.

Discontinued operations consumed £299m (FY2019: £266m) of inventory, £4m (FY2019: £5m) was charged for the write-down of inventory and £nil (FY2019: £1m) was released from provisions no longer required. Further details of discontinued operations are disclosed in note 28.

### Inventory provisioning

	31 July 2020 £m	31 July 2019 £m
Gross inventory carried at full value	368	357
Gross value of inventory partly or fully provided for	132	111
	500	468
Inventory provision	(54)	(51)
<b>Inventory after provisions</b>	<b>446</b>	<b>417</b>

## 15 TRADE AND OTHER RECEIVABLES

	31 July 2020 £m	31 July 2019 £m
<b>Non-current</b>		
Trade receivables	-	1
Contract assets	46	45
Other receivables	6	6
	<b>52</b>	<b>52</b>
<b>Current</b>		
Trade receivables	448	574
Prepayments	23	25
Contract assets	123	125
Other receivables	33	40
	<b>627</b>	<b>764</b>

Trade receivables do not carry interest. Management considers that the carrying value of trade and other receivables approximates to the fair value. Trade and other receivables, including prepayments, accrued income and other receivables qualifying as financial instruments are accounted for at amortised cost. The maximum credit exposure arising from these financial assets is £580m (FY2019: £713m).

Contract assets comprise unbilled balances not yet due on contracts, where revenue recognition does not align with the agreed payment schedule. The main movements in the year arise from increases in contract asset balances of £6m (FY2019: £14m) principally within Smiths Interconnect, offset by £7m of foreign currency translation losses (FY2019: £8m gain).

A number of Flex-Tek's customers provide supplier finance schemes which allow their suppliers to sell trade receivables, without recourse, to banks. This is commonly known as invoice discounting or factoring. During FY2020 Flex-Tek collected £68m of receivables through these schemes (FY2019: £8m), the cash received via these schemes is classified as an operating cash inflow as it has arisen from operating activities.

Trade receivables are disclosed net of provisions for expected credit loss, with historical write-offs used as a basis and a default risk multiplier applied to reflect country risk premium. Credit risk is managed separately for each customer and, where appropriate, a credit limit is set for the customer based on previous experience of the customer and third party credit ratings. The Group has no significant concentration of credit risk, with exposure spread over a large number of customers. The largest single customer is the US Federal Government, representing 7% (FY2019: 6%) of Group revenue.

### Ageing of trade receivables

	31 July 2020 £m	31 July 2019 £m
Trade receivables which are not yet due	342	432
Trade receivables which are between 1-30 days overdue	51	69
Trade receivables which are between 31-60 days overdue	18	18
Trade receivables which are between 61-90 days overdue	9	12
Trade receivables which are between 91-120 days overdue	12	9
Trade receivables which are more than 120 days overdue	51	58
	<b>483</b>	<b>598</b>
Expected credit loss allowance provision	(35)	(24)
<b>Trade receivables</b>	<b>448</b>	<b>574</b>

## Movement in expected credit loss allowance

	31 July 2020 £m	31 July 2019 £m
Brought forward loss allowance at the start of the period	24	24
Exchange adjustments	(2)	1
Increase in allowance recognised in the income statement	18	6
Amounts written off or recovered during the year	(5)	(7)
<b>Carried forward loss allowance at the end of the year</b>	<b>35</b>	<b>24</b>

## 16 TRADE AND OTHER PAYABLES

	31 July 2020 £m	31 July 2019 £m
<b>Non-current</b>		
Other payables	15	15
Contract liabilities	36	15
	<b>51</b>	<b>30</b>
<b>Current</b>		
Trade payables	178	221
Other payables	12	12
Other taxation and social security costs	25	19
Accruals	194	201
Contract liabilities	118	116
	<b>527</b>	<b>569</b>

Trade and other payables, including accrued expenses and other payables qualifying as financial instruments, are accounted for at amortised cost and are categorised as Trade and other financial payables in note 21.

Contract liabilities comprise deferred income balances of £154m (FY2019: £131m) in respect of payments being made in advance of revenue recognition. The movement in the year arises primarily from the long term contracts of the Smiths Detection division where invoicing under milestones precedes the delivery of the program performance obligations. Revenue recognised in the year includes £126m (FY2019: £85m) that was included in the opening contract liabilities balance. This revenue primarily relates to the delivery of performance obligations in the Smiths Detection business.

## 17 FINANCIAL ASSETS

At 31 July 2020, £11m (FY2019: £13m) was held on deposit with banks as security for liabilities or letters of credit.

The remaining balance of financial assets relates to the Group's investments in early stage businesses that are developing or commercialising related technology.

## 18 BORROWINGS AND NET DEBT

This note sets out the calculation of net debt, an important measure in explaining our financing position. The net debt figure includes accrued interest and fair value adjustments relating to hedge accounting.

	31 July 2020 £m	31 July 2019 represented* £m
<b>Cash and cash equivalents</b>		
Net cash and deposits	366	289
<b>Short-term borrowings</b>		
Lease liabilities	(31)	-
Interest accrual	(10)	(9)
	<b>(41)</b>	<b>(9)</b>
<b>Long-term borrowings</b>		
\$400m 3.625% US\$ Guaranteed notes 2022	(308)	(329)
€600m 1.25% Eurobond 2023	(546)	(564)
€650m 2.00% Eurobond 2027	(601)	(607)
Lease liabilities	(65)	-
	<b>(1,520)</b>	<b>(1,500)</b>
<b>Borrowings</b>	<b>(1,561)</b>	<b>(1,509)</b>
Derivatives managing interest rate risk and currency profile of the debt	82	45
<b>Net debt (excludes net debt of £28m in discontinued operations (FY2019: net cash of £23m) )</b>	<b>(1,113)</b>	<b>(1,175)</b>

\* The FY2019 comparatives have been represented to include the fair value of derivatives used for the management of net debt interest rate and currency risks as part of the net debt balance.

## Movements in assets/(liabilities) arising from financing activities

	Changes in net debt					Changes in other financing items: FX contracts £m	Total liabilities from financing activities £m
	Cash and cash equivalents £m	Other short-term borrowings £m	Long-term borrowings £m	Interest rate & cross-currency swaps £m	Net debt* £m		
At 31 July 2018	717	(203)	(1,407)	43	(850)	4	(846)
Foreign exchange gains/(losses)	10	(4)	(47)	-	(41)	5,733	5,692
Net cash (outflow)	(218)	-	-	(30)	(248)	(5,733)	(5,981)
Repayment of borrowings	(194)	194	-	-	-	-	-
Capitalisation, interest accruals and unwind of capitalised fees	-	2	(1)	30	31	-	31
Fair value movement from interest rate hedging	-	-	(46)	-	(46)	-	(46)
Revaluation of derivative contracts	-	-	-	2	2	(1)	1
Reclassified to asset/liability held for distribution to owners (note 28)	(26)	2	1	-	(23)	(4)	(27)
<b>At 31 July 2019</b>	<b>289</b>	<b>(9)</b>	<b>(1,500)</b>	<b>45</b>	<b>(1,175)</b>	<b>(1)</b>	<b>(1,176)</b>
Adoption of IFRS 16	-	(26)	(79)	-	(105)	-	(105)
Sub-total	289	(35)	(1,579)	45	(1,280)	(1)	(1,281)
Foreign exchange gains/(losses)	(26)	1	40	-	15	(3,780)	(3,765)
Net cash inflow from continuing operations **	103	-	-	-	103	3,780	3,883
Lease liabilities acquired	-	-	(1)	-	(1)	-	(1)
Net movement from lease modifications	-	(6)	(20)	-	(26)	-	(26)
Fair value movement from interest rate hedging	-	-	10	-	10	-	10
Revaluation of derivative contracts	-	-	-	37	37	(1)	36
Interest expense taken to income statement***	-	(4)	(30)	(13)	(47)	-	(47)
Interest paid	-	-	29	13	42	-	42
Payment of lease liabilities	-	34	-	-	34	-	34
Reclassification to short-term	-	(31)	31	-	-	-	-
<b>At 31 July 2020</b>	<b>366</b>	<b>(41)</b>	<b>(1,520)</b>	<b>82</b>	<b>(1,113)</b>	<b>(2)</b>	<b>(1,115)</b>

\*The FY2019 comparatives have been represented to include the fair value of derivatives used for the management of net debt interest rate and currency risks as part of the net debt balance.

\*\*The £103m of net cash inflow from continuing operations excludes £6m of net cash outflow from discontinued operations. Net cash inflow for the total Group including discontinued operations was £97m.

\*\*\*The Group has also incurred £8m of bank charges that are expensed when paid and are not included in net debt.

### Cash and cash equivalents

	31 July 2020 £m	31 July 2019 £m
Cash at bank and in hand	173	153
Short-term deposits	193	136
<b>Cash and cash equivalents</b>	<b>366</b>	<b>289</b>

Cash and cash equivalents include highly liquid investments with maturities of three months or less. Borrowings are accounted for at amortised cost and are categorised as other financial liabilities. See note 18 for a maturity analysis of borrowings. Interest of £31m (FY2019: £36m) was charged to the consolidated income statement in the period in respect of public bonds.

### Cash pooling

Cash and overdraft balances in interest compensation cash pooling systems are reported gross on the balance sheet. The cash pooling agreements incorporate a legally enforceable right of net settlement. However, as there is no intention to settle the balances net, these arrangements do not qualify for net presentation. At 31 July 2020 the total value of overdrafts on accounts

in interest compensation cash pooling systems was £nil (FY2019: £nil). The balances held in zero balancing cash pooling arrangements have daily settlement of balances. Therefore netting is not relevant.

### Secured loans

Loans amounting to £nil (FY2019: £nil) were secured on plant and equipment with a book value of £nil (FY2019: nil).

### Change of control

The Company has in place credit facility agreements under which a change in control would trigger prepayment clauses. The Company also 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.

## 19 FINANCIAL RISK MANAGEMENT

The Group's international operations and debt financing expose it to financial risks which include the effects of changes in foreign exchange rates, debt market prices, interest rates, credit risks and liquidity risks. The management of operational credit risk is discussed in note 15.

### Treasury Risk Management Policy

The Board maintains a Treasury Risk Management Policy, which governs the treasury operations of the Group and its subsidiary companies and the consolidated financial risk profile to be maintained. A report on treasury activities, financial metrics and compliance with the Policy is prepared monthly. This is circulated to the Chief Financial Officer each month and key elements to the Audit and Risk Committee on a semi-annual basis.

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

Centrally directed cash management systems exist globally to manage overall liquid resources efficiently across the divisions. The Group uses financial instruments to raise financing for its global operations, to manage related interest rate and currency financial risk, and to hedge transaction risk within subsidiary companies.

The Group does not speculate in financial instruments. All financial instruments hedge existing business exposures and all are recognised on the balance sheet.

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

### Credit quality

The Group's strategy is to maintain a solid investment-grade rating to ensure access to the widest possible sources of financing at the right time and to minimise the resulting cost of debt capital. The credit ratings at the end of July 2020 were BBB+ / Baa2 (both stable) from Standard & Poor's and Moody's respectively. An essential element of an investment-grade rating is consistent and robust cash-flow metrics. The Group's objective is to maintain a net debt/headline EBITDA ratio at two times or lower over the medium term. Capital management is discussed in more detail in note 26.

### Debt and interest rate

The Group's risk management objectives are to ensure that the majority of funding is drawn from the public debt markets, the average maturity profile of gross debt is at or greater than three years, and between 40-60% of gross debt is at fixed rates. At 31 July 2020 these measures were 100% (FY2019: 100%), 4.2 years (FY2019: 5.2 years) and 53% (FY2019: 48%).

The Group remains in full compliance with all covenants within its external debt agreements. Interest rate risk management is discussed in note 19(b).

### Liquidity management

The Group's objective is to ensure that at any time undrawn committed facilities, net of short-term overdraft financing, are at least £300m and that committed facilities have at least 12 months to run until maturity. At 31 July 2020, these measures were £611m (FY2019: £655m) and 51 months (FY2019: 51 months). At 31 July 2020, net cash resources were £366m (FY2019: £289m). Liquidity risk management is discussed in note 19(d).

### Currency management

The Group is an international business with the majority of its net assets denominated in foreign currency. We protect our balance sheet and reserves from adverse foreign exchange movements by financing our foreign currency assets where appropriate in the same currency. The Group's objective for managing transaction currency exposure is to reduce medium-term volatility to cash-flow, margins and earnings. Foreign exchange risk management is discussed in note 18(a) below.

**(a) Foreign exchange risk****Transactional currency exposure**

The Group is exposed to foreign currency risks arising from sales or purchases by businesses in currencies other than their functional currency. It is Group policy that, when the net foreign exchange exposure to known future sales and purchases is material, this exposure is hedged using forward foreign exchange contracts. The net exposure is calculated by adjusting the expected cash-flow for payments or receipts in the same currency linked to the sale or purchase. This policy minimises the risk that the profits generated from the transaction will be affected by foreign exchange movements which occur after the price has been determined. Hedge accounting documentation and effectiveness testing are only undertaken if it is cost effective.

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

	At 31 July 2020				
	Sterling £m	US\$ £m	Euro £m	Other £m	Total £m
<b>Financial assets and liabilities</b>					
Financial instruments included in trade and other receivables	26	293	116	145	580
Financial instruments included in trade and other payables	(37)	(176)	(62)	(65)	(340)
Cash and cash equivalents	50	194	38	84	366
Borrowings not designated as net investment hedges	(21)	(41)	(31)	(14)	(107)
	18	270	61	150	499
Exclude balances held in operations with the same functional currency	(16)	(84)	(60)	(146)	(306)
Exposure arising from intra-group loans	-	(87)	23	(100)	(164)
Future forward foreign exchange contract cash flows	32	(161)	26	103	-
	<b>34</b>	<b>(62)</b>	<b>50</b>	<b>7</b>	<b>29</b>
	At 31 July 2019				
	Sterling £m	US\$ £m	Euro £m	Other £m	Total £m
<b>Financial assets and liabilities</b>					
Financial instruments included in trade and other receivables	35	380	130	168	713
Financial instruments included in trade and other payables	(47)	(204)	(70)	(73)	(394)
Cash and cash equivalents	27	150	23	89	289
	15	326	83	184	608
Exclude balances held in operations with the same functional currency	(15)	(155)	(75)	(177)	(422)
Exposure arising from intra-group loans	-	(11)	55	(41)	3
Forward foreign exchange contracts	(17)	(149)	(19)	185	-
	<b>(17)</b>	<b>11</b>	<b>44</b>	<b>151</b>	<b>189</b>

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

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

	Impact on profit for the year 31 July 2020 £m	Gain/(loss) recognised in reserves 31 July 2020 £m	Impact on profit for the year 31 July 2019 £m	Gain/(loss) recognised in reserves 31 July 2019 £m
US dollar	(8)	(2)	(10)	3
Euro	(3)	2	(3)	(1)
Sterling	3	(2)	10	(2)

These sensitivities were calculated before adjusting for tax and exclude the effect of quasi-equity intra-group loans.

## Cash-flow hedging

The Group uses forward foreign exchange contracts to hedge future foreign currency sales and purchases. At 31 July 2020, contracts with a nominal value of £110m (FY2019: £54m) were designated as hedging instruments. In addition, the Group had outstanding foreign currency contracts with a nominal value of £203m (FY2019: £431m) which were being used to manage transactional foreign exchange exposures, but were not accounted for as cash-flow hedges. The fair value of the contracts is disclosed in note 20.

The majority of hedged transactions will be recognised in the consolidated income statement in the same period that the cash-flows are expected to occur, with the only differences arising because of normal commercial credit terms on sales and purchases. It is the Group's policy to hedge 80% of certain exposures for the next two years and 50% of highly probable exposures for the next 12 months

Hedge effectiveness is determined at the inception of the hedge relationship, and through periodic prospective effectiveness assessments to ensure that an economic relationship exists between the hedged item and hedging instrument. The foreign exchange forward contracts have similar critical terms to the hedged items, such as the notional amounts and maturities. Therefore, there is an economic relationship and the hedge ratio is established as 1:1.

The main sources of hedge ineffectiveness in these hedging relationships is the effect of the counterparty and the Group's own credit risk on the fair value of the foreign exchange forward contracts, which is not reflected in the fair value of the hedged item attributable to changes in foreign exchange rates and the risk of over-hedging where the hedge relationship requires re-balancing. No other sources of ineffectiveness emerged from these hedging relationships. Any hedge ineffectiveness is recognised immediately in the income statement in the period that it occurs. Of the foreign exchange contracts designated as hedging instruments, 98% are for periods of 12 months or less (FY2019: 100%).

The following table presents a reconciliation by risk category of the cash-flow hedge reserve and analysis of other comprehensive income in relation to hedge accounting:

		Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
Brought forward cash-flow hedge reserve at start of year		-	2
Foreign exchange forward contracts:	Net fair value gains on effective hedges	1	2
	Amount reclassified to income statement – revenue	(2)	(2)
	Amount reclassified to income statement – cost of sales	1	(2)
<b>Carried forward cash-flow hedge reserve at end of year</b>		<b>-</b>	<b>-</b>

The following tables set out information regarding the change in value of the hedged item used in calculating hedge ineffectiveness as well as the impacts on the cash-flow hedge reserve:

Hedged item	Hedged exposure	Hedging instrument	Financial year	Changes in value of the hedged item for calculating ineffectiveness £m	Changes in value of the hedging instrument for calculating ineffectiveness £m	Cash-flow hedge reserve	
						Continued hedges £m	Discontinued hedges £m
Sales and purchases	Foreign currency risk	Foreign exchange contracts	FY2020	1	(1)	1	-
			FY2019	2	(2)	-	-

Cash-flow hedges generated £nil of ineffectiveness in FY2020 (FY2019: £nil) which was recognised in the income statement through finance costs.

## Translational currency exposure

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

## Net investment hedges

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

	At 31 July 2020			At 31 July 2019*		
	US\$ £m	Euro £m	Total £m	US\$ £m	Euro £m	Total £m
Loans designated as net investment hedges	(303)	(484)	(787)	(325)	(490)	(815)
Cross-currency swap	(572)	-	(572)	(613)	-	(613)
	<b>(875)</b>	<b>(484)</b>	<b>(1,359)</b>	<b>(938)</b>	<b>(490)</b>	<b>(1,428)</b>

\*The comparatives for the year to 31 July 2019 have been represented to show Euro hedging instruments at a summary net level in currency.

At 31 July 2020, cross-currency swaps hedged the Group's exposure to US dollars and Euros (31 July 2019: US dollars and Euros). All the cross-currency swaps designated as net investment hedges are non-current (FY2019: non-current).

Swaps generating £329m of the US dollar exposure (FY2019: £353m) will mature in April 2023 and swaps generating £243m of the US dollar exposure (FY2019: £260m) will mature in February 2027.

In addition, non-swapped borrowings were also used to hedge the Group's exposure to US dollars and euros (31 July 2019 US dollars and euros). Borrowings generating £303m of the US dollar exposure (FY2019: £325m) will mature in October 2022. Borrowings generating £536m of the euro exposure (FY2019: £543m) will mature in April 2023 and borrowings generating £308m of the euro exposure (FY2019: £312m) will mature in February 2027.

Hedge effectiveness is determined at the inception of the hedge relationship, and through periodic prospective effectiveness assessments to ensure that an economic relationship exists between the hedged item and hedging instrument. The swaps and borrowings have the same notional amount as the hedged items and therefore, there is an economic relationship with the hedge ratio established as 1:1.

The main sources of hedge ineffectiveness in these hedging relationships is the effect of the counterparty and the Group's own credit risk on the fair value of the foreign exchange forward contracts which is not reflected in the fair value of the hedged item and the risk of over-hedging where the hedge relationship requires re-balancing. No other sources of ineffectiveness emerged from these hedging relationships. Any hedge ineffectiveness is recognised immediately in the income statement in the period that it occurs.

The following table presents a reconciliation by risk category of the net investment hedge reserve and analysis of other comprehensive income in relation to hedge accounting:

	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
Brought forward net investment hedge reserve at start of year	(383)	(304)
Cross-currency swaps		
Net fair value gains on effective hedges	37	(35)
Bonds		
Net fair value gains on effective hedges	32	(44)
<b>Carried forward net investment hedge reserve at end of year</b>	<b>(314)</b>	<b>(383)</b>

The following table sets out information regarding the change in value of the hedged item used in calculating hedge ineffectiveness as well as the impacts on the net investment hedge reserve as at 31 July 2020 and 31 July 2019:

Hedged item	Hedged exposure	Hedging instrument	Financial year	Changes in value of the hedged item for calculating ineffectiveness £m	Changes in value of the hedging instrument for calculating ineffectiveness £m	Net investment hedge reserve	
						Continued hedges £m	Discontinued hedges £m
Overseas operation	Foreign currency risk	Forward contracts	FY2020	-	-	-	-
		Cross-currency swaps	FY2020	(37)	40	37	-
		Bonds	FY2020	(32)	32	32	-
				<b>(69)</b>	<b>72</b>	<b>69</b>	<b>-</b>
Overseas operation	Foreign currency risk	Forward contracts	FY2019	-	(1)	-	-
		Cross-currency swaps	FY2019	35	(37)	(35)	-
		Bonds	FY2019	44	(44)	(44)	-
				<b>79</b>	<b>(82)</b>	<b>(79)</b>	<b>-</b>

Net investment hedges generated £3m of ineffectiveness in FY2020 (FY2019:£nil) which was recognised in the income statement through finance costs.

The fair values of these net investment hedges are subject to exchange rate movements. Based on the hedging instruments in place at the year-end, if the specified currencies were to strengthen 10% while all other market rates remained constant, it would have the following effect:

	Loss recognised in hedge reserve 31 July 2020 £m	Loss recognised in hedge reserve 31 July 2019 £m
US dollar	97	104
Euro	54	54

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

#### (b) Interest rate risk

The Group operates an interest rate policy designed to optimise interest cost and reduce volatility in reported earnings. The Group's current policy is to require interest rates to be fixed within a band of between 40% and 60 % of the level of gross debt. This is achieved through fixed rate borrowings and interest rate swaps. At 31 July 2020, 53% (FY2019: 48%) of the Group's gross borrowings were at fixed interest rates, after adjusting for interest rate swaps and the impact of short maturity derivatives designated as net investment hedges.

The Group monitors its fixed rate risk profile against both gross and net debt. For medium-term planning, it focuses on gross debt to eliminate the fluctuations of variable cash levels over the cycle. The weighted average interest rate on borrowings and cross-currency swaps at 31 July 2020, after interest rate swaps, is 2.20% (FY2019: 3.22%).

### Interest rate profile of financial assets and liabilities and the fair value of borrowings

The following table shows the interest rate risk exposure of investments, cash and borrowings, with the borrowings adjusted for the impact of interest rate hedging. The other financial assets and liabilities do not earn or bear interest and for all financial instruments except for borrowings the carrying value is not materially different from their fair value.

	As at 31 July 2020				As at 31 July 2019			
	At fair value through profit or loss £m	Cash and cash equivalents £m	Borrowings £m	Fair value of borrowings £m	At fair value through profit or loss £m	Cash and cash equivalents £m	Borrowings £m	Fair value of borrowings £m
Fixed interest								
Less than one year	-	-	(41)	(41)	-	-	-	-
Between one and five years	-	-	(423)	(429)	-	-	(384)	(391)
Greater than five years	-	-	(322)	(334)	-	-	(314)	(342)
<b>Total fixed interest financial liabilities</b>	<b>-</b>	<b>-</b>	<b>(786)</b>	<b>(804)</b>	<b>-</b>	<b>-</b>	<b>(698)</b>	<b>(733)</b>
Floating rate interest financial assets/(liabilities)*	8	305	(775)	(775)	6	238	(811)	(811)
<b>Total interest-bearing financial assets/(liabilities)</b>	<b>8</b>	<b>305</b>	<b>(1,561)</b>	<b>(1,579)</b>	<b>6</b>	<b>238</b>	<b>(1,509)</b>	<b>(1,544)</b>
Non-interest-bearing assets in the same category	11	61	-	-	13	51	-	-
<b>Total</b>	<b>19</b>	<b>366</b>	<b>(1,561)</b>	<b>(1,579)</b>	<b>19</b>	<b>289</b>	<b>(1,509)</b>	<b>(1,544)</b>

\*Fair value gains and losses in this category of assets are recognised in other comprehensive income.

### Interest rate hedging

The Group also has exposures to the fair values of non-derivative financial instruments such as EUR and USD fixed rate borrowings. To manage the risk of changes in these fair values, the Group has entered into fixed-to-floating interest rate swap and cross-currency interest rate swaps which for accounting purposes are designated as fair value hedges.

At 31 July 2020 and 31 July 2019, the Group had designated the following hedges against variability in the fair value of borrowings arising from fluctuations in base rates:

- \$150m interest rate swap which matures on 12 October 2022 partially hedging the USD 2022 Guaranteed notes; and
- €400m of the fixed/floating element of EUR/USD interest rate swaps maturing on 28 April 2023 partially hedging the € 2023 Eurobond.

Additionally at 31 July 2020 the Group designated the following hedge against variability in the fair value of borrowings arising from fluctuations in base rates:

- €300m of the fixed/floating and € exchange exposure of EUR/USD interest rate swaps maturing on 23 February 2027 partially hedging the € 2027 Eurobond.

The fair values of the hedging instruments are disclosed in note 20. The effect of the swaps is to convert £745m (FY2019: £761m) debt from fixed rate to floating rate. The swaps have similar critical terms to the hedged items, such as the reference rate, reset dates, notional amounts, payment dates and maturities. Therefore, there is an economic relationship and the hedge ratio is established as 1:1. Hedge effectiveness is determined at the inception of the hedge relationship, and through periodic prospective effectiveness assessments to ensure that an economic relationship exists between the hedged item and hedging instrument.

The main sources of hedge ineffectiveness in these hedging relationships are the effect of the counterparty and the Group's own credit risk on the fair value of the cross-currency and interest rate swaps and currency basis risk on cross-currency interest rate swaps which are not reflected in the fair value of the hedged item. No other sources of ineffectiveness emerged from these hedging relationships. Any hedge ineffectiveness is recognised immediately in the income statement in the period that it occurs.

The following table sets out the details of the hedged exposures covered by the Group's fair value hedges:

Hedged item	Hedged exposure	Financial year	Changes in value of hedged item for calculating ineffectiveness £m	Changes in value of the hedging instrument for calculating ineffectiveness £m	Carrying amount		Accumulated fair value adjustments on hedged item	
					Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fixed rate	Interest rate risk	FY2020	10	1	-	475	-	11
bonds (a)	Interest rate & currency rate risk	FY2020	-	(5)	-	270	-	20
			<b>10</b>	<b>(4)</b>	-	<b>745</b>	-	<b>31</b>
Fixed rate	Interest rate risk	FY2019	8	(5)	-	123	-	2
bonds (a)	Interest rate & currency rate risk	FY2019	44	(37)	-	638	-	39
			<b>52</b>	<b>(42)</b>	-	<b>761</b>	-	<b>41</b>

(a) Classified as borrowings

Fair value hedges generated a £6m ineffectiveness gain in FY2020 (FY2019: £10m loss) which was recognised in the income statement through finance costs.

### 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 investments at 31 July 2020, 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 less than £5m impact (FY2019: £5m impact) on the Group's profit before tax.

### (c) Financial credit risk

The Group is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, but does not currently expect any counterparties to fail to meet their obligations. Credit risk is mitigated by the Board-approved policy of only placing cash deposits with highly rated relationship bank counterparties within counterparty limits established by reference to their Standard & Poor's long-term debt rating. In the normal course of business, the Group operates cash pooling systems, where a legal right of set-off applies.

The maximum credit risk exposure in the event of other parties failing to perform their obligations under financial assets, excluding trade and other receivables and derivatives, totals £385m at 31 July 2020 (FY2019: £308m).

	31 July 2020 £m	31 July 2019 £m
Cash in AAA liquidity funds	160	85
Cash at banks with at least a AA- credit rating	28	97
Cash at banks with all other A credit ratings	164	97
Cash at other banks	14	10
Investments in bank deposits	11	13
Other investments	8	6
	<b>385</b>	<b>308</b>

At 31 July 2020, the maximum exposure with a single bank for deposits and cash is £124m (FY2019: £179m), whilst the maximum mark to market exposure with a single bank for derivatives is £29m (FY2019: £17m). These banks have AAA and AA- credit ratings respectively (FY2019: Both A+ & AA-).

**(d) Liquidity risk****Borrowing facilities**

The Board policy specifies the maintenance of unused committed credit facilities of at least £300m at all times to ensure it has sufficient available funds for operations and planned development. The Group has Revolving Credit Facilities of \$110m maturing on 1 November 2023 and \$690m maturing 1 November 2024. At the balance sheet date, the Group had the following undrawn credit facilities:

	31 July 2020 £m	31 July 2019 £m
Expiring after more than two years	<b>611</b>	<b>655</b>

The Bank of England confirmed Smiths' eligibility to access the Covid Corporate Financing Facility ('CCFF') in principle from 30 April 2020 with an indicative aggregate group limit of £600m. Utilisation of the CCFF, which closes to new issuance on 23 March 2021, is not anticipated.

**Cash deposits**

As at 31 July 2020, £192m (FY2019: £136m) of cash and cash equivalents was on deposit with various banks of which £12m (FY2019: £32m) was on deposit with UK banks, £160m (FY2019: £85m) was in liquidity funds and £11m (FY2019: £13m) of investments comprised bank deposits held to secure liabilities and letters of credit.

**Gross contractual cash-flows for borrowings**

	As at 31 July 2020				As at 31 July 2019			
	Borrowings (note 18) £m	Fair value adjustments £m	Contractual interest payments £m	Total contractual cash-flows £m	Borrowings (note 18) £m	Fair value adjustments £m	Contractual interest payments £m	Total contractual cash-flows £m
Less than one year	(41)	-	(30)	(71)	(9)	-	(31)	(40)
Between one and two years	(20)	-	(30)	(50)	-	-	(31)	(31)
Between two and three years	(870)	22	(24)	(872)	-	-	(31)	(31)
Between three and four years	(10)	-	(12)	(22)	(893)	20	(25)	(898)
Between four and five years	(8)	-	(12)	(20)	-	-	(12)	(12)
Greater than five years	(612)	9	(24)	(627)	(607)	20	(36)	(623)
<b>Total</b>	<b>(1,561)</b>	<b>31</b>	<b>(132)</b>	<b>(1,662)</b>	<b>(1,509)</b>	<b>40</b>	<b>(166)</b>	<b>(1,635)</b>

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**

	As at 31 July 2020			As at 31 July 2019		
	Receipts £m	Payments £m	Net cash-flow £m	Receipts £m	Payments £m	Net cash-flow £m
<b>Assets</b>						
Less than one year	174	(175)	(1)	217	(236)	(19)
Greater than one year	674	(595)	79	712	(652)	60
<b>Liabilities</b>						
Less than one year	144	(144)	-	241	(238)	3
Greater than one year	-	3	3	19	(18)	1
<b>Total</b>	<b>992</b>	<b>(911)</b>	<b>81</b>	<b>1,189</b>	<b>(1,144)</b>	<b>45</b>

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 20.

**Gross contractual cash-flows for other financial liabilities**

The contractual cash-flows for financial liabilities included in trade and other payables are £331m (FY2019: £384m) due in less than one year, £6m (FY2019: £6m) due between one and five years, and £3m (FY2019: £3m) due after more than five years.

## 20 DERIVATIVE FINANCIAL INSTRUMENTS

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

	At 31 July 2020			
	Contract or underlying nominal amount £m	Fair value		
		Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	110	1	(1)	-
Foreign exchange contracts (not hedge accounted)	203	1	(3)	(2)
<b>Total foreign exchange contracts</b>	<b>313</b>	<b>2</b>	<b>(4)</b>	<b>(2)</b>
Cross-currency swaps (fair value and net investment hedges)	572	78	-	78
Interest rate swaps (fair value hedges)	114	4	-	4
<b>Total financial derivatives</b>	<b>999</b>	<b>84</b>	<b>(4)</b>	<b>80</b>
Balance sheet entries:				
Non-current	690	82	-	82
Current	309	2	(4)	(2)
<b>Total financial derivatives</b>	<b>999</b>	<b>84</b>	<b>(4)</b>	<b>80</b>

	At 31 July 2019			
	Contract or underlying nominal amount £m	Fair value		
		Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	54		(2)	(2)
Foreign exchange contracts (not hedge accounted)	431	4	(3)	1
<b>Total foreign exchange contracts</b>	<b>485</b>	<b>4</b>	<b>(5)</b>	<b>(1)</b>
Cross-currency swaps (fair value and net investment hedges)	613	46		46
Interest rate swaps (fair value hedges)	123		(1)	(1)
<b>Total financial derivatives</b>	<b>1,221</b>	<b>50</b>	<b>(6)</b>	<b>44</b>
Balance sheet entries:				
Non-current	777	47	(1)	46
Current	444	3	(5)	(2)
<b>Total financial derivatives</b>	<b>1,221</b>	<b>50</b>	<b>(6)</b>	<b>44</b>

The maturity profile, average interest and foreign currency exchange rates of the hedging instruments used in the Group's hedging strategies is as follows:

Hedged exposure	Hedging instrument	Maturity at 31 July 2020			Maturity at 31 July 2019		
		Up to one year	One to five years	More than five years	Up to one year	One to five years	More than five years
<b>Fair value hedges</b>							
Interest rate risk	- Notional amount (£m)	-	114	-	-	123	-
	Interest rate swaps – Average spread over 6 month USD LIBOR	-	1.797%	-	-	1.797%	-
	- Notional amount (£m)	-	360	-	-	364	-
	Interest rate swaps – Average spread over 3 month EUR LIBOR	-	1.015%	-	-	1.015%	-
Interest rate risk/ Foreign currency risk	- Notional amount (£m)	-	-	254	-	-	254
	Cross-currency swaps (EUR:GBP) – Average exchange rate	-	-	0.845	-	-	0.8450
	- Average spread over 3 month USD LIBOR	-	-	1.750%	-	-	1.750%
<b>Net investment hedges</b>							
Foreign currency risk	- Notional amount (£m)	-	329	-	-	353	-
	Cross-currency swaps (EUR:USD) – Average exchange rate	-	1.0773	-	-	1.0773	-
	- Notional amount (£m)	-	-	243	-	-	260
	Cross-currency swaps (GBP:USD) – Average exchange rate	-	-	1.2534	-	-	1.2534
<b>Cash-flow hedges</b>							
Foreign currency risk	- Notional amount (£m)	59	3	-	24	-	-
	Foreign exchange contracts (EUR:USD) – Average exchange rate	1.0744	1.1731	-	1.1885	-	-
	- Notional amount (£m)	19	-	-	12	-	-
	Foreign exchange contracts (EUR:GBP) – Average exchange rate	0.9483	-	-	0.9021	-	-
	- Notional amount (£m)	8	-	-	-	-	-
	Foreign exchange contracts (EUR:AUD) – Average exchange rate	1.6544	-	-	-	-	-
	- Notional amount (£m)	10	-	-	12	-	-
	Foreign exchange contracts (USD:GBP) – Average exchange rate	1.2589	-	-	1.3523	-	-
	- Notional amount (£m)	6	-	-	6	-	-
	Foreign exchange contracts (GBP:CZK) – Average exchange rate	29.7191	-	-	28.8236	-	-
	- Notional amount (£m)	4	1	-	-	-	-
	Foreign exchange contracts (USD:JPY) – Average exchange rate	103.0538	100.6200	-	-	-	-

At 31 July 2020, the Group had forward foreign exchange contracts with a nominal value of £110m (FY2019: £54m) designated as cash-flow hedges. These forward foreign exchange contracts are in relation to sale and purchase of multiple currencies with varying maturities up to 20 August 2021. The largest single currency pairs are disclosed above and make up 100% of the notional hedged exposure. The notional and fair values of these foreign exchange forward derivatives are shown in the nominal amount and fair value of derivative contracts table above.

### Accounting for other derivative contracts

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

### Netting

International Swaps and Derivatives Association (ISDA) master netting agreements are in place with derivative counterparties except for contracts traded on a dedicated international electronic trading platform used for operational foreign exchange hedging. Under these agreements if a credit event occurs, all outstanding transactions under the ISDA are terminated and only a single net amount per counterparty is payable in settlement of all transactions. The ISDA agreements do not meet the criteria for offsetting, since the offsetting

is enforceable only if specific events occur in the future, and there is no intention to settle the contracts on a net basis.

	Assets 31 July 2020 £m	Liabilities 31 July 2020 £m	Assets 31 July 2019 £m	Liabilities 31 July 2019 £m
Gross value of assets and liabilities	84	(4)	50	(6)
Related assets and liabilities subject to master netting agreements	(2)	2	(2)	2
<b>Net exposure</b>	<b>82</b>	<b>(2)</b>	<b>48</b>	<b>(4)</b>

## 21 FAIR VALUE OF FINANCIAL INSTRUMENTS

As at 31 July 2020	Notes	Basis for determining fair value	At amortised cost £m	At fair value through profit or loss £m	At fair value through OCI £m	Total carrying value £m	Total fair value £m
<b>Financial assets</b>							
Other investments	17	A	-	11	-	11	11
Other investments	17	E	-	-	8	8	8
Cash and cash equivalents	18	A	206	160	-	366	366
Trade and other financial receivables	15	A/B	679	-	-	679	679
Derivative financial instruments	20	B	-	84	-	84	84
<b>Total financial assets</b>			<b>885</b>	<b>255</b>	<b>8</b>	<b>1,148</b>	<b>1,148</b>
<b>Financial liabilities</b>							
Trade and other financial payables	16	A	(578)	-	-	(578)	(578)
Short-term borrowings	18	C	(10)	-	-	(10)	(10)
Long-term borrowings	18	C	(1,455)	-	-	(1,455)	(1,473)
Leases liabilities	18	D	(96)	-	-	(96)	(96)
Derivative financial instruments	20	B	-	(4)	-	(4)	(4)
<b>Total financial liabilities</b>			<b>(2,139)</b>	<b>(4)</b>	<b>-</b>	<b>(2,143)</b>	<b>(2,161)</b>

As at 31 July 2019	Notes	Basis for determining fair value	At amortised cost £m	At fair value through profit or loss £m	Total carrying value £m	Total fair value £m
<b>Financial assets</b>						
Other investments	17	A	-	13	13	13
Other investments	17	E	-	6	6	6
Cash and cash equivalents	18	A	153	136	289	289
Trade and other financial receivables	15	A/B	816	-	816	816
Derivative financial instruments	20	B	-	50	50	50
<b>Total financial assets</b>			<b>969</b>	<b>205</b>	<b>1,174</b>	<b>1,174</b>
<b>Financial liabilities</b>						
Trade and other financial payables	16	A	(599)	-	(599)	(599)
Short-term borrowings	18	C	(9)	-	(9)	(9)
Long-term borrowings	18	C	(1,500)	-	(1,500)	(1,535)
Finance leases		D	(3)	-	(3)	(3)
Derivative financial instruments	20	B	-	(6)	(6)	(6)
<b>Total financial liabilities</b>			<b>(2,111)</b>	<b>(6)</b>	<b>(2,117)</b>	<b>(2,152)</b>

The fair value of a financial instrument is the price at which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's-length transaction. Fair values have been determined with reference to available market information at the balance sheet date, using the methodologies described below:

- A Carrying value is assumed to be a reasonable approximation to fair value for all of these assets and liabilities (Level 2 as defined by IFRS 13 Fair Value Measurement).
- B Fair values of derivative financial assets and liabilities and trade receivables held to collect or sell are estimated by discounting expected future contractual cash-flows using prevailing interest rate curves. Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date. These financial instruments are included on the balance sheet at fair value, derived from observable market prices (Level 2 as defined by IFRS 13 Fair Value Measurement).
- C Borrowings are carried at amortised cost. Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date. The fair value of borrowings is estimated using quoted prices (Level 1 as defined by IFRS 13).
- D Leases are carried at amortised cost. Amounts denominated in foreign currencies are valued at the exchange rate prevailing at the balance sheet date. The fair value of the lease contract is estimated by discounting contractual future cash-flows (Level 2 as defined by IFRS 13).
- E The fair value of investments is estimated as Level 3 as defined by IFRS 13.

IFRS 13 defines a three level valuation hierarchy:

Level 1 – quoted prices for similar instruments

Level 2 – directly observable market inputs other than Level 1 inputs

Level 3 – inputs not based on observable market data

## 22 COMMITMENTS

### Operating lease commitments – minimum lease payments

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

	31 July 2019	
	Land and buildings £m	Other £m
Payments due:		
– not later than one year	36	8
– later than one year and not later than five years	84	9
– later than five years	17	
	<b>137</b>	<b>17</b>

From 1 August 2019, the Group has recognised lease liabilities in accordance with IFRS 16 Leases in respect of leased properties, vehicles and equipment. See accounting policies and note 18 for further information.

### Other commitments

At 31 July 2020, commitments, comprising bonds and guarantees arising in the normal course of business, amounted to £240m (FY2019: £209m), including pension commitments of £54m (FY2019: £54m). In addition, the Group has committed expenditure on capital projects amounting to £6m (2019: £14m).

## 23 PROVISIONS AND CONTINGENT LIABILITIES

	Trading	Non-headline and legacy			Total
	£m	John Crane, Inc. litigation £m	Titeflex Corporation litigation £m	Other £m	£m
<b>At 31 July 2018</b>	<b>23</b>	<b>223</b>	<b>78</b>	<b>14</b>	<b>338</b>
Foreign exchange rate movements	1	17	5	1	24
Business combinations	-	-	-	12	12
Provision charged	15	15	-	-	30
Provision released	(6)	-	(6)	-	(12)
Unwind of provision discount	-	6	2	-	8
Utilisation	(12)	(24)	(5)	(3)	(44)
Reclassified to liability held for distribution to owners (note 28)	(3)	-	-	(2)	(5)
<b>At 31 July 2019</b>	<b>18</b>	<b>237</b>	<b>74</b>	<b>22</b>	<b>351</b>
Current liabilities	17	29	16	4	66
Non-current liabilities	1	208	58	18	285
<b>At 31 July 2019</b>	<b>18</b>	<b>237</b>	<b>74</b>	<b>22</b>	<b>351</b>
Foreign exchange rate movements	(1)	(17)	(5)	(1)	(24)
Provision charged	9	30	1	3	43
Provision released	(4)	-	-	(1)	(5)
Unwind of provision discount	-	4	1	-	5
Utilisation	(8)	(23)	(5)	(3)	(39)
<b>At 31 July 2020</b>	<b>14</b>	<b>231</b>	<b>66</b>	<b>20</b>	<b>331</b>
Current liabilities	12	26	13	4	55
Non-current liabilities	2	205	53	16	276
<b>At 31 July 2020</b>	<b>14</b>	<b>231</b>	<b>66</b>	<b>20</b>	<b>331</b>

The John Crane, Inc. and Titeflex Corporation litigation provisions are the only provisions that are discounted.

## Trading

The provisions included as trading represent amounts provided for in the ordinary course of business. Trading provisions are charged and released through headline profit.

### Warranty provision and product liability

At 31 July 2020, the Group has warranty and product liability provisions of £13m (FY2019: £17m). Warranties over the Group's products typically cover periods of between one and three years. Provision is made for the likely cost of after-sales support based on the recent past experience of individual businesses.

### Commercial disputes and litigation in respect of ongoing business activities

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

### Contingent liabilities

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

The Group operates in some markets where the risk of unethical or corrupt behaviour is material and has procedures, including an employee 'Ethics Alertline', to help it identify potential issues. Such procedures will, from time to time, give rise to internal investigations, sometimes conducted with external support, to ensure that Smiths Group properly understands risks and concerns and can take steps both to manage immediate issues and to improve its practices and procedures for the future. The Group is not aware of any issues which are expected to generate material financial exposures.

## Non-headline and legacy

### John Crane, Inc.

John Crane, Inc. (JCI) is one of many co-defendants in numerous lawsuits pending in the United States in which plaintiffs are claiming damages arising from alleged exposure to, or use of, products previously manufactured which contained asbestos. Until 2006, the awards, the related interest and all material defence costs were met directly by insurers. In 2007, JCI secured the commutation of certain insurance policies in respect of product liability. Provision is made in respect of the expected costs of defending known and predicted future claims and of adverse judgments in relation thereto, to the extent that such costs can be reliably estimated.

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

JCI continues to actively monitor the conduct and effect of its current and expected asbestos litigation, including the most efficacious presentation of its 'safe product' defence, and intends to continue to resist these asbestos claims based upon this defence. The table below summarises the JCI claims experience over the last 40 years since the start of this litigation:

	Year ended 31 July 2020	Year ended 31 July 2019	Year ended 31 July 2018	Year ended 31 July 2017	Year ended 31 July 2016
<b>JCI claims experience</b>					
Claims against JCI that have been dismissed	297,000	285,000	277,000	273,000	247,000
Claims JCI is currently a defendant in	25,000	38,000	43,000	50,000	74,000
Cumulative final judgments, after appeals, against JCI since 1979	149	144	140	138	137
Cumulative value of awards (\$'m) since 1979	175	168	164	160	158

### The number of claims outstanding at 31 July 2020 reflects the benefit of 13,000 claims being dismissed in the year.

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

#### John Crane, Inc. litigation provision

The provision is based on past history of JCI claims and well-established tables of asbestos-related disease incidence projections. The provision is determined using advice from asbestos valuation experts, Bates White LLC. The assumptions made in assessing the appropriate level of provision include: the period over which the expenditure can be reliably estimated; the future trend of legal costs; the rate of future claims filed; the rate of successful resolution of claims; and the average amount of judgments awarded.

Established incidence curves can be used to estimate the likely future pattern of asbestos-related disease. However, JCI's claims experience is also significantly impacted by other factors which influence the US litigation environment. These can include: changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels in specific jurisdictions which move the balance of risk and opportunity for claimants; and legislative and procedural changes in both the state and federal court systems.

The projections use a limited time horizon on the basis that Bates White LLC consider that there is substantial uncertainty in the asbestos litigation environment. So probable expenditures are not reasonably estimable beyond this time horizon. Asbestos is the longest running mass tort litigation in American history and is constantly evolving in ways that cannot be anticipated. JCI's defence strategy also generates a significantly different pattern of legal costs and settlement expenses from other defendants. Thus JCI is in an extremely rare position, and evidence from other litigation cannot be used to improve the reliability of the projections. A ten year (FY2019: ten year) time horizon has been used based on past experience regarding significant changes in the litigation environment that have occurred every few years and on the amount of time taken in the past for some of those changes to impact the broader asbestos litigation environment.

The rate of future claims filed has been estimated using well-established tables of asbestos incidence projections to determine the likely population of potential claimants, and JCI's past experience to determine what proportion of this population will make a claim against JCI. The JCI products generally referred to in claims had industrial and marine applications. As a result, the incidence curve used for JCI projections excludes construction workers, and is a composite of the curves that predict asbestos exposure-related disease from shipyards and other occupations. This is consistent with JCI's litigation history.

The rate of successful resolution of claims and the average amount of any judgments awarded are projected based on the past history of JCI claims, since this is the best available evidence, given JCI's unusual strategy of defending all claims.

The future trend of legal costs is estimated based on JCI's past experience, adjusted to reflect the assumed levels of claims and trial activity, since the number of trials is a key driver of legal costs.

#### John Crane, Inc. litigation insurance recoveries

While JCI has certain excess liability insurance, JCI has met defence costs directly. The calculation of the provision does not take account of any potential recoveries from insurers.

**John Crane, Inc. litigation provision history**

The JCI asbestos litigation provision has developed over the last five years as follows:

	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m
<b>John Crane, Inc. litigation provision</b>					
Gross provision	235	257	251	260	267
Discount	(4)	(20)	(28)	(23)	(15)
Discounted pre-tax provision	<b>231</b>	<b>237</b>	<b>223</b>	<b>237</b>	<b>252</b>
Deferred tax	(59)	(50)	(48)	(79)	(84)
Discounted post-tax provision	<b>172</b>	<b>187</b>	<b>175</b>	<b>158</b>	<b>168</b>
<b>Operating profit charge/(credit)</b>					
Increased provisions for adverse judgments and legal defence costs	14	7	13	17	8
Change in US risk-free rates	16	8	(6)	(13)	7
Subtotal – items charged to the provision	30	15	7	4	15
Litigation management, legal fees in connection with litigation against insurers and defence strategy	1	2	3	11	8
Recoveries from insurers	(3)	(11)	-	(6)	(16)
Total operating profit charge	28	6	10	9	7
<b>Cash-flow</b>					
Provision utilisation - legal defence costs and adverse judgements	(23)	(24)	(27)	(24)	(22)
Litigation management expense	(1)	(2)	(3)	(11)	(8)
Recoveries from insurers	3	11	-	6	16
Net cash outflow	(21)	(15)	(30)	(29)	(14)

**John Crane, Inc. litigation provision sensitivities**

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

**Statistical reliability of projections over the ten year time horizon**

In order to evaluate the statistical reliability of the projections, a population of outcomes is modelled using randomised verdict outcomes. This generated a distribution of outcomes with future spend at the 5th percentile of £214m and future spend at the 95th percentile of £271m (FY2019: £234m and £297m, respectively). Statistical analysis of the distribution of these outcomes indicates that there is a 50% probability that the total future spend will fall between £222m and £244m (FY2019: between £242m and £267m), compared to the gross provision value of £235m (FY2019: £257m).

**Sensitivity of the projections to changes in the time horizon used**

If the asbestos litigation environment becomes more volatile and uncertain, the time horizon over which the provision can be calculated may reduce. Conversely, if the environment became more stable, or JCI changed approach and committed to long-term settlement arrangements, the time period covered by the provision might be extended.

The projections use a ten year time horizon. Reducing the time horizon by one year would reduce the provision by £20m (FY2019: £17m) and reducing it by five years would reduce the provision by £106m (FY2019: £100m).

We consider, after obtaining advice from Bates White LLC, that to forecast beyond ten years requires that the litigation environment remains largely unchanged with respect to the historical experience used for estimating future asbestos expenditures. Historically, the asbestos litigation environment has undergone significant changes more often than every ten years. If one assumed that the asbestos litigation environment would remain unchanged for longer and extended the time horizon by one year, it would increase the provision by £17m (FY2019: £14m) and extending it by five years would increase the provision by £69m (FY2019: £59m). However, there are also reasonable scenarios that, given certain recent events in the US asbestos litigation environment, would result in no additional asbestos litigation for JCI beyond ten years. At this time, how the asbestos litigation environment will evolve beyond ten years is not reasonably estimable.

### John Crane, Inc. contingent liabilities

Provision has been made for future defence costs and the cost of adverse judgments expected to occur. JCI's claims experience is significantly impacted by other factors which influence the US litigation environment. These can include: changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels; and legislative and procedural changes in both the state and federal court systems. As a result, whilst the Group anticipates that asbestos litigation will continue beyond the period covered by the provision, the uncertainty surrounding the US litigation environment beyond this point is such that the costs cannot be reliably estimated.

Although the methodology used to calculate the JCI litigation provision can in theory be applied to show claims and costs for longer periods, the Directors consider, based on advice from Bates White LLC, that the level of uncertainty regarding the factors used in estimating future costs is too great to provide for reasonable estimation of the numbers of future claims, the nature of such claims or the cost to resolve them for years beyond the ten year time horizon.

### Titeflex Corporation

Titeflex Corporation, a subsidiary of the Group in the Flex-Tek division, has received a number of claims in the United States of America from insurance companies seeking recompense on a subrogated basis for the effects of damage allegedly caused by lightning strikes in relation to its flexible gas piping product. It has also received product liability claims regarding this product in the United States of America, some in the form of purported class actions. Titeflex Corporation believes that its products are a safe and effective means of delivering gas when installed in accordance with the manufacturer's instructions and local and national codes. However some claims have been settled on an individual basis without admission of liability. Equivalent third-party products in the US market-place face similar challenges.

### Titeflex Corporation litigation provision

The continuing progress of claims and the pattern of settlement, together with recent market-place activity, provide sufficient evidence to recognise a liability in the accounts. Therefore provision has been made for the costs which the Group is expected to incur in respect of future claims to the extent that such costs can be reliably estimated. Titeflex Corporation sells flexible gas piping with extensive installation and safety guidance designed to assure the safety of the product and minimise the risk of damage associated with lightning strikes.

The assumptions made in assessing the appropriate level of provision, which are based on past experience, include: the period over which expenditure can be reliably estimated; the number of future settlements; the average amount of settlements; and the impact of statutes of repose and safe installation initiatives on the expected number of future claims.

The provision of £66m (FY2019: £74m) is a discounted pre-tax provision using discount rates, being the risk-free rate on US debt instruments for the appropriate period. The deferred tax asset related to this provision is shown within the deferred tax balance (note 6).

	31 July 2020 £m	31 July 2019 £m
Gross provision	86	118
Discount	(20)	(44)
Discounted pre-tax provision	<b>66</b>	<b>74</b>
Deferred tax	(16)	(18)
Discounted post-tax provision	<b>50</b>	<b>56</b>

### Titeflex Corporation litigation provision history

A charge of £1m (FY2019: £6m credit) has been recognised by Titeflex Corporation in respect of changes to the estimated cost of future claims from insurance companies seeking recompense for damage allegedly caused by lightning strikes. The lower gross provision value has been driven by foreign exchange rate movements and a reduction in the average number of claims per year, offset by decreasing US dollar discount rates.

### Titeflex Corporation litigation provision sensitivities

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

The projections incorporate a long-term assumption regarding the impact of safe installation initiatives on the level of future claims. If the assumed annual benefit of bonding and grounding initiatives were 0.5% higher, the provision would be £6m (FY2019: £5m) lower, and if the benefit were 0.5% lower, the provision would increase by £7m (FY2019: £6m).

The projections use assumptions of future claims that are based on both the number of future settlements and the average amount of those settlements. If the assumed average number of future settlements increased 10%, the provision would rise by £5m (FY2019: £6m), with an equivalent fall for a reduction of 10%. If the assumed amount of those settlements increased 10%, the provision would rise by £3m (FY2019: £3m), also with an equivalent fall for a reduction of 10%.

### Other non-headline and legacy

Legacy provisions comprise provisions relating to former business activities and properties no longer used by Smiths. Non-headline provisions comprise all provisions that were disclosed as non-headline items when they were charged to the consolidated income statement. These provisions include non-headline reorganisation, disposal indemnities and litigation in respect of old products and discontinued business activities.

### Reorganisation

At 31 July 2020, there were reorganisation provisions of £3m relating to the various restructuring programmes that are expected to be utilised in the next 18 months.

### Property

At 31 July 2020, there were provisions of £12m (FY2019: £14m) related to actual and potential environmental issues for sites currently or previously occupied by Smiths operations and £3m (FY2019: £1m) related to dilapidations provisions.

## 24 SHARE CAPITAL

	Number of shares	Issued capital £m	Consideration £m
<b>Ordinary shares of 37.5p each</b>			
Total share capital at 31 July 2018	395,761,227	148	
Exercise of share options	195,554	-	2
<b>Total share capital at 31 July 2019</b>	<b>395,956,781</b>	<b>148</b>	
Exercise of share options	254,399	1	2
<b>Total share capital at 31 July 2020</b>	<b>396,211,180</b>	<b>149</b>	

### Share capital structure

As at 31 July 2020, the Company's issued share capital was 396,211,180 ordinary shares with a nominal value of 37.5p per share, all of the issued share capital was in free issue and all issued shares are fully paid.

The Company's ordinary shares are listed and admitted to trading on the Main Market of the London Stock Exchange. The Company has an American Depositary Receipt (ADR) programme and one ADR equates to one ordinary share. As at 31 July 2020, 7,120,155 ordinary shares were held by the nominee of the programme in respect of the same number of ADRs in issue.

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. None of the ordinary shares carry any special rights with regards to control of the Company or distributions made by the Company.

There are no known agreements relating to, or restrictions on, voting rights attached to the ordinary shares (other than the 48 hour cut-off for casting proxy votes prior to a general meeting). There are no restrictions on the transfer of shares, and there is no requirement to obtain approval for a share transfer. There are no known arrangements under which financial rights are held by a person other than the holder of the ordinary shares. There are no known limitations on the holding of shares.

### Powers of Directors

The Directors are authorised to issue and allot shares and to buy back shares subject to annual shareholder approval at the AGM. Such authorities were granted by shareholders at the 2019 AGM, and at the 2020 AGM it will be proposed that the Directors be granted new authorities to allot and buy back shares.

### Repurchase of shares

The Company did not purchase any of its own shares in its own name during the financial year ended 31 July 2020, all share purchases have been made by an Employee Benefit Trust with the shares acquired used to satisfy Company share plan commitments. As at 21 September 2020 (the latest practicable date for inclusion in this report), the Company had an unexpired authority to repurchase ordinary shares up to a maximum of 40m ordinary shares. As at 21 September 2020, the Company did not hold any shares in treasury. Any ordinary shares purchased may be cancelled or held in treasury.

### Employment share schemes

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 2020, the trust held no ordinary shares in the Company. The trust waived its dividend entitlement on its holding during the year, and the trust abstains from voting any shares held at general meetings.

## 25 DIVIDENDS

The following dividends were declared and paid in the period:

	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
FY2019 ordinary final dividend of 31.80p (FY2018: 30.75p) paid 15 November 2019	126	122
FY2020 ordinary interim dividend of nil (FY2019: 14.10p)	-	56
	<b>126</b>	<b>178</b>

In March 2020, the Board considered it prudent not to declare an interim dividend for HY2020 until such time as trading conditions became clearer and there was less uncertainty. Reflecting the Group's strong performance and financial position, the Board has recommended a total dividend of 35.0p per share for the year. This is comprised of a delayed interim dividend of 11.0p and a proposed final dividend of 24.0p.

Shareholders will be asked to approve the final dividend component of the total dividend at the 2020 AGM. If the final dividend is approved, it will be payable, along with the interim dividend, on 20 November 2020 to shareholders on the register of members at 6.00pm on 23 October 2020 (the record date). The interim dividend does not require the approval of shareholders and is therefore not included in the resolutions put to the AGM. As payment of these dividends will occur outside the period, they have not been included as a liability in these accounts.

### Waiver of dividends

The following waived all dividends payable in the year, and all future dividends, on their shareholdings in the Company:

- Wealth Nominees Limited (Smiths Industries Employee Share Trust)
- Reuter File Limited

## 26 RESERVES

Retained earnings include the value of Smiths Group plc shares held by the Smiths Industries Employee Benefit Trust. In the year the Company issued 1,234,907 (FY2019: 1,170,315) shares to the Trust, and the Trust purchased 1,181,849 shares (FY2019: 1,222,607 shares) in the market for a consideration of £18m (FY2019: £19m). At 31 July 2020, the Trust held nil (FY2019: 53,058) ordinary shares.

The capital redemption reserve, revaluation reserve and merger reserve arose from share repurchases, revaluations of property, plant and equipment, and merger accounting for business combinations before the adoption of IFRS, respectively.

### Capital management

Capital employed comprises total equity adjusted for goodwill recognised directly in reserves, net post-retirement benefit related assets and liabilities, net litigation provisions relating to non-headline items and net debt. The efficiency of the allocation of the capital to the divisions is monitored through the return on capital employed (ROCE). This ratio is calculated over a rolling 12-month period and is the percentage that headline operating profit comprises of monthly average capital employed. The ROCE was 11.8% (FY2019: 14.4%), see note 30.

The capital structure is based on the Directors' judgement of the balance required to maintain flexibility while achieving an efficient cost of capital.

The ratio of net debt to headline EBITDA of 1.9 (FY2019: 1.8) is within the Group's stated policy of 2.0 or less over the medium term. The Group's robust balance sheet and record of strong cash generation is more than able to fund the immediate investment needs and other legacy obligations. See note 30 for the definition of headline EBITDA and the calculation of this ratio.

As part of its capital management the Group strategy is to maintain a solid investment grade credit rating to ensure access to the widest possible sources of financing and to minimise the resulting cost of capital. At 31 July 2020, the Group had a credit rating of BBB+/Baa2 (FY2019: BBB+/Baa2) with Standard & Poor's and Moody's respectively.

The Board has a progressive dividend policy for future pay-outs, with the aim of increasing dividends in line with the long-term underlying growth in earnings. In setting the level of dividend payments, the Board will take into account prevailing economic conditions and future investment plans, along with the objective to maintain minimum dividend cover of around 2 times.

### Hedge reserve

31 July 2020 £m	31 July 2019 £m
--------------------	--------------------

The hedge reserve on the balance sheet comprises:

– net investment hedge reserve from continuing operations net of £3m deferred tax (FY2019: £nil)	(311)	(383)
– net investment hedge reserve from discontinued operations	(1)	-
	<b>(312)</b>	<b>(383)</b>

See transactional currency exposure risk management disclosures in note 19 for additional details of cash-flow hedges, and translational currency exposure risk management disclosure also in note 19 for additional details of net investment hedges.

### Non-controlling interest

The Group has recorded a non-controlling interest of £21m in John Crane Japan Inc., representing a 30% interest. John Crane Japan Inc. generated operating profits of £9m in the period, cash inflows from operating activities of £11m and paid dividends of £2m and tax of £3m. At 31 July 2020, the company contributed £60m of net assets to the Group.

## 27 ACQUISITIONS

On 31 October 2019, Smiths Interconnect completed the acquisition of 100% of the share capital of Reflex Photonics Inc. for an enterprise value of CAD\$40m. Reflex Photonics is a business that manufactures ruggedised high-speed optical products for space, aerospace, defence, avionics, and industrial applications. The acquisition strengthens Smiths Interconnect's position in these markets. The intangible assets recognised on acquisition comprise customer relationships, intellectual property and technology. Goodwill represents the expected synergies from the strategic fit of the acquisition and the value of the expertise in the assembled workforce.

From the date of acquisition to 31 July 2020, Reflex Photonics contributed £5m to revenue and less than £1m to profit before taxation. If the Group had acquired this business from the beginning of the financial year, the acquisition would have contributed £8m to revenue and less than £1m to profit before taxation. The provisional fair values at the date of acquisition are:

	Total £m
<b>Non-current assets</b>	
– acquired intangible assets	15
– plant and machinery	2
– right-of-use assets	1
<b>Current assets</b>	
– inventory	2
– trade and other receivables	1
<b>Current liabilities</b>	
– trade and other payables	(3)
– current tax	(3)
<b>Non-current liabilities</b>	
– lease liabilities	(1)
<b>Net assets acquired</b>	<b>14</b>
<b>Goodwill on current year acquisitions</b>	<b>10</b>
Cash paid during the year	24
<b>Total consideration</b>	<b>24</b>

### Acquisitions in previous years

The Group acquired United Flexible in the prior year. Since the acquisition the Group has undertaken a thorough review of the business and has adjusted the fair value of assets and liabilities on the acquisition balance sheet, resulting in a £1m increase in the goodwill associated with this acquisition in the current year

## 28 DISCONTINUED OPERATIONS AND BUSINESSES HELD FOR DISTRIBUTION TO OWNERS

The Group formally committed to pursue a demerger of the Smiths Medical business and separately list it on the UK Stock Exchange in FY2019 and at 31 July 2019 it was determined that the project had progressed sufficiently for Smiths Medical business to be accounted for as a discontinued operation and as a business held for distribution to owners.

The demerger project was paused in March 2020 due to the unprecedented circumstances of the second half of FY2020. Management has determined that, as the Group remains demonstrably committed to the demerger of Smiths Medical, the criteria for classification as discontinued and held for distribution to owners continue to be met.

### Discontinued operations

The financial performance of the Smiths Medical business in the current and prior years is presented below:

	Year ended 31 July 2020			Year ended 31 July 2019		
	Headline £m	Non- headline (note 3) £m	Total £m	Headline £m	Non- headline (note 3) £m	Total £m
Revenue	918	-	918	874	-	874
Cost of sales	(418)	-	(418)	(412)	-	(412)
Gross profit	500	-		462	-	462
Sales and distribution costs	(187)	-	(187)	(183)	-	(183)
Administrative expenses	(129)	(23)	(152)	(132)	(13)	(145)
Profit on business disposal	-	-	-	-	17	17
<b>Operating profit</b>	<b>184</b>	<b>(23)</b>	<b>161</b>	<b>147</b>	<b>4</b>	<b>151</b>
Finance costs	(4)	62	58	(3)	(38)	(41)
Taxation	(41)	22	(19)	(32)	7	(25)
<b>Profit from discontinued operations</b>	<b>139</b>	<b>61</b>	<b>200</b>	<b>112</b>	<b>(27)</b>	<b>85</b>

£3m (FY2019: £3m) of interest was capitalised as part of the costs of Smiths Medical development projects. £1m (FY2019: £1m) of tax relief has been recognised as current tax relief in the period. The demerger of the Medical division is not anticipated to give rise to material tax charges. However, it is noted that the relevant regulatory filings and clearances are still in progress.

#### Businesses held for distribution to owners

The carrying value of the assets and liabilities of the Smiths Medical business as at 31 July 2020 and 31 July 2019 is as follows:

	31 July 2020 £m	31 July 2019 £m
Assets classified as held for distribution to owners:		
Intangible assets	734	746
Property, plant and equipment	141	135
Right of use assets	54	-
Inventories	164	151
Deferred tax assets	14	13
Current tax receivable	3	2
Trade and other receivables	148	138
Cash and cash equivalents	20	26
Financial derivatives	1	5
<b>Assets classified as held for distribution to owners</b>	<b>1,279</b>	<b>1,216</b>
Liabilities classified as held for distribution to owners:		
Financial liabilities		
- borrowings	-	(3)
- lease liabilities	(48)	-
- financial derivatives	(4)	(2)
Trade and other payables	(167)	(137)
Current tax payable	(10)	(11)
Deferred tax liabilities	(53)	(48)
Retirement benefit obligations	(5)	(6)
Provisions for liabilities and charges	(8)	(6)
<b>Liabilities classified as held for distribution to owners</b>	<b>(295)</b>	<b>(213)</b>

### Acquisition of Access Scientific, LLC

On 12 May 2020, Smiths Medical completed the acquisition of 100% of the share capital of Access Scientific, LLC a broad-spectrum vascular access and infection prevention company. The acquisition of Access Scientific, LLC extends Smiths Medical's vascular access product portfolio. The provisional fair values at the date of acquisition are:

	Total £m
Intangible assets- technology and customer relationships	4
Inventories	1
<b>Net assets acquired</b>	<b>5</b>
<b>Goodwill on acquisition</b>	<b>7</b>
Cash paid during the year	12
<b>Total consideration</b>	<b>12</b>

### Contract liabilities from variable consideration agreements

Smiths Medical has a number of agreements with Group Purchasing Organisations and Individual Development Networks offering variable pricing arrangements on sales creating the need for rebates to be paid.

Included within trade and other payables are £41m of contract liabilities relating to variable consideration agreements (FY2019: £51m). These contract liabilities are estimated based on current sales and an applicable erosion rate. The erosion rate is based on historical rebate trends and adjusted for inventory maintained at distributor sites. There has been no recent history of material revisions to this contract liability.

### Intangible assets

The Smiths Medical intangible assets comprise:

	31 July 2020 £m	31 July 2019 £m
Goodwill	564	594
Development costs	140	127
Acquired intangibles	20	17
Software, patents and intellectual property	10	8
<b>Intangible assets</b>	<b>734</b>	<b>746</b>

During the year impairment tests were carried out for capitalised development costs for products that were still under development and acquired intangibles where there were indications of impairment. Value in use calculations were used to determine the recoverability of these assets.

### Intellifuse programme intangible asset

The Smiths Medical development costs above include £80m (FY2019: £64m) for the Intellifuse programme, which is considered to be an individually material intangible asset. Intellifuse is designed to be a multi-generational development programme to deliver a, rackable, stackable, interoperable, and extendable platform for both Large Volume Pumps and Syringe Pumps.

The US Food and Drug Administration (FDA) regulatory clearance path for infusion devices has become more challenging as the FDA has increased general scrutiny on all infusion technologies. During FY2020 Smiths Medical has experienced delays in achieving regulatory clearance for Intellifuse from the US FDA; competitors have also experienced such delays.

Although CE Mark regulatory approval for the sale of Intellifuse in the European Union was achieved in FY2020, the delay in US FDA regulatory clearance together with the assumed timetable of competitor launches has impacted the commercial viability and timelines for the launch of Intellifuse. Management remain confident on the technical feasibility of Intellifuse and the scope of work required to achieve FDA approval. However this delay is considered to be a potential indicator of impairment and therefore a detailed impairment review of the Intellifuse programme has been undertaken.

IAS 36 'Impairment of Assets' states that the recoverable amount of an asset is the greater of its 'fair value less costs to sell' and its 'value in use'. Therefore the impairment review for Intellifuse was completed using a fair value less cost to sell (Fair Value) valuation model. Since valuations of identical assets in active markets are not available, nor are market observables, the valuation is based on assumptions which a third party would use in estimating a fair value in an arm's length sale process.

The result of this impairment testing is that the estimated Fair Value of Intellifuse exceeded the carrying value by £38m. Therefore no impairment charge has been recognised on the Intellifuse programme. This conclusion is supported by a separate impairment review undertaken on a value in use basis.

The Fair Value model utilised for impairment testing used the following key assumptions:

- 9% post-tax discount rate;
- 15.5% tax amortisation benefit;
- 1% cost to sell;
- an additional period of development to gain FDA clearance and prepare for commercial launch;
- 8 year sales forecast focused on North America only, being the expected primary market, excluding for modelling purposes the opportunities from other regions where CE Mark regulatory approval has already been obtained;
- 7 year annuity for related Disposables and Software Licenses in North America; and
- manufacturing and operating expenses priced as if they were outsourced to a third party, based on the third quartile of data points in third party benchmarking studies.

If the assumptions used in the impairment review were changed to a greater extent than as presented in the following table, the changes would, in isolation, lead to an impairment loss being recognised for the year ended 31 July 2020:

	Change required for carrying value to equal recoverable amount
Delay in commercial launch of product	20 month further delay
Post-tax discount rate	+370 bps increase
Volume of sales achieved per annum	-2,650 bps decrease

#### Cash-flow from discontinued operations

Cash-flows from discontinued operations included in the consolidated cash-flow statement is as follows:

	31 July 2020 £m	31 July 2019 £m
Net cash inflow from operating activities	141	149
Net cash-flow used in investing activities	(55)	(28)
Net cash-flow used in financing activities	(83)	(60)
	<b>3</b>	<b>61</b>

Movement in net cash held in disposal group includes £9m of foreign exchange losses, generating a total outflow of £6m.

## Pro-forma balance sheet of the Group excluding Smiths Medical

31 July 2020  
£m

<b>Non-current assets</b>	
Intangible assets	1,564
Property, plant and equipment	218
Right of use assets	94
Financial assets – other investments	19
Retirement benefit assets	516
Deferred tax assets	102
Trade and other receivables	52
Financial derivatives	82
	<b>2,647</b>
<b>Current assets</b>	
Inventories	446
Current tax receivable	46
Trade and other receivables	627
Cash and cash equivalents	366
Financial derivatives	2
	<b>1,487</b>
<b>Total assets</b>	<b>4,134</b>
<b>Current liabilities</b>	
Financial liabilities	(45)
Provisions for liabilities and charges	(55)
Trade and other payables	(527)
Current tax payable	(79)
	<b>(706)</b>
<b>Non-current liabilities</b>	
Financial liabilities	(1,520)
Provisions for liabilities and charges	(276)
Retirement benefit obligations	(139)
Corporation tax payable	(5)
Deferred tax liabilities	(27)
Trade and other payables	(51)
	<b>(2,018)</b>
<b>Total liabilities</b>	<b>(2,724)</b>
<b>Net assets</b>	<b>1,410</b>

## Additional segmental information for discontinued operations

Headline operating profit for discontinued operations is stated after charging depreciation £nil (FY2019: £19m), amortisation £nil (FY2019: £21m) and share based payments £1m (FY2019: £nil). The capital expenditure on property, plant and equipment, capitalised development and other intangible assets for discontinued operations is £46m (FY2019: £45m).

Revenue for the Smiths Medical discontinued operation is analysed by the following product lines: Infusion Systems £323m (FY2019: £307m), Vascular Access £275m (FY2019: £286m) and Vital Care/Other £320m (FY2019: £281m). Revenue by destination and non-current operating assets by location for discontinued operations is shown below:

	Year ended 31 July 2020				Year ended 31 July 2019			
	Americas £m	Europe, Middle East & Africa £m	Asia- Pacific £m	Total £m	Americas £m	Europe, Middle East & Africa £m	Asia-Pacific £m	Total £m
Revenue	488	282	148	<b>918</b>	493	233	148	<b>874</b>
Intangible assets, right of use assets and property, plant and equipment	780	96	53	<b>929</b>	772	64	45	<b>881</b>

Revenue by destination attributable to the United Kingdom was £69m (FY2019: £28m). Revenue earned in the United States of America is significant totalling £438m (FY2019: £447m). Revenue by destination has been selected as the basis for attributing revenue to geographical areas as this is the attribution used by management to review the performance of the business.

Non-current assets located in the United Kingdom total £33m (FY2019: £16m). Significant non-current assets are held in the United States of America totalling £732m (FY2019: £762m).

## 29 CASH-FLOW

### Cash-flow from operating activities

	Year ended 31 July 2020			Year ended 31 July 2019		
	Headline £m	Non- headline £m	Total £m	Headline £m	Non- headline £m	Total £m
Operating profit – continuing operations	327	(86)	241	427	(101)	326
– discontinued operations	184	(23)	161	147	4	151
Amortisation of intangible assets	13	57	70	36	45	81
Impairment of intangible assets	12	-	12	-	-	-
Depreciation of property, plant and equipment	41	-	41	56	-	56
Depreciation of right of use assets	33	-	33	-	-	-
Loss on disposal of property, plant and equipment	3	-	3	4	-	4
Profit on disposal of businesses	-	(1)	(1)	-	(18)	(18)
Share-based payment expense	10	-	10	15	-	15
Retirement benefits*	8	(41)	(33)	7	(6)	1
Decrease/(increase) in inventories	(73)	-	(73)	(52)	4	(48)
Decrease/(increase) in trade and other receivables	76	4	80	(105)	-	(105)
Increase/(decrease) in trade and other payables	49	(2)	47	60	6	66
Increase/(decrease) in provisions	1	-	1	(7)	(19)	(26)
Cash generated from operations	<b>684</b>	<b>(92)</b>	<b>592</b>	<b>588</b>	<b>(85)</b>	<b>503</b>
Interest paid	(57)	-	(57)	(64)	-	(64)
Interest received	7	-	7	6	-	6
Tax paid	(113)	-	(113)	(99)	-	(99)
<b>Net cash inflow from operating activities</b>	<b>521</b>	<b>(92)</b>	<b>429</b>	<b>431</b>	<b>(85)</b>	<b>346</b>
- continuing operations	<b>356</b>	<b>(68)</b>	<b>288</b>	<b>277</b>	<b>(80)</b>	<b>197</b>
- discontinued operations	<b>165</b>	<b>(24)</b>	<b>141</b>	<b>154</b>	<b>(5)</b>	<b>149</b>

\* The retirement benefits non-headline operating cash-flows principally relate to employer contributions to legacy defined benefit and post-retirement healthcare plans.

### Headline cash measures

The Group measure of headline operating cash includes capital expenditure supporting organic growth and excludes interest and tax.

	Year ended 31 July 2020			Year ended 31 July 2019		
	Headline £m	Non- headline £m	Total £m	Headline £m	Non- headline £m	Total £m
<b>Net cash inflow from operating activities</b>	<b>521</b>	<b>(92)</b>	<b>429</b>	<b>431</b>	<b>(85)</b>	<b>346</b>
Include:						
Expenditure on capitalised development, other intangible assets and property, plant and equipment	(110)	-	(110)	(118)	-	(118)
Repayment of lease liabilities	(47)	-	(47)	-	-	-
Disposals of property, plant and equipment	1	-	1	4	-	4
Investment in financial assets relating to operating activities and pensions financing outstanding at the balance sheet date	-	-	-	2	-	2
<b>Free cash-flow</b>			<b>273</b>			<b>234</b>
Exclude:						
Investment in financial assets relating to operating activities and pensions financing outstanding at the balance sheet date	-	-	-	(2)	-	(2)
Repayment of lease liabilities	47	-	47	-	-	-
Interest paid	57	-	57	64	-	64
Interest received	(7)	-	(7)	(6)	-	(6)
Tax paid	113	-	113	99	-	99
<b>Operating cash-flow</b>	<b>575</b>	<b>(92)</b>	<b>483</b>	<b>474</b>	<b>(85)</b>	<b>389</b>

### Headline cash conversion

Headline operating cash conversion for the total Group is calculated as follows:

	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
Headline operating profit - including discontinued operations	511	574
Depreciation and amortisation of held for distribution assets	(45)	-
Pro-forma profit including depreciation and amortisation on held for distribution assets	<b>466</b>	<b>574</b>
Headline operating cash-flow	<b>575</b>	<b>474</b>
<b>Headline operating cash conversion</b>	<b>123%</b>	<b>83%</b>

### Reconciliation of free cash-flow to total movement in cash and cash-equivalents

	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
<b>Free cash-flow</b>	<b>273</b>	234
Acquisition of businesses	(36)	(277)
Disposal of businesses and discontinued operations	1	22
Other net cash-flows used in financing activities (note: repayment of lease liabilities is included in free cash-flow)	(141)	(391)
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>97</b>	<b>(412)</b>

### 30 ALTERNATIVE PERFORMANCE MEASURES

The Group uses several alternative performance measures ('APMs') in order to provide additional useful information on underlying trends and the performance and position of the Group. APMs are non-GAAP and not defined by IFRS; therefore they may not be directly comparable with other companies' APMs and should not be considered a substitute for IFRS measures.

The Group uses these measures, which are common across the industry, for planning and reporting purposes. The measures are also used in discussions with the investment analyst community and by credit rating agencies.

We have identified and defined the following key measures which are used within the business by management to assess the performance of the Group's businesses:

Term	Definition and purpose
Capital employed	Capital employed is a non-statutory measure of invested resources. It comprises statutory net assets and is adjusted to add goodwill recognised directly in reserves in respect of subsidiaries acquired before 1 August 1998 and eliminate post-retirement benefit assets and liabilities and non-headline litigation provisions related to John Crane, Inc. and Titeflex Corporation, both net of deferred tax, and net debt. It is used to monitor capital allocation within the Group. See below for a reconciliation from net assets to capital employed.
Capital expenditure	Comprise additions to property, plant and equipment, capitalised development and other intangible assets, excluding assets acquired through business combinations.
Headline cash conversion ratio	Comprise cash flow from operations before non-headline items as a percentage of headline operating profit. This measure is used to show the proportion of headline operating profit converted into cash flow from operations before investment, finance costs, non-headline items and taxation. The calculation is shown in note 29.
Dividend cover - headline	Dividend cover is the ratio of headline earnings per share, see note 5, to dividend per share, see note 25.
Divisional headline operating profit ('DHOP')	DHOP comprise divisional earnings before central costs, finance costs and taxation. DHOP is used to monitor divisional performance. A reconciliation of DHOP to operating profit is shown in note 1.
Free cash-flow	Free cash-flow is calculated by adjusting the net cash inflow from operating activities to include capital expenditure, the repayment of lease liabilities and proceeds from the disposal of property, plant and equipment. The measure shows cash generated by the Group before discretionary expenditure on acquisitions and returns to shareholders. A reconciliation of free cash-flow is shown in note 29.
Gross debt	Gross debt is total borrowings (bank, bonds and lease liabilities). It is used to provide an indication of the Group's overall level of indebtedness.
Gross vitality	Gross vitality is calculated as the percentage of revenue over the last 12 months derived from new products and services launched in the last three years.
Headline	The Group has defined a 'headline' measure of performance that excludes material non-recurring items or items considered non-operational/trading in nature. Items excluded from headline are referred to as non-headline items. This measure is used by the Group to measure and monitor performance excluding material non-recurring items or items considered non-operational. See note 3 for an analysis of non-headline items.
Headline EBITDA	EBITDA is a widely used profit measure, not defined by IFRS, being earnings before interest, taxation, depreciation and amortisation. A reconciliation of headline operating profit to headline EBITDA is shown in the note below.
Net debt	Net debt is total borrowings (bank, bonds and lease liabilities) less cash balances and derivatives used to manage the interest rate risk and currency profile of the debt. This measure is used to provide an indication of the Group's overall level of indebtedness and is widely used by investors and credit rating agencies. See note 18 for an analysis of net debt.
Non-headline	The Group has defined a 'headline' measure of performance that excludes material non-recurring items or items considered non-operational/trading in nature. Items excluded from headline are referred to as non-headline items. This is used by the Group to measure and monitor material non-recurring items or items considered non-operational. See note 3 for an analysis of non-headline items.
Operating cash-flow	Comprise free cash-flow and excludes cash-flows relating to interest and taxation. The measure shows how cash is generated from operations in the Group. A reconciliation of operating cash-flow is shown in note 29.
Operating profit	Operating profit is earnings before finance costs and tax. A reconciliation of operating profit to profit before tax is shown on the income statement. This common measure is used by the Group to measure and monitor performance.
Headline operating profit excluding restructuring and write-downs	Headline operating profit is adjusted for strategic restructuring programme costs and write-downs. See note 2 for a reconciliation.

Ratio of capital expenditure to depreciation and amortisation	Represents the amount of capital expenditure as a proportion of the depreciation and amortisation charge for the period. This measure shows the level of reinvestment into operations.
Return on capital employed ('ROCE')	Smiths ROCE is calculated over a rolling 12-month period and is the percentage that headline operating profit represents of the monthly average capital employed on a rolling 12-month basis. This measure of return on invested resources is used to monitor performance and capital allocation within the Group. See below for Group ROCE and note 1 for divisional headline operating profit and divisional capital employed.
Total Group stock turns	Total Group stock turns during the year is calculated as the last 12 month cost of sales divided by the 12 month average inventory. This measure is included as a key performance indicator of the Group to measure the efficiency of the Group
Underlying	Underlying measures are calculated by excluding the effects of foreign exchange, disposals and acquisitions, strategic restructuring programme costs and write-downs (see note 2), and to include depreciation and amortisation charges for Smiths Medical. Underlying measures are used by the Group to monitor performance.
Working capital	Working capital is calculated as the sum of the 12-month rolling average of inventory, trade receivables, contract assets, trade payables and contract liabilities.

### Capital employed

Capital employed is a non-statutory measure of invested resources. It comprises statutory net assets adjusted to add goodwill recognised directly in reserves in respect of subsidiaries acquired before 1 August 1998 of £787m (FY2019: £787m) and eliminate post-retirement benefit assets and liabilities and non-headline litigation provisions related to John Crane, Inc. and Titeflex Corporation, both net of related tax, and net debt.

	Notes	31 July 2020 £m	31 July 2019 £m
<b>Net assets</b>		<b>2,394</b>	<b>2,381</b>
Adjust for:			
Goodwill recognised directly in reserves		787	787
Post-retirement benefit assets and liabilities	8	(372)	(311)
Tax related to post-retirement benefit assets and liabilities		70	55
John Crane, Inc. litigation provisions and related tax	23	172	187
Titeflex Corporation litigation provisions and related tax	23	50	56
Net debt (including £28m of net debt in discontinued operations (FY2019:£23m cash))	18	1,141	1,152
Derivatives managing interest rate and currency profile of the debt in the prior year*		-	45
<b>Capital employed</b>		<b>4,242</b>	<b>4,352</b>

\*The Group's definition of net debt has been updated in FY2020 to include the fair value of derivatives used for the management of interest rate and currency profile. The calculation basis for capital employed in FY2019 has not been represented for this change.

### Return on capital employed

	Notes	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
Headline operating profit for previous 12 months – including discontinued operations		511	574
Average capital employed	1	4,315	3,972
<b>ROCE</b>		<b>11.8%</b>	<b>14.4%</b>

### Credit metrics - total Group including discontinued operations

Smiths Group monitors the ratio of net debt to headline EBITDA as part of its management of credit ratings, see note 26 for details. This ratio is presented for the whole Group, including discontinued operations, and is calculated as follows:

#### Headline earnings before interest, tax, depreciation and amortisation (headline EBITDA)

##### - total Group including discontinued operations

	Notes	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
<b>Headline operating profit</b>		<b>327</b>	<b>427</b>
Include:			
– headline operating profit of discontinued operations	28	184	147
Exclude:			
– depreciation of property, plant and equipment	12	41	56
– depreciation of right of use assets	13	33	-
– amortisation and impairment of development costs	10	18	23
– amortisation of software, patents and intellectual property	10	7	13
<b>Headline EBITDA</b>		<b>610</b>	<b>666</b>

£1m of software amortisation was charged to restructuring projects and treated as a non-headline cost.

#### Ratio of net debt to headline EBITDA – total Group including discontinued operations

	Notes	Year ended 31 July 2020 £m	Year ended 31 July 2019 £m
Headline EBITDA		610	666
Net debt – incl. £20m of net cash and £48m lease liabilities in discontinued operations (FY2019: £23m cash)	18	1,141	1,197
<b>Ratio of net debt to headline EBITDA</b>		<b>1.9</b>	<b>1.8</b>

## 31 POST BALANCE SHEET EVENTS

Details of the delayed interim dividend and proposed final dividend announced since the end of the reporting period are given in note 25.

In August 2020, Smiths Detection completed the acquisition of PathSensors Inc, which complements and accelerates its biological capability to detect pathogens for broad end-market applications.