News release

London, Wednesday 23 September 2015

For immediate release

Annual results for the year ended 31 July 2015

	Headline*				Statutory	
	2015 £m	2014 £m	Reported	Underlying#	**2015 £m**	2014 £m
Revenue	**2,897**	2,952	(2)%	(2)%	**2,897**	2,952
Operating profit	**511**	504	1%	1%	**394**	378
Operating margin	**17.6%**	17.1%	50 bps		**13.6%**	12.8%
Pre-tax profit	**459**	445	3%	3%	**325**	302
Basic EPS	**86.1p**	81.8p	5%		**62.4p**	59.0p
Free cash-flow	**158**	143				
Dividend	**41.00p**	40.25p	2%		**41.00p**	40.25p
Return on capital employed	**16.0%**	15.7%	30 bps			

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

#Organic growth adjusting for foreign exchange translation.

Highlights

- Headline EPS up 5% and continued strong headline operating cash conversion at 95%
- Smiths Medical delivered highest revenue growth in almost a decade
- John Crane aftermarket strength underpinned a resilient performance
- Smiths Detection achieved margin improvement and strengthened order book
- Difficult trading conditions at Smiths Interconnect; continued positive results from Flex-Tek
- Increased investment in growth initiatives through *Engineered for Growth* programme
- Net accounting pension deficit reduced to £108m – its lowest reported level since 2008

"While Group revenues fell 2% with tougher trading in Smiths Interconnect, Smiths Detection and John Crane, headline operating margin rose on a recovery in profitability at Detection as management action strengthened its business performance. Smiths Medical achieved its highest revenue growth in almost 10 years helped by innovation in infusion pumps and some competitor disruption. John Crane delivered a resilient performance supported by its robust business model, focused on aftermarket services. Smiths Interconnect reported lower revenues with continued tough trading conditions; the impact on operating profit was exacerbated by the division's high operational gearing. Flex-Tek benefited from continued growth in US residential construction, specialty heating elements and aerospace demand.

"Over the last eight years, we have increased our investment in revenue growth opportunities through investment in innovation, expansion in emerging markets and better sales & marketing effectiveness. Our *Fuel for Growth* restructuring programme is on track and has generated £33m of annual savings which were largely reinvested in growth initiatives as part of our *Engineered for Growth* plans.

"Looking ahead, our investment initiatives are building a solid foundation to accelerate medium-term revenue growth. We see positive momentum in Smiths Medical, Smiths Detection and Flex-Tek, albeit against the backdrop of continuing global economic uncertainty. John Crane is likely to experience further pressures from lower capital expenditure by energy services customers, although the aftermarket services business is expected to prove more resilient. Smiths Interconnect is expected to see modest improvement in some of its commercial markets. Overall, the phasing of group results is expected to be slightly more weighted towards the second half than usual."

Philip Bowman
Chief Executive

Divisional highlights*

	% of Group revenue	Underlying revenue growth*	Underlying headline operating profit growth*	Headline operating profit margin*		Return on capital employed*	
				2015	2014	**2015**	2014
John Crane	31%	**(2)%**	**(2)%**	**24.8%**	24.9%	**25.8%**	26.7%
Smiths Medical	29%	**4%**	**2%**	**19.8%**	19.8%	**14.7%**	14.5%
Smiths Detection	16%	**(7)%**	**167%**	**11.9%**	4.8%	**9.6%**	3.9%
Smiths Interconnect	15%	**(9)%**	**(34)%**	**11.6%**	16.0%	**9.1%**	13.7%
Flex-Tek	9%	**4%**	**1%**	**18.5%**	18.9%	**33.6%**	34.0%
Group	100%	**(2)%**	**1%**	**17.6%**	17.1%	**16.0%**	15.7%

**All figures are on a headline basis. Revenue and profit growth are at constant currency and exclude the impact of acquisitions and disposals.*

John Crane

- Revenue down 2% driven mainly by weaker demand from first-fit customers
- Aftermarket for rotating equipment resilient with revenue up 4%
- Margins broadly maintained at 24.8% benefiting from product mix and continued focus on cost controls
- Absent any market improvement, revenue likely to decline on weaker first-fit demand despite aftermarket resilience

Smiths Medical

- Revenue up 4% due to strong ambulatory infusion performance and recovery in disposables
- Margins maintained with higher volumes and efficiencies and despite increased investment and price pressure
- Strong emerging market performance led by much improved results in key markets such as China
- Revenue growth expected to moderate after strong infusion year; margins likely to improve despite investment

Smiths Detection

- Revenue down 7% with tough trading and a variable contract flow; but good progress on stabilising operations
- Margins up 710 bps as last year's £30m of one-off charges were not repeated and helped by efficiency gains
- Recent contract wins have strengthened order book for delivery in FY16
- Margins are expected to continue to benefit from cost saving actions despite price and mix pressures

Smiths Interconnect

- Revenue 9% lower with continued pressures across Microwave and Connectors offsetting growth in Power
- Margins down 440 basis points on lower volumes, adverse operational gearing and adverse mix
- Market conditions expected to improve slightly enabling a modest performance improvement next year

Flex-Tek

- Revenue up 4% driven by US residential construction, specialty heating elements and aero/automotive hoses
- Margins down 40 bps reflecting increased investment in new product development and adverse product mix
- US construction and aerospace demand supports growth; margin outlook stable despite increased investment

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Presentation

The presentation slides and a live webcast of the presentation to analysts are available at www.smiths.com/results at 09.00 (UK time) on Wednesday 23 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: 0808 237 0062

International: +44 (0)20 3426 2890

US/Canada toll free: 1 877 841 4558

An audio replay is available for seven days on the following numbers (access PIN 660764#):

UK toll free: 0808 237 0026

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US/Canada toll free: 1 866 535 8030

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 £325m (2014: £302m) and earnings per share were 62.4p (2014: 59.0p).

See note 3 to the accounts for the definition of headline profit measures and note 4 for an analysis of exceptional items.

Chief Executive's review

Results summary

Smiths Group has delivered another resilient performance against the backdrop of a challenging and uncertain global economy. Headline earnings per share improved 5% with increased operating margins and lower tax and financing costs. The results demonstrate the strengths and benefits of our diversified group of leading-edge, technology-focused businesses that serve a wide range of end markets and geographies. We saw good revenue growth in Smiths Medical and Flex-Tek, but difficult end markets in John Crane, Detection and Interconnect pushed down overall revenues. Headline operating margin improved largely as a result of better performance in Smiths Detection against a weak comparator period.

We maintained our programme of operational improvements and efficiencies across the businesses, helping to fund increased investment in high-growth markets and new product development in order to accelerate medium-term revenue growth.

John Crane withstood the impact of a lower oil price on the wider energy services sector to deliver a resilient performance on the strength of its aftermarket-focused business model. Underlying revenue declined as higher aftermarket revenues were offset by pressures from its first-fit business. Headline operating margins were maintained. Smiths Medical saw strong revenue growth as a result of its recent investment and sales focus on infusion pumps and a recovery in disposables following the US distributor destocking last year. Margins were maintained on higher volumes and efficiency gains, offset by greater investment in new products, ongoing price pressure and transactional foreign exchange. Revenue at Smiths Detection fell as it continued to manage its variable contract flow and faced difficult markets with volume and price pressures. However, margins rebounded sharply as last year's non-recurring costs were not repeated and the benefits from cost-saving initiatives began to emerge. It also secured significant new orders to strengthen the order book for the new financial year. Smiths Interconnect had a disappointing year as customer spending delays and some programme slowdowns in Microwave and Connectors offset revenue growth in Power. Margins fell on the reduced volumes and associated cost absorption issues as well as adverse mix. Flex-Tek revenues benefited from growth from its US residential construction products, specialty heating elements and hoses for aerospace and automotive applications. Headline operating profit grew slightly despite increased investment in marketing and innovation.

Strategy

Our strategy is to grow shareholder value by:

- Delivering revenue growth through investment in organic drivers, including new product development and expansion in high-growth markets, and through targeted acquisitions;
- Enhancing margins through a relentless drive for operational improvement across all our businesses;
- Attracting and retaining the best people and finding smarter ways of working;
- Promoting a culture of responsibility in everything we do;
- Generating strong operating cash-flows with efficient balance sheet management; and
- Allocating capital rigorously across the business, through both organic investment and acquisitions & disposals.

We continue to pursue these objectives and some examples of our progress are set out below. While all these objectives are important, the area where we see the most opportunity to generate value is to grow the business both organically and through M&A. This remains a key priority for the Group as we seek to reposition the business.

Investing to accelerate revenue growth – *Engineered for Growth*

In the year, we launched a new Group-wide programme – *Engineered for Growth* – to accelerate our organic revenue performance. It is focused around four initiatives: sales and marketing excellence, quality improvement, China, and innovation. This programme is designed to share and leverage our expertise across the divisions and to build momentum in these targeted areas. This multi-year programme is expected to deliver improved results over the medium term as the initiatives gain traction. We held a senior management conference in April this year, focusing on the *Engineered for Growth* agenda to review progress and to align the organisation around the four initiatives.

Sales and marketing excellence – We are investing to upgrade our sales and marketing capabilities to become a more customer and market-led business. Group-wide sales and marketing councils have been formed to improve customer insight and market segmentation. Our newly created Sales Academy, has now trained 170 sales leaders at four separate events in its first year and we have more scheduled during the coming financial year.

Quality – We have a valuable opportunity to improve our offering by providing the right products and services on time, while minimising scrap, rework and other inefficiencies. We have developed a suite of metrics for defining the cost of poor quality with the aim of driving out these costs across the Group.

China – We have continued to prioritise resource and investment into China and have now opened a Smiths Group office in Shanghai that has begun to provide key local expertise in legal, government affairs and commercial practice for all the divisions.

Innovation – We have increased our investment in R&D over recent years and we are committed to ensuring this is at least matched by the contribution of new products to our revenues. Our first innovation awards were also presented this year to celebrate excellence in three areas: new markets, new processes and new technology. Awards will be made in future years for the best innovations in these areas at a divisional level with the best of these being put forward for best in Group awards.

We are focused on improving the effectiveness of our innovation spend. Our company-funded investment in R&D increased in John Crane, Smiths Medical and Flex-Tek but declined 4% overall to £104m – mainly as a result of reductions in Smiths Detection and Smiths Interconnect as they seek efficiencies in their investment and as projects conclude. For example, recent product launches at Smiths Detection, such as the XCT checked baggage screener, signal the end of an investment phase on such projects. Smiths Detection has focused its investment more tightly around products that are expected to deliver more certain returns and has cut investment in less attractive, non-strategic project areas.

Recent new product launches included John Crane's AURA 220 gas seal, the first of a new family of gas seals to be unveiled, which uses a common global design and patented polymeric sealing device to help cut operating costs. Smiths Medical launched the Medfusion interoperability platform that enables automatic programming, charting and reporting for our Medfusion syringe pumps. The latest generation of Graseby syringe pumps grew well following their launch in China this year. Smiths Interconnect introduced two further semiconductor test sockets to address the nascent wafer level chip scale package sector while investments in data centre power systems focused on PowerHub2, a new power distribution unit, and PowerWave Silver, a busway product targeted at emerging market requirements. Smiths Detection's new IONSCAN 600 explosives trace detector is set to extend the success of a system that has played a leading role in aviation security over the last 15 years. Checkpoint.Evo, a new software solution that greatly enhances inspection and integration capabilities at airport checkpoints, was also launched and has already attracted orders. Increased innovation spend in Flex-Tek helped deliver new developments in 3000 and 5000 psi hoses for aerospace applications and new specialty heating elements.

Programme to fund growth investment

We are funding investment in these growth initiatives through our *Fuel for Growth* programme, which we began two years ago. It is expected to generate £60m of annual savings for reinvestment in sales, marketing and new product development. The programme will cost approximately £120m and is being treated as an exceptional item. There is also some accompanying capital expenditure, with £17m incurred to date. This restructuring focuses on three areas: manufacturing footprint optimisation; organisational effectiveness; and the upgrading of information systems. For example, during the year, Smiths Detection and Smiths Medical both closed three sites in North America while Smiths Interconnect continued to consolidate its manufacturing sites in its Connectors business. To date, we have incurred costs of £66m across the programme, which has delivered annualised savings of £33m.

	Programme to date		Total programme expectations	
	Costs to date	Annualised savings to date	Total costs by end FY 2017	Full annual benefits by end FY 2017
John Crane	12	10	27	13
Smiths Medical	26	12	50	23
Smiths Detection	16	4	28	10
Smiths Interconnect	11	7	11	9
Flex-Tek	1	0	4	5
Total	**66**	**33**	**120**	**60**

Promoting responsibility

Behaving ethically, working safely and reducing our environmental impact help create long-term shareholder value. We have introduced safety activities aimed at instilling a 'zero harm' culture so that potential risks are identified and managed before they even reach near-miss status. Lost time incidents were maintained at their record low levels and a marginal increase in the recordable rate during the year stemmed largely from incidents at a limited number of sites. The root causes have been identified and addressed. We also continued to make good progress overall in meeting medium-term environmental targets for reductions in energy, greenhouse gas emissions, waste and water consumption.

Cash generation and balance sheet

The business delivered another strong year of operating cash generation with a cash conversion rate of 95%. Free cash-flow was improved by £15m to £158m.

We have a strong balance sheet. We had a successful €600m bond issue with a fixed coupon of 1.25% and an eight-year term, which formed part of our ongoing refinancing programme, helping to extend maturity profiles and reinforcing the stability of our balance sheet for the long term.

Managing our pension liabilities

The quantitative easing policies adopted by central banks in recent years have driven discount rates down to historic lows, causing a significant expansion in the liabilities of defined benefit pension schemes of many UK corporates. In the case of Smiths, these legacy pension schemes have been a substantial drain on the Group's cash resources and posed constraints on the Board's strategic flexibility to reshape its portfolio of businesses.

However, much has been done over recent years, in conjunction with the pension scheme trustees, to mitigate liabilities and de-risk the assets so that they correspond more closely to the liabilities. The benefits of these actions, as well as the significant cash contributions, have caused the accounting pension deficit to fall to £108m – its lowest reported level since 2008. Although the preliminary results of the triennial reviews for the two UK schemes have yet to be agreed with the UK Trustees, the actions taken in recent years have resulted in significant reductions in the actuarial deficits. For example, the actuarial deficit for the Smiths Industries Pension Scheme has improved from £535m in March 2012 to around £330m in March 2015. Netting of the escrow assets would allow a further substantial improvement, and lessen the cash needs of the scheme and significantly free the Board's hand to simplify and focus the Group's structure.

Dividend

The Board has 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. While the medium-term objective is to maintain this dividend cover, we will operate some flexibility in applying the 2.5 times cover to take account of short-term impacts such as foreign exchange.

The Board has recommended a final dividend of 28p per share giving a total for the year of 41p, an increase of 2% reflecting the strong cash conversion in the year. The final dividend will be paid on 20 November to shareholders registered at the close of business on 23 October. The ex-dividend date is 22 October.

Outlook

Looking ahead, our investment initiatives are building a solid foundation to accelerate medium-term revenue growth. We see positive momentum in Smiths Medical, Smiths Detection and Flex-Tek, albeit against the backdrop of continuing global economic uncertainty. John Crane is likely to experience further pressures from lower capital expenditure by energy services customers, although the aftermarket services business is expected to prove more resilient. Smiths Interconnect is expected to see modest improvement in some of its commercial markets. Overall, the phasing of Group results is expected to be slightly more biased towards the second half than usual.

Outlook statements for the divisions are provided in the Operational review.

Operational review

Revenue

Revenue declined 2% on a reported and underlying basis. The reported revenue decline of £55m to £2,897m included a currency translation benefit of £1m offset by a £1m reduction from a small business disposal in John Crane. The £55m underlying decline was due to growth in Smiths Medical (+£32m) and Flex-Tek (+£10m) being more than offset by declines at Smiths Interconnect (-£40m), Smiths Detection (-£34m) and John Crane (-£23m).

Profit

Headline operating profit grew 1% on a reported and underlying basis to £511m. Headline operating margin improved 50 basis points to 17.6% (2014: 17.1%). The £7m reported increase comprises a £2m benefit from currency exchange translation and a £5m underlying improvement. The main drivers of the £5m underlying growth were the profit improvement in Smiths Detection (+£34m) from the non-repeat of £30m of one-off costs incurred last year, increased volumes and cost savings in Smiths Medical (+£3m) and growth in aerospace and specialty heat products at Flex-Tek (+£1m), which were partially offset by the lower volumes, reduced overhead cost recovery and adverse mix at Smiths Interconnect (-£25m), the tough trading in the first-fit business within John Crane (-£6m) and higher corporate costs (-£2m) from increased investment in *Engineered for Growth* initiatives.

Operating profit on a statutory basis, after taking account of the items excluded from the headline figures, was £394m (2014: £378m) – see notes 3 and 4 for information on the excluded items. The increase was driven mainly by the improvement in profitability at Smiths Detection and lower exceptional operating costs.

The net interest charge on debt was reduced to £52m (2014: £59m), primarily due to the repayment of the $250m 6.05% fixed rate Notes in May 2014. Headline profit before tax increased £14m, or 3%, to £459m (2014: £445m) driven by the higher headline operating profit and lower finance charge. On an underlying basis, headline profit before tax increased 3%.

The Group's tax rate on headline profit for the period was 25.5% (2014: 27.0%). Headline earnings per share rose 5% to 86.1p (2014: 81.8p).

On a statutory basis, profit before tax increased £23m to £325m (2014: £302m); it is stated after taking account of exceptional costs, a pensions finance charge of £8m (2014: £9m) and other items excluded from the headline measure.

Cash generation

Operating cash generation remained strong with headline operating cash of £484m (2014: £490m), representing 95% (2014: 97%) 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 increased £15m to £158m (2014: £143m). 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 £266m (2014: £256m).

Dividends paid in the period on ordinary shares amounted to £160m (2014: £275m consisting of final and special dividends).

Net debt at 31 July 2015 was £818m, slightly up from £804m at 31 July 2014. The continued strong cash generation was sufficient to fund the business operation, the legacy cash costs of pension contributions and product liability litigation and dividends to shareholders.

John Crane

	2015 £m	2014 £m	Reported growth	Underlying growth
Revenue	**905**	941	(4)%	(2)%
Headline operating profit	**225**	234	(4)%	(2)%
Headline operating margin	**24.8%**	24.9%	(10) bps	
Statutory operating profit	**165**	166	(1)%	
Return on capital employed	**25.8%**	26.7%	(90) bps	

Performance

John Crane delivered a resilient performance reflecting the business model strength and consistent focus on aftermarket services, which have stood up well to a challenging energy services market. Underlying revenue fell 2%, while reported revenue, including £12m of adverse foreign exchange translation and £1m related to a small divestiture, declined 4%. Underlying revenue reflects declining sales in the first-fit business. The order book was strong at the end of the year, albeit below last year's record high.

Headline operating profit margin fell slightly to 24.8%. Reported headline operating profit declined 4% (£9m), on the back of a £6m, or 2%, fall in underlying profit and an adverse currency translation of £3m. The underlying decline was driven by lower volumes partly offset by the benefits of cost control actions and product mix. The difference between statutory and headline operating profit primarily reflects a £27m goodwill impairment of John Crane Production Solutions as a result of the impact of lower oil prices on their customers; the cost of John Crane, Inc. asbestos litigation of £19m, amortisation of acquired intangible assets of £7m and restructuring costs of £5m. Return on capital employed declined 90 basis points to 25.8% because of lower profitability. Revenues for the upstream energy business were reclassified from aftermarket to first-fit because the business demonstrates cyclical characteristics that are more closely aligned with the first-fit business – see note 1.

Aftermarket revenue rose 4%, continuing to illustrate the strength of end-customer demand. This business generates more than half of John Crane's revenue with growth mainly driven by strong demand for our services as refineries operate at full capacity. In the second half, John Crane's aftermarket business signed multiple agreements with customers around the world, including Phillips66 Texas, Suncor Energy Canada, Solvay Brazil, Sanyo Chemical, Mexichem Columbia and Ingredion Argentina, representing the diverse mix of processing industries we serve including pulp and paper, chemical, food, and oil and gas. To continue strengthening our aftermarket customer support capabilities, we invested in machining capacity in two service super centres in North America.

Underlying sales to first-fit customers fell 9% as market pressures caused by the fall in energy prices affected our business broadly across most geographies. While we continue to see delays globally in oil and gas projects which have not yet secured funding, John Crane's overall project win-rate is higher than in the previous period, reflecting a concerted effort to expand the installed base. Our exclusive framework agreement for part of the Kuwait National Petroleum Company's (KNPC) Clean Fuels Project is an example of a large project win during the period. First-fit sales were also affected by declines in the upstream energy services business, John Crane Production Solutions, due to especially severe conditions in this market. This business entered a new agreement with a Canadian-based company called MANTL to give our customers access to a cost-efficient pump technology.

Revenue from emerging markets rose 5% on an underlying basis and now comprises 24% of sales. The largest increases came from growth across Latin America, including Mexico, Colombia and Chile.

Research and development

John Crane increased investment in R&D by 17%, continuing to illustrate its commitment to address future market needs. Our focus remains on developing engineered solutions and technology advancements that meet customers' growing processing demands while promoting reduced environmental impact and improved energy efficiency. A recent investment in additive manufacturing through the installation of a 3D laser printer for metal is providing our engineers with far faster capability for on-demand production of highly complex and unique prototype components.

In the first half of the period, we introduced the AURA 220 gas seal. It represents the next generation of advanced gas seal technology and is the first to be unveiled as part of a new family of gas seals. The company also launched Engineering U, a new accelerated career development programme for promising entry-level mechanical engineers, with the first 12-month US-based pilot programme being completed this year.

Customer trials are underway for John Crane's new Predictive Diagnostics System, which is designed to reduce customers' operational costs by predicting their maintenance needs and minimising operational disruption. The new technology was designed to provide real-time health assessments and predictive diagnostics for mechanical seals. However, we are also evaluating other applications for the system. Additionally, we launched a next-generation fibreglass sucker rod that increases production output, improves load strength and reduces lifting costs for oil producers.

Outlook

We expect global energy markets to remain challenging for the coming year, with depressed oil prices and significant market uncertainty. Absent any improvement in conditions, revenue is expected to decline further despite the strong order book. We currently anticipate operating margins to be in the lower half of our previously disclosed medium-term range (22-25%).

Smiths Medical

	2015 £m	2014 £m	Reported growth	Underlying growth
Revenue	**836**	804	4%	4%
Headline operating profit	**166**	159	4%	2%
Headline operating margin	**19.8%**	19.8%	-	
Statutory operating profit	**142**	142	-	
Return on capital employed	**14.7%**	14.5%	20 bps	

Performance

Reported and underlying revenue both grew 4% driven by a very strong performance by our Infusion systems products. Infusion systems growth stemmed from strong returns on recent investments in ambulatory infusion amid competitor disruption in this space. As anticipated at half year, second half underlying growth slowed to 2%, following a first half of 6%, reflecting last year's strong second half comparator and a return to more normal market dynamics. We have realigned our product portfolio into four categories to more accurately reflect how we manage the business. The prior year comparators have been restated accordingly – see the commentary below and note 1.

Reported headline operating profit grew 4% (£7m) and headline operating margin was stable at 19.8%. Foreign exchange translation accounted for £4m of the increase while underlying profit grew by £3m, or 2%. Underlying profit improvement benefited from revenue gains and productivity savings despite price pressure (£10m) and foreign exchange transaction impacts (£6m). Investment in product innovation increased, funded by productivity savings and growth. The difference between statutory and headline operating profit reflects amortisation of acquired intangible assets of £8m and restructuring costs of £16m.

Return on capital employed rose 20 basis points to 14.7% reflecting the improved profitability, offset by higher capital expenditure and working capital increases. Capital expenditure included investment in new product development, manufacturing footprint changes, and manufacturing tooling. Working capital increases consisted primarily of inventory build for manufacturing site changes and improved supply.

Our ongoing *Fuel for Growth* restructuring programme is expected to deliver £23m of annual benefits by the end of 2016/17. In the year, we completed the closure of our Rossendale and Rockland manufacturing facilities, as well as closing our Norwell commercial site in the US. We have also begun the relocation of our global headquarters to a new location in Minneapolis, Minnesota, bringing together several key functions, particularly marketing and product innovation to reinforce our growth agenda. Restructuring programmes have delivered a 5% reduction in indirect headcount during the year.

While trading conditions eased slightly in the US, the environment in other developed markets remained soft with revenues affected by price erosion, healthcare capital spending constraints, and relatively flat procedure growth rates. Developing market sales rose by 8%. The China business reversed its 2014 decline, achieving 14% growth, with all business units growing. India grew by 23% as the new direct sales organisation continues to deliver strong performance. Brazil grew 5%. Performance in many of our distributor markets has been constrained by challenging conditions, including deteriorating security in some markets, currency controls, slow government payments, and the adverse impact on distributor exports from weakening currencies.

Infusion systems underlying revenue grew by 11% with continued success of our CADD-Solis pumps and disposables globally, aided by competitor disruption. The new C6 syringe pump was launched in China under the Graseby brand, beginning the modernisation of our product range in that market. We continue to invest in the development of interoperability and recently launched a number of products, including the Pharmguard Server 2.0, that further enhance our capabilities in this area.

Vascular access revenues were flat versus prior year, driven by growth of 8% in developing markets which offset a 1% decline in developed markets caused by base business price erosion in peripheral intravenous catheters (PIVC). Gains in sharps safety and conventional catheters, primarily in our developing markets, offset declines in safety catheters, pressure monitoring and interventional imaging.

Vital care underlying revenue grew by 2%, driven by bronchial hygiene and silicone tracheostomy. There was also a strong performance in China, driven by fluid warming and tracheostomy, and in India, which together contributed to 1% of the total underlying revenue growth.

Specialty products revenue was flat year-on-year, with growth in in vitro fertilisation and diabetes offsetting declines in patient monitoring, due to price pressures, and animal health, due to distributor self-sourcing initiatives.

Research and development

Investment in new product development increased to 5.4% of revenue (2014: 4.8%), with total R&D spend of £45m (2014: £38m). Longer term, we are targeting an investment rate of 6% of sales. In the past year, R&D has been restructured and streamlined. The investments in cultural change and process optimisation have driven improvements in efficiency, programme discipline and execution, and prioritisation of resources. The product development team in Shanghai is now fully established and focused on delivering products geared specifically towards the Chinese market.

Our vitality index, measured as sales from products launched in the last three years, improved to 9% (2014: 7%). This primarily reflects strong sales of ambulatory infusion products. Launches during the year included the Medfusion Interoperability platform (including PharmGuard 2.0) that enables automated programming, charting and reporting for our Medfusion 4000 range of syringe pumps. Graseby C6 and F6 syringe pumps were launched in China, having been developed by the Shanghai R&D team. Another important launch was Acapella single pack, contributing to the strong growth of bronchial hygiene globally.

Further increases in R&D investment are planned, and we are developing more robust product roadmaps that reflect the higher level of available resources.

Outlook

Trading conditions in developed markets are likely to stabilise in the medium term, but with continued challenges from healthcare cost controls and price pressures. However, we expect to see continued growth in developing markets where we are well positioned. While we anticipate continued solid performance in Infusion systems, the competitor disruption experienced this year is unlikely to continue and performance is expected to moderate with a return to more normal competitive dynamics. We have successfully driven savings through variable and fixed-cost productivity initiatives as well as site rationalisation this year, and will continue to pursue future cost reductions to ensure our competitiveness. While we expect some improvement in operating margin, we will also look to reinvest savings in revenue growth drivers.

Smiths Detection

	2015 £m	2014 £m	Reported growth	Underlying growth
Revenue	**467**	512	(9)%	(7)%
Headline operating profit	**55**	25	124%	167%
Headline operating margin	**11.9%**	4.8%	710 bps	
Statutory operating profit	**45**	23	96%	
Return on capital employed	**9.6%**	3.9%	570 bps	

Performance

Smiths Detection delivered a strong recovery in profitability without last year's non-recurring charges and as its programme of restructuring and cost-saving initiatives gained traction. A much improved foundation is now established for future growth. Market conditions remained challenging, resulting in a 7%, or £34m, underlying decline in revenue. The ports and borders, transportation and military markets weakened but were partially offset by an encouraging performance in critical infrastructure. Reported revenue declined £45m, including £11m of adverse currency translation.

Government budgets, which heavily influence purchasing decisions for detection products, remain severely constrained, affecting most of the major global manufacturers of security equipment. The medium-term growth prospects for the security market, nevertheless, remain positive amid continuing international concerns over terrorism and geopolitical unrest. This view is supported by a strong order book with significant contracts won in the period for airport installations across the Middle East and in the UK.

Headline operating profit recovered well in the second half, resulting in an underlying increase of 9%, or £4m, after adjusting for last year's £30m charge for one-off costs. The improvement was a result of stronger cost control measures, operational efficiency savings and transactional foreign exchange gains. Headline operating margin recovered strongly to 11.9%. Adverse foreign exchange translation reduced headline operating profit by £4m.

The success of a number of business improvement initiatives, part of the Group's *Fuel for Growth* programme, has started to transform the business. The cost base has been reduced and stronger management controls implemented, including a more rigorous bid strategy for tenders. These actions have stabilised the business and are expected to provide a sound platform for future growth.

Fuel for Growth resulted in exceptional restructuring costs for Smiths Detection of £10m, accounting for most of the difference between statutory and headline operating profit. Specific cost-saving measures, which included the closure of three facilities in North America, will contribute annual savings in Smiths Detection of some £10m, at an expected total cost of £28m, by the end of FY2017.

Return on capital responded to better controls and profitability, rising 570 basis points to 9.6%.

Transportation, accounting for 52% of revenue, declined 5% on an underlying basis against the previous year, which had benefited from a large contract with Doha Airport. The continuing importance of the Middle East as a major aviation hub, however, was further underlined by the General Aviation Council of Saudi Arabia's decision to purchase 120 x-ray systems and integrated security lanes for passenger bag screening for 26 airports across Saudi Arabia

In one of its biggest single airport orders, Smiths Detection will equip the new terminal at Abu Dhabi airport with the entire hold baggage system and passenger screening checkpoints in a contract worth $125m. The terminal is due to be completed in 2017.

The hold baggage systems at Abu Dhabi will include the HI-SCAN 10080 XCT, a next-generation high-speed explosives detection system. These were also selected by London Heathrow to support its out-of-gauge requirements. In addition to the supply of screening equipment, both the Abu Dhabi and Heathrow contracts will be supported by multi-year service agreements, which will help to build aftermarket revenues. Service support, accounting for 36% of revenue, saw a 9% sales increase across all markets. This remains a major growth driver.

Revenue from critical infrastructure was especially strong, increasing 13% on an underlying basis, including a significant order to safeguard Saudi Arabian ministries, armed forces facilities and royal palaces. Critical infrastructure sales in the US grew by 39% where important orders included networked X-ray equipment to the New York State Unified Court System.

Underlying revenue in ports and borders fell 34%, with the decline most noticeable in Europe and the US where increased competitive pressures caused a big drop in volumes. Nevertheless, we won a significant award to supply Mobile Inspection Systems to Nicaraguan Customs. The award, including technical assistance, supports plans to modernise and optimise security checks at ports and border crossings.

Revenues for military and emergency responders declined 14% on an underlying basis, as defence budgets remained constrained. We continued to win long-term contracts, however, principally from the US Department of Defense. These included a $27m order for mobile medical shelters for the US Army, which also exercised an option for a $23m production order on an existing contract for its JCAD chemical agent detector programme.

Research and development

A more targeted approach to the development of new products, systems and technologies as well as the completion of some existing projects resulted in a reduction of 32% in company-funded R&D to £25m, 5.3% of sales (2014: 7.3%). Capitalised projects accounted for £4m of the funded R&D (2014: £10m). Customer and government support for R&D totalled £3m in the period (2014: £4m), bringing total R&D spend to £28m (2014: £41m).

More tightly focused investment means fewer projects, but the product pipeline remains strong and is designed to meet emerging customer needs and deliver competitive advantage. For example, the new IONSCAN 600 explosives trace detector is set to extend the success of a system that has enhanced aviation security over the last 15 years, with nearly 25,000 of the previous versions installed worldwide. Following approval under the EU standard for passenger and cargo checkpoint screening, an order for Spanish airports was recently received for almost 300 of the latest IONSCANs. Current initiatives also include a new focus on software development and value engineering projects, which will deliver products better able to compete in some cost-critical sectors.

Outlook

Recent contract wins and the improved order book are expected to deliver increased revenues in the coming year. Headline operating margins should be broadly maintained as the benefits of ongoing cost reduction initiatives are balanced by investment in future revenue growth.

Smiths Interconnect

	2015 £m	2014 £m	Reported growth	Underlying growth
Revenue	**420**	445	(6)%	(9)%
Headline operating profit	**49**	71	(31)%	(34)%
Headline operating margin	**11.6%**	16.0%	(440) bps	
Statutory operating profit	**28**	49	(43)%	
Return on capital employed	**9.1%**	13.7%	(460) bps	

Performance

Reported revenue declined 6%, or £25m. Excluding a foreign exchange benefit of £15m, underlying revenue fell 9%, or £40m, due to a combination of major customers significantly cutting volumes, programme slowdowns and delays, and persistently tough conditions in several markets such as telecoms and defence. The Microwave business was particularly affected in commercial markets. The decline in Connectors was less pronounced while Power delivered low growth as a strong performance in data centres was offset by a continued decline of the protection product lines.

Reported headline operating profit fell 31%, or £22m, despite a foreign exchange gain of £3m. Underlying headline operating profit fell 34%, or £25m. The difference between statutory and headline operating profit reflects amortisation of acquired intangible assets of £18m and exceptional restructuring costs of £3m.

Margins declined 440 basis points to 11.6% with year-on-year reductions in all three business areas. The main contributing factors were adverse mix, reflecting revenue weakness in higher margin sectors, and negative operational gearing from lower volumes, particularly in Microwave. Pricing pressure also continued in several sectors. We maintained a continued focus on procurement, value engineering and improving operational efficiencies through lean manufacturing and automation. Investment was maintained in key growth enablers, particularly new product development and sales initiatives.

Return on capital employed fell 460 basis points with the lower profitability.

Connectors underlying revenues fell 4% as we saw pressures across several end markets. Defence sales continue to decline primarily due to the prolonged slowdown of the Eurofighter programme. Medical sales also reduced as our biggest customer lost market share and cut inventories. Similarly in semiconductor test, our western customers faced strengthening Asian competition. We are investing to expand our presence in Asia and we won a new Chinese customer in the period. Commercial aerospace revenues were flat despite the impact of reduced demand for a Chinese project while it goes through flight testing. Operationally, the Americas factory consolidation was completed, with manufacturing moved from California and New England into existing facilities in Mexico and the mid-West. Back office activities were also consolidated in one location.

In Microwave, underlying revenues fell 19% following a strong prior year with significant declines in commercial markets only partially offset by low growth in military as US defence budgets stabilised. Much of the decline came from a single test and measurement customer that dramatically reduced its volumes of high-performance cable assemblies for smartphone testing. The other major contributor was US wireless telecoms where one operator also cut back spending and there was also evidence of saturation in the market for passive intermodulation test equipment. In other geographies, telecoms revenues grew due to an Australian carrier aggressively building out a new frequency band. In commercial aerospace, sales to the primary customer for our current airborne antenna system declined, but we continue to pursue new customers with new product offerings. Improved demand for military antennas, filters and microwave assemblies provided some growth in defence revenues, and substantial orders were received for a new submarine antenna system and components for next-generation radar systems.

Underlying revenue in Power increased 5% with data centre sales in the US growing very strongly, particularly in the second half. A combination of increased demand from existing co-location customers, increased win-rates, new product introductions and several large projects with new enterprise customers drove sales growth. Service also contributed double-digit revenue growth. The strong data centre performance was offset by declines in power conditioning equipment for industrial applications and power protection equipment for telecoms and defence. On a positive note, a new product for power-over-ethernet applications launched towards the end of the year is being well received.

Research and development

Total R&D of £25m, or 6.0% of revenue, declined by £2m or 10 basis points. Company-funded R&D remained broadly constant as a proportion of revenue (5.4%), while customer-funded R&D, mostly for defence programmes, continued the trend of recent years and reduced to less than £3m.

Investments continued to be focused on opportunities in higher growth sectors. Connectors launched a new high-speed data connector for aerospace and defence applications. Two further semiconductor test sockets were also introduced to address the nascent wafer level chip scale package (WLCSP) sector. In Microwave, good progress was made on next-generation airborne satellite communication antenna systems which are now entering the initial qualification phase, and a new vector analyser was recently launched. Investments in data centre power products focused on PowerHub2, a new power distribution unit, and PowerWave Silver, a lower rated busway offering targeted at emerging market requirements.

Outlook

General market conditions are expected to stabilise in the year ahead. However, individual customer and programme dynamics will continue to affect demand. Margins should stabilise as restructuring benefits and operational efficiencies are expected to outweigh increased investment, pricing pressure and cost inflation.

Flex-Tek

	2015 £m	2014 £m	Reported growth	Underlying growth
Revenue	**269**	250	8%	4%
Headline operating profit	**50**	47	5%	1%
Headline operating margin	**18.5%**	18.9%	(40) bps	
Statutory operating profit	**41**	37	11%	
Return on capital employed	**33.6%**	34.0%	(40) bps	

Performance

Reported revenues grew 8%, or £19m, of which £10m was driven by underlying growth of 4% and £10m from foreign exchange translation. Aerospace sales continued to gain momentum with revenue strengthening in the fourth quarter. Heat Solutions made further progress driven by its specialty heating products which delivered its third year of double digit revenue growth. Fluid Management revenues benefited from order wins on new aircraft platforms with deliveries starting in the fourth quarter. Headline operating margin fell 40 basis points to 18.5%, mainly due to changing product mix within the Construction business. The reported increase in operating profit of 5% (£3m) stemmed from £2m of currency exchange translation and £1m from underlying growth driven by the aerospace and specialty heat segments and pricing.

Return on capital employed was virtually unchanged at 34%.

The difference between statutory and headline operating profit principally reflects exceptional litigation costs of £8m.

In Fluid Management, business from new aircraft platforms, including continued success with the 5000 psi hose products, began to boost results, with underlying revenue up 2%. Demand remains strong, with major airframe manufacturers Airbus and Boeing and engine manufacturers Pratt & Whitney, GE, and Rolls-Royce placing new orders, pushing the large commercial jet backlog to record levels.

Sales of our flexible gas piping and HVAC ducting to the construction market rose 6%. Revenue growth benefited from pricing on gas piping products and strong demand for our Thermaflex business. Sales of gas piping products slowed in the final quarter reflecting a change in product mix. New sales efforts introducing our flexible gas piping into the UK market have met early success and we plan to expand into other western European countries.

Heat Solutions underlying revenue grew 8%, driven by a mix of sales growth in specialty heating elements and flat demand in the appliance sector. Prices for nickel, the primary component in heating elements, continued to decline, but are expected to have minimal impact on results in the near term due to increased processing costs. The year showed improved sales to distributors, via cross-selling efforts with ducting and gas piping, and stronger sales to OEM HVAC equipment and appliance makers. Revenues from our custom heating elements continue to grow and we have increased our R&D investment in new technologies. Heat Solutions achieved 12% growth in China during the year.

Underlying revenue at Flexible Solutions declined 3%, with higher sales for medical hose products in the sleep apnoea market and sales growth in the US industrial market more than offset by continued market size reduction in floor care. Growth in specialty applications and R&D investment in medical products continue to deliver positive results.

Research and development

We are seeing commercial success from our increased R&D investment for approvals on next-generation airplanes and new heating technologies. We continue to seek acquisition opportunities that build on the strength of the businesses and the experienced management team.

In Fluid Management, new product development spending continues to focus on requirements for the next generation of quieter, more fuel-efficient aircraft, and developments in 3000 psi and 5000 psi hoses are expected to drive future revenues.

We also continue to pursue opportunities to develop specialty heating elements that open up higher margin markets and create scope for additional revenue growth,

Outlook

Both the underlying aerospace market demand and increasing output rates of the primary OEMs continue to be positive indications for the Fluid Management business. US residential housing numbers are expected to show modest improvement, although higher interest rates and stricter lending practices could hinder anticipated growth rates. Improved general economic conditions are expected to benefit the Heat Solutions and Flexible Solutions growth in specialty applications, along with continued economic development in China.

Financial review

Earnings per share
Basic headline earnings per share from continuing activities were 86.1p (2014: 81.8p). The reported 5% increase reflects the improvement in headline operating profit, a reduced finance charge and a lower headline tax rate.

On a statutory basis, the basic earnings per share from continuing activities were 62.4p (2014: 59.0p).

Exceptional and other items relating to continuing activities excluded from headline profit before tax
These items amounted to a charge of £134m compared to a charge of £143m in 2014. They comprised:

- Amortisation of intangible assets acquired in business combinations of £33m (2014: £39m) and a £27m goodwill impairment charge for John Crane Production Solutions because of the impact of a lower oil price environment on its customers. The ongoing amortisation charge relates principally to technology and customer relationships;
- £23m charge (2014: £53m) in connection with John Crane, Inc. asbestos litigation;
- £9m charge (2014: £11m) in connection with Titeflex Corporation litigation;
- £38m charge for restructuring (2014: £29m) in respect of the *Fuel for Growth* programme;
- £14m gain on changes to post-retirement benefits;
- £8m charge for retirement benefit finance (2014: £9m);
- £8m charge for legacy retirement benefit administration (2014: £6m);
- £4m of financing losses (2014: £2m);and
- £2m net gain (2014: £4m) on disposals and other acquisition costs.

In the period to 31 July 2014, in addition to the above, there was a £2m gain on the legal settlement of an item originally reported as non-headline and a diabetes royalty payment which were also excluded from headline performance.

Cash generation and net debt
Operating cash generation remained strong with headline operating cash-flow of £484m (2014: £490m), representing 95% (2014: 97%) 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 increased by £15m to £158m (2014: £143m). Free cash-flow is stated after all legacy costs, interest and taxes but before acquisitions and dividends.

On a statutory basis, net cash inflow from operations was £266m (2014: £256m).

Dividends paid in the year on ordinary shares amounted to £160m (2014: £275m including the annual dividend of £157m and special dividend of £118m).

Net debt at 31 July was £818m, an increase of £14m from the £804m at 31 July 2014. The continued strong cash generation was sufficient to fund the business operations, the legacy cash costs of pension contributions and product liability litigation and dividends to shareholders.

Interest and other financing costs
Interest payable on debt, net of interest earned on cash deposits, was £52m compared with £59m in 2014. This reduction primarily reflects lower interest rates on debt during the year. Interest costs were covered 9.8 times by headline operating profit.

The Group accounts for pensions using IAS 19. As required by this standard, a finance charge of £8m (2014: £9m) is recognised reflecting the unwinding of the discount on the net pension liability.

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 £110m in R&D (2014: £117m), equivalent to 3.8% of revenue (2014: 4.0%). Of that total, £104m was funded by the Company compared with £109m in 2014, a decrease of 4%. This decrease was caused by some long-running programmes coming to an end and as we seek to improve the efficiency of our innovation investment. We actively seek funding from customers to support R&D and this amounted to £6m (2014: £8m). Under IFRS, certain development costs are capitalised, and this amounted to £20m in the period (2014: £24m). The reduction in capitalised development relates to Smiths Detection and the conclusion of certain long-running projects.

Taxation
The headline tax charge for 2015 of £117m (2014: £120m) represented an effective rate of 25.5% on the headline profit before taxation (2014: 27.0%). On a statutory basis, the tax charge on continuing activities was £77m (2014: £67m).

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 25.5% and 26.5% is expected in the year ending 31 July 2016.

In the 2015 financial year, Smiths Group paid £91m in direct corporate tax on profits and £106m in employment and other taxes. The Group additionally collected £216m on behalf of tax authorities primarily from employees but also other indirect taxes such as VAT. The total amount of tax paid over to tax authorities during the year totalled £413m.

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-related assets and liabilities net of tax, litigation provisions relating to exceptional items net of tax, and net debt. ROCE increased 30 basis points to 16.0% (2014: 15.7%) as a result of increased profitability in Smiths Medical and Smiths Detection more than offsetting reduced profitability in John Crane, Smiths Interconnect and Flex-Tek.

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 2015 and evaluating liabilities at period-end AA corporate bond interest rates.

The tables below disclose the net status across a number of individual plans. Where any individual plan shows a surplus under IAS 19, this is disclosed on the balance sheet as a retirement benefit asset. The IAS 19 surplus of any one plan is not available to fund the IAS 19 deficit of another plan. The net pension deficit has reduced to £108m at 31 July 2015 from £242m at 31 July 2014. The deficit reduction reflects the benefit of contributions, gains on UK assets and an experience gain on liabilities as part of the UK triennial valuations partly offset by the impact of lower UK bond yields and new mortality assumptions for the US plans. 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:

	31July 2015	**31 January 2015**	**31 July 2014**
Funded plans			
UK plans – funding status	**104%**	99%	99%
US plans – funding status	**78%**	73%	84%
Other plans – funding status	**86%**	80%	79%

	31July 2015	**31 January 2015**	**31 July 2014**
Deficit			
Funded plans	**7**	(224)	(135)
Unfunded plans	**(115)**	(114)	(107)
Total deficit	**(108)**	(338)	(242)
Retirement benefit assets	**170**	158	123
Retirement benefit liabilities	**(278)**	(496)	(365)
	(108)	(338)	(242)

In the coming year, cash contributions to all the schemes are expected to total approximately £132m (2014: £85m), including £32m to fund a buyout arrangement for US pensioners in August 2015. In addition, the Group will invest £24m in an escrow account as part of the funding plan agreed with the Smiths Industries Pension Scheme (SIPS). These contributions are subject to the outcome of the triennial reviews with the UK trustees that are currently underway.

The approximate pension membership for the three main schemes at the end of July 2015 is set out in the table below. Actions to provide a cash settlement to deferred members in the US helped to reduce overall pensioner numbers by around 8%. The $500m buyout arrangement for US pensioners in August 2015 has resulted in a further reduction of c. 5,620 pensioners in the coming financial year as individual annuities are purchased for all existing pensioners

Pension scheme members at 31 July 2015	SIPS	TIGPS	US plans	Total
Deferred active	390	250	2,510	**3,150**
Deferred	10,850	13,180	2,990	**27,020**
Pensioners	13,020	16,950	5,620	**35,590**
Total	**24,260**	**30,380**	**11,120**	**65,760**

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.

	31July 2015	31 July 2014		31 January 2015
Average rates:				
US dollar	**1.56**	1.64	Dollar strengthened 5%	1.59
Euro	**1.33**	1.21	Euro weakened 10%	1.27
Year-end rates:				
US dollar	**1.56**	1.69	Dollar strengthened 7%	1.50
Euro	**1.42**	1.26	Euro weakened 13%	1.33

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 2014 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 2015, 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 2015 £m	Year ended 31 July 2014 £m
Continuing operations			
Revenue	1	**2,897**	2,952
Cost of sales		**(1,564)**	(1,626)
Gross profit		**1,333**	1,326
Sales and distribution costs		**(406)**	(398)
Administrative expenses		**(533)**	(550)
Operating profit	2	**394**	378
Comprising			
– headline operating profit	3	**511**	504
– exceptional items, amortisation of acquired intangibles	3	**(117)**	(126)
		394	378
Interest receivable		**3**	3
Interest payable		**(55)**	(62)
Other financing losses		**(9)**	(8)
Net finance charges – retirement benefits	9	**(8)**	(9)
Finance costs	5	**(69)**	(76)
Profit before taxation		**325**	302
Comprising			
– headline profit before taxation	3	**459**	445
– exceptional items, amortisation of acquired intangibles and other financing gains and losses	3	**(134)**	(143)
		325	302
Taxation	7	**(77)**	(67)
Profit for the year		**248**	235
Attributable to			
Smiths Group shareholders		**246**	233
Non-controlling interests		**2**	2
		248	235
Earnings per share	6		
Basic		**62.4p**	59.0p
Diluted		**61.8p**	58.4p

Consolidated statement of comprehensive income

	Notes	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
Profit for the period		**248**	235
Other comprehensive income			
Actuarial gains/(losses) on retirement benefits	9	**60**	(77)
Taxation recognised on actuarial movements	7	**21**	6
Other comprehensive income and expenditure which will not be reclassified to the consolidated income statement		**81**	(71)
Other comprehensive income which will be, or has been, reclassified			
Exchange gains/(losses)		**9**	(257)
Fair value gains/(losses)			
– on available for sale financial assets		**11**	3
– deferred in the period on cash-flow and net investment hedges		**(6)**	119
– reclassified to income statement		**1**	(3)
Total other comprehensive income		**96**	(209)
Total comprehensive income		**344**	26
Attributable to			
Smiths Group shareholders		**343**	25
Non-controlling interests		**1**	1
		344	26

Consolidated balance sheet

	Notes	31 July 2015 £m	31 July 2014 £m
Non-current assets			
Intangible assets	11	**1,518**	1,544
Property, plant and equipment	13	**259**	258
Financial assets – other investments	17	**156**	117
Retirement benefit assets	9	**170**	123
Deferred tax assets	7	**218**	185
Trade and other receivables	15	**40**	35
Financial derivatives	20	**4**	9
		2,365	2,271
Current assets			
Inventories	14	**454**	427
Current tax receivable		**30**	34
Trade and other receivables	15	**616**	635
Cash and cash equivalents	18	**495**	190
Financial derivatives	20	**20**	8
		1,615	1,294
Total assets		**3,980**	3,565
Non-current liabilities			
Financial liabilities			
– borrowings	18	**(1,150)**	(982)
– financial derivatives	20	**(6)**	(4)
Provisions for liabilities and charges	23	**(253)**	(245)
Retirement benefit obligations	9	**(278)**	(365)
Deferred tax liabilities	7	**(71)**	(58)
Trade and other payables	16	**(24)**	(28)
		(1,782)	(1,682)
Current liabilities			
Financial liabilities			
– borrowings	18	**(163)**	(12)
– financial derivatives	20	**(12)**	(5)
Provisions for liabilities and charges	23	**(79)**	(82)
Trade and other payables	16	**(466)**	(464)
Current tax payable		**(50)**	(75)
		(770)	(638)
Total liabilities		**(2,552)**	(2,320)
Net assets		**1,428**	1,245
Shareholders' equity			
Share capital	24	**148**	148
Share premium account		**349**	346
Capital redemption reserve		**6**	6
Revaluation reserve		**1**	1
Merger reserve		**235**	235
Retained earnings	26	**743**	559
Hedge reserve	26	**(63)**	(58)
Total shareholders' equity		**1,419**	1,237
Non-controlling interest equity		**9**	8
Total equity		**1,428**	1,245

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 2014		494	242	559	(58)	1,237	8	1,245
Profit for the year				246		246	2	248
Other comprehensive income								
Actuarial gains on retirement benefits and related tax				81		81		81
Exchange gains/(losses)				10		10	(1)	9
Fair value gains/(losses) and related tax				11	(5)	6		6
Total comprehensive income for the year				348	(5)	343	1	344
Transactions relating to ownership interests								
Exercises of share options	24	3				3		3
Taxation recognised on share options	7			(1)		(1)		(1)
Purchase of own shares	26			(11)		(11)		(11)
Dividends								
– equity shareholders	25			(160)		(160)		(160)
– non-controlling interest								
Share-based payment	10			8		8		8
At 31 July 2015		**497**	**242**	**743**	**(63)**	**1,419**	**9**	**1,428**

	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 2013		488	242	930	(174)	1,486	7	1,493
Profit for the year				233		233	2	235
Other comprehensive income								
Actuarial losses on retirement benefits and related tax				(71)		(71)		(71)
Exchange (losses)/gains				(256)		(256)	(1)	(257)
Fair value gains/(losses) and related tax				3	116	119		119
Total comprehensive income for the year				(91)	116	25	1	26
Transactions relating to ownership interests								
Exercises of share options	24	6				6		6
Taxation recognised on share options	7			(1)		(1)		(1)
Purchase of own shares	26			(13)		(13)		(13)
Dividends								
– equity shareholders	25			(275)		(275)		(275)
– non-controlling interest								
Share-based payment	10			9		9		9
At 31 July 2014		**494**	**242**	**559**	**(58)**	**1,237**	**8**	**1,245**

Consolidated cash-flow statement

	Notes	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
Net cash inflow from operating activities	27	**266**	256
Cash-flows from investing activities			
Expenditure on capitalised development		**(18)**	(23)
Expenditure on other intangible assets		**(18)**	(17)
Purchases of property, plant and equipment	13	**(59)**	(54)
Disposals of property, plant and equipment		**11**	5
Investment in financial assets		**(27)**	(28)
Acquisition of businesses			(1)
Disposals of businesses		**2**	3
Net cash-flow used in investing activities		**(109)**	(115)
Cash-flows from financing activities			
Proceeds from exercise of share options	24	**3**	6
Purchase of own shares		**(11)**	(13)
Dividends paid to equity shareholders	25	**(160)**	(275)
Cash inflow/(outflow) from matured derivative financial instruments		**4**	11
Increase in new borrowings		**568**	138
Reduction and repayment of borrowings		**(257)**	(180)
Net cash-flow used in financing activities		**147**	(313)
Net increase/(decrease) in cash and cash equivalents		**304**	(172)
Cash and cash equivalents at beginning of year		**189**	387
Exchange differences		**2**	(26)
Cash and cash equivalents at end of year	18	**495**	189
Cash and cash equivalents at end of year comprise			
– cash at bank and in hand		**104**	115
– short-term deposits		**391**	75
– bank overdrafts			(1)
		495	189
Included in cash and cash equivalents per the balance sheet		**495**	190
Included in overdrafts per the balance sheet			(1)
		495	189

Reconciliation of net cash-flow to movement in net debt

	Notes	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
Net increase/(decrease) in cash and cash equivalents		**304**	(172)
Net (increase)/decrease in borrowings resulting from cash-flows		**(311)**	42
Movement in net debt resulting from cash-flows		**(7)**	(130)
Capitalisation, interest accruals and unwind of capitalisation fees		**(1)**	3
Movement from fair value hedging		**7**	(3)
Exchange differences		**(13)**	70
Movement in net debt in the year	18	**(14)**	(60)
Net debt at start of year		**(804)**	(744)
Net debt at end of year	18	**(818)**	(804)

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, on a going concern basis and under the historical cost convention modified to include revaluation of certain financial instruments, share options and pension assets and liabilities, held at fair value as described below.

The accounting policies adopted are consistent with those of the previous financial year.

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 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 £39m (2014: £29m) has been recognised in the period in respect of contracts in progress at the period end with a total expected value of £137m (2014: £113m) and cumulative revenue recognised to date of £100m (2014: £70m). A 5% reduction in the proportion of the contract activity recognised in the current period would have reduced operating profit by less than £1m for both Smiths Detection and Smiths Interconnect (2014: less than £1m).

In addition to contracts accounted for on a percentage of completion basis, Smiths Detection also has long-term contractual arrangements for the sale of goods and services. Margins achieved on these contracts can reflect the impact of commercial decisions made in different economic circumstances. In addition, contract delivery is subject to commercial and technical risks which can affect the outcome of the contract.

Smiths Medical has rebate arrangements in place with some distributors in respect of sales to end customers where sales prices have been negotiated by Smiths Medical. Rebates are estimated based on the level of discount derived from sales data from distributors, the amount of inventory held by distributors and the time lag between the initial sale to the distributor and the rebate being claimed. The rebate accrual at 31 July 2015 was £21m (2014: £19m).

Taxation

The Group has recognised deferred tax assets of £28m (2014: £21m) relating to losses and £99m (2014: £91m) 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 7.

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 independent actuarial advice to select the values of critical estimates. The estimates, and the effect of variances in key estimates, are disclosed in note 9.

At 31 July 2015 there is a retirement benefit asset of £170m (2014: £123m) 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 buyouts would cost significantly more than the present value of the scheme liabilities calculated in accordance with IAS 19: Employee benefits.

Working capital provisions

For inventory and receivables, if the carrying value is higher than the expected recoverable value, the Group makes provisions writing down the assets to their recoverable value. The recoverable value of inventory is estimated using historical selling prices, sales activity and customer contracts. The recoverable value of receivables is considered individually for each customer and incorporates past experience and progress with collecting receivables.

At 31 July 2015 the carrying value of inventory incorporates provisions of £72m (2014: £76m). The inventory turn rate of 3.4 (2014: 3.8) varies across the five divisions. Smiths Detection has the slowest inventory utilisation with a turn rate of 2.8 (2014: 3.1). See note 14 for additional information about inventory.

At 31 July 2015 the gross value of receivables partly provided for or more than three months overdue was £57m (2014: £45m) and there were provisions of £22m (2014: £17m) against these receivables which were carried at a net value of £35m (2014: £28m). See note 15 for disclosures on credit risk and ageing of trade receivables.

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, including the sales and margin volatility in Smiths Detection and Smiths Interconnect and disclosures on the sensitivity of the impairment testing to these key assumptions, including details of the changes in assumptions which would be required to trigger an impairment in Smiths Detection or Smiths Interconnect Power.

Provisions for liabilities and charges

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 of £216m (2014: £204m) 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. Whilst published incidence curves can be used to estimate the likely future pattern of asbestos related disease, John Crane, Inc.'s claims experience is significantly impacted by other factors which influence the US litigation environment. These can include: changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels; and legislative and procedural changes in both the state and federal court systems. Therefore, 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. John Crane, Inc. takes account of the advice of an expert in asbestos liability estimation in quantifying the expected costs.

As previously reported, Titeflex Corporation, a subsidiary of the Group in the Flex-Tek division, has received a number of claims from insurance companies seeking recompense on a subrogated basis for the effects of damage allegedly caused by lightning strikes in relation to its flexible gas piping product. It has also received a number of product liability claims regarding this product, some in the form of purported class actions. Titeflex Corporation believes that its products are a safe and effective means of delivering gas when installed in accordance with the manufacturer's instructions and local and national codes; however some claims have been settled on an individual basis without admission of liability. Provision of £71m (2014: £61m) has been made for the costs which the Group is expected to incur in respect of these claims. However, because of the significant uncertainty associated with the future level of claims, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred.

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.

All provisions may be subject to potentially material revisions from time to time if new information becomes available as a result of future events. See note 23 for details of the assumptions and disclosures on the sensitivity of the provision calculations.

Accounting policies

Basis of consolidation

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

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

Associates are entities over which the Group has significant influence but 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.

For the convenience of users, supplementary primary financial statements translated into US dollars have been presented after the Group financial record. Assets and liabilities have been translated into US dollars at the exchange rate at the date of that balance sheet and income, expenses and cash-flows are translated at average exchange rates for the period.

Revenue

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

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.

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 and disposals;
- 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 and 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 remeasurements 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 13: Fair value measurement' requires fair value measurements to be classified according to the following hierarchy:

- level 1 – quoted prices in active markets for identical assets or liabilities;
- level 2 – valuations in which all inputs are observable either directly (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.

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

Dividends

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

Recent accounting developments

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

- 'IFRS 9: Financial instruments'
- 'IFRS 15: Revenue from contracts with customers'

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. In particular the review of the impact of 'IFRS 15: Revenue from contracts with customers' will require an assessment at contract level for the military and long-term service businesses, and the impact of adopting this standard cannot be reliably estimated until this work is substantially complete.

These standard are under review by the EU. Smiths will confirm their adoption date after the standards have been approved by the EU.

Parent Company

The accounts of the Parent Company, Smiths Group plc, have been prepared in accordance with UK GAAP. The Company accounts are presented in separate financial statements.

The principal subsidiaries of the Parent Company are listed in the above accounts.

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

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 – infusion systems, vascular access (including safety needles), patient airway and temperature management equipment and specialty devices in areas of in vitro fertilisation, diagnostics and emergency patient transport;
- 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 at each Board meeting to the Board of directors. This information is prepared using the same accounting policies as the consolidated financial information except that the Group uses headline operating profit to monitor 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 2015
	John Crane £m	**Smiths Medical £m**	**Smiths Detection £m**	**Smiths Interconnect £m**	**Flex-Tek £m**	**Corporate costs £m**	**Total £m**
Revenue	**905**	**836**	**467**	**420**	**269**		**2,897**
Divisional headline operating profit	**225**	**166**	**55**	**49**	**50**		**545**
Corporate headline operating costs						**(34)**	**(34)**
Headline operating profit/(loss)	**225**	**166**	**55**	**49**	**50**	**(34)**	**511**
Exceptional operating items (note 4)	**(25)**	**(16)**	**(10)**	**(3)**	**(9)**	**14**	**(49)**
Legacy retirement benefits	**(1)**					**(7)**	**(8)**
Amortisation and impairment of acquired intangible assets	**(34)**	**(8)**		**(18)**			**(60)**
Operating profit/(loss)	**165**	**142**	**45**	**28**	**41**	**(27)**	**394**
Exceptional finance costs – adjustment to discounted provision (note 4)	**(4)**				**(1)**		**(5)**
Net finance costs – other							**(64)**
Profit before taxation							**325**

							Year ended 31 July 2014
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £m
Revenue	941	804	512	445	250		2,952
Divisional headline operating profit	234	159	25	71	47		536
Corporate headline operating costs						(32)	(32)
Headline operating profit/(loss)	234	159	25	71	47	(32)	504
Exceptional operating items (note 4)	(56)	(8)	(1)	(5)	(10)	(1)	(81)
Legacy retirement benefits (restated)						(6)	(6)
Amortisation and impairment of acquired intangible assets	(12)	(9)	(1)	(17)			(39)
Operating profit/(loss)	166	142	23	49	37	(39)	378
Exceptional finance costs – adjustment to discounted provision (note 4)	(5)				(1)		(6)
Net finance costs – other (restated)							(70)
Profit before taxation							302

1 Segment information continued

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

						31 July 2015
	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	**96**	**175**	**84**	**38**	**22**	**415**
Working capital assets	**351**	**247**	**260**	**160**	**83**	**1,101**
Operating assets	**447**	**422**	**344**	**198**	**105**	**1,516**
Derivatives, tax and retirement benefit assets						**442**
Goodwill and acquired intangibles						**1,351**
Corporate assets						**176**
Cash						**495**
Total assets						**3,980**
Working capital liabilities	**(141)**	**(108)**	**(156)**	**(64)**	**(37)**	**(506)**
Corporate and non-headline liabilities						**(316)**
Derivatives, tax and retirement benefit liabilities						**(417)**
Borrowings						**(1,313)**
Total liabilities						**(2,552)**
Average divisional capital employed	**872**	**1,126**	**577**	**535**	**148**	**3,258**
Average corporate capital employed						**(61)**
Average total capital employed						**3,197**

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 £815m (2014: £815m) and eliminate post-retirement benefit related assets and liabilities and litigation provisions relating to exceptional items, both net of related tax, and net debt.

						31 July 2014
	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	91	159	97	39	19	405
Working capital assets	350	228	275	161	73	1,087
Operating assets	441	387	372	200	92	1,492
Derivatives, tax and retirement benefit assets						359
Goodwill and acquired intangibles						1,382
Corporate assets						142
Cash						190
Total assets						3,565
Working capital liabilities	(143)	(97)	(166)	(70)	(26)	(502)
Corporate and non-headline liabilities						(317)
Derivatives, tax and retirement benefit liabilities						(507)
Borrowings						(994)
Total liabilities						(2,320)
Average divisional capital employed	876	1,100	632	518	139	3,265
Average corporate capital employed						(47)
Average total capital employed						3,218

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

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

							Year ended 31 July 2015
	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
Depreciation	**14**	**18**	**4**	**9**	**3**	**1**	**49**
Amortisation of capitalised development		**13**	**10**				**23**
Amortisation of software, patents and intellectual property	**3**	**3**	**2**	**1**		**6**	**15**
Amortisation of acquired intangibles						**33**	**33**
Impairment of goodwill						**27**	**27**
Share-based payment	**2**	**1**	**1**		**1**	**4**	**9**

1 Segment information continued

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

Year ended 31 July 2014	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Reconciling items £m	Total £m
Depreciation	14	16	5	7	3	1	46
Amortisation of capitalised development		12	9				21
Amortisation of software, patents and intellectual property	2	2	4	1		4	13
Amortisation of acquired intangibles						39	39
Share-based payment	2	1	1	1	1	4	10

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 2015	**19**	**44**	**11**	**12**	**5**	**6**	**97**
Capital expenditure year ended 31 July 2014	18	44	14	11	3	5	95

The reconciling items comprise corporate capital expenditure through Smiths Business Information Services on IT equipment and software.

Analysis of revenue

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

John Crane	First-fit £m	Aftermarket: Oil, gas and petrochemical £m	Aftermarket: Chemical and pharmaceutical £m	Aftermarket: Distributors £m	Aftermarket: General industry £m	Total £m
Revenue year ended 31 July 2015	**396**	**277**	**79**	**71**	**82**	**905**
Revenue year ended 31 July 2014 (restated)	443	267	81	68	82	941

John Crane has reviewed the classification of their upstream energy services business. Revenue of £62m (2014: £83m) has been reclassified from Aftermarket: oil, gas and petrochemical to First-fit to reflect the cyclical characteristics of the business. As a result of this change, Original equipment manufacture has been renamed First-fit as this better describes the activities of the combined constituents.

Smiths Medical	Infusion systems £m	Vascular access £m	Vital care £m	Specialty products £m	Total £m
Revenue year ended 31 July 2015	**262**	**279**	**225**	**70**	**836**
Revenue year ended 31 July 2014 (restated)	235	277	221	71	804

Smiths Medical has realigned their product portfolio to reflect how they monitor business performance. Revenue for the year under the previous reporting categories is: Medication delivery £269m (2014: £241m); Vital care £328m (2014: £328m); and Safety devices £239m (2014: £235m).

Smiths Detection	Transportation £m	Ports and borders £m	Military £m	Critical infrastructure £m	Non-security £m	Total £m
Revenue year ended 31 July 2015	**243**	**50**	**69**	**105**		**467**
Revenue year ended 31 July 2014 (restated)	263	78	74	96	1	512

Sales previously separately reported as emergency responders have been included in military sales, reflecting the similar product technology.

Smiths Interconnect	Connectors £m	Microwave £m	Power £m	Total £m
Revenue year ended 31 July 2015	**149**	**168**	**103**	**420**
Revenue year ended 31 July 2014	153	198	94	445

Flex-Tek	Fluid Management £m	Flexible Solutions £m	Heat Solutions £m	Construction Products £m	Total £m
Revenue year ended 31 July 2015	**69**	**51**	**65**	**84**	**269**
Revenue year ended 31 July 2014 (restated)	66	51	57	76	250

Flex-Tek has moved high-pressure hose manufacturing from Fluid Management to Flexible Solutions. Revenue of £17m (2014: £17m) has been reclassified as a result of this reorganisation.

1 Segment information continued

Analysis of revenue continued

The Group’s statutory revenue is analysed as follows:

	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
Sale of goods	**2,600**	2,683
Services	**268**	239
Contracts	**29**	30
	2,897	2,952

Analysis by geographical areas

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

	Revenue		Intangible assets and property plant and equipment	
	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m	**31 July 2015 £m**	31 July 2014 £m
United Kingdom	**121**	119	**119**	132
Germany	**128**	148	**270**	304
France	**81**	88	**16**	19
Other European	**290**	340	**58**	67
United States of America	**1,378**	1,319	**1,172**	1,132
Canada	**111**	121	**14**	14
Mexico	**40**	32	**9**	9
Japan	**93**	106	**14**	16
China	**98**	113	**57**	53
Rest of the World	**557**	566	**48**	56
	2,897	2,952	**1,777**	1,802

2 Operating profit is stated after charging

	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
Research and development expense	**84**	85
Operating leases		
– land and buildings	**31**	29
– other	**9**	10

	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
Audit services		
Fees payable to the Company’s auditors for the audit of the Company’s annual financial statements	**3**	2
Fees payable to the Company’s auditors and its associates for other services		
– the audit of the Company’s subsidiaries	**2**	3
	5	5
All other services	**1**	1

Other services comprise tax advisory services £0.1m (2014: £0.2m), tax compliance services £0.1m (2014: £0.1m) and one-off IT and consulting projects £0.4m (2014: £0.5m).

Total fees for non-audit services comprise 12% (2014: 17%) of audit fees.

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 are not hedge accounted under IAS 39; and
- scheme administration costs, financing credits and charges relating to retirement benefits.

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

	Notes	**Year ended 31 July 2015 £m**	Year ended 31 July 2014 £m
Operating profit		**394**	378
Exclude			
– exceptional operating items	4	**49**	81
– legacy retirement benefits	9	**8**	6
– impairment of goodwill	12	**27**	
– amortisation of acquired intangible assets	11	**33**	39
Non-headline items in operating profit		**117**	126
Headline operating profit		**511**	504
Finance costs		**(69)**	(76)
Exclude			
– exceptional finance costs	4	**5**	6
– other financing gains and losses		**4**	2
– other financing costs retirement benefits	5,9	**8**	9
Non-headline items in finance costs		**17**	17
Headline finance costs		**(52)**	(59)
Profit before taxation		**325**	302
Non-headline items in operating profit		**117**	126
Non-headline items in finance costs		**17**	17
Headline profit before taxation		**459**	445
Profit after taxation – continuing operations		**248**	235
Exclude			
– non-headline items in profit before taxation		**134**	143
– tax on excluded items	7	**(40)**	(53)
		94	90
Headline profit after taxation – continuing operations		**342**	325

Headline earnings before interest, tax, depreciation and amortisation

Headline EBITDA, calculated as follows, is used to calculate one of Smiths cash-flow targets, see note 26 for details.

	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
Headline operating profit	**511**	504
Exclude:		
Depreciation	**49**	46
Amortisation of development costs	**23**	21
Amortisation of software, patents and intellectual property	**15**	13
Headline EBITDA	**598**	584

4 Exceptional items

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

	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
Operating items		
Restructuring programmes	**(38)**	(29)
Gains on changes to post-retirement benefits (note 9)	**14**	
Profit on disposals and acquisitions and disposal costs	**2**	4
Resolution of items originally posted as non-headline		2
Litigation		
– provision for Titeflex Corporation claims (note 23)	**(8)**	(10)
– provision for John Crane, Inc. asbestos litigation (note 23)	**(19)**	(48)
	(49)	(81)
Financing items		
Exceptional finance costs – adjustment to discounted provisions		
– provision for Titeflex Corporation claims (note 23)	**(1)**	(1)
– provision for John Crane, Inc. asbestos litigation (note 23)	**(4)**	(5)
	(54)	(87)

Year ended 31 July 2015

Restructuring costs include £39m in respect of *Fuel for Growth* and a £1m credit for provisions relating to earlier restructuring programmes which were released in the period. The *Fuel for Growth* programme, which involves redundancy, relocation and consolidation of manufacturing, is considered exceptional by virtue of its size and impact on the Group's operations.

Gains of £14m on changes to post-retirement benefits arise from a settlement offer by the US defined benefit pension plans – allowing deferred members a one-off option to elect to cash out their retirement entitlements rather than receive a pension at retirement – which was completed in September 2014 (see note 9).

A charge of £8m has been made by Titeflex Corporation in respect of changes to the estimated cost of future claims including those from insurance companies seeking recompense for damage allegedly caused by lightning strike. The change comprises £7m in respect of movements in the gross provision and £1m relating to changes in discounting.

The operating charge in respect of John Crane, Inc. litigation comprises £14m in respect of increased provision for adverse judgments and legal defence costs, £4m in respect of litigation management and legal fees in connection with litigation against insurers, and £1m arising from the decrease in US risk-free rates.

The final resolution of items previously reported as exceptional has been reported as exceptional because the earlier transactions were treated as exceptional items. The litigation provisions for Titeflex Corporation and John Crane, Inc., and the commutation of insurance policies received by John Crane, Inc., were reported as exceptional in the year of recognition. Consequently, the ongoing adjustments to these provisions are reported as exceptional items.

Year ended 31 July 2014

Restructuring costs included a final charge of £3m in respect of the Smiths Detection improvement programme and £26m in respect of *Fuel for Growth*. These programmes, which involve redundancy, relocation and consolidation of manufacturing, are considered exceptional by virtue of their size.

Profit on disposals includes the expiry of certain warranties on the disposal of Cross Match Technologies, Inc., which has generated an additional profit of £3m.

A charge of £10m was recognised by Titeflex Corporation. This reflected costs (which are not expected to recur) associated with one anomalous case which was settled during the year together with the estimated cost of future claims including those from insurance companies seeking recompense for damage allegedly caused by lightning strike, net of small gains relating to changes in discounting.

The operating charge in respect of John Crane, Inc. litigation comprised £49m in respect of increased provision for adverse judgments and legal defence costs, £1m in respect of legal fees in connection with litigation against insurers, less £2m arising from changes in US risk-free rates. The increase in the provision reflected two large historical judgments which were settled in the year.

5 Net finance costs

	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
Interest receivable	**3**	3
Interest payable		
– bank loans and overdrafts, including associated fees	**(8)**	(7)
– other loans	**(47)**	(55)
Interest payable	**(55)**	(62)
Other financing gains/(losses)		
– fair value gains/(losses) on hedged debt	**8**	(3)
– fair value (losses)/gains on fair value hedge	**(8)**	3
– net foreign exchange (losses)/gains	**(4)**	(2)
– exceptional finance costs – adjustment to discounted provisions	**(5)**	(6)
Other financing losses	**(9)**	(8)
Net interest expense on retirement benefit obligations	**(8)**	(9)
Net finance costs	**(69)**	(76)

6 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 2015 £m	Year ended 31 July 2014 £m
Profit attributable to equity shareholders for the year		
– total	**246**	233
Average number of shares in issue during the year	**394,742,972**	394,296,986

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 398,552,818 (2014: 398,399,449) 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 2015 no options (2014: no options) were excluded from this calculation because their effect was anti-dilutive for continuing operations.

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

	Year ended 31 July 2015		Year ended 31 July 2014	
	£m	**EPS (p)**	£m	EPS (p)
Profit attributable to equity shareholders of the Parent Company	**246**	**62.4**	233	59.0
Exclude				
Non-headline items and related tax (note 3)	**94**	**23.7**	90	22.8
Headline	**340**	**86.1**	323	81.8
Statutory earnings per share – diluted (p)		**61.8**		58.4
Headline earnings per share – diluted (p)		**85.3**		81.0

7 Taxation

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

	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
The taxation charge in the consolidated income statement for the year comprises		
– current income tax charge	**71**	93
– current tax adjustments in respect of prior periods	**(1)**	(4)
Current taxation	**70**	89
– deferred taxation	**7**	(22)
Total taxation expense in the consolidated income statement	**77**	67

Reconciliation of the tax charge

The tax expense on the profit for the year for continuing operations is different from the standard rate of corporation tax in the UK of 20.7% (2014: 22.3%). The difference is reconciled as follows:

	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
Profit before taxation – continuing operations	**325**	302
Notional taxation expense at UK rate of 20.7% (2014: 22.3%)	**67**	67
Different tax rates on non-UK profits and losses	**6**	7
Non-deductible expenses, tax credits and non-taxable income	**(6)**	(6)
Adjustments to unrecognised deferred tax	**11**	5
Prior year true-up	**(1)**	(6)
	77	67
Comprising		
– taxation on headline profit	**117**	120
– tax on non-headline loss	**(40)**	(53)
Taxation expense in the consolidated income statement	**77**	67

The head office of Smiths Group is domiciled in the UK, so the tax charge has been reconciled to UK tax rates. In recent years, Smiths has made substantial payments to its UK defined benefit pension plans which generated significant UK tax losses.

	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
Tax on items charged/(credited) to equity		
Deferred tax charge/(credit)		
– retirement benefit schemes	**(21)**	(6)
– share options	**1**	1
	(20)	(5)

The net retirement benefit credit to equity includes £nil (2014: £1m) 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.

7 Taxation continued
Deferred taxation

	Excess tax depreciation on fixed assets and goodwill £m	Share-based payment £m	Retirement benefit obligations £m	Capitalised development expenditure £m	Other £m	Total £m
At 31 July 2013	(84)	7	52	(38)	175	112
Credit/(charge) to income statement	4	(1)	(9)		28	22
Credit/(charge) to equity		(1)	6			5
Exchange adjustments	8		(5)	4	(19)	(12)
At 31 July 2014	(72)	5	44	(34)	184	127
Deferred tax assets	(19)	5	44	(9)	164	185
Deferred tax liabilities	(53)			(25)	20	(58)
At 31 July 2014	(72)	5	44	(34)	184	127
Credit/(charge) to income statement	(3)	1	(11)	1	5	(7)
Credit/(charge) to equity		(1)	21			20
Exchange adjustments	(6)		2	(2)	13	7
At 31 July 2015	**(81)**	**5**	**56**	**(35)**	**202**	**147**
Deferred tax assets	(15)	5	56	(8)	180	218
Deferred tax liabilities	(66)			(27)	22	(71)
At 31 July 2015	**(81)**	**5**	**56**	**(35)**	**202**	**147**

Included in other deferred tax balances above are:

- a deferred tax asset of £28m (2014: £21m) relating to losses carried forward. The Group has recognised deferred tax on the basis that operations show a consistent pattern of improving results and the Group has implemented plans to support continuing improvements or the losses relate to specific, identified non-recurring events;
- a deferred tax asset of £126m (2014: £117m) relating to provisions where current tax relief is only available as payments are made. Of this asset, £72m (2014: £68m) relates to the John Crane, Inc. litigation provision, and £27m (2014: £23m) relates to Titeflex Corporation. See note 23 for additional information on provisions; and
- a deferred tax asset of £26m (2014: £18m) relating to inventory where current tax relief is only available when the inventory is sold.

The Group has not recognised deferred tax relating to deductible temporary differences in the UK amounting to £400m (2014: £534m) and non-UK losses amounting to £126m (2014: £120m).

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 deferred tax has not been recognised is set out below.

Restricted losses

	2015 £m	**Expiry of losses**	2014 £m	Expiry of losses
Territory				
– Americas	**36**	**2019-2035**	31	2016-2034
– Asia	**12**	**2016-2022**	6	2016-2021
Total restricted losses	**48**		37	
Unrestricted losses				
– operating losses	**453**	**No expiry**	433	No expiry
Total	**501**		470	

8 Employees

	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
Staff costs during the period		
Wages and salaries	**731**	718
Social security	**86**	86
Share-based payment (note 10)	**9**	10
Pension costs (including defined contribution schemes) (note 9)	**31**	32
	857	846

The average number of persons employed was:

	Year ended 31 July 2015	Year ended 31 July 2014
John Crane	**6,950**	6,850
Smiths Medical	**7,950**	7,850
Smiths Detection	**2,150**	2,250
Smiths Interconnect	**3,850**	4,000
Flex-Tek	**2,050**	2,000
Smiths Business Information Services	**250**	200
Corporate	**50**	50
	23,250	23,200

Smiths Business Information Services directly employs people working in its operations. All the costs of IT infrastructure and support, including these employment costs, are reflected in reported divisional operating profit.

Key management

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

	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
Key management compensation		
Salaries and short-term employee benefits	**12.7**	9.0
Cost of post-retirement benefits		0.1
Cost of share-based incentive plans	**2.7**	3.4

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

	Year ended 31 July 2015		Year ended 31 July 2014	
	Number of instruments '000	Weighted average price	Number of instruments '000	Weighted average price
CIP	**589**		706	
ESOS	**18**	**£10.97**	31	£10.12
LTIP	**1,374**		1,629	
SAYE	**11**	**£9.19**	10	£8.57

Related party transactions

There were no related party transactions in the year ended 31 July 2015 (31 July 2014: no transactions).

9 Post-retirement benefits

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

Defined contribution plans

The Group operates 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 consolidated income statement in respect of all these plans was £28m (2014: £30m).

Defined benefit and post-retirement healthcare plans

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

For all schemes, pension costs are assessed in accordance with the advice of independent, professionally qualified actuaries. These valuations have been updated by independent qualified actuaries in order to assess the liabilities of the schemes as at 31 July 2015. Scheme assets are stated at their market values. Contributions to the schemes are made on the advice of the actuaries.

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

	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
At beginning of period	**(242)**	(254)
Exchange adjustment	**(3)**	19
Reclassification of small unfunded obligations	**(2)**	
Current service cost	**(3)**	(3)
Scheme administration costs	**(8)**	(6)
Past service cost, curtailments, settlements	**14**	
Finance charges – retirement benefits	**(8)**	(9)
Contributions by employer	**84**	88
Actuarial gain/(loss)	**60**	(77)
Movement in surplus restriction		
Net retirement benefit liability	**(108)**	(242)

UK pension schemes

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

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

Smiths Industries Pension Scheme ("SIPS")

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

The most recent actuarial valuation of this scheme is being performed using the Projected Unit Method as at 31 March 2015, and experience gains and losses identified during this valuation have been incorporated into the IAS 19 valuation. Under the current funding plan for SIPS Smiths pays cash contributions of £3m a month until October 2019. In addition, Smiths invests £2m a month in index-linked gilts held in an escrow account. The escrow account remains an asset of the Group until 2020, see note 17. At that time, the assets in escrow will be 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 funding valuation.

SIPS will implement Guaranteed Minimum Pensions equalisation in respect of members contracted out of the State Earnings Related Pensions Scheme prior to 6 April 1997, once the government has completed its consultations and confirmed an approach. It is not yet possible to reliably quantify the impact of this adjustment. The liability for Barber equalisation has been recognised, increasing the deficit at 31 July 2015 by £1m.

The duration of the SIPS liabilities is around 23 years (2014: 23 years) for active deferred members, 23 years (2014: 23 years) for deferred members and 12 years (2014: 11 years) for pensioners and dependants.

TI Group Pension Scheme ("TIGPS")

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

The most recent actuarial valuation of this scheme is being performed using the Projected Unit Method as at 5 April 2015. Under the current funding plan for TIGPS Smiths pays cash contributions of £16m a year until April 2016.

9 Post-retirement benefits continued

Defined benefit and post-retirement healthcare plans continued

UK pension schemes continued

TI Group Pension Scheme ("TIGPS") continued

Under the governing documentation of the TIGPS, any future surplus would be returnable to Smiths Group plc by refund, assuming gradual settlement of the liabilities over the lifetime of the scheme. If TIGPS was wound up while it had members, the scheme would need to buy out the benefits of all members. The buyouts would cost significantly more than the present value of the scheme liabilities calculated in accordance with IAS 19 (revised).

TIGPS is compliant with all identified requirements of Barber equalisation. TIGPS will implement Guaranteed Minimum Pensions equalisation in respect of members contracted out of the State Earnings Related Pensions Scheme prior to 6 April 1997, once the government has completed its consultations and confirmed an approach. It is not yet possible to reliably quantify the impact of this adjustment.

The duration of the TIGPS liabilities is around 21 years (2014: 23 years) for active deferred members, 19 years (2014: 20 years) for deferred members and 11 years (2014:10 years) for pensioners and dependants.

US pension plans

The most recent valuations of the six principal US pension and post-retirement healthcare plans were performed at 1 January 2014.

The pension plans were closed with effect from 30 April 2009 and benefits were calculated as at that date and are not revalued. Governance of the US pension plans is managed by a Settlor Committee appointed by Smiths Group Services Corp. The US pension plans offered deferred members a one-off option to elect to cash out their retirement entitlements rather than receive a pension at retirement. Lump sum payments of $150m were made in August and September 2014. This programme generated a settlement gain of £14m.

The duration of the liabilities for the largest US plan is around 14 years (2014: 18 years) for active deferred members, 19 years (2014: 19 years) for deferred members and 10 years (2014: 9 years) for pensioners and dependants.

On 14 August 2015 the US funded plans completed a buy-out of retiree liabilities for $527m, transferring the obligation to pay pensions to Voya Retirement Insurance and Annuity Company.

Risk management

The pensions schemes are exposed to risks that:

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

These risks are managed separately for each pension scheme. However Smiths has adopted a common approach of closing defined benefit schemes to cap members' entitlements and supporting trustees in adopting investment strategies which match assets to future obligations, after allowing for the funding position of the scheme.

TIGPS with a mature member profile, and a strong funding position, has been able to progress its matching strategy to the point where 50% of liabilities are covered by matching annuities, eliminating investment return, longevity, inflation and funding risks. In September 2013, the Trustees of the TIGPS invested a further £160m in annuities matched with specific liabilities of the Scheme.

In August 2014 SIPS adjusted the scheme investment strategy. The scheme is now invested in diversified growth funds and a synthetic equity mandate with BlackRock, using exchange-traded futures, which are derivative contracts entered into for a fixed term, to invest in global equity markets. If equity markets rise, the value of the synthetic equity mandate will increase, whilst if equity markets fall, the value of the synthetic equity mandate will fall. The value of the mandate can be positive or negative depending upon movement in the global equity markets. The risk and return characteristics of synthetic equities are similar to physical equities. As at 31 July 2015 the SIPS synthetic equity futures generated a £497m (2014 £nil) exposure to equities.

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

	2015 UK	**2015 US**	**2015 Other**	2014 UK	2014 US	2014 Other
Rate of increase in salaries	**n/a**	**n/a**	**2.6%**	n/a	n/a	2.6%
Rate of increase for active deferred members	**4.1%**	**n/a**	**n/a**	4.2%	n/a	n/a
Rate of increase in pensions in payment	**3.2%**	**n/a**	**1.0%**	3.3%	n/a	0.9%
Rate of increase in deferred pensions	**3.2%**	**n/a**	**0.1%**	3.3%	n/a	0.1%
Discount rate	**3.5%**	**4.4%**	**3.3%**	4.0%	4.4%	3.8%
Inflation rate	**3.2%**	**n/a**	**1.6%**	3.3%	n/a	1.6%
Healthcare cost increases	**4.7%**	**n/a**	**2.1%**	4.3%	n/a	2.3%

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

Discount rate assumptions

The UK schemes use a discount rate based on the yield on the iBOXX over 15-year AA-rated corporate bond index, adjusted if necessary to better reflect the shape of the yield curve considering the Aon Hewitt GBP Select AA curve. For the USA, the discount rate referenced Moody's Aa annualised yield, the Citigroup High Grade Index, the Merrill Lynch 15+ years High Quality Index and the Towers Watson cash-flow matching models.

9 Post-retirement benefits continued

Defined benefit and post-retirement healthcare plans continued

Risk management continued

Mortality assumptions

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 2014 CMI projections, blended to a long-term rate of 1.25%. The mortality assumptions used in the principal US schemes are based on the RP-2014 table projected generationally with scale MP-14 as of 31 July 2015. 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 schemes				US schemes			
	Male 31 July 2015	**Female 31 July 2015**	Male 31 July 2014	Female 31 July 2014	**Male 31 July 2015**	**Female 31 July 2015**	Male 31 July 2014	Female 31 July 2014
Member who retires next year at age 65	**23**	**24**	23	25	**22**	**24**	20	21
Member, currently 45, when they retire in 20 years' time	**25**	**27**	25	27	**23**	**26**	20	21

Sensitivity

Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 July 2015 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 2015 £m	**Increase/ (decrease) in scheme assets £m**	**(Increase)/ decrease in scheme liabilities £m**	Profit before tax for year ended 31 July 2014 £m	Increase/ (decrease) in scheme assets £m	(Increase)/ decrease in scheme liabilities £m
Rate of mortality – 1 year increase in life expectancy	**(4)**	**47**	**(157)**	(3)	45	(131)
Rate of mortality – 1 year decrease in life expectancy	**4**	**(47)**	**160**	4	(45)	133
Rate of inflation – 0.25% increase	**(3)**	**13**	**(89)**	(3)	12	(87)
Discount rate – 0.25% increase	**5**	**(19)**	**139**	5	(20)	141
Market value of scheme assets – 2.5% increase	**3**	**80**		3	73	

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

Retirement benefit plan assets

	31 July 2015 £m				31 July 2014 £m			
	UK schemes	**US schemes**	**Other countries**	**Total**	UK schemes	US schemes	Other countries	Total
Cash and cash equivalents								
– Cash	**41**	**17**		**58**	593			593
– Liquidity funds	**201**	**1**		**202**	43	60		103
Equities								
– UK funds	**123**		**1**	**124**	178		4	182
– North American funds	**129**	**110**	**2**	**241**	157	137	2	296
– other regions and global funds	**227**	**47**	**16**	**290**	269	57	14	340
Government bonds								
– index-linked bonds	**1,052**			**1,052**	657			657
– fixed-interest bonds	**171**	**71**	**11**	**253**	92	65	11	168
Corporate bonds	**284**	**199**	**2**	**485**	267	181	2	450
Insured liabilities	**783**			**783**	811		1	812
Property								
– UK property	**174**			**174**	181			181
– other property								
Other	**338**		**17**	**355**	1		17	18
Total market value	**3,523**	**445**	**49**	**4,017**	3,249	500	51	3,800

SIPS has a synthetic equity investment strategy using exchange-traded futures to invest in global equity markets. At 31 July 2015 the aggregate value of these derivatives was a liability of less than £1m. UK other investments also include £330m of investments in diversified growth funds held by SIPS. At 31 July 2014 SIPS was changing investment strategy, so it held £326m cash that was reinvested in diversified growth funds shortly after the year-end.

The scheme assets do not include any property occupied by, or other assets used by, the Group. The only financial instruments of the Group included in scheme assets are ordinary equity shares in Smiths Group plc held in broad-based equity investment funds.

9 Post-retirement benefits continued

Defined benefit and post-retirement healthcare plans continued

Retirement benefit plan assets continued

Liquidity funds, equities and bonds are valued using quoted market prices in active markets. Insured liabilities comprise annuity policies matching the scheme obligation to identified groups of pensioners. These assets are valued at the actuarial valuation of the corresponding liability, reflecting this matching relationship. Property is valued by specialists applying recognised property valuation methods incorporating current market data on rental yields and transaction prices.

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

	31 July 2015 £m			31 July 2014 £m		
	SIPS	TIGPS	US schemes	SIPS	TIGPS	US schemes
Present value of funded scheme liabilities						
– Active deferred members	**(92)**	**(76)**	**(102)**	(71)	(74)	(97)
– Deferred members	**(756)**	**(625)**	**(130)**	(714)	(589)	(221)
– Pensioners	**(995)**	**(823)**	**(336)**	(999)	(810)	(277)
Present value of funded scheme liabilities	**(1,843)**	**(1,524)**	**(568)**	(1,784)	(1,473)	(595)
Market value of scheme assets	**1,813**	**1,693**	**445**	1,639	1,594	500
Surplus/(deficit)	**(30)**	**169**	**(123)**	(145)	121	(95)

Net retirement benefit obligations

	31 July 2015 £m				31 July 2014 £m			
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
Market value of scheme assets	**3,523**	**445**	**49**	**4,017**	3,249	500	51	3,800
Present value of funded scheme liabilities	**(3,385)**	**(568)**	**(57)**	**(4,010)**	(3,275)	(595)	(65)	(3,935)
Surplus/(deficit)	**138**	**(123)**	**(8)**	**7**	(26)	(95)	(14)	(135)
Unfunded pension plans	**(52)**	**(7)**	**(37)**	**(96)**	(50)	(6)	(33)	(89)
Post-retirement healthcare	**(7)**	**(11)**	**(1)**	**(19)**	(7)	(10)	(1)	(18)
Present value of unfunded obligations	**(59)**	**(18)**	**(38)**	**(115)**	(57)	(16)	(34)	(107)
Net pension liability	**79**	**(141)**	**(46)**	**(108)**	(83)	(111)	(48)	(242)
Post-retirement assets	**169**		**1**	**170**	121		2	123
Post-retirement liabilities	**(90)**	**(141)**	**(47)**	**(278)**	(204)	(111)	(50)	(365)
Net pension liability	**79**	**(141)**	**(46)**	**(108)**	(83)	(111)	(48)	(242)

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

Amounts recognised in the consolidated income statement

	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
Amounts charged/(credited) to operating profit		
Current service cost	**3**	3
Settlement (gain)/loss	**(14)**	
Scheme administration costs	**8**	6
	(3)	9
The operating cost is charged/(credited) as follows:		
Cost of sales	**1**	
Sales and distribution costs	**1**	1
Administrative expenses	**9**	8
Exceptional operating items	**(14)**	
	(3)	9
Amounts charged to finance costs		
Net interest cost	**8**	9

9 Post-retirement benefits continued

Defined benefit and post-retirement healthcare plans continued

Amounts recognised directly in the consolidated statement of comprehensive income

	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
Actuarial gains/(losses)		
Difference between interest credit and return on assets	**239**	97
Experience gains and losses on scheme liabilities	**46**	6
Actuarial gains/(losses) arising from changes in demographic assumptions	**(15)**	30
Actuarial gains/(losses) arising from changes in financial assumptions	**(210)**	(210)
Movements in surplus restriction		
	60	(77)

Changes in present value of funded scheme assets

	31 July 2015 £m				31 July 2014 £m			
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
At beginning of period	**3,249**	**500**	**51**	**3,800**	3,146	501	49	3,696
Interest on assets	**128**	**20**	**2**	**150**	137	22	2	161
Actuarial gain on scheme assets	**242**	**(6)**	**3**	**239**	58	32	7	97
Employer contributions	**53**	**23**	**3**	**79**	53	26	3	82
Assets distributed on settlement			**(1)**	**(1)**				
Scheme administration costs	**(4)**	**(4)**		**(8)**	(4)	(2)		(6)
Exchange adjustments		**40**	**(5)**	**35**		(52)	(7)	(59)
Benefits paid	**(145)**	**(128)**	**(4)**	**(277)**	(141)	(27)	(3)	(171)
At end of period	**3,523**	**445**	**49**	**4,017**	3,249	500	51	3,800

Changes in present value of funded defined benefit obligations

	31 July 2015 £m				31 July 2014 £m			
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
At beginning of period	**(3,275)**	**(595)**	**(65)**	**(3,935)**	(3,160)	(621)	(62)	(3,843)
Current service cost			**(1)**	**(1)**	(1)		(1)	(2)
Interest on obligations	**(128)**	**(23)**	**(3)**	**(154)**	(136)	(27)	(3)	(166)
Past service gain/(cost)								
Actuarial (loss)/gain on liabilities	**(127)**	**(43)**	**1**	**(169)**	(119)	(39)	(10)	(168)
Liabilities extinguished on settlement		**14**		**14**				
Exchange adjustments		**(49)**	**7**	**(42)**		65	8	73
Benefits paid	**145**	**128**	**4**	**277**	141	27	3	171
At end of period	**(3,385)**	**(568)**	**(57)**	**(4,010)**	(3,275)	(595)	(65)	(3,935)

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

	Assets		Obligations	
	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
At beginning of period			**(107)**	(107)
Reclassification of small unfunded obligations			**(2)**	
Current service cost			**(2)**	(1)
Interest on obligations			**(4)**	(4)
Actuarial loss			**(10)**	(6)
Employer contributions	**6**	6		
Exchange adjustments			**4**	5
Benefits paid	**(6)**	(6)	**6**	6
At end of period			**(115)**	(107)

Cash contributions

Company contributions to the funded defined benefit pension plans for 2015 totalled £79m (2014: £82m).

In 2016 the following cash contributions to the Group's principal defined benefit schemes are expected: £36m to SIPS; £17m to TIGPS; and approximately £74m to other plans, including the US defined benefit scheme. Expected cash payments for 2016 total £127m.

In addition, in accordance with the current funding plan for SIPS, £2m a month will be invested in UK government bonds held in escrow. A new funding plan is being negotiated with the SIPS trustees, following the 31 March 2015 valuation.

10 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 three-year growth of headline EPS adjusted to exclude tax; 30% of the award is conditional on three -year TSR relative to the FTSE 100 (excluding financial services companies); and 20% of the award is conditional on three -year average annual headline operating cash conversion.

Divisional LTIP awards are made to selected divisional senior executives. Divisional LTIP awards made in 2014 have six performance conditions:

- 30% conditional on average underlying revenue growth;
- 30% conditional on either revenue growth from successful acquisitions, where success is evaluated by measuring performance relative to the acquisition case, or Return on Capital Employed (ROCE), depending on the divisional priorities. ROCE is defined in note 26;
- 10% conditional on improvements in new product vitality;
- 10% conditional on growth in revenue from China;
- 10% conditional on achievement of an employee engagement target, measured relative to the dynamic IBM Employee Engagement Index; and
- 10% conditional on improvements in divisional quality metrics.

Divisional LTIP awards made before 2014 have three performance conditions, and the relative significance of the conditions reflects the strategic priorities for each division. The performance conditions are: 20% to 40% of the awards are conditional on three -year revenue growth; 30% to 40% of the awards are conditional on three -year average annual headline operating margins; and 30% to 40% of the awards are conditional on three -year average annual headline operating 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 three-year performance period, awards will lapse. There is no re-testing of the performance conditions.

Smiths Group Co-Investment Plan (CIP)

Under the CIP participants are required to invest 50% of their post-tax bonus purchasing 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. If ROCE exceeds WACC by an average margin of 3% per annum, the enhanced performance condition is met, and a second matching share will be issued for every purchased share.

10 Employee share schemes continued

	CIP	Long-term incentive plans	Other share schemes	Total	Weighted average price for option plans £
Ordinary shares under option ('000)					
1 August 2013	1,874	2,367	2,086	6,327	£2.98
Granted	412	927	398	1,737	£2.27
Update of estimates		6		6	£0.00
Exercised	(546)	(349)	(657)	(1,552)	£3.87
Lapsed	(172)	(256)	(83)	(511)	£1.49
31 July 2014	1,568	2,695	1,744	6,007	£2.67
Granted	533	1,240	302	2,075	£1.31
Exercised	(580)	(258)	(418)	(1,256)	£2.62
Lapsed	(152)	(1,028)	(134)	(1,314)	£0.97
31 July 2015	**1,369**	**2,649**	**1,494**	**5,512**	**£2.57**

Options were exercised on an irregular basis during the period. The average closing share price over the financial year was 1,176.19p (2014: 1,353.95p). 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 at 31 Jul 2015 ('000)**	**Weighted average remaining contractual life at 31 July 2015 (months)**	Total shares under option at 31 Jul 2014 ('000)	Weighted average remaining contractual life at 31 July 2014 (months)	**Options exercisable at 31 July 2015 ('000)**	**Exercisable weighted average exercise price for options exercisable at 31 July 2015**	Options exercisable at 31 July 2014 ('000)	Exercisable weighted average exercise price for options exercisable at 31 July 2014
£0.00 – £2.00	**4,018**	**15**	4,263	9				
£2.01 – £6.00	**18**	**17**	164	9			23	£5.69
£6.01 – £10.00	**1,091**	**27**	1,093	30	**263**	**£8.97**	463	£8.85
£10.01 – £14.00	**385**	**25**	487	34	**257**	**£10.96**	289	£10.96

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 2015 and 2014 are volatility of 20% to 25% (2014: 25%) and dividend yield of 3.75% (2014: 3.75%). Assumptions on expected volatility and expected option term have been made on the basis of historical data, for the period corresponding with the vesting period of the option. These generated a weighted average fair value for CIP of £12.47 (2014: £14.04), Group long-term incentive plans of £10.78 (2014: £12.26) and divisional long-term incentive plans of £12.55 (2014: £14.12). 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 £9m (2014: £10m), of which £8m (2014: £9m) relates to equity-settled share-based payment.

11 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 2013	1,553	218	430	156	2,357
Exchange adjustments	(156)	(22)	(42)	(9)	(229)
Business combinations	1				1
Additions		24		18	42
Disposals	(3)	(4)	(2)	(1)	(10)
At 31 July 2014	1,395	216	386	164	2,161
Exchange adjustments	26	9	19	2	56
Additions		20		18	38
Disposals		(8)	(2)	(7)	(17)
At 31 July 2015	**1,421**	**237**	**403**	**177**	**2,238**
Amortisation					
At 1 August 2013	98	94	308	111	611
Exchange adjustments	(9)	(10)	(32)	(7)	(58)
Charge for the year		21	39	13	73
Disposals	(3)	(3)	(2)	(1)	(9)
At 31 July 2014	86	102	313	116	617
Exchange adjustments	2	4	14	1	21
Charge for the year		23	33	15	71
Impairment charge	27				27
Disposals		(8)	(2)	(6)	(16)
At 31 July 2015	**115**	**121**	**358**	**126**	**720**
Net book value at 31 July 2015	**1,306**	**116**	**45**	**51**	**1,518**
Net book value at 31 July 2014	1,309	114	73	48	1,544
Net book value at 1 August 2013	1,455	124	122	45	1,746

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 2013	75	144	211	430
Exchange adjustments	(7)	(14)	(21)	(42)
Business combinations				
Disposals		(2)		(2)
At 1 August 2014	68	128	190	386
Exchange adjustments	4	10	5	19
Disposals		(2)		(2)
At 31 July 2015	**72**	**136**	**195**	**403**
Amortisation				
At 1 August 2013	40	98	170	308
Exchange adjustments	(4)	(10)	(18)	(32)
Charge for the year	5	15	19	39
Disposals		(2)		(2)
At 31 July 2014	41	101	171	313
Exchange adjustments	2	8	4	14
Charge for the year	6	13	14	33
Disposals		(2)		(2)
At 31 July 2015	**49**	**120**	**189**	**358**
Net book value at 31 July 2015	**23**	**16**	**6**	**45**
Net book value at 31 July 2014	27	27	19	73
Net book value at 1 August 2013	35	46	41	122

12 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 2016 budget, the four-year strategic plan approved by the Board and detailed divisional strategic projections, where these have been prepared and approved by the Board.

Goodwill is allocated by division as follows:

	2015 £m	2015 Number of CGUs	2014 £m	2014 Number of CGUs
John Crane	**92**	**3**	121	4
Smiths Medical	**508**	**1**	481	1
Smiths Detection	**343**	**1**	369	1
Smiths Interconnect	**340**	**5**	317	3
Flex-Tek	**23**	**2**	21	2
	1,306	**12**	1,309	11

As required by IAS 36, the allocation of goodwill to CGUs for the Core Rotating Equipment business in John Crane has been revised following the integration of the manufacturing operations of original equipment and aftermarket businesses. Scenario tests modelling the previous allocation indicate that there would not have been any impairment under the previous allocation.

The goodwill allocated to Smiths Interconnect Microwave has been split into three business units: Smiths Interconnect Microwave Subsystems, Smiths Interconnect Microwave Telecoms and Smiths Interconnect Microwave Components, following a restructuring of the Smiths Interconnect Microwave operations to increase business flexibility. There would not have been any impairment if the three new CGUs had been tested on an aggregate basis.

Goodwill impairment

John Crane Production Solutions ("JCPS")

JCPS is a business unit of John Crane focused on the servicing and provision of onshore down-hole 'artificial lift' pumping hardware and systems. Goodwill of £5m (2014: £30m) is allocated to JCPS. An impairment test was carried out In January 2015 because the significant decline in oil prices since 31 July 2014 had adversely affected JCPS customers. JCPS anticipated that customers would scale back expansion plans and work to reduce running costs. Following this impairment test, the JCPS goodwill has been impaired by £27m because JCPS is now expected to have lower operating margins and less growth in the future, significantly reducing the value in use of the business.

The impairment loss has been recognised in John Crane administration expenses, and excluded from headline operating profit for the division, as part of "impairment of goodwill and amortisation of acquired intangible assets".

	Year ended 31 July 2015	Year ended 31 July 2014
Impairment loss recognised	**£27m**	
Basis of valuation	**value in use**	value in use
Discount rate used for impairment test	**12.9%**	12.6%
Long-term growth rates	**2.2%**	2.2%

Sales assumptions for JCPS are based on:

- anticipated levels of maintenance and repair activities based on the current forward curve for oil prices; and
- expected North American drilling activity.

The gross margins included in the projections are lower than historical due to lower levels of activity. As required by 'IAS 36: Impairment of assets', margin projections for JCPS are based on the current fixed cost base, and do not incorporate any future restructuring.

Impairment testing assumptions

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. The discount rates disclosed incorporate risk adjustments where the projected sales and margins are affected by significant delivery risks. Pre-tax rates of 10.7% to 16.2% (2014: 10.7% to 13.6%) 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 2.16% (2014: 2.03%). These rates do not reflect the long-term assumptions used by the Group for investment planning.

12 Impairment testing continued
Goodwill continued

Impairment testing assumptions continued

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

	Year ended 31 July 2015					
	John Crane	Smiths Medical	Smiths Detection	Smiths Interconnect		
	Core Rotating Equipment			Microwave Subsystems	Connectors	Power
Net book value of goodwill (£m)	**82**	**508**	**343**	**72**	**85**	**123**
Discount rate	**11.9%**	**10.7%**	**14.4%**	**12.6%**	**15.4%**	**12.2%**
Period covered by management projections	**5 years**	**5 years**	**5 years**	**5 years**	**5 years**	**5 years**
Long-term growth rates	**2.0%**	**2.2%**	**2.2%**	**2.5%**	**1.5%**	**2.5%**

	Year ended 31 July 2014				
	Smiths Medical	Smiths Detection	Smiths Interconnect		
			Microwave	Connectors	Power
Net book value of goodwill (£m)	481	369	124	79	114
Discount rate	10.7%	12.5%	13.6%	13.2%	11.4%
Period covered by management projections	5 years	5 years	5 years	5 years	5 years
Long-term growth rates	2.0%	2.3%	1.0%	1.5%	2.5%

The remaining balance of the goodwill represents smaller individual amounts which have been allocated to smaller CGUs.

Sensitivity analysis

Smiths Detection

Smiths Detection's value in use exceeds its carrying value by £117m (2014: £165m). Sensitivity analysis performed around the base case assumptions has indicated that for Smiths Detection, the following changes in assumptions (in isolation), would cause the value in use to fall below the carrying value:

	Year ended 31 July 2015 Change required to trigger impairment	Year ended 31 July 2014 Change required to trigger impairment
Forecast operating cash-flow	**24% reduction**	30% reduction
Discount rate	**250 basis points higher**	300 basis points higher
Long-term growth rates	**670 basis points lower**	690 basis points lower

Sales assumptions for Smiths Detection are based on:

- the current order book and tenders in progress, including airport, cargo scanning and military opportunities;
- expected market growth rates. Market growth drivers considered include
  - passenger numbers for air transportation;
  - global trade for cargo screening;
  - increased regulatory standards to detect a wider range of substances at lower threat mass; and
  - expected rate of replacement for units initially installed following 11 September 2001.
- expected rate of adoption of new products and technologies, including HI-SCAN 10080 XCT for baggage handling systems, HI-SCAN 6040-2is for critical infrastructure and Ace-ID and IONSCAN 600 for trace; and
- forecast servicing of the installed product base.

Margin projections for Smiths Detection are based on historical margins, projected margins on tenders in progress and the current fixed cost base.

Smiths Detection is currently implementing *Fuel for Growth* restructuring initiatives, see note 4. As a result, the directors also reviewed the fair value less costs to sell for the division when considering the results of the impairment testing. This additional work also indicated that the Smiths Detection goodwill was not impaired.

12 Impairment testing continued

Goodwill continued

Sensitivity analysis continued

Smiths Interconnect Power

Smiths Interconnect Power's value in use exceeds its carrying value by £14m (2014: £8m). Sensitivity analysis performed around the base case assumptions has indicated that for Smiths Interconnect Power, the following changes in assumptions (in isolation), would cause the value in use to fall below the carrying value:

	Year ended 31 July 2015 Change required to trigger impairment	Year ended 31 July 2014 Change required to trigger impairment
Forecast operating cash-flow	**10% reduction**	6% reduction
Discount rate	**100 basis points higher**	40 basis points higher
Long-term growth rates	**190 basis points lower**	70 basis points lower

Sales assumptions for Smiths Interconnect Power are based on:

- the current order book;
- proportion of recent tenders which have been successful; and
- independent projections of the expected growth of the data centre market in North America.

Margin projections for Smiths Interconnect Power are based on current variable costs and production capacity, and the expected costs of increasing capacity to support higher levels of sales.

The directors also reviewed the fair value less costs to sell for the division when considering the results of the impairment testing, which also supported the conclusion that the Smiths Interconnect Power goodwill was not impaired.

Smiths Interconnect Microwave Components

Goodwill of £52m is allocated to Smiths Interconnect Microwave Components. The value in use, calculated using a discount rate of 15.6% and a growth rate of 2.4%, exceeds its carrying value by £11m. Sensitivity analysis performed around the base case assumptions has indicated that for Smiths Interconnect Microwave Components, the following changes in assumptions (in isolation), would cause the value in use to fall below the carrying value:

	Year ended 31 July 2015 Change required to trigger impairment
Forecast operating cash-flow	**16% reduction**
Discount rate	**210 basis points higher**
Long-term growth rates	**490 basis points lower**

Sales assumptions for Smiths Interconnect Microwave Components are based on:

- the current order book;
- sales projections from major customers; and
- developments in key customer markets including smartphone testing equipment.

Margin projections for Smiths Interconnect Microwave Components incorporate the variable cost structure of the current production capacity.

The directors also reviewed the fair value less costs to sell for the division when considering the results of the impairment testing, which also supported the conclusion that the Smiths Interconnect Microwave Components goodwill was not impaired.

Other CGUs

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. Value in use calculations were used to determine the recoverable values of these assets.

No impairment charges have been incurred (2014: £nil).

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 2013	199	554	230	983
Exchange adjustments	(20)	(58)	(23)	(101)
Additions	6	34	14	54
Disposals	(1)	(10)	(9)	(20)
At 31 July 2014	184	520	212	916
Exchange adjustments	3	13	(3)	13
Additions	7	37	15	59
Disposals	(13)	(33)	(25)	(71)
Business disposals		(1)		(1)
At 31 July 2015	**181**	**536**	**199**	**916**
Depreciation				
At 1 August 2013	98	420	185	703
Exchange adjustments	(10)	(44)	(19)	(73)
Charge for the year	8	26	12	46
Disposals	(1)	(9)	(8)	(18)
At 31 July 2014	95	393	170	658
Exchange adjustments	2	11	(2)	11
Charge for the year	7	28	14	49
Disposals	(7)	(28)	(25)	(60)
Business disposals		(1)		(1)
At 31 July 2015	**97**	**403**	**157**	**657**
Net book value at 31 July 2015	**84**	**133**	**42**	**259**
Net book value at 31 July 2014	89	127	42	258
Net book value at 1 August 2013	101	134	45	280

14 Inventories

	31 July 2015 £m	31 July 2014 £m
Inventories comprise		
Raw materials and consumables	**157**	143
Work in progress	**96**	94
Finished goods	**203**	194
	456	431
Less: payments on account	**(2)**	(4)
	454	427

The Group consumed £1,293m (2014: £1,326m) of inventories during the period. £13m (2014: £21m) was recognised as an expense resulting from the write-down of inventory and £4m (2014: £4m) was released to the consolidated income statement from inventory provisions charged in earlier years but no longer required.

15 Trade and other receivables

	31 July 2015 £m	31 July 2014 £m
Non-current		
Trade receivables	**29**	26
Accrued income	**5**	3
Prepayments		1
Other receivables	**6**	5
	40	35
Current		
Trade receivables	**560**	578
Accrued income	**17**	18
Prepayments	**14**	13
Other receivables	**25**	26
	616	635

Trade receivables do not carry interest. Management considers that the carrying value of trade and other receivables approximates to the fair value. Trade and other receivables, including prepayments, accrued income and other receivables qualifying as financial instruments are classified as 'loans and receivables'. The maximum credit exposure arising from these financial assets is £611m (2014: £624m).

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 5% (2014: less than 4%) of Group revenue.

Ageing of trade receivables

	31 July 2015 £m	31 July 2014 £m
Trade receivables which are not impaired and not yet due	**468**	483
Trade receivables which are not impaired and less than three months overdue	**86**	93
Trade receivables which are not impaired and more than three months overdue	**32**	25
Gross value of partially and fully provided receivables	**25**	20
	611	621
Provision for bad and doubtful debts	**(22)**	(17)
Trade receivables	**589**	604

16 Trade and other payables

	31 July 2015 £m	31 July 2014 £m
Non-current		
Other payables	**24**	28
Current		
Trade payables	**192**	198
Other payables	**11**	8
Other taxation and social security costs	**18**	22
Accruals	**191**	193
Deferred income	**54**	43
	466	464

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

17 Financial assets

Available for sale financial assets include £147m (2014: £111m) 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 9 for additional details.

The Group also invests in early stage businesses that are developing or commercialising related technology. In the current year £2m (2014: £nil) was invested in John Crane technologies and £1m (2014: £3m) was invested in interconnect technologies.

18 Borrowings and net debt

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

	31 July 2015 £m	31 July 2014 £m
Cash and cash equivalents		
Net cash and deposits	**495**	190
Short-term borrowings		
Bank overdrafts		(1)
£150m 7.25% Sterling Eurobond 2016	**(150)**	
Bank and other loans	**(1)**	(1)
Interest accrual	**(12)**	(10)
	(163)	(12)
Long-term borrowings		
£150m 7.25% Sterling Eurobond 2016		(150)
€300m 4.125% Eurobond 2017	**(214)**	(243)
$175m 7.37% US$ Private placement 2018	**(112)**	(104)
$250m 7.20% US$ Guaranteed notes 2019	**(159)**	(147)
Revolving Credit Facility 2020		(106)
$400m 3.625% US$ Guaranteed notes 2022	**(253)**	(231)
€600m 1.25% Eurobond 2023	**(410)**	
Bank and other loans	**(2)**	(1)
	(1,150)	(982)
Borrowings	**(1,313)**	(994)
Net debt	**(818)**	(804)

On 28 April 2015 Smiths Group plc issued a €600m Eurobond with an eight-year maturity and a fixed coupon of 1.25%.

Borrowings are accounted for at amortised cost and are categorised as other financial liabilities. See note 19 for a maturity analysis of borrowings.

Interest of £42m (2014: £48m) was charged to the consolidated income statement in this period in respect of public bonds.

Net cash and cash equivalents

	31 July 2015 £m	31 July 2014 £m
Cash at bank and in hand	**104**	115
Short-term deposits	**391**	75
Cash and cash equivalents	**495**	190
Bank overdrafts		(1)
Net cash and cash equivalents	**495**	189

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

Netting

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

At 31 July 2015 and 31 July 2014 there was no material gross presentation on interest compensation cash pooling systems.

The balances held in zero balancing cash pooling arrangements are not included in this disclosure, since these arrangements have daily settlement of balances.

18 Borrowings and net debt continued

Movements in net debt

	Net cash and cash equivalents £m	Other short-term borrowings £m	Long-term borrowings £m	Net debt £m
At 31 July 2014	189	(11)	(982)	(804)
Foreign exchange gains and losses	2		(15)	(13)
Net cash inflow	304			304
Repayment of borrowings		1	256	257
Drawdown of borrowings			(568)	(568)
Capitalisation, interest accruals and unwind of capitalised fees		(1)		(1)
Fair value movement from interest rate hedging		(1)	8	7
Change in maturity analysis		(151)	151	
At 31 July 2015	**495**	**(163)**	**(1,150)**	**(818)**

Secured loans

Loans amounting to £3m (2014: £2m) were secured on plant and equipment with a book value of £3m (2014: £2m).

19 Financial risk management

The Group's international operations and debt financing expose it to financial risks which include the effects of changes in foreign exchange rates, 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 15.

(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 2015
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Financial assets and liabilities					
Financial instruments included in trade and other receivables	**34**	**316**	**111**	**150**	**611**
Financial instruments included in trade and other payables	**(41)**	**(185)**	**(55)**	**(55)**	**(336)**
Cash and cash equivalents	**311**	**115**	**20**	**49**	**495**
Borrowings not designated as net investment hedges	**(151)**	**(11)**	**(3)**		**(165)**
	153	**235**	**73**	**144**	**605**
Exclude balances held in operations with the same functional currency	**(155)**	**(149)**	**(72)**	**(138)**	**(514)**
Exposure arising from intra-group loans		**(101)**	**(28)**	**(49)**	**(178)**
Forward foreign exchange contracts	**(163)**	**48**	**79**	**36**	
	(165)	**33**	**52**	**(7)**	**(87)**

19 Financial risk management continued

	At 31 July 2014				
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Financial assets and liabilities					
Financial instruments included in trade and other receivables	34	322	115	153	624
Financial instruments included in trade and other payables	(37)	(171)	(69)	(60)	(337)
Cash and cash equivalents	24	77	27	62	190
Borrowings not designated as net investment hedges	(150)	(10)	(3)		(163)
	(129)	218	70	155	314
Exclude balances held in operations with the same functional currency	128	(167)	(71)	(142)	(252)
Exposure arising from intra-group loans		(37)		(3)	(40)
Forward foreign exchange contracts	(87)	29	31	27	
	(88)	43	30	37	22

Financial instruments included in trade and other receivables comprise trade receivables, accrued income and other receivables which qualify as financial instruments. Similarly, financial instruments included in trade and other payables comprise trade payables, accrued expenses and other payables 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 2015 £m	**Gain/(loss) recognised in reserves 31 July 2015 £m**	Impact on profit for the year 31 July 2014 £m	Gain/(loss) recognised in reserves 31 July 2014 £m
US dollar	**4**	**(2)**	4	(1)
Euro		**4**	(1)	
Sterling	**1**		4	1

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 2015 contracts with a nominal value of £317m (2014: £201m) were designated as hedging instruments. In addition, the Group had outstanding foreign currency contracts with a nominal value of £314m (2014: £237m) which were being used to manage transactional foreign exchange exposures, but were not accounted for as cash-flow hedges. The fair value of the contracts is disclosed in note 20.

The majority of hedged transactions will be recognised in the consolidated income statement in the same period that the cash-flows are expected to occur, with the only differences arising as a result of normal commercial credit terms on sales and purchases. Of the foreign exchange contracts designated as hedging instruments 92% are for periods of 12 months or less (2014: 100%).

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

	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
Brought forward cash-flow hedge reserve at start of year		2
Exchange adjustments		
Gains/(losses) on effective cash-flow hedges recognised in equity	**2**	1
Amounts removed from the hedge reserve and recognised in the following lines on the income statement		
– revenue		(4)
– cost of sales	**1**	1
Carried forward cash-flow hedge reserve at end of year	**3**	

19 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 2015
	Sterling £m	**US$ £m**	**Euro £m**	**Other £m**	**Total £m**
Loans designated as net investment hedges		**(524)**	**(624)**		**(1,148)**
Cross currency swap contracts		**(306)**	**302**		**(4)**
Currency swap contracts	**90**			**(90)**	
	90	**(830)**	**(322)**	**(90)**	**(1,152)**

					At 31 July 2014
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges		(588)	(243)		(831)
Currency swap contracts	185	(45)	(50)	(90)	
	185	(633)	(293)	(90)	(831)

At 31 July 2015 swap contracts in other currencies hedged the Group's exposure to Canadian dollars, Japanese yen and Chinese renminbi (31 July 2014: Canadian dollars, Japanese yen and Chinese renminbi).

All the currency swap contracts designated as net investment hedges are current (2014: 58% current with the balance maturing within two years). The cross currency swap contracts will mature in April 2023.

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

	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
Brought forward net investment hedge reserve at start of year	**(58)**	(176)
Amounts deferred in the period on effective net investment hedges	**(8)**	118
Carried forward net investment hedge reserve at end of year	**(66)**	(58)

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 2015 £m	Loss recognised in hedge reserve 31 July 2014 £m
US dollar	**80**	64
Euro	**35**	29

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

(b) Interest rate risk

The Group operates an interest rate policy designed to optimise interest cost and reduce volatility in reported earnings. The Group's current policy is to require interest rates to be fixed for greater than 70% of the level of gross debt. This is achieved primarily through fixed rate borrowings, and also through the use of interest rate swaps. At 31 July 2015 57% (2014: 63%) of the Group's gross borrowings were at fixed interest rates, after adjusting for interest rate swaps and the impact of short maturity derivatives designated as net investment hedges. The Group monitors its fixed rate risk profile against both gross and net debt. For medium-term planning, it now focuses on gross debt to eliminate the fluctuations of variable cash levels over the cycle.

The weighted average interest rate on borrowings and cross-currency swaps at 31 July 2015, after interest rate swaps, is 3.98% (2014: 4.51%).

19 Financial risk management continued

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

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

	Available for sale investments 31 July 2015 £m	**Cash and cash equivalents 31 July 2015 £m**	**Borrowings 31 July 2015 £m**	**Fair value of borrowings 31 July 2015 £m**	Available for sale investments 31 July 2014 £m	Cash and cash equivalents 31 July 2014 £m	Borrowings 31 July 2014 £m	Fair value of borrowings 31 July 2014 £m
Fixed interest								
Less than one year			**(151)**	**(158)**			(1)	(1)
Between one and five years			**(399)**	**(443)**			(544)	(619)
Greater than five years	**147**		**(296)**	**(290)**	111		(146)	(142)
Total fixed interest financial assets/(liabilities)	**147**		**(846)**	**(891)**	111		(691)	(762)
Floating rate interest financial assets/(liabilities)		**467**	**(467)**	**(467)**		169	(303)	(303)
Total interest-bearing financial assets/(liabilities)	**147**	**467**	**(1,313)**	**(1,358)**	111	169	(994)	(1,065)
Non-interest-bearing assets/(liabilities) in the same category	**9**	**28**			6	21		
Total	**156**	**495**	**(1,313)**	**(1,358)**	117	190	(994)	(1,065)

Interest rate hedging

At 31 July 2015 the Group has designated the following fair value hedges

- US$150m interest rate swaps which mature on 12 October 2022 hedging the US$ 2022 Guaranteed notes;
- €120m interest rate swaps which mature on 5 May 2017 hedging the € 2017 Eurobond; and
- the fixed/floating element of €400m of €/US$ interest rate swaps which mature on 28 April 2023 hedging the € 2023 Eurobond.

These positions hedge the risk of variability in the fair value of borrowings arising from fluctuations in base rates. At 31 July 2014, the first two of these hedging arrangements were in place.

The fair values of the hedging instruments are disclosed in note 20. The effect of the swaps is to convert £462m (2014: £184m) debt from fixed rate to floating rate.

Sensitivity of interest charges to interest rate movements

The Group has exposure to sterling, US dollar and euro interest rates. However the Group does not have a significant exposure to interest rate movements for any individual currency. Based on the composition of net debt and foreign exchange rates at 31 July 2015, 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 £0.2m (2014: £0.7m) impact on the Group's profit before tax.

Based on the investments held at 31 July 2015 a one percentage point (100 basis points) increase in sterling interest rates would reduce the carrying value of investments by £19m (2014: £15m), 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 placing cash deposits with highly rated relationship bank counterparties within counterparty limits established by reference to their Standard & Poor's long-term debt rating. In the normal course of business, the Group operates cash pooling systems, where a legal right of set-off applies.

The maximum credit risk exposure in the event of other parties failing to perform their obligations under financial assets, excluding trade and other receivables and derivatives, totals £651m at 31 July 2015 (2014: £307m).

	31 July 2015 £m	31 July 2014 £m
UK government bonds with at least a AA credit rating (note 17)	**147**	111
Cash at banks with at least a AA- credit rating	**268**	111
Cash at banks with a A+ credit rating	**194**	43
Cash at other banks	**33**	36
Other investments	**9**	6
	651	307

At 31 July 2015 the maximum exposure with a single bank for deposits and cash is £108m (2014: £60m), whilst the maximum mark to market exposure for derivatives is £4m (2014: £3m). These banks have AA- and AA- credit rating, respectively (2014: AA- and A).

19 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, which is provided by a multi-currency revolving credit facility.

On 19 February 2014 Smiths completed the refinancing of its existing $800m Revolving Credit Facility. The first of two uncommitted extension options was exercised on 4 February 2015. The facility now matures on 19 February 2020. The remaining uncommitted one-year extension option can be exercised in December 2015. At the balance sheet date the Group had the following undrawn credit facilities:

	31 July 2015 £m	31 July 2014 £m
Expiring within one year		
Expiring between one and two years		
Expiring after two years	**512**	367
	512	367

Cash deposits

As at 31 July 2015, £391m (2014: £75m) of cash and cash equivalents was on deposit with various banks of which £301m (2014: £4m) was on deposit in the UK.

Gross contractual cash-flows for borrowings

	Borrowings (Note 18) 31 July 2015 £m	**Fair value adjustments 31 July 2015 £m**	**Contractual interest payments 31 July 2015 £m**	**Total contractual cash-flows 31 July 2015 £m**	Borrowings (Note 18) 31 July 2014 £m	Fair value adjustments 31 July 2014 £m	Contractual interest payments 31 July 2014 £m	Total contractual cash-flows 31 July 2014 £m
Less than one year	**(163)**	**(1)**	**(41)**	**(205)**	(12)		(36)	(48)
Between one and two years	**(215)**	**3**	**(43)**	**(255)**	(150)		(48)	(198)
Between two and three years	**(113)**		**(34)**	**(147)**	(243)	5	(37)	(275)
Between three and four years	**(159)**	**(1)**	**(26)**	**(186)**	(104)		(27)	(131)
Between four and five years			**(15)**	**(15)**	(254)	(1)	(19)	(274)
Greater than five years	**(663)**	**(16)**	**(39)**	**(718)**	(231)	(6)	(30)	(267)
Total	**(1,313)**	**(15)**	**(198)**	**(1,526)**	(994)	(2)	(197)	(1,193)

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 2015 £m	**Payments 31 July 2015 £m**	**Net cash-flow 31 July 2015 £m**	Receipts 31 July 2014 £m	Payments 31 July 2014 £m	Net cash-flow 31 July 2014 £m
Assets						
Less than one year	**326**	**(304)**	**22**	256	(247)	9
Greater than one year	**20**	**(18)**	**2**	81	(73)	8
Liabilities						
Less than one year	**470**	**(483)**	**(13)**	222	(225)	(3)
Greater than one year	**326**	**(320)**	**6**	26	(16)	10
Total	**1,142**	**(1,125)**	**17**	585	(561)	24

This table presents the undiscounted future contractual cash-flows for all derivative financial instruments. For this disclosure, cash-flows in foreign currencies are translated using the spot rates at the balance sheet date. The fair values of these financial instruments are presented in note 20.

Gross contractual cash-flows for other financial liabilities

The contractual cash-flows for financial liabilities included in trade and other payables are: £324m (2014: £323m) due in less than one year, £7m (2014: £9m) due between one and five years and £5m (2014: £5m) due after more than five years.

20 Derivative financial instruments

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

				At 31 July 2015
	Contract or underlying nominal amount			Fair value
	£m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	**317**	**8**	**(5)**	**3**
Foreign exchange contracts (not hedge accounted)	**314**	**2**	**(2)**	
Total foreign exchange contracts	**631**	**10**	**(7)**	**3**
Currency swaps (net investment hedges)	**97**	**7**		**7**
Currency swaps (not hedge accounted)	**157**	**3**	**(5)**	**(2)**
	254	**10**	**(5)**	**5**
Cross currency swaps (fair value and net investment hedges)	**276**		**(4)**	**(4)**
Interest rate swaps (fair value hedges)	**180**	**4**	**(2)**	**2**
Total financial derivatives	**1,341**	**24**	**(18)**	**6**
Balance sheet entries				
Non-current		**4**	**(6)**	**(2)**
Current		**20**	**(12)**	**8**
Total financial derivatives		**24**	**(18)**	**6**

				At 31 July 2014
	Contract or underlying nominal amount			Fair value
	£m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	201	3	(3)	
Foreign exchange contracts (not hedge accounted)	237	1	(1)	
Total foreign exchange contracts	438	4	(4)	
Currency swaps (net investment hedges)	214	7	(1)	6
Interest rate swaps (fair value hedges)	184	6	(4)	2
Total financial derivatives	836	17	(9)	8
Balance sheet entries				
Non-current		9	(4)	5
Current		8	(5)	3
Total financial derivatives		17	(9)	8

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.

Netting

International Swaps and Derivatives Association (ISDA) master netting agreements are in place with derivative counterparties except for contracts traded on a dedicated international electronic trading platform used for operational foreign exchange hedging. Under these agreements if a credit event occurs, all outstanding transactions under the ISDA are terminated and only a single net amount per counterparty is payable in settlement of all transactions. The ISDA agreements do not meet the criteria for offsetting, since the offsetting is enforceable only if specific events occur in the future, and there is no intention to settle the contracts on a net basis.

	Assets 31 July 2015 £m	Liabilities 31 July 2015 £m	Assets 31 July 2014 £m	Liabilities 31 July 2014 £m
Gross value of assets and liabilities	**24**	**(18)**	17	(9)
Related assets and liabilities subject to master netting agreements	**(4)**	**4**	(4)	4
Net exposure	**20**	**(14)**	13	(5)

21 Fair value of financial instruments

	Notes	Carrying value 31 July 2015 £m	Fair value 31 July 2015 £m	Carrying value 31 July 2014 £m	Fair value 31 July 2014 £m
Level 1 valuations					
Financial assets – other investments	17	**147**	**147**	111	111
Level 2 valuations					
Financial derivatives – assets	20	**24**	**24**	17	17
Borrowings	18	**(1,313)**	**(1,358)**	(994)	(1,065)
Financial derivatives – liabilities	20	**(18)**	**(18)**	(9)	(9)
Level 3 valuations					
Financial assets – other investments		**9**	**9**	6	6

Investments with level 1 valuations comprise quoted government bonds.

Derivatives, including forward exchange contracts, currency swaps, interest rate instruments, and embedded derivatives, are valued at the net present value of the future cash-flows calculated using market data at the balance sheet date (principally exchange rates and yield curves).

Borrowings are valued at the net present value of the future cash-flows using credit spreads and yield curves derived from market data. 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.

Cash, trade receivables and trade payables are excluded from this table because carrying value is a reasonable approximation to fair value for all these assets and liabilities.

22 Commitments

Operating lease commitments – minimum lease payments

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

	31 July 2015		31 July 2014	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Payments due				
– not later than one year	**31**	**7**	29	7
– later than one year and not later than five years	**57**	**7**	56	8
– later than five years	**22**		8	
	110	**14**	93	15

Other commitments

At 31 July 2015, commitments, comprising bonds and guarantees arising in the normal course of business, amounted to £159m (2014: £153m), including pension commitments of £54m (2014: £51m).

23 Provisions and contingent liabilities

	Trading	Exceptional and legacy			Total
		John Crane, Inc. litigation	Titeflex Corporation litigation	Other	
	£m	£m	£m	£m	£m
At 31 July 2014	43	204	61	19	327
Exchange adjustments		17	5		22
Provision charged	17	15	8	13	53
Provision released	(6)			(2)	(8)
Unwind of provision discount		4	1		5
Utilisation	(28)	(24)	(4)	(11)	(67)
At 31 July 2015	**26**	**216**	**71**	**19**	**332**
Current liabilities	21	27	17	14	79
Non-current liabilities	5	189	54	5	253
At 31 July 2015	**26**	**216**	**71**	**19**	**332**

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

Trading

Warranty provision and product liability

At 31 July 2015 there are warranty and product liability provisions of £24m (2014: £35m). Warranties over the Group's products typically cover periods of between one and three years. Provision is made for the likely cost of after-sales support based on the recent past experience of individual businesses.

Commercial disputes and litigation in respect of ongoing business activities

The Group has on occasion been required to take legal action to protect its intellectual property and other rights against infringement. It has also had to defend itself against proceedings brought by other parties, including product liability and insurance subrogation claims. Provision is made for any expected costs and liabilities in relation to these proceedings where appropriate, though there can be no guarantee that such provisions (which may be subject to potentially material revision from time to time) will accurately predict the actual costs and liabilities that may be incurred. Trading provisions include £1m (2014: £7m) in connection with ongoing price audits of overhead cost recovery charges associated with certain historical supply arrangements.

Contingent liabilities

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

The Group operates in some markets where the risk of unethical or corrupt behaviour is material and has procedures, including an employee 'Ethics Alertline', to help it identify potential issues. Such procedures will, from time to time, give rise to internal investigations, sometimes conducted with external support, to ensure that Smiths Group properly understands risks and concerns and can take steps both to manage immediate issues and to improve its practices and procedures for the future. From time to time the Group also 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.

Exceptional and legacy

John Crane, Inc.

John Crane, Inc. ("JCI") is one of many co-defendants in numerous lawsuits pending in the United States in which plaintiffs are claiming damages arising from alleged exposure to, or use of, products previously manufactured which contained asbestos. Until 2006, the awards, the related interest and all material defence costs were met directly by insurers. In 2007, JCI secured the commutation of certain insurance policies in respect of product liability. 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. Pending the outcome of that litigation, JCI has met 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.

23 Provisions and contingent liabilities continued

Exceptional and legacy continued

John Crane, Inc. continued

John Crane, Inc. litigation provision

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 242,000 claims (2014: 235,000 claims) against JCI have been dismissed before trial over the last 36 years. JCI is currently a defendant in cases involving approximately 76,000 claims (2014: 80,000 claims). Despite the large number of claims brought against JCI, since the inception of the litigation it has had final judgments against it, after appeals, in 133 cases (2014: 131 cases) over the period, and has had to pay awards amounting to approximately US$153m (2014: US$149m). JCI has also incurred significant additional defence costs. The litigation involves claims for a number of allegedly asbestos related diseases, with awards, when made, for mesothelioma tending to be larger than those for the other diseases JCI's ability to defend mesothelioma cases successfully is, therefore, likely to have a significant impact on its annual aggregate adverse judgment and defence costs.The provision is based on past history and published tables of asbestos incidence projections and is determined using asbestos valuation experts, Bates White LLC. Whilst published incidence curves can be used to estimate the likely future pattern of asbestos related disease, John Crane, Inc.'s claims experience is significantly impacted by other factors which influence the US litigation environment. These can include: changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels; and legislative and procedural changes in both the state and federal court systems. 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.

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 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 7). Set out below is the gross, discounted and post-tax information relating to this provision:

	31 July 2015 £m	31 July 2014 £m
Gross provision	**236**	227
Discount	**(20)**	(23)
Discounted pre-tax provision	**216**	204
Deferred tax	**(72)**	(68)
Discounted post-tax provision	**144**	136

John Crane, Inc. litigation provision sensitivities

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.

Statistical analysis of the provision indicates that there is a 50% probability that the total future spend will fall between £221m and £248m (2014: between £212m and £239m), compared to the gross provision value of £236m (2014: £227m).

John Crane, Inc. contingent liabilities

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

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. It has also received a number of product liability claims regarding this product, some in the form of purported class actions. Titeflex Corporation believes that its products are a safe and effective means of delivering gas when installed in accordance with the manufacturer's instructions and local and national codes; however some claims have been settled on an individual basis without admission of liability. Equivalent third-party products in the US marketplace face similar challenges.

23 Provisions and contingent liabilities continued
Exceptional and legacy continued
Titeflex Corporation continued
Titeflex Corporation litigation provision
The continuing progress of claims and the pattern of settlement, together with the recent market place activity, provide sufficient evidence to recognise a liability in the accounts. Therefore provision has been made for the costs which the Group is expected to incur in respect of future claims to the extent that such costs can be reliably estimated. Titeflex Corporation sells flexible gas piping with extensive installation and safety guidance (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.

The provision of £71m (2014: £61m) 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 7).

	31 July 2015 £m	31 July 2014 £m
Gross provision	**77**	67
Discount	**(6)**	(6)
Discounted pre-tax provision	**71**	61
Deferred tax	**(27)**	(23)
Discounted post-tax provision	**44**	38

Titeflex Corporation litigation provision sensitivities
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.

Titeflex Corporation contingent liabilities
The Group anticipates that litigation might continue beyond the period covered by the provision. However, the uncertainty surrounding the US litigation environment beyond this point (which reflects factors such as changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels; and legislative and procedural changes in both the state and federal court systems) is such that the costs cannot be reliably estimated.

Other exceptional and legacy
Legacy provisions comprise provisions relating to former business activities and properties no longer used by Smiths. Exceptional provisions comprise all provisions which were disclosed as exceptional items when they were charged to the consolidated income statement.

These provisions cover exceptional reorganisation, vacant properties, disposal indemnities and litigation in respect of old products and discontinued business activities.

Reorganisation and property
At 31 July 2015 there were provisions of £6m (2014: £6m) related to *Fuel for Growth*, £6m (2014: £7m) related to onerous leases and dilapidations provisions, and £1m (2014: £1m) related to actual and potential environmental issues for sites which were no longer occupied by Smiths operations.

The *Fuel for Growth* provisions are expected to be spent in 2016.

Disposal
Other provisions include disposal provisions of £3m (2014: £3m) relating 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 four years.

24 Share capital

	Number of shares	Issued capital £m	Consideration £m
Ordinary shares of 37.5p each			
At 31 July 2013	393,818,510	148	
Exercise of share options	637,625		6
At 31 July 2014	394,456,135	148	
Exercise of share options	403,869		3
Total share capital at 31 July 2015	**394,860,004**	**148**	

At 31 July 2015 all of the issued share capital was in free issue. All issued shares are fully paid.

25 Dividends

The following dividends were declared and paid in the period:

	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
Ordinary final dividend of 27.50p for 2014 (2013: 27.00p) paid 21 November 2014	**108**	107
Special dividend of 30.00p for 2013 paid 22 November 2013		118
Ordinary interim dividend of 13.00p for 2015 (2014: 12.75p) paid 24 April 2015	**52**	50
	160	275

The final dividend for the year ended 31 July 2015 of 28.00p per share was recommended by the Board on 22 September 2015 and will be paid to shareholders on 20 November 2015, 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 23 October 2015.

26 Reserves

Retained earnings include the value of Smiths Group plc shares held by the Smiths Industries Employee Benefit Trust. In the year the Company issued nil (2014: nil) shares to the Trust, and the Trust purchased 838,032 shares (2014: 895,489 shares) in the market. At 31 July 2015 the Trust held 852 (2014: 855) ordinary shares.

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

Capital management

Capital employed comprises total equity adjusted for goodwill recognised directly in reserves, net post-retirement benefit related assets and liabilities, net litigation provisions relating to exceptional items and net debt. The efficiency of the allocation of the capital to the divisions is monitored through the return on capital employed (ROCE). This ratio is calculated over a rolling 12-month period and is the percentage that headline operating profit comprises of monthly average capital employed. The ROCE was 16.0% (2014: 15.7%).

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 16% (2014: 15%).

The ratio of net debt to headline EBITDA of 1.4 (2014: 1.4) is close to the medium term target of 1.5 to 2.0. The Group's robust balance sheet and record of strong cash generation is more than able to fund the immediate investment needs and other legacy obligations.

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 2015 the Group had a credit rating of BBB+/Baa2 (2014: 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 90% and a ratio of net debt to headline EBITDA of less than two. For the year ended 31 July 2015 these measures were 95% (2014: 97%) and 1.4 (2014: 1.4).

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

Hedge reserve

	31 July 2015 £m	31 July 2014 £m
The hedge reserve on the balance sheet comprises		
– cash-flow hedge reserve	**3**	
– net investment hedge reserve	**(66)**	(58)
	(63)	(58)

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

27 Cash-flow

Cash-flow from operating activities

	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
Operating profit – continuing	**394**	378
Amortisation of intangible assets	**71**	73
Impairment of intangible assets	**27**	
Loss on disposal of property, plant and equipment	**1**	2
Loss/(profit) on disposal of business	**1**	(3)
Depreciation of property, plant and equipment	**49**	46
Share-based payment expense	**8**	9
Retirement benefits	**(85)**	(79)
(Increase)/decrease in inventories	**(30)**	4
Decrease/(increase) in trade and other receivables	**11**	(13)
Decrease in trade and other payables	**(4)**	(9)
(Decrease)/increase in provisions	**(22)**	19
Cash generated from operations	**421**	427
Interest	**(64)**	(76)
Tax paid	**(91)**	(95)
Net cash inflow from operating activities	**266**	256

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 2015 £m	Year ended 31 July 2014 £m
Net cash inflow from operating activities	**266**	256
Exclude:		
Interest	**64**	76
Tax paid	**91**	95
Cash outflow in respect of exceptional operating items	**66**	74
Pension deficit payments	**84**	82
Include:		
Expenditure on capitalised development, other intangible assets and property, plant and equipment	**(95)**	(94)
Disposals of property, plant and equipment in the ordinary course of business	**8**	1
Headline operating cash-flow	**484**	490

Free cash-flow

	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
Net cash inflow from operating activities	**266**	256
Expenditure on capitalised development, other intangible assets and property, plant and equipment	**(95)**	(94)
Disposals of property, plant and equipment	**11**	5
Investment in financial assets relating to pensions financing	**(24)**	(24)
Free cash-flow	**158**	143
Investment in other financial assets	**(3)**	(4)
Acquisition of businesses		(1)
Disposal of businesses	**2**	3
Net cash-flow used in financing activities	**147**	(313)
Net increase/(decrease) in cash and cash equivalents	**304**	(172)