News release

London, Wednesday 14 March 2012

For immediate release

Interim results for the half year ended 28 January 2012

	Headline*				Statutory	
	2012 £m	2011 £m	Growth	Underlying#	**2012 £m**	2011 £m
Continuing activities						
Revenue	**1,415**	1,372	3%	1%	**1,407**	1,372
Operating profit	**244**	239	2%	2%	**132**	208
Operating margin	**17.2%**	17.4%	(20) bps	–	**9.4%**	15.2%
Pre-tax profit	**217**	212	2%	2%	**111**	189
Basic EPS	**40.4p**	39.9p	1%		**21.4p**	35.7p
Free cash-flow	**81**	70				
Dividend	**11.75p**	11.25p	4%		**11.75p**	11.25p
Return on capital employed	**16.0%**	16.6%	(60) bps			

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

#Organic growth at constant currency.

Highlights

- Resilient performance in a difficult trading environment
- Headline revenue up 3%; headline operating profit up 2%
- Continued investment in new products and new markets driving growth
- Emerging market sales up from 12.5% to 15% of Group sales
- Good headline margin progression in John Crane, Smiths Medical and Flex-Tek
- Performance improvement initiatives on track in Smiths Detection; improving order book
- Improved headline operating cash conversion at 82% – with free cash-flow of £81m
- Dividend up 4%

"The Group has made good progress despite the challenging economic environment, particularly for businesses serving government-funded customers such as Smiths Detection and Smiths Interconnect, where performance has been disappointing. Remediation in Smiths Detection is on track, although the benefits will be weighted to the second half. Elsewhere, John Crane continues to report strong growth driven by investment in oil and gas infrastructure. Performance at Flex-Tek was encouraging and Smiths Medical has been resilient against a tough trading backdrop. Our results continue to benefit from restructuring initiatives and operational improvements. These savings are being reinvested to build a solid foundation to accelerate medium-term revenue growth.

"We have increased our focus on top-line growth through new product development, sales effectiveness, expansion of our emerging market exposure and targeted acquisitions. The trading environment remains uncertain and sustained pressures on government spending are likely to affect some of our divisions. However, we continue to see further potential to grow sales, drive operational improvements and deliver strong cash conversion. We remain confident of meeting expectations for the full year."

Philip Bowman
Chief Executive

Divisional highlights*

	% of Group headline sales	Underlying headline sales growth*	Underlying headline profit growth*	Headline operating profit margin		Headline return on capital employed	
				2012	2011	**2012**	2011
John Crane	33%	**13%**	**24%**	**20.9%**	19.0%	**23.8%**	20.5%
Smiths Medical	29%	**(1)%**	**4%**	**23.5%**	22.6%	**17.3%**	16.0%
Smiths Detection	16%	**(11)%**	**(36)%**	**9.3%**	13.9%	**7.6%**	13.0%
Smiths Interconnect	14%	**(6)%**	**(29)%**	**13.1%**	18.1%	**12.8%**	17.4%
Flex-Tek	8%	**2%**	**36%**	**15.5%**	11.6%	**25.1%**	20.6%
Group	100%	**1%**	**2%**	**17.2%**	17.4%	**16.0%**	16.6%

John Crane
- Sales driven by growth in both original equipment and aftermarket revenue, particularly in the oil and gas sector
- Margins improved 190 basis points to 20.9%, benefiting from increased volumes
- TCE acquisition completed and integration well underway; expands our bearings aftermarket offering
- Strong order book supports growth for the full year in sales and margins

Smiths Medical
- Margins up 90 basis points to 23.5% through cost saving initiatives and mix benefits despite some price pressure
- Tough operating environment with healthcare spend squeezed by government budgets and unemployment
- Increased investment in sales capabilities in emerging markets and new product development
- Investment will step up further during the second half; which is expected to support future sales growth

Smiths Detection
- Revenue declined reflecting reduced demand in most sectors, particularly military and ports & borders
- Margins affected by lower volumes, restructuring costs and the impact of historic low margin contracts
- Performance improvement programme on track; delivered £5m of savings from £40m target by FY 2014
- Full year sales expected to be similar to last year, margins will benefit from restructuring initiatives
- Strong product pipeline and significant contract wins lay a solid foundation for 2013

Smiths Interconnect
- Sales affected by lower sales in military and connectors offsetting growth in telecoms
- Margins reduced by lower volumes, operational gearing, adverse pricing/mix and restructuring costs
- Integration of Power Holdings, Inc. is on track, expanding our product offering into new markets
- Several new contract wins and contract phasing is expected to support some improvement in second half sales
- Second half margins are expected to benefit from better volumes and restructuring

Flex-Tek
- Improved volumes, mix and pricing contributed to a strong increase in margins
- Sales growth driven primarily by the aerospace sector and with modest growth in US residential construction
- Fluid management is expected to see continued growth while construction and appliances markets are uncertain
- Margins are geared to volume improvements across Flex-Tek's end markets

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

Contact details

Investor enquiries

Peter Durman, Smiths Group
+44 (0)20 7808 5535
+44 (0)7825 145336
peter.durman@smiths.com

Media enquiries

Colin McSeveny, Smiths Group
+44 (0)20 7808 5534
colin.mcseveny@smiths.com

Anthony Cardew, Cardew Group
+44 (0)20 7930 0777
anthony.cardew@cardewgroup.com

Presentation

The presentation slides and a live webcast of the presentation to analysts are available at www.smiths.com/results at 09.00 (UK time) on Wednesday 14 March. A recording of the webcast is available later that day. A live audio broadcast of the presentation is also available by dialling (no access code required):

UK toll free: 0800 368 1916

International: +44 (0)20 3140 0722

US/Canada toll free: 1 855 716 1594

An audio replay is available for seven days on the following numbers (access PIN 382043#):

UK toll free: 0800 368 1890

International: +44 (0)20 3140 0698

US/Canada toll free: 1 877 846 3918

Photography

Original high-resolution photography and broadcast quality video is available to the media from the media contacts above or from http://www.smiths.com/images.aspx.

Statutory reporting

Statutory reporting takes account of all items excluded from headline performance. On a statutory basis, pre-tax profit from continuing operations was £111m (2011: £189m) and earnings per share were 21.4p (2011: 35.7p).

The items excluded from headline performance comprise:

- amortisation of acquired intangible assets of £25m (2011: £22m);
- £18m in connection with John Crane, Inc. asbestos litigation (2011: £5m);
- £52m for the establishment of a provision to resolve potential future claims alleging product liability in Titeflex Corporation (2011: nil);
- £12m of exceptional restructuring costs (2011: £5m);
- £8m in relation to a change in the basis of estimating sales rebates;
- acquisition costs of £2m (2011: £1m);
- £1m profit on disposal of businesses (2011: nil);
- £11m for retirement benefit finance income (2011: £12m); and
- financing losses of £1m (2011: £2m).

Chief Executive's review

The Group continued to make solid progress against a challenging economic environment, gaining further benefits from its programme of operational improvements. These results also demonstrate the overall strength and breadth of our diversified portfolio of businesses. In summary, overall headline sales and profitability benefited from organic growth in John Crane and Flex-Tek and recent acquisitions. These more than offset sales declines in our businesses with exposure to government-funded customers, particularly Smiths Interconnect and Smiths Detection. In these businesses, constraints on government spending in areas such as defence have held back the Group's overall sales and profit performance. Smiths Medical delivered further margin improvement despite sustained tough trading conditions for medical devices. We continue to see gains from our Group-wide restructuring initiatives and we are now delivering the initial cost savings from the performance improvement programme in Smiths Detection. At this early stage, Detection's margins are bearing some of the costs while the benefits will be weighted towards the second half and next financial year. Across the Group, we remain focused on delivering against our four key financial criteria: driving sales growth, enhancing margins, generating cash and improving returns.

Investing in sales growth

We have increased our focus on investment in new product development and innovation, a key driver of future sales and margin growth as new products typically command higher margins and deliver superior returns. We increased company-funded investment in R&D by 1% to £50m and secured a further £5m of customer-funded investment to bring our total spend to £55m, or 3.9% of sales (2011: 4.0%). This is a long-term commitment that is delivering new product launches across the Group. Smiths Detection is scheduled to unveil a record number of products over the next 18 months. Two notable launches already achieved are RadSeeker, a new radiological detector that has received its first order from US homeland security, and GUARDION, our first portable chemical identifier to use gas chromatography/mass spectrometry technology. The development of a next generation explosives detection system for screening airport checked baggage, in co-operation with Analogic Corporation, is meeting our programme milestones. In Smiths Medical, one of our largest recent product developments, Medfusion™ 4000, received FDA 510(k) clearance in September enabling a US launch which should benefit the second half. New product sales are also gaining from the recent introduction of Graseby pumps in the emerging markets and CADD®-Solis VIP in Europe. Through new product development, John Crane has continued to enhance its portfolio of environmentally focused seals and extend the high pressure capabilities of its compressor dry gas seals. John Crane's strategy to broaden its portfolio outside mechanical seals in product lines such as bearings and filters is also delivering results, with these products growing at 16% in the period.

We have also directed investment into improving our capabilities in the emerging markets. For example, in Smiths Medical we intend to recruit an additional 300 employees this fiscal year into targeted markets to build our sales opportunities. John Crane continued to build out its service network and test rig capacity around the world, with new or expanded facilities in the Middle East, Asia and Latin America, as well as in the developed markets. It has also broadened its product offering in China. Smiths Detection plans to establish a manufacturing facility in Asia during the second half in order to serve the fast-growing local market better and benefit from the lower costs. Overall, emerging market sales for the Group grew 24%, so that they now represent around 15% of total sales.

Enhancing margins and cash generation

Margins remain a key focus and have continued to benefit from the major restructuring programme that began in 2008, delivering further savings of £5m in the period. To date, we have generated savings of £61m against our total planned savings of £70m when completed next financial year.

The full year results will also benefit from the performance improvement programme underway in Smiths Detection. It is expected to deliver annualised savings of £40m by the end of financial year 2014, at a cost of £40m. We have delivered £5m of the £15m savings that we expect this year. These initiatives will lower the fixed cost base and make the business better able to respond to variations in demand while improving customer service.

Headline operating cash generation improved by £15m to £201m resulting in a headline operating cash conversion of 82%. We expect the cash conversion at the full year to be in the range of 90-100%.

Managing our legacy liabilities

We manage two areas of material historic liabilities: actuarial deficits on our defined benefit pension plans and ongoing product liability litigation.

The net funding position for the pension schemes has deteriorated in recent years as a result of increased liabilities caused by low bond yields (exacerbated by quantitative easing) and increased longevity, and the poor asset performance of equities versus gilts. Since the end of July, the accounting deficit has deteriorated by £260m to £459m, primarily reflecting further declines in bond discount rates. Over recent years, the Group has taken steps to minimise this liability by closing the defined benefit schemes and capping obligations for post-retirement health benefits. In addition, the Group agreed 10-year funding plans with the UK Trustees and these plans will be reviewed at the next triennial review commencing in March 2012.

For more than 30 years, John Crane, Inc. ("JCI"), a US subsidiary of John Crane, has defended product liability litigation relating to various sealing products containing asbestos that JCI ceased making in 1985. We disclose in our accounts details of recent claims experience and of the provisions established for these liabilities. During the period, the number of claims in which JCI is a defendant continued to fall.

Over recent years, Titeflex Corporation, a subsidiary of Flex-Tek, has also experienced subrogated product liability claims relating to alleged defects in its flexible gas piping products. The number of claims received each year and the cost of resolving them has varied. The associated costs of between £3m and £5m a year have historically been charged against headline profit. Equivalent third party products in the US marketplace face similar challenges with the profile of legal activity appearing to increase in recent times. The continuing progress of claims and the pattern of settlement, together with the recent marketplace activity, now provide sufficient evidence to recognise a provision in these accounts to defend potential future claims over the next 10 years. This has resulted in an exceptional charge of £52m. Titeflex believes that its products are a safe and effective means of delivering gas when installed in accordance with manufacturer's instructions and local and national codes. Further details are given in notes 4 and 12 to the accounts.

Dividend

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

The Board has declared an interim dividend of 11.75p per share, an increase of 4%. The interim dividend will be paid on 20 April to shareholders registered at the close of business on 23 March. The ex-dividend date is 21 March.

Outlook

The economic environment remains uncertain and continued pressures on government spending are likely to affect some of our divisions. However, we still see further potential to grow sales, drive operational improvements and deliver strong cash conversion. We remain confident of meeting expectations for the full year. Outlook statements for the divisions are provided in the Business review.

Business review

Revenue

Headline revenue increased by 3%, or £43m, to £1,415m. The net impact of acquisitions and disposals contributed £24m and currency translation added another £6m. On an underlying basis, excluding currency translation and acquisitions, sales grew 1%, or £13m. This underlying increase was driven primarily by strong growth at John Crane (up £55m), and Flex-Tek (up £2m) that more than offset sales declines in Smiths Detection (down £28m), Smiths Interconnect (down £11m) and Smiths Medical (down £5m). Reported revenue at £1,407m includes a one-off adjustment of £8m in respect of a change in basis of estimating customer rebates at Smiths Medical (see note 4 to the accounts for further details). This change has been prompted by the availability of better data and estimation techniques.

Profit

Headline operating profit rose £5m to £244m comprising a £4m, or 2%, underlying increase in headline operating profit and £1m benefit from the net impact of acquisitions and disposals. The main drivers of this £4m underlying improvement were higher volumes and cost savings at John Crane (up £19m), higher volumes, prices and mix at Flex-Tek (up £5m), operational efficiencies at Smiths Medical (up £3m), partly offset by lower volumes and adverse mix at both Smiths Detection (down £13m) and Smiths Interconnect (down £10m). Smiths Detection's profitability was also held back as it began its restructuring programme and charged £3m of costs to headline operating profit. Corporate centre costs were broadly in line with last year. Group headline operating margin fell slightly to 17.2% (2011: 17.4%).

Operating profit on a statutory basis, after taking account of the items excluded from the headline figures, was £132m (2011: £208m). The reduction in operating profit is due to exceptional items of £88m (2011: £8m – see note 4 to the accounts).

The net interest charge on debt increased slightly to £31m (2011: £29m), reflecting the higher average levels of debt. Contribution from associates increased by £2m to £4m. As a result, headline profit before tax increased by £5m to £217m (2011: £212m). On an underlying basis, headline profit before tax grew by 2%. Headline pre-tax profit now excludes the pension finance credit and the comparative figures have been restated accordingly.

The Group's tax rate on headline profit for the period was 26.5% (2011: 26.0% - restated). Headline earnings per share increased by 1% to 40.4p (2011: 39.9p).

On a statutory basis, pre-tax profit was £111m (2011: £189m); it was stated after taking account of the pensions finance credit of £11m (2011: £12m) and other items excluded from the headline measure.

Cash generation

Operating cash generation remained strong with headline operating cash of £201m (2011: £186m) representing 82% (2011: 78%) of headline operating profit (see note 14 to the accounts for a reconciliation of headline operating cash to statutory cash-flow measures). Free cash-flow improved £11m to £81m (2011: £70m). Free cash-flow is stated after interest and tax but before acquisitions, financing activities and dividends.

On a statutory basis, net cash inflow from continuing operations was £133m (2011: £107m).

Dividends paid in the period on ordinary shares amounted to £98m (2011: £92m).

Net debt at 28 January was £957m, up from £729m at 31 July 2011. The increase in net debt reflects the net effect of acquisitions and disposal (£168m) and dividends (£98m).

Divisional review

The divisional performances are reviewed below in descending order of their size by revenue.

John Crane

	2012 £m	2011 £m	Reported growth	Underlying growth
Sales	**469**	412	14%	13%
Headline operating profit	**98**	79	25%	24%
Headline operating margin	**20.9%**	19.0%	190 bps	
Statutory operating profit	**75**	68		
Return on capital employed	**23.8%**	20.5%	330 bps	

John Crane grew sales by £57m (13.8%) reflecting a £55m (13%) underlying increase in revenue and a £2m benefit from the acquisition of the business of Turbo Components and Engineering Inc. (TCE), which completed in October 2011. Higher sales for first-fit original equipment and increased aftermarket revenue across all end markets, particularly oil, gas and petrochemical, drove the underlying growth.

Reported headline operating profit rose 25% driven by a £19m (24%) increase in underlying profit and a £1m contribution from TCE, offset by adverse currency translation (£1m). Margins increased 190 basis points to 20.9% from the prior year. The profitability improvement stems from increased volumes, benefits from our cost-saving initiatives and better pricing on aftermarket sales. These were partly offset by adverse mix as a result of faster growth in first-fit original equipment sales. Investment in lower margin original equipment projects which are expected to deliver long-term aftermarket revenues also slightly constrained the improvement. Return on capital employed rose 330 basis points to 23.8% on the back of the improved profitability.

On an underlying basis, overall aftermarket sales grew 12%, benefiting principally from strong demand in the oil, gas and petrochemical sectors. Aftermarket revenue from rotating equipment (seals, seal support systems, couplings, bearings and filtration, together representing 89% of sales) increased 11% with growth across all sectors. Sales for John Crane Production Solutions, our upstream energy services business (JCPS, representing 11% of sales), advanced 15% as a result of greater activity in US onshore gas and oil production.

First-fit original equipment revenue rose 16% on an underlying basis as customers continued to invest in new capital projects. We saw growth in activity across the globe, primarily centred on the oil, gas and petrochemical sectors. Despite some pricing pressure, we continue to invest heavily in certain original equipment projects around the world to ensure a robust pipeline of future aftermarket activity.

Our sales and service network continues to expand in response to growing market demands in all regions. Service centres have opened in Arizona and Alaska in the USA, and our first service centre in Turkey is due to open in summer. In the UK, the relocated and expanded Aberdeen service centre became operational in December 2011, offering condition monitoring expertise and product servicing capabilities. In Western Australia a new sales and service facility opened to support the oil and gas, and minerals and mining industries. The greatly expanded Dubai facility was officially opened in February 2012. It houses one of the world's largest gas seal test rigs, allowing customers to watch testing on site or online. Full service including diagnostic, inspection and refurbishment capabilities for all seals is now available at the Dubai facility which also features a new central parts warehouse serving the Middle East and Africa.

Expansion of manufacturing of the 'Safematic' and metal bellows seal lines in China continued with the recent introduction of a seal line for pipelines. Our presence in China has also grown with the opening of a new training facility and the upgrade, relocation and opening of three other service facilities. In March 2012, expansion work began on the Rio Claro plant in Sao Paolo, Brazil, for the manufacture of the American Petroleum Institute (API) standard seal system reservoirs and Indufil filters to meet local customer requirements.

Research and development

Approximately £5m in research and development has been invested in improved materials, emission control seals, condition monitoring, and in expanding the performance range of our high duty couplings, hydrodynamic bearings and gas seal product lines. This includes development of a gas seal compliant with the new API 692 specification which addresses critical operating conditions associated with slow roll, use of seal face coatings and bi-directional capabilities. Other new product investment targets high duty slurry seals and un-cooled boiler feed water seals developed for "green" applications within the expanding Power Generation industry. As process industries strive to reduce their carbon footprint, John Crane has invested significantly in developing a new test rig that advances the measurement of seal energy consumption. This will promote design enhancements that both minimise energy requirements and environmental impact.

To support advanced material development projects and further improve our forensics capabilities, we have invested in a new scanning electron microscope to help us precisely analyse material properties in support of research activities. It will also provide critical and timely information to our customers by analysing problematic field applications and reliability solutions. We continue to invest in developing seal interface groove technologies, diamond coatings, surface texturing, and nano-composites to improve performance in difficult-to-seal environments.

As a leader in the design and application of hydrodynamic bearings, John Crane Bearing Technologies has not only invested in a major test facility in Gottingen, Germany, but also now joined the Texas A&M Turbomachinery Research Consortium. This gives access to and collaboration with academic experts in the field of bearings and rotor dynamics, specialised test facilities, and state-of-the-art analytical design software.

All John Crane's R&D initiatives focus firmly on improving the overall reliability, safety, environmental compliance and up-time of our customers rotating equipment and plants which use our products. Following a strategic review of our new product development opportunities, we are embarking on initiatives that are expected to deliver an increase in R&D investment of about 15% annually over the next few years.

Business developments

Building on a globally established market leading position in mechanical seals, we have expanded addressable market opportunities by developing closely aligned new product lines in hydrodynamic bearings, power transmission couplings and filtration systems. These new product lines now represent about 16% of our total rotating equipment product sales revenue, and achieved organic sales growth of over 14% in the first half. An emphasis on cross selling and aftermarket penetration of the OEM bearings and filtration businesses is now generating significant new gas filtration system upgrade opportunities in the Middle East. It has also resulted in several large filter element spares orders in Latin America. Integration of TCE is progressing well and sets the foundation for the future growth of our bearings aftermarket services.

John Crane's customer-centric focus on local service excellence and technical expertise combine to achieve maximum equipment reliability and plant up-time which ultimately drive production performance and customer profitability.

Outlook

John Crane's order rate remains strong and is expected to support sales growth in the second half, although the rate of growth is expected to ease against a strong comparator period. Margins will benefit from the additional volume and the full year impact of the cost saving initiatives. However, we will continue to make strategic investments in longer term growth opportunities such as the expansion of our sales and service network, targeted large first-fit installation projects and greater presence in growth markets.

Smiths Medical

	2012 £m	2011 £m	Reported growth	Underlying growth
Headline sales	**417**	418	0%	(1)%
Headline operating profit	**98**	94	4%	4%
Headline operating margin	**23.5%**	22.6%	90 bps	
Statutory sales	**409**	418	(2)%	
Statutory operating profit	**82**	85		
Return on capital employed	**17.3%**	16.0%	130 bps	

Smiths Medical's headline operating profit rose 4% (£4m) and headline operating margin increased 90 basis points to 23.5%. Margins benefited from our ongoing initiatives to cut manufacturing costs and overheads, as well as a favourable product mix.

At reported exchange rates, sales were broadly flat with £4m of positive foreign currency translation offset by a £5m (1%) decline in underlying sales. The slight fall reflected difficult trading conditions in the medical devices sector. These stemmed from adverse pricing and capital spending constraints in some countries and a slowdown in procedure growth rates in the US and Europe because of economic pressures and unemployment. These pressures were particularly acute in Europe given the prevailing austerity measures and economic uncertainty. In addition, flooding in Thailand temporarily halted supplies of large volume infusion pump disposable sets to the European market, which is expected to have some residual impact in the second half. Overall consumables sales, which represent almost 85% of our total revenue, were flat despite continued erosion of diabetes disposables (£1m) and an additional £5m decline from product areas such as patient monitoring and kitting, where we continue to focus on more profitable product lines. Hardware sales fell 5%, largely due to the timing of infusion pump shipments, as well as the tougher trading environment.

Headline sales and operating profit both exclude an £8m charge which reflects our decision to change the basis for estimating the accrual for rebates to distributors. This change has been prompted by the availability of better data and estimation techniques.

Return on capital employed improved 130 basis points to 17.3% as a result of the increased profits.

While developed markets remain challenging, emerging markets continue to provide growth opportunities as the quality of and access to healthcare improves. We are expanding our efforts and presence in these markets. We intend adding approximately 300 headcount this year into selected countries, including China, Brazil, India, and various Southeast Asia and Middle East markets in order to leverage our broad product portfolio more effectively. We are already seeing early signs of success from this strategy, with robust sales growth in the first half in markets such as India (up 40%) and Latin America (up 11%).

Sales of safety devices grew 2%, primarily due to the strong performance of safety needles and arterial blood sampling devices in many developed and emerging markets, as well as improved safety catheter sales in the US. Interest in both safety needle and catheter products remains high in developed markets and is growing in emerging markets. In Europe, Smiths Medical is also well placed to benefit from the EU Directive, adopted in 2010, to improve workplace safety by preventing sharps injuries. In addition, we have seen a recovery in vascular access, particularly huber needles (3%) and central venous catheters (10%), in most markets.

Medication delivery sales, excluding diabetes, declined 3%. Ambulatory infusion sales grew 2% through the continued success of our CADD®-Solis pumps and dedicated disposable sets. However, revenues from our infusion disposables declined, reflecting the Thai supply disruption. Also, sales of Medfusion™ 3500 syringe pumps slowed ahead of the February 2012 launch of the Medfusion™ 4000 wireless pump and platform. Our Medfusion™ 4000 order pipeline is strong and we are well positioned for growth in this market.

Vital care underlying sales declined 2% amid continued sluggish procedure volumes in developed countries and reimbursement pricing pressure in Japan. The assisted reproduction business grew by 19%, while the temperature management, general anaesthesia, invasive blood pressure monitoring, respiratory and tracheostomy businesses all contributed single digit growth. These gains were offset by declines in patient monitoring and kitting product lines where we have continued to eliminate low margin stock-keeping units.

We also continue to optimise our manufacturing and distribution footprint to deliver a more efficient supply chain. At the beginning of this fiscal year, the operational responsibility for our European distribution centre in Nijmegen, Netherlands, was brought in-house to reduce costs and improve performance. Our operational footprint strategy of enhancing regional manufacturing is supporting our growth in emerging markets, and we will consider selective investment in China, Eastern Europe and Brazil over the next few years. We continue to pursue variable cost productivity initiatives aggressively, which have contributed to margin expansion and enabled further investment in sales and marketing resources.

Research and development
Investment in R&D remains a priority. Our total first half R&D spend of £16m (2011: £16m) amounted to 3.8% of sales (2011: 3.7%). At the same time, we have launched an initiative to streamline the organisation, upgrade talent, improve processes and invest in emerging market R&D in particular, expanding our product development team in Shanghai.

Revenue from products launched in the last three years represented 8% of sales, partially driven by the launches of our Graseby 2000/2100 large volume pumps in emerging markets and the CADD®-Solis VIP in Europe. The recent North American launch of Medfusion™ 4000 leaves us well positioned to support further growth in the important hospital syringe pump segment. Likewise, our neuraxial safety device, CorrectInject®, has launched in the UK and represents an important new product line in our pain management business. In addition to new launches, we are also extending the penetration of existing products into new regions, broadening our offering particularly in emerging markets.

Outlook
While developed markets are expected to remain challenging in the short term as healthcare cost controls and persistent unemployment put pressure on price and volumes, we will continue to seek cost saving initiatives such as value engineering and footprint optimisation. These will help fund investments in new product development and further expansion of sales and marketing resources in growth markets. Emerging market revenues are expected to continue to grow strongly, albeit from a small base, and we expect to generate significant growth as our investments gain further traction.

Smiths Detection

	2012 £m	2011 £m	Reported growth	Underlying growth
Sales	**220**	248	(11)%	(11)%
Headline operating profit	**20**	34	(41)%	(36)%
Headline operating margin	**9.3%**	13.9%	(460) bps	
Statutory operating profit	**9**	33		
Return on capital employed	**7.6%**	13.0%	(540) bps	

Reported sales at Smiths Detection declined 11% as underlying revenue fell £28m. A £2m gain from foreign currency translation was offset by a £2m net impact from acquisitions and disposals. Underlying sales fell mainly because of government budget cuts around the world, most notably affecting the military sector. A significant majority of sales are influenced by more than 100 governments and their agencies. The impact offset strong growth in certain other markets, notably in critical infrastructure and in the emerging markets.

Servicing the market-leading installed base of our equipment is also providing growth opportunities. A greater focus led to a 9% increase in aftermarket sales in the first half of the year.

Operating margins fell 460 basis points to 9.3% as headline operating profit declined by £13m on an underlying basis. This was driven by the fall in sales volumes, restructuring costs of £3m charged against headline operating profit, the impact of some low margin contracts negotiated in previous years and an unfavourable product mix from reduced military sales. A major cost reduction programme is starting to deliver benefits and will contribute even more in the second half as implementation gathers pace. This, combined with anticipated sales growth, should lead to better margins in the remainder of the year. The profitability decline also caused the 540 basis point fall in return on capital, to 7.6%.

The performance improvement programme, announced at the start of the period, is expected to deliver £40m of annualised savings by the end of the 2014 fiscal year and is on target to deliver benefits of £15m this year. The programme will cost £40m, of which £33m will be treated as an exceptional item over three years. The remaining £7m will be charged against headline operating profit this financial year, of which £3m was incurred in the first half.

Site rationalisation and headcount reduction, notably in the US with closure of a major office in New Jersey already announced, has begun. Value engineering projects are being widely adopted and a close focus on daily operating expenditure is delivering significant savings. A new production facility for X-ray systems will be opened in Asia-Pacific, giving Smiths Detection a local supply of its core technology into the world's fastest growing air transportation market. Production at the plant will begin this calendar year. Wiesbaden, Germany, will remain as a major production centre and the R&D centre of excellence for X-ray technology. Production of X-ray systems has already been established in the US as part of our global development strategy to create a flexible manufacturing base, where customer proximity provides a major competitive advantage.

Transportation sales were in line with last year despite depressed investment by most airport operators and governments. The US Transportation Security Administration budget approval process was significantly delayed and project investment levels were much reduced for 2012. However, in Europe some operators have decided to invest in current standard explosives detection equipment for hold baggage and freight, ahead of the introduction of new legislation requiring upgraded X-ray systems.

In contrast, delays in adopting a uniform standard in Europe for detecting liquids in hand luggage slowed re-investment in the latest technologies. The new deadline of April 2013 should allow screened liquids to be carried on to aircraft without the need for containers to be opened. Where investment is taking place, our Advanced Threat Identification X-ray (aTiX) system, the first to receive EU Standard 2 Type C certification, is the clear system of choice. Around 50 aTiX machines were ordered by Frankfurt International Airport. A larger version of the scanner gained EU Explosive Detection Systems approval for hold luggage.

Underlying revenue from critical infrastructure grew 21% as greater focus on the market, supported by increased sales resources, helped secure contracts in various regions. These included the first sale of the new radiation detector, RadSeeker, a $4.5m order from the U.S. Domestic Nuclear Detection Office. More than 150 security systems, including X-ray scanners, trace detectors and people-screening systems, were supplied to the prison service in Argentina.

Underlying sales in ports and borders fell some 26%, reflecting lower levels of government spend. Recent market activity is strong, with enquiry levels and backlog improving markedly as countries recognise the revenue-generating potential from better contraband detection as well as strengthened border security. Major contracts for high energy cargo scanners were awarded by Nigeria and Cayman. The latter has provided the customs department with the most sophisticated systems now operating in the Caribbean to deter the regional flow of weapons, narcotics and contraband.

Underlying military sales fell 42% due to extended phasing of major contracts and cuts in military budgets. A drop in the number of conflicts involving US and international forces has seen military spending revert to more normal levels and fewer programmes implemented. However, production has continued on the latest JCAD (Joint Chemical Agent Detector) for the US Army, under our main long-running military contract. Activity in some major integrated programmes remains at encouraging levels.

At the start of the second half of the year, the US Navy announced the award of a $9 million contract for our mobile weather information systems which support mission planning and military operations.

Research and development

Smiths Detection remains committed to the funded development of its principal technologies and new products and systems, the great majority funded and managed internally. Company funded R&D held steady at £17m although it increased as a percentage of sales to 7.6% (2011: 7.0%). This includes £7m of capitalised projects. Smiths Detection actively seeks customer and government support for R&D which totalled £3m in the period (2011: £4m). Total R&D spend was £20m (2011: £21m) or 9.1% of sales.

Our next generation explosives scanner for hold baggage will be launched this year. It will combine multi-view X-ray technology and three-dimensional computed tomography (CT) in a single system providing both greater security screening potential and high throughput – an extremely attractive offering for airport operators. Prototype testing has progressed well.

This year sees the highest number of product launches in Smiths Detection's history. In addition to the RadSeeker radiation detector, the programme includes advanced GUARDION portable chemical identifier; a successor to the HazMatID which has been used extensively by emergency response teams; X-ray systems for air cargo screening; and a lower weight mobile cargo inspection systems.

Outlook

The current order book is ahead of the same period last year and is expected to support a similar level of sales for the full year, subject to the timing and profile of contracts. There has been encouraging growth in the order book for delivery during FY2013, as it benefits from significant recent contract wins. Headline operating margins will benefit from our restructuring initiatives. Product launches will open up opportunities for new technologies while expansion in emerging markets will help offset the impact of lower government spending in western countries.

Smiths Interconnect

	2012 £m	2011 £m	Reported growth	Underlying growth
Sales	**200**	186	7%	(6)%
Headline operating profit	**26**	34	(23)%	(29)%
Headline operating margin	**13.1%**	18.1%	(500) bps	
Statutory operating profit	**16**	27		
Return on capital employed	**12.8%**	17.4%	(460) bps	

Reported sales for Smiths Interconnect grew 7%, or £14m, driven mainly by the acquisition of Power Holdings Inc. (PDI) which added £24m. Underlying sales fell £11m, or 6%, against a strong comparator period. Challenging conditions in several end markets, particularly military, medical, and semiconductor testing, depressed sales of connectors and power protection components. Wireless telecommunications proved a notable positive in the period and resulted in growth in microwave communications sales.

Reported headline operating profit decreased 23%, or £8m. Excluding the £2m profit benefit from the PDI acquisition, underlying headline operating profit fell 29% (£10m), with margins down 460 basis points to 13.5%. This margin decrease stemmed mainly from the lower volumes and the associated operational gearing caused by the lower military sales. The business also experienced weaker gross margins due to sales mix and pricing pressure. Associated headcount reductions were made in several facilities and one manufacturing plant was closed. At two further facilities, we transferred a significant portion of the manufacturing capacity to low-cost countries as part of an ongoing initiative. In addition, we continue to benefit from procurement initiatives which helped to offset cost inflation. There was a further 40 basis points of margin decline associated with the lower relative margins at PDI, although plans are already in place to improve PDI's margins through operational and procurement initiatives.

Return on capital employed declined to 12.8% as a result of the lower profitability in the underlying business and the impact of the PDI acquisition. The PDI acquisition forms part of Group strategy to invest in complementary technologies and gain access to attractive markets with the aim of delivering improved growth and post-tax returns of at least 12% by the third year of ownership.

From an end market perspective, underlying sales in wireless telecoms grew 12%, largely as a result of growth in Asia and Australia. The military and aerospace segment declined 15%, reflecting US Department of Defense budget cutbacks and delays to some military programmes. Underlying sales to the rail, medical, automation and test markets fell 7% because of lower demand from medical and semiconductor test customers.

Looking ahead, Smiths Interconnect will align its reporting segments to its three technology areas of Connectors, Microwave and Power.

In Connectors, underlying sales declined 14% due to a mixture of effects. The military market was soft in both the US and Europe and orders from two major medical equipment customers slowed markedly against strong prior year comparators. In addition, the seasonal slowdown in the semiconductor test and the more general board test markets was unusually pronounced, reflecting the impact on customer supply chains from the flooding in South East Asia. The industrial sector remained robust despite uncertainty surrounding the economic environment in Europe. Transportation markets, both rail and aerospace, were positive and we were selected as a preferred supplier by a major European railway locomotive and rolling stock company. We gained significant orders for electronic warfare and phased-array radar applications and achieved design wins for new missile and radar programmes.

Microwave sales grew 6%. In wireless telecommunications, we outperformed the prevailing market conditions as projects to optimise existing networks, particularly by Australian operators, led to significant sales growth of filter products. In addition, sales of our passive intermodulation test instruments benefited from certain European and Chinese operators adopting the technology to help improve the performance of their networks. In contrast, US operator spending slowed considerably and the defence market remained weak. Towards the end of the period, military bookings began to show some signs of recovery. These included the release of a delayed $5.4m order for sub-assemblies used in an anti-IED device, strong orders for space applications and a follow-on $7.4m order related to a naval satellite communication system. Sales of the KuStream airborne satellite antenna system increased during the period albeit at a slower rate than anticipated because of programme and production issues.

The addition of PDI, which achieved sales and profits in line with expectations, boosted Power sales by 88%. Excluding PDI, underlying revenues declined 18% primarily due to a combination of delays in expected US military orders and a strong prior comparator period which included a significant one-off military programme. Sales into wireless telecommunications applications weakened, hit by a reduction in US operator capital expenditure and strong competition in China. Growth in public safety applications and recent contract wins with telecommunication equipment manufacturers proved notable exceptions. Although the medical market was also soft over the period, Smiths Interconnect succeeded in developing a relationship with a medical equipment manufacturer for the global supply of power conditioning units.

Research and development

Company-funded R&D spend increased 8% to £11m or 5.5% of sales. Excluding PDI, spend of £10m, or 5.6% of sales, increased on the prior period with higher investments in commercial products offset by lower spend on military projects. In addition, we received a further £2m of customer-funded investment, predominantly within Microwave defence applications, which was slightly above last year.

Investments continue to be spread across the division, although we focus on opportunities that provide the best returns, evidenced by over 30% of sales coming from products developed in the last three years. Examples include: smaller, higher density connectors for semiconductor test applications, millimetre-wave components for a new radar system that will enable helicopters to operate safely in poor visibility such as fog and sand/dust, a major product enhancement for our passive intermodulation test equipment, and new power and radio frequency protection devices for wireless telecommunications tower top electronics.

Business developments

In October 2011, Smiths Interconnect acquired PDI, a leading designer and manufacturer of specialist power distribution, conditioning and monitoring systems. Based in Richmond, Virginia, PDI is the parent company for Power Distribution, Inc., Marelco Power Systems, Inc. and Onyx Power, Inc. With additional facilities in Santa Ana, California and Howell, Michigan, PDI employs around 370 people. More than 90% of its revenues come from non-government funded markets.

The acquisition transforms Smiths Interconnect's power offering, adding a new range of products and growth potential through access to more attractive and higher growth end markets such as data centres as well as sales and operational synergy opportunities. Integration is progressing according to plan and should be substantially complete before the end of the financial year. Value creation opportunities have been identified and actions plans are in place with benefits expected to start accruing within months. A focus on international expansion opportunities, with new sales resources and channels added in Europe, India and China, will help drive additional sales growth. The sharing of manufacturing best practices will benefit margins.

Outlook

Although the full year sales outlook remains uncertain with sustained weaknesses in some industrial and defence markets, margins are expected to improve in the second half as a result of the benefits of first half cost reduction actions and ongoing operational initiatives. Full year performance will also benefit from the acquisition of PDI. In wireless telecommunications, several network optimisation projects will end in the second half, although both the Microwave and Power businesses are well placed to benefit if the expected increase in US network operator capital expenditure materialises. The semiconductor test market is generally expected to improve in 2012 although whether this will be early enough to provide a benefit this financial year is still uncertain. Industrial markets are expected to be adversely impacted by the continuing uncertainty in the Eurozone. Market conditions affecting PDI are likely to be mixed with growth of data centre applications partly offset by continued volatility in the alternative energy sector. We are alert to the need to manage costs aggressively and we continue to monitor markets closely to this effect. In the event of further deterioration, we will take the appropriate actions to reduce costs.

Flex-Tek

	2012 £m	2011 £m	Reported growth	Underlying growth
Sales	**109**	107	2%	2%
Headline operating profit	**17**	12	36%	36%
Headline operating margin	**15.5%**	11.6%	390 bps	
Statutory operating (loss)/profit	**(35)**	11		
Return on capital employed	**25.1%**	20.6%	450 bps	

Flex-Tek's sales grew 2%, or £2m, on an underlying and reported basis. This improvement, driven by sales growth in aerospace components, was slightly offset by weakness in our heating element business for the household appliance sector, depressed by the flat US residential construction market. Headline operating profit margins rose 390 basis points to 15.5% as a result of the increased volumes and associated operational gearing and positive mix from the faster growing aerospace sales. The underlying increase in operating profit of £5m stemmed from higher volumes (£2m) and pricing and benefits of our cost saving initiatives (£1m). There was also a £2m gain from the change in accounting treatment for the legal defence costs associated with the flexible gas piping business. In previous years these costs had been charged to headline operating profit but are now being treated as an exceptional item (see notes 4 and 12 to the accounts). Return on capital employed rose 450 basis points as a result of the improved profitability.

In Fluid Management, sales of components to aerospace customers improved 14% on an underlying basis, helped by higher volumes on major airframe platforms from Airbus and Boeing and engines from Pratt & Whitney and GE. The order book for our commercial aviation OEM business remains strong and we have gained market share in our overhaul & repair service segment. In addition, sales to the US automotive market for both fuel and brake applications remain robust.

Sales to the construction market were up 4% despite the continued uncertainty in US housing. According to the US Census Bureau, the 2011 seasonally adjusted annual rate of new single family home starts was slightly above 300,000, the lowest since records began in 1963. However, we continue to gain market share by cross-selling our ducting, flexible gas piping and HVAC heating element product lines to the US distribution market.

Heat Solutions underlying revenues fell 12% as sales of heating elements to residential HVAC customers weakened by comparison to the prior year. Consumer confidence remains cautious in the US and OEM appliance manufacturers continue to project low single growth rates in the US markets.

Underlying sales of flexible hose from the Flexible Solutions division were down 1% against the prior year with a slight uptick in industrial products offset by weakness in the floor care market.

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

Outlook

The first half benefitted from the culmination of restructuring gains, a fairly stable environment for commodities and continued strength in aerospace. These have enhanced our margins and lay a solid foundation for the second half. Flex-Tek remains leveraged to a recovery in housing and should continue to benefit from a robust commercial aerospace cycle. Future performance may be influenced by a rise in commodity prices as well as increased investment in new product development.

Financial review

Earnings per share
Basic headline earnings per share from continuing activities were 40.4p (2011: 39.9p), a growth of 1%. This reflects increased headline pre-tax profit which has been partly offset by a higher tax charge.

On a statutory basis, the basic earnings per share from continuing activities were 21.4p (2011: 35.7p).

Exceptional and other items relating to continuing activities excluded from headline profits
These items amounted to a charge of £106m compared to a charge of £23m in 2011. They comprised:

- Amortisation of intangible assets acquired in business combinations of £25m (2011: £22m). The charge relates principally to technology and customer relationships;
- A charge of £18m (2011: £5m) in connection with John Crane, Inc. asbestos litigation;
- A charge of £52m (2011: nil) to resolve potential future claims alleging product liability in Titeflex Corporation. In previous years, the costs of resolving notified claims were charged to headline operating profit;
- A charge of £12m (2011: £5m) in respect of restructuring, mostly in connection with the performance improvement programme in Smiths Detection announced last year;
- A charge of £8m in relation to a change in the basis of estimating sales rebates in Smiths Medical;
- Acquisition costs of £2m (2011: £1m);
- £1m profit on disposal of businesses (2011: nil);
- Pension finance income of £11m (2011: £12m); this was previously treated as part of headline profit and the prior year income statement has been restated; and
- Financing costs of £1m (2011: £2m). These represent exchange movements on derivatives and other financing instruments not hedge accounted under IFRS.

Cash generation and net debt
Operating cash generation remained strong with headline operating cash of £201m (2011: £186m) representing 82% (2011: 78%) of headline operating profit (see note 14 to the accounts for a reconciliation of headline operating cash to statutory cash-flow measures). Free cash-flow improved £11m to £81m (2011: £70m). Free cash-flow is stated after interest and tax but before acquisitions, financing activities and dividends.

On a statutory basis, net cash inflow from continuing operations was £133m (2011: £107m).

Dividends paid in the period on ordinary shares amounted to £98m (2011: £92m).

Net debt at 28 January was £957m, up from £729m at 31 July 2011. The increase in net debt reflects the net effect of acquisitions and disposal (£168m) and dividends (£98m).

Headline interest and other financing costs
Interest payable on debt, net of interest earned on cash deposits, was £31m compared with £29m in 2011. This reduction reflects the higher average levels of debt. Interest costs were covered 7.8 times by headline operating profits.

The Group accounts for pensions using IAS19. As required by this standard, a finance credit is recognised reflecting the expected return on pension scheme assets and a finance charge is recognised reflecting the unwinding of the discount on the future pension liability. The net financing credit was £11m (2011: £12m). As of 1 August 2011, we now report headline pre-tax profit excluding this item. The headline measures are intended to report the underlying performance of the Group excluding factors which are outside management control.

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

We invested a total of £55m in R&D (2011: £56m) on continuing operations, equivalent to 3.9% of sales (2011: 4.0%). Of that total, £50m was funded by the Company compared with £49m in 2011, an increase of 1%. We actively seek funding from customers to support R&D and this amounted to £5m (2011: £7m). Under IFRS, certain development costs are capitalised, and this amounted to £14m in the period (2011: £16m). The gross capitalisation is shown as an intangible asset. Where customers contribute to the costs of development, the contribution is included as deferred income and disclosed within trade and other payables.

Taxation
The headline tax charge of £57m (2011: £55m - restated) represented an effective rate of 26.5% on the headline profit before taxation (2011: 26.0% - restated). This rate is expected to be sustained for the full year. On a statutory basis, the tax charge on continuing activities was £26m (2011: £48m).

The Group continues to take advantage of global manufacturing, research and development and other tax incentives, the tax-efficient use of capital and tax compliance management. However, our increased profitability in areas with higher tax rates will cause the headline tax rate to increase over time with a rate of between 27-29% expected over the medium term.

Return on capital employed

The return on capital employed (ROCE) is calculated over a rolling 12-month period and is the percentage that headline operating profit comprises of monthly average capital employed. Capital employed comprises total equity adjusted for goodwill recognised directly in reserves, post-retirement benefit assets and liabilities and litigation provisions relating to exceptional items, both net of tax, and net debt. In the light of the recognition of the Titeflex litigation provision, the Board has decided to restate capital employed to exclude significant litigation provisions (see note 2 to the accounts). The ROCE declined 60 basis points to 16.0% (2011: 16.6%), reflecting the lower profitability in Smiths Detection and Smiths Interconnect as well as the investment in the Power Holdings acquisition that completed in October 2011.

Retirement benefits

As required by IFRS the balance sheet reflects the net surplus or deficit in retirement benefit plans, taking assets at their market values at 28 January 2012 and evaluating liabilities at period-end AA corporate bond interest rates.

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

The net pension deficit has risen to £459m at 28 January 2012 from £199m at 31 July 2011. The increase reflects a fall in discount rates of over 50 basis points since 31 July 2011.

The retirement benefit position was:

	28 January 2012	31 July 2011	29 January 2011
Funded plans			
UK plans – funding status	**94%**	101%	104%
US plans – funding status	**70%**	76%	78%
Other plans – funding status	**77%**	77%	70%

	28 January 2012 £m	31 July 2011 £m	29 January 2011 £m
Surplus/(deficit)			
Funded plans	**(367)**	(108)	(29)
Unfunded plans	**(92)**	(91)	(90)
Total deficit	**(459)**	(199)	(119)
Retirement benefit assets	**51**	141	151
Retirement benefit liabilities	**(510)**	(340)	(270)
	(459)	(199)	(119)

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

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

The approximate pension membership for the three main schemes at around the end of January 2012 is set out in the table below:

Pension scheme membership	SIPS	TIGPS	US plans	Total
Deferred active	700	320	3,940	**4,960**
Deferred	12,480	15,180	6,510	**34,170**
Pensioners	12,910	18,890	5,470	**37,270**
Total	**26,090**	**34,390**	**15,920**	**76,400**

Exchange rates

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

	28 January 2012	29 January 2011		31 July 2011
Average rates:				
US dollar	**1.58**	1.57	Dollar weakened 1%	1.60
Euro	**1.16**	1.18	Euro strengthened 2%	1.16
Period end rates:				
US dollar	**1.57**	1.58	Dollar strengthened 1%	1.64
Euro	**1.19**	1.16	Euro weakened 3%	1.14

Risk management

The principal risks and uncertainties affecting the business activities of the Group and relevant mitigating activities were set out on pages 52 to 56 of the Annual Report for the year ended 31 July 2011, a copy of which is available at the Company's website at www.smiths.com. The key risks and uncertainties are summarised below:

Economic outlook

Economic and financial market conditions may lead to recession and may cause adverse effects on customers or suppliers with consequential capacity or cash-flow implications for Smiths Group.

Financial risks

Financial risk, whether from foreign exchange fluctuations, availability of funding, changes in tax rates or availability of insurance cover may cause adverse effects on the Group's net assets, earnings or liquidity.

Global supply chain/concentration of manufacturing

Reliance on sole suppliers or concentration of manufacturing in the supply chain – especially in areas exposed to natural catastrophe – may result in disruption to the supply of products.

Government customers

Over 40% revenues are from governments or influenced by governments. Many such governments are reducing expenditure in the present economic environment with consequential risks to revenue.

Information technology

Information systems are subject to security risk and play an important part in business processes, both internally and externally.

Acquisitions and disposals

Acquisitions are subject to execution risk and it may be difficult to integrate than expected so that the full benefits are not realised.

Compliance with legislation and regulations

A complex legislative and regulatory environment applies to the Group's activities such that failure to comply could lead to financial penalty.

Pension funding

Defined benefit pension scheme obligations are funded by Group companies based on actuarial assumptions. Changes in discount rates, inflation, returns or mortality could lead to material changes in funding requirements.

Product liability and litigation

Product liability claims and litigation, particularly given the Group's significant sales exposure to the US market, may have a significant impact on the financial results.

Technology and innovation

Product innovation is key to long-term revenue growth. Failure of the Group to innovate its products and services could materially affect market share and sales growth.

Talent and succession planning

Suitably qualified personnel are an important asset that underpins the Group's success; failure to attract or retain such personnel may result in weaker growth and returns.

Developments since the Annual Report

In the view of the Board, the risks and uncertainties affecting the Group for the remaining six months of the financial year continue to be those set out briefly above and more fully in the Annual Report. Since the Annual Report, there has been a sustained risk that certain Eurozone members fail to meet their sovereign debt obligations which could destabilise the Euro currency and result in currency devaluations in some of our Eurozone markets. We are preparing plans to mitigate these effects should they occur. Continued constraints on government budgets are likely to put pressure on public sector spending in areas such as healthcare, defence and homeland security in markets in which the Group operates. This budgetary pressure has also caused payment terms to lengthen with some government-funded customers, particularly in Southern Europe, although we continue to manage any overdue debts very closely. Otherwise, there may be other effects, such as changes in the fiscal and regulatory policies in the countries where the Group conducts its business.

Statement of directors' responsibilities

The Interim report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the Interim report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority. The Disclosure and Transparency Rules ("DTR") require that the accounting policies and presentation applied to the half-yearly figures must be consistent with those applied in the latest published annual accounts, except where the accounting policies and presentation are to be changed in the subsequent annual accounts, in which case the new accounting policies and presentation should be followed, and the changes and the reasons for the changes should be disclosed in the Interim report, unless the United Kingdom Financial Services Authority agrees otherwise.

The directors confirm that this condensed set of financial statements has been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting' as adopted by the European Union, and that the interim management report herein includes a fair review of:

- the important events that have occurred during the first six months of the financial year and their impact on the condensed set of financial statements as required by DTR 4.2.7;
- the principal risks and uncertainties for the remaining six months of the year as required by DTR 4.2.7; and
- related party transactions that have taken place in the first six months of the current financial year and changes in the related party transactions described in the previous annual report that have materially affected the financial position or performance of the group during the first six months of the current financial year as required by DTR 4.2.8.

The directors of Smiths Group plc are listed in the Smiths Group plc Annual Report for the year ended 31 July 2011, and there have been no changes in the membership of the board.

For and on behalf of the Board of Directors:

Philip Bowman
Chief Executive

Peter Turner
Finance Director

13 March 2012

Independent review report to Smiths Group plc

Introduction

We have been engaged by the Company to review the condensed set of financial statements in the Interim report for the period ended 28 January 2012, which comprises the consolidated income statement, consolidated statement of comprehensive income, consolidated balance sheet, consolidated statement of changes in equity, consolidated cash flow statement and related notes. We have read the other information contained in the Interim report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

Directors' responsibilities

The Interim report is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the Interim report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

As disclosed in note 1, the annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this Interim financial report has been prepared in accordance with International Accounting Standard 34, "Interim Financial Reporting", as adopted by the European Union.

Our responsibility

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the Interim report based on our review. This report, including the conclusion, has been prepared for and only for the Company for the purpose of the Disclosure and Transparency Rules of the Financial Services Authority and for no other purpose. We do not, in producing this report, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the Interim financial report for the period ended 28 January 2012 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

PricewaterhouseCoopers LLP
Chartered Accountants
13 March 2012
London

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

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

Consolidated income statement (unaudited)

	Notes	Period ended 28 January 2012 £m	Period ended 29 January 2011 £m	Year ended 31 July 2011 £m
Continuing operations				
Revenue	2	**1,407.4**	1,371.7	2,842.0
Cost of sales		**(764.6)**	(734.5)	(1,534.0)
Gross profit		**642.8**	637.2	1,308.0
Sales and distribution costs		**(200.3)**	(192.4)	(384.3)
Administrative expenses		**(311.8)**	(236.4)	(490.1)
Profit on disposal of businesses	4	**0.9**		4.4
Operating profit		**131.6**	208.4	438.0
Comprising				
– headline operating profit	3	**244.0**	238.7	516.9
– exceptional items, amortisation of acquired intangibles	3	**(112.4)**	(30.3)	(78.9)
		131.6	208.4	438.0
Interest receivable		**1.3**	0.9	1.8
Interest payable		**(32.6)**	(29.8)	(60.3)
Other financing losses		**(3.8)**	(4.7)	(9.2)
Other finance income – retirement benefits		**10.5**	12.0	23.3
Finance costs		**(24.6)**	(21.6)	(44.4)
Share of post-tax profits of associated companies		**4.2**	1.8	4.3
Profit before taxation		**111.2**	188.6	397.9
Comprising				
– headline profit before taxation (restated)*	3	**216.9**	211.6	462.7
– exceptional items, amortisation of acquired intangibles and other financing gains and losses	3	**(105.7)**	(23.0)	(64.8)
		111.2	188.6	397.9
Taxation	5	**(26.4)**	(48.3)	(91.8)
Profit after taxation – continuing operations		**84.8**	140.3	306.1
(Loss)/profit after taxation – discontinued operations		**(0.1)**	34.1	79.0
Profit for the period		**84.7**	174.4	385.1
Attributable to				
Smiths Group shareholders		**83.8**	173.8	383.8
Non-controlling interests		**0.9**	0.6	1.3
		84.7	174.4	385.1
Earnings per share	7			
Basic		**21.4p**	44.4p	98.0p
Basic – continuing operations		**21.4p**	35.7p	77.8p
Diluted		**21.2p**	44.0p	97.1p
Diluted – continuing operations		**21.2p**	35.4p	77.1p
Dividends per share (declared)	6			
– interim		**11.75p**	11.25p	11.25p
– final				25.00p
		11.75p	11.25p	36.25p

*As disclosed in the Annual Report 2011, from 1 August 2011 the definition of headline profit has been amended to exclude financing credits and charges relating to retirement benefits, see note 3.

Consolidated statement of comprehensive income (unaudited)

	Notes	**Period ended 28 January 2012 £m**	Period ended 29 January 2011 £m	Year ended 31 July 2011 £m
Profit for the period		**84.7**	174.4	385.1
Other comprehensive income				
Exchange gains/(losses)		**30.3**	16.0	(9.3)
Actuarial (losses)/gains on retirement benefits		**(286.4)**	150.4	(0.2)
Taxation recognised on actuarial movements		**18.2**	(30.0)	10.9
Fair value gains/(losses)				
– on available for sale financial assets		**4.5**	1.2	4.1
– deferred in the period on cash-flow and net investment hedges		**(22.7)**	(8.6)	8.3
– reclassified to income statement		**3.2**	1.2	(0.2)
Total other comprehensive income		**(252.9)**	130.2	13.6
Total comprehensive income		**(168.2)**	304.6	398.7
Attributable to				
Smiths Group shareholders		**(169.4)**	303.8	397.0
Non-controlling interests		**1.2**	0.8	1.7
		(168.2)	304.6	398.7

Consolidated balance sheet (unaudited)

	Notes	28 January 2012 £m	29 January 2011 £m	31 July 2011 £m
Non-current assets				
Intangible assets	9	**1,779.8**	1,639.6	1,610.2
Property, plant and equipment	10	**279.7**	290.4	282.8
Investments accounted for using the equity method		**21.8**	15.2	18.5
Financial assets – other investments		**48.3**	28.6	31.6
Retirement benefit assets	8	**51.4**	151.0	140.6
Deferred tax assets		**231.8**	154.8	174.8
Trade and other receivables		**36.3**	32.7	33.6
Financial derivatives		**6.5**	7.8	6.4
		2,455.6	2,320.1	2,298.5
Current assets				
Inventories		**476.6**	431.9	432.5
Current tax receivable		**15.0**		16.4
Trade and other receivables		**616.2**	613.3	612.8
Cash and cash equivalents	11	**145.8**	136.8	261.1
Financial derivatives		**13.1**	8.3	5.7
		1,266.7	1,190.3	1,328.5
Total assets		**3,722.3**	3,510.4	3,627.0
Non-current liabilities				
Financial liabilities				
– borrowings	11	**(907.0)**	(993.4)	(978.4)
– financial derivatives		**(1.3)**	(2.4)	(1.5)
Provisions for liabilities and charges	12	**(239.0)**	(214.4)	(174.1)
Retirement benefit obligations	8	**(510.3)**	(270.3)	(339.6)
Deferred tax liabilities		**(92.3)**	(77.0)	(77.6)
Trade and other payables		**(44.3)**	(35.0)	(45.1)
		(1,794.2)	(1,592.5)	(1,616.3)
Current liabilities				
Financial liabilities				
– borrowings	11	**(195.8)**	(22.9)	(11.7)
– financial derivatives		**(12.3)**	(6.9)	(8.9)
Provisions for liabilities and charges	12	**(81.0)**	(67.0)	(74.7)
Trade and other payables		**(432.2)**	(418.6)	(454.2)
Current tax payable		**(94.9)**	(78.9)	(81.3)
		(816.2)	(594.3)	(630.8)
Total liabilities		**(2,610.4)**	(2,186.8)	(2,247.1)
Net assets		**1,111.9**	1,323.6	1,379.9
Shareholders' equity				
Share capital		**147.2**	147.0	147.1
Share premium account		**330.7**	326.5	329.1
Capital redemption reserve		**5.8**	5.8	5.8
Revaluation reserve		**1.7**	1.7	1.7
Merger reserve		**234.8**	234.8	234.8
Retained earnings		**524.6**	738.5	775.6
Hedge reserve		**(140.2)**	(136.2)	(120.6)
Total shareholders' equity		**1,104.6**	1,318.1	1,373.5
Non-controlling interest equity		**7.3**	5.5	6.4
Total equity		**1,111.9**	1,323.6	1,379.9

Consolidated statement of changes in equity (unaudited)

	Notes	Share capital and share premium £m	Other reserves £m	Retained earnings £m	Hedge reserve £m	Equity shareholders' funds £m	Non-controlling Interest £m	Total equity £m
At 31 July 2011		476.2	242.3	775.6	(120.6)	1,373.5	6.4	1,379.9
Profit for the period				83.8		83.8	0.9	84.7
Other comprehensive income								
Exchange gains/(losses)				30.1	(0.1)	30.0	0.3	30.3
Actuarial losses on retirement benefits net of tax				(268.2)		(268.2)		(268.2)
Fair value gains/(losses)				4.5	(19.5)	(15.0)		(15.0)
Total comprehensive income for the period				(149.8)	(19.6)	(169.4)	1.2	(168.2)
Transactions relating to ownership interests								
Exercises of share options		1.7				1.7		1.7
Taxation recognised on share options				(0.9)		(0.9)		(0.9)
Purchase of own shares				(9.7)		(9.7)		(9.7)
Dividends								
– equity shareholders	6			(98.1)		(98.1)		(98.1)
– non-controlling interest							(0.3)	(0.3)
Share-based payment				7.5		7.5		7.5
At 28 January 2012		**477.9**	**242.3**	**524.6**	**(140.2)**	**1,104.6**	**7.3**	**1,111.9**

	Notes	Share capital and share premium £m	Other reserves £m	Retained earnings £m	Hedge reserve £m	Equity shareholders' funds £m	Non-controlling Interest £m	Total equity £m
At 31 July 2010		461.8	242.3	519.5	(128.8)	1,094.8	5.0	1,099.8
Profit for the period				173.8		173.8	0.6	174.4
Other comprehensive income								
Exchange gains				15.8		15.8	0.2	16.0
Actuarial gains on retirement benefits net of tax				120.4		120.4		120.4
Fair value gains/(losses)				1.2	(7.4)	(6.2)		(6.2)
Total comprehensive income for the period				311.2	(7.4)	303.8	0.8	304.6
Transactions relating to ownership interest								
Exercises of share options		11.7				11.7		11.7
Purchase of own shares				(8.6)		(8.6)		(8.6)
Dividends								
– equity shareholders	6			(91.9)		(91.9)		(91.9)
– non-controlling interest							(0.3)	(0.3)
Share-based payment				8.3		8.3		8.3
At 29 January 2011		**473.5**	**242.3**	**738.5**	**(136.2)**	**1,318.1**	**5.5**	**1,323.6**

Consolidated cash-flow statement (unaudited)

	Notes	**Period ended 28 January 2012 £m**	Period ended 29 January 2011 £m	Year ended 31 July 2011 £m
Net cash inflow from operating activities	14	**133.2**	106.6	321.7
Cash-flows from investing activities				
Expenditure on capitalised development		**(13.1)**	(15.5)	(30.6)
Expenditure on other intangible assets		**(5.5)**	(2.9)	(10.2)
Purchases of property, plant and equipment		**(21.1)**	(19.6)	(49.3)
Disposals of property, plant and equipment			1.5	4.5
Investment in financial assets		**(12.0)**	(0.2)	(0.3)
Acquisition of businesses		**(169.0)**	(10.9)	(18.5)
Disposal of Aerospace			(6.8)	(6.2)
Disposals of businesses		**0.9**	(0.3)	3.9
Net cash-flow used in investing activities		**(219.8)**	(54.7)	(106.7)
Cash-flows from financing activities				
Proceeds from exercise of share options		**1.7**	11.7	14.4
Purchase of own shares		**(9.7)**	(8.6)	(8.6)
Dividends paid to equity shareholders		**(98.1)**	(91.9)	(136.1)
Dividends paid to non-controlling interests		**(0.3)**	(0.3)	(0.3)
Cash outflow from matured derivative financial instruments		**(2.6)**	(1.5)	1.0
Increase in new borrowings		**92.3**	0.9	1.6
Reduction and repayment of borrowings		**(16.7)**	(0.7)	(1.2)
Net cash-flow used in financing activities		**(33.4)**	(90.4)	(129.2)
Net (decrease)/increase in cash and cash equivalents		**(120.0)**	(38.5)	85.8
Cash and cash equivalents at beginning of the period		**260.7**	172.2	172.2
Exchange differences		**1.4**	2.3	2.7
Cash and cash equivalents at end of the period		**142.1**	136.0	260.7
Cash and cash equivalents at end of the period comprise				
– cash at bank and in hand		**122.3**	121.0	232.0
– short-term deposits		**23.5**	15.8	29.1
– bank overdrafts		**(3.7)**	(0.8)	(0.4)
		142.1	136.0	260.7

Notes to the Interim report (unaudited)

1 Basis of preparation

The condensed interim financial information covers the six month period ended 28 January 2012 and has been prepared under International Financial Reporting Standards (IFRS) as adopted by the European Union, in accordance with International Accounting Standard 34 'Interim Financial Reporting' and the Disclosure and Transparency Rules of the Financial Services Authority. It is unaudited but has been reviewed by the auditors and their report is attached to this document.

The interim financial information does not constitute statutory accounts within the meaning of Section 434 of the Companies Act 2006. It should be read in conjunction with the statutory accounts for the year ended 31 July 2011, which were prepared in accordance with IFRS as adopted by the European Union and have been filed with the Registrar of Companies. The auditors' report on these statutory accounts was unqualified and did not contain a statement under Section 498(2) or (3) of the Companies Act 2006.

Accounting policies

The condensed interim financial information has been prepared on the basis of the accounting policies applicable for the year ending 31 July 2012. These accounting policies are consistent with those applied in the preparation of the financial statements for the year ended 31 July 2011, except for the inclusion of income and expenditure relating to Titeflex Corporation litigation in exceptional items (see note 4) and the adoption of:

- Amendment to IFRIC 14, 'Prepayment of a Minimum Funding Requirement'
- IAS 24 (revised) 'Related party disclosures'
- Amendment to IFRS 7, 'Financial instruments:Disclosures'

There have been no material changes as a result of adopting these new accounting requirements.

Significant judgements, key assumptions and estimates

The preparation of the accounts in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the accounts and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from these estimates. The key estimates and assumptions used in these consolidated financial statements are set out below.

Revenue recognition

The timing of revenue recognition on long-term funded contracts depends on the assessed stage of completion of contract activity at the balance sheet date. This assessment requires the expected total contract revenues and costs to be estimated based on the current progress of the contract.

Revenue of £11.6m (31 July 2011: £27.9m) has been recognised in respect of contracts in progress at the period end with a total expected value of £130.2m (31 July 2011: £129.3m). A 5% increase in the proportion of the contract activity recognised in the current year would have increased operating profit by an estimated £0.2m (31 July 2011: £1.1m).

Revenue recognition requires the estimation of rebates that will be provided in respect of sales which have been made before the balance sheet date. Smiths Medical has rebate arrangements in place with some distributors in respect of sales to end customers where the sales prices have been negotiated directly by Smiths Medical. During the period, as a result of the availability of better information, the basis of estimating these rebates was revised. The estimation is based on the level of discount derived from sales data from distributors, the amount of inventory held by distributors and the time lag between the initial sale to the distributor and the rebate being claimed. The rebate accrual at 28 January 2012 was £18m (31 July 2011: £10.2m).

Impairment

Goodwill is tested at least annually for impairment in accordance with the accounting policy for goodwill set out in the Annual Report 2011. The recoverable amounts of cash generating units are determined based on value in use calculations. These calculations require the use of estimates including projected future cash-flows and other future events.

Provisions for liabilities and charges

The consolidated financial statements include a provision for litigation of £258.0m (2011: £196.1m).

As previously reported, John Crane, Inc., a subsidiary of the Group, is currently one of many co-defendants in litigation relating to products previously manufactured which contained asbestos. Provision has been made for the future defence costs which the Group is expected to incur and the expected costs of future adverse judgments against John Crane, Inc. However, because of the significant uncertainty associated with the future level of asbestos claims and of the costs arising out of the related litigation, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred and, as a result, the provision may be subject to potentially material revisions from time to time if new information becomes available as a result of future events. John Crane, Inc. takes account of the advice of an expert in asbestos liability estimation in quantifying the expected costs.

In recent years Titeflex Corporation, a subsidiary of the Group in the Flex-Tek division, has received a number of claims from insurance companies seeking recompense on a subrogated basis for the effects of damage allegedly caused by lightning strikes in relation to its flexible gas piping product. 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 has now been made for the costs which the Group is expected to incur in respect of future subrogation claims. However, because of the significant uncertainty associated with the future level of subrogation 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. As a result the provision may be subject to potentially material revisions if new information becomes available.

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

Retirement benefits

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

At 28 January 2012 there is a retirement benefit asset of £51.4m (31 July 2011: £140.6m) which arises from the rights of the employers to recover the surplus at the end of the life of the scheme. If the pension schemes were wound up while they still had members, the schemes would need to buy out the benefits of all members. The buy outs would cost significantly more than the present value of the scheme liabilities calculated in accordance with IAS 19: Employee benefits.

Taxation

The Group has recognised deferred tax assets of £29.5m (31 July 2011: £26.0m) relating to losses and £44.4m (31 July 2011: £50.6m) relating to the John Crane, Inc. litigation provision. The recognition of assets pertaining to these items involves judgement by management as to the likelihood of realisation of these deferred tax assets and this is based on a number of factors, which seek to assess the expectation that the benefit of these assets will be realised, including appropriate taxable temporary timing differences and it has been concluded that there are sufficient taxable profits in future periods to support recognition.

2 Segment information

Analysis by operating segment

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

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

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

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

						Period ended 28 January 2012
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Revenue	**469.3**	**408.7**	**220.0**	**200.1**	**109.3**	**1,407.4**
Divisional headline operating profit	**97.9**	**97.9**	**20.5**	**26.2**	**16.9**	**259.4**
Corporate headline operating costs						**(15.4)**
Headline operating profit	**97.9**	**97.9**	**20.5**	**26.2**	**16.9**	**244.0**
Divisional exceptional operating items (note 4)	**(15.8)**	**(8.2)**	**(11.0)**	**(1.9)**	**(51.7)**	**(88.6)**
Corporate exceptional operating items (note 4)						**1.0**
Amortisation of acquired intangible assets	**(7.5)**	**(7.9)**	**(0.7)**	**(8.6)**	**(0.1)**	**(24.8)**
Operating profit/(loss)	**74.6**	**81.8**	**8.8**	**15.7**	**(34.9)**	**131.6**
Exceptional finance costs – adjustment to discounted provision (note 4)	**(2.4)**					**(2.4)**
Net finance costs – other						**(22.2)**
Share of post-tax profits of associate companies			**4.2**			**4.2**
Profit before taxation						**111.2**

Smiths Medical revenue includes the impact of the £7.8m charge for revision of estimated rebates, which has been included in divisional exceptional operating items (see note 4). Revenue calculated on the same basis as headline operating profit would be £416.5m for Smiths Medical and £1,415.2m for Smiths Group.

						Period ended 29 January 2011
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Revenue	412.4	417.9	247.7	186.3	107.4	1,371.7
Divisional headline operating profit	78.5	94.3	34.4	33.8	12.4	253.4
Corporate headline operating costs						(14.7)
Headline operating profit	78.5	94.3	34.4	33.8	12.4	238.7
Divisional exceptional operating items (note 4)	(3.0)	(0.8)	(0.7)	(0.6)	(1.8)	(6.9)
Corporate exceptional operating items (note 4)						(1.1)
Amortisation of acquired intangible assets	(7.3)	(8.4)	(0.6)	(6.0)		(22.3)
Operating profit	68.2	85.1	33.1	27.2	10.6	208.4
Exceptional finance costs – adjustment to discounted provision (note 4)	(3.0)					(3.0)
Net finance costs – other						(18.6)
Share of post-tax profits of associate companies			1.8			1.8
Profit before taxation						188.6

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

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

						28 January 2012
	John Crane £m	**Smiths Medical £m**	**Smiths Detection £m**	**Smiths Interconnect £m**	**Flex-Tek £m**	**Total £m**
Property, plant, equipment, development projects and other intangibles	**97.2**	**159.9**	**106.0**	**35.8**	**22.4**	**421.3**
Investments in associates			**21.8**			**21.8**
Working capital assets	**337.7**	**258.0**	**296.2**	**159.1**	**66.4**	**1,117.4**
Operating assets	**434.9**	**417.9**	**424.0**	**194.9**	**88.8**	**1,560.5**
Derivatives, tax and retirement benefit assets						**317.8**
Goodwill and acquired intangibles						**1,625.4**
Corporate assets						**72.8**
Cash						**145.8**
Total assets						**3,722.3**
Working capital liabilities	**(145.3)**	**(97.0)**	**(144.3)**	**(62.4)**	**(23.3)**	**(472.3)**
Corporate and non-headline liabilities						**(324.2)**
Derivatives, tax and retirement benefits						**(711.1)**
Borrowings						**(1,102.8)**
Total liabilities						**(2,610.4)**
Average divisional capital employed	**874.6**	**1,153.6**	**679.5**	**467.2**	**127.8**	**3,302.7**
Average corporate capital employed						**(45.5)**
Average total capital employed						**3,257.2**

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

Capital employed is a non-statutory measure of invested resources. It comprises statutory net assets adjusted to add goodwill recognised directly in reserves in respect of subsidiaries acquired before 1 August 1998 of £815.2m (29 January 2011: £815.2m) and eliminate post-retirement benefit assets and liabilities and litigation provisions relating to exceptional items, both net of related tax, and net debt. In the light of the recognition of the Titeflex litigation provision in 2012, the board has decided to exclude significant litigation provisions from the definition of capital employed. Accordingly, capital employed in 2011 has been restated to exclude the John Crane, Inc. litigation provision and related deferred tax.

29 January 2011	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Average divisional capital employed (restated)	865.8	1,202.2	659.1	415.5	128.9	3,271.5
Average corporate capital employed						(122.4)
Average total capital employed (restated)						3,149.1

31 July 2011	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Property, plant, equipment, development projects and other intangibles	99.8	158.4	104.8	34.1	22.3	419.4
Investments in associates			18.5			18.5
Working capital assets	327.9	246.5	304.1	129.6	63.5	1,071.6
Operating assets	427.7	404.9	427.4	163.7	85.8	1,509.5
Derivatives, tax and retirement benefit assets						343.9
Goodwill and acquired intangibles						1,464.1
Corporate assets						48.4
Cash						261.1
Total assets						3,627.0
Working capital liabilities	(160.1)	(93.6)	(152.2)	(61.5)	(34.8)	(502.2)
Corporate and non-headline liabilities						(245.9)
Derivatives, tax and retirement benefits						(508.9)
Borrowings						(990.1)
Total liabilities						(2,247.1)
Average divisional capital employed (restated)	863.9	1,159.4	664.8	431.2	126.1	3,245.4
Average corporate capital employed						(86.3)
Average total capital employed (restated)						3,159.1

Analysis of revenue

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

	Original equipment manufacture	Aftermarket				Total
John Crane	£m	Oil, gas and petrochemical £m	Chemical and pharmaceutical £m	Distributors £m	General industry £m	£m
Revenue period ended 28 January 2012	**172.4**	**181.7**	**38.2**	**33.1**	**43.9**	**469.3**
Revenue period ended 29 January 2011	147.0	161.5	34.7	30.3	38.9	412.4

Smiths Medical	Medication delivery £m	Vital care £m	Safety devices £m	Total £m
Revenue period ended 28 January 2012	**112.4**	**168.4**	**127.9**	**408.7**
Revenue period ended 29 January 2011	117.9	172.4	127.6	417.9

Smiths Detection	Transportation £m	Ports and borders £m	Military £m	Emergency responders £m	Critical infrastructure £m	Non-security £m	Total £m
Revenue period ended 28 January 2012	**97.2**	**32.5**	**21.6**	**9.7**	**53.7**	**5.3**	**220.0**
Revenue period ended 29 January 2011	97.0	42.5	37.4	11.2	41.6	18.0	247.7

Smiths Interconnect	Connectors £m	Microwave £m	Power Management £m	Total £m
Revenue period ended 28 January 2012	**71.9**	**86.3**	**41.9**	**200.1**
Revenue period ended 29 January 2011 (restated)	83.4	80.6	22.3	186.3

Flex-Tek	Fluid Management £m	Flexible Solutions £m	Heat Solutions £m	Construction £m	Total £m
Revenue period ended 28 January 2012	**37.8**	**17.1**	**25.5**	**28.9**	**109.3**
Revenue period ended 29 January 2011	33.1	17.3	29.1	27.9	107.4

Following the acquisition of Power Holdings Inc, Smiths Interconnect has reviewed its product groupings, and determined that reporting sales by technology sub-group would provide more consistent information about trends in sales of similar products. Consequently, the 29 January 2011 sales, which were previously reported by end market, have been restated into the current technology sub-group structure. Revenue for the period by end market is Telecom £53.0m (2011: £46.5m), Military and aerospace £70.2m (2011: £82.7m) and Rail, medical, automation, test and data centres £76.9m (2011: £57.1m).

3 Headline profit measures

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

The following items have been excluded from the headline measure:

- exceptional items, including income and expenditure relating to material litigation in respect of products no longer in production;
- amortisation of intangible assets acquired in a business combination – the amortisation charge is a non-cash item, and the directors believe that it should be added back to give a clearer picture of underlying performance;
- other financing gains and losses, which represent the potentially volatile gains and losses on derivatives and other financial instruments which do not fall to be hedge accounted under IAS 39; and
- financing credits and charges relating to retirement benefits.

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

	Notes	**Period ended 28 January 2012 £m**	Period ended 29 January 2011 (restated) £m	Year ended 31 July 2011 (restated) £m
Operating profit		**131.6**	208.4	438.0
Exclude				
– exceptional operating items	4	**87.6**	8.0	29.4
– amortisation of acquired intangible assets	9	**24.8**	22.3	49.5
Non-headline items in operating profit		**112.4**	30.3	78.9
Headline operating profit		**244.0**	238.7	516.9
Finance costs		**(24.6)**	(21.6)	(44.4)
Exclude				
– exceptional finance costs	4	**2.4**	3.0	6.1
– other financing gains and losses		**1.4**	1.7	3.1
– other finance income – retirement benefits		**(10.5)**	(12.0)	(23.3)
Non-headline items in finance costs		**(6.7)**	(7.3)	(14.1)
Headline finance costs		**(31.3)**	(28.9)	(58.5)
Profit before taxation		**111.2**	188.6	397.9
Non-headline items in operating profit		**112.4**	30.3	78.9
Non-headline items in finance costs		**(6.7)**	(7.3)	(14.1)
Headline profit before taxation		**216.9**	211.6	462.7
Profit after taxation – continuing operations		**84.8**	140.3	306.1
Exclude				
– non-headline items in profit before taxation		**105.7**	23.0	64.8
– tax on excluded items		**(31.1)**	(6.7)	(30.9)
		74.6	16.3	33.9
Headline profit after taxation – continuing operations		**159.4**	156.6	340.0

The comparative figures disclosed in the table above have been restated to exclude financing credits and charges relating to retirement benefits from headline profit measures.

4 Exceptional items

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

	Period ended 28 January 2012 £m	Period ended 29 January 2011 £m	Year ended 31 July 2011 £m
Operating items			
Restructuring programmes	**(11.4)**	(5.4)	(15.7)
Revision of estimated rebates	**(7.8)**		
Release of diabetes provision			1.5
Gains on changes to post-retirement benefits			10.2
Profit on disposal of businesses	**0.9**		4.4
Costs of acquisitions	**(2.0)**	(0.4)	(1.5)
Litigation			
– provision for Titeflex Corporation subrogation claims (note 12)	**(51.7)**		
– provision for John Crane, Inc. asbestos litigation (note 12)	**(15.6)**	(2.2)	(28.3)
	(87.6)	(8.0)	(29.4)
Financing items			
Exceptional finance costs – adjustment to discounted provision (note 12)	**(2.4)**	(3.0)	(6.1)
	(90.0)	(11.0)	(35.5)

Period ended 28 January 2012

Restructuring costs comprise £11.0m in respect of the improvement programme in Smiths Detection announced in September 2011 and £0.4m in respect of the restructuring of the corporate headquarters and divisional reorganisation which began in 2008. These two programmes, which involve redundancy, relocation and consolidation of manufacturing, are considered exceptional by virtue of their size.

A charge of £7.8m has been made by Smiths Medical to reflect a change to the historical basis of estimating the accrual for rebates to distributors (See note 2). This change has arisen due to the availability of improved data from distributors. Had this approach been used in prior years, there would have been no material impact on the revenue or operating profits of Smiths Medical in any of the prior five financial years and no material impact is expected on future revenue or profit. The charge has been recorded as an exceptional item on the basis that it is an unusual non-recurring item that distorts current year trading performance.

The profit on disposal of businesses arises from the resolution of indemnities in respect of disposals in previous years.

A charge of £51.7m has been made by Titeflex Corporation in respect of the estimated cost of future claims from insurance companies seeking recompense for damage allegedly caused by lightning strike (see note 12).

The operating charge in respect of John Crane, Inc. litigation comprises £8.3m in respect of increased provision for adverse judgments and legal defence costs, £0.4m in respect of legal fees in connection with litigation against insurers, and £6.9m arising from the reduction in US risk free rates.

5 Taxation

The interim tax charge of 23.8% is calculated by applying the estimated effective headline tax rate of 26.5% for the year ended 31 July 2012 to headline profit before tax and then taking into account the tax effect of non-headline items in the interim period.

The figures for 29 January 2011 and 31 July 2011 have been restated to reflect the change in the definition of headline profit, see note 3.

A reconciliation of total and headline tax charge is as follows:

	Period ended 28 January 2012		Period ended 29 January 2011 (restated)		Year ended 31 July 2011 (restated)	
	Continuing operations £m	Tax rate	Continuing operations £m	Tax rate	Continuing operations £m	Tax rate
Profit before taxation	**111.2**		188.6		397.9	
Taxation	**(26.4)**	**23.8%**	(48.3)	25.6%	(91.8)	23.0%
Adjustments						
Non-headline items excluded from profit before taxation (note 3)	**105.7**		23.0		64.8	
Taxation on non-headline items	**(31.1)**		(6.7)		(30.9)	
Headline						
Headline profit before taxation	**216.9**		211.6		462.7	
Taxation on headline profit	**(57.5)**	**26.5%**	(55.0)	26.0%	(122.7)	26.5%

The net deferred tax balance has increased £42.3m to £139.5m (31 July 2011: £97.2m). Movements in the period include a credit of £18.2m to other comprehensive income relating to the recognition of actuarial losses on retirement benefits and a credit of £26.3m in respect of movements on litigation provisions (see note 4).

6 Dividends

The following dividends were declared and paid in the period:

	Period ended 28 January 2012 £m	Period ended 29 January 2011 £m	Year ended 31 July 2011 £m
Ordinary final dividend of 25.0p for 2011 (2010: 23.50p) paid 25 November 2011	**98.1**	91.9	91.9
Ordinary interim dividend of 11.25p for 2011 paid 21 April 2011			44.2
	98.1	91.9	136.1

An interim dividend of 11.75p per share was declared by the Board on 13 March 2012 and will be paid to shareholders on 20 April 2012. This dividend has not been included as a liability in these accounts and is payable to all shareholders on the register of Members at close of business on 23 March 2012.

7 Earnings per share

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

	Period ended 28 January 2012 £m	Period ended 29 January 2011 £m	Year ended 31 July 2011 £m
Profit attributable to equity shareholders for the year			
– continuing	**83.9**	139.7	304.8
– total	**83.8**	173.8	383.8
Average number of shares in issue during the year	**392,520,793**	391,253,353	391,718,941

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 394,811,180 (period ended 29 January 2011: 394,628,373; year ended 31 July 2011: 395,240,785) ordinary shares, being the average number of ordinary shares in issue during the year adjusted by the dilutive effect of employee share schemes.

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

	Period ended 28 January 2012		Period ended 29 January 2011 (restated)		Year ended 31 July 2011 (restated)	
	£m	**EPS (p)**	£m	EPS (p)	£m	EPS (p)
Profit attributable to equity shareholders of the Parent Company	**83.9**	**21.4**	139.7	35.7	304.8	77.8
Exclude						
Non-headline items and related tax (note 3)	**74.6**	**19.0**	16.3	4.2	33.9	8.7
Headline	**158.5**	**40.4**	156.0	39.9	338.7	86.5
Headline EPS – diluted (p)		**40.1**		39.5		85.7

The figures for 29 January 2011 and 31 July 2011 have been restated to reflect the change in the definition of headline profit, see note 3.

8 Post-retirement benefits

Smiths operates a number of defined benefit plans throughout the world. The principal schemes are in the United Kingdom and in the United States and assets are held in separate trustee-administered funds. Where any individual scheme shows a surplus under IAS 19, this is disclosed on the balance sheet as a retirement benefit asset. The IAS 19 surplus of any one scheme is not available to fund the IAS 19 deficit of another scheme. These schemes are closed, and no further benefits are being accrued. The Group also provides defined contribution plans for its UK and US employees.

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

	28 January 2012		29 January 2011		31 July 2011	
	UK	**US**	**UK**	**US**	**UK**	**US**
Rate of increase in salaries	**n/a**	**n/a**	n/a	n/a	n/a	n/a
Rate of increase for active deferred members	**3.9%**	**n/a**	4.4%	n/a	4.4%	n/a
Rate of increase in pensions in payment	**3.0%**	**n/a**	3.5%	n/a	3.5%	n/a
Rate of increase in deferred pensions	**3.0%**	**n/a**	3.5%	n/a	3.5%	n/a
Discount rate	**4.7%**	**4.5%**	5.6%	5.5%	5.3%	5.1%
Inflation rate	**3.0%**	**n/a**	3.5%	n/a	3.5%	n/a
Healthcare cost increases	**5.0%**	**n/a**	5.0%	n/a	5.0%	n/a

A current service charge of £1.9m and an interest credit of £10.5m have been recognised in the six month period to 28 January 2012 in respect of defined benefit pension and post-retirement healthcare plans.

There were no significant changes in the market value of post-retirement benefit scheme assets in the interim period. The increase in the present value of scheme liabilities is largely due to lower corporate bond yields leading to lower discount rates.

The amounts recognised in the balance sheet were as follows:

	28 January 2012 £m	29 January 2011 £m	31 July 2011 £m
Balance sheet			
Market value of funded plan assets	**3,231.6**	3,230.9	3,272.6
Present value of funded scheme liabilities	**(3,597.4)**	(3,260.2)	(3,379.7)
Unfunded pension plans	**(69.1)**	(66.9)	(68.2)
Post-retirement healthcare	**(22.9)**	(22.3)	(22.5)
Unrecognised asset due to surplus restriction	**(1.1)**	(0.8)	(1.2)
Net retirement benefit liability	**(458.9)**	(119.3)	(199.0)
Retirement benefit assets	**51.4**	151.0	140.6
Retirement benefit obligations	**(510.3)**	(270.3)	(339.6)
Net retirement benefit liability	**(458.9)**	(119.3)	(199.0)

The retirement benefit asset arises from the rights of the employers to recover the surplus at the end of the life of the scheme. If the pension schemes were wound up while they had members, the schemes would need to buy out the benefits of all members. The buy outs would cost significantly more than the present value of scheme liabilities calculated in accordance with IAS 19: Employee benefits.

9 Intangible assets

	Goodwill £m	Development costs £m	Acquired intangibles £m	Software, patents and intellectual property £m	Total £m
Cost					
At 1 August 2011	1,389.7	162.5	351.9	132.2	2,036.3
Exchange adjustments	23.3	4.4	11.4	1.5	40.6
Business combinations	105.5		53.2		158.7
Additions		13.6		5.5	19.1
Disposals				(0.1)	(0.1)
At 28 January 2012	**1,518.5**	**180.5**	**416.5**	**139.1**	**2,254.6**
Amortisation					
At 1 August 2011	93.9	63.4	183.6	85.2	426.1
Exchange adjustments	1.4	1.4	5.9	1.1	9.8
Charge for the period		7.6	24.8	6.6	39.0
Disposals				(0.1)	(0.1)
At 28 January 2012	**95.3**	**72.4**	**214.3**	**92.8**	**474.8**
Net book value at 28 January 2012	**1,423.2**	**108.1**	**202.2**	**46.3**	**1,779.8**
Net book value at 29 January 2011	1,300.8	94.3	198.3	46.2	1,639.6
Net book value at 31 July 2011	1,295.8	99.1	168.3	47.0	1,610.2

The increase in goodwill and acquired intangibles relates to new businesses acquired during the period. See note 15 for details.

10 Property, plant and equipment

	Land and buildings £m	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
Cost or valuation				
At 1 August 2011	190.3	495.7	209.5	895.5
Exchange adjustments	3.2	10.7	1.2	15.1
Business combinations	0.3	1.0	0.2	1.5
Additions	2.9	12.1	6.1	21.1
Disposals	(0.5)	(4.4)	(3.2)	(8.1)
At 28 January 2012	**196.2**	**515.1**	**213.8**	**925.1**
Depreciation				
At 1 August 2011	87.1	362.7	162.9	612.7
Exchange adjustments	1.8	8.4	1.0	11.2
Charge for the period	3.6	17.3	7.4	28.3
Disposals	(0.1)	(4.0)	(2.7)	(6.8)
At 28 January 2012	**92.4**	**384.4**	**168.6**	**645.4**
Net book value at 28 January 2012	**103.8**	**130.7**	**45.2**	**279.7**
Net book value at 29 January 2011	104.0	139.0	47.4	290.4
Net book value at 31 July 2011	103.2	133.0	46.6	282.8

11 Borrowings and net debt

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

	28 January 2012 £m	29 January 2011 £m	31 July 2011 £m
Cash and cash equivalents			
Net cash and deposits	**145.8**	136.8	261.1
Short-term borrowings			
Bank overdrafts	**(3.7)**	(0.8)	(0.4)
$250m 5.45% US$ Private placement 2013	**(163.4)**		
Bank and other loans	**(2.8)**	(1.4)	(1.2)
Interest accrual	**(25.9)**	(20.7)	(10.1)
	(195.8)	(22.9)	(11.7)
Long-term borrowings			
$250m 5.45% US$ Private placement 2013		(165.9)	(158.3)
$250m 6.05% US$ Guaranteed notes 2014	**(158.5)**	(156.9)	(151.4)
$800m Revolving Credit Facility 2015	**(73.2)**		
£150m 7.25% Sterling Eurobond 2016	**(149.4)**	(149.2)	(149.3)
€300m 4.125% Eurobond 2017	**(254.6)**	(253.0)	(260.2)
$175m 7.37% US$ Private placement 2018	**(111.3)**	(110.4)	(106.4)
$250m 7.20% US$ Guaranteed notes 2019	**(158.0)**	(156.5)	(151.0)
Bank and other loans	**(2.0)**	(1.5)	(1.8)
	(907.0)	(993.4)	(978.4)
Borrowings	**(1,102.8)**	(1,016.3)	(990.1)
Net debt	**(957.0)**	(879.5)	(729.0)

Cash and overdraft balances in interest compensation cash pooling systems are reported gross on the balance sheet. This gross up increased cash and overdrafts by £2.1m at 28 January 2012 (29 January 2011: £0.4m; 31 July 2011: £0.1m).

Movements in net debt

	Net cash and cash equivalents £m	Other short-term borrowing £m	Long-term borrowings £m	Net debt £m
At 31 July 2011	260.7	(11.3)	(978.4)	(729.0)
Foreign exchange gains and losses	1.4		(14.2)	(12.8)
Net cash inflow/(outflow)	(120.0)			(120.0)
Repayment of borrowings		0.7	16.0	16.7
Drawdown of borrowings		(1.5)	(90.8)	(92.3)
Capitalisation, interest accruals and unwind of capitalised fees		(11.9)	(0.1)	(12.0)
Fair value movement from interest rate hedging		(4.0)	(3.6)	(7.6)
Change in maturity analysis		(164.1)	164.1	
At 28 January 2012	**142.1**	**(192.1)**	**(907.0)**	**(957.0)**

12 Provisions for liabilities and charges

	Warranty provision and product liability £m	Reorganisation £m	Property £m	Disposal £m	John Crane, Inc. litigation £m	Other litigation £m	Total £m
At 31 July 2011	37.6	7.8	3.4	3.9	181.7	14.4	248.8
Exchange adjustments		0.2			8.4	0.7	9.3
Business combinations	0.4						0.4
Provision charged	11.3	10.8	0.2		16.2	51.9	90.4
Provision released	(1.4)	(0.7)	(0.5)		(1.0)		(3.6)
Unwind of provision discount					2.4		2.4
Utilisation	(7.8)	(3.0)	(0.2)		(12.4)	(4.3)	(27.7)
At 28 January 2012	**40.1**	**15.1**	**2.9**	**3.9**	**195.3**	**62.7**	**320.0**

Analysed as:

	28 January 2012 £m	29 January 2011 £m	31 July 2011 £m
Current liabilities	**81.0**	67.0	74.7
Non-current liabilities	**239.0**	214.4	174.1
	320.0	281.4	248.8

Reorganisation

The increase in the reorganisation provision is in respect of the performance improvement programme in Smiths Detection.

Litigation

John Crane, Inc.

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

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

JCI is actively monitoring 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 all asbestos claims based upon this defence. Approximately 206,000 claims against JCI have been dismissed before trial over the last 32 years. JCI is currently a defendant in cases involving approximately 99,000 claims. Despite the large number of claims brought against JCI, it has had final judgments against it, after appeals, in only 113 cases over the period, and has had to pay awards amounting to approximately US$109m. JCI has also incurred significant additional defence costs and, whilst the number of claims being filed against JCI and other defendants has been declining, the proportion of mesothelioma claims has increased, and JCI's ability to defend these cases is likely to have a significant impact on its annual aggregate adverse judgment and defence costs.

The assumptions made in assessing the appropriate level of provision include:

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

The provision is based on past history and allows for decreasing levels of new claims based on published tables of asbestos incidence projections and is determined using asbestos valuations experts, Bates White LLC. The projections use a 10 year time horizon on the basis that Bates White LLC consider that there is substantial uncertainty in the asbestos litigation environment so probable expenditures are not reasonably estimable beyond this time horizon, see note 13.

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

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

	28 January 2012 £m	29 January 2011 £m	31 July 2011 £m
Gross provision	**211.2**	207.1	203.1
Discount	**(15.9)**	(38.9)	(21.4)
Discounted pre-tax provision	**195.3**	168.2	181.7
Deferred tax	**(44.4)**	(44.7)	(50.6)
Discounted post-tax provision	**150.9**	123.5	131.1

Titeflex Corporation

In recent years Titeflex Corporation, a subsidiary of the Group in the Flex-Tek division, has received a number of claims from insurance companies seeking recompense on a subrogated basis for the effects of damage allegedly caused by lightning strikes in relation to its flexible gas piping product. 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. The number of claims received each year and the cost of resolving them has varied. The associated costs of between £3m and £5m a year have historically been charged against headline operating profit. Equivalent third-party products in the US marketplace face similar challenges with the profile of legal activity appearing to increase in recent times. The continuing progress of claims and the pattern of settlement, together with the recent market place activity, now 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 subrogation claims to the extent that such costs can be reliably estimated. Titeflex Corporation sells flexible gas piping with extensive installation and safety guidance (revised in 2008) designed to assure the safety of the product and minimise the risk of damage associated with lightning strikes.

The assumptions made in assessing the appropriate level of provision, which are based on past experience, include:

- The period over which expenditure can be reliably estimated
- The number of future settlements
- The average amount of settlements

The projections use a rolling 10 year time horizon on the basis that there is substantial uncertainty in the US litigation environment so probable expenditures are not reasonably estimable beyond this time horizon, see note 13.

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

The provision is a discounted pre-tax provision using discount rates, being the risk-free rate on US debt instruments for the appropriate period.

The JCI and Titeflex Corporation litigation provisions are the only provisions which are discounted.

13 Contingent liabilities and commitments

John Crane, Inc.

As stated in note 12, John Crane, Inc. ("JCI") is involved in numerous law suits pending in the United States in which plaintiffs are claiming damages arising from exposure to, or use of, products containing asbestos. The JCI products generally referred to in these cases are ones in which the asbestos fibres were encapsulated in such a manner that, according to tests conducted on behalf of JCI, the products were safe. JCI ceased manufacturing products containing asbestos in 1985.

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

Titeflex Corporation

As stated in Note 12, Titeflex Corporation has made provision for the cost of expected future subrogation claims. The Group considers claims might continue beyond the period covered by the provision; however because of the uncertainty surrounding the US litigation environment beyond this period, the costs cannot be reliably estimated.

Other contingent liabilities and commitments

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

14 Cash-flow from operating activities

	Period ended 28 January 2012 £m	Period ended 29 January 2011 £m	Year ended 31 July 2011 £m
Operating profit – continuing	**131.6**	208.4	438.0
Amortisation of intangible assets	**39.0**	36.1	72.3
Impairment of intangible assets			5.5
Profit on disposal of property, plant and equipment	**1.3**		(0.7)
Profit on disposal of business	**(0.9)**		(4.4)
Depreciation of property, plant and equipment	**28.3**	32.2	63.4
Share-based payment expense	**7.5**	8.3	13.8
Retirement benefits	**(22.1)**	(23.7)	(77.6)
Increase in inventories	**(32.3)**	(38.5)	(46.7)
Decrease/(increase) in trade and other receivables	**25.5**	(27.3)	(33.1)
(Decrease)/increase in trade and other payables	**(37.8)**	1.2	43.7
Increase/(decrease) in provisions	**59.1**	(13.7)	5.2
Cash generated from operations	**199.2**	183.0	479.4
Interest	**(20.6)**	(26.2)	(66.8)
Tax paid	**(45.4)**	(50.2)	(90.9)
Net cash inflow from operating activities	**133.2**	106.6	321.7

Headline operating cash-flow

	Period ended 28 January 2012 £m	Period ended 29 January 2011 £m	Year ended 31 July 2011 £m
Net cash inflow from operating activities	**133.2**	106.6	321.7
Exclude			
Interest	**20.6**	26.2	66.8
Tax paid	**45.4**	50.2	90.9
Cash outflow in respect of exceptional operating items	**22.4**	18.8	34.8
Pension deficit payments	**19.3**	21.0	60.1
Include			
Expenditure on capitalised development, other intangible assets and property, plant and equipment	**(39.7)**	(38.0)	(90.1)
Disposals of property, plant and equipment in the ordinary course of business		1.5	4.5
Headline operating cash-flow	**201.2**	186.3	488.7

Free cash-flow

	Period ended 28 January 2012 £m	Period ended 29 January 2011 £m	Year ended 31 July 2011 £m
Net cash inflow from operating activities	**133.2**	106.6	321.7
Expenditure on capitalised development, other intangible assets and property, plant and equipment	**(39.7)**	(38.0)	(90.1)
Disposals of property, plant and equipment in the ordinary course of business		1.5	4.5
Investment in financial assets relating to pensions financing	**(12.0)**		
Free cash-flow	**81.5**	70.1	236.1
Investment in other financial assets		(0.2)	(0.3)
Acquisition of businesses	**(169.0)**	(10.9)	(18.5)
Disposal of Aerospace		(6.8)	(6.2)
Disposal of businesses	**0.9**	(0.3)	3.9
Net cash-flow used in financing activities	**(33.4)**	(90.4)	(129.2)
Net (decrease)/increase in cash and cash equivalents	**(120.0)**	(38.5)	85.8

15 Acquisitions

During the six months ended 28 January 2012, the Group acquired the business of Turbo Components and Engineering Inc. ("TCE") (October 2011) on behalf of John Crane and 100% of the equity share capital of Power Holdings Inc. ("PDI") (October 2011) on behalf of Smiths Interconnect.

TCE services, repairs and builds replacement bearings and seals used in critical rotating equipment. This acquisition adds capability for servicing bearings to the John Crane aftermarket platform, creating an end-to-end product and service solution for John Crane's customers. The intangible assets recognised on this acquisition comprise the order book on acquisition, customer relationships and a contractual non-compete agreement. Goodwill represents the potential future growth from expanding the business through the John Crane global service network. The goodwill recognised is expected to be deductible for tax purposes.

PDI designs and manufactures specialist power distribution, conditioning and monitoring systems. PDI will be incorporated into Smiths Interconnect's power protection group, where it expands the range of power quality technologies into new, specialised, high growth markets. The intangible assets recognised on this acquisition comprise technology, customer relationships and trademarks. Goodwill represents the potential future growth from expanding the customer base and developing new technologies. £28.0m of the goodwill recognised is expected to be deductible for tax purposes.

From the date of acquisition to 28 January 2012, the acquisitions contributed £25.9m to revenue, £2.8m to headline profit before taxation and loss of £2.3m to profit before taxation due to the amortisation of acquired intangible assets. If Smiths had acquired the businesses at the beginning of the financial period, the acquisitions would have contributed £44.5m to revenue and a loss of £8.9m to profit before tax.

The values set out below are provisional pending finalisation of the fair values attributable, and will be finalised by October 2012.

	Power Holdings Inc.			Other acquisitions			
	Book value £m	Fair value adjustments £m	Provisional fair value £m	Book value £m	Fair value adjustments £m	Provisional fair value £m	Total £m
Non-current assets							
– intangible assets		49.5	**49.5**		3.7	**3.7**	**53.2**
– land and buildings	0.3		**0.3**				**0.3**
– plant and equipment	0.8		**0.8**	0.5	(0.1)	**0.4**	**1.2**
Current assets							
– trade and other receivables	24.4	(0.1)	**24.3**	1.8		**1.8**	**26.1**
– other current assets	7.3	(1.0)	**6.3**	0.4	(0.1)	**0.3**	**6.6**
Non-current liabilities							
– other liabilities	(0.4)	(12.2)	**(12.6)**				**(12.6)**
Current liabilities							
– overdrafts	(0.4)		**(0.4)**	(0.1)		**(0.1)**	**(0.5)**
– other current liabilities	(11.9)	(0.1)	**(12.0)**	(0.4)		**(0.4)**	**(12.4)**
Net assets acquired	**20.1**	**36.1**	**56.2**	**2.2**	**3.5**	**5.7**	**61.9**
Goodwill on current year acquisitions			**98.1**			**7.4**	**105.5**
Total consideration			**154.3**			**13.1**	**167.4**
Cash paid during the period – current year acquisitions							**168.2**
Deferred consideration – current year acquisitions							**(0.8)**
Total consideration							**167.4**

16 Related party transactions

The related party transactions in the period were consistent with the nature and size of transactions disclosed in the Annual Report for the year ended 31 July 2011.