smiths
bringing technology to life

News release

London, Wednesday 19 September 2012
For immediate release

Annual results for the year ended 31 July 2012

	Headline*				Statutory	
	2012 £m	2011 £m	Growth	Underlying#	**2012 £m**	2011 £m
Revenue	**3,038**	2,842	7%	5%	**3,030**	2,842
Operating profit	**554**	517	7%	7%	**407**	438
Operating margin	**18.2%**	18.2%	–	–	**13.4%**	15.4%
Pre-tax profit	**497**	463	7%	7%	**366**	398
Basic EPS	**92.6p**	86.5p	7%		**65.4p**	77.8p
Free cash-flow	**217**	236				
Dividend	**38.0p**	36.25p	5%		**38.0p**	36.25p
Return on capital employed	**16.5%**	16.4%	10 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 and impairment of acquired intangible assets, profit/loss on disposal of businesses, costs of acquisitions, pension finance credit and financing gains/losses from currency hedging. Free cash-flow and return on capital employed are described in the Financial review. 2011 headline pre-tax profit, headline basic EPS and return on capital have been restated (see notes 1 and 3 to the accounts).

#Organic growth at constant currency.

Highlights

- Headline revenue 7% higher; growth across all divisions
- Headline operating profit up 7% - as investment in growth drivers is increased
- Company-funded investment in new product development up 9% to £107m
- Emerging market revenue up 14%; now representing 15% of Group revenues
- Performance improvement initiatives on track in Smiths Detection; improving order book
- Strong headline operating cash conversion at 99% – with free cash-flow of £217m
- Dividend up 5%

“Smiths Group has performed well in a persistently tough economic environment, growing revenue across all divisions with a stronger performance in the second half. Headline margins were maintained while we significantly increased our investment in sales, marketing and new product development. We achieved strong cash conversion, and return on capital was also ahead of last year.

“The economic environment remains uncertain. Pressures on government spending are expected to continue, particularly given the risk of budget sequestration in the US and widespread concerns over national debt levels in parts of Europe. These conditions are likely to continue to constrain those parts of our business with government-funded customers.

“However, our investment initiatives are building a solid foundation to accelerate medium-term revenue growth. We will continue to deliver operational improvements and efficiencies, while balancing increased investment in the drivers of long-term profitable growth with opportunities to enhance margins and returns. Subject to economic conditions, I am confident we can continue to grow sales, deliver further operational improvements, achieve strong cash conversion and improve returns.”

Philip Bowman
Chief Executive

Divisional highlights*

	% of Group headline revenue	Underlying headline revenue growth*	Underlying headline profit growth*	Headline operating profit margin		Headline return on capital employed	
				2012	2011	**2012**	2011
John Crane	32%	**9%**	**11%**	**21.6%**	21.1%	**24.0%**	21.8%
Smiths Medical	28%	**2%**	**2%**	**23.5%**	23.4%	**17.6%**	16.9%
Smiths Detection	17%	**3%**	**13%**	**13.3%**	12.8%	**10.3%**	9.8%
Smiths Interconnect	15%	**3%**	**(9)%**	**14.7%**	17.8%	**12.3%**	15.7%
Flex-Tek	8%	**5%**	**36%**	**16.3%**	12.5%	**28.4%**	21.9%
Group	100%	**5%**	**7%**	**18.2%**	18.2%	**16.5%**	16.4%

John Crane
- Revenue up 9% driven by both original equipment and aftermarket revenue, particularly in the oil and gas sector
- Margins improved 50 basis points to 21.6%, while increasing investment in future growth drivers
- TCE acquisition completed and integration well underway; expands our bearings aftermarket offering
- Order book provides visibility for continued growth through the first half of financial year 2013.

Smiths Medical
- Revenue growth of 2% driven by strong H2 with new product launches and growth in emerging markets
- Growth despite tough operating environment with healthcare spend constraints and pricing pressures
- Invested £7m in additional sales capabilities in emerging markets; 9% increase in new product development
- Investment initiatives will continue in the coming year to drive future sales growth

Smiths Detection
- Revenue up 3% with strong H2 recovery; driven by transportation, critical infrastructure and ports and borders
- Margins benefiting from £8m of efficiency savings, net of restructuring costs
- Performance improvement programme on track with site rationalisation and 8% headcount reduction
- Significant recent contract wins and strong product pipeline lay a solid foundation for 2013

Smiths Interconnect
- Revenue up 3% driven by strong growth in microwave offset by declines in connectors and power management
- Revenue also helped by acquisition of Power Holdings, Inc., by expanding our product offering into new markets
- Margins reduced by adverse pricing/mix and the dilutive impact of Power Holdings acquisition
- Markets remain challenging, particularly for defence customers

Flex-Tek
- Revenue up 5% driven primarily by aerospace and US residential construction
- Improved volumes, mix and pricing contributed to a strong increase in margins
- The aerospace and US construction sectors are expected to support continued sales growth
- Margins are geared to volume improvements across Flex-Tek's end markets

**All figures are on a headline basis. Revenue 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 19 September. A recording of the webcast is available later that day. A live audio broadcast of the presentation is also available by dialling (no access code required):

UK toll free: 0800 368 1916

International: +44 (0)20 3140 0722

US/Canada toll free: 1 866 978 9967

An audio replay is available for seven days on the following numbers (access PIN 386092#):

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 £366m (2011: £398m) and earnings per share were 65.4p (2011: 77.8p).

The items excluded from headline performance comprise:

- amortisation and impairment of acquired intangible assets of £62m (2011: £50m);
- £44m in connection with John Crane, Inc. asbestos litigation (2011: £34m);
- £55m for the establishment of a provision to resolve potential future claims alleging product liability in Titeflex Corporation (2011: nil);
- £15m of exceptional restructuring costs (2011: £16m);
- £8m in relation to a change in the basis of estimating sales rebates in Smiths Medical (2011: nil);
- acquisition costs of £2m (2011: £1m);
- £3m gain on reassessed contingent consideration (2011: nil);
- £38m deferred tax asset written off in respect of UK taxation (2011: nil);
- £31m profit on disposal of businesses (2011: £4m);
- £24m for retirement benefit finance income (2011: £23m); and
- financing losses of £3m (2011: £3m).

Chief Executive's review

Against a persistently tough macroeconomic backdrop, Smiths Group has performed well. The results reflect the benefit of the operational and margin improvement programmes implemented over the past four years. The focus on improved data-based decision making, performance enhancement and consistency of approach has delivered a significant and sustainable improvement in the underlying profitability, returns and quality of the Group's businesses. We have also continued to benefit from the strength and breadth of being a diversified industrial company, with our portfolio of leading-edge, technology-driven businesses serving a broad range of geographies and markets.

We achieved improvements on safety and environmental metrics and on sales, cash and returns. Our drive to accelerate revenue growth has begun to deliver results, with revenue growing across all five divisions. Headline operating profit margins improved in all but Smiths Interconnect, as a result of volume leverage, better pricing and our continued focus on operational improvement and restructuring. Cash conversion remained strong and we delivered further improvements in return on capital employed.

John Crane grew revenue strongly on continued demand from its end markets, particularly the oil and gas sector; although the rate of growth eased during the second half. Margins progressed to record highs as a result of the higher volumes and better pricing, more than offsetting cost inflation and investment in specific OEM opportunities. Smiths Medical delivered an acceleration in revenue growth during the year with a strong contribution from new products such as Medfusion 4000 and CADD-Solis. Margins advanced slightly, while we substantially increased investment in future growth drivers, such as new product development and sales and marketing. This result has been achieved despite a tough operating environment, particularly in the mature markets of the US and Europe, where budget pressures and pricing have been difficult. Smiths Detection performed strongly in the second half in both sales and profit, driven by equipment sales to airports and critical infrastructure which more than offset declines in military and emergency responder revenue. The performance improvement programme, announced last year, also generated cost savings and operational enhancements. Smiths Interconnect also saw a better second half resulting in overall revenue growth despite declines in its military sales as a result of lower defence spending. However, margins suffered with adverse pricing/mix and the dilutive impact of the acquisition of Power Holdings Inc. (PDI). Flex-Tek grew revenue across the aerospace and construction markets, supporting higher margins as a result of its strong operational gearing.

Investing to accelerate revenue growth – new products
We have maintained technology leadership in many areas through a firm commitment to new product development and innovation, a key driver of future revenue and margin growth as new products typically command higher margins. We raised company-funded investment in R&D by 9% to £107m and secured a further £10m of customer-funded investment to take our total spend to £117m, or 3.8% of revenue (2011: 3.9%). This long-term investment is delivering results with several important new product launches. Smiths Medical saw an uplift in revenue driven by Medfusion 4000 in the US and the release of CADD- Solis PIB and VIP platforms outside the US. Smiths Detection unveiled several new products including a lightweight mobile X-ray system for cargo screening; GUARDION, a gas chromatography and mass spectrometry chemical identifier; and HazMatID Elite, an improved infra-red identifier for unknown chemical threats. Detection has also launched a new checked baggage screener, which received EU certification in September. It uses multi-view X-ray and three-dimensional computed tomography to achieve enhanced detection and throughput capabilities. John Crane has continued to make progress on its portfolio of environmentally focused zero and low emission seals and on extending the high pressure capabilities of its compressor dry gas seals.

Investing to accelerate revenue growth – high-growth markets
We expanded our presence in emerging markets with an impressive 14% increase in revenue, so that they now represent around 15% of the Group. Investment in these high growth markets remains a priority. In Smiths Medical, we expanded our sales force by 250 in targeted markets such as China, India and Brazil. At the same time, we have a programme to register a greater proportion of our products in these markets. In John Crane, we opened a new state-of-the-art test and diagnostic facility for all seals at a key service centre in Dubai to serve the Middle East. This is additional to new and expanded facilities in Asia and Latin America, as well as an expanded product offering in China. Smiths Detection has opened a new X-ray manufacturing hub in Malaysia to serve the Asian market.

Driving savings to enhance margins and invest in growth
Margins have continued to benefit from the major restructuring programme that began in 2008, delivering further savings of £14m in the period. This programme is now largely complete with annualised savings of £70m, against our total planned savings of £70m. The costs to achieve the programme were £55m.

Last year, we also launched a performance improvement programme in Smiths Detection which is scheduled to deliver annualised savings of £40m by the end of financial year 2014, at a cost of £40m. In its first year, the programme delivered savings of £15m with £11m expected in the coming financial year. This will lower the fixed cost base and enable the business to respond better to variations in demand while improving customer service.

Improving capabilities through cross-divisional working

We intend to improve performance and capabilities in all five businesses through cross-divisional working groups who share best practice and a consistent approach to processes and reporting in areas of common interest. To date, groups focusing on quality and innovation have been established. One has developed a consistent approach to measuring the cost of 'unquality' and is identifying further opportunities to improve quality, thereby reducing costs. The other has adopted a common gate-driven approach for managing innovation projects. We will continue to evaluate what other areas of Smiths Group could benefit from such an approach.

Enhancing talent throughout the organisation

We have progressively raised the bar in terms of fostering talent in order to drive our strategic initiatives forward. There are now more rigorous and consistent processes to assess talent and we are investing more in preparing and monitoring personal development plans. A new senior leadership programme has also been introduced to complement the existing scheme for junior managers. While this focus has helped strengthen the team, we will continue to challenge ourselves as to whether we have the appropriate skill sets across the organisation.

Strong cash generation

We achieved another strong year of cash generation. Headline operating cash generation improved by £60m to £549m resulting in headline operating cash conversion of 99% (2011: 95%). This was more than offset by the net impact of acquisitions and disposals, pension contributions and dividends, increasing net debt by £62m to £791m. The Group benefits from high cash conversion and a sound balance sheet.

Allocating capital to maximise returns

Improving returns on capital by enhancing margins while operating an efficient capital base remains a key priority. Overall Group return on capital rose by 10 basis points to 16.5%. We achieved improved returns across all divisions except Smiths Interconnect where they declined as a result of lower profitability in its underlying business and the impact of the PDI acquisition.

Subject to suitable market conditions, we continue to manage the portfolio of businesses through a combination of acquisitions that satisfy our strategic and financial objectives and disposals that realise additional value for our shareholders. This is undertaken in the context of continuing to manage the legacy issues of the actuarial deficits on the defined benefit pension plans and ongoing historic product liability litigation.

During the year, the Group made two acquisitions and one significant disposal. Smiths Interconnect acquired Power Holdings Inc., a leading designer and manufacturer of specialist power distribution, conditioning and monitoring systems, for $235m. The acquisition exemplifies the Group strategy to invest in complementary technologies and gain access to attractive markets. In October, John Crane acquired the business of Turbo Components and Engineering Inc. which services, repairs and builds replacement bearings and seals used in critical rotating equipment. It establishes a template for bearings aftermarket servicing that will accelerate the roll-out of John Crane's aftermarket offering through its global network. In July, Smiths Detection sold its interest in Cross Match Technologies Inc., a biometrics business that was considered non-core, raising £45m in cash.

Managing our legacy liabilities

The Group manages 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 weaker asset performance of equities relative to gilts. The funding position has worsened over the past five years despite the actions the Group has taken to minimise liabilities, resulting in curtailment gains of around £75m, and cash contributions amounting to £378m over this period. The triennial reviews for the two main UK schemes with valuation dates of March and April 2012 are underway and are scheduled to complete this coming financial year.

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 but more recently has cost between £3m and £5m a year. A provision was recognised in the interim accounts to defend potential future claims over the next 10 years. Further details are given in notes 4 and 22 to the accounts.

Dividend

The Board has adopted a progressive dividend policy for future payouts while maintaining a dividend cover of around 2.5 times. This policy will enable us to retain sufficient cash-flow to meet our legacy liabilities and finance our investment in the drivers of growth.

The Board has recommended a final dividend of 26.25p per share, giving a total for the year of 38.0p, an increase of 5%. The final dividend will be paid on 23 November to shareholders registered at the close of business on 26 October. The ex-dividend date is 24 October.

Outlook

The economic environment remains uncertain. Pressures on government spending are expected to continue, particularly given the risk of budget sequestration in the US and widespread concerns over national debt levels in parts of Europe. These are likely to restrain those parts of our business with government-funded customers.

However, our investment initiatives are building a solid foundation to accelerate medium-term revenue growth. We will continue to deliver operational improvements and efficiencies, while balancing increased investment in the drivers of long-term profitable growth with opportunities to enhance margins and returns. Subject to economic conditions, I am confident we can continue to grow sales, deliver operational improvements, achieve strong cash conversion and improve returns. Outlook statements for the divisions are provided in the Business review.

Business review

Revenue

Headline revenue increased by 7%, or £196m, to £3,038m. The net impact of acquisitions and disposals contributed £52m and currency translation added a further £6m. On an underlying basis, excluding currency translation and acquisitions, revenue grew £138m. This increase was achieved by underlying revenue growth across all five divisions: John Crane (up £79m), Smiths Medical (up £20m), Detection (up £16m), Smiths Interconnect (up £13m) and Flex-Tek (up £10m). Reported revenue at £3,030m includes a one-off adjustment of £8m in respect of a change in the basis of estimating customer rebates at Smiths Medical (see note 4 to the accounts for further details). This change, which was reported at the half year, has been prompted by the availability of better data and estimation techniques.

Profit

Headline operating profit rose £37m to £554m. Headline operating margin was maintained at 18.2% (2011: 18.2%). The growth comprises a £34m, or 7%, underlying increase in headline operating profit, a £2m benefit from the net impact of acquisitions and £1m from favourable currency translation. The main drivers of this £34m underlying improvement were higher volumes and pricing at John Crane (up £20m), higher volumes and a change in accounting treatment for litigation at Flex-Tek (up £10m), cost savings at Smiths Detection (up £8m), increased volumes offsetting adverse pricing and higher investment at Smiths Medical (up £5m), partly offset by adverse mix and price at Smiths Interconnect (down £6m). Corporate centre costs were up £3m on last year including £1m of cost in the captive insurer subsidiary from meeting operating company insurance claims.

Operating profit on a statutory basis, after taking account of the items excluded from the headline figures, was £407m (2011: £438m).

The net interest charge on debt increased to £63m (2011: £59m) reflecting the higher average levels of debt. Contribution from associates, which relates to our share of the post-tax profits of Cross Match Technologies Inc., increased by £2m to £6m. Our equity interest in this business was sold in July 2012. Headline profit before tax increased by £34m to £497m (2011: £463m - restated). On an underlying basis, headline profit before tax grew by 7%. 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: 26.5% - restated). Headline earnings per share increased by 7% to 92.6p (2011: 86.5p - restated).

On a statutory basis, profit before tax decreased £32m to £366m (2011: £398m); it is stated after taking account of the pensions finance credit of £24m (2011: £23m) and other items excluded from the headline measure.

Cash generation

Operating cash generation remained strong with headline operating cash of £549m (2011: £489m), representing 99% (2011: 95%) of headline operating profit (see note 27 to the accounts for a reconciliation of headline operating cash and free cash-flow to statutory cash-flow measures). Free cash-flow fell £19m to £217m (2011: £236m). Free cash-flow is stated after interest, tax and pensions financing, but before acquisitions, financing activities and dividends.

On a statutory basis, net cash inflow from continuing operations was £332m (2011: £322m).

Dividends paid in the year on ordinary shares amounted to £144m (2011: £136m).

Net debt at 31 July was £791m, up from £729m at 31 July 2011. The increase in net debt reflects strong cash generation that was more than offset by outflows from the net impact of acquisitions and disposals (£120m), dividends (£144m) and pension funding (£122m).

John Crane

	2012 £m	2011 £m	Reported growth	Underlying growth
Revenue	**973**	894	9%	9%
Headline operating profit	**210**	189	11%	11%
Headline operating margin	**21.6%**	21.1%	50 bps	
Statutory operating profit	**155**	143		
Return on capital employed	**24.0%**	21.8%	220 bps	

John Crane grew revenue by £79m (9%), driven by a £79m increase in underlying revenue, and a £6m benefit from the acquisition of the business of Turbo Components and Engineering Inc. (TCE), offset by £6m of adverse currency translation. Higher revenue from first-fit original equipment and increased aftermarket revenue across all end markets, particularly oil and gas, and chemical, drove the underlying growth.

Reported headline operating profit rose 11% driven by a £20m (11%) increase in underlying profit and a £2m contribution from TCE, offset by adverse currency translation (£1m). Margins increased 50 basis points to 21.6% from the prior year. This underlying improvement in profitability stems predominantly from increased volumes, benefits from our cost-saving initiatives and better pricing on aftermarket sales. These gains in margin occurred despite increased investment in highly competitive first-fit original equipment projects, higher sales and marketing spend and cost inflation. Return on capital employed improved 220 basis points to 24.0% because of improved profitability.

Statutory operating profit at £155m reflects the cost of John Crane, Inc. asbestos litigation (£40m).

Overall aftermarket revenue grew 9% on an underlying basis, benefiting principally from strong demand in the oil and gas, and chemical sectors. Aftermarket revenue from rotating equipment (seals, seal support systems, couplings, bearings and filtration, together representing 89% of revenue) increased 9% with growth across all sectors. Sales for John Crane Production Solutions, representing 11% of revenue, advanced 8% as a result of greater activity in US onshore oil and gas production.

First-fit original equipment revenue rose 9% 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 and gas, and chemical sectors. John Crane continues to invest in targeted 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. New service centres have opened in Turkey, Western Australia and Alaska. The greatly expanded Dubai facility was officially opened in February 2012.

In China, localised manufacturing and commercial impact of the 'Safematic' pulp and paper seal lines, and the new metal bellow seal line continue to strengthen our developing aftermarket position. The opening of a new training facility and the upgrade, relocation and opening of three other service facilities in China have strengthened our footprint and field support capabilities. Expansion work began on the Rio Claro plant in Sao Paulo, Brazil, for the manufacture of American Petroleum Institute (API) standard seal system reservoirs, and John Crane Indufil filtration systems.

This focus on emerging market expansion is delivering results with a 14% sales increase, such that these faster growth areas now represent over 20% of John Crane sales. Continued investment will enhance our sales and service capabilities as well as broadening our product range in these key markets in the Middle East, Asia and Latin America.

Research and development

John Crane is committed to increasing investment in research and development. Investment in new product development increased 8% to over £11m. The company's focus remains on developing products that support reduced environmental impact, energy efficiency, condition monitoring and control, and provide engineered solutions to address our customers' growing processing demands.

The company is currently expanding its portfolio of seals offered to the mining and minerals, power generation and oil and gas markets. Developments in these areas include expanded split seal designs, slurry seals, uncooled boiler-feed seals and the use of innovative materials that enhance seal, bearing and coupling performance capabilities. John Crane is also investing in new product designs to meet the local needs of emerging markets.

John Crane additionally continues to research slow-roll conditions, face coatings, and bi-directional capabilities for turbo gas seals with a view to achieving step changes in sealing performance to extend uptime in difficult rotating equipment operating environments.

Business developments

John Crane has also pursued a strategy to expand its addressable market by making targeted acquisitions that add complementary technologies and products while also leveraging its extensive network of sales and service centres. This was behind the acquisition of Houston-based Turbo Components and Engineering Inc. (TCE) in October 2011. TCE services, repairs and builds replacement bearings and seals used in critical rotating equipment and adds to our existing engineered bearings business which was formed through acquisitions in 2007 and 2009. The acquisition accelerates plans to develop an aftermarket services business to support our existing engineered bearings offering. Progress in market penetration of the expanded product line continues to advance globally, with several new accounts won in bearings and filtration.

The bearings and filters business is now integrated within rotating equipment, which is managed in three geographical units.

Paul Cox stepped down as Divisional General Manager of John Crane in May. The process to appoint a permanent replacement is well advanced and in the interim, Tedd Smith, the Divisional General Manager of Flex-Tek, is running the division. We remain convinced that there is significant unrealised potential within this business.

Outlook

John Crane's order book is expected to support continued sales growth in the first half of the year. However, the outlook beyond that remains uncertain given the economic turbulence in Europe and slowdowns in several major economies around the world. Full-year sales growth will be dependent upon sustained maintenance and repair activity in our key end markets as well as continued investment in capital projects in high-growth regions. Margins will benefit from on-going operational efficiency efforts, offset by strategic investments in longer-term growth opportunities such as the expansion of our sales and service network, targeted large projects and increasing our presence in growth markets.

Smiths Medical

	2012 £m	2011 £m	Reported growth	Underlying growth
Headline revenue	**864**	838	3%	2%
Headline operating profit	**203**	196	3%	2%
Headline operating margin	**23.5%**	23.4%	10 bps	
Statutory revenue	**856**	838	2%	
Statutory operating profit	**180**	178		
Return on capital employed	**17.6%**	16.9%	70 bps	

Smiths Medical grew headline revenue 3%, or £26m, reflecting an underlying increase in revenue of £20m (2%), as well as a currency benefit of £6m. The underlying growth resulted from new product launches, particularly Medfusion 4000 and CADD-Solis PIB and VIP platforms, emerging market revenue (9% growth, now representing over 10% of revenue) and a broadening of our product sales efforts. Headline operating profit rose 3% (£7m) and headline operating margin increased 10 basis points to 23.5%. These results were achieved despite pricing pressure in many markets and increased investment in a range of growth initiatives, including new product development and sales capabilities in emerging markets. Margins benefited from initiatives to cut manufacturing costs and overheads, as well as a favourable product mix.

Statutory revenue and operating profit both include an £8m charge which reflects our decision to change the basis for estimating the accrual for rebates to distributors. This change was prompted by the availability of better data and estimation techniques; and was reflected in the interim accounts.

Return on capital employed improved 70 basis points to 17.6% as a result of the increased profits.

The underlying growth in revenue and profitability was achieved despite difficult trading conditions in the medical devices sector. These stemmed from adverse pricing, capital spending constraints and a slowdown in procedure growth rates in some countries. The pressures were particularly acute in Europe given the prevailing austerity measures and economic uncertainty. However, procedure rates in the US and some other markets have shown recent signs of improvement. Consumables sales, which represent almost 85% of our total revenue, were up 1%. Hardware revenue improved 6%, largely due to strong sales of the new wireless Medfusion 4000 syringe pumps, as well as CADD-Solis and VIP ambulatory pumps.

While developed markets remain testing, 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, adding approximately 250 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. We are already seeing early signs of success with double digit revenue growth in India, China, the Middle East and Latin America.

Revenue from safety devices grew 4%, 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 positioned to benefit from the EU Directive, adopted in 2010, to improve workplace safety by preventing sharps-related injuries. We anticipate two safety catheter product launches in the coming year to capture global opportunities and replace declining conventional catheter sales. In addition, we have seen a recovery in vascular access, particularly huber needles and central venous catheters in most markets.

Medication delivery revenue experienced strong growth in the second half and, excluding diabetes, full year results improved 4%. Ambulatory infusion revenue rose 9% through the continued success of our CADD-Solis pumps and dedicated disposable sets, as well as CADD-Solis PIB and VIP sales outside the US. Infusion system revenue also grew, primarily due to Medfusion 4000. This new product continues to have a robust order pipeline, and we are well placed to capture further growth in this market.

Vital care underlying revenue was flat, despite relatively sluggish procedure volumes and pricing pressures in developed countries, particularly reimbursement pricing pressure in Japan. Assisted reproduction, general anaesthesia, invasive blood pressure monitoring, respiratory and tracheotomy businesses all grew. Patient monitoring posted a strong performance due to enhanced capnography sales. These gains were offset by a slight decline in temperature management and declines in veterinary and kitting product lines where we are eliminating low-margin stock-keeping units.

We also continue to optimise our manufacturing and distribution footprint to deliver a more efficient supply chain. Operational responsibility for our European distribution centre in Nijmegen, Netherlands, has been brought in-house to reduce costs and improve performance. We continue to pursue variable cost productivity initiatives aggressively, contributing to margin expansion and enabling further investment in sales and marketing resources.

Research and development

Investment in R&D remains a priority, increasing 9%. Our total R&D spend of £34m (2011: £31m) comprised 3.9% of revenue (2011: 3.7%). We continued to narrow the number of pipeline projects to ensure there is adequate investment in the highest impact products. This is raising the rate of project execution and will continue to increase overall R&D effectiveness.

Revenue from products launched in the last three years totalled some 10.5%, an increase on the prior year. During the year, we launched two significant medication delivery products: our Medfusion 4000 syringe pump with wireless connectivity into the US and Canadian markets and the release of our CADD-Solis PIB and VIP platforms outside the US. These launches have driven significant growth, consolidating our leadership in the syringe and ambulatory pump markets. We received FDA 510(k) clearance for our new ViaValve Safety IV Catheter in North America, while in Europe we have CE clearance for our new Jelco IntuitIV Safety IV Catheter. We have also launched new blood collection products that extend our VeniPuncture Needle-Pro and Saf-T Wing blood collection range of products. In emerging markets, we have registered multiple safety product ranges in Brazil, China and India, where we are engaging our customers on the benefits of adopting safety devices. In the UK, we unveiled our CorrectInject Safety System, an innovative connection system designed to enhance patient safety through a reduction in the risk of misconnection, while minimising change in clinical technique. We anticipate further CorrectInject system-related product launches in the coming year.

Outlook

Developed markets are likely to remain challenging in the short term as healthcare cost controls and unemployment put pressure on price and volumes. In the US, the medical device excise tax of 2.3% is expected constrain growth and margins, though we will seek to offset the impact, primarily through operational improvements and increased focus on higher margin products. Against these trading conditions, our R&D pipeline is strong and we will seek to drive sales growth through increased investment and new product introductions, coupled with a continued emphasis on customer-facing resources and sales effectiveness.

Smiths Detection

	2012 £m	2011 £m	Reported growth	Underlying growth
Revenue	**519**	510	2%	3%
Headline operating profit	**69**	66	6%	13%
Headline operating margin	**13.3%**	12.8%	50 bps	
Statutory operating profit	**84**	64		
Return on capital employed	**10.3%**	9.8%	50 bps	

Revenue at Smiths Detection grew 3% (£16m) on an underlying basis, excluding the impact of acquisitions and disposals and currency translation. A £1m gain from foreign currency translation was offset by a £8m net impact from acquisitions and disposals, arising from the sale of the food inspection business in March 2011 and an optical analysis company in February 2012. The 17% recovery in underlying revenue in the second half was driven by growth in transportation, critical infrastructure and ports and borders, which more than offset declines in the military and emergency responder sectors.

Headline operating margins improved 50 basis points to 13.3% as headline operating profit rose by £3m, or 13%, on an underlying basis. This was driven by cost savings from the performance improvement programme, announced at the start of the period, which more than offset the impact of some low margin contracts negotiated in previous years, additional investment in sales resources and an unfavourable product mix from reduced military sales.

Statutory operating profit includes profits from the disposal of Cross Match Technologies Inc. (£27m) and exceptional restructuring costs (£13m).

The improvement in profitability resulted in a 50 basis point improvement in return on capital, which rose to 10.3%.

The performance improvement programme delivered £15m of savings and incurred £20m of costs, of which £13m was treated as exceptional. The programme is expected to deliver £40m of annualised savings by the end of the 2014 financial year. It will cost £40m overall, of which £9m is expected in the coming year, treated as exceptional costs.

Site rationalisation and an 8% headcount reduction significantly boosted cost savings. In the US, five business units have been closed or divested over an 18-month period, with continuing operations now focused at three main sites. We have begun to evaluate opportunities for value engineering projects and there was a close focus on all expenditure which delivered savings. A new global manufacturing initiative for X-ray machines, centred on three regional hubs, will also deliver performance improvements. This includes a new production facility for X-ray systems in Malaysia, which opened at the end of the period and will grow substantially during the coming year, eventually employing 170 people. The 130,000 sq. ft site will enable Smiths Detection to supply its technology directly to the world's fastest growing air transportation market, and respond quickly to customer requirements in the region.

Wiesbaden, Germany, will remain as a major X-ray production centre, while continuing as the R&D centre of excellence for the technology. The third hub is at the Edgewood facility in the US, which was expanded by 100,000 sq. ft with the addition of a manufacturing and training area, as part of a $9m investment over the past five years. This will significantly expand X-ray systems production in the US.

Servicing the extensive installed base of our equipment is a major focus and, based on current growth levels, aftermarket operations are set to account for 30% of total revenues within three to four years. There was a 10% increase in aftermarket revenue in the year to 26% of revenue.

Revenue from emerging markets grew 10% driven by the Middle East, Brazil and Poland. Revenue in Brazil, including a major cargo screening equipment contract, was helped by investment in sales and marketing resources following the acquisition of our Brazilian distributor in the previous year.

The impact of government spending and legislative actions can be significant for Smiths Detection. In our largest market, the US, constrained budgets continue to affect key departments such as Homeland Security and Defense. Additional disruptions to government spending patterns are expected as a consequence of the forthcoming US elections. In Europe, there was a further postponement of legislation to adopt a uniform standard for detecting liquids in hand luggage, which could delay investment in the latest technologies ahead of the European Commission reconsidering its legislative plans later in the year.

Transportation revenue increased 12% including a number of airport contracts in Germany, Sweden, Austria, Poland and US. Investment by most airport operators and governments has been curtailed but new airports and terminals are planned, mainly in the Middle East and Asia Pacific region.

A greater focus on sales to the critical infrastructure sector saw underlying revenue grow 21%. This market, which includes government buildings, public utilities, prisons, hotels and other strategic sites, is central to our drive to achieve a greater proportion of regular run-rate business. This will bring more stability to balance the unpredictability of major programmes and our target is more than 30% of revenue derived from such regular orders, within two to three years.

Underlying revenue in ports and borders also grew 7%, and although spending by national governments was reduced, enquiry levels are encouragingly high. Major contracts for high-energy cargo scanners were awarded by Brazil, India, Azerbaijan and Nigeria. Market opportunities should be improved by the launch of a lightweight mobile system enabling easier operation in the field than traditional systems.

In the military sector, underlying revenue fell 31% due to cuts in military budgets. This reflects reduced spending patterns in line with the lower number of conflicts involving US and international forces. However, contracts continue to be awarded under the US Army's long-running JCAD (Joint Chemical Agent Detector) programme, resulting in $49m of orders since April 2012, of which $39m was booked as revenue in 2012.

Research and development

Smiths Detection remains committed to the funded development of its main technologies and new products and systems. The effectiveness of this investment was evidenced over the past year by the highest number of product launches in Smiths Detection's history.

Company-funded R&D increased 7% to £37m (2011: £35m), as a percentage of revenue reaching 7.2% (2011: 6.9%). This includes £15m of capitalised projects. Smiths Detection actively seeks customer and government support for R&D which totalled £6m in the period (2011: £8m). Total R&D spend was £43m (2011: £43m) or 8.3% of revenue.

Principal launches included GUARDION, a dual-technology chemical identifier; HazMatID Elite, a smaller, faster, lighter and more durable infrared identifier for unknown chemical threats; X-ray systems for air cargo screening; and a new mobile cargo inspection system.

At the start of the new financial year, the HI-SCAN 10080 XCT was launched. It is a next-generation explosives scanner for hold baggage which has recently received certification from the EU authorities. It combines 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. Critical to its success will be certification and approvals from the TSA, the key agency in the USA.

Outlook

The current order book is comfortably ahead of the same time last year and is expected to support sales growth over the coming year, with the benefit of major contract wins. Future revenues should also be strengthened by the expansion of our aftermarket business, although overall sales growth may be affected by the level of government spending. Headline operating margins are expected to gain from the restructuring initiatives now underway in the performance improvement programme.

Smiths Interconnect

	2012 £m	2011 £m	Reported growth	Underlying growth
Revenue	**449**	379	18%	3%
Headline operating profit	**66**	68	(2)%	(9)%
Headline operating margin	**14.7%**	17.8%	(310) bps	
Statutory operating profit	**34**	49		
Return on capital employed	**12.3%**	15.7%	(340) bps	

Reported revenue for Smiths Interconnect grew 18%, or £70m, driven mainly by the acquisition of Power Holdings Inc. (PDI) which added £54m. Underlying revenue grew £13m, or 3%, reflecting a strong second half performance from Microwave partially offset by tough trading conditions continuing to impact both Connectors and Power.

Reported headline operating profit declined 2%, or £2m. Excluding the £4m profit benefit from the PDI acquisition (net of integration costs), underlying headline operating profit fell 9% (£6m). Margins declined 310 basis points to 14.7% due to a combination of adverse operational gearing caused by lower volumes, particularly in Connectors, and a 90 basis point dilutive impact from PDI. First half gross margins were weak because of sales mix and pricing pressure. In response, we cut costs including headcount reductions in several facilities, closed one production plant, started the closure of another, outsourced some non-core manufacturing processes and transferred selected production capacity to low-cost countries. In addition, procurement initiatives continue to offset cost inflation. These actions helped increase second half margins compared with the first half. Action plans are also in place to improve PDI's margins through operational and procurement initiatives.

Return on capital employed declined to 12.3% as a result of the lower profitability in the underlying business and the impact of the PDI acquisition.

As announced in the interim results, the Smiths Interconnect reporting segments now align with its three technology areas of Connectors, Microwave and Power. Following the acquisition of PDI, the business was reorganised into these three technology areas and divisional management monitor and control the business on this basis.

In Connectors, underlying revenue fell 10% due to a combination of factors. First half performance was affected by the impact of flooding in South East Asia on customer supply chains and the seasonal slowdown in the semiconductor test sector. Two major medical equipment customers also cut orders. These factors improved in the second half whilst European demand fell, particularly in industrial markets due to economic pressures. The defence segment remained challenging throughout the year although we gained significant orders for electronic warfare and phased-array radar applications and achieved design wins for new missile and radar programmes. Revenue from rail customers grew significantly with contract wins in locomotive, rolling stock and signalling applications.

Microwave performed strongly with underlying revenue growth of 20%. In wireless telecommunications, despite a difficult environment, we successfully leveraged our technical and commercial capabilities to perform strongly. The increasing worldwide demand for smartphones and wireless devices is driving growth in both broadband test equipment and network upgrades to provide additional capacity and speed to support data demands. In two larger projects we provided cable assemblies for a production test application, and filter products to increase network performance and capacity for an Australian operator. Although the defence sector generally remains weak, we continued to focus on technologies and applications deemed as investment priorities. For example, in UAV (Unmanned Aerial Vehicle) applications we won contracts for a tactical GPS receiver and a new datalink ground antenna. We also gained funding for the next phase of our US Navy satellite communication terminal production programme which continues to be a significant revenue contributor. In commercial aerospace, sales of the KuStream airborne satellite antenna system strengthened as we resolved programme and production issues that affected the first half.

The addition of PDI more than doubled revenue from Power management. However, on an underlying basis, revenue fell by 12% because of delays in US military orders, a strong previous comparator period which included a significant one-off military programme, and fierce competition in China. In addition, we experienced soft demand from the North American wireless telecommunications market. But during the year we developed next-generation products to provide protection for nascent remote radio head technology and radio frequency protectors for broadband applications. Power management also remains well placed to benefit from the mandated adoption of Positive Train Control technology on US railroads, with power protection products to be used in towers, signals, wayside station and communications applications.

From an end-market perspective across Smiths Interconnect, underlying revenue grew 1% in wireless telecoms, rose 4% in military and aerospace, and an aggregate 5% in the medical, rail, automation and test markets.

Research and development

Total R&D spend increased to £27m or 6.0% of revenue (2011: £25m or 6.6% of revenue). Excluding PDI and customer-funding, which remained constant at £4m and was primarily defence project related, the underlying company-funded portion decreased to £20m (2011: £21m).

Investment focused more on commercial products and markets in accordance with Smiths Interconnect's strategy to allocate resources to higher growth sectors and opportunities offering the best returns. Examples include miniaturisation and high data rate connector technologies for semiconductor test applications; millimetre-wave components for a new radar system enabling helicopters to operate safely in poor visibility; and power and radio frequency protection devices for wireless telecommunications tower-top electronics. Innovation remains a core priority and the proportion of revenue from products or technologies developed in the last three years was maintained at over 30%.

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 also has facilities in Santa Ana, California and Howell, Michigan. The acquisition transforms our 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. It also offers sales and operational synergy opportunities and reduces the division's exposure to government-funded customers. Integration is essentially complete. Performance to date has fallen short of initial expectations due to a significant reduction in demand in the highly volatile alternative energy sector and flattening in PDI's core North American data centre market. This has led to a £11m impairment charge against statutory operating profit.

Data centre market growth projections remain positive for the medium to long term, which, combined with new international sales resources in Europe, India and China, will drive revenue improvements. Value creation opportunities have been identified and actions to improve manufacturing processes and margin performance are underway.

Outlook

Despite a positive ratio of orders to sales in the year and a stronger order book to start the current year, many of our markets remain challenging. US defence spending is projected to fall and, although we are relatively well-placed in some key technology sectors and on some good long-term programmes, the military market faces a significant headwind. Similarly, this year's growth in wireless telecommunications will provide a tough comparator in an essentially flat market. The commercial markets of semiconductor test and data centres are expected to be more robust, but will also be hindered by macroeconomic conditions and consumer spending patterns. Although volumes may decline in some sectors, margins should benefit from prior-year restructuring actions and ongoing operational efficiency initiatives.

Flex-Tek

	2012 £m	2011 £m	Reported growth	Underlying growth
Revenue	**233**	221	6%	5%
Headline operating profit	**38**	28	38%	36%
Headline operating margin	**16.3%**	12.5%	380 bps	
Statutory operating (loss)/profit	**(17)**	26		
Return on capital employed	**28.4%**	21.9%	650 bps	

Flex-Tek's reported revenue grew 6%, or £12m, driven by an underlying increase of £10m (5%) and a £2m gain from currency translation. The improvement was generated by revenue growth from aerospace components and sales to the US residential construction market. This was partially offset by weakness in the household appliance sector of our heating element business. Headline operating margin rose 380 basis points to 16.3% 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 £10m stemmed from higher volumes, pricing and the benefits of our cost-saving initiatives. There was also a £5m 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 22 to the accounts). Excluding this change in accounting treatment, the underlying headline operating profit rose 18%.

As announced at the half year, a provision has been established in these accounts to resolve future claims, resulting in a charge of £55m, leading to a statutory operating loss of £17m.

Return on capital employed rose 650 basis points on the back of the improved profitability.

In Fluid Management, sales of components to aerospace customers improved 13% on an underlying basis. This was achieved as a result of 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 and repair service segment. Demand in the commercial aviation market continues to be driven by increased passenger traffic, fuel and operating efficiency, and lower noise levels. In addition, sales of our flexible hose assemblies to the US automotive market for both fuel and brake applications remain robust.

Sales of our flexible gas piping and HVAC ducting to the construction market rose 11%. According to the US Census Bureau, the July 2012 seasonally adjusted annual rate of new single family home starts was slightly above 500,000, a level that has been fairly constant in 2012. Growth has been achieved, resulting in increased market share, by cross-selling our ducting, flexible gas piping and HVAC heating element product lines to the US distribution market. In addition, our Construction Products division has benefited from consolidation at the distributor level. Our customers have been highly active acquirers of distributors in the US and Canada.

Heat Solutions underlying revenue was 9% lower than the prior year, primarily because sales of heating elements to residential HVAC customers remain weak in the US as a result of the uncertain economy. The lower revenue was also due to reduced nickel prices and the correspondingly lower surcharges passed along to customers (£2m). Consumer confidence remains cautious in the US and OEM appliance manufacturers continue to project low single growth rates in the US markets. We have seen an uptick in sales of our custom heating elements as our R&D investments have yielded new products and new applications. Also the cross-selling efforts to the US distributor market have increased our sales of replacement aftermarket HVAC heating elements.

Underlying revenue of the Flexible Solutions division was flat against the previous year. Sales of new medical hose products in the sleep apnoea market and share gains in the US industrial market were offset by continued weakness in the floor care market. We continue to see positive results from this division as it transitions from a focus in floor care to more specialty, engineered products and markets.

Flex-Tek continues to increase R&D spend in Heat Solutions and Fluid Management and is seeing commercial success from this investment. In our Asian manufacturing facilities, in China and India, our investments are showing positive results. We continue to seek new opportunities to grow our market share, expand our product portfolio, and target potential bolt-on acquisitions to build on the strength of the business and the management team.

Outlook

The improved sales rate seen in the second half of the year is expected to continue. Fluid Management is in a robust aerospace sales cycle which is expected to be maintained for some time. The strong sales should deliver better margins. The US housing market appears to have levelled in the second half of the year and we expect a gradual improvement in the coming year. The backlog of unsold houses has decreased, mortgage rates remain at historic low levels, and credit is more widely available. These factors should help bolster the sales of our Heat Solutions and Construction Products divisions. Flexible Solutions is expected to deliver modest growth with the general improvement in the US economy.

Financial review

Earnings per share
Basic headline earnings per share from continuing activities were 92.6p (2011: 86.5p - restated), a growth of 7%. This reflects an increased headline operating profit which has been partly offset by a higher tax rate.

On a statutory basis, the basic earnings per share from continuing activities were 65.4p (2011: 77.8p).

Exceptional and other items relating to continuing activities excluded from headline profit before tax
These items amounted to a charge of £131m compared to a charge of £65m in 2011. They comprised:

– Amortisation and impairment of intangible assets acquired in business combinations of £62m (2011: £50m). The charge relates principally to technology and customer relationships;

– A charge of £44m (2011: £34m) in connection with John Crane, Inc. asbestos litigation;

– A charge of £55m for the establishment of a provision to resolve potential future claims alleging product liability in Titeflex Corporation (2011: nil);

– A charge of £15m (2011: £16m) in respect of restructuring. This is part of two programmes: a Group-wide restructuring plan that began in 2008 and is now largely complete and a performance improvement programme in Smiths Detection that will conclude in 2014;

– A charge of £8m in relation to a change in the basis of estimating sales rebates in Smiths Medical (2011: nil);

– Acquisition costs of £2m (2011: £1m);

– £31m profit on disposal of businesses (2011: £4m)

– A £3m gain on reassessed contingent consideration;

– A credit of £24m for retirement benefit income (2011: £23m);and

– A financing loss of £3m (2011: £3m). This represents 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 £549m (2011: £489m), representing 99% (2011: 95%) of headline operating profit (see note 27 to the accounts for a reconciliation of headline operating cash and free cash-flow to statutory cash-flow measures). Free cash-flow fell £19m to £217m (2011: £236m). 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 £332m (2011: £322m).

Dividends paid in the year on ordinary shares amounted to £144m (2011: £136m).

Net debt at 31 July was £791m, up from £729m at 31 July 2011. The increase in net debt reflects strong cash generation that was more than offset by outflows from the net impact of acquisitions and disposals (£120m), dividends (£144m) and pension funding (£122m).

Headline interest and other financing costs
Interest payable on debt, net of interest earned on cash deposits, was £63m compared with £59m in 2011. This increase reflects the higher average levels of debt. Interest costs were covered 8.8 times by headline operating profits.

The Group accounts for pensions using IAS19. As required by this standard, a finance credit is recognised reflecting the expected return on pension scheme assets and a finance charge is recognised reflecting the unwinding of the discount on the future pension liability. The net financing credit was £24m (2011: £23m). As of 1 August 2011, we now report headline pre-tax profit excluding this item and comparative figures have been adjusted accordingly. The headline measures are intended to report the underlying performance of the Group.

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 £117m in R&D (2011: £111m), equivalent to 3.8% of revenue (2011: 3.9%). Of that total, £107m was funded by the Company compared with £99m in 2011, an increase of 9%. We actively seek funding from customers to support R&D and this amounted to £10m (2011: £12m). Under IFRS, certain development costs are capitalised, and this amounted to £29m in the period (2011: £31m). 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 fundamental principles of the Group's approach to taxation remain unchanged. The Group seeks to mitigate the burden of taxation in a responsible manner to enhance its competitive position on a global basis while managing its relationships with tax authorities on the basis of full disclosure, co-operation and legal compliance. A semi-annual tax report is reviewed by the Audit Committee to monitor compliance with these principles to ensure the Group delivers its tax objectives.

The headline tax charge for 2012 of £132m (2011: £123m - restated) represented an effective rate of 26.5% on the headline profit before taxation (2011: 26.5% - restated). This is unchanged from the 2011 restated rate which now excludes financing credits and charges relating to retirement benefits, which are no longer part of headline profit before taxation. On a statutory basis, the tax charge on continuing activities was £108m (2011: £92m).

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. A rate of between 27% and 29% is expected in the year ending 31 July 2013.

Exceptional taxation

At 31 July 2011 the Group recognised UK tax assets relating to revenue losses brought forward and deferred capital allowances of £37.7m. The value of these assets is reviewed regularly and is dependent on the ability to recover them against forecast UK taxable profits. Having considered the impact of the increased pension deficit on the outlook for the UK tax base, the Group has decided to derecognise the tax assets at 31 July 2012 as an exceptional non-headline tax charge because it is no longer probable that they will be recovered. These tax allowances however remain available to the Group and can be utilised should the UK tax base improve.

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 net of tax, litigation provisions relating to exceptional items net of tax, and net debt. In the light of the recognition of the Titeflex litigation provision, the Board decided at the interim results to restate capital employed to exclude significant litigation provisions (see note 1 to the accounts). The restatement reduced the ROCE previously reported at 31 July 2011 from 17.0% to 16.4%. The ROCE improved 10 basis points to 16.5% (2011: 16.4%) as a result of improved profitability across most divisions which more than offset reduced profitability in 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 31 July 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 increased to £620m at 31 July 2012 from £199m at 31 July 2011. The increase reflects the impact of poor asset returns and, particularly, the impact of very low corporate bond rates upon which the liability is calculated.

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

The retirement benefit position was:

	31 July 2012	28 January 2012	31 July 2011
Funded plans			
UK plans – funding status	**91%**	94%	101%
US plans – funding status	**67%**	70%	76%
Other plans – funding status	**67%**	77%	77%

	31 July 2012 £m	28 January 2012 £m	31 July 2011 £m
Deficit			
Funded plans	**(516)**	(367)	(108)
Unfunded plans	**(104)**	(92)	(91)
Total deficit	**(620)**	(459)	(199)
Retirement benefit assets	**7**	51	141
Retirement benefit liabilities	**(627)**	(510)	(340)
	(620)	(459)	(199)

In the coming year, cash contributions to the schemes are expected to total approximately £90m (2012: £115m). 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 July is set out in the table below:

Pension scheme membership	**SIPS**	**TIGPS**	**US plans**	**Total**
Deferred active	680	320	3,590	**4,590**
Deferred	12,240	14,860	6,850	**33,950**
Pensioners	12,910	18,650	5,310	**36,870**
Total	**25,830**	**33,830**	**15,750**	**75,410**

Exchange rates

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

	31 July 2012	**31 July 2011**		28 January 2012
Average rates:				
US dollar	**1.58**	1.60	Dollar strengthened 1%	1.58
Euro	**1.20**	1.16	Euro weakened 3%	1.16
Period end rates:				
US dollar	**1.57**	1.64	Dollar strengthened 4%	1.57
Euro	**1.27**	1.14	Euro weakened 11%	1.19

Financial information

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

The statutory accounts for the year ended 31 July 2011 have been filed with the Registrar of Companies. The auditors have reported on those accounts and on the statutory accounts for the year ended 31 July 2012, which will be filed with the Registrar of Companies following the Annual General Meeting. Both the audit reports were unqualified and did not contain any statement under section 498 of the Companies Act 2006.

Consolidated income statement

	Notes	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Continuing operations			
Revenue	1	**3,030.1**	2,842.0
Cost of sales		**(1,645.9)**	(1,534.0)
Gross profit		**1,384.2**	1,308.0
Sales and distribution costs		**(411.9)**	(384.3)
Administrative expenses		**(596.5)**	(490.1)
Profit on disposal of businesses	4	**30.8**	4.4
Operating profit	2	**406.6**	438.0
Comprising			
– headline operating profit	3	**553.7**	516.9
– exceptional items, amortisation of acquired intangibles	3	**(147.1)**	(78.9)
		406.6	438.0
Interest receivable		**2.2**	1.8
Interest payable		**(64.8)**	(60.3)
Other financing losses		**(7.3)**	(9.2)
Other finance income – retirement benefits		**23.5**	23.3
Finance costs	5	**(46.4)**	(44.4)
Share of post-tax profits of associated companies	14	**5.7**	4.3
Profit before taxation		**365.9**	397.9
Comprising			
– headline profit before taxation (restated)*	3	**496.8**	462.7
– exceptional items, amortisation of acquired intangibles and other financing gains and losses (restated)*	3	**(130.9)**	(64.8)
		365.9	397.9
Taxation	6	**(107.6)**	(91.8)
Profit after taxation – continuing operations		**258.3**	306.1
(Loss)/profit – discontinued operations	7	**(0.1)**	79.0
Profit for the year		**258.2**	385.1
Attributable to			
Smiths Group shareholders		**256.6**	383.8
Non-controlling interests		**1.6**	1.3
		258.2	385.1
Earnings per share	9		
Basic		**65.4p**	98.0p
Basic – continuing operations		**65.4p**	77.8p
Diluted		**64.9p**	97.1p
Diluted – continuing operations		**64.9p**	77.1p

*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

	Notes	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Profit for the period		**258.2**	385.1
Exchange losses		**(9.9)**	(9.3)
Cumulative exchange gains recycled on disposals		**(4.9)**	
Actuarial losses on retirement benefits	10	**(559.0)**	(0.2)
Taxation recognised on actuarial movements	6	**52.4**	10.9
Fair value gains/(losses)			
– on available for sale financial assets		**4.4**	4.1
– deferred in the period on cash-flow and net investment hedges		**(10.7)**	8.3
– reclassified to income statement		**6.4**	(0.2)
Taxation recognised on fair value gains and losses		**1.5**	
Total other comprehensive income		**(519.8)**	13.6
Total comprehensive income		**(261.6)**	398.7
Attributable to			
Smiths Group shareholders		**(263.5)**	397.0
Non-controlling interests		**1.9**	1.7
		(261.6)	398.7

Consolidated balance sheet

	Notes	31 July 2012 £m	31 July 2011 £m
Non-current assets			
Intangible assets	12	**1,717.1**	1,610.2
Property, plant and equipment	13	**270.5**	282.8
Investments accounted for using the equity method	14		18.5
Financial assets – other investments	15	**60.9**	31.6
Retirement benefit assets	10	**7.2**	140.6
Deferred tax assets	6	**203.3**	174.8
Trade and other receivables	17	**37.4**	33.6
Financial derivatives	21	**7.2**	6.4
		2,303.6	2,298.5
Current assets			
Inventories	16	**438.5**	432.5
Current tax receivable		**15.3**	16.4
Trade and other receivables	17	**634.4**	612.8
Cash and cash equivalents	19	**205.6**	261.1
Financial derivatives	21	**7.9**	5.7
		1,301.7	1,328.5
Total assets		**3,605.3**	3,627.0
Non-current liabilities			
Financial liabilities			
– borrowings	19	**(821.7)**	(978.4)
– financial derivatives	21	**(1.1)**	(1.5)
Provisions for liabilities and charges	22	**(254.4)**	(174.1)
Retirement benefit obligations	10	**(627.4)**	(339.6)
Deferred tax liabilities	6	**(69.5)**	(77.6)
Trade and other payables	18	**(37.5)**	(45.1)
		(1,811.6)	(1,616.3)
Current liabilities			
Financial liabilities			
– borrowings	19	**(175.3)**	(11.7)
– financial derivatives	21	**(10.6)**	(8.9)
Provisions for liabilities and charges	22	**(77.3)**	(74.7)
Trade and other payables	18	**(468.2)**	(454.2)
Current tax payable		**(81.5)**	(81.3)
		(812.9)	(630.8)
Total liabilities		**(2,624.5)**	(2,247.1)
Net assets		**980.8**	1,379.9
Shareholders' equity			
Share capital	23	**147.3**	147.1
Share premium account		**331.9**	329.1
Capital redemption reserve		**5.8**	5.8
Revaluation reserve		**1.7**	1.7
Merger reserve		**234.8**	234.8
Retained earnings	24	**376.1**	775.6
Hedge reserve	24	**(124.8)**	(120.6)
Total shareholders' equity		**972.8**	1,373.5
Non-controlling interest equity		**8.0**	6.4
Total equity		**980.8**	1,379.9

Consolidated statement of changes in equity

	Notes	Share capital and share premium £m	Other reserves £m	Retained earnings £m	Hedge reserve £m	Equity shareholders' funds £m	Non-controlling Interest £m	Total equity £m
At 31 July 2011		476.2	242.3	775.6	(120.6)	1,373.5	6.4	1,379.9
Profit for the year				256.6		256.6	1.6	258.2
Other comprehensive income								
Exchange (losses)/gains				(15.2)	0.1	(15.1)	0.3	(14.8)
Actuarial losses on retirement benefits and related tax				(506.6)		(506.6)		(506.6)
Fair value gains/(losses) and related tax				5.9	(4.3)	1.6		1.6
Total comprehensive income for the year				(259.3)	(4.2)	(263.5)	1.9	(261.6)
Transactions relating to ownership interests								
Exercises of share options	23	3.0				3.0		3.0
Taxation recognised on share options	6			(0.8)		(0.8)		(0.8)
Purchase of own shares	24			(9.7)		(9.7)		(9.7)
Dividends								
– equity shareholders	8			(144.1)		(144.1)		(144.1)
– non-controlling interest							(0.3)	(0.3)
Share-based payment	29			14.4		14.4		14.4
At 31 July 2012		**479.2**	**242.3**	**376.1**	**(124.8)**	**972.8**	**8.0**	**980.8**

	Notes	Share capital and share premium £m	Other reserves £m	Retained earnings £m	Hedge reserve £m	Equity shareholders' funds £m	Non-controlling Interest £m	Total equity £m
At 31 July 2010		461.8	242.3	519.5	(128.8)	1,094.8	5.0	1,099.8
Profit for the year				383.8		383.8	1.3	385.1
Other comprehensive income								
Exchange (losses)/gains				(9.8)	0.1	(9.7)	0.4	(9.3)
Actuarial losses on retirement benefits and related tax				10.7		10.7		10.7
Fair value gains/(losses)				4.1	8.1	12.2		12.2
Total comprehensive income for the year				388.8	8.2	397.0	1.7	398.7
Transactions relating to ownership interest								
Exercises of share options	23	14.4				14.4		14.4
Taxation recognised on share options	6			(1.8)		(1.8)		(1.8)
Purchase of own shares	24			(8.6)		(8.6)		(8.6)
Dividends								
– equity shareholders	8			(136.1)		(136.1)		(136.1)
– non-controlling interest							(0.3)	(0.3)
Share-based payment	29			13.8		13.8		13.8
At 31 July 2011		**476.2**	**242.3**	**775.6**	**(120.6)**	**1,373.5**	**6.4**	**1,379.9**

Consolidated cash-flow statement

	Notes	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Net cash inflow from operating activities	27	**331.5**	321.7
Cash-flows from investing activities			
Expenditure on capitalised development		**(27.6)**	(30.6)
Expenditure on other intangible assets		**(13.5)**	(10.2)
Purchases of property, plant and equipment	13	**(50.1)**	(49.3)
Disposals of property, plant and equipment		**0.7**	4.5
Investment in financial assets		**(24.3)**	(0.3)
Acquisition of businesses	28	**(167.5)**	(18.5)
Disposal of Aerospace	7		(6.2)
Disposals of businesses		**47.3**	3.9
Net cash-flow used in investing activities		**(235.0)**	(106.7)
Cash-flows from financing activities			
Proceeds from exercise of share options	23	**3.0**	14.4
Purchase of own shares		**(9.7)**	(8.6)
Dividends paid to equity shareholders	8	**(144.1)**	(136.1)
Dividends paid to non-controlling interests		**(0.3)**	(0.3)
Cash (outflow)/inflow from matured derivative financial instruments		**(1.7)**	1.0
Increase in new borrowings		**174.8**	1.6
Reduction and repayment of borrowings		**(173.5)**	(1.2)
Net cash-flow used in financing activities		**(151.5)**	(129.2)
Net (decrease)/increase in cash and cash equivalents		**(55.0)**	85.8
Cash and cash equivalents at beginning of year		**260.7**	172.2
Exchange (loss)/gain		**(2.0)**	2.7
Cash and cash equivalents at end of year	19	**203.7**	260.7
Cash and cash equivalents at end of year comprise			
– cash at bank and in hand		**130.8**	232.0
– short-term deposits		**74.8**	29.1
– bank overdrafts		**(1.9)**	(0.4)
		203.7	260.7
Included in cash and cash equivalents per the balance sheet		**205.6**	261.1
Included in overdrafts per the balance sheet		**(1.9)**	(0.4)
		203.7	260.7

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

Reconciliation of net cash-flow to movement in net debt

	Notes	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Net (decrease)/increase in cash and cash equivalents		**(55.0)**	85.8
Net decrease/(increase) in borrowings resulting from cash-flows		**(1.3)**	(0.4)
Movement in net debt resulting from cash-flows		**(56.3)**	85.4
Capitalisation, interest accruals and unwind of capitalisation fees		**(0.5)**	2.7
Movement from fair value hedging		**(4.2)**	3.6
Exchange differences		**(1.4)**	16.1
Movement in net debt in the year	19	**(62.4)**	107.8
Net debt at start of year		**(729.0)**	(836.8)
Net debt at end of year	19	**(791.4)**	(729.0)

Accounting policies

Basis of preparation

The accounts have been prepared in accordance with the Companies Act 2006 applicable to companies reporting under International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee (IFRS IC) interpretations, as adopted by the European Union in response to the IAS regulation (EC 1606/2002), under the historical cost convention modified to include revaluation of certain financial instruments, share options and pension assets and liabilities, held at fair value as described below.

The accounting policies adopted are consistent with those of the previous financial year except for the adoption of:

– Amendment to IFRIC 14, 'Prepayment of a Minimum Funding Requirement';

– IAS 24 (revised) 'Related party disclosures'; and

– Amendment to IFRS 7, 'Financial instruments: Disclosures'

The adoption of new standards has not materially affected reported financial position or performance.

In addition, following the inclusion of net expenditure relating to Titeflex Corporation litigation in exceptional items the description of the relevant category of exceptional items has been amended from: "income and expenditure relating to John Crane, Inc. asbestos litigation" to "income and expenditure relating to material litigation in respect of products no longer in production".

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 £34.5m (2011: £27.9m) has been recognised in respect of contracts in progress at the year end with a total expected value of £172.2m (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 £0.7m (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 with Smiths Medical. During the year, 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 the sales data from the distributor, the amount of inventory held by distributors and the time lag between the initial sale to the distributor and the rebate being claimed. The rebate accrual at 31 July 2012 was £18.8m (2011: £10.2m).

Impairment

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

Provisions for liabilities and charges

The consolidated financial statements include a provision for litigation of £278.0m (2011: £196.1m), see note 22.

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. As disclosed in note 4, 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. The estimates, and the effect of variances in key estimates, are disclosed in note 10.

At 31 July 2012 there is a retirement benefit asset of £7.2m (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 £16.1m (2011: £26.0m) relating to losses and £74.1m (2011: £50.6m) relating to the John Crane, Inc. and Titeflex Corporation litigation provisions. The recognition of assets pertaining to these items involves judgement by management as to the likelihood of realisation of these deferred tax assets and this is based on a number of factors, which seek to assess the expectation that the benefit of these assets will be realised, including appropriate taxable temporary timing differences and it has been concluded that there are sufficient taxable profits in future periods to support recognition. Further detail on the Group's deferred taxation position is included in note 6.

Accounting policies

Basis of consolidation

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

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

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

Foreign currencies

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

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

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

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

Revenue

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

Sale of goods

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

Services

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

Construction contracts

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

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

Employee benefits

Share-based compensation

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

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

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

Pension obligations and post-retirement benefits

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

For defined benefit plans and post-retirement healthcare schemes the liability for each scheme recognised in the balance sheet is the present value of the obligation at the balance sheet date less the fair value of any plan assets. The obligation is calculated annually by independent actuaries using the projected unit credit method. The present value is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related liability. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised in full in the period in which they occur, outside of the income statement and are presented in the statement of comprehensive income. Past service costs are recognised immediately in the income statement, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs are amortised on a straight-line basis over the vesting period.

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

Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

Exceptional items

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

– profits/(losses) on disposal of businesses and costs of acquisitions;

– spend on the integration of significant acquisitions and other major restructuring programmes;

– significant goodwill or other asset impairments;

– income and expenditure relating to material litigation in respect of products no longer in production; and

– other particularly significant or unusual items.

Exceptional items are excluded from the headline profit measures used by the Group. See note 3 for the basis of calculation of these measures.

Taxation

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

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

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

Deferred tax liabilities and assets are not discounted.

Discontinued operations

A discontinued operation is a component of the Group's business that represents a separate major line of business or geographical area of operations that has been disposed of, has been abandoned or meets the criteria to be classified as held for sale.

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

Intangible assets

Goodwill

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

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

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

Research and development

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

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

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

Intangible assets acquired in business combinations

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

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

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

Software, patents and intellectual property

The estimated useful lives are as follows:

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

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

Property, plant and equipment

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

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

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

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

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in, first-out (FIFO) method. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). The cost of items of inventory which take a substantial period of time to complete includes attributable borrowing costs for all items whose production began after 1 August 2009. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

Trade and other receivables

Trade receivables are initially recognised at fair value and subsequently measured at amortised cost, less any appropriate provision for estimated irrecoverable amounts. A provision is established for irrecoverable amounts when there is objective evidence that amounts due under the original payment terms will not be collected.

Provisions

Provisions for warranties and product liability, disposal indemnities, restructuring costs, vacant leasehold property and legal claims are recognised when: the Company has a legal or constructive obligation as a result of a past event; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Provisions are discounted where the time value of money is material.

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

Assets and businesses held for sale

Assets and businesses classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell. Impairment losses on initial classification as held for sale and gains or losses on subsequent re-measurements are included in the income statement. No depreciation is charged on assets and businesses classified as held for sale.

Assets and businesses are classified as held for sale if their carrying amount will be recovered or settled principally through a sale transaction rather than through continuing use. The asset or business must be available for immediate sale and the sale must be highly probable within one year.

Cash and cash equivalents

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

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

Financial assets

The classification of financial assets depends on the purpose for which the assets were acquired. Management determines the classification of an asset at initial recognition and re-evaluates the designation at each reporting date. Financial assets are classified as: loans and receivables, available for sale financial assets or financial assets where changes in fair value are charged (or credited) to the income statement.

Financial assets are initially recognised at transaction price when the Group becomes party to contractual obligations. The transaction price used includes transaction costs unless the asset is being fair valued through the income statement.

The subsequent measurement of financial assets depends on their classification. Loans and receivables are measured at amortised cost using the effective interest rate method. Available for sale financial assets are subsequently measured at fair value, with unrealised gains and losses being recognised in other comprehensive income. Financial assets where changes in fair value are charged (or credited) to the income statement are subsequently measured at fair value. Realised and unrealised gains and losses arising from changes in the fair value of the ‘financial assets at fair value through the income statement’ category are included in the income statement in the period in which they arise.

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

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

Financial liabilities

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

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

Derivative financial instruments and hedging activities

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

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

Fair value hedge

Changes in the fair values of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair values of the hedged assets or liabilities that are attributable to the hedged risk.

Net investment hedge

Hedges of net investments in foreign operations are accounted for similarly to cash-flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in other comprehensive income; the gain or loss relating to any ineffective portion is recognised immediately in the income statement.

When a foreign operation is disposed of gains and losses accumulated in equity related to that operation are included in the income statement.

Cash-flow hedge

The effective portions of changes in the fair values of derivatives that are designated and qualify as cash-flow hedges are recognised in equity. The gain or loss relating to any ineffective portion is recognised immediately in the income statement.

Amounts accumulated in the hedge reserve are recycled in the income statement in the periods when the hedged items will affect profit or loss (for instance when the forecast sale that is hedged takes place). If a forecast transaction that is hedged results in the recognition of a non-financial asset (for example, inventory) or a liability, the gains and losses previously deferred in the hedge reserve are transferred from the reserve and included in the initial measurement of the cost of the asset or liability.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in the hedge reserve at that time remains in the reserve and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in other comprehensive income is immediately transferred to the income statement.

Fair value of financial assets and liabilities

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

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

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

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

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

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

Dividends

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

Recent accounting developments

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

- 'IFRS 9: Financial instruments'
- 'IFRS 10: Consolidated financial statements'
- 'IAS 27 (Revised 2011): Separate financial statements'
- 'IFRS 11: Joint arrangements'
- 'IAS 28 (Revised 2011): Associates and joint ventures'
- 'IFRS 12: Disclosure of interests in other entities'
- 'IFRS 13: Fair value measurement'
- 'IAS 19: Employee benefits (revised 2011)'
- 'Amendment to IAS 1: Presentation of Financial Statements - Presentation of items of other comprehensive income'

A review of the impact of these standards and interpretations is being undertaken, and the impact of adopting them will be determined once this review has been completed. Based on the work completed to date, the changes are not expected to have a material impact on the Group's reported position or performance, except for the implementation of IAS 19: Employee benefits (revised 2011). This standard, which is expected to be implemented in the year ending 31 July 2014 is likely to result in the recognition of a financing charge in respect of retirement benefits. For the year ended 31 July 2012, calculating the finance charge in accordance with the new requirements would have increased finance costs by £36.1m (2011: £39.2m). Under the current accounting policies the Group recognises actuarial gains and losses directly in other comprehensive income, as required by the new standard.

Notes to the accounts

1 Segment information

Analysis by operating segment

The Group is organised into five divisions: 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.

							Year ended 31 July 2012
	John Crane £m	**Smiths Medical £m**	**Smiths Detection £m**	**Smiths Interconnect £m**	**Flex-Tek £m**	**Corporate costs £m**	**Total £m**
Revenue	**973.4**	**855.8**	**519.2**	**448.5**	**233.2**		**3,030.1**
Divisional headline operating profit	**209.9**	**202.5**	**69.1**	**66.0**	**38.0**		**585.5**
Corporate headline operating costs						**(31.8)**	**(31.8)**
Headline operating profit/(loss)	**209.9**	**202.5**	**69.1**	**66.0**	**38.0**	**(31.8)**	**553.7**
Exceptional operating items (note 4)	**(39.9)**	**(8.8)**	**16.1**	**(1.2)**	**(54.5)**	**2.8**	**(85.5)**
Amortisation and impairment of acquired intangible assets	**(15.0)**	**(14.2)**	**(1.4)**	**(30.8)**	**(0.2)**		**(61.6)**
Operating profit/(loss)	**155.0**	**179.5**	**83.8**	**34.0**	**(16.7)**	**(29.0)**	**406.6**
Exceptional finance costs – adjustment to discounted provision (note 4)	**(4.0)**				**(0.5)**		**(4.5)**
Net finance costs – other							**(41.9)**
Share of post-tax profits of associate companies			**5.7**				**5.7**
Profit before taxation							**365.9**

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 £863.6m for Smiths Medical and £3,037.9m for Smiths Group.

							Year ended 31 July 2011
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £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)	(28.7)
Headline operating profit/(loss)	188.7	196.2	65.5	67.6	27.6	(28.7)	516.9
Exceptional operating items (note 4)	(30.9)	(1.6)	(0.3)	(1.4)	(1.8)	6.6	(29.4)
Amortisation and impairment of acquired intangible assets	(14.5)	(16.6)	(1.2)	(17.2)			(49.5)
Operating profit/(loss)	143.3	178.0	64.0	49.0	25.8	(22.1)	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

1 Segment information continued

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

	Year ended 31 July 2012						
	John Crane £m	**Smiths Medical £m**	**Smiths Detection £m**	**Smiths Interconnect £m**	**Flex-Tek £m**	**Reconciling items £m**	**Total £m**
Depreciation	**14.1**	**23.8**	**8.4**	**7.9**	**3.7**	**1.1**	**59.0**
Amortisation	**2.7**	**13.4**	**13.0**	**0.8**	**0.1**	**53.1**	**83.1**
Other non-cash items							
– share-based payment	**3.4**	**2.1**	**0.3**	**0.7**	**1.5**	**6.3**	**14.3**
– asset impairments						**10.7**	**10.7**

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

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

The capital expenditure for each division is:

	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
Capital expenditure year ended 31 July 2012	**16.8**	**31.7**	**20.2**	**7.9**	**2.9**	**12.6**	**92.1**
Capital expenditure year ended 31 July 2011	16.2	31.2	22.7	8.1	3.5	8.8	90.5

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

	31 July 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	**98.1**	**155.9**	**99.4**	**34.7**	**22.1**	**410.2**
Working capital assets	**338.2**	**243.4**	**293.6**	**159.1**	**68.2**	**1,102.5**
Operating assets	**436.3**	**399.3**	**393.0**	**193.8**	**90.3**	**1,512.7**
Derivatives, tax and retirement benefit assets						**240.9**
Goodwill and acquired intangibles						**1,558.9**
Corporate assets						**87.2**
Cash						**205.6**
Total assets						**3,605.3**
Working capital liabilities	**(160.3)**	**(95.3)**	**(143.1)**	**(70.6)**	**(24.7)**	**(494.0)**
Corporate and non-headline liabilities						**(343.4)**
Derivatives, tax and retirement benefit liabilities						**(790.1)**
Borrowings						**(997.0)**
Total liabilities						**(2,624.5)**
Average divisional capital employed	**875.7**	**1,152.0**	**668.6**	**535.5**	**133.7**	**3,365.5**
Average corporate capital employed						**(16.1)**
Average total capital employed						**3,349.4**

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 (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.

1 Segment information continued

	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 benefit liabilities						(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

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

Analysis of revenue

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

	Original equipment manufacture	Aftermarket				Total
John Crane	£m	Oil, gas and petrochemical £m	Chemical and pharmaceutical £m	Distributors £m	General industry £m	£m
Revenue year ended 31 July 2012	**359.5**	**374.2**	**80.6**	**68.6**	**90.5**	**973.4**
Revenue year ended 31 July 2011	330.1	344.0	74.0	62.6	83.2	893.9

Smiths Medical	Medication delivery £m	Vital care £m	Safety devices £m	Total £m
Revenue year ended 31 July 2012	**241.2**	**346.6**	**268.0**	**855.8**
Revenue year ended 31 July 2011	233.1	345.6	259.7	838.4

Smiths Detection	Transportation £m	Ports and borders £m	Military £m	Emergency responders £m	Critical infrastructure £m	Non-security £m	Total £m
Revenue year ended 31 July 2012	**245.4**	**81.4**	**55.6**	**20.2**	**110.1**	**6.5**	**519.2**
Revenue year ended 31 July 2011	218.6	75.7	79.5	25.4	86.9	23.8	509.9

Smiths Interconnect	Connectors £m	Microwave £m	Power management £m	Total £m
Revenue year ended 31 July 2012	**156.3**	**202.9**	**89.3**	**448.5**
Revenue year ended 31 July 2011	173.1	165.8	40.1	379.0

Flex-Tek	Fluid Management £m	Flexible Solutions £m	Heat Solutions £m	Construction Products £m	Total £m
Revenue year ended 31 July 2012	**80.1**	**36.0**	**55.6**	**61.5**	**233.2**
Revenue year ended 31 July 2011	70.3	35.9	60.1	54.5	220.8

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 31 July 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 £97.4m (2011: £94.6m); military and aerospace £170.9m (2011: £163.9m); and rail, medical, automation, test and data centres £180.2m (2011: £120.5m).

1 Segment information continued

Analysis of revenue continued

The Group's statutory revenue is analysed as follows:

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Sale of goods	**2,792.0**	2,630.9
Services	**212.5**	178.3
Contracts	**25.6**	32.8
	3,030.1	2,842.0

Analysis by geographical areas

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

	Revenue		Intangible assets, property plant and equipment and investments accounted for using the equity method	
	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m	**31 July 2012 £m**	31 July 2011 £m
United Kingdom	**130.3**	124.5	**143.8**	146.2
Germany	**171.8**	161.0	**299.4**	333.9
France	**95.8**	93.1	**15.8**	17.8
Other European	**374.8**	357.5	**72.0**	86.1
United States of America	**1,353.0**	1,275.4	**1,276.0**	1,135.5
Canada	**125.8**	119.6	**10.7**	12.9
Mexico	**34.7**	25.2	**9.2**	9.9
Japan	**129.5**	149.4	**22.7**	22.2
China	**92.8**	82.0	**60.3**	63.6
Rest of the World	**521.6**	454.3	**77.7**	83.4
	3,030.1	2,842.0	**1,987.6**	1,911.5

2 Operating profit is stated after charging

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Research and development expense	**78.5**	68.0
Operating leases		
– land and buildings	**27.0**	25.3
– other	**11.6**	10.9

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Audit services		
Fees payable to the Company's auditors for the audit of the parent company and consolidated accounts	**0.5**	0.5
Fees payable to the Company's auditors and its associates for other services		
– the audit of the Company's subsidiaries, pursuant to legislation	**3.4**	3.5
– other services pursuant to legislation	**0.1**	0.1
	4.0	4.1
Tax services		
– advisory services	**0.1**	0.5
– compliance services	**0.1**	
All other services	**0.5**	0.5

Other services relate to one-off projects.

3 Headline profit measures

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

The following items have been excluded from the headline measure:

– exceptional items, including income and expenditure relating to material litigation in respect of products no longer in production;

– amortisation and impairment of intangible assets acquired in a business combination – the charge is a non-cash item, and the directors believe that it should be added back to give a clearer picture of underlying performance;

– 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	**Year ended 31 July 2012 £m**	Year ended 31 July 2011 (restated) £m
Operating profit		**406.6**	438.0
Exclude			
– exceptional operating items	4	**85.5**	29.4
– amortisation and impairment of acquired intangible assets	12	**61.6**	49.5
Non-headline items in operating profit		**147.1**	78.9
Headline operating profit		**553.7**	516.9
Finance costs		**(46.4)**	(44.4)
Exclude			
– exceptional finance costs	4	**4.5**	6.1
– other financing gains and losses		**2.8**	3.1
– other financing income – retirement benefits	5	**(23.5)**	(23.3)
Non-headline items in finance costs		**(16.2)**	(14.1)
Headline finance costs		**(62.6)**	(58.5)
Profit before taxation		**365.9**	397.9
Non-headline items in operating profit		**147.1**	78.9
Non-headline items in finance costs		**(16.2)**	(14.1)
Headline profit before taxation		**496.8**	462.7
Profit after taxation – continuing operations		**258.3**	306.1
Exclude			
– non-headline items in profit before taxation		**130.9**	64.8
– tax on excluded items	6	**(62.0)**	(30.9)
– exceptional taxation items	4, 6	**37.7**	
		106.6	33.9
Headline profit after taxation – continuing operations		**364.9**	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.

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

4 Exceptional items

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

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Operating items		
Restructuring programmes	**(15.4)**	(15.7)
Revision of estimated rebates	**(7.8)**	
Diabetes	**0.6**	1.5
Gains on changes to post-retirement benefits (note 10)		10.2
Profit on disposal of businesses	**30.8**	4.4
Adjustment to contingent consideration provided on acquisitions	**2.4**	
Costs of acquisitions	**(2.0)**	(1.5)
Litigation		
– provision for Titeflex Corporation subrogation claims (note 22)	**(54.5)**	
– provision for John Crane, Inc. asbestos litigation (note 22)	**(39.6)**	(28.3)
	(85.5)	(29.4)
Financing items		
Exceptional finance costs – adjustment to discounted provision		
– provision for Titeflex Corporation subrogation claims (note 22)	**(0.5)**	
– provision for John Crane, Inc. asbestos litigation (note 22)	**(4.0)**	(6.1)
	(90.0)	(35.5)
Taxation items		
Exceptional tax costs – write off UK deferred tax asset	**(37.7)**	
	(127.7)	(35.5)

Year ended 31 July 2012

Restructuring costs comprise £12.6m in respect of the improvement programme in Smiths Detection announced in September 2011 and £2.8m in respect of the 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 1). This change has arisen due to the availability of improved data from distributors. Had this approach been used in previous 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, which has been recognised as a reduction in revenue, has been treated as an exceptional item on the basis that it is an unusual non-recurring item that distorts the current year trading performance.

The profit on disposal of businesses comprises £26.8m profit on the sale of the Group's interest in Cross Match (see note 14), £0.1m relating to small non-core business sold in the year and £3.9m from the resolution of indemnities in respect of disposals in previous years.

A charge of £54.5m 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 strikes (see note 22).

The operating charge in respect of John Crane, Inc. litigation comprises £28.3m in respect of increased provisions for adverse judgments and legal defence costs, £0.9m in respect of legal fees in connection with litigation against insurers, and £10.4m arising from the reduction in US risk free rates.

At 31 July 2011 the Group recognised UK tax assets relating to revenue losses brought forward and deferred capital allowances of £37.7m. The value of these assets is reviewed regularly and is dependent on the ability to recover them against forecast UK taxable profits. Having considered the impact of the increased pension deficit on the outlook for the UK tax base, the Group has decided to derecognise the tax assets at 31 July 2012 as an exceptional non-headline tax charge because it is no longer probable that they will be recovered.

Year ended 31 July 2011

The restructuring of corporate headquarters and divisional reorganisation was announced in 2008, and a second phase of this project was introduced in 2010. The total cost of this restructuring, including redundancy, relocation and consolidation of manufacturing, was considered exceptional by virtue of its size. Costs of £15.7m were recognised in the year ended 31 July 2011.

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

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

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

5 Net finance costs

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Interest receivable	**2.2**	1.8
Interest payable		
– bank loans and overdrafts, including associated fees	**(7.1)**	(6.6)
– other loans	**(57.7)**	(53.7)
Interest payable	**(64.8)**	(60.3)
Other financing gains/(losses)		
– fair value (losses)/gains on hedged debt	**(4.0)**	3.6
– fair value gains/(losses) on fair value hedge	**4.0**	(3.6)
– net foreign exchange (losses)/gains	**(2.8)**	(3.1)
– exceptional finance costs – adjustment to discounted provision	**(4.5)**	(6.1)
Other financing losses	**(7.3)**	(9.2)
Retirement benefits		
– return on plan assets	**203.0**	198.4
– interest cost	**(179.5)**	(175.1)
Retirement benefits	**23.5**	23.3
Net finance costs	**(46.4)**	(44.4)

6 Taxation

	Continuing Year ended 31 July 2012 £m	Continuing Year ended 31 July 2011 £m	Discontinued Year ended 31 July 2012 £m	Discontinued Year ended 31 July 2011 £m
The taxation charge for the year comprises				
– current taxation	**95.5**	67.0		(25.0)
– deferred taxation	**12.1**	24.8		
Total taxation expense in the income statement	**107.6**	91.8		(25.0)
Current taxation				
– UK corporation tax				
– foreign tax	**95.5**	67.0		
– discontinued tax				(25.0)
	95.5	67.0		(25.0)

Reconciliation of the total tax charge

The tax expense on the profit for the year is different from the standard rate of corporation tax in the UK of 25.3% (2011: 27.3%). The difference is reconciled as follows:

	Continuing Year ended 31 July 2012 £m	Continuing Year ended 31 July 2011 £m	Discontinued Year ended 31 July 2012 £m	Discontinued Year ended 31 July 2011 £m
Profit before tax	**365.9**	397.9	**(0.1)**	54.0
Notional taxation expense at UK rate of 25.3% (2011: 27.3%)	**92.6**	108.6		14.7
Effect of overseas taxation	**12.7**	15.1		
Compliance benefits	**(16.1)**	(16.1)		
Local incentives	**(9.8)**	(10.1)		
Tax effect of other non-headline items	**(9.5)**	(5.7)		
Exceptional tax costs	**37.7**			
Tax effect of Aerospace sale				(39.7)
	107.6	91.8		(25.0)
Comprising				
– taxation on headline profit (restated – see note 3)	**131.9**	122.7		
– tax on non-headline loss (restated – see note 3)	**(62.0)**	(30.9)		
– exceptional taxation items (see note 4)	**37.7**			
– tax on sale of discontinued operations				(25.0)
Total taxation expense in the income statement	**107.6**	91.8		(25.0)

6 Taxation continued

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Tax on items (charged)/credited to equity		
Deferred tax charge/(credit)		
– retirement benefit schemes	**(52.4)**	(10.9)
– losses deferred in the period on cash-flow hedges	**(1.5)**	
– share options	**0.8**	1.8
	(53.1)	(9.1)

The net retirement benefit credit to equity includes £6.5m (2011: £11.6m) relating to UK schemes. The UK schemes are closed and this amount represents tax relief that was set off against amounts previously charged to equity.

Deferred taxation

	Excess tax depreciation on fixed assets and goodwill £m	Share-based payment £m	Retirement benefit obligations £m	Capitalised development expenditure £m	Other £m	Total £m
At 31 July 2010	(53.6)	9.1	67.1	(22.4)	116.2	116.4
Credit/(charge) to income statement	(1.7)	1.5	(22.9)	(5.6)	3.9	(24.8)
Credit/(charge) to equity		(1.8)	10.9			9.1
Business combinations	(1.4)					(1.4)
Exchange adjustments	1.8		(2.4)	1.1	(2.6)	(2.1)
At 31 July 2011	(54.9)	8.8	52.7	(26.9)	117.5	97.2
Deferred tax assets	9.6	8.6	52.0	(5.6)	110.2	174.8
Deferred tax liabilities	(64.5)	0.2	0.7	(21.3)	7.3	(77.6)
At 31 July 2011	(54.9)	8.8	52.7	(26.9)	117.5	97.2
Credit/(charge) to income statement	(6.5)	(3.8)	(13.5)	(5.6)	17.3	(12.1)
Credit/(charge) to equity		(0.8)	52.4		1.5	53.1
Business combinations	(12.3)				4.7	(7.6)
Exchange adjustments	(1.7)		1.2	(1.2)	4.9	3.2
At 31 July 2012	**(75.4)**	**4.2**	**92.8**	**(33.7)**	**145.9**	**133.8**
Deferred tax assets	(9.2)	4.1	89.7	(8.4)	127.1	203.3
Deferred tax liabilities	(66.2)	0.1	3.1	(25.3)	18.8	(69.5)
At 31 July 2012	**(75.4)**	**4.2**	**92.8**	**(33.7)**	**145.9**	**133.8**

Included in other deferred tax balances above is:

– a deferred tax asset of £16.1m (2011: £26.0m) relating to losses carried forward. The reduction mainly relates to £23.5m of deferred tax no longer recognised on UK losses (see below) offset by £10.1m deferred tax relating to additional loss recognition in the US; and

– a deferred tax asset of £76.2m (2011: £65.0m) relating to provisions where current tax relief is only available as payments are made. Of this asset, £51.1m (2011: £50.6m) relates to the John Crane, Inc. litigation provision, and £23.0m (2011: £3.7m) relates to Titeflex Corporation. See note 22 for additional information on provisions.

The Group has not recognised deferred tax assets relating to tax losses of £380.4m (2011: £225.4m) and pensions and other long term liabilities of £504.3m (2011: £96.9m) due to uncertainty as to their recoverability. This includes £327.1m (2011: £2.3m) relating to the UK pension deficit.

The large increase in unrecognised deferred tax on losses mainly relates to the UK. Deferred tax of £23.5m on UK losses and £14.2m on other assets has been derecognised this year as potentially higher contributions to retirement benefit schemes mean the UK is unlikely to generate sufficient taxable profits to utilise the deductible temporary differences related to the deferred tax assets, The resulting charge of £37.7m has been treated as an exceptional tax item (note 4). These tax allowances remain available to the Group and can be utilised should the UK tax base improve.

6 Taxation continued

The expiry date of operating losses carried forward is dependent upon the law of the various territories in which the losses arise. A summary of expiry dates for losses in respect of which restrictions apply is set out below.

Restricted losses

	2012 £m	Expiry of losses	2011 £m	Expiry of losses
Territory				
– Americas	**13.5**	**2019-2025**	13.3	2019-2025
– Asia	**4.2**	**2016-2019**	3.2	2014-2018
Total restricted losses	**17.7**		16.5	
Unrestricted losses				
– operating losses	**362.7**	**No expiry**	208.9	No expiry
Total	**380.4**		225.4	

7 Discontinued operations

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

(Loss)/profit on disposal of operation

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Provisions and disposal costs	**(0.1)**	54.0
Pre-tax (loss)/profit on disposal	**(0.1)**	54.0

Cash received from disposal of Aerospace operations		
Disposal costs		(6.2)
Net cash outflow on disposal		(6.2)

The profit on disposal in 2011 arises from the resolution and time barring of certain disposal indemnities.

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

Results from discontinued operations

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
(Loss)/profit on disposal	**(0.1)**	54.0
Tax credit (note 6)		25.0
Profit for the period	**(0.1)**	79.0
Earnings per share from discontinued operations – pence		
Basic	**0.0p**	20.2p
Diluted	**0.0p**	20.0p

The tax credit of £25.0m in 2011 reflects the resolution of the tax treatment of the disposal profits.

Cash-flows from discontinued operations

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
(Loss)/profit before taxation (including (loss)/profit on disposal of Aerospace operations)	**(0.1)**	54.0
(Loss)/profit on disposal of discontinued operations	**0.1**	(54.0)
Net cash inflow from operating activities		

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

8 Dividends

The following dividends were declared and paid in the period:

	Year ended 31 July 2012 £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
Ordinary interim dividend of 11.75p for 2012 (2011: 11.25p) paid 20 April 2012	**46.0**	44.2
	144.1	136.1

The final dividend for the year ended 31 July 2012 of 26.25p per share was recommended by the Board on 18 September 2012 and will be paid to shareholders on 23 November 2012, subject to approval by the shareholders. This dividend has not been included as a liability in these accounts and is payable to all shareholders on the register of Members at close of business on 26 October 2012.

9 Earnings per share

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

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Profit attributable to equity shareholders for the year		
– continuing	**256.7**	304.8
– total	**256.6**	383.8
Average number of shares in issue during the year	**392,583,140**	391,718,941

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 395,479,272 (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. For the year ended 31 July 2012 options over 869,284 (2011: no shares) were excluded from this calculation because their effect was anti-dilutive for continuing operations.

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

	Year ended 31 July 2012		Year ended 31 July 2011 (restated)	
	£m	EPS (p)	£m	EPS (p)
Profit attributable to equity shareholders of the Parent Company	**256.7**	**65.4**	304.8	77.8
Exclude				
Non-headline items and related tax (note 3)	**106.6**	**27.2**	33.9	8.7
Headline	**363.3**	**92.6**	338.7	86.5
Headline EPS – diluted (p)		**91.9**		85.7

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

10 Post-retirement benefits

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

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

Pension costs are assessed in accordance with the advice of independent, professionally-qualified actuaries. The most recent actuarial valuations of the two principal UK schemes (SIPS and TIGPS) were performed using the Projected Unit Method as at 31 March 2009 and 5 April 2009. The most recent valuations of the six principal US pension and post-retirement healthcare plans were performed at 1 January 2010. These valuations have been updated by independent qualified actuaries in order to assess the liabilities of the schemes as at 31 July 2012. The triennial valuations of the principal UK schemes at 31 March 2012 and 5 April 2012 are in progress. Scheme assets are stated at their market values. Contributions to the schemes are made on the advice of the actuaries.

10 Post-retirement benefits continued

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

	2012 UK	2012 US	2012 Other	2011 UK	2011 US	2011 Other
Rate of increase in salaries	**n/a**	**n/a**	**3.1%**	n/a	n/a	2.9%
Rate of increase for active deferred members	**3.7%**	**n/a**	**n/a**	4.4%	n/a	n/a
Rate of increase in pensions in payment	**2.8%**	**n/a**	**0.8%**	3.5%	n/a	1.3%
Rate of increase in deferred pensions	**2.8%**	**n/a**	**0.8%**	3.5%	n/a	0.6%
Discount rate	**4.1%**	**3.8%**	**4.1%**	5.3%	5.1%	5.3%
Inflation rate	**2.8%**	**n/a**	**1.6%**	3.5%	n/a	1.8%
Healthcare cost increases	**5.0%**	**n/a**	**2.3%**	5.0%	n/a	2.5%

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

The mortality assumptions used in the principal UK schemes are based on the recent actual mortality experience of members within each scheme. The assumptions are based on the new SAPS All birth year tables with relevant scaling factors based on the experience of the schemes. The assumption also allows for future improvements in life expectancy in line with the 2011 CMI projections blended to a long term rate of 1% for SIPS, and in line with 80%/60% of the Long Cohort for males/ females respectively with an annual underpin of 1% for TIGPS. The mortality assumptions used in the principal US schemes are based on the most recent mortality study table produced for retired pensioners in the US (RP 2000 table). The table selected allows for future mortality improvements and applies an adjustment for job classification (blue collar versus white collar). The assumptions give the following:

Expected further years of life	UK Male	UK Female	US Male	US Female
Member who retires next year at age 65 (in UK TIGPS/SIPS)	22/23	24/25	19	21
Member, currently 45, when they retire in 20 years time	24	26	19	21

The assets in the scheme and the expected rates of return as at 31 July 2012 were:

31 July 2012	UK schemes Long-term rate of return	UK schemes Value £m	US schemes Long-term rate of return	US schemes Value £m	Other countries Long-term rate of return	Other countries Value £m	Total £m
Equities	**7.2%**	**1,294.1**	**7.3%**	**245.1**	**9.2%**	**12.9**	**1,552.1**
Government bonds	**2.5%**	**168.0**	**2.3%**	**43.5**	**4.8%**	**7.0**	**218.5**
Corporate bonds	**4.1%**	**81.8**	**3.8%**	**169.5**	**5.0%**	**0.5**	**251.8**
Insured liabilities	**4.1%**	**665.7**			**4.1%**	**3.7**	**669.4**
Property	**6.8%**	**177.1**			**10.4%**	**0.8**	**177.9**
Other	**2.9%**	**458.2**			**3.7%**	**19.7**	**477.9**
Total market value		**2,844.9**		**458.1**		**44.6**	**3,347.6**
Present value of funded scheme liabilities		**(3,116.7)**		**(680.6)**		**(66.3)**	**(3,863.6)**
Deficit		**(271.8)**		**(222.5)**		**(21.7)**	**(516.0)**
Unfunded pension plans		**(46.1)**		**(6.9)**		**(28.0)**	**(81.0)**
Post-retirement healthcare		**(9.2)**		**(13.0)**		**(0.9)**	**(23.1)**
Present value of unfunded obligations		**(55.3)**		**(19.9)**		**(28.9)**	**(104.1)**
Unrecognised asset due to surplus restriction						**(0.1)**	**(0.1)**
Net pension liability		**(327.1)**		**(242.4)**		**(50.7)**	**(620.2)**
Post-retirement assets		**7.2**					**7.2**
Post-retirement liabilities		**(334.3)**		**(242.4)**		**(50.7)**	**(627.4)**
Net pension liability		**(327.1)**		**(242.4)**		**(50.7)**	**(620.2)**

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

10 Post-retirement benefits continued

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

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

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

Amounts recognised in the income statement

	Year ended 31 July 2012				Year ended 31 July 2011			
	Funded defined benefit pension schemes			**Unfunded pension/post-retirement healthcare plans**	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans
	UK £m	**US £m**	**Other £m**	**£m**	UK £m	US £m	Other £m	£m
Amounts (credited)/charged to operating profit								
Current service cost	**0.3**		**2.0**	**1.1**	0.4	0.2	2.1	0.9
Past service (gain)/cost			**(0.4)**		(10.2)	0.1		
Curtailment (gains)/losses			**(0.1)**			(0.9)	(0.1)	0.1
Total (credit)/charge	**0.3**		**1.5**	**1.1**	(9.8)	(0.6)	2.0	1.0
Amounts (credited)/charged to finance costs								
Expected return on pension scheme assets	**(170.4)**	**(29.9)**	**(2.7)**		(169.9)	(26.0)	(2.5)	
Interest on pension scheme liabilities	**143.6**	**28.2**	**3.2**	**4.5**	140.1	27.2	3.2	4.6
Net return	**(26.8)**	**(1.7)**	**0.5**	**4.5**	(29.8)	1.2	0.7	4.6
Total (credit)/charge to income statement	**(26.5)**	**(1.7)**	**2.0**	**5.6**	(39.6)	0.6	2.7	5.6

The UK past service gain of £10.2m in 2011 relates to changes in certain early retirement terms. The actual return on scheme assets was a profit of £104.4m (2011: profit of £337.8m).

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

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Cost of sales	**0.7**	0.5
Sales and distribution costs	**0.8**	0.4
Administrative expenses	**1.4**	1.9
Exceptional operating items		(10.2)
	2.9	(7.4)

10 Post-retirement benefits continued

Amounts recognised directly in the consolidated statement of comprehensive income

Net actuarial losses of £559.0m (2011: losses of £0.2m) have been reported in the statement of comprehensive income. This includes a gain of £1.1m (2011: loss of £0.5m) in respect of unrecognised assets owing to surplus restriction. Cumulative actuarial losses from 1 August 2004 reported in the statement of comprehensive income are £1,117.5m (2011: cumulative losses of £558.5m).

Changes in present value of defined benefit obligations

	Year ended 31 July 2012				Year ended 31 July 2011			
	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans
	UK £m	US £m	Other £m	£m	UK £m	US £m	Other £m	£m
At beginning of period	**(2,775.7)**	**(543.8)**	**(60.2)**	**(90.7)**	(2,658.0)	(543.4)	(57.1)	(89.2)
Current service cost	**(0.3)**		**(2.0)**	**(1.1)**	(0.4)	(0.2)	(2.1)	(0.9)
Interest on obligations	**(143.6)**	**(28.2)**	**(3.2)**	**(4.5)**	(140.1)	(27.2)	(3.2)	(4.6)
Employee contributions			**(0.4)**				(0.4)	
Past service gain/(cost)			**0.4**		10.2	(0.1)		
Actuarial (loss)/gain on liabilities	**(330.2)**	**(107.9)**	**(7.5)**	**(15.8)**	(116.6)	(22.9)	2.7	(2.3)
Curtailment gain/(cost)			**0.1**			0.9	0.1	(0.1)
Exchange adjustments		**(27.4)**	**4.2**	**1.7**		25.3	(2.5)	(0.3)
Benefits paid	**133.1**	**26.7**	**2.3**	**6.3**	129.2	23.8	2.3	6.7
At end of period	**(3,116.7)**	**(680.6)**	**(66.3)**	**(104.1)**	(2,775.7)	(543.8)	(60.2)	(90.7)

Changes in present value of scheme assets

	Year ended 31 July 2012				Year ended 31 July 2011			
	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans	Funded defined benefit pension schemes			Unfunded pension/post-retirement healthcare plans
	UK £m	US £m	Other £m	£m	UK £m	US £m	Other £m	£m
At beginning of period	**2,813.6**	**412.8**	**46.2**		2,616.3	386.6	40.2	
Expected return on assets	**170.4**	**29.9**	**2.7**		169.9	26.0	2.5	
Actuarial gain/(loss) on scheme assets	**(94.2)**	**(1.6)**	**(2.9)**		115.8	22.6	1.0	
Employer contributions	**88.2**	**23.3**	**3.8**	**6.3**	40.8	20.0	2.9	6.7
Employee contributions			**0.4**				0.4	
Exchange adjustments		**20.4**	**(3.3)**			(18.6)	1.5	
Benefits paid	**(133.1)**	**(26.7)**	**(2.3)**	**(6.3)**	(129.2)	(23.8)	(2.3)	(6.7)
At end of period	**2,844.9**	**458.1**	**44.6**		2,813.6	412.8	46.2	

Cash contributions

Company contributions to the funded defined benefit pension plans for 2012 totalled £115.3m (2011: £63.7m), including £50m to the TIGPS.

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

– Cash contributions to SIPS of £36m a year for 10 years.

– An initial investment of £25m in index-linked gilts – held in an escrow account – with further ongoing monthly investments of £2m for nine years. The first monthly instalment was paid in August 2011. The escrow account remains an asset of the Group (see note 15) until 2020. At that time the assets in escrow are allocated subject to the funding position of SIPS. In addition, the escrow account may revert to the Group, should there be a surplus at an intervening triennial review.

– A cash contribution to the TIGPS of £50m which was paid in May 2012, with further biannual payments of £8m thereafter. These payments were subject to the funding position of the Scheme in the six months ended 5 April 2012.

Triennial valuations of the principal UK schemes as at 31 March 2012 and 5 April 2012 are currently in progress, and the Group will negotiate new funding plans with the scheme trustees based on these valuations.

In addition to the funding plans referred to above, the Group agreed to make cash contributions to other schemes in respect of any future service cost based on actuarial advice.

In 2013 the following cash contributions to the Group's principal defined benefit schemes are expected: £36m to SIPS; £16m to TIGPS; and approximately £38m to other plans, including the US defined benefit scheme. Expected cash payments for 2013 total £90m. In addition, £24m will be invested in UK government bonds held in escrow, in accordance with the funding plan explained above.

10 Post-retirement benefits continued

History of schemes

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Balance sheet					
Present value of defined benefit obligations	**(3,967.7)**	(3,470.4)	(3,347.7)	(3,112.1)	(2,968.9)
Fair value of scheme assets	**3,347.6**	3,272.6	3,043.1	2,775.1	2,959.9
Unrecognised asset due to surplus restriction	**(0.1)**	(1.2)	(0.7)	(2.0)	(1.5)
Deficit	**(620.2)**	(199.0)	(305.3)	(339.0)	(10.5)
Post-retirement assets	**7.2**	140.6	80.3	39.2	174.2
Post-retirement liabilities	**(627.4)**	(339.6)	(385.6)	(378.2)	(184.7)
Deficit	**(620.2)**	(199.0)	(305.3)	(339.0)	(10.5)

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m	Year ended 31 July 2010 £m	Period ended 31 July 2009 £m	Period ended 31 July 2008 £m
Experience gains/(losses)					
Experience gains/(losses) on scheme liabilities	**45.4**	(25.5)	31.5	100.5	(6.4)
Experience gains/(losses) on scheme assets	**(98.7)**	139.4	167.5	(345.4)	(350.0)
Movement on restricted surplus	**1.1**	(0.5)	1.3	(0.5)	0.9

Experience gains on liabilities in 2012 and 2009 include the impact of using the latest available member data for the UK triennial valuations which were in progress at 31 July 2012 and 31 July 2009 respectively.

Sensitivity

The valuation of post-retirement schemes involves judgements about uncertain future events. Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 July 2012 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions. While each of these sensitivities holds all other assumptions constant, in practice such assumptions rarely change in isolation and the impacts may offset to some extent.

	Profit before tax for year ended 31 July 2012 £m	Increase/ (decrease) in scheme assets £m	(Increase)/ decrease in scheme liabilities £m
Rate of mortality – 1 year increase in life expectancy	(3.5)	39.3	(128.4)
Rate of mortality – 1 year decrease in life expectancy	3.7	(40.3)	130.3
Rate of inflation – 0.25% increase	(2.9)	12.5	(87.0)
Discount rate – 0.25% increase	(2.5)	(16.7)	141.0
Expected return on scheme assets – 0.25% increase	5.4		
Market value of scheme assets – 2.5% increase	3.5	66.0	(0.1)
Healthcare cost trends – 1% increase			
Healthcare cost trends – 1% decrease			

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

Defined contribution plans

The Group operates a number of defined contribution plans across many countries. In the UK a defined contribution plan has been offered since the closure of the UK defined benefit pension plans. In the US a 401k defined contribution plan operates. The total expense recognised in the income statement in respect of all these plans was £29.0m (2011: £29.6m).

11 Employees

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Staff costs during the period		
Wages and salaries	**740.5**	698.4
Social security	**84.4**	82.4
Share-based payment (note 29)	**14.3**	13.8
Pension costs (including defined contribution schemes) (note 10)	**32.4**	32.9
	871.6	827.5

The average number of persons employed was:

	Year ended 31 July 2012	Year ended 31 July 2011
John Crane	**7,000**	6,800
Smiths Medical	**7,750**	7,550
Smiths Detection	**2,300**	2,500
Smiths Interconnect	**4,100**	4,000
Flex-Tek	**2,000**	2,000
Corporate	**50**	50
	23,200	22,900

Key management

The key management of the Group comprises Smiths Group plc Board directors and Executive Committee members.

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Key management compensation		
Salaries and short-term employee benefits	**10.1**	9.2
Cost of post-retirement benefits	**0.1**	0.1
Cost of share-based incentive plans	**5.7**	4.0

No member of key management had any material interest during the period in a contract of significance (other than a service contract or a qualifying third party indemnity provision) with the Company or any of its subsidiaries. Options and awards held at the end of the period by key management in respect of the Company's share-based incentive plans were:

	Year ended 31 July 2012		Year ended 31 July 2011	
	Number of instruments '000	Weighted average price	Number of instruments '000	Weighted average price
CIP	**778**		540	
ESOS	**168**	**£8.93**	194	£8.81
VSP	**611**		852	
LTIP	**728**			
SAYE	**5**	**£7.28**	4	£6.81

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

Related party transactions

The Group has a service contract with a company connected to a member of the Executive Committee. Costs of £0.3m (2011: £0.2m) were incurred in respect of this arrangement.

12 Intangible assets

	Goodwill £m	Development costs £m	Acquired intangibles (see table below) £m	Software, patents and intellectual property £m	Total £m
Cost					
At 1 August 2010	1,379.5	135.2	355.5	124.9	1,995.1
Exchange adjustments	(12.2)	(3.7)	(7.7)	(0.7)	(24.3)
Business combinations	22.4		4.1		26.5
Additions		31.0		10.2	41.2
Disposals				(2.2)	(2.2)
At 31 July 2011	1,389.7	162.5	351.9	132.2	2,036.3
Exchange adjustments	(1.4)	3.5	8.5	0.3	10.9
Business combinations	100.2		53.2		153.4
Additions		28.5		13.5	42.0
Disposals	(0.4)	(13.2)		(2.6)	(16.2)
At 31 July 2012	**1,488.1**	**181.3**	**413.6**	**143.4**	**2,226.4**
Amortisation					
At 1 August 2010	95.1	48.2	137.5	75.7	356.5
Exchange adjustments	(1.2)	(1.0)	(3.4)	(0.5)	(6.1)
Charge for the year		16.2	44.0	12.1	72.3
Impairment charge			5.5		5.5
Disposals				(2.1)	(2.1)
At 31 July 2011	93.9	63.4	183.6	85.2	426.1
Exchange adjustments	(0.2)	1.1	3.9	(0.1)	4.7
Charge for the year		19.3	50.9	12.9	83.1
Impairment charge			10.7		10.7
Disposals		(13.2)		(2.1)	(15.3)
At 31 July 2012	**93.7**	**70.6**	**249.1**	**95.9**	**509.3**
Net book value at 31 July 2012	**1,394.4**	**110.7**	**164.5**	**47.5**	**1,717.1**
Net book value at 31 July 2011	1,295.8	99.1	168.3	47.0	1,610.2
Net book value at 1 August 2010	1,284.4	87.0	218.0	49.2	1,638.6

In addition to goodwill, the acquired intangible assets comprise:

	Patents, licences and trademarks £m	Technology £m	Customer relationships £m	Total acquired intangibles £m
Cost				
At 1 August 2010	68.7	122.5	164.3	355.5
Exchange adjustments	(2.1)	(5.1)	(0.5)	(7.7)
Business combinations			4.1	4.1
At 31 July 2011	66.6	117.4	167.9	351.9
Exchange adjustments	3.0	5.5		8.5
Business combinations (note 28)	3.8	16.1	33.3	53.2
At 31 July 2012	**73.4**	**139.0**	**201.2**	**413.6**
Amortisation				
At 1 August 2010	20.0	46.0	71.5	137.5
Exchange adjustments	(0.7)	(2.2)	(0.5)	(3.4)
Charge for the year	5.1	13.3	25.6	44.0
Impairment charge	0.8		4.7	5.5
At 31 July 2011	25.2	57.1	101.3	183.6
Exchange adjustments	1.1	2.7	0.1	3.9
Charge for the year	6.0	15.4	29.5	50.9
Impairment charge	0.9	2.7	7.1	10.7
At 31 July 2012	**33.2**	**77.9**	**138.0**	**249.1**
Net book value at 31 July 2012	**40.2**	**61.1**	**63.2**	**164.5**
Net book value at 31 July 2011	41.4	60.3	66.6	168.3
Net book value at 1 August 2010	48.7	76.5	92.8	218.0

12 Intangible assets continued

Impairment testing

Goodwill

Goodwill is not amortised but is tested for impairment at least annually. Value in use calculations are used to determine the recoverable amount of goodwill held allocated to each group of cash generating units (CGU). Value in use is calculated as the net present value of the projected risk-adjusted cash-flows of the CGU. These forecast cash-flows are based on the 2013 budget and the four year divisional strategic plan, which have both been approved by the Board. Goodwill is allocated by division as follows:

	2012 £m	2012 Number of CGUs	2011 £m	2011 Number of CGUs
John Crane	**139.2**	**4**	132.9	6
Smiths Medical	**514.5**	**1**	497.2	1
Smiths Detection	**376.9**	**1**	406.9	1
Smiths Interconnect	**341.5**	**3**	237.5	4
Flex-Tek	**22.3**	**2**	21.3	2
	1,394.4	**11**	1,295.8	14

As discussed in the business review, both John Crane and Smiths Interconnect have changed their sub-divisional reporting structure this year. The divisions now report and review performance using fewer regional groups and business units. As required by IAS 36, following these reorganisations, the allocation of goodwill to CGUs for impairment testing was reviewed, and it was established that goodwill is now monitored, and should be tested for impairment, using the new reporting structures.

John Crane and Smiths Medical have strong aftermarket and consumables businesses, with consistent sales trends. Smiths Detection and Smiths Interconnect have greater sales and margin volatility due to lower levels of recurring revenue and involvement in government funded programmes, particularly defence, and customer led technology innovation. The key assumptions used in value in use calculations are:

– Sales: projected sales are built up with reference to markets and product categories. They incorporate past performance, historical growth rates and projections of developments in key markets.

– Margins: projected margins reflect historical performance and the impact of all completed projects to improve operational efficiency and leverage scale. The projections do not include the impact of future restructuring projects to which the Group is not yet committed.

– Discount rate: the discount rates have been calculated based on the Group's weighted average cost of capital and risks specific to the CGU being tested. Pre-tax rates of 12.3% to 14.1% (2011: 11.1% to 14.1%) have been used for the impairment testing.

– Long term growth rates: As required by IAS 36, growth rates for the period after the detailed forecasts are based on the long-term GDP projections of the primary market for the CGU. The average growth rate used in the testing was 2.29% (2011: 2.42%). These rates do not reflect the long-term assumptions used by the Group for investment planning.

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

	Smiths Medical	Smiths Detection	Smiths Interconnect		
			Microwave	Connectors	Power management
					Year ended 31 July 2012
Net book value of goodwill (£m)	**514.5**	**376.9**	**134.2**	**84.7**	**122.6**
Discount rate	**12.3%**	**13.5%**	**14.1%**	**14.1%**	**13.1%**
Period covered by management projections	**5 years**	**5 years**	**5 years**	**5 years**	**5 years**
Long-term growth rates	**2.20%**	**2.50%**	**2.72%**	**2.32%**	**2.59%**
					Year ended 31 July 2011
Net book value of goodwill (£m)	497.2	406.9	128.4	80.8	28.3
Discount rate	11.2%	11.2%	13.0%	11.1%	13.0%
Period covered by management projections	5 years	5 years	5 years	5 years	5 years
Long-term growth rates	2.47%	2.00%	2.25%	2.25%	2.25%

The 2011 information for Smiths Interconnect has been restated to reflect the new CGU structure, with weighted averages disclosed for the discount rate and growth rates. The remaining balance of the goodwill represents smaller individual amounts which have been allocated to smaller CGUs.

12 Intangible assets continued

Impairment testing continued

Goodwill continued

Sensitivity analysis

Sensitivity analysis performed around the base case assumptions has indicated that for Smiths Interconnect Power management, the following changes in assumptions (in isolation), would cause the value in use to fall below the carrying value:

	Change required to trigger impairment
Forecast operating cash-flow	12% reduction
Discount rate	1.4% higher
Long-term growth rates	2.8% lower

For the other CGUs, sensitivity analysis performed around the base case assumptions has indicated that no reasonable changes in key assumptions would cause the carrying amount of any of the CGUs to exceed their respective recoverable amounts.

Other intangible assets

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

In the year ended 31 July 2012 impairment charges of £10.7m were incurred on intangible assets arising from the PDI acquisition. Value in use calculations were used to determine the recoverable values of these assets. The impairment charges arose because product sales have been lower than expected with a consequential impact on the future value of the technology, customer relationships and brands. The impairment charge has been included in Smiths Interconnect administrative expenses and it is excluded from the calculation of headline operating profit.

In the year ended 31 July 2011 impairment charges of £5.5m were incurred on intangible assets acquired in two other business combinations. Value in use calculations were used to determine the recoverable values of these assets. The impairment charges arose because current and forecast profitability was below the levels originally projected. The impairment charge was included in Smiths Interconnect administrative expenses and excluded from the calculation of headline operating profit.

13 Property, plant and equipment

	Land and buildings £m	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
Cost or valuation				
At 1 August 2010	187.0	493.6	210.0	890.6
Exchange adjustments	(1.8)	(9.0)	1.2	(9.6)
Business combinations		0.2	0.1	0.3
Additions	7.8	26.6	14.9	49.3
Disposals	(2.7)	(15.7)	(16.7)	(35.1)
At 31 July 2011	190.3	495.7	209.5	895.5
Exchange adjustments	0.6	5.7	(3.4)	2.9
Business combinations	0.3	1.0	0.2	1.5
Additions	6.0	27.8	16.3	50.1
Disposals	(4.3)	(12.9)	(8.9)	(26.1)
Business disposals	(0.2)	(1.3)		(1.5)
At 31 July 2012	**192.7**	**516.0**	**213.7**	**922.4**
Depreciation				
At 1 August 2010	82.5	345.0	160.4	587.9
Exchange adjustments	(1.3)	(6.8)	0.7	(7.4)
Charge for the year	7.8	38.9	16.7	63.4
Disposals	(1.9)	(14.4)	(14.9)	(31.2)
At 31 July 2011	87.1	362.7	162.9	612.7
Exchange adjustments	1.0	5.1	(2.4)	3.7
Charge for the year	7.5	34.7	16.8	59.0
Disposals	(2.7)	(12.1)	(7.7)	(22.5)
Business disposals	(0.2)	(0.8)		(1.0)
At 31 July 2012	**92.7**	**389.6**	**169.6**	**651.9**
Net book value at 31 July 2012	**100.0**	**126.4**	**44.1**	**270.5**
Net book value at 31 July 2011	103.2	133.0	46.6	282.8
Net book value at 1 August 2010	104.5	148.6	49.6	302.7

14 Investments accounted for using the equity method

	31 July 2012 £m	31 July 2011 £m
Investments in associated companies		
At start of period	**18.5**	13.6
Exchange adjustment	**(0.9)**	0.8
Share of results after tax	**5.7**	4.3
Disposal	**(23.3)**	
Dividend received		(0.2)
At end of period		18.5

On 16 July 2012 the Group disposed of its interest in Cross Match Technologies, Inc., incorporated in the United States, for a consideration of £45.0m.

The Group's share of the revenue of associates was £28.8m (2011: £23.7m). At 31 July 2011 the total assets of associates were £59.9m and liabilities were £13.5m, representing Cross Match Technologies, Inc, and 35.6% of these assets and liabilities were attributable to Smiths Group.

15 Financial assets

Available for sale financial assets include £58.4m (2011: £29.1m) UK government bonds. This investment forms part of the deficit funding plan agreed with the trustee of one of the principal UK pension schemes. See note 10 for additional details.

16 Inventories

	31 July 2012 £m	31 July 2011 £m
Inventories comprise		
Raw materials and consumables	**147.9**	145.1
Work in progress	**91.3**	94.7
Finished goods	**209.5**	197.2
	448.7	437.0
Less: payments on account	**(10.2)**	(4.5)
	438.5	432.5

The Group consumed £1,397.7m (2011: £1,332.6m) of inventories during the period. £10.9m (2011: £11.3m) was recognised as an expense resulting from the write-down of inventory and £2.9m (2011: £3.0m) was released to the income statement from inventory provisions charged in earlier years but no longer required.

17 Trade and other receivables

	31 July 2012 £m	31 July 2011 £m
Non-current		
Trade receivables	**27.9**	23.7
Prepayments and accrued income	**4.1**	5.3
Other receivables	**5.4**	4.6
	37.4	33.6
Current		
Trade receivables	**578.9**	564.2
Prepayments and accrued income	**40.6**	32.9
Other receivables	**14.9**	15.7
	634.4	612.8

Trade receivables do not carry interest. Management considers that the carrying value of trade and other receivables approximates to the fair value. Trade and other receivables, including prepayments, accrued income and other debtors qualifying as financial instruments are classified as 'loans and receivables'. The maximum credit exposure arising from these financial assets is £628.4m (2011: £606.5m).

Trade receivables are disclosed net of provisions for bad and doubtful debts. The provisions for bad and doubtful debts are based on specific risk assessment and reference to past default experience.

Credit risk is managed separately for each customer and, where appropriate, a credit limit is set for the customer based on previous experience of the customer and third party credit ratings. The Group has no significant concentration of credit risk, with exposure spread over a large number of customers. The largest single customer is the US Federal Government, representing less than 4% (2011: 6%) of Group revenue.

17 Trade and other receivables continued

Ageing of trade receivables

	31 July 2012 £m	31 July 2011 £m
Trade receivables which are not impaired and not yet due	**485.7**	472.4
Trade receivables which are not impaired and less than three months overdue	**89.0**	84.2
Trade receivables which are not impaired and more than three months overdue	**28.5**	28.5
Gross value of partially and fully provided receivables	**21.2**	16.8
	624.4	601.9
Provision for bad and doubtful debts	**(17.6)**	(14.0)
Trade receivables	**606.8**	587.9

18 Trade and other payables

	31 July 2012 £m	31 July 2011 £m
Non-current		
Other creditors	**37.5**	45.1
Current		
Trade creditors	**193.8**	190.3
Bills of exchange payable	**2.2**	0.7
Other creditors	**15.4**	19.4
Other taxation and social security costs	**21.3**	22.5
Accruals and deferred income	**235.5**	221.3
	468.2	454.2

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

19 Borrowings and net debt

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

	31 July 2012 £m	31 July 2011 £m
Cash and cash equivalents		
Net cash and deposits	**205.6**	261.1
Short-term borrowings		
Bank overdrafts	**(1.9)**	(0.4)
$250m 5.45% US$ Private placement 2013	**(161.7)**	
Bank and other loans	**(1.2)**	(1.2)
Interest accrual	**(10.5)**	(10.1)
	(175.3)	(11.7)
Long-term borrowings		
$250m 5.45% US$ Private placement 2013		(158.3)
$250m 6.05% US$ Guaranteed notes 2014	**(159.1)**	(151.4)
£150m 7.25% Sterling Eurobond 2016	**(149.4)**	(149.3)
€300m 4.125% Eurobond 2017	**(240.9)**	(260.2)
$175m 7.37% US$ Private placement 2018	**(111.6)**	(106.4)
$250m 7.20% US$ Guaranteed notes 2019	**(158.5)**	(151.0)
Bank and other loans	**(2.2)**	(1.8)
	(821.7)	(978.4)
Borrowings	**(997.0)**	(990.1)
Net debt	**(791.4)**	(729.0)

Borrowings are accounted for at amortised cost and are categorised as other financial liabilities. See note 20 for a maturity analysis of borrowings. The repayment dates on borrowings repayable after five years range from 2018 to 2019.

Interest of £42.1m (2011: £42.3m) was charged to the consolidated income statement in this period in respect of public bonds.

19 Borrowings and net debt continued

Net cash and cash equivalents

	31 July 2012 £m	31 July 2011 £m
Cash at bank and in hand	**130.8**	232.0
Short-term deposits	**74.8**	29.1
Cash and cash equivalents	**205.6**	261.1
Bank overdrafts	**(1.9)**	(0.4)
Net cash and cash equivalents	**203.7**	260.7

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

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	(2.0)	(0.4)	1.0	(1.4)
Net cash inflow/(outflow)	(55.0)			(55.0)
Repayment of borrowings		2.8	170.7	173.5
Drawdown of borrowings		(1.5)	(173.3)	(174.8)
Capitalisation, interest accruals and unwind of capitalised fees			(0.5)	(0.5)
Fair value movement from interest rate hedging		1.6	(5.8)	(4.2)
Change in maturity analysis		(164.6)	164.6	
At 31 July 2012	**203.7**	**(173.4)**	**(821.7)**	**(791.4)**

Secured loans

Loans amounting to £3.4m (2011: £3.0m) were secured on plant and equipment with a book value of £3.3m (2011: £2.9m).

20 Financial risk management

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

Treasury and risk management policies are set by the Board. The policy sets out specific guidelines to manage foreign exchange risk, interest rate risk, credit risk and the use of financial instruments to manage risk. The instruments and techniques used to manage exposures include foreign currency derivatives, debt and other interest rate derivatives. The central treasury function monitors financial risks and compliance with risk management policies. The management of operational credit risk is discussed in note 17.

(a) Foreign exchange risk

Transactional currency exposure

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

Hedge accounting documentation and effectiveness testing are only undertaken if it is cost effective.

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

					At 31 July 2012
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Financial assets and liabilities					
Financial instruments included in trade and other receivables	**30.4**	**327.3**	**127.8**	**142.9**	**628.4**
Financial instruments included in trade and other payables	**(42.4)**	**(170.9)**	**(69.4)**	**(68.3)**	**(351.0)**
Cash and cash equivalents	**18.5**	**88.8**	**24.4**	**73.9**	**205.6**
Borrowings not designated as net investment hedges	**(149.4)**	**(11.4)**	**(4.0)**	**(0.4)**	**(165.2)**
	(142.9)	**233.8**	**78.8**	**148.1**	**317.8**
Exclude balances held in operations with the same functional currency	**142.6**	**(154.2)**	**(78.8)**	**(143.1)**	**(233.5)**
Exposure arising from intra-group loans		**(144.0)**		**(20.5)**	**(164.5)**
Forward foreign exchange contracts	**(48.0)**	**(34.7)**	**95.0**	**(12.3)**	
	(48.3)	**(99.1)**	**95.0**	**(27.8)**	**(80.2)**

20 Financial risk management continued

	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
					At 31 July 2011
Financial assets and liabilities					
Financial instruments included in trade and other receivables	35.3	290.7	144.2	136.3	606.5
Financial instruments included in trade and other payables	(50.3)	(141.4)	(78.8)	(64.6)	(335.1)
Cash and cash equivalents	55.8	58.5	32.9	113.9	261.1
Borrowings not designated as net investment hedges	(149.0)	(10.8)	(3.0)		(162.8)
	(108.2)	197.0	95.3	185.6	369.7
Exclude balances held in operations with the same functional currency	108.5	(147.8)	(98.4)	(183.4)	(321.1)
Exposure arising from intra-group loans		(93.5)	(8.8)	8.7	(93.6)
Forward foreign exchange contracts	(104.4)	65.1	62.9	(23.6)	
	(104.1)	20.8	51.0	(12.7)	(45.0)

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

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

	Impact on profit for the year 31 July 2012 £m	**Gain/(loss) recognised in reserves 31 July 2012 £m**	Impact on profit for the year 31 July 2011 £m	Gain/(loss) recognised in reserves 31 July 2011 £m
US dollar	**0.1**	**(4.2)**	5.9	(3.4)
Euro	**3.6**	**4.1**	(1.8)	4.2
Sterling	**(4.1)**	**0.9**	0.5	1.6

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

Cash-flow hedging

The Group uses foreign currency contracts to hedge future foreign currency sales and purchases. At 31 July 2012 contracts with a nominal value of £279.4m (2011: £217.7m) were designated as hedging instruments. In addition, the Group had outstanding foreign currency contracts with a nominal value of £249.9m (2011: £241.0m) which were being used to manage transactional foreign exchange exposures, but were not accounted for as cash-flow hedges. The fair value of the contracts is disclosed in note 21.

The majority of hedged transactions will be recognised in the income statement in the same period that the cash-flows are expected to occur, with the only differences arising as a result of normal commercial credit terms on sales and purchases. Of the foreign exchange contracts designated as hedging instruments 98.5% are for periods of 12 months or less (2011: 99.9%).

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

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Brought forward cash-flow hedge reserve at start of year	**(0.3)**	(0.6)
Exchange adjustments	**0.1**	0.1
Gains/(losses) on effective cash-flow hedges recognised in equity	**(10.9)**	0.4
Amounts removed from the hedge reserve and recognised in the following lines on the income statement		
– revenue	**5.5**	0.2
– cost of sales	**0.9**	(0.4)
Carried forward cash-flow hedge reserve at end of year	**(4.7)**	(0.3)

20 Financial risk management continued

Translational currency exposure

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

Net investment hedges

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

					At 31 July 2012
	Sterling £m	**US$ £m**	**Euro £m**	**Other £m**	**Total £m**
Loans designated as net investment hedges		**(590.9)**	**(240.9)**		**(831.8)**
Currency swap contracts	**192.4**	**(69.4)**	**(39.2)**	**(83.8)**	
	192.4	**(660.3)**	**(280.1)**	**(83.8)**	**(831.8)**

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

At 31 July 2012 swap contracts in other currencies hedged the Group's exposure to Canadian dollars, Japanese yen and Chinese renminbi (31 July 2011: Australian dollars, Canadian dollars, Japanese yen and Chinese renminbi).

Of the contracts designated as net investment hedges, 55% (2011: 54%) are current and the balance matures over the next three years (2011: three years).

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

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Brought forward net investment hedge reserve at start of year	**(120.3)**	(128.2)
Amounts deferred in the period on effective net investment hedges	**0.2**	7.9
Carried forward net investment hedge reserve at end of year	**(120.1)**	(120.3)

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

	Loss recognised in hedge reserve 31 July 2012 £m	Loss recognised in hedge reserve 31 July 2011 £m
US dollar	**65.6**	60.4
Euro	**25.0**	27.6

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

20 Financial risk management continued

(b) Interest rate risk

The Group operates an interest rate policy designed to optimise interest cost and reduce volatility in reported earnings. The Group's current policy is to require interest rates to be fixed for greater than 60% of the level of net debt. This is achieved primarily through fixed rate borrowings, and also through the use of interest rate swaps. At 31 July 2012 92.0% (2011: 98.5%) of the Group's net borrowings were at fixed interest rates, after adjusting for interest rate swaps and the impact of short maturity derivatives designated as net investment hedges.

The weighted average interest rate on borrowings and cross-currency swaps at 31 July 2012, after interest rate swaps, is 5.5% (2011: 5.5%).

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

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

	Available for sale investments 31 July 2012 £m	Cash and cash equivalents 31 July 2012 £m	Borrowings 31 July 2012 £m	Fair value of borrowings 31 July 2012 £m	Available for sale investments 31 July 2011 £m	Cash and cash equivalents 31 July 2011 £m	Borrowings 31 July 2011 £m	Fair value of borrowings 31 July 2011 £m
Fixed interest (adjusted for interest rate hedging)								
Less than one year			**(65.0)**	**(66.1)**			(1.2)	(1.2)
Between one and five years			**(451.5)**	**(500.8)**			(363.4)	(403.6)
Greater than five years	**58.4**		**(270.2)**	**(333.4)**	29.1		(414.2)	(463.0)
Total fixed interest financial assets/(liabilities) (adjusted for interest rate hedging)	**58.4**		**(786.7)**	**(900.3)**	29.1		(778.8)	(867.8)
Floating rate interest financial assets/(liabilities)		**189.0**	**(210.3)**	**(210.3)**		243.1	(211.3)	(211.3)
Total interest bearing financial assets/(liabilities)	**58.4**	**189.0**	**(997.0)**	**(1,110.6)**	29.1	243.1	(990.1)	(1,079.1)
Non-interest bearing assets/(liabilities) in the same category	**2.5**	**16.6**			2.5	18.0		
Total	**60.9**	**205.6**	**(997.0)**	**(1,110.6)**	31.6	261.1	(990.1)	(1,079.1)

Interest rate hedging

The Group has designated US$150.0m interest rate swaps which mature on 28 January 2013 and €120.0m interest rate swaps which mature on 5 May 2017 as fair value hedges on the US Private placement and the Eurobond respectively which mature on the same dates. These positions hedge the risk of variability in the fair value of borrowings arising from fluctuations in base rates.

The fair values of the hedging instruments are disclosed in note 21. The effect of the swaps is to convert £190.0m (2011: £196.3m) debt from fixed rate to floating rate.

Sensitivity of interest charges to interest rate movements

The Group has exposure to sterling, US dollar and euro interest rates. However the Group does not have a significant exposure income statement to interest rate movements for any individual currency. Based on the composition of net debt and foreign exchange rates at 31 July 2012, and taking into consideration all fixed rate borrowings and interest rate swaps in place, a one percentage point (100 basis points) change in average floating interest rates for all three currencies would have a £0.6m (2011: £nil) impact on the Group's profit before tax.

Based on the investments held at 31 July 2012 a one percentage point (100 basis points) increase in sterling interest rates would reduce the carrying value of investments by £8.7m, generating a corresponding charge to reserves.

(c) Financial credit risk

The Group is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, but does not currently expect any counterparties to fail to meet their obligations. Credit risk is mitigated by the Board approved policy of only selecting counterparties with a strong investment grade long-term credit rating for cash deposits and assigning financial limits to individual counterparties. In the normal course of business, the Group operates cash pooling systems, where a legal right of set-off applies.

The maximum credit risk exposure in the event of other parties failing to perform their obligations under financial assets, excluding trade and other receivables and derivatives, totals £266.5m at 31 July 2012 (2011: £292.7m).

	31 July 2012 £m	31 July 2011 £m
UK government bonds with a AAA credit rating (note 15)	**58.4**	29.1
Cash at banks with at least a AA- credit rating	**135.1**	236.6
Cash at banks with a A+ credit rating	**57.4**	21.1
Cash at other banks	**13.1**	3.4
Other investments	**2.5**	2.5
	266.5	292.7

At 31 July 2012 the maximum exposure with a single bank for deposits and cash is £55.8m (2011: £57.1m), whilst the maximum mark to market exposure for derivatives is £3.5m (2011: £5.3m). These banks have AA- and A+ credit rating, respectively (2011: AA- and AA).

20 Financial risk management continued

(d) Liquidity risk

Borrowing facilities

The Board policy specifies the maintenance of unused committed credit facilities of at least £200m at all times to ensure it has sufficient available funds for operations and planned development. This is provided by a US$800m multi-currency revolving credit facility, which matures in December 2015. At the balance sheet date the Group had the following undrawn credit facilities:

	31 July 2012 £m	31 July 2011 £m
Expiring within one year		
Expiring between one and two years		
Expiring after two years	**510.6**	486.8
	510.6	486.8

Cash deposits

As at 31 July 2012, £74.8m (2011: £29.1m) of cash and cash equivalents was on deposit with various banks of which £35.9m (2011: £4.5m) was on deposit in the UK.

Gross contractual cash-flows for borrowings

	Borrowings (Note 19) 31 July 2012 £m	**Fair value adjustments 31 July 2012 £m**	**Contractual interest payments 31 July 2012 £m**	**Total contractual cash-flows 31 July 2012 £m**	Borrowings (Note 19) 31 July 2011 £m	Fair value adjustments 31 July 2011 £m	Contractual interest payments 31 July 2011 £m	Total contractual cash-flows 31 July 2011 £m
Less than one year	**(175.3)**	**1.2**	**(44.0)**	**(218.1)**	(11.7)	(1.1)	(46.9)	(59.7)
Between one and two years	**(160.3)**	**(0.5)**	**(50.1)**	**(210.9)**	(159.2)	6.2	(54.0)	(207.0)
Between two and three years	**(1.0)**		**(40.4)**	**(41.4)**	(152.3)	(0.7)	(49.8)	(202.8)
Between three and four years	**(149.4)**	**(0.6)**	**(40.3)**	**(190.3)**			(40.5)	(40.5)
Between four and five years	**(240.9)**	**5.3**	**(29.4)**	**(265.0)**	(149.3)	(0.7)	(40.5)	(190.5)
Greater than five years	**(270.1)**	**(1.1)**	**(31.2)**	**(302.4)**	(517.6)	(3.6)	(59.4)	(580.6)
Total	**(997.0)**	**4.3**	**(235.4)**	**(1,228.1)**	(990.1)	0.1	(291.1)	(1,281.1)

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

Gross contractual cash-flows for derivative financial instruments

	Receipts 31 July 2012 £m	**Payments 31 July 2012 £m**	**Net cash-flow 31 July 2012 £m**	Receipts 31 July 2011 £m	Payments 31 July 2011 £m	Net cash-flow 31 July 2011 £m
Assets						
Less than one year	**285.9**	**(276.4)**	**9.5**	182.3	(166.6)	15.7
Greater than one year	**76.3**	**(69.5)**	**6.8**	102.4	(92.5)	9.9
Liabilities						
Less than one year	**295.8**	**(306.4)**	**(10.6)**	351.3	(359.5)	(8.2)
Greater than one year	**30.2**	**(31.1)**	**(0.9)**	26.8	(27.0)	(0.2)
Total	**688.2**	**(683.4)**	**4.8**	662.8	(645.6)	17.2

This table presents the undiscounted future contractual cash-flows for all derivative financial instruments. For this disclosure, cash-flows in foreign currencies are translated using the spot rates at the balance sheet date. The fair values of these financial instruments are presented in note 21.

Gross contractual cash-flows for other financial liabilities

The contractual cash-flows for financial liabilities included in trade and other payables are: £328.4m (2011: £309.9m) due in less than one year, £18.4m (2011: £20.9m) due between one and five years and £4.2m (2011: £4.3m) due after more than five years.

21 Financial derivatives

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

				At 31 July 2012
	Contract or underlying nominal amount			**Fair value**
	£m	**Assets £m**	**Liabilities £m**	**Net £m**
Foreign exchange contracts (cash-flow hedges)	**279.4**	**2.7**	**(8.6)**	**(5.9)**
Foreign exchange contracts (not hedge accounted)	**249.9**	**1.4**	**(1.7)**	**(0.3)**
Total foreign exchange contracts	**529.3**	**4.1**	**(10.3)**	**(6.2)**
Currency swaps (net investment hedges)	**192.5**	**2.6**	**(1.4)**	**1.2**
Interest rate swaps (fair value hedges)	**190.0**	**8.4**		**8.4**
Total financial derivatives	**911.8**	**15.1**	**(11.7)**	**3.4**
Balance sheet entries				
Non-current		**7.2**	**(1.1)**	**6.1**
Current		**7.9**	**(10.6)**	**(2.7)**
Total financial derivatives		**15.1**	**(11.7)**	**3.4**

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

Currency swaps not hedge accounted

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

Accounting for other derivative contracts

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

Fair value hierarchy

All derivatives values are calculated using valuation methodologies in which all the inputs are either market data or derived from market data.

22 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	(1.0)	0.1	0.1	0.1	9.0	0.9	9.2
Business combinations	0.4						0.4
Provision charged	22.4	11.3	6.9		42.5	55.2	138.3
Provision released	(6.0)	(0.7)	(0.5)		(3.7)	(0.2)	(11.1)
Unwind of provision discount					4.0	0.5	4.5
Utilisation	(18.9)	(12.7)	(0.5)		(20.4)	(5.9)	(58.4)
At 31 July 2012	**34.5**	**5.8**	**9.4**	**4.0**	**213.1**	**64.9**	**331.7**

Analysed as:

	31 July 2012 £m	31 July 2011 £m
Current liabilities	**77.3**	74.7
Non-current liabilities	**254.4**	174.1
	331.7	248.8

Warranty provision and product liability

Warranties over the Group's products typically cover periods of between one and three years. Provision is made for the likely cost of after-sales support based on the recent past experience of individual businesses.

Reorganisation and property

At 31 July 2012 a provision of £9.4m (2011: £nil) relates to the performance improvement programme in Smiths Detection.

Disposal

The disposal provision relates to warranties and other obligations in respect of the disposal of the Marine Systems and Aerospace businesses. Most of the balance is expected to be utilised within the next five years.

Litigation

John Crane, Inc.

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

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

JCI continues to actively monitor the conduct and effect of its current and expected asbestos litigation, including the most efficacious presentation of its 'safe product' defence, and intends to continue to resist these asbestos claims based upon this defence. Approximately 221,000 claims against JCI have been dismissed before trial over the last 33 years. JCI is currently a defendant in cases involving approximately 86,000 claims. Despite the large number of claims brought against JCI, it has had final judgments against it, after appeals, in only 115 cases over the period, and has had to pay awards amounting to approximately US$111m. JCI has also incurred significant additional defence costs and, whilst the number of claims being filed against JCI and other defendants has been declining, the proportion of mesothelioma claims has increased, and JCI's ability to defend these cases successfully is likely to have a significant impact on its annual aggregate adverse judgment and defence costs.

22 Provisions for liabilities and charges continued

Litigation continued

John Crane, Inc. continued

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

– The period over which the expenditure can be reliably estimated.

– The future trend of legal costs.

– The rate of future claims filed.

– The rate of successful resolution of claims.

– The average amount of judgments awarded.

The provision is based on past history and allows for decreasing levels of new claims based on published tables of asbestos incidence projections and is determined using asbestos valuation experts, Bates White LLC. 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 25.

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

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

	31 July 2012 £m	31 July 2011 £m
Gross provision	**226.3**	203.1
Discount	**(13.2)**	(21.4)
Discounted pre-tax provision	**213.1**	181.7
Deferred tax	**(51.1)**	(50.6)
Discounted post-tax provision	**162.0**	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 but, more recently, has cost between £3m and £5m a year. These costs 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 25.

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 of £61.8m (£11.2m) is a discounted pre-tax provision using discount rates, being the risk-free rate on US debt instruments for the appropriate period.

22 Provisions for liabilities and charges continued

Litigation continued

Other litigation

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

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

23 Share capital

	Number of shares	Issued capital £m	Consideration £m
Ordinary shares of 37.5p each			
At 31 July 2011	392,350,403	147.1	
Exercise of share options	375,540	0.2	3.0
Total share capital at 31 July 2012	**392,725,943**	**147.3**	

At 31 July 2012 all of the issued share capital was in free issue. All issued shares are fully paid.

24 Reserves

Retained earnings include the value of Smiths Group plc shares held by the Smiths Industries Employee Benefit Trust. In the year the Company issued nil (2011: nil) shares to the Trust, and the Trust purchased 1,026,514 (2011: 700,892 shares) in the market. At 31 July 2012 the Trust held 855 (2011: 855) ordinary shares with a market value of £0.0m (2011: £0.0m).

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

Capital management

Capital employed comprises total equity adjusted for goodwill recognised directly in reserves, net post-retirement benefit assets and liabilities, net litigation provisions relating to exceptional items and net debt. Capital employed has been restated, see note 1. The efficiency of the allocation of the capital to the divisions is monitored through the return on capital employed (ROCE). This ratio is calculated over a rolling 12-month period and is the percentage that headline operating profit comprises of monthly average capital employed. The ROCE was 16.5% (2011:16.4% restated). See note 1 for details of the restatement of capital employed.

The capital structure is based on the directors' judgement of the balance required to maintain flexibility while achieving an efficient cost of capital. The Group has a target gearing, calculated on a market value basis, of approximately 20%. At the balance sheet date the Group had gearing of 17% (2011: 15%).

As part of its capital management the Group strategy is to maintain a solid investment grade credit rating to ensure access to the widest possible sources of financing and to minimise the resulting cost of capital. At 31 July 2012 the Group had a credit rating of BBB+/Baa2 (2011: BBB+/Baa2) with Standard & Poor's and Moody's respectively. The credit rating is managed through the following cash-flow targets: headline operating cash conversion of greater than 80% and a ratio of net debt to headline EBITDA of less than two. For the year ended 31 July 2012 these measures were 99% (2011: 95%) and 1.2 (2011: 1.2).

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

Hedge reserve

	31 July 2012 £m	31 July 2011 £m
The hedge reserve on the balance sheet comprises		
– cash-flow hedge reserve	**(4.7)**	(0.3)
– net investment hedge reserve	**(120.1)**	(120.3)
	(124.8)	(120.6)

See transactional currency exposure risk management disclosures in note 20 for additional details of cash-flow hedges, and translational currency exposure risk management disclosure also in note 20 for additional details of net investment hedges.

25 Contingent liabilities and commitments

John Crane, Inc.

As stated in note 22, John Crane, Inc. (“JCI”) is involved in numerous lawsuits pending in the United States in which plaintiffs are claiming damages arising from exposure to, or use of, products containing asbestos. The JCI products generally referred to in these cases are ones in which the asbestos fibres were encapsulated in such a manner that, according to tests conducted on behalf of JCI, the products were safe. JCI ceased manufacturing products containing asbestos in 1985.

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

Titeflex Corporation

As stated in Note 22, 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, legal challenges to the scope and validity of patents, and product liability and insurance subrogation claims. These types of proceedings (or the threat of them) are also used to create pressure to encourage negotiated settlement of disputes. Any claim brought against the Group (with or without merit), could be costly to defend. These matters are inherently difficult to quantify. In appropriate cases a provision is recognised based on best estimates and management judgement but there can be no guarantee that these provisions (which may be subject to potentially material revision from time to time**)** will result in an accurate prediction of the actual costs and liabilities that may be incurred. There are also contingent liabilities in respect of litigation for which no provisions are made.

At 31 July 2012, contingent liabilities, comprising bonds and guarantees arising in the normal course of business, amounted to £167.4m (2011: £137.8m), including pension commitments of £49.5m (2011: £43.1m).

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

26 Operating lease commitments – minimum lease payments

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

	31 July 2012		31 July 2011	
	Land and buildings £m	**Other £m**	Land and buildings £m	Other £m
Payments due				
– not later than one year	**31.0**	**8.4**	30.4	9.1
– later than one year and not later than five years	**66.8**	**10.8**	64.1	8.8
– later than five years	**12.6**		22.7	0.1
	110.4	**19.2**	117.2	18.0

27 Cash-flow

Cash-flow from operating activities

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Operating profit – continuing	**406.6**	438.0
Amortisation of intangible assets	**83.1**	72.3
Impairment of intangible assets	**10.7**	5.5
Loss/(profit) on disposal of property, plant and equipment	**3.7**	(0.7)
Profit on disposal of business	**(30.8)**	(4.4)
Depreciation of property, plant and equipment	**59.0**	63.4
Share-based payment expense	**14.4**	13.8
Retirement benefits	**(118.6)**	(77.6)
Increase in inventories	**(4.3)**	(46.7)
Increase in trade and other receivables	**(6.8)**	(33.1)
Increase in trade and other payables	**0.9**	43.7
Increase in provisions	**71.8**	5.2
Cash generated from operations	**489.7**	479.4
Interest	**(64.5)**	(66.8)
Tax paid	**(93.7)**	(90.9)
Net cash inflow from operating activities	**331.5**	321.7

27 Cash-flow continued

Smiths Group cash-flow measures

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

Headline operating cash-flow

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Net cash inflow from operating activities	**331.5**	321.7
Exclude:		
Interest	**64.5**	66.8
Tax paid	**93.7**	90.9
Cash outflow in respect of exceptional operating items	**38.2**	34.8
Pension deficit payments	**111.2**	60.1
Include:		
Expenditure on capitalised development, other intangible assets and property, plant and equipment	**(91.2)**	(90.1)
Disposals of property, plant and equipment in the ordinary course of business	**0.7**	4.5
Headline operating cash-flow	**548.6**	488.7

Free cash-flow

	Year ended 31 July 2012 £m	Year ended 31 July 2011 £m
Net cash inflow from operating activities	**331.5**	321.7
Expenditure on capitalised development, other intangible assets and property, plant and equipment	**(91.2)**	(90.1)
Disposals of property, plant and equipment	**0.7**	4.5
Investment in financial assets relating to pensions financing	**(24.0)**	
Free cash-flow	**217.0**	236.1
Investment in other financial assets	**(0.3)**	(0.3)
Acquisition of businesses	**(167.5)**	(18.5)
Disposal of Aerospace		(6.2)
Disposal of businesses	**47.3**	3.9
Net cash-flow used in financing activities	**(151.5)**	(129.2)
Net (decrease)/increase in cash and cash equivalents	**(55.0)**	85.8

28 Acquisitions

During the year ended 31 July 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 management 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 31 July 2012, the acquisitions contributed £60.1m to revenue, £4.4m to headline profit before taxation and loss of £16.1m to profit before taxation due to the amortisation and impairment of acquired intangible assets. If Smiths had acquired the businesses at the beginning of the financial period, the acquisitions would have contributed £78.7m to revenue and a loss of £22.7m to profit before tax.

28 Acquisitions continued

	Power Holdings Inc.			Other acquisitions			Total
	Book value £m	Fair value adjustments £m	Fair value £m	Book value £m	Fair value adjustments £m	Fair value £m	£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	(0.2)	24.2	1.8		1.8	**26.0**
– other current assets	7.3	(1.0)	6.3	0.4	(0.1)	0.3	**6.6**
Non-current liabilities							
– other liabilities	(0.4)	(7.6)	(8.0)				**(8.0)**
Current liabilities							
– overdrafts				(0.1)		(0.1)	**(0.1)**
– other current liabilities	(11.9)	(0.1)	(12.0)	(0.4)		(0.4)	**(12.4)**
Net assets acquired	20.5	40.6	61.1	2.2	3.5	5.7	**66.8**
Goodwill on current year acquisitions			92.8			7.4	**100.2**
Total consideration			153.9			13.1	**167.0**
Cash paid during the period – current year acquisitions							**167.0**
Deferred consideration paid – prior year acquisitions							**0.5**
Total consideration							**167.5**

29 Employee share schemes

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

Long-Term Incentive Plan (LTIP)

The LTIP is a share plan under which an award over a capped number of shares will vest after the end of the three year performance period if performance conditions are met. Group LTIP awards are made to selected senior corporate executives, including the executive directors. These awards have three performance conditions: 50% of the award is conditional on 3-year headline EPS growth; 30% of the award is conditional on 3-year TSR relative to the FTSE 100 (excluding financial services companies); and 20% of the award is conditional on 3-year average annual headline cash conversion.

Divisional LTIP awards are made to selected divisional senior executives. These awards also have three performance conditions, and the relative significance of the conditions reflects the strategic priorities for each division: 20% to 40% of the awards are conditional on 3-year revenue growth; 30% to 40% of the awards are conditional on 3-year average annual headline operating margins; and 30% to 40% of the awards are conditional on 3-year average annual headline cash conversion.

Each performance condition has a threshold below which no shares vest and a maximum performance target at or above which the award vests in full. For performance between 'threshold' and 'maximum', awards vest on a straight-line sliding scale. The performance conditions are assessed separately, so performance on one condition does not affect the vesting of the other elements of the award. To the extent that the performance targets are not met over the 3-year performance period, awards will lapse. There is no re-testing of the performance conditions.

2010 Value Sharing Plan (2010 VSP)

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

2008 Value Sharing Plan (2008 VSP)

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

29 Employee share schemes continued

Smiths Group Co-Investment Plan (CIP)

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

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

	CIP	Long term incentive plans	Other share schemes	Total	Weighted average price for option plans £
Ordinary shares under option ('000)					
1 August 2010	877	1,770	6,432	9,079	£6.15
Granted	730	785	123	1,638	£0.78
Update of estimates		122		122	£0.00
Exercised	(216)	(517)	(1,744)	(2,477)	£6.28
Lapsed	(51)	(303)	(373)	(727)	£6.46
31 July 2011	1,340	1,857	4,438	7,635	£5.37
Granted	752	1,133	257	2,142	£0.97
Update of estimates		96		96	£0.00
Exercised	(254)	(773)	(393)	(1,420)	£2.20
Lapsed	(130)	(14)	(827)	(971)	£7.07
31 July 2012	**1,708**	**2,299**	**3,475**	**7,482**	**£4.10**

Options were exercised on an irregular basis during the period. The average closing share price over the financial year was 992.15p (2011: 1,240.24p). There has been no change to the effective option price of any of the outstanding options during the period.

Range of exercise prices	Total shares under option ('000)	Weighted average remaining contractual life (months)	**Options exercisable at 31 July 2012 ('000)**	Options exercisable at 31 July 2011 ('000)	**Exercisable weighted average exercise price for options exercisable at 31 July 2012**
£0.00 – £2.00	4,008	18			**£0.00**
£2.01 – £6.00	463	17	**2**	2	**£5.69**
£6.01 – £10.00	1,979	42	**1,387**	2,106	**£8.52**
£10.01 – £14.00	1,032	62	**947**	907	**£10.97**

For the purposes of valuing options to arrive at the share-based payment charge, the Binomial option pricing model has been used for most schemes and the Monte Carlo method is used for schemes with total shareholder return performance targets. The key assumptions used in the models for 2012 and 2011 are volatility of 27% to 30% (2011: 30%) and dividend yield of 3.75% (2011: 3.33%). Assumptions on expected volatility and expected option term have been made on the basis of historical data, for the period corresponding with the vesting period of the option. These generated a weighted average fair value for CIP of £9.44 (2011: £12.40), group long term incentive plans of £7.14 (2011: £13.86) and divisional long term incentive plans of £8.94 (2011: £12.35). The fair value disclosed for the CIP award treats the two matching shares as separate options.

Included within staff costs is an expense arising from share-based payment transactions of £14.3m (2011: £13.8m), of which £14.4m (2011: £13.8m) relates to equity-settled share-based payment.

At 31 July 2012 the creditor relating to cash-settled schemes is £0.4m (2011: £0.6m).