SMITHS GROUP PLC
Annual Report FY2018

CREATING THE FUTURE

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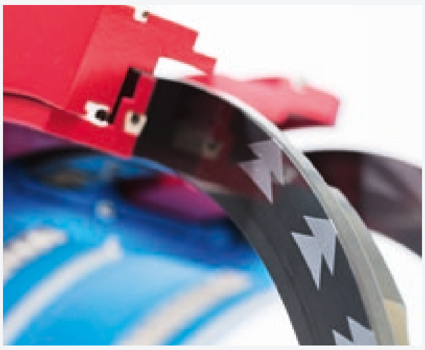
"I was attracted to Smiths by its enormous potential, and that potential has to be realised in the form of growth. Almost a year in, I am even more confident in both the potential, and our ability to translate it into superior returns to shareholders."



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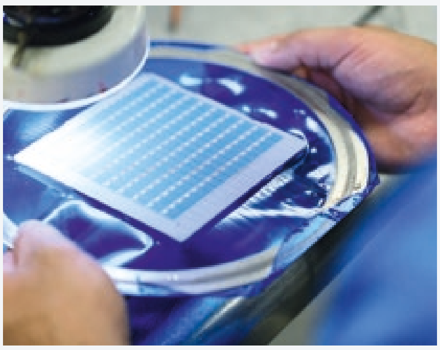


WHO WE ARE

Smiths is a world leader in the practical application of advanced technologies.

We've been at the heart of modern life for over 160 years and today touch the lives of millions.

We push boundaries to solve the world's challenges, making it safer, healthier, more efficient and more connected.

WE'RE CREATING THE FUTURE

FY2018 HIGHLIGHTS

DELIVERING OUR RETURN TO GROWTH

Our ambition is to establish Smiths as one of the world's leading technology companies. FY2018 marks an important milestone on that journey.

£m	FY2018	FY2017	Reported change	Underlying[2] change
Revenue	£3,213m	£3,280m	(2)%	+2%
Headline EBITDA[1]	£641m	£690m	(7)%	
Headline operating profit[1]	£544m	£589m	(8)%	+3%
Headline operating profit margin[1]	16.9%	18.0%	(110)bps	+10bps
Statutory operating profit	£494m	£674m	(27)%	
Profit before tax	£487m	£528m	(8)%	
Earnings per ordinary share – basic				
Headline[1]	90.7p	97.6p	(7)%	+4%
Statutory	70.0p	144.1p	(51)%	
Dividends per ordinary share	44.55p	43.25p	+3%	
Headline operating cash[1]	£538m	£695m	(23)%	
Headline cash conversion[3]	99%	118%		
Free cash-flow	£302m	£370m	(18)%	
Net debt	£893m	£967m		
Net debt/Headline EBITDA[1]	1.4x	1.4x		
Return on Capital Employed (ROCE)	14.6%	16.2%	(160)bps	

This is our Annual Report for the financial year ended 31 July 2018.

1 **Headline**: definitions of headline metrics, and information about adjustments to statutory measures are provided in Note 3 to the financial statements.

2 **Underlying**: modifies headline performance to: adjust prior year to reflect an equivalent period of ownership for divested businesses; include restructuring and pension administration costs as headline for both years; and exclude the effects of foreign exchange, acquisitions and supplemental sales for divested businesses. See the presentation of results note on p129 for further details.

3 Cash conversion is the ratio measuring headline operating cash over headline operating profit.

PORTFOLIO STRENGTH

~80%

FY2017: ~75%

~80% of the Group is well positioned in attractive markets, up from ~75% last year. Driven by increased organic investment and targeted M&A activity.

- Integration of Morpho Detection on track
- Flex-Tek's acquisition of the heating element division of Osram Sylvania Inc.
- John Crane's disposal of the Bearings business
- John Crane's acquisition of Seebach GmbH, a high performance filtration business

RECORDABLE INCIDENT RATE

0.38 per 100 colleagues

FY2017: 0.38

We maintained our record low recordable incident rate in FY2018 as we work to create safe and secure workplaces for our people.

HIGHER-GROWTH REGIONS*

17%

FY2017: 16%

Revenue from higher-growth regions increased by 6% on an underlying[2] basis to 17%, with strong growth in China and India.

* See page 06 for definition.

AFTERMARKET NEW KPI

57%

FY2017: 55%

Aftermarket, a core characteristic of a Smiths business, increased by 200bps, taking aftermarket sales as a percentage of Group revenue to 57%, driven by John Crane and Smiths Detection.

STOCK TURNS NEW KPI

3.7x

FY2017: 3.5x

Stock turns measures speed and efficiency across our operations. Our focus on operational excellence drove further improvement with stock turns up 0.2x to 3.7x.

R&D

4.6%

FY2017: 4.6%

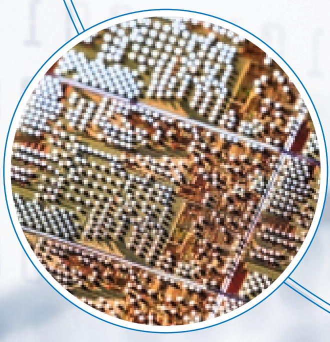
R&D cash costs in line with last year at 4.6% as we continue to invest for growth.

VITALITY NEW KPI

13%

Vitality measures the effectiveness of our innovation, showing revenue from products launched in the last three years as a percentage of total revenue.

A BUSINESS FIT FOR THE FUTURE

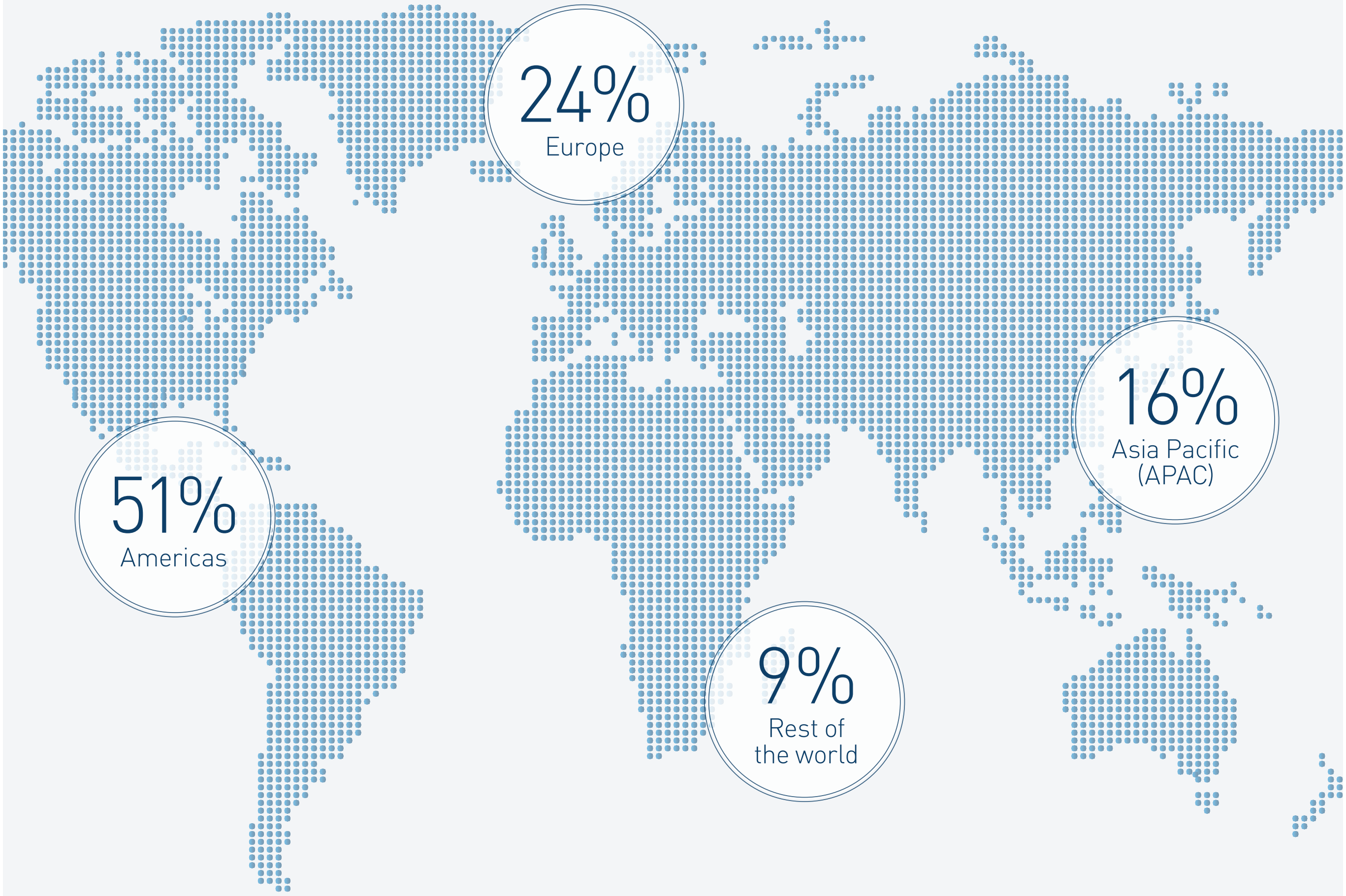


STRATEGIC REPORT

OUR GLOBAL BUSINESS

WE HAVE OPERATIONS IN MORE THAN 50 COUNTRIES. OUR SOLUTIONS REACH c.200 COUNTRIES AND TERRITORIES

REVENUE BY DESTINATION



c.22,000
EMPLOYEES WORLDWIDE

17%
REVENUE FROM HIGHER-GROWTH REGIONS*

* Comprised of territories whose real GDP growth exceeds the G7 average.

OUR MARKETS

WE TARGET MARKETS WITH STRONG LONG-TERM GROWTH PROSPECTS

MEDICAL TECHNOLOGY

Our products make a vital contribution to our customers' ability to save and enhance lives. There is growing demand for medical technology worldwide, driven by ageing populations, the increasing incidence of chronic diseases, and the expansion of healthcare spending in developing countries. Smiths Medical focuses heavily on this market and both Smiths Interconnect and Flex-Tek supply solutions that support the manufacture of medical devices.

SECURITY AND DEFENCE

Our threat detection equipment helps keep people and assets safe. Demand in the security market is driven by persistent and evolving terror threats, changing security regulations, and increased global air travel and trade. Aftermarket opportunities rise as the installed base grows. The defence segment is served by Smiths Detection through imaging and sensing detection products and by Smiths Interconnect through secure connectivity solutions. Growth in this market is primarily driven by defence and security spending.

GENERAL INDUSTRY

Customers put their trust in our products and services to support a wide range of general industrial applications in sectors including petrochemical, mining, pulp & paper, water treatment, semiconductor testing, heating elements, automotive and rail transportation. These sectors and others are served by John Crane, Smiths Interconnect and Flex-Tek, with growth generally tracking increases in GDP worldwide.

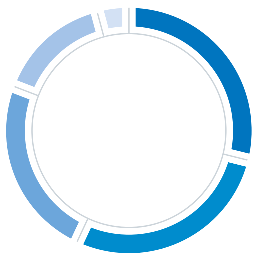
OIL & GAS

John Crane's mechanical seals and systems support oil & gas operations worldwide in downstream refineries, midstream pipelines and gas storage activities. Growth is driven by increases in global demand for energy, productivity and enhanced environmental and safety requirements. There is a growing requirement for aftermarket and service contracts.

SPACE AND COMMERCIAL AEROSPACE

Satellite launches, deep space exploration and emerging activities such as asteroid mining are driving demand for high reliability solutions in the space market. Growth in commercial aerospace is coming from new fuel-efficient aircraft and increasing passenger and freight traffic. Flex-Tek provides hydraulic hoses and fuel lines for airframes and engines and Smiths Interconnect supplies ultra high-quality connectors, microwave components and antenna systems for aircraft and satellite communications.

REVENUE BY MARKET



Medical technology	29%
Security and defence	28%
General industry	24%
Oil & gas	15%
Space and commercial aerospace	4%

All of our markets are driven by the ever-changing nature of the world.

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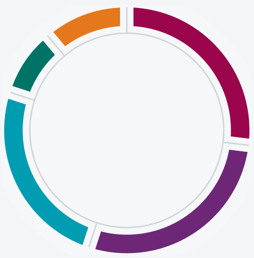
OUR DIVISIONS

OUR DIVISIONS ARE EXPERTS IN THEIR CHOSEN MARKETS

DIVISIONAL REVENUE SPLIT



John Crane	27%
Smiths Medical	28%
Smiths Detection	25%
Smiths Interconnect	9%
Flex-Tek	11%

DIVISIONAL HEADLINE OPERATING PROFIT SPLIT

John Crane	34%
Smiths Medical	26%
Smiths Detection	22%
Smiths Interconnect	7%
Flex-Tek	11%

JOHN CRANE

Mission-critical solutions for global energy and process industries

REVENUE

£881m

HEADLINE OPERATING PROFIT MARGIN

22.9%

- A global leader in flow control for rotating equipment
- Strong proprietary technology and expertise in applied engineering
- Broad installed base in Oil & Gas and Non-Oil & Gas
- Strong aftermarket service offering with c.200 sales and service centres
- Long-term customer relationships

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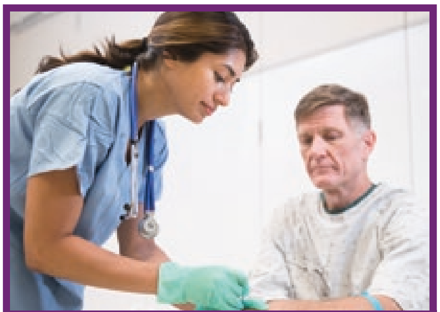

SMITHS MEDICAL

High-quality, cost-effective medical devices and consumables that are vital to patient care globally

REVENUE

£885m

HEADLINE OPERATING PROFIT MARGIN

17.6%

- A category leader in our chosen markets
- Trusted brands with a reputation for quality and safety
- Strong, defensible intellectual property
- c.80% of revenue from single-use devices and proprietary consumables
- Strong customer relationships and extensive global sales network

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MARKETS KEY

- Medical technology
- Security and defence
- General industry
- Oil & gas
- Space and commercial aerospace

SMITHS DETECTION

A global leader in the detection and identification of security threats and contraband

REVENUE

£793m

HEADLINE OPERATING PROFIT MARGIN

16.9%

- A global market leader with differentiated technologies leveraged across a broad range of markets
- Significant R&D capability
- Operating in several regulated markets requiring product certification
- Increasing digitisation and aftermarket revenue
- Long-term customer relationships

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SMITHS INTERCONNECT

Solutions for high-speed, secure connectivity in demanding applications

REVENUE

£300m

HEADLINE OPERATING PROFIT MARGIN

14.1%

- Innovative and technically differentiated offerings
- Ultra-high reliability solutions used in demanding applications
- Strong research and engineering capabilities
- Customer intimacy, responsiveness and product customisation
- Global presence, reach and support

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FLEX-TEK

Innovative components to heat and move fluids and gases

REVENUE

£354m

HEADLINE OPERATING PROFIT MARGIN

18.9%

- High performance products
- Leading capability in design and manufacture
- Market-leading residential gas tubing products
- High performance flexible tubing for aerospace
- Strong customer relationships

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A CHANGING WORLD

SHAPING THE FUTURE OF SMITHS

There are many possible futures for Smiths.
We monitor mega trends to inform our strategy, which drives our innovation agenda so we can create the future.

INCREASED DIGITISATION AND CONNECTIVITY

Converting information into digital formats supports connectivity, making products smarter and able to exchange information with other devices and platforms. This is driving new business models and value creative solutions for our customers.

HOW SMITHS IS WELL POSITIONED

- Digital solutions are central to many of our products, e.g. software in Smiths Detection equipment, Smiths Medical's connected pumps, John Crane's predictive diagnostic sensors and Smiths Interconnect's digital networks for space applications
- We are close to our customers and offer cutting edge technological expertise
- Our Digital Forge centre of excellence is helping to leverage software expertise across the Group

AGEING POPULATION AND HEALTHCARE DEMANDS

The world's population is growing and ageing. The over 60 global cohort is expected to double by 2050 and triple by 2100*. Ageing populations increases the need for medical technology.

HOW SMITHS IS WELL POSITIONED

- Smiths Medical's digitised devices enable remote care, and support 'smart' hospitals through automation and increased efficiency
- Customer intimacy drives continuous improvement in our products, and strong and sustained R&D is supporting the next generation of innovation

* United Nations World Population Prospects 2017.

ENERGY DEMANDS AND EFFICIENCIES

Energy demand is increasing worldwide, with estimated growth of 1.3%* per annum, and a changing mix with gas growing faster than oil. Environmental regulations and the need to reduce harmful emissions are also impacting the energy landscape.

HOW SMITHS IS WELL POSITIONED

- We are focusing on technology and new product development that will enable a smarter, greener future, such as John Crane's dry gas seals that help to reduce methane emissions
- Customer intimacy enables us to jointly deliver solutions that meet specific needs

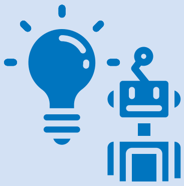
* BP 2018 Global Energy Outlook.

ARTIFICIAL INTELLIGENCE (AI)

AI – the capability of a machine to imitate intelligent human behaviour, learn from past iterations and enhance its capabilities and knowledge – is nascent but evolving rapidly and applications can already be found in many industries.

HOW SMITHS IS WELL POSITIONED

- Our Digital Forge is supporting Group-wide progress in the application of AI
- Our Smiths Detection CORSYS™ software platform leverages AI to enable our customers to make better informed decisions



MOBILITY AND GLOBALISATION

The growth of infrastructures supporting travel and trade is creating a smaller world for people and goods. With this comes the need for enhanced security and speed of transaction.

HOW SMITHS IS WELL POSITIONED

- We have a global footprint with operations in over 50 countries
- Growth in air travel, urbanisation and global trade are key demand drivers for Smiths Detection
- Applications at Smiths Interconnect support high speed trains and secure connectivity for aircraft and satellite communications

NEW BUSINESS MODELS

Business models enabled by new technology will emerge and these require agile structures. Trends include customisation, new service models and the sharing economy. We are embracing this evolution to remain competitive and create new value propositions.

HOW SMITHS IS WELL POSITIONED

- We are asset-light, helping us to be competitive and agile in a sustainable way
- A high proportion of our revenue (57%) comes from aftermarket services
- Customer intimacy and technological expertise are elements of the Smiths Excellence System, our shared operating model

DEMAND FOR TALENT

Advances in technology, globalisation, demographic trends and competition are increasing the demand for specialised talent. Our HR strategy is to attract, retain, develop, engage and inspire the right people.

HOW SMITHS IS WELL POSITIONED

- Our people are a sustainable source of competitive advantage and we are committed to enabling them to be the best they can be
- We reward our colleagues for their contributions and enable them to share in our success. We aim to engage them so that they are more innovative, productive, effective and happier at work

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WHAT IS i³?

OUR GROUP-WIDE INNOVATION FRAMEWORK

i³ – innovation, implementation and inspiration – identifies mega and emerging trends, translating them into revenue opportunities in our markets.

This drives our innovation agenda and enables us to stay at the cutting edge of knowledge and product development.

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CHAIRMAN'S STATEMENT

BUILDING A BUSINESS FIT FOR THE FUTURE

Building sustainable competitive advantage requires the right combination of world-class operating excellence, innovation, growth and people development. This is what we have been pursuing at Smiths.

I have traditionally used these statements to outline a management philosophy targeted at building sustainable competitive advantage and higher levels of organic growth. So I will continue that tradition this year. I will expand on a few of these management concepts in greater detail in this statement and also briefly report on our progress in FY2018. Chief Executive Andy Reynolds Smith will expand on this topic in his section of this report. I've previously defined our approach to growth as an 'everybody wins' strategy. My goal in all these statements is to be informative, helpful and factual in describing how the Company thinks about its products and markets, the value it ascribes to people, how it competes and how it intends to be sustainable.

In terms of the details of our approach to creating new shareholder value in the Smiths business, little has changed from my Chairman's statement last year. Referring back to the days of the great British industrialists in the 1970s and 1980s, an outcome of their intense focus on short-term results was that many UK and, indeed, US companies gradually became trapped in a paradigm of high margin and low growth. As we all know, Smiths was in a very similar position for many years.

Immediate and consistent financial success were the two historical objectives of most companies. The more enlightened companies stayed the course of finding a better balance between the present and the future and between stronger organic growth and margin enhancement. But the intense short-term pressures often led management teams to compromise and invest less than they should in the future. The outcome was stagnation, and slowly decreasing competitiveness. However, despite the merits of achieving higher levels of organic growth, let's not deceive ourselves; changing from a management philosophy of 'squeeze the lemon harder' to another of 'stimulating organic growth through innovation' can be a tricky exercise in 'performing while transforming'.

As I mentioned in last year's Chairman's Statement, the laboratory of life teaches us that various industries have maximum best-in-class operating margins. Once these best-in-class margins have been achieved by a company – if they can in fact be achieved – the new value creation objective always runs out of roadway unless a company finds new ways of achieving organic growth. If not, earnings and returns plateau and stock prices stagnate, except for the incremental market growth offered by the particular local market. And I stress again that the growth we seek is primarily organic growth, not just acquisitive growth.

The real danger that emerges when a company pushes margins unnaturally high, is that it produces unhappy customers who see the company's financial reports and think the profit sharing is unfair. It also becomes the birthplace of new competition that is attracted by the magnet of high margins. That's less of a problem if the high margin is driven by growth that is born of innovation. Companies with a combination of high growth and low margin, or of low growth and high margin, are ultimately destined to pivot toward a rebalance because neither one of these two performance extremes is sustainable in the long run. If they don't, the result will inevitably be an unhappy ending.

MAKING THE WORLD SAFER

88 million containers traverse the globe each year, but only around 2% are physically inspected at ports and borders. Smiths Detection has developed CORSYS™, a pioneering, AI-driven software solution, designed specifically for the Security Operations market. Partnering with Microsoft and Hitachi Consulting, this new solution enables operators to increase the number of containers inspected, while providing a significant increase in the inspection precision and greatly improving overall efficiency. Evaluating 100% of containers with CORSYS™ will allow our customers to know more about each container and choose the right ones to inspect.

88 million

cargo containers traverse the globe each year but only around 2% are physically inspected

So what can a company normally expect in terms of growth?

Niels Bohr, the Nobel prize-winning theoretical physicist, is famously quoted as saying 'forecasting is very difficult, especially when it concerns the future'. He was right. But some parts of forecasting are fairly easy, especially if you do the same old thing. Whilst on the physicists theme, Albert Einstein also said "One definition of madness is to perform the same experiment over and over again but expect different results". In the vernacular, if you always do what you always did, you'll always get what you always got.

The reality is that if a company participates in a 2% growth market, without active intervention to produce a different outcome, the company will grow at 2%, assuming of course that it is properly combating attrition of its core business. Worse, as new competitors enter the market, the company may actually grow at less than 2% as these new market entrants nibble away at their market share.

In an ideal situation, a company must grow faster than every competitor in the market, otherwise it's implicitly planning never to be better than second place.

For the low growth, high margin companies, the best new value creator is produced by higher levels of organic growth. When starting on a journey of change and value creation improvement, management teams often ask themselves, what should we do first? Try to push operating margins higher or try to get more organic growth? There is a compelling answer here. Depending on the exact starting point, the ratio of value creation for 100bps of organic growth or 100bps of operating margin typically ranges between 4x and 12x. The magic which companies must therefore discover is how to grow again. That has been the challenge for Smiths since I became its Chairman – and for many years before it. I will outline our mechanism for achieving that later in this statement.

How we compete: competitive platforms

So, the principal challenge for any company is how to build sustainable competitive advantage. This requires the right combination of world-class operating excellence, innovation, growth and people development. This is what we have been pursuing at Smiths.

Industrial companies like Smiths compete with each other in a number of different ways. They use a set of competitive platforms; there are seven in most industrial company cases. The first platform is cost, the second is technology, the third is distribution, the fourth is customer service, the fifth is brands and marketing, the sixth is people and the seventh is industrial design. I have included industrial design because great design is not only beautiful, it's usually simple. With simplicity comes low-cost, elegance, reliability and ease of manufacture. But in this list, the single most important factor is the calibre of people you hire and inspire because nothing in a corporation ever happens except through people.

CHAIRMAN'S STATEMENT CONTINUED

The importance of these seven competitive platforms varies depending on which part of the market is being served. If we think of the market as a pyramid where the various segments are divided into three horizontal layers of 'good', 'better', then 'best', the requirements needed to compete effectively in each level of the marketplace segmentation are different. What is considered 'better' or 'best', for example, will vary depending on the state of maturity of a particular market, especially when we consider emerging ones. What is a 'good' product in a developed market may actually appear to be a 'better' product in a developing market. And that changes over time as a market gradually moves from emerging to developed. Medical markets have a softer version of this market tiering because, which one of us wants to receive an opening price point heart valve, even if it is cheap? Nobody.

Opening price point products always require a company to be the lowest cost producer to be successful and sustainable. High-technology companies obviously require their leading competitive vector to be technology – but they also need attractive costs too. All companies require great distribution, customer service, good brands and marketing plus good industrial design. No matter how great or how inexpensive a product is, without proper distribution, the product will fail.

So I repeat that our primary goal is to achieve higher levels of organic growth, while significantly improving operations excellence and people development. We have begun to make significant progress along this three avenue journey. As previously, we will selectively enhance and turbocharge this approach with appropriate acquisitions.

As I have said in previous statements, the primary tool we use for separating us from the pack is innovation, which underpins all of our competitive platforms. While new products are rightly seen as the primary manifestation of innovation, we also need innovation in our route to market, our manufacturing processes, materials science, algorithmic development through mathematics, etc. If a company doesn't cannibalise its own products then someone else will. The Eastman Kodak Company is a classic example of how this can go terribly wrong. But the greatest crystal balls on the future are mathematics, the electronics and software that bring it to life, plus materials science. This includes all the popular elements we think of today such as Artificial Intelligence, the Internet of Things, machine learning, computer vision, natural language processing, robotics, Industry 4.0, mathematical taxonomy, 3D printing, etc.

Some observers may naturally ask, "Why can't you push innovation and growth faster in Smiths Medical?" There are some market realities here. New product innovation is actually toughest in regulated markets such as medical where patient safety, the scrutiny and requirements of regulatory bodies is at its highest. Even seemingly small product modifications can require thousands of pages of submissions to the FDA. Sales forecasts can also be challenging with completely new medical products because, unlike in unregulated markets, new products cannot be presold to hospitals. That brings Niels Bohr's comment on forecasting to real life.

Nevertheless, the fact remains that a company can neither save nor spend its way into prosperity, but it can innovate its way there. In most places at Smiths, the Company had underinvested for many years. When we began this journey three years ago, the new product Vitality Index was zero or near zero in almost every reporting division and sub-segment, and had been so for many years. The Smiths management team has done a magnificent job in getting this moving again.

The bird's eye view of a company

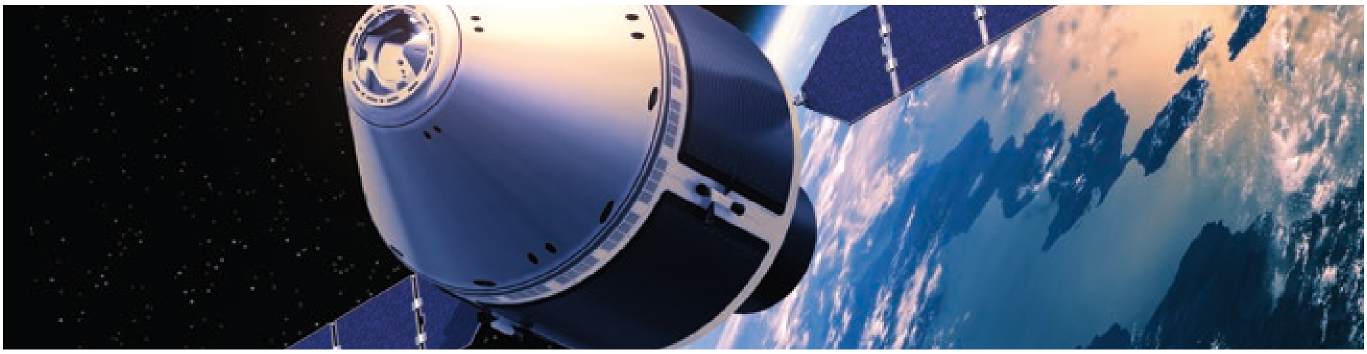
To stand back from the above detail, at the 30,000 ft. level, companies are about four things:

1. A dream (for the future)
2. A strategy to achieve that dream
3. People
4. Relentless execution

While some observers may prefer different words to mine, the word 'dream' here describes a combination of fervent hope and desire for a better future. If a company doesn't have a dream it will simply become a figurative version of Alice's conversation with the Cheshire cat at the crossroads in Lewis Carroll's Alice's Adventures in Wonderland. Undecided and indecisive. Our dream is to become one of the great engineering technology companies of the world, but we will start by first becoming one of the great engineering technology companies of the UK. This is a long haul, but it is an achievable one and a worthy one in my view.

Our strategy to achieve this dream is to use operations excellence and innovation as our two primary tools, and superb people as the driving force. The circumstances surrounding each of the Smiths businesses vary somewhat, but the core set of ideas of how to achieve them are largely the same in every business we own.

WE'RE CREATING THE FUTURE



As regards our people, that vital ingredient, the objective here is to inspire the voluntary engagement of our employees, and give them a stimulating career within an exciting growth environment in an innovation-oriented company. Gradually our employment brand will build and more and more people will choose Smiths as an employer. We will invest in them, just as we invest in operational excellence and innovation.

> “Our strategy to achieve this dream is to use operations excellence and innovation as our two primary tools, and superb people as the driving force.”

And, finally, relentless execution. I have found in a lifetime of work experience that very few companies cannot be improved by the application of imagination, creativity and relentless effort. No matter how hard the challenge, or how long the road, problems always eventually yield to this combination of factors. So it will be for Smiths.

The four lines of my 30,000 ft comment above are foundation stones and, without all four simultaneously supporting the corporation, we have what mathematicians call a 'null set'. So we therefore expand our framework for eventual success by adding investment in people to our investments in operations excellence and innovation.

The calculus of growth

I return to my central theme. Over the years, companies have found many different ways to drive organic growth. But it always comes from doing something new. While innovation is itself not a process at the strategic level, methods to achieve growth are. The rules for achieving it are as follows:

1. In the core markets of the company (2% in our earlier example), a company must discover (through segmentation analysis) or create (through innovation), pockets of new organic growth in their core at multiples of the underlying market. The core is always the best place to begin.
2. Line extension and geographic expansion.
3. Gain market share year after year (in a statement of the obvious, no great company was ever created by losing market share each year).
4. Having the courage and discipline to prioritise differently; reallocate and move resources from low-growth markets to high-growth markets.
5. Invent completely new markets or products.

There is no other calculus for growth than this one and it can be applied systematically in any business. As I have mentioned before over the years, three of the five strategies listed above require innovation. This is the pathway we've been following at Smiths.

On the road to success

Smiths has made great progress in FY2018, with the return to organic revenue growth for the first time in five years. Further enhancement of growth and margins must come from further reducing the use of working capital, the cost of poor quality, and on-time service performance.

When a company embarks on a change as radical and thorough as the one which we are engaged, there is always significant upfront investment in time, money and human resources. A company which has a history of innovation and new product development always has a family of growing innovative products in the market paying for the new ones being developed. In most cases at Smiths, we are having to play catch-up, which makes the transition to growth and innovation trickier. But it is the way to make the Company more competitive and sustainable in the long-term. It will produce better growth and better earnings as the challenges gradually yield to the combination of imagination, creativity, relentless effort and of course, the all-important financial investment.

I'd like to thank all of our investors for believing in our story. It will work – I'm sure of it – and as I said in 2017, ultimately all of us will be the beneficiaries.

SIR GEORGE BUCKLEY
CHAIRMAN

GOING INTO DEEP SPACE WITH NASA

Providing mission-critical support to NASA's manned spacecraft Orion, during its deep space mission.

Two of our divisions are providing mission-critical support to NASA's manned spacecraft Orion, during its deep space mission. Smiths Interconnect's rugged connectors support high-speed data rates that will keep digital signals transmitting despite the extreme vibration of blast-off and splash-down. Bespoke tests run by Flex-Tek improved and proved the robustness of the Space Launch System's fuel manifolds.

CHIEF EXECUTIVE'S Q&A

RETURN TO GROWTH

FY2018 marks a very important milestone on our journey. We said that this would be the year that we returned to growth and we've done that. Our next objective is to deliver continued, sustainable growth, on the way to outperforming our markets.

When I joined Smiths, the thing that I felt, and continue to feel the strongest about, is the level of opportunity and potential that we have in this business.

We're now three years into a journey towards delivering our dream of building a world-leading technology company. Right across the organisation we're focused on creating a business that executes consistently, is a leader in innovation and attracts, retains and develops the very best people.

We are creating the future of Smiths.

Q

In 2016 you set out your new strategy and vision for the Group. What progress have you made this year?

A

Over the last three years we've been putting in place the building blocks that will support sustainable growth into the future. We're successfully implementing the Smiths Excellence System (SES), our Group-wide operating model that helps drive speed and efficiency, ensures consistent execution and supports the development of a culture of continuous improvement. We've also put in place a new Group-wide innovation framework, i^3, to ensure that Smiths stays at the cutting edge of technology and continues to deliver innovative services and products that meet or exceed customer needs. Finally, most importantly, we've developed and rolled out a global people plan that ensures we are investing in the right way in our most valuable resource.

Driving operational improvement takes time; innovation and bringing new products to market takes time; and, developing the culture of an organisation with a 160-year history takes time; but we're making real and measurable progress as you can see from our KPIs on page 25. These include, for the first time, our new Vitality Index which measures the effectiveness of our innovation by tracking revenue from products and services launched in the last three years.

This year we also continued to make progress on strengthening our portfolio by improving the market positions of each of our businesses with the aim of achieving and maintaining top three leadership positions.

> "Driving operational improvement takes time; innovation and bringing it to market takes time; and, developing the culture of an organisation that is over 160 years old takes time; but we're making real and measurable progress."

We said three years ago that around 60% of our business was well positioned in attractive markets and we're now at around 80%. We've got there through a combination of targeted organic investment decisions and a disciplined approach to acquisitions and disposals, having sold eight non-core operations and bought four businesses that have increased our momentum and strengthened competitiveness.

We aim to buy well and sell well and I'm particularly pleased that our acquisition of Morpho Detection last year, which significantly enhanced Smiths Detection, is being successfully integrated with synergies being delivered ahead of plan.

In the coming years I expect the percentage of the Smiths business that is well positioned will continue to improve. But note that this is not a dash to 100% – portfolio review is a continuous process. In parallel, we're constantly thinking about those bigger portfolio prioritisation decisions across the Group that will ensure we're allocating our capital appropriately to drive maximum value creation. We can't do everything big. We're thinking with great clarity around the risk and return potential of each of our business areas, from an organic and non-organic perspective.

> "We're constantly thinking about those bigger portfolio prioritisation decisions across the Group that will ensure we're allocating our capital appropriately to drive maximum value creation."

We said that FY2018 would be the year that we returned to growth and we've done that. We delivered this growth despite some disappointing setbacks in our Medical division. Importantly, the Group achieved this growth while maintaining our underlying operating margin. This has been enabled by our relentless focus on driving efficiency and productivity improvements to help fund investment in growth. This is a key point for me. Investing in the future is critical, but it has to come without taking a backwards step in profitability.

FY2018 marks a very important milestone on our journey. Our next objective is to deliver continued, sustainable growth, on the way to outperforming our markets.

Q

As a Group with five divisions, what does it mean to be a Smiths business?

A

First impressions may suggest that our businesses are diverse; but they all share the Smiths DNA. A Smiths business is targeted in attractive markets where we can achieve and maintain a top three leadership position. Our businesses share the same four characteristics, which embody how we create value: technological differentiation; increasing digitisation; a high proportion of aftermarket and services; and sustainably competitive and asset-light. You should expect us to focus investment in businesses which match these characteristics.

These are the characteristics that define the Group and our shared culture and values guide how we behave. For us, our values are more than just words, we use them every day to direct our decisions and actions, to make sure that Smiths is both a place people want to work and an organisation that people want to do business with.

Our characteristics and culture are wrapped together by the SES operating model and, together, these are our source of sustainable growth, competitive advantage and strong returns for all our stakeholders.

Q

What do you see as the priority to ensure you deliver on your vision for the Group?

A

Our people. They are the difference between success and failure.

It's critical that we have the right team in place to lead this business into the future, and I believe we do. The breadth of experience and strength of leadership throughout the Group is a real differentiator for us in executing our strategy.

Developing and recognising the broader talent we have across the organisation is central to the Smiths people plan. We've made great strides on that this year, with enhanced employee communication, widely available development opportunities, and stronger employer branding.

We have also increased our focus on diversity and inclusion at all levels. This is a key priority for me. I'm inspired by the unique ideas and perspectives that my colleagues bring to work each day and I truly believe that creating a more inclusive environment is the foundation of innovative thinking. All of our efforts in this area are focused on ensuring that we can attract, retain, develop, engage and inspire the very best people.

CHIEF EXECUTIVE'S Q&A CONTINUED

Having the right team in place, doing things the right way is vital to our future success. Integrity is one of our core values and is central to our new Code of Ethics. It means we do the right thing, every time, regardless of whether someone is looking – it's part of our Smiths Way of doing things.

I'd like to thank everyone at Smiths for their hard work in FY2018, a year that has marked our return to growth.

Q

As Chief Executive you have a lot of responsibilities. What keeps you awake at night?

A

It's the need for speed. We have big ambitions at Smiths. Our strategy is on track but, in an ever-changing world where our markets are moving fast, we need to keep up the pace and make sure we stay ahead; identifying mega and emerging trends in our markets and in the world to shape our strategy and build our future.

Our execution has become far more consistent and our risk management system is strong but, as we saw this year at Smiths Medical, we can all suffer setbacks. These were one-off disruptions that impacted on the division's overall performance in FY2018. In advance of the new EU Medical Device Regulation in 2020, one of Smiths Medical's European Notified Body service providers was decertified for some products. This led to the temporary suspension of some of Smiths Medical's products in Europe.

> "In an ever-changing world where our markets are moving fast, we need to keep up the pace."

As a result of this, and the termination of two contracts in the US, the division didn't deliver the growth that we had been expecting. This was very disappointing, but we are confident that the regulatory and contract challenges will progressively abate – and the growing contribution of new products should see Smiths Medical revenues back in growth for the full year.

Q

In the near term how is the Group positioned for FY2019?

A

In FY2019 we anticipate at least sustaining the rate of underlying revenue growth. As in previous years, Group performance in FY2019 is expected to be weighted towards the second half. Foreign exchange will provide a tailwind to reported headline revenue and operating profit, if current rates prevail.

Over the medium term we remain confident that we can grow faster than our markets. This is driven by our strategy to focus the portfolio for growth and deliver world-class competitiveness, underpinned by our strong financial framework. In parallel with continued active portfolio management, the Board remain confident that this will drive long-term sustainable growth and attractive returns.

ANDY REYNOLDS SMITH
CHIEF EXECUTIVE

STRENGTHENING THE PORTFOLIO

In April 2017, we acquired Morpho Detection. The acquisition positions us well to benefit from global aviation market growth, with:

- A combined technology roadmap with strong R&D capability;
- Improved commercial positioning with a broader product portfolio, which supported the $50m contract win with Airports Authority of India this year;
- Improved operating structure with common processes and removal of duplication, all of which supports the delivery of the expected $30m cost synergies.

Smiths Detection's now broader product portfolio supported the $50m contract win with Airports Authority of India

OUR EXECUTIVE COMMITTEE

Our Executive Committee is responsible for implementing our strategy, ensuring consistent execution and embedding our culture and values

ANDY REYNOLDS SMITH
Chief Executive
Joined Smiths in 2015. Background: Chief Executive, Automotive, GKN plc; Ingersoll Rand; Siebe plc and Delphi Automotive Systems.
For full biography see page 72.

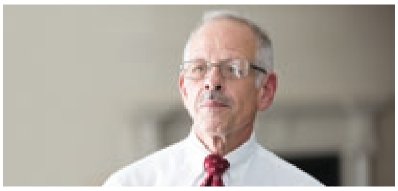
JOHN SHIPSEY
Chief Financial Officer
Joined Smiths in 2017. Background: CFO at Dyson for 12 years; 13 years in senior finance and strategy roles at Diageo plc.
For full biography see page 72.

JEAN VERNET
President, John Crane
Joined Smiths in 2017. Background: CFO of Expro; Grid Net and Formfactor; Director of Risk at Rio Tinto Alcan; Schlumberger.

CHRIS HOLMES
President, Smiths Medical
Joined Smiths in 2015. Appointed President of Smiths Medical in 2017. Background: Senior VP of Operations & Supply Chain at 3M; Executive VP of the Industrial Business Group, 3M.

ROLAND CARTER
President, Smiths Detection and Asia Pacific Joined Smiths in 1991. Appointed President of Smiths Detection in 2018; previously President of Smiths Interconnect and Managing Director for Smiths Connectors.

KAREN BOMBA
President, Smiths Interconnect
Joined Smiths in 2017. Background: President and CEO of Morpho Detection; CEO of Labinal; COO of Zoltek; CEO of Messier-Bugatti, USA.



TEDD SMITH
President, Flex-Tek
Joined Smiths in 1991 with acquisition of Flexible Technologies. Appointed President of Flex-Tek in 2002. Prior roles included CFO, Executive VP of Operations and General Manager.

JULIAN FAGGE
Group Strategy and M&A Director
Joined Smiths in 2013 as Group Financial Controller. Appointed Group Strategy and M&A Director in 2017. Background: Royal Caribbean Cruises; Procter & Gamble; PwC.

SHEENA MACKAY
Group HR Director
Joined Smiths in 2016. Background: Group HR Director at Aggreko plc, BBA Aviation plc and SSL International plc, starting her career at GEC plc.

PHILIPPE ROMAN
Group Operations Director
Joined Smiths in 2016. Background: Group Purchasing, Supply Chain and IT Director at GKN plc; Global Operations Director at GKN Driveline; Faurecia; Valéo; PSA; Deloitte Consulting.

MEL ROWLANDS
Group General Counsel Joined Smiths in 2013. Appointed Group General Counsel in 2018. Previously Company Secretary and Deputy Group General Counsel. Background: BG Group plc; Linde AG; Edwards Group; Centrica plc.

OUR BUSINESS MODEL

THE SMITHS WAY IS HOW WE DO THINGS

It starts with the core characteristics that define our businesses and the values that guide how we behave.

It encompasses our shared operating model, focused on excellence, innovation, and consistent execution.

THE **CORE CHARACTERISTICS** THAT DEFINE OUR BUSINESSES

We actively manage our portfolio of businesses to ensure they are targeted in growing markets where we can sustainably achieve a top three leadership position. Our businesses share the same characteristics, which embody how we create value.

TECHNOLOGY DIFFERENTIATION

INCREASING **DIGITISATION**

TARGETED IN GROWING MARKETS

HIGH PROPORTION OF **AFTERMARKET AND SERVICES**

SUSTAINABLY COMPETITIVE AND **ASSET-LIGHT**

WE ARE UNITED BY OUR **SHARED CULTURE AND VALUES**

Our values are more than just words, we use them to guide every decision and action as we work to make Smiths one of the world's leading technology companies.

ACHIEVING WORLD-CLASS COMPETITIVENESS THROUGH **EXCELLENCE AND INNOVATION**

The Smiths Excellence System (SES) is our shared operating model. It helps us apply best practice across the Group to drive speed and efficiency. We work to ensure consistent execution and a culture of continuous improvement.

TECHNOLOGY

We are at the forefront of technology and develop products that meet our customers' evolving needs. We bring innovative, differentiated solutions to market quickly.

PRODUCTION

We work to continuously improve our production processes to enhance safety and increase efficiency and quality. Much of our manufacturing is small-batch and made to meet specific customer orders, which helps us to be asset-light and flexible.

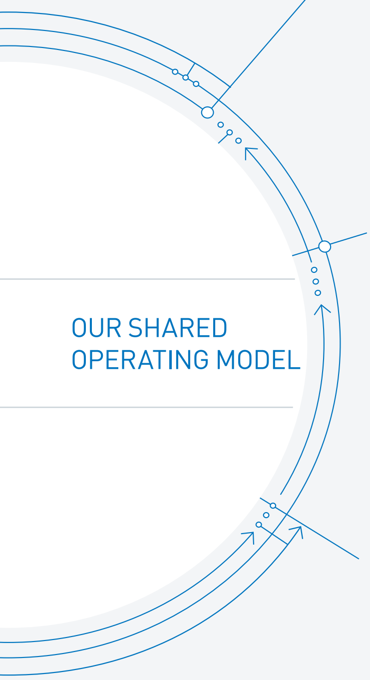
PROGRAMME

We work to drive consistent and flawless execution. Many of our businesses provide a high level of aftermarket service generating customer loyalty, understanding of our product performance and increased resilience throughout the cycle.

INNOVATION

Read more on how we manage our resources and relationships

60



PEOPLE

Our people are critical to our success. We work to attract, retain, engage, develop and inspire the best people.

CUSTOMER

We partner with our customers to shape product innovation and technology development. Deep market knowledge enables us to achieve a high degree of customer intimacy, allowing us to anticipate their specific needs.

OUR SHARED OPERATING MODEL

SUPPLY CHAIN

We build strong, strategic supplier relationships to deliver quality, efficiency and flexibility. This enables us to meet the expectations of our customers.

DRIVES SMARTER AND FASTER NEW PRODUCT DEVELOPMENT AND COMMERCIALISATION

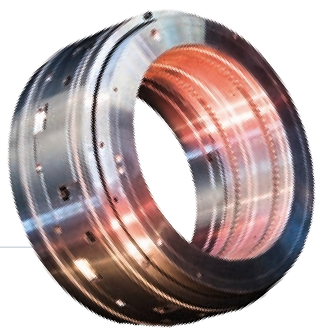
As a globally aligned organisation we are committed to doing business responsibly, generating value for all our stakeholders.

CREATING **WIDER VALUE** FOR OUR STAKEHOLDERS

ATTRACTING AND RETAINING **THE BEST TALENT**

PRODUCTS AND SERVICES THAT GO **BEYOND CUSTOMER EXPECTATIONS**

OPERATING RESPONSIBLY WHICH INCLUDES HEALTH AND SAFETY, ENVIRONMENT AND ETHICS



SUSTAINABLE RETURNS TO SHAREHOLDERS

+4%

Headline EPS underlying growth[1]

+3%

Dividends per share growth

1 **Underlying**: modifies headline performance to: adjust prior year to reflect an equivalent period of ownership for divested businesses; include restructuring and pension administration costs as headline for both years; and exclude the effects of foreign exchange, acquisitions and supplemental sales for divested businesses. See the presentation of results note on p129 for further details.

OUR STRATEGY

WE ARE SEEING COMPREHENSIVE BENEFITS FROM IMPLEMENTING OUR THREE KEY STRATEGIC OBJECTIVES

1 OUTPERFORM OUR CHOSEN MARKETS

Focus the portfolio on our most attractive markets globally, where we can sustainably maintain a scalable top three leadership position.

FOCUS THE PORTFOLIO FOR GROWTH THROUGH ORGANIC INVESTMENT AND A HIGHLY DISCIPLINED APPROACH TO ACQUISITIONS AND DISPOSALS

Progress in FY2018

We continued to invest in R&D and innovation in a focused and commercial way. During the year we launched:

- John Crane's new Aura™ dry gas seal range, reducing methane emissions;
- Over 20 new Smiths Medical products;
- CORSYS™, a new Smiths Detection AI based platform;
- Smiths Interconnect's SpaceNXT™ for next generation space applications;
- Flex-Tek's Thermaflex® floating core Heating Ventilation and Air Conditioning (HVAC) duct.

We continued to focus the portfolio into profitable and high-growth markets:

- Morpho Detection integration progressing to plan;
- Acquired the heating element division of Osram Sylvania Inc. in Flex-Tek;
- Disposed of our Bearings business in John Crane;
- Acquired Seebach GmbH, a high-performing filtration business in John Crane;
- We now have ~80% of our portfolio with leadership positions in attractive markets.

Priorities for FY2019

Drive the market share growth of our businesses in chosen markets through effective R&D investment

Continue to focus the portfolio and grow the percentage of the Group that is well positioned

Maintain a disciplined approach to acquisitions that will enhance our capabilities and leadership

INCREASE OUR FOCUS ON HIGHER-GROWTH REGIONS

Progress in FY2018

We continued to make progress in growing our presence in higher-growth regions, which now represent 17% of Group revenue which grew by 6%[1] in FY2018. This is supported by multiple actions across the Group including:

- Creation of the Asia Pacific leadership team;
- John Crane's contract wins in Thailand and China;
- Smiths Medical's strong growth in India and China;
- Opened the customer experience centre in Malaysia for Smiths Detection;
- Smiths Detection's contract win with Airports Authority of India;
- Smiths Interconnect's joint venture signed with Sichuan Huafeng in China;
- Flex-Tek's Heat Solutions strong growth in China.

Priorities for FY2019

Continue to embed and execute our new operating model and strategy for Asia Pacific

Look for partnership opportunities in India and China to strengthen our business

1 **Underlying:** modifies headline performance to: adjust prior year to reflect an equivalent period of ownership for divested businesses; include restructuring and pension administration costs as headline for both years; and exclude the effects of foreign exchange, acquisitions and supplemental sales for divested businesses. See the presentation of results note on p129 for further details.

2

DELIVER WORLD-CLASS COMPETITIVENESS

Drive world-class competitiveness through: a shared operating model (SES) that drives speed and efficiency on a sustainable basis; investing in innovation for technological differentiation; and building a learning organisation that enables our people to be the best that they can be.

DELIVER THE SMITHS EXCELLENCE SYSTEM (SES) – A SHARED OPERATING MODEL FOCUSED ON CONTINUOUS IMPROVEMENT, SPEED AND EFFICIENCY

Progress in FY2018

We continued to embed SES. Key highlights included:

- Continued to improve our top tier safety culture;
- Introduced SES fundamentals to further develop capabilities and drive continuous improvement;
- Developed IT roadmaps, to accelerate enabling technology and software deployment;
- Launched SES training academy.

We deployed best practice sharing via SES cross-divisional projects, such as:

- Production – established six Model Value Streams, to showcase best practices and pilot collaborative robots (CoBots), additive manufacturing and augmented reality technology applications;
- Supply – launched transformation projects to improve operational planning and inventory optimisation.

We have introduced Stock Turns and Aftermarket revenue as a percentage of total revenue as Group KPIs.

Priorities for FY2019

Safety and zero-harm remains our number one focus

Continue to drive Group-wide capability development and continuous improvement

Implement IT roadmaps

Expand SES projects to accelerate associated business performance benefits through best practices

CREATE A CULTURE OF INNOVATION

Progress in FY2018

i³ is driving the innovation agenda, and participated in the funding and development of key projects.

We opened our first Digital Forge in the San Francisco Bay area with a team of technologists, who have capabilities in AI and machine learning, digital signal processing, web software development, DevOps, cyber security, user interfaces, and software architecture.

Forge and divisional collaborations include:

- John Crane's Sense™
- Smiths Medical's large volume pump
- Smiths Detection's CORSYS™
- Smiths Interconnect's Integrated Data Terminal

We have added Vitality Index as a new KPI. This measures revenue from products launched in the last three years as a percentage of total revenue.

Priorities for FY2019

Increase our Vitality Index with new revenue streams, product lines and capabilities

Translate our future scenario planning into near-term products and services

Drive the culture of innovation deeper into the organisation

Expand our strategic partner network to help accelerate our innovation and commercialisation

OUR STRATEGY CONTINUED

2 DELIVER WORLD-CLASS COMPETITIVENESS CONTINUED

BUILD A LEARNING ORGANISATION

Progress in FY2018

Continued to embed our values, strategy and operating model across Smiths to support a unified Group.

Progressed our people plan to improve attraction, retention, development and engagement of employees.

Evolved our senior leadership programme with our partner UCLA.

Progressed our early career talent strategy.

Increased our focus on diversity and inclusion at all levels.

Held the first Smiths Day which celebrated The Smiths Way across our locations globally.

Priorities for FY2019

Progress our people plan and diversity and inclusion strategy through a wide set of initiatives

Launch our enhanced Leadership programme

Globalise our finance graduate programme and launch our engineering graduate programme

3 STRONG FINANCIAL FRAMEWORK

Our financial framework underpins the delivery of our strategy and value creation by optimising cash generation and allocating capital to the best value creation opportunities. Our governance framework is supported by robust risk management and strong financial control to help maintain our investment-grade credit rating.

DELIVER PROFITABLE GROWTH WITH SUSTAINABLE MARGINS

Progress in FY2018

Returned to organic growth for the first time since 2013 with underlying revenue growth of +2%.

Margin up 10bps compared to FY2017 on an underlying[1] basis.

FOCUS THE PORTFOLIO ON SUSTAINABLY COMPETITIVE AND ASSET-LIGHT BUSINESSES

Progress in FY2018

Further focused the portfolio with two acquisitions and one disposal.

Strong cash generation and conversion has enabled further investment and value creation.

APPLY STRONG FINANCIAL DISCIPLINE TO THE WAY WE MANAGE THE BUSINESS AND INVEST

Progress in FY2018

New R&D stage gate process has strengthened capital allocation decisions.

Further strengthened the balance sheet with net debt/headline EBITDA at 1.4x.

Maintained an investment-grade credit rating.

1 **Underlying:** modifies headline performance to: adjust prior year to reflect an equivalent period of ownership for divested businesses; include restructuring and pension administration costs as headline for both years; and exclude the effects of foreign exchange, acquisitions and supplemental sales for divested businesses. See the presentation of results note on p129 for further details.

KEY PERFORMANCE INDICATORS

Our KPIs are aligned with our strategic objectives. Progress against them is monitored by our management processes and they drive our executive remuneration policy.

OPERATIONAL PERFORMANCE

KPI	Performance		Ambition	Strategic objective
PORTFOLIO STRENGTH	FY2018	~80%	85%+ revenue from top 3 positions in attractive markets	1
	FY2017	~75%		
	FY2016	~60%		
R&D CASH COSTS AS % SALES	FY2018	4.6%	5.0-6.0%	1
	FY2017	4.6%		
	FY2016	4.0%		
VITALITY INDEX* NEW KPI	FY2018	13%	~20%	1 & 2
STOCK TURNS NEW KPI	FY2018	3.7x	~6.0x	2
	FY2017	3.5x		
	FY2016	3.2x		
AFTERMARKET % NEW KPI	FY2018	57%	60%+	1
	FY2017	55%		
	FY2016	53%		
EMPLOYEE ENGAGEMENT	FY2018	73%		2
	FY2017	71%		

FINANCIAL PERFORMANCE

KPI	Performance		Ambition	Strategic objective
UNDERLYING REVENUE GROWTH	FY2018	2%	Outperform our chosen markets	1
	FY2017	(1)%		
	FY2016	(2)%		
% Revenue from higher-growth regions	FY2018	17%		1
	FY2017	16%		
	FY2016	16%		
OPERATING MARGIN	FY2018	16.9%	18-20%	2 & 3
	FY2017	18.0%		
	FY2016	17.3%		
Cost of poor quality	FY2018	1.7%		2
	FY2017	2.1%		
Procurement savings	FY2018	£44m		2
	FY2017	£42m		
ROCE	FY2018	14.6%	16-18% through the cycle	2 & 3
	FY2017	16.2%		
	FY2016	15.3%		
WORKING CAPITAL % SALES**	FY2018	26%	~20%	2
	FY2017	27%		
CASH CONVERSION*	FY2018	99%	100%+	2 & 3
	FY2017	118%		
	FY2016	102%		

* See pages 02 and 03 for definitions.

** Working capital as a percentage of sales is calculated as the 12-month rolling average of inventory, trade receivables and associated provisions, unbilled receivables, trade payables and deferred revenue as a percentage of total annual sales.

CHIEF FINANCIAL OFFICER'S REVIEW

FY2018 PERFORMANCE REVIEW

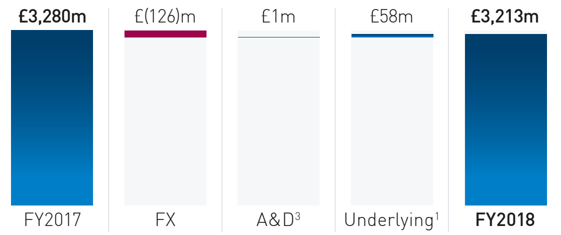
Revenue

The Group returned to growth, with underlying[1] revenue up 2%. This marked an important milestone on our journey to deliver sustained outperformance. Reported revenue of £3,213m (FY2017: £3,280m) was down (2)% primarily due to £(126)m of adverse foreign exchange translation. Underlying[1] revenue was up 2%, or £58m. Growth in John Crane, Flex-Tek and Smiths Detection was partially offset by the performance in Smiths Medical and Smiths Interconnect. Second half growth was 5%, reflecting an improving trend over the year.

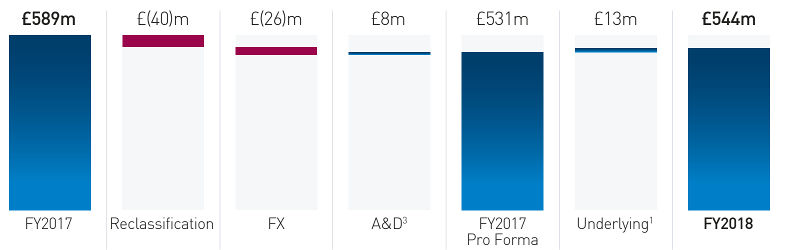
Operating profit

On a reported basis, headline operating profit of £544m (FY2017: £589m) was down (8)%. After adjustment for £(40)m of restructuring and pension administration costs (reported as non-headline in FY2017), £(26)m of adverse foreign exchange translation and an £8m net impact from acquisitions and disposals, headline operating profit was up 3% on an underlying[1] basis. This was driven by good underlying[1] headline operating profit growth in Smiths Detection, John Crane and Flex-Tek, partially offset by the disruptions in Smiths Medical. Central costs decreased by £5m on an underlying[1] basis to £(57)m, but included increased investment in innovation to support sustainable growth.

REVENUE



OPERATING PROFIT[2]



Operating profit on a statutory basis, after taking account of the items excluded from the headline figures, was £494m (FY2017: £674m) – see note 3 to the accounts for information on the excluded items. Non-headline charges of £(50)m reflect the change in reporting of restructuring costs and pension administration costs as headline items (FY2017: £(33)m restructuring costs and £(7)m operating charge for pension administration were classified as non-headline items) and the £175m profit on disposal of businesses generated in FY2017.

1 **Underlying:** modifies headline performance to: adjust prior year to reflect an equivalent period of ownership for divested businesses; include restructuring and pension administration costs as headline for both years; and exclude the effects of foreign exchange, acquisitions and supplemental sales for divested businesses. See the presentation of results note on p129 for further details.

2 **Headline:** definitions of headline metrics, and information about adjustments to statutory measures are provided in note 3 to the financial statements.

3 Includes disposals and FY2018 performance from acquisitions that do not have comparators for the prior year.

Margin

Headline operating margin increased 10bps to 16.9% on an underlying[1] basis. This improvement was driven by continued focus on operational excellence, as well as volume growth and Morpho cost synergies, partially offset by the disruptions in Smiths Medical. On a reported basis headline operating margin decreased (110)bps.

Finance costs

Headline finance costs of £(57)m (FY2017: £(61)m) were £4m lower driven by the repayment of higher coupon debt. Statutory finance costs were £(59)m (FY2017: £(73)m).

Tax

The principles of the Group's approach to taxation remain unchanged. The Group seeks to manage the cost of taxation in a responsible manner to enhance its competitive position on a global basis while managing its relationships with tax authorities on the basis of full disclosure, co-operation and legal compliance. The headline tax charge for the year of £126m (FY2017: £140m) represents an effective rate of 25.8% (FY2017: 26.5%). This was impacted by the new US tax legislation, where 44% of our revenue originates. The statutory tax rate of 35.9% includes one-time costs associated with US tax reform.

An effective tax rate of c.25% is expected for the year ending 31 July 2019.

The forecast has been updated to recognise the impacts of a shift in profit mix and non-deductibles.

Total profit and earnings per share

Total statutory profit for the year of £279m and EPS of 70.0p was down 51% on a reported basis, impacted by the non-headline items; but on an underlying[1] basis EPS was up 4%.

R&D

The Group's investment in R&D was maintained with R&D cash costs at 4.6% of sales or £147m (FY2017: 4.6% or £150m).

R&D income statement costs increased to £131m (FY2017: £125m), an underlying[1] increase of 8%. In FY2018, we reported our Vitality Index of 13% for the first time. It measures the revenue from new products launched in the past three years as a percentage of total revenue.

Net capex, Depreciation & Amortisation

Net capex at £102m (FY2017: £98m) represented 1.1x depreciation and amortisation, broadly in line with last year (FY2017: 1.0x).

Working capital

Movement in working capital was an outflow of £(16)m (FY2017: £85m inflow), reflecting higher receivables following strong growth in the latter part of the year as well as higher inventory to support the return to growth. Working capital as a percentage of sales improved to 26% (FY2017: 27%).

Operating cash

Cash conversion was good at 99% (FY2017: 118%) translating into headline operating cash-flow of £538m (FY2017: £695m). Statutory operating cash was £405m (FY2017: £479m). See note 29 to the financial statements for a reconciliation of headline operating cash to statutory cash-flow measures.

Pension

The net accounting pension position has improved to a surplus of £381m (FY2017: £224m). The Group continues to work with the Trustees to de-risk the pension schemes. In August 2017, the Smiths Industries Pension Scheme (SIPS) entered a £207m buy-in with Canada Life, and in December 2017 the US scheme paid $36m to members who opted to take lump sums in lieu of pension.

In FY2017, formal valuations of the Group's principal UK defined benefit schemes were undertaken one year ahead of the triennial deadline and concluded in June 2018. The updated valuations showed that SIPS had a surplus of £32m and the TI Group Pension Scheme had a £35m deficit on a funding basis. The Company has agreed to continue funding these schemes with total annual contributions of £24m (FY2017: £27m). For FY2019, we expect total cash contributions of up to £45m across all schemes (FY2018: £49m).

	Accounting valuation		Cash contribution	
	FY2018	FY2017	Going forward	FY2018
SIPS scheme	£303m	£213m	£12m	£24m
TI scheme	£223m	£177m	£12m	£3m
Total UK schemes	£526m	£390m	£24m	£27m
Total Group	**£381m**	**£224m**	**c.£45m**	**£49m**

CHIEF FINANCIAL OFFICER'S REVIEW CONTINUED

Acquisitions and disposals

During the year, the Group acquired two businesses and made one disposal. For more information, please read notes 26, 27 and 28 of the accounts.

- On 1 November 2017, Flex-Tek acquired the heating element division of Osram Sylvania Inc. for £15m.
- On 31 May 2018, John Crane disposed of its Bearings business for $35m.
- On 13 June 2018, John Crane acquired from Seebach GmbH a highly technological filtration business for €60m.

Litigation

Smiths Group faces different types of litigation in different jurisdictions. Please see below an update on the two litigation provisions. For more information, please refer to note 22 of the accounts.

John Crane, Inc. litigation

John Crane, Inc. (JCI), a subsidiary of the Group, continues to actively monitor the conduct and effect of its current and expected asbestos litigation, including the effective presentation of its 'safe product' defence, and intends to resist these asbestos cases based on this defence. Approximately 277,000 claims against JCI have been dismissed before trial over the last 39 years. JCI is currently a defendant in cases involving approximately 43,000 claims. Despite these large numbers of claims, since the inception of litigation JCI has had final judgments against it in 140 cases, and has had to pay awards amounting to approximately $164m.

At 31 July 2018, the aggregate provision for JCI asbestos litigation, including for adverse judgments and defence costs, amounted to £223m (2017: £237m) expressed at the then current exchange rate. In deciding upon the amount of the provision, JCI has relied on independent expert advice from a specialist.

Titeflex Corporation litigation

Titeflex Corporation, a subsidiary of the Group in the Flex-Tek division, has received a number of claims in recent years from insurance companies seeking recompense on a subrogated basis for the effects of damage allegedly caused by its flexible gas piping products being energised by lightning strikes. It has also received a number of product liability claims relating to 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.

At 31 July 2018, provision of £78m (FY2017: £84m) has been made for the costs which the Group expects to incur in respect of these claims.

For both litigation provisions, because of the significant uncertainty associated with the future level of claims and of the costs arising out of the related litigation, there is no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred.

Free cash flow

Free cash flow of £302m (FY2017: £370m) decreased by (18)% reflecting the £157m decrease in headline operating cash-flow, offset by lower pension contributions and tax payments. See note 29 to the accounts for further details.

Dividend

The Board has a progressive dividend policy, aiming to increase dividends in line with long-term underlying growth in earnings and cash-flow. This policy enables us to retain sufficient cash-flow to finance investment in the drivers of growth and meet our financial obligations. In setting the level of dividend payments, the Board takes into account prevailing economic conditions and future investment plans, along with the objective to maintain minimum dividend cover of around 2.0x.

The Board is recommending a final dividend of 30.75p per share (FY2017: 29.70p per share), to be paid on 16 November 2018 to shareholders on the register at close of business on 19 October 2018. This will bring the total dividend for the year to 44.55p per share (FY2017: 43.25p per share), a year-on-year increase of 3%.

Dividends paid in the year on ordinary shares amounted to £172m (FY2017: £167m), which were covered by the Group's free cash-flow generation.

Debt

Net debt at 31 July 2018 was £893m, a reduction of £74m in the period. Net debt to EBITDA remained unchanged at 1.4x. Gross debt was £1,610m (FY2017: £1,749m) and cash reserves were £717m (FY2017: £782m). Of the gross debt, £203m fell due within one year; the majority was repaid in September 2018 when the Group redeemed $250m 7.2% Notes. Our strong balance sheet continues to allow us to deploy significant further investment capacity to support sustainable growth.

The maturity profile of the major tranches of the debt in issue is as follows:

2019 – £190m ($250m 7.20% bond), which was repaid early in September 2018

2022 – £298m ($400m 3.625% bond)

2023 – £533m (€600m 1.25% bond)

2027 – £575m (€650m 2.00% bond)

Return on capital employed

ROCE declined (160)bps to 14.6% (FY2017: 16.2%) primarily due to the reclassification of restructuring and pension administration costs as headline items. The ROCE movement also reflects recent investments, such as the acquisition of Morpho Detection, which are expected to generate superior returns over the longer-term.

Accounting policies and recent accounting developments

The accounts in this report are prepared under IFRS, as adopted by the European Union (EU). The accounting policies used in preparing these accounts are set out on pages 127 to 133.

A number of new standards and amendments to standards and interpretations have been issued but are not yet effective for the current accounting period. None of these are expected to have a material impact on the consolidated financial statements of the Group. For further details, please refer to page 133. Certain standards which could be expected to have an impact are outlined below.

IFRS 9: Financial instruments – the changes will not have a quantitative impact on the financial statements. An expected credit loss will need to be recognised on all financial assets held at amortised costs as well as qualitative enhancements to the interest rate and foreign currency risk management disclosures.

IFRS 15: Revenue from contracts with customers – a reasonable estimate of the expected impact on the reported results for FY2018: a £(16)m reduction in revenue, no impact on operating profit and a £(1)m reduction in net assets.

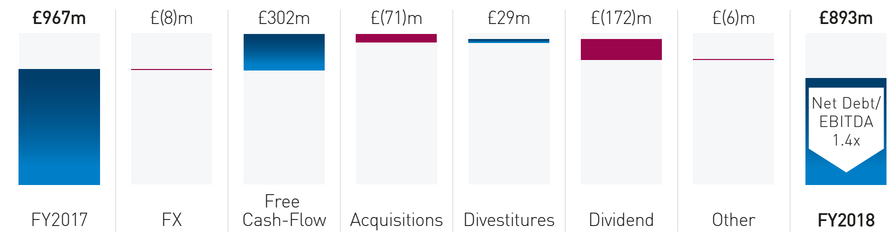
IFRS 16: Leases – the standard now requires all material lease liabilities and corresponding 'right of use' assets to be recognised on the balance sheet.

NET DEBT BRIDGE

5.5 years
Weighted average debt maturity

3.7%
Weighted average interest rate

BBB+/Baa2
Stable credit rating



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.

EXCHANGE RATES

	Average rates			Period-end rates		
	31 July 2018	31 July 2017		**31 July 2018**	31 July 2017	
USD	**1.35**	1.27	USD weakened by 6%	**1.31**	1.32	USD strengthened by 1%
EUR	**1.13**	1.16	EUR strengthened by 3%	**1.12**	1.12	EUR unchanged

JOHN SHIPSEY
CHIEF FINANCIAL OFFICER

DIVISIONAL REVIEW

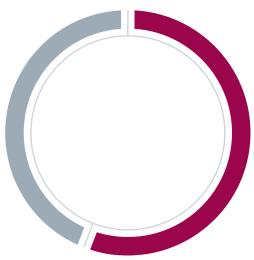
JOHN CRANE

Mission-critical solutions for global energy and process industries

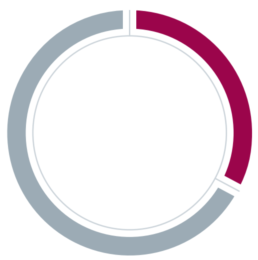
FY2018 PERFORMANCE

Revenue	Headline operating profit	Headline operating margin
£881m	£202m	22.9%
+5%[1]	+6%[1]	

REVENUE BY SECTOR



REVENUE MIX



COMPETITIVE STRENGTHS

- A global leader in flow control for rotating equipment
- Strong proprietary technology and expertise in applied engineering
- Broad installed base in Oil & Gas and Non-Oil & Gas
- Strong aftermarket service offering with c.200 sales and service centres
- Long-term customer relationships

GROWTH DRIVERS

- Oil & gas markets recovering driven by underlying energy demand
- Expansion in high growth markets
- Pent-up demand for maintenance and upgrades in oil & gas and petrochemical
- Need for operation improvements in non-oil & gas industries
- Disruptive innovations including materials science advancements and digital transformation

CUSTOMERS

We serve process industries including oil & gas, pharmaceutical, chemical, petrochemical, power generation, mining, water treatment, and pulp & paper, as well as pump and turbo machinery original equipment manufacturers (OEMs). Our customers include Chevron, International Paper, ExxonMobil, Shell, BASF, Sulzer, GE, Solar and Siemens.

PRINCIPAL OPERATING REGIONS

We have operations in more than 50 countries, including around 200 sales and service centres.

SUPPLIERS

We align purchasing across our global supply chain with regional procurement. Direct sourcing includes metals, ceramics, and advanced materials and parts.

COMPETITORS

Our main competitors are Flowserve and Eagle Burgmann (seals and systems), Danaher and Hydac (filtration), and Rexnord (couplings).

1 **Underlying:** modifies headline performance to: adjust prior year to reflect an equivalent period of ownership for divested businesses; include restructuring and pension administration costs as headline for both years; and exclude the effects of foreign exchange, acquisitions and supplemental sales for divested businesses. See the presentation of results note on p129 for further details.

MARKETS AND TRENDS

We combine technology leadership with proven field experience, helping to optimise customers' manufacturing operations.

Our comprehensive product portfolio includes mechanical seals, seal support systems, power transmission couplings and specialised filtration systems. These engineered solutions drive reliability improvements in customer operations.

Our large installed base – built over the last century across several vertical markets – drives significant aftermarket demand. We have one of the largest global sales and service networks ensuring proximity to customers and rapid service. These centres provide a range of services, including repair and refurbishment, upgrades and retrofits, root cause analysis, and alignment and condition monitoring to improve equipment performance and reduce operational downtime.

Our primary vertical market – oil & gas – has experienced the most severe market downturn in the last 30 years. Major oil & gas producers remain cautious around capital expenditures in the face of low and volatile commodity prices, although we have seen improving market sentiment and expect a gradual recovery over the next few years. In particular, customers are investing in growing areas such as liquified natural gas and pipelines, and we have recently seen increased aftermarket activity in the form of demand for ongoing maintenance and upgrades.

We believe mega trends, such as the global demand for energy, higher productivity and more stringent environmental and safety requirements, will continue to generate demand for our products over the longer term.

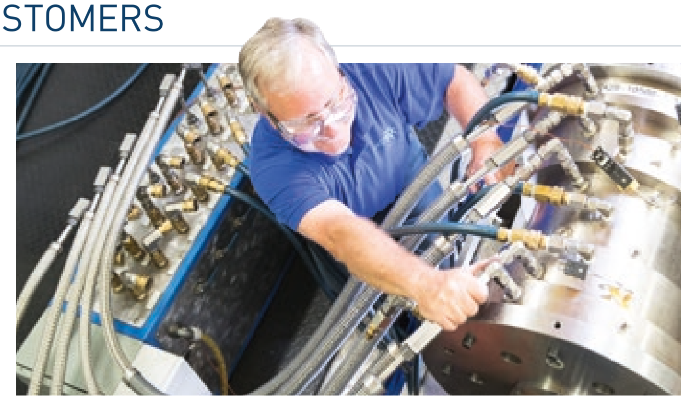
We also have a significant and growing presence in other process industries (around 44% of revenue), including pharmaceutical, chemical, power generation, mining, water treatment, and pulp & paper. We expect these verticals will continue to grow in the near term, helped by building demand in higher-growth regions. Although global industrial production forecasts remain cautious due to an uncertain macro-environment, drivers such as improved plant productivity, workforce safety and equipment reliability will continue to create growth opportunities over the medium to long term.

Around 67% of our sales stem from the aftermarket servicing and support of existing installed equipment, which has proven resilient. We continue to expand our footprint through opening new service centres in selected higher-growth markets, as well as the best in class field service teams.

GOING ABOVE AND BEYOND FOR OUR CUSTOMERS

RESPONDING TO HURRICANE HARVEY

After the devastation of Hurricane Harvey in Texas, John Crane worked around the clock to help return a petrochemical customer's major polyethylene facility to full operation. Working in an extremely challenging environment replacing and repairing over 300 items, including our wet and dry gas seals, the plants returned to full capacity safely and ahead of schedule, reducing downtime and lost revenue.



DIVISIONAL REVIEW CONTINUED

JOHN CRANE
CONTINUED

STRATEGY

Our strategy is to reinforce our global leadership in technologies and services for rotating equipment, with a competitively differentiated offering that will deliver above-market, long-term growth in the most attractive process industries.

We will maintain differentiation by investing in product development, broadening our aftermarket value proposition, delivering operational excellence (with a particular focus on safety and quality), and accelerating growth through bolt-on acquisitions. We will also continue to diversify into non-oil & gas segments and higher-growth regions.

PROGRESS IN FY2018

- Continued success in penetrating non-oil & gas sectors, particularly in chemical, pharmaceutical, mining, pulp & paper and general industry
- Further progress in our continuous improvement and lean manufacturing journey to reduce waste and increase productivity
- Product development for various markets including the launch of a new pipeline seal, a new single use seal, a new line of competitive filtration elements and continued expansion of the Aura™ dry gas seal product range
- Continued investment in digital transformation technology for John Crane Sense™
- Co-branding and development of a pump/seal performance management system with a customer
- Acquisition of Seebach GmbH to complement John Crane's existing filtration business, further enhancing its technology leadership in energy applications, and providing innovative solutions and capabilities to grow into mission-critical chemical and process industries
- Successful divestment of our Bearings business

PRIORITIES FOR FY2019

- Continue expansion in selected process industries
- Develop and launch new products and expand more into innovative digital technologies
- Enhance productivity and cost competitiveness throughout the supply chain
- Maximise aftermarket performance and expand our service offering
- Build out selected high-growth markets
- Successful integration of Seebach GmbH
- Expand manufacturing network capacity to serve our growing markets

DID YOU KNOW...

Since John Crane launched its innovative dry gas seal technology, we've helped to prevent millions of tonnes of methane from being vented to the atmosphere, helping to protect our environment and saving our customers money.

FY2018 FINANCIAL PERFORMANCE

	FY2018	FY2017	Underlying[1] change	Reported change
Revenue	£881m	£885m	+5%	Flat
Headline operating profit[2]	£202m	£204m	+6%	(1)%
Headline operating margin[2]	22.9%	23.0%	+10bps	(10)bps
Statutory operating profit	£199m	£190m		+5%
Return on capital employed	22.9%	22.9%		Flat
R&D % of revenue	1.3%	1.1%		+20bps

PERFORMANCE

John Crane delivered a good performance, returning to growth with revenue up 5% on an underlying[1] basis. Reported revenue was flat, reflecting £(31)m of adverse foreign exchange translation and a £(16)m net impact from the disposals of Artificial Lift and the Bearings business, and the acquisition of Seebach GmbH.

Underlying[1] sales from John Crane's Oil & Gas and Non-Oil & Gas activities were up c.7% and c.3% respectively, reflecting the improving trend in global energy markets and continued growth in John Crane's chemical, pharma, mining and pulp & paper activities. These market conditions were also reflected in improving underlying[1] sales of Original Equipment ('OE'), which were up 1%. Investment in OE projects and the expansion of the installed base continued during the period. Multiple new project agreements were secured, including contracts in Oil & Gas in Asia and the Middle East, as well as marine, chemical and pulp & paper contracts in the USA, Europe and Asia. John Crane's large installed base and leading service offering positioned it well to satisfy pent-up aftermarket demand for repairs, maintenance and upgrades; underlying[1] aftermarket revenue grew 8% during the period.

Revenue from higher-growth regions, which represent 25% of sales, grew 14% on an underlying[1] basis with strong sales growth in China.

Headline operating profit of £202m increased 6% on an underlying[1] basis, driven by improved volumes. Headline operating profit margin was 22.9%, up 10bps on an underlying[1] basis with the positive impact of volume growth partially offset by geographic mix and the costs of restarting capacity. The difference between statutory and headline operating profit primarily reflects movement in the provision for John Crane, Inc. asbestos litigation, offset by gains on disposals.

ROCE was flat at 22.9% driven by the net impact of the two disposals, one acquisition and increased profitability.

John Crane has made further progress on focusing the business on leading positions in attractive markets. In May 2018, John Crane sold its Bearings business for an enterprise value of $35m, and in June 2018 completed the acquisition of Seebach GmbH, a highly engineered filtration solutions business, for an enterprise value of €60m. We continue to look for opportunities to enhance John Crane's technology leadership and service offering.

RESEARCH AND DEVELOPMENT

Cash R&D expenditure during the period increased by 15% to 1.3% of sales (FY2017: 1.1%). Product developments included:

- A new dry gas seal in the Aura™ range which reduces methane emissions
- An advanced seal for crude oil pipeline pumps which supports pump efficiency and tolerance of harsh operating environments
- An innovative filtration design tool to enhance performance
- Continued development of John Crane's Sense™ predictive diagnostics systems

1 **Underlying:** modifies headline performance to: adjust prior year to reflect an equivalent period of ownership for divested businesses; include restructuring and pension administration costs as headline for both years; and exclude the effects of foreign exchange, acquisitions and supplemental sales for divested businesses. See the presentation of results note on p129 for further details.

2 **Headline:** definitions of headline metrics, and information about adjustments to statutory measures are provided in Note 3 to the financial statements.

DIVISIONAL REVIEW CONTINUED

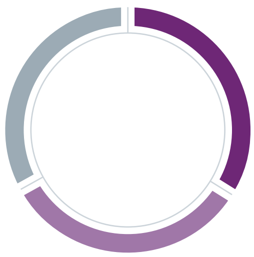
SMITHS MEDICAL

High-quality, cost-effective medical devices and consumables that are vital to patient care globally

FY2018 PERFORMANCE

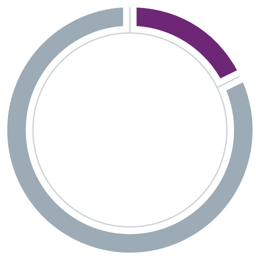
Revenue	Headline operating profit	Headline operating margin
£885m	£156m	17.6%
(2)%[1]	(14)%[1]	

REVENUE BY SECTOR



Infusion Systems	34%
Vascular Access	33%
Vital Care and Specialty Products	33%

REVENUE MIX



Original equipment	18%
Aftermarket/consumables	82%

CUSTOMERS

80% of our revenue is derived from hospitals while the remainder comes from clinics, homecare providers, surgery centres and products sold to other original equipment manufacturers (OEMs).

PRINCIPAL OPERATING REGIONS

We sell our products in over 120 countries, with operations in over 30.

SUPPLIERS

Assured supply of quality products is critical in the industry. We work with our supply chain to reduce costs, drive efficiencies, and ensure high quality standards and continuity of supply.

COMPETITORS

Our competitors range from large multi-national medical device manufacturers such as Medtronic, Becton Dickinson, Baxter and B. Braun, through to small, single-product companies.

COMPETITIVE STRENGTHS

- A category leader in our chosen markets
- Trusted brands with a reputation for quality and safety
- Strong, defensible intellectual property
- c.80% of revenue from single-use devices and proprietary consumables
- Strong customer relationships and extensive global sales network

GROWTH DRIVERS

- Ageing populations with increasing personalised healthcare and patient expectation/quality of life
- Increasing incidence of chronic diseases
- Increasing need for connected systems and data analytics
- Growth of alternate site and home-based healthcare
- Growing healthcare spend in developing markets

1 **Underlying:** modifies headline performance to: adjust prior year to reflect an equivalent period of ownership for divested businesses; include restructuring and pension administration costs as headline for both years; and exclude the effects of foreign exchange, acquisitions and supplemental sales for divested businesses. See the presentation of results note on p129 for further details.

MARKETS AND TRENDS

The medical device industry remains attractive, with strong growth drivers. The global market we serve is estimated to be £7.2bn and growing at 3-4% annually, with growth drivers such as expansion of developing markets, ageing populations, increasing need for connected systems and data analytics, and growth of alternate site and home-based healthcare and innovation.

Our Infusion Systems products deliver medication for treating conditions such as acute and chronic pain, cancer, pulmonary hypertension and Parkinson's disease, in hospital and home settings. We are one of the market leaders in ambulatory infusion and have strong positions in the syringe pump market. The increasing incidence of chronic conditions, and the continued advancement of digital connectivity between infusion devices, remote monitoring systems and hospital information systems, is expected to drive growth in this area over the longer term.

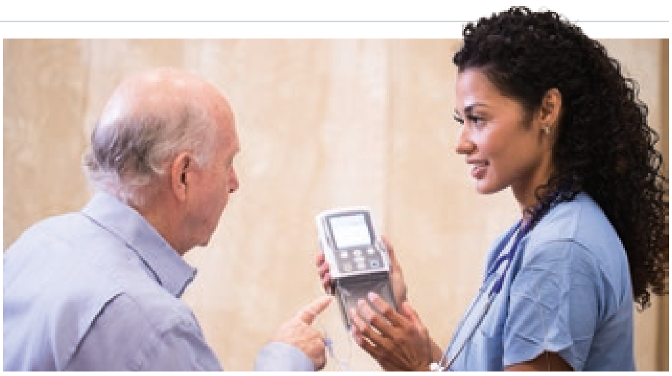
Our Vascular Access products protect healthcare workers and patients from the risk of infection. Our portfolio covers a range of functions, including drawing blood, catheters for the infusion of fluids and medication, injecting vaccinations, delivering chemotherapeutic agents and monitoring blood pressure for critically ill patients. Continued growth in the Vascular Access market is expected as safety regulations drive the use of safety-engineered syringes and catheters to protect healthcare workers from needlestick injuries and blood exposure, while reducing hospital-acquired infections for patients. These are growth drivers we are well positioned to serve.

Our Vital Care products help to manage patient airways before, during and after surgery, alleviating breathing difficulties, improving bronchial hygiene and helping maintain body temperature. Key growth drivers for these therapies include the expansion of enhanced recovery after surgery (ERAS) and the prevalence of chronic obstructive pulmonary disease (COPD).

KEEPING PATIENTS ON THE MOVE

CONNECTING HOSPITALS AND PATIENTS

Smiths Medical's CADD®-Solis wireless infusion pump delivers pain medication to patients while allowing them to remain mobile. Integrated with PharmGuard® Infusion Management software, this innovative platform supports coordinated wireless updates to drug libraries and software, increasing efficiency for our healthcare customers who no longer need to update pumps individually – and allows sharing of infusion information with patients' electronic medical records.



DIVISIONAL REVIEW CONTINUED

SMITHS MEDICAL CONTINUED

STRATEGY

Our objective is to achieve category leadership in the Infusion Systems segment and in selected Vascular Access and Vital Care segments. We will build on our reputation for high-quality, innovative solutions, creating a portfolio of leading, effective and valued total solutions and services that drive sustained competitiveness and above-market growth in our chosen segments.

We will achieve this primarily through a pipeline of innovative organic developments, including investment in product development, manufacturing and supply chain optimisation, and efficiency gains in marketing and distribution models.

We will also continue to drive progress in higher-growth regions and new channels to market outside the hospital.

PROGRESS IN FY2018

- Over 20 new products launched across all three segments
- Expanded presence in higher-growth regions
- Expanded US distribution for non-hospital-based Infusion Systems

PRIORITIES FOR FY2019

- Continue the introduction of organically developed new products, to support core-market category leadership
- Enter higher-growth, adjacent categories
- Expand distribution and sales within non-acute and homecare channels
- Increase penetration in higher-growth economies
- Accelerate category scale and competitiveness
- Continued focus on improving operational efficiency

DID YOU KNOW...

The new Neoheel™ Safety Lancet, used to collect quality blood samples from infants and toddlers, is designed to require fewer heel puncture sites. The result is less time to complete the test, less bruising and, importantly, less crying.

FY2018 FINANCIAL PERFORMANCE

	FY2018	FY2017	Underlying[1] change	Reported change
Revenue	£885m	£951m	(2)%	(7)%
Headline operating profit[2]	£156m	£209m	(14)%	(26)%
Headline operating margin[2]	17.6%	22.0%	(250)bps	(440)bps
Statutory operating profit	£152m	£286m		(47)%
Return on capital employed	13.1%	16.7%		(360)bps
R&D % of revenue	5.8%	6.4%		(60)bps

PERFORMANCE

Smiths Medical underlying[1] revenue was down (2)%. The division's performance was impacted by the transition to a new Notified Body for European Conformity registration. This led to a short-term suspension of some Smiths Medical products in Europe. This disruption and the loss of two contracts in the US offset good underlying[1] growth that was underpinned by a growing contribution from products launched during the year. Reported revenue fell (7)%, reflecting £(37)m of adverse foreign exchange translation and the £(11)m impact of the divestment of the Wallace product line in November 2016.

Costs associated with the Notified Body transition and implementation of the new EU Medical Device Regulation in 2020 are expected to be £10-15m in each of FY2019 and FY2020.

Underlying[1] revenue was up 4% in Infusion Systems driven by sales of ambulatory infusion disposables, partially offset by the impact of a contract termination. Vascular Access underlying[1] revenue declined by (4)% as a result of lower peripheral intravenous catheter ('PIVC') sales. Underlying[1] revenue from Vital Care and Specialty Products was down (6)%, with growth in tracheostomy and general anaesthesia offset by a contract termination.

Revenue from higher-growth regions, which represents 10% of sales, increased 10% on an underlying[1] basis, driven by growth in China and India.

Headline operating profit declined (14)% on an underlying[1] basis. This included adjustment for £(16)m restructuring costs in the prior year. In addition, there were higher R&D costs associated with new product launches, and costs of transition to a new Notified Body in Europe. As a result, headline operating margin was (250)bps lower than the prior year on an underlying[1] basis at 17.6%. The difference between statutory and headline operating profit included £(3)m of amortisation of acquired intangible assets.

ROCE decreased (360)bps to 13.1%, reflecting the lower profitability.

Post year end, Smiths Medical made further progress on focusing the business on scalable leading positions in its chosen markets, and agreed the sale of its sterile water bottling business to Amsino Healthcare (USA), Inc., for an enterprise value of $40m. The deal is expected to complete in the first half of FY2019.

RESEARCH AND DEVELOPMENT

Cash R&D expenditure was 5.8% of sales (FY2017: 6.4%) with an increase in the income statement R&D costs. Smiths Medical continues to invest in research and development to support long-term, sustainable growth, with the development of innovative, commercially focused products across the portfolio. Over 20 new products were launched during the year. These included:

- CADD™ VIP ambulatory pump for homecare and alternate sites
- Upgrades to the PharmGuard® server platform for connecting CADD Solis™ and Medfusion™ wireless pumps to hospital networks
- EchoGlo™ needle, an ultrasound-guidable needle line for targeted delivery of pain management medications in nerve block procedures
- Sol-M, blood-draw venipuncture safety devices designed to reduce the risk of infection and blood contamination
- A Closed System Catheter for the Chinese market that prevents blood exposure and reduces IV set-up time
- A next generation paediatric tracheostomy tube line that is MRI-safe and DEHP-free

1 **Underlying:** modifies headline performance to: adjust prior year to reflect an equivalent period of ownership for divested businesses; include restructuring and pension administration costs as headline for both years; and exclude the effects of foreign exchange, acquisitions and supplemental sales for divested businesses. See the presentation of results note on p129 for further details.

2 **Headline:** definitions of headline metrics, and information about adjustments to statutory measures are provided in Note 3 to the financial statements.

DIVISIONAL REVIEW CONTINUED

SMITHS DETECTION

A global leader in the detection and identification of security threats and contraband

FY2018 PERFORMANCE

Revenue	Headline operating profit	Headline operating margin
£793m	£134m	16.9%
+1%[1]	+16%[1]	

REVENUE BY SECTOR

Air Transportation	68%
Ports and Borders	7%
Defence	4%
Urban Security	21%

REVENUE MIX

Original equipment	56%
Aftermarket	44%

CUSTOMERS

Almost half of total revenue is influenced by c.100 governments and their agencies. Major customers include airports, cargo and freight forwarders, ports, customs authorities, prisons and the armed forces.

PRINCIPAL OPERATING REGIONS

We sell our products to around 150 countries and territories, with facilities in Germany, France, the UK, Malaysia, and the USA.

SUPPLIERS

We coordinate manufacturing and purchasing activity globally to achieve economies of scale and meet stringent quality and delivery standards.

COMPETITORS

We compete with a wide range of companies in each end-use market. Those with the broadest global reach include Nuctech, Rapiscan and L-3 SDS.

COMPETITIVE STRENGTHS

- A global market leader with differentiated technologies leveraged across a broad range of markets
- Significant R&D capability
- Operating in several regulated markets requiring product certification
- Increasing digitisation and aftermarket revenue
- Long-term customer relationships

GROWTH DRIVERS

- Persistent and evolving terror threats
- Changing security regulations for air cargo and passengers
- Growing urbanisation and the need to protect people and assets
- Global trade, e-commerce and passenger numbers
- Equipment replacement cycle, typically 7–10 years
- Growth of security infrastructure in emerging markets

1 **Underlying:** modifies headline performance to: adjust prior year to reflect an equivalent period of ownership for divested businesses; include restructuring and pension administration costs as headline for both years; and exclude the effects of foreign exchange, acquisitions and supplemental sales for divested businesses. See the presentation of results note on p129 for further details.

MARKETS AND TRENDS

Demand for detection equipment and service is forecast to continue to grow at mid-single digits per annum over the near term, driven by ongoing geopolitical unrest and the resulting terrorist and criminal threats, but there is considerable variation by geography and market segment.

Almost half of our customers are government-funded so budget constraints affect market revenues. Nevertheless, our growing installed equipment base creates significant opportunities for aftermarket (service and support) and digital revenues through the sale of software upgrades.

The heavily regulated air transportation segment is our largest market. Rising passenger volumes, together with continuing security threats, a strong replacement cycle and increasing air freight volumes are expected to continue to support market growth and new airport investment. Systems which integrate networked screening equipment with airport and passenger data are being used to improve the efficiency and effectiveness of the security process, and are expected to drive increased demand.

In the ports and borders market, the continued growth of world-wide trade volumes combined with increasing regulatory standards is expected to drive demand for security screening equipment and digital solutions. Powerful technologies are required to address a variety of threats as governments become increasingly concerned about the smuggling of explosives, weapons and radiological materials, while continuing to recognise the strong revenue-generating potential from contraband detection.

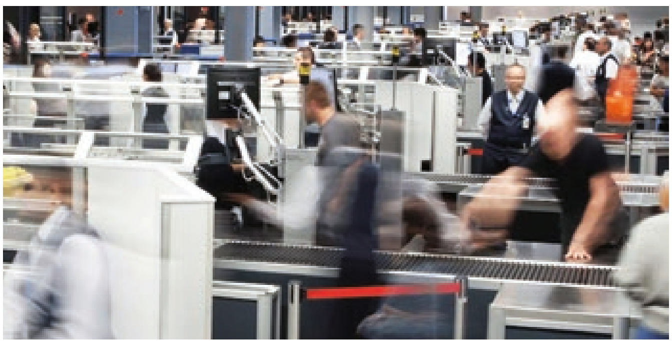
Global demand for chemical warfare agent detection equipment and other threat-specific sensors required by the military is forecast to grow steadily in our key NATO-oriented markets but is affected by the highly cyclical nature of the associated procurement cycles.

The urban security market is large but fragmented and unregulated. The major sub-segments of critical infrastructure, mass transit and crowded spaces, have specific customer needs and challenges. Demand in each is growing, driven by increasing urbanisation and the response by public and private sector organisations to a wide and ever-increasing range of threats, as they seek to provide better protection for their customers, staff and assets.

MAKING THE WORLD SAFER

IMPROVING SECURITY FOR TRAVELLERS

Helping reduce traveller frustration and improve throughput at security checks, as well as increasing efficiency for customers, Smiths Detection's HI-SCAN 6040 CTiX allows passengers to leave electronics and liquids in their bags. Rendering 3D images, the CTiX enables operators to examine scanned contents from every angle, giving more accurate data to aid security judgements.



DIVISIONAL REVIEW CONTINUED

SMITHS DETECTION CONTINUED

STRATEGY

We aim to equip our customers with high-integrity solutions that satisfy security needs in the context of an ever-evolving threat and regulatory environment, while meeting their broader commercial and operational requirements. Through technology-led investment, we also play an increasingly important role in future proofing our customers' business through digital transformation.

We continue to drive profitable revenues from aftermarket, digital products and software upgrades to extend machine life and counteract the volatility of prime contracting.

Operational improvements based on quality, waste elimination and reduced lead times are delivering savings, which are reinvested in the development of products and software solutions.

PROGRESS IN FY2018

- Integration of Morpho Detection on track
- Maintained strong share of installed base through the European Standard 3 hold baggage recapitalisation
- Uptake of integrated checkpoint solutions and CORSYS™ proceeding as planned
- Focused investment in key product initiatives: Air Transportation – both hold baggage and checkpoint; software upgrades; remote diagnostics; and Defence
- ECAC, TSA and CAAC certifications for key products
- Continuous improvement initiatives to implement lean standards, eliminate waste, improve flow and reduce working capital

PRIORITIES FOR FY2019

- Complete the integration of Morpho Detection
- Extend presence and capabilities in Ports and Borders and Urban Security market segments
- Refresh our go-to-market approach in key geographies – especially Asia
- Drive R&D investment behind key initiatives
- Deliver further growth in aftermarket and digital revenues
- Maintain focus on continuous improvement initiatives

DID YOU KNOW...

Our high-energy cargo inspection systems can 'see' through up to 410mm of steel, optimising security checks at ports and border crossings by screening whole trucks, containers and vehicles for threats and illegal contraband.

FY2018 FINANCIAL PERFORMANCE

	FY2018	FY2017	Underlying[1] change	Reported change
Revenue	£793m	£687m	+1%	+15%
Headline operating profit[2]	£134m	£103m	+16%	+30%
Headline operating margin[2]	16.9%	15.0%	+240bps	+190bps
Statutory operating profit	£93m	£70m		+33%
Return on capital employed	12.1%	12.6%		(50)bps
R&D % of revenue	7.4%	7.1%		+30bps

PERFORMANCE

Smiths Detection underlying[1] revenue increased by 1%. Second half underlying[1] growth of 11% reflected continued strong growth in Air Transportation enhanced by the phasing of contract deliveries. Full year growth was partially offset by declines in Ports & Borders and Defence. Overall aftermarket revenue grew by 1% on an underlying[1] basis and now accounts for 44% of total revenue (FY2017: 39%). On a reported basis, revenue increased by 15%; this included £124m of incremental revenue associated with the acquisition of Morpho Detection ('Morpho'), and £(22)m of adverse foreign exchange translation.

Revenue in Air Transportation increased 20% on an underlying[1] basis. Air Transportation is Smiths Detection's largest segment and, following the acquisition of Morpho, now represents 68% of total revenue. During the period there was strong growth in EMEA as a result of deliveries associated with the ECAC Standard 3 Regulation for hold baggage. Major deliveries included projects in the UK, Frankfurt and Amsterdam, as well as in the US and Saudi Arabia. Contract wins included: providing Helsinki Airport with eight XCT units to upgrade its hold baggage system; a $70m contract with the TSA for hold baggage systems across the USA, and a contract to sell 151 trace detection devices across airports in China. Revenue from Ports & Borders fell (43)% on an underlying[1] basis following the completion of key programmes in Italy, Mali and Kuwait last year. Contract wins included an order for CORSYS™ by the Port of Rotterdam. Underlying[1] revenue in Defence decreased by (46)% against last year's strong comparator and reflects the wind down of some major US military programmes. Urban Security revenues increased 3% on an underlying[1] basis, driven by growing sales of hand-held devices to detect and identify nuclear-threats to the US Department for Homeland Security.

Revenue from higher-growth regions represented 19% of sales, broadly in line with the prior year on an underlying[1] basis. Good sales growth in India was offset by the completion of projects in South Korea, Pakistan and Turkey. We continue to experience pricing pressure in some end-use markets, and in unregulated parts of the market from lower-priced competitors.

Headline operating profit increased 16% on an underlying[1] basis, reflecting volume growth and the delivery of cost synergies associated with the Morpho acquisition. Headline reported operating margin increased by 240bps on an underlying[1] basis to 16.9%, reflecting these cost synergies as well as other efficiency savings and the benefit of one-off items associated with long-term programmes. The difference between statutory and headline operating profit primarily reflects integration costs associated with the acquisition of Morpho and amortisation of acquired intangibles. The integration of Morpho continues to progress well, with the benefits of the combination supporting new contract wins, including a $50m contract with Airports Authority of India. The $30m of annualised cost synergies are now expected to be delivered in full by the end of FY2019, one year ahead of schedule.

ROCE decreased (50)bps to 12.1% driven by the impact of the Morpho acquisition.

RESEARCH AND DEVELOPMENT

Cash R&D expenditure during the period was 7.4% of sales, or 6.3% excluding customer funded R&D (FY2017: 7.1% and 6.0% respectively). Specific highlights included continued investment in:

- A range of solutions for the Chinese aviation market
- Freight and cargo scanners that can now detect lithium batteries
- Next generation chemical warfare agent detection devices for the defence market
- Digital solutions – including CORAL, our advanced predictive analytics suite for hold baggage detection systems and Checkpoint.evo^plus, our integrated checkpoint screening and management platform

1 **Underlying:** modifies headline performance to: adjust prior year to reflect an equivalent period of ownership for divested businesses; include restructuring and pension administration costs as headline for both years; and exclude the effects of foreign exchange, acquisitions and supplemental sales for divested businesses. See the presentation of results note on p129 for further details.

2 **Headline:** definitions of headline metrics, and information about adjustments to statutory measures are provided in Note 3 to the financial statements.

DIVISIONAL REVIEW CONTINUED

SMITHS INTERCONNECT

Solutions for high-speed, secure connectivity in demanding applications

FY2018 PERFORMANCE

Revenue	Headline operating profit	Headline operating margin
£300m	£42m	14.1%
(1)%[1]	(2)%[1]	

REVENUE BY SECTOR

Defence	40%
Semiconductor	17%
Medical	11%
Space	8%
Commercial Aerospace	10%
Rail, Industrial, Other	14%

COMPETITIVE STRENGTHS

- Innovative and technically differentiated offerings
- Ultra-high reliability solutions used in demanding applications
- Strong research and engineering capabilities
- Customer intimacy, responsiveness and product customisation
- Global presence, reach and support

GROWTH DRIVERS

- Increased connectivity supporting growth in space applications and in commercial aerospace
- Growing urbanised population requiring transportation and infrastructure
- Increasing geopolitical uncertainty
- Ageing population and rising need for connected healthcare services

CUSTOMERS

Our blue-chip customers are prime contractors, key original equipment manufacturers (OEMs) and sub-system manufacturers. Examples include Raytheon, Lockheed Martin, BAE Systems, Huawei, NVIDIA and Biosense Webster.

PRINCIPAL OPERATING REGIONS

We have 23 locations in ten countries across North and Central America, Europe and Asia. We sell products to over 50 different countries around the world.

SUPPLIERS

We cultivate deep supplier partnerships that enable new technology developments, quality and efficiency, whilst endeavouring to have no substantial dependencies on individual sources.

COMPETITORS

Our competitors differ depending on the market being served. They range from the large multinationals such as Amphenol, TE and Molex to the more niche and single technology providers.

1 **Underlying:** modifies headline performance to: adjust prior year to reflect an equivalent period of ownership for divested businesses; include restructuring and pension administration costs as headline for both years; and exclude the effects of foreign exchange, acquisitions and supplemental sales for divested businesses. See the presentation of results note on p129 for further details.

MARKETS AND TRENDS

Increasing connectivity and the demand for high-speed and reliable applications is the key growth driver across our six key end-markets.

We provide a range of mission-critical products to the defence market, including microwave technology and high-speed connector solutions. These are deployed in the most extreme environments. The current economic environment and increasing geopolitical uncertainty creates a platform for growth.

We provide sophisticated test sockets, probe heads and cable assembly solutions for semiconductor testing applications. The semiconductor market has seen marked growth this year. The high rate of technology refresh, increased functionality and the greater connectivity requirements of electronic devices are key drivers.

Our medical portfolio includes high-reliability enhanced signal integrity performance connectors for applications requiring higher bandwidth and data rates, including advanced imaging, augmented reality, and surgical robotics. A growing, ageing population and the rise in chronic diseases continue to drive growth for the global medical market.

In space and commercial aerospace, we provide connectors, components and satellite communications antenna solutions for various aircraft and space applications. The commercial aerospace market remains robust, driven by increasing passenger and freight demand, particularly in developing regions, and the need to upgrade aircraft fleets to more efficient models.

In the rail market, our cable solutions provide communications connectivity and our connector solutions are used in applications such as control, command and signalling in autonomous train systems. Growth is in part driven by increasing demand for sophisticated digital train systems that improve safety, security and high data-rate connectivity for passengers. To penetrate the growing Chinese market, and specifically commercial aviation and high speed train applications, we have signed a joint venture agreement with Sichuan Huafeng which is a major manufacturer of electronic components in China.

WE ARE CREATING THE FUTURE

GETTING INTO SPACE FASTER

Smiths Interconnect is creating higher reliability products for next generation space applications with their innovative SpaceNXT™ programme. Pre-testing and qualifying components for space use reduces lead times and the cost of ownership for customers, and improves the customer experience.

DIVISIONAL REVIEW CONTINUED

SMITHS INTERCONNECT CONTINUED

STRATEGY

We aim to be the supplier of choice to customers that value our broad portfolio of innovative and technically differentiated connectivity solutions. We focus on the most attractive applications in the defence, semiconductor test, medical, space, commercial aerospace and rail markets. Our aim is to grow our market positions in all regions and continue to embed our key account partnerships and channels to market.

We want to outperform our competitors and market growth through customer-focus, innovation and service as well as attracting and retaining the best talent available.

We drive competitiveness through R&D and fund our investments through manufacturing efficiency.

PROGRESS IN FY2018

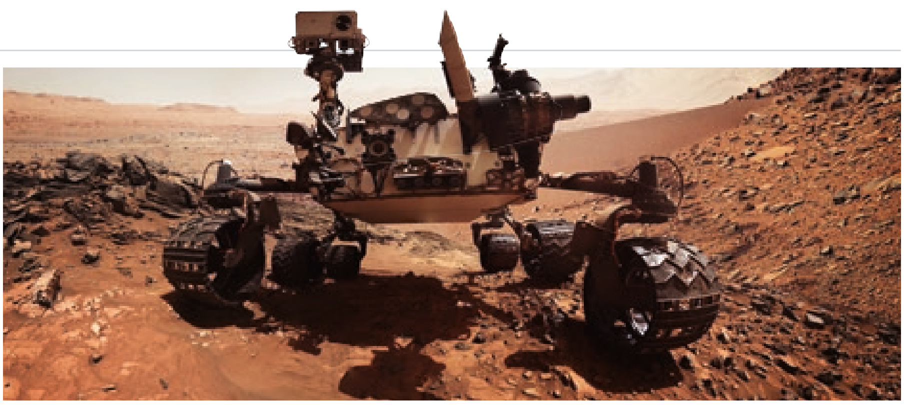
- Simplified global structure to improve communication and agility around customer focus, engineering and technology
- Focused on six attractive core end-markets
- Further embedded our Key Account Management programme to facilitate customer focus and gain access to new programmes and technology partnerships
- Further simplified our distribution channels to improve service and reliability
- Increased investment in R&D to drive new technology and products for the future
- Signed a joint venture agreement with Sichuan Huafeng to strengthen our presence in the commercial aerospace and rail markets in China

PRIORITIES FOR FY2019

- Continue to focus on strategic markets, customers and sales channels
- Expand key account programme
- International expansion, particularly in Asia building on the launch of the joint venture with Sichuan Huafeng
- Increase vitality rate and introduction of new products
- Reduce costs through value engineering and scale efficiencies

DID YOU KNOW...

Smiths Interconnect's microwave components are used on the Mars Rover to compensate for temperature variations from -65°C to +150°C, enabling it to maintain a consistent signal strength in extreme atmospheric conditions, ensuring long-term, mission-critical success.



FY2018 FINANCIAL PERFORMANCE

	FY2018	FY2017	Underlying[1] change	Reported change
Revenue	£300m	£419m	(1)%	(28)%
Headline operating profit[2]	£42m	£56m	(2)%	(25)%
Headline operating margin[2]	14.1%	13.4%	(10)bps	+70bps
Statutory operating profit	£37m	£124m		(70)%
Return on capital employed	11.9%	11.4%		+50bps
R&D % of revenue	7.0%	6.7%		+30bps

PERFORMANCE

Smiths Interconnect's underlying[1] revenue was down (1)%, reflecting an improved trend in the second half, especially in the Defence, Semiconductor Test and Rail markets. On a reported basis, revenue declined by (28)%, reflecting a £(96)m impact from the divestments of Power and Telecoms businesses in January and May 2017 respectively, and £(19)m of adverse foreign exchange translation.

Underlying[1] revenue in the Defence segment grew by 1%, supported by increased defence spending in the US, Europe and the Middle East, including programmes such as Eurofighter, Joint Strike Fighter, Gripen and various naval programmes. In the Medical segment, underlying[1] revenue grew by 7% driven by strong sales of highly specialist connectors for patient monitoring and imaging systems. In the Space segment, revenue increased 3% driven by higher connectivity product content within satellite programs. The Rail segment increased by 10% driven by power and data connectors. Commercial Aerospace declined by (20)% due to lower sales of antenna systems. Semiconductor Test declined by (9)% primarily due to order timing.

Revenue from higher-growth regions, which represents 16% of sales, decreased by (9)% on an underlying[1] basis as a result of order timing in Semiconductor Test.

Headline operating profit declined (2)% on an underlying[1] basis to £42m, where an improvement in gross margin was offset by investment in sales, marketing and R&D to drive future growth. Headline operating margin was broadly in line with last year at 14.1%, on an underlying[1] basis. The difference between statutory and headline operating profit primarily reflects adjustments for amortisation of acquired intangibles and the loss on disposal of a trade investment.

In April 2018, Smiths Interconnect signed a joint venture agreement with Sichuan Huafeng Enterprise Group Co. Ltd – a major manufacturer of electronic components in China. The combined portfolio of highly specialised electronic components and customer relationships is expected to accelerate penetration and growth in this important market.

ROCE increased 50bps to 11.9% driven by disposal of the Power and Telecoms businesses in FY2017.

RESEARCH AND DEVELOPMENT

Cash R&D expenditure was 7.0% of revenue (FY2017: 6.7%) (6.0% excluding customer funded R&D, FY2017: 5.5%). Product developments included:

- Volta semiconductor solutions for testing integrated chip packages
- SpaceNXT™ HC Series – a range of high reliability microwave components qualified for next-generation commercial space applications
- SpaceNXT™ Q Series – a range of flexible cable assemblies qualified for space applications
- Eclipta™ connector – a double ended edge card contact technology for disposable medical applications

1 **Underlying:** modifies headline performance to: adjust prior year to reflect an equivalent period of ownership for divested businesses; include restructuring and pension administration costs as headline for both years; and exclude the effects of foreign exchange, acquisitions and supplemental sales for divested businesses. See the presentation of results note on p129 for further details.

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DIVISIONAL REVIEW CONTINUED

FLEX-TEK

Innovative components to heat and move fluids and gases

FY2018 PERFORMANCE

Revenue	Headline operating profit	Headline operating margin
£354m	£67m	18.9%
+10%[1]	+10%[1]	

REVENUE BY SECTOR

Construction Products	30%
Fluid Management	25%
Heat Solutions	26%
Flexible Solutions	19%

COMPETITIVE STRENGTHS

- High performance products
- Leading capability in design and manufacture
- Market leading residential gas tubing products
- High performance flexible tubing for aerospace
- Strong customer relationships

GROWTH DRIVERS

- Steady growth of the US housing construction market
- Expanding international market for corrugated stainless steel tubing for residential housing
- Continued increase in large commercial aircraft production
- Growth of medical devices, especially for the treatment of sleep apnoea
- Expansion in higher-growth markets

CUSTOMERS

We serve the US construction industry, domestic appliance, aerospace engine and airframe manufacturers and other specialist markets. Large customers include Watsco, Boeing, Airbus, Pratt & Whitney, GE, Samsung, Trane and Carrier.

PRINCIPAL OPERATING REGIONS

The majority of our sales and operations are in North America, with some operations and a growing sales mix across Europe and Asia.

SUPPLIERS

We source key materials from world-class companies selected to provide the quality, service and value needed for mission-critical components. Key materials include metal components, electrical controls, and plastic resins.

COMPETITORS

We compete with leading providers in each of our product categories. Examples include Parker-Hannifin and Eaton for aerospace tubing, Omega Flex for flexible natural gas tubing, and Nibe for heating elements.

1 **Underlying:** modifies headline performance to: adjust prior year to reflect an equivalent period of ownership for divested businesses; include restructuring and pension administration costs as headline for both years; and exclude the effects of foreign exchange, acquisitions and supplemental sales for divested businesses. See the presentation of results note on p129 for further details.

MARKETS AND TRENDS

Our business is structured around four segments: Heat Solutions; Construction Products; Fluid Management; and Flexible Solutions. Key markets include US residential and commercial construction, global aerospace tubing and hoses, and electrical heating elements.

Our business performance generally follows macroeconomic indicators such as US GDP, US housing growth, healthcare spending and capital goods expenditure. Population growth drives residential construction and domestic appliance demand in the US, while high-growth markets drive commercial aerospace demand through increasing air passenger and freight volumes and investment in next-generation aircraft. The diverse nature of our markets reduces our reliance on any specific technology, although we are primarily exposed to the US economy.

In heating, we are one of the world's largest manufacturers of open coil heating elements. These specialised elements and thermal systems provide consistent temperature controls to improve system efficiency and performance for heating ventilation and air conditioning (HVAC) equipment, tumble dryer, and other bespoke applications. Growth in Heat Solutions is largely driven by the US housing market, along with an increasing number of specialty heating applications in North America and Asia. Steady growth in US housing is also driving demand for our leading flexible gas piping and HVAC ducting in our Construction Products segment.

Our Heat Solutions elements are also used in the manufacturing of medical devices, and our Flexible Solutions hoses are used in this market too, particularly for respiratory care devices. Increasing global healthcare spend is driving growth.

In the automotive market our hoses are used to deliver fuel and brake fluid and will play a crucial role in the delivery of gas and hydrogen in next-generation vehicles.

In aerospace, we are a market-leading provider of specialty, high-performance flexible and rigid fluid management tubing assemblies that provide reliable, efficient delivery of hydraulic fluids and jet fuel for commercial and military aircraft globally. The market for commercial aircraft remains strong, with a current OEM order book of over 14,000 aircraft.

MAKING THE WORLD MORE EFFICIENT

BROADENING OUR PRODUCT PORTFOLIO

Flex-Tek acquired the heating element division of Osram Sylvania Inc. in FY2018. This acquisition has enhanced our exposure to attractive end-markets and geographies, whilst broadening our product portfolio in bespoke heating solutions and improving our technological capabilities. The integration is complete and synergies have been delivered to plan.

DIVISIONAL REVIEW CONTINUED

FLEX-TEK CONTINUED

STRATEGY

Our strategy is to outperform our chosen markets through technological differentiation, with the need for safer, more energy-efficient solutions providing opportunities for us to establish leadership positions across our segments.

We aim to do this by developing our product portfolio, expanding in our target regions, growing existing market shares and driving operational excellence to increase competitiveness. We also consider the right strategic bolt-on acquisitions to support growth.

Specific focus areas include growing our share in the US housing market, expanding our international markets for gas tubing and securing positions on next-generation aircraft.

PROGRESS IN FY2018

- Integration of the Osram Sylvania Inc. heating solutions business into Heat Solutions
- Expanded Gastite sales in Construction Products in the UK
- Fluid Management progress on delivering products for new aerospace platforms
- High growth rate for medical tubing in Flexible Solutions
- Further progress in China in Heat Solutions
- New product launches with the Thermaflex® floating core flexible duct

PRIORITIES FOR FY2019

- Expand through new technologies for Heat Solutions applications
- Grow Gastite in Europe for Construction
- Launch new FlashShield+ product in Gastite for Construction Products
- Win new aerospace platform for Fluid Management
- Expand revenue in Asia, especially China

DID YOU KNOW...

Flex-Tek's aerospace heater range – used for testing air and inert gas applications in the aviation industry – can ramp temperature up and down by 50°C per second and heat up to 900°C in custom designs, and are helping to develop faster, safer and more fuel efficient aircraft components.

FY2018 FINANCIAL PERFORMANCE

	FY2018	FY2017	Underlying[1] change	Reported change
Revenue	**£354m**	£338m	+10%	+4%
Headline operating profit[2]	**£67m**	£65m	+10%	+2%
Headline operating margin[2]	**18.9%**	19.3%	Flat	(40)bps
Statutory operating profit	**£68m**	£68m		Flat
Return on capital employed	**35.0%**	35.8%		(80)bps
R&D % of revenue	**0.6%**	0.6%		Flat

PERFORMANCE

Flex-Tek delivered a strong performance with revenue up 10% on an underlying[1] basis, with growth in all segments. On a reported basis revenue increased 4%, despite a £(17)m adverse foreign exchange translation.

Construction revenue grew 5% on an underlying[1] basis, with both Gastite and Thermaflex benefiting from continued growth in the US housing market. Fluid Management revenue was up 11% on an underlying[1] basis, driven by strong sales of its aerospace solutions across a range of engine and airframe platforms. Heat Solutions revenue increased by 17% on an underlying[1] basis, principally due to growth in its engineered solutions as well as increased sales of clothes dryer elements and heating, ventilation and air conditioning (HVAC) systems. Flexible Solutions underlying[1] revenue growth of 10% was driven by increased demand from the medical sector, partially offset by a decline in the floor care segment.

Revenue from higher-growth regions, which represents 9% of sales, increased 16%, driven by strong sales into China and India.

On an underlying[1] basis headline operating profit increased 10% to £67m and headline operating margin was in line with the prior year at 18.9%. The difference between statutory and headline operating profit is primarily due to a reduction in the provision for Titeflex Corporation for subrogation claims.

In November 2017 the Heat Solutions business completed the acquisition of the heating element division of Osram Sylvania, Inc. The integration of the business is now largely complete and the benefits of broadening its portfolio into faster growing engineered heating solutions are starting to flow through.

ROCE decreased (80)bps to 35.0%, driven by the acquisition of Osram's heating element business.

RESEARCH AND DEVELOPMENT

R&D expenditure remained consistent at 0.6% of sales (FY2017: 0.6%), focused on market-leading innovative solutions to meet specific customer needs. Product developments included:

- Thermaflex floating core HVAC duct
- Gastite's FlashShield II, the next generation of flexible gas piping which is expected to launch in FY2019

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RISK MANAGEMENT

A PROACTIVE APPROACH TO RISK

We operate across a range of markets and geographies and are prepared to accept certain levels of risk in pursuing our ambition of establishing Smiths as one of the world's leading technology companies.

We are clear about the specific risks we face and take a proactive approach to risk management, in order to maximise opportunities, drive better commercial decision-making, and protect our businesses and our people.

RISK GOVERNANCE

The Board and its Committees set the 'tone at the top' and approve the strategy of the Group. The Board ensures appropriate oversight and monitoring through a number of mechanisms, including strategy reviews, Committee meetings, management reports and focused reviews of selected risk areas.

On behalf of the Board, the Audit Committee is responsible for reviewing and assessing the effectiveness of the Group's risk management and internal control systems. The review process covers financial, operational and compliance controls, as well as the Group's principal risks.

The Executive Committee is responsible for designing the Enterprise Risk Management (ERM) framework and ensuring that it is effectively deployed throughout the Group. The Executive Committee also ensures that the Board's risk appetite is understood by risk owners and decision-makers across the Group, and conducts an annual assessment of strategic risk.

Divisional and functional teams are responsible for day-to-day management and reporting of risks. They identify new and emerging risks, escalate where appropriate, and take action to manage risks as required. Our divisions also conduct an annual assessment of strategic risk and make formal presentations to the Audit Committee each year.

Internal Audit provides independent and objective assurance, to both the Audit and Executive Committees, on the adequacy and effectiveness of our risk management and internal control processes.
It facilitates the ERM process and provides site-based controls reviews and assurance reviews of key programmes, processes and systems.

HOW WE MANAGE RISK

THE ENTERPRISE RISK MANAGEMENT PROCESS

Any business involves constant risk management – it is an integral part of day-to-day operations. Our ERM process supports open communication on risk between the Board and Audit Committee, the Executive Committee, and our divisions, functions and sites. It enables us to manage and monitor the risks which threaten successful execution of our strategy and ensures that our strategic, financial and operational risks are appropriately considered by the Executive Committee and by the Board.

During FY2018 a risk workshop was facilitated by the Director of Internal Audit at the Executive Committee. This workshop resulted in an update to the principal risk register which was presented to the Audit Committee. The Audit Committee selected three of the principal risks – ethics and compliance (focus on agents and distributors), cyber security, and growth markets (focus on Asia) – for deep dive reviews at both the Executive and Audit Committees.

A further 51 risk workshops were facilitated at operational sites during the year to gather a 'bottom-up' view of risk.

Within the ERM framework, we operate a 'three lines of defence approach'. This model ensures that the three lines – Risk Ownership and Mitigation, Monitoring and Compliance, and Independent Assurance – are clearly defined and work effectively.

The Audit Committee on behalf of the Board has reviewed the effectiveness of the risk management process, considering the principal risks and uncertainties, actions taken by management to manage those risks, and the Board's risk appetite in respect of each risk. The Directors consider the risk management process to be effective. It recognises that this is an ongoing process and work will continue in FY2019.

BOARD AND AUDIT COMMITTEE

- Setting the strategy and 'tone at the top'
- Reviewing and assessing the effectiveness of risk management and internal control systems
- Monitoring through Board processes

EXECUTIVE COMMITTEE AND SENIOR MANAGEMENT

- Designing and establishing the risk management system and internal controls
- Ensuring that the risk appetite of the Board is understood by risk owners and decision-makers
- Ensuring risks are adequately managed

1ST LINE OF DEFENCE
RISK OWNERSHIP AND MITIGATION

Operational teams

- Understanding roles and responsibilities
- Establishing and applying internal control systems
- Complying with policies
- Following risk management processes

2ND LINE OF DEFENCE
MONITORING AND COMPLIANCE

Risk and compliance functions

- Maintaining financial and operational controls
- Monitoring risks
- Managing the ERM process
- Ensuring security, quality and health and safety

3RD LINE OF DEFENCE
INDEPENDENT ASSURANCE

Internal audit function

- Auditing and providing assurance on internal controls, programme controls, system controls and risk management processes

Regulators and external audit

RISK MANAGEMENT CONTINUED

PRINCIPAL RISKS AND UNCERTAINTIES

We maintain a register of principal risks and uncertainties covering the strategic, operational, financial and compliance risks faced by the Group.

We review each risk and rate them according to the current net risk position i.e. the likelihood of occurrence, taking into account external factors and current internal mitigating controls, and we consider an appropriate target exposure or risk appetite. This, and our 'velocity' metric, which reflects the expected time we would have to react should a risk materialise, drives mitigation priorities. Our trend metric shows the net position of the risk year-on-year.

We updated our register of principal risks and uncertainties following the Executive Committee workshop held during FY2018.

While we continue to monitor and manage a wider range of risks, the tables below summarise those which might have the greatest impact if they were to materialise, and the key mitigating controls in place to address them. These principal risks are ordered based on our current consideration of potential impact, taking into account the time we would have to react.

Risk	Potential impact	Key mitigating controls
TECHNOLOGY Differentiated new products and services are critical to our success. We may be unable to maintain technological differentiation or to meet customers' needs and may face disruptive innovation by a competitor.	– Loss of market share – Material adverse effect on profitable growth – Erosion of our reputation as a leader in our markets and of our ability to attract and retain talent – Need for higher R&D spend to maintain sales growth	– Diversified technology portfolio serving a range of sectors and geographies, mitigating exposure to any one sector or area – Proactive repositioning of the portfolio around the most attractive markets, where we can sustainably hold a top three position based on technology leadership – Sustained and smarter investment in R&D (FY2018: 4.6% of revenue, FY2017: 4.6%) – Focus on building a culture of innovation – Innovation Fund to leverage critical mass and accelerate key areas – New Product Introduction (NPI) process rolled out across divisions to accelerate time to market

Strategic objective

2
DELIVER WORLD-CLASS COMPETITIVENESS

Current	Target	Trend	Velocity
		↔	Y

Risk	Potential impact	Key mitigating controls
PEOPLE People are our only truly sustainable source of competitive advantage and competition for key skills is intense, especially around science, technology, engineering and mathematics (STEM) disciplines. We may not be successful in attracting, retaining, developing, engaging and inspiring the right people with the right skills to achieve our growth ambitions.	– Inability to attract key talent leading to a loss of competitive advantage – Difficulty in retaining personnel, at all levels of the organisation, leading to a loss of competitive advantage – In acquisitions, losing key personnel from the newly-acquired business which may significantly impact performance and value	– Investment to build a learning organisation with a focus on culture, reward and recognition – Implementation of the right HR infrastructure – Delivery of a range of learning and development opportunities at all levels of the organisation – Talent and succession plan reviews – Remuneration packages evaluated regularly against market trends – Chief Executive assessment of the leadership team – Annual performance management reviews for the majority of employees using best practice processes such as 360 degree feedback surveys – Formal career counselling for senior people in the business – A clearly defined people integration plan for acquisitions

Strategic objective

2
DELIVER WORLD-CLASS COMPETITIVENESS

Current	Target	Trend	Velocity
			Y

Key

Current exposure to risk			Target exposure of risk			Trend: Net position of risk vs FY2017			Velocity: Time to react		
									Y	M	W
Low	Medium	High	Low	Medium	High	Lessened	No change	Increased	Years	Months	Days/ Weeks

RISK MANAGEMENT CONTINUED

Risk	Potential impact	Key mitigating controls
PRODUCT QUALITY In the ordinary course of business, we are potentially subject to product liability claims and lawsuits, including potential class actions. The mission-critical nature of many of our solutions makes the potential consequences of failure more serious than may otherwise be the case. **Strategic objective** 2 DELIVER WORLD-CLASS COMPETITIVENESS	– Recall of products due to manufacturing flaws, component failures and/or design defects in order to avoid serious, or potentially catastrophic, failure – Exposure to losses in the event of a cyber security breach relating to our products, particularly at Smiths Detection and Smiths Medical. These include not only customer losses, but also those of a potentially large class of third parties – Damage to our reputation and reduction in market acceptance of, and demand for, our products from an adverse event involving one of our products	– The US SAFETY Act provides legislative protection for certain Smiths Detection products in the US. We support efforts to implement similar legislation in other markets – Divisional quality risk assessments that address product failures, product compliance, regulatory compliance, product performance, product safety and market authorisation risks – Quality assurance processes embedded in manufacturing locations for critical equipment, supporting compliance with industry regulations (e.g. FAA, FDA, API, etc.) – Quality development and quality integration built into NPI processes – Material litigation managed under the oversight of the Group General Counsel – Group-wide Quality Council drives standard definitions, identifies and shares best practice and reduces the cost of poor quality – Insurance cover for product liability – Risk analysis and mitigation processes relating to product cyber-resilience embedded in the product lifecycle process. Proactive steps taken to ensure product cyber-related risks are continually monitored and managed

Current	Target	Trend	Velocity
		↔	W

Risk | **Potential impact** | **Key mitigating controls**

CYBER SECURITY

Cyber attacks seeking to compromise the confidentiality, integrity and availability of IT systems and the data held on them are a continuing risk. We operate in markets and product areas which are known to be of interest to cyber criminals.

Potential impact

- Compromised confidentiality, integrity and availability of our assets resulting from a cyber attack, impacting our ability to deliver to customers and, ultimately, financial performance and reputation
- Exposure to significant losses in the event of a cyber security breach relating to our security or medical products. These include not only customer losses, but also those of a potentially large class of third parties

Key mitigating controls

- Board oversight of the approach to mitigating cyber risks
- Proactive focus on information and cyber security risks supported by a strong governance framework
- Group-wide assessment of critical information assets and protection to enhance security
- Information Security Awareness programme
- Security monitoring to provide early detection of hostile activity on Smiths networks and an incident management process
- Partnership and monitoring arrangements in place with critical third parties, including communications service providers
- Risk analysis and mitigation processes relating to product cyber-resilience embedded in the product lifecycle process

Strategic objective

2
DELIVER WORLD-CLASS COMPETITIVENESS

Current	Target	Trend	Velocity
Low	Low	No change	W

Key

Current exposure to risk	Target exposure of risk	Trend: Net position of risk vs FY2017	Velocity: Time to react
Low, Medium, High	Low, Medium, High	Lessened, No change, Increased	Y Years, M Months, W Days/Weeks

RISK MANAGEMENT CONTINUED

Risk	Potential impact	Key mitigating controls
ECONOMY AND GEOPOLITICS While global economic conditions remain relatively benign, there is concern that we are in the late stage of the economic cycle. Threats to free trade are increasing. **Strategic objective** 1 OUTPERFORM OUR TARGET MARKETS 2 DELIVER WORLD-CLASS COMPETITIVENESS	– Stresses on operational capacity resulting from a recovery in volumes driven by higher oil prices – Governments continue to look for ways to improve tax revenues to ease fiscal budget pressures – Adverse impact on business performance due to the imposition of tariffs. Sanctions have already affected trade with Iran and Russia. The consequences of Brexit are uncertain. Potential effects applicable to many businesses include economic and operational uncertainty, volatility of currency exchange, regulatory changes and the imposition of tariffs on trade between the UK and the Eurozone – Geopolitical tensions, most notably in the Middle East and the Koreas, carry a direct financial threat, particularly if the latter escalates into a global issue	– Diversified portfolio of businesses which mitigates exposure to any one country or sector and geographic spread that mitigates the impact of trade barriers between regions – Divisions monitor order flows and other leading indicators so that they may respond quickly to deteriorating trading conditions and tariffs/barriers to free trade – Identification and application of learnings from past downturns through the cycle – Sustainable tax strategy to optimise the Group's position – Representation of our interests by our Government Relations team – Trade compliance officers monitor compliance with sanctions and other trade restrictions – Monitoring of the ongoing negotiations between the UK and the EU in order to assess the potential impact of Brexit and any transitional arrangements that may be agreed

Current	Target	Trend	Velocity
		↔	Y

Risk	Potential impact	Key mitigating controls
GROWTH MARKETS A significant proportion of our revenue comes from the US and European markets, with a notable proportion coming from governments. **Strategic objective** 1 OUTPERFORM OUR TARGET MARKETS	– Failure to develop other markets and geographies impacts strategic progress and financial performance – Significant disruption to government budgets results in fewer contracts being awarded to Smiths Detection, Smiths Medical and Smiths Interconnect, impacting financial performance	– A diversified portfolio of businesses mitigates exposure to any one country, sector or customer – Growth strategy that places emphasis on expanding operations in higher-growth markets and regions that are currently underserved, including Asia – Strategic process to capture continuing opportunities in current markets – Government Relations function that collaborates with colleagues across the Group to advise on developments – More resilient services and consumable components built into some of our government-related business

Current	Target	Trend	Velocity
		↔	Y

Risk	Potential impact	Key mitigating controls
ETHICS AND COMPLIANCE We have c.22,000 employees in more than 50 countries. Individuals may not all behave in accordance with the Company's values and ethical standards. We operate in highly regulated markets requiring strict adherence to laws with risk areas including: – bribery and corruption; – anti-trust matters; – international trade laws and sanctions; – human rights, modern slavery and international labour standards; and – General Data Protection Regulation (GDPR).	– Failure to comply with export regulations leads to significant fines and a loss of export privileges – Failure to meet strict conditions within government contracts, particularly in the US, could have serious financial and reputational consequences – Increased risk of illegal anti-competitive activity such as collusion with competitors, due to operating in relatively consolidated markets. US fines and penalties imposed for price fixing, bid rigging and other cartel-type activities can exceed $100m per violation – Ethics or compliance breach causes harm to our reputation, financial performance, customer relationships and our ability to attract and retain talent	– Group-wide ethics framework which includes the Smiths Way, the Code of Business Ethics and the Supplier Code of Conduct – Policies and procedures to mitigate distributor and agent-related risks including due diligence, contractual controls and internal approvals – Anti-bribery and corruption training for all employees supported by the 'Speak Out' line encouraging the reporting of ethics violations (includes a non-retaliation policy) – Reporting and investigation mechanisms – Competition law/anti-trust training programmes and guidance – Network of trade compliance officers across the Group that oversee import and export activities – Dedicated staff at Smiths Medical who maintain close contact with the FDA and other key regulators – Group General Counsel and divisional General Counsels monitor legislative changes and report and monitor actions as necessary – Anti-Modern Slavery Policy and procedures to reduce the risk of modern slavery within the Company and our supply chain – GDPR working group driving programme to ensure compliance

Strategic objective

2
DELIVER WORLD-CLASS COMPETITIVENESS

Current	Target	Trend	Velocity
Low	Low	No change	W

Key

Current exposure to risk	Target exposure of risk	Trend: Net position of risk vs FY2017	Velocity: Time to react
Low / Medium / High	Low / Medium / High	Lessened / No change / Increased	Y Years / M Months / W Days/Weeks

RISK MANAGEMENT CONTINUED

Risk | **Potential impact** | **Key mitigating controls**

CONTRACTUAL LIABILITIES

We may fail to deliver the products and services we are obliged to deliver, or fail in our contractual execution due to delays or breaches by our suppliers or other counterparties.

Potential impact

- Production delays, unexpected increases in costs of materials, freight, quality and warranty issues resulting from differences between estimated and actual costs in our medium and long-term contracts
- Breach of contract resulting in significant expenses due to disputes and claims, loss of customers, damage to Smiths reputation with other customers/ prospective customers, and loss of revenue and profit due to higher costs, liquidated damages or other penalties. Smiths contracts, particularly those with governments, may include terms that provide for unlimited liabilities, including for loss of profits, IP indemnities, perpetual warranties or allowing the counterparty to cancel modify or terminate unilaterally and seek alternative sources of supply at Smiths expense

Key mitigating controls

- Contracts managed and delivered by programme management teams that regularly review risks and take appropriate action
- Review and approval process for significant and higher-risk contracts in place at Group and divisional levels
- Diversified nature of the Group mitigates exposure to any single contract
- Programmes in place across the Group that harmonise the contract review process
- Cross divisional US Government working group determines and shares best practice on government contracting

Strategic objective

2
DELIVER WORLD-CLASS COMPETITIVENESS

Current	Target	Trend	Velocity
		⟷	M

Risk | **Potential impact** | **Key mitigating controls**

ACQUISITIONS AND INTEGRATION

Our strategy is predicated primarily on organic growth. However, acquisitions can also play a role in building and/or strengthening competitive positions. Acquisitions carry risk, but also opportunity.

We may invest substantial funds and resources in acquisitions which fail to deliver on expectations – due to incorrect appraisal of the target and/or poor execution. The opposite risk is that (perhaps through an excess of caution) we miss out on opportunities to build market-leading positions and growth.

Potential impact

- Poor acquisitions lead directly to financial damage and indirectly to loss of shareholder confidence in management
- Newly-acquired products and solutions deliver less value, fewer synergies, or require more investment than anticipated
- Fall in our return on capital employed measure
- Financial performance suffers from goodwill or other acquisition-related impairment charges

Key mitigating controls

- Investment in greater internal capability for the evaluation and execution of transactions
- Regular reviews of the acquisition pipeline and a stage-gated M&A process
- Detailed due diligence and integration work in accordance with our acquisitions and disposals policy
- Larger transactions approved only by the full Board
- Post-acquisition reviews with lessons learned incorporated into future projects

Strategic objective

1
OUTPERFORM OUR TARGET MARKETS

3
STRONG FINANCIAL FRAMEWORK

Current	Target	Trend	Velocity
		⟷	M

Risk	Potential impact	Key mitigating controls
SUPPLY CHAIN – MANUFACTURING Timely, efficient supply of raw materials and purchased components is critical to our ability to deliver to our customers drive growth. Manufacturing continues to be exposed to external events which could have significant adverse consequences, including natural catastrophes, disease pandemics and terrorist attacks. We are also affected by the social, economic, regulatory and political conditions where we operate. **Strategic objective** 2 DELIVER WORLD-CLASS COMPETITIVENESS	– Inability to deliver products/solutions to customers, impacting financial performance and reputation	– Supply Excellence pillar of our SES operating model delivers increased focus on efficient, resilient and cost-effective supply – Business continuity and disaster recovery plans in place and tested for critical locations – Regular evaluation of key sites for a range of risk factors using externally benchmarked assessments – Business interruption and property damage insurance

Current	Target	Trend	Velocity
			W

Risk	Potential impact	Key mitigating controls
SUPPLY CHAIN – SOLE SOURCE Our businesses depend on the availability and timely delivery of raw materials and purchased components. Where sole or single source suppliers are the only qualified source of raw material and/or components, any disruption to supply could adversely impact production, associated customers and the downstream supply chain. **Strategic objective** 2 DELIVER WORLD-CLASS COMPETITIVENESS	– Inability to deliver products/solutions to customers, impacting financial performance and reputation	– Risk management process based on failure mode and effects analysis (FMEA) principles developed by the Group Strategic Sourcing team that includes sole or single suppliers – Mitigation plans, including qualification of alternative sources of supply where appropriate, in place – All critical suppliers screened on a daily basis with any change to risk status communicated to the appropriate procurement leader for analysis and follow-up

Current	Target	Trend	Velocity
			W

Key

Current exposure to risk	Target exposure of risk	Trend: Net position of risk vs FY2017	Velocity: Time to react
Low, Medium, High	Low, Medium, High	Lessened, No change, Increased	Y Years, M Months, W Days/Weeks

RESOURCES AND RELATIONSHIPS

DOING THINGS THE RIGHT WAY IS A RESPONSIBILITY, NOT A CHOICE

Being a responsible business is deeply embedded in how we think, operate and manage our key resources and relationships with all our stakeholders.

WORKING IN THE SMITHS WAY

The Smiths Way is how we do things. From our shared vision and values that define our culture and our strategy, to our operating model, the Smiths Excellence System (SES), it's ensuring we do the right things, in the right way.

SES helps us manage our business, and our resources and relationships more efficiently and sustainably, under our six pillars – customer, people, technology, programme, production and supply.

In this section, we outline how our responsible business focus areas map across the six pillars. However, most topics, particularly health, safety and environment (HSE) and our ethics and compliance activities, are applied across more than one pillar.

OUR APPROACH TO HEALTH AND SAFETY

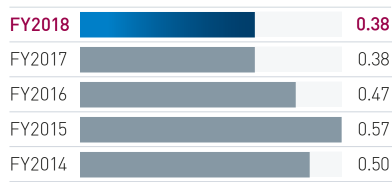
Health and safety is a top priority at Smiths and underpins the way we operate in every part of our business. We work to create safe and secure workplaces for our people, our customers, our suppliers and all other stakeholders.

Our safety culture is built around a cross-divisional network of health, safety and environment (HSE) leaders. They share ideas and best practices, and implement initiatives to help improve our safety performance. While HSE management systems are used to identify and prioritise risks, we also encourage colleagues to take ownership of safety by sharing feedback and suggesting improvements.

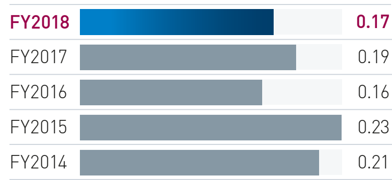
Our people recognise our commitment to health and safety. Safety came out as one of the highest scores in our most recent My Say colleague survey, when colleagues were asked if they agreed with the statement 'Safety is a top priority here'. In our Group-wide safety assessment, administered by DuPont Security Solutions, we were pleased that colleagues said our safety culture – based on HSE leadership, structure, and processes – was continually improving.

To track our progress, we closely monitor our recordable incident rate (RIR) – where incidents require medical attention beyond first aid – and lost-time incident rate (LTIR) – where an employee is unable to work the day following an incident – per 100 employees, per year across Smiths.

RECORDABLE INCIDENT RATE (per 100 colleagues)



LOST TIME INCIDENT RATE (per 100 colleagues)



Figures vary from those reported in prior years due to the reclassification of a small number of incidents as outcomes became known.

During FY2018, as part of our journey towards 'zero harm', we launched several Group-wide initiatives to help improve our safety performance, including our safety behaviours programme and forklift safety survey. Online safety training, hand safety and safe driving campaigns are planned for FY2019.

CUSTOMER

We work closely with our customers to deliver innovative products and value-adding support.

At Smiths, our goal is to continuously enhance the customer experience and increase the value we create for them.

CUSTOMER ENGAGEMENT AND SATISFACTION

We take time to understand customer challenges and anticipate their needs, partnering to steer innovation and technology development, delivering high-quality products, and optimising lead times.

We're investing in customer relationship management (CRM) tools and training to improve customer engagement and satisfaction. We'll continue to improve this by focusing on five core areas – pricing, deal follow-up, key account management, customer complaint management, and order-to-delivery management.

We seek to create trusting partnerships with our customers. We are committed to adhering to our Code of Business Ethics (Code) (see PEOPLE section – Ethics and Support), applying our shared values, and complying with all applicable international and local rules and regulations. We also encourage our customers to contact our Speak Out reporting line if they identify any behaviour that's not in line with our Code.

CREATING CUSTOMER VALUE

We drive value by working closely with our customers all the way from product development and delivery, to end-use and aftermarket support – but the creation of customer value starts with understanding their needs.

We actively engage with our customers during concept and design stages of our New Product Introduction (NPI) process and aim to provide integrated, full lifecycle support. We also introduced a futuring process to predict how our customers' needs will evolve, as influenced by mega trends, macro trends and emerging trends and technologies, which we'll continue in FY2019.

ANTI-BRIBERY AND ANTI-CORRUPTION

We regularly review our policies and procedures to reduce our exposure to bribery. We provide regular anti-bribery training, and have clear policies and procedures to regulate giving and receiving of gifts and hospitality, and how we interact with government officials. Our gifts register helps us monitor compliance with these policies.

We apply strict controls around the appointment of distributors and agents to make sure we know who we're dealing with. In FY2018 we enhanced our distributor and agents due diligence processes and implemented an audit programme to support these efforts. As part of this process, we ask potential distributors and agents to complete a questionnaire with any issues identified and remedial actions taken. In addition, we use third-party due diligence services to supplement our own due diligence. Where the potential risks of bribery are particularly high we use investigators on the ground to provide enhanced due diligence. We'll continue to monitor activities in FY2019. We also continue to educate colleagues on this important issue through our ethics and compliance training programmes.

ANTI-TRUST

We're committed to competing fairly within the markets we operate in. We provide colleagues whose roles may expose them to competition law risks with regular training and in FY2018 we refreshed our Anti-trust policy and supporting materials, including our trade and industry event register.

DEVELOPING INNOVATIVE PRODUCTS FOR OUR CUSTOMERS

COLLABORATING WITH UPS

Smiths Detection worked closely with UPS, one of the world's largest air freight companies, to develop a software interface that transfers CT X-ray image data collected from Detection's XCT systems straight to UPS's IBX database.

This helps UPS move massive volumes of image data, speeding up and securing their cargo shipping operations. The team worked on-site with the UPS software team to modify configurations and software while testing the limits of the new system.

RESOURCES AND RELATIONSHIPS CONTINUED

PEOPLE

Our people are our most important sources of sustainable competitive advantage.

Our people strategy is focused on building a learning organisation that attracts, retains, develops, engages and inspires our people to be the best they can be.

CULTURE, ENGAGEMENT AND COMMUNICATION

Our Smiths Way of working helps us align our culture, strategy and operating model to create an inspiring and innovative workplace.

We hold our My Say colleague survey twice a year to inform the co-creation of action plans that are helping to make Smiths a better place to work. Our May 2018 survey maintained our high response rate of 87%, with more than 30,000 comments. The results reflected improvements in many areas, including overall engagement, culture and communications.

To further embed our Smiths Way culture, we held our first ever Smiths Day with events and celebrations all over the world. We also introduced our colleague smartphone app, Smiths Now, to enhance engagement, share news across the business and encourage peer-to-peer communication.

Our annual Smiths Excellence Awards, recognising the highest levels of achievement across our six SES pillars, as well as outstanding contributions to HSE and to our communities, continues to be a highlight for colleagues.

May 2018 My Say survey

ENGAGEMENT SCORE	COMMENTS
73	30,000+

June 2017: 71

Employee engagement My Say score, based on an average score for two questions assessing how happy colleagues are working at Smiths and pride in Smiths.

LEADERSHIP AND LEARNING

We are building a learning organisation that supports our people through formal and informal development programmes, to allow them to reach their full potential. This includes our SES Academy, which will be launched in FY2019 to provide progressive training for all colleagues across a range of professional disciplines. We also plan to partner with a leading academic institution to deliver a portfolio of lean six sigma belted programmes.

Our success is driven by the effectiveness of our leaders. We continued our executive development programme at UCLA, California, enhancing our senior leadership capabilities. In FY2019, we'll implement a new leadership programme to help new and existing managers be more effective in their roles at Smiths.

We also look to fill our talent pipeline by focusing on attracting graduates and early career talent to Smiths – with a focus on talent who have an interest in science, technology, engineering and maths. Through our early career initiatives, we offer graduate and internship roles within a structured development programme.

REWARD AND RECOGNITION

Recognising and rewarding our colleagues in a fair and open way helps them feel valued, supported and incentivised to succeed. To stay competitive, and attract and retain the curious and innovative people we need to drive our growth, it's critical that we offer a comprehensive and meaningful approach to reward and recognition.

Cross-divisional job movement, aligned incentive plans, international mobility and clear career paths are all opportunities we're working to build on. Creating a shared global job architecture enables greater movement and development opportunities for colleagues to expand and enhance their careers at Smiths.

In FY2018, we also became an accredited living wage employer in the UK.

DIVERSITY AND INCLUSION

To fuel our growth and meet the evolving needs of our stakeholders, we must draw on the innovative thinking of a diverse employee population.

Our aim is a diverse, high-performing workforce that reflects our global business and is supported by an inclusive culture that engages all individuals, and values their talents and perspectives. Our recently introduced Diversity and Inclusion (D&I) Plan aligns with this intent, outlining our philosophy, targets and actions to establish ourselves as a diverse and inclusive company, including our unconscious bias programme and virtual D&I forums.

CELEBRATING OUR PEOPLE AND SUCCESSES

FIRST EVER GLOBAL SMITHS DAY

On 7 June 2018, we celebrated our first ever Smiths Day – bringing together colleagues from every division, function and region around the world.

In addition to local celebrations, musical performances, charity events and STEM education initiatives, our Chief Executive, Andy Reynolds Smith hosted two global town hall sessions to connect with colleagues and announce our 2018 Excellence Awards finalists.

Andy said: "I found the enthusiasm shown all over the world really inspiring. It underlined to me what can be achieved when motivated colleagues get together, support each other, and collaborate with real focus."

Our goal is to increase the diversity of our entire population, including more equal representation of women. This year, we also published our 2017 and 2018 UK Gender Pay Gap (GPG) Reports. We remain committed to increasing the proportion of women in senior roles and building a diverse senior management team, and our FY2018 report showed that overall we're already making progress in reducing the gap year-on-year.

	Male	Female	Total
Board of Directors	9	2	11
Executive Committee*	8	3	11
Senior managers**	237	35	272
All employees	13,400	8,300	21,700

* Andy Reynolds Smith and John Shipsey are included on both the Board of Directors and Executive Committee.

** Includes certain employees who report directly to an Executive Committee member, lead a large operational site or sales region, or who are a director of a subsidiary undertaking.

It's our policy to provide equal employment opportunities. We recruit, select and promote our people on the basis of their qualifications, skills, aptitude and attitude. In employment-related decisions, we comply with all applicable anti-discrimination requirements in the relevant jurisdictions. People with disabilities are given full consideration for employment and subsequent training (including retraining, if needed, for people who have become disabled), career development and promotion on the basis of their aptitudes and abilities. We endeavour to find jobs for those who are unable to continue in their existing job because of disability.

ETHICS AND SUPPORT

We want to create a culture where colleagues feel safe and respected. For us, that means applying our shared values of integrity, respect, ownership, customer focus and passion to our actions and decisions every day.

Our values are at the heart of what it means to be Smiths and in FY2018 we revised our Code of Business Ethics (Code) to reflect this. The updated Code provides guidance, including through real-life scenarios, to help colleagues understand how to address challenging and ethical issues they may encounter at work. In FY2019, we'll update our online ethics training module to reflect these changes.

We also launched our 'Speak Out' campaign in FY2018 to remind and encourage colleagues to report behaviour that's inconsistent with the Code and our values through their line manager, HR and legal teams, or through our confidential reporting Alertline.

SECURITY

We take vigorous measures to safeguard colleagues and visitors all over the world to protect our business from security threats. All locations have site security plans which adhere to Group-wide standards.

In FY2019, we'll continue to review and identify potential risks and ensure the protection of our physical and intellectual property.

COMMUNITY ENGAGEMENT

We get involved in local communities to build strong community relationships, a sense of pride in our business, and engage our people. We manage community relationships locally, with each business focusing on markets and communities important to them. We offer Group-level support to charities and organisations that show how a donation will increase wellbeing through improvements to education, health, welfare or environment.

In FY2018, the Group made charitable donations of £88,000. In addition, colleagues donated and raised money for a number of good causes, through a range of fundraising initiatives. We celebrate the best of these initiatives at our annual Group-wide Excellence Awards.

POLITICAL DONATIONS

As a Group, we made contributions to non-EU political parties totalling $52,000 (£40,200) during FY2018. The political contributions were made on a bi-partisan basis in the US, in accordance with US state and federal election laws, in order to raise awareness and to promote Smiths interests.

CONTRIBUTING TO OUR LOCAL COMMUNITIES

SUPPORTING CHILDREN AFFECTED BY CANCER

Coming together to support their local community, the team at Flex-Tek partnered with a local ATV (all-terrain vehicle) camp for children affected by cancer. Together, they cleaned the camp, landscaped and cleared driving trails, and built a new volleyball court – giving the children a chance to spend quality time with friends and family, away from the hospital.

RESOURCES AND RELATIONSHIPS CONTINUED

TECHNOLOGY

Our innovative technology helps make the world safer, healthier and more efficient.

Technology and innovation is the life blood of Smiths. It helps fill our future product pipeline, create new business models, bring value to our customers and drive sustainable growth.

INNOVATION FRAMEWORK

Our Group-wide innovation framework – i^3 – is helping us foster an innovative, future-focused and customer-centric culture through a disciplined approach to innovation, aligned with our strategy for growth. It's helping us translate our expertise and insight into innovative new products, services and business models through our futuring process, already resulting in funded proposals, such as CORSYS™, Smiths Detection's AI based software platform.

To support our ambitions, we opened our first Digital Forge in the San Francisco Bay area in FY2018, designed to accelerate our digital projects and provide a co-innovation space for us, our customers and other partners. We also held workshops throughout the year to drive innovative thinking, identify and develop solutions for future problems, and collaborate on forward-thinking technologies.

Our new cross-divisional communities of practice are also helping to connect subject matter experts from across the business through dedicated online forums.

Our approach to collaboration, innovation and breakthrough thinking also extends to external partnerships. In FY2018, we signed strategic partnerships with Microsoft, to accelerate and enable our digital transformation, and Carnegie Mellon, to advance our additive manufacturing capabilities.

RESEARCH AND DEVELOPMENT

We have taken great strides to balance our innovation investment profile and establish targets for R&D spend and vitality, which measures our percentage of total revenue derived from new products launched in the last three years. The tools used to measure vitality give us a holistic view of the organic pipeline, improving insight and decision-making.

INVESTMENT IN R&D (PERCENTAGE OF SALES)

4.6%

FY2017: 4.6%

PROGRAMME

We aim for consistent and flawless execution across all we do.

Our products and solutions are used in some of the most highly-regulated markets in the world, requiring compliance with strict regulatory requirements.

PRODUCT LIFECYCLE MANAGEMENT

We design new products by thinking holistically from customer need and problem definition through product conception to introduction, and from end-use to end of life. This approach is collaborative and cross-functional to create solutions that delight customers, create value and make the world healthier, safer and more productive.

New product introduction

We've developed a standard, flexible New Product Introduction (NPI) process across the Group. This scalable methodology is tailored to market and product, ensuring investment is proportionate, and helps maintain our crucial new product innovation pipeline. The methodology is based on a stage-gate approach with regular internal audits to ensure commercial effectiveness and improve our speed and effectiveness of bringing new products to market.

IMAGINING THE FUTURE

EXAMINING EMERGING TRENDS AND TECHNOLOGIES

Innovative, breakthrough thinking is vital to helping us establish Smiths as one of the world's leading technology companies.

This year, we held our first Futuring workshop, bringing together colleagues from across the business to examine current and emerging trends and technologies, at a market and global level. Together, they outlined future problem statements, and generated ideas and solutions to these problems that are now being developed into reality.

PRODUCTION

Product cyber security

Our products are used in mission-critical applications in highly-regulated industries. As our focus on digital transformation increases we're committed to ensuring the highest standards of cyber security. We apply a unified, top-level approach to leverage our scale and maximise product security. In FY2018, we focused on cyber security, and process and controls, with both being incorporated into our NPI process.

Product safety

Our approach to product lifecycle management means thinking about safety at every step – including how the product is designed, manufactured, used and disposed of. We are developing common quality procedures to minimise product safety and quality issues, and monitor performance through quality control processes and systems.

In FY2018, we established a cross-divisional restricted substances working group to help minimise the use of hazardous materials in our products and ensure compliance with local regulations.

We constantly drive for enhanced production efficiency, effectiveness and quality.

We're committed to ensuring that every product is manufactured efficiently, to the highest standard of quality and safety, and that we minimise our impact on the environment.

PRODUCT QUALITY

Our cross-divisional quality council drives our approach to quality through standardised policies, processes and guidelines, to help our Divisions embed quality in their work, supported by a culture of sharing knowledge and continuous improvement.

We focus our broad performance monitoring on two quality metrics – defects per million parts shipped (DPPM) and cost of poor quality (COPQ). COPQ includes the costs of waste, corrective work, warranty claims, returns and penalties, measured as a percentage of annual revenue.

In FY2018, we recorded

DEFECTS PER MILLION PARTS SHIPPED	COST OF POOR QUALITY
424	1.7%
FY2017: 459	FY2017: 2.1%

LEAN AND CONTINUOUS IMPROVEMENT

We incorporate continuous improvement and lean methodology to improve safety, quality, cycle time, delivery performance and productivity. Model value streams across our business allow us to test the effectiveness of new manufacturing technologies and approaches in a live environment. These projects are already recording significant improvements in HSE, quality, efficiency and lead times.

We're embracing new manufacturing technologies by piloting additive manufacturing, deploying collaborative robots (CoBots) in live production, and automating product lines in some areas. We also have augmented reality trials underway to understand the potential benefits to operations.

In FY2019, we'll continue to embed lean and continuous improvement tools and resources within manufacturing and service sites, establishing a common approach to production across the Group.

TRANSFORMING MANUFACTURING THROUGH TECHNOLOGY

COLLABORATIVE ROBOTS IN A LIVE PRODUCTION ENVIRONMENT

We're investing in new production technologies to bring the biggest benefits, without adding unnecessary complexity to what we do. In FY2018, our Smiths Interconnect manufacturing facility in Alajuela, Costa Rica, celebrated the introduction of the first CoBot to be fully deployed in a live production environment at Smiths. This new style of robot allows the production team to safely interact with the CoBot as it assembles and tests high volume electronic components as part of the production process.

RESOURCES AND RELATIONSHIPS CONTINUED

PRODUCTION CONTINUED

ENVIRONMENTAL MANAGEMENT

We're committed to using energy and natural resources efficiently within our operations and reducing our greenhouse gas (GHG) emissions, through advanced production processes that decrease waste and energy consumption. We've also invested in environmental management systems that drive improvement in our performance and focus on procuring energy that produces no GHG emissions.

Our HSE and GHG policies are used by each division to develop tailored strategies. We closely monitor energy and water use, waste generation and GHG emissions to identify potential improvements, sharing mitigating action plans and best practice across the Group.

ENVIRONMENTAL PERFORMANCE

In FY2013, we set environmental targets to reduce, by FY2018, our energy usage, GHG emissions and waste generation by 15%, and our water usage by 10%, all normalised to revenue. By the end of FY2018, we'd met and exceeded three of our four targets.

Performance against environmental metrics

	FY2013-2018 target	FY2018 outcome
Energy	(15)%	(13)%
Greenhouse gas emissions	(15)%	(38)%
Total non-recycled waste	(15)%	(27)%
Water consumption	(10)%	(29)%

Reduction targets are compared to the FY2013 baseline year and normalised to FY2018 revenue.

Energy and GHG emissions

Our GHG emissions calculations and reporting follows the Greenhouse Gas protocol (operational approach) and cover emissions from all sources under our control, grouped under: Scope 1 – direct GHG emissions from owned assets; and Scope 2 – GHG emissions from supplied electricity. Emissions from company vehicles and fugitive sources are not deemed to be material, and so are not in our reported totals.

Environmental goals

We've set new three-year environmental improvement targets for FY2019 in accordance with our HSE and GHG policies.

By FY2021, we aim to reduce our GHG emissions by a further 5%, normalised to revenue, and increase our use of renewable energy by an additional 5% – from the current 43% of our electricity use – by using more energy efficient equipment and green energy contracts.

We'll focus on reducing water usage by an additional 5%, normalised to revenue, in regions where water resources are reported as 'limited' by other agencies. While we don't operate in any regions defined as 'stressed' by UNESCO, we've identified sites where we can have an impact on local resources by minimising our water use. We've also targeted an increase in the amount we recycle to 75%, including waste, water and other materials, within our operations and local sites.

Emissions

		FY2018	FY2017	FY2016
Absolute values				
Scope 1 (direct emissions)	t CO_2e	12,241	11,143	12,088
Scope 2 (indirect emissions)	t CO_2e	55,841	62,072	69,004
Total	t CO_2e	68,082	73,215	81,092
Normalised values				
Scope 1 (direct emissions)	t CO_2e/£m revenue	3.65	3.74	3.95
Scope 2 (indirect emissions)	t CO_2e/£m revenue	16.63	20.83	22.56
Total	t CO_2e/£m revenue	20.28	24.57	26.51

MINIMISING OUR ENVIRONMENTAL IMPACT

REDUCING OUR WATER USE

Thinking outside the box, a John Crane facility has installed a closed loop wastewater recycling system which allows them to re-use treated water used during production for flushing toilets. Designed to reduce water consumption by 15%, this project is reinforcing our Group-wide commitment to reducing our environmental impact.

SUPPLY

We're building strong strategic supplier relationships to ensure quality, efficiency and flexibility.

We apply our shared values to everything we do, and ask our suppliers to do the same.

SUPPLIER ENGAGEMENT AND CONDUCT

Our Supplier Code of Conduct, revised in FY2018, makes clear our expectations of suppliers when it comes to ethical behaviour, the supply of minerals from socially and environmentally responsible sources, and the environment.

To grow sustainably, we need strong, smart partnerships to generate and capture value. We want to limit our partnerships to those suppliers who are committed to Smiths and the way we do things.

Supplier contracts and payment terms vary across the Group. We aim to contract with our suppliers in line with local practice and meet our contractual obligations with regard to payment.

SUPPLY CHAIN MANAGEMENT

We apply an end-to-end, cross-functional, total value approach to supply chain management. This helps deliver better forecast accuracy, OTIF (on-time and in-full) delivery and improved lead times for customers, as well as improved stock turns, production costs and working capital for Smiths.

We measure supplier performance through OTIF delivery and supplier quality. In FY2019, we'll introduce supplier score cards to drive performance improvement and further develop our supplier relationship management tools.

TRADE COMPLIANCE

Doing business in the right way means respecting laws wherever we operate. Our trade compliance policies and procedures set out the necessary controls and provide corporate oversight of transactions. Our cross-divisional trade compliance working group meets regularly to share best practice and address emerging issues. We also regularly assess trade activities at the site level to identify risks and review controls.

HUMAN RIGHTS AND TACKLING MODERN SLAVERY

We're committed to upholding all internationally recognised human rights standards wherever we do business, and to addressing any modern slavery risks in our operations and supply chain.

During FY2018, we conducted an internal site survey and made an assessment of existing suppliers using a variety of factors, including country ranking on the Global Slavery Index. Our sites and suppliers identified as high-risk were asked to complete a questionnaire with any issues identified investigated, and remedial actions taken. We also revised our standard supply contracts to require our suppliers to ensure their own suppliers follow our anti-modern-slavery and labour standards commitments.

We launched a modern slavery awareness campaign to further educate our people on the risks of modern slavery at our facilities and those of our suppliers. You can read our latest modern slavery statement on our website.

In FY2019, we'll continue our due diligence drive with a focus on tier one suppliers, and enhance our monitoring capabilities, supplier controls, and human rights training.

STAYING AHEAD OF SUPPLY CHAIN RISK

ASSESSING THE HEALTH OF OUR SUPPLY CHAIN

We source a wide range of materials and components to make the technologies our customers rely on. To give us constant visibility of the health of our supply chain and react faster to emerging risks, we developed a dedicated supplier risk tool that aggregates data on 6,000 of our suppliers representing over 90% of our spend.

GOING CONCERN AND VIABILITY STATEMENT

GOING CONCERN

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic report. The financial position of the Company, its cash-flows, liquidity position and borrowing facilities are described in the Chief Financial Officer's review. In addition, the notes to the accounts include the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk.

The Company's financial position, including access to liquid resources and a committed undrawn credit facility, together with its debt maturity profile, provide confidence that the Group has sufficient financial resources and is well placed to manage its business and its liabilities as they fall due. As a consequence, the Directors believe that the Company will continue in operation for the foreseeable future and for a period of at least 12 months from the date of this report and therefore continue to adopt the going concern basis of accounting in preparing the annual accounts of the Company and the Group.

In coming to this conclusion, the Directors have taken account of the Group's risk management process and have paid particular attention to the Group's principal risks. More information can be found on pages 50-59.

VIABILITY STATEMENT

During the year the Directors also assessed the longer-term prospects of the Group, taking into account its current position, a robust assessment of the Company's principal risks, particularly those which could threaten the business model, and a range of internal and external factors.

The Directors have determined a three-year period to 31 July 2021 to be appropriate for the viability assessment. This is because based on the historical performance of the Group a three-year outlook represents an optimum balance of long-term projection and acceptable forecasting accuracy. This period also takes into account considerations such as the maturity of the Group's borrowing facilities and the cyclicality of the performance of the Group's underlying markets. In order to assess the Group's viability the Directors developed a set of plausible scenarios (standalone and combined) based on the Group's principal risks, each with potentially high-impact outcomes.

In assessing the impact of each of the scenarios the Directors reviewed the current financial position and prospects of the Group, including current year business performance, the detailed budget for FY2019 and the three-year Strategic Plan. Consideration was then given to the magnitude of the gross risks and their potential impact, directly or indirectly, on the Group's future performance and liquidity. The assessment included stress testing the Group's financial capacity to absorb the impact of such adverse events, either individually or in combination, and what mitigating actions the Group could take to respond to them in order to protect its business.

The Directors also considered the Group's ability to raise additional liquidity. In performing this assessment the Directors have taken comfort from the diversity of the Group's businesses across different markets, industries, geographies, products and customers.

Based on the robust assessment, the Directors confirm that they have a reasonable expectation the Group will remain viable for the three-year period being assessed and will continue to operate and meet its liabilities as they fall due. The Directors have no reason to doubt that the Group will continue in business beyond the period under assessment.

SCENARIOS MODELLED

	Link to principal risks
SCENARIO 1: A natural or other disaster destroys key manufacturing facilities resulting in severe disruption to approximately one-quarter of Smiths Medical's production.	SUPPLY CHAIN – MANUFACTURING
SCENARIO 2: A fault in a critical product within Smiths Medical causes the product range to be suspended by global regulatory authorities pending further investigation. Trade licences are subsequently revoked until the products are tested to be safe.	PRODUCT QUALITY
SCENARIO 3: A corruption scandal leads to global regulatory penalties and damage to the Group's reputation. The corruption scandal also leads to heavy penalties against the Group in its main markets.	ETHICS AND COMPLIANCE
SCENARIO 4: A major environmental disaster arises from product failure. A severe oil spill at an offshore drill causes marine damage and environmental hazards for local residents. Investigations identify a fault in John Crane's mechanical seals as the root cause, and John Crane is judged to bear a share of the recovery costs and damages claimed.	PRODUCT QUALITY
SCENARIO 5: A product cyber-attack at a major global hub airport located in North America. Subsequently civil, military and governmental licences are revoked.	CYBER SECURITY
SCENARIO 6: Combination of scenarios 1 & 4; **SCENARIO 7:** Combination of scenarios 2 & 5	

The Strategic report was approved by the Board on 20 September 2018.

By order of the Board

ANDY REYNOLDS SMITH
CHIEF EXECUTIVE

LONG-TERM THINKING

GOVERNANCE

CHAIRMAN'S INTRODUCTION

STRATEGIC OPPORTUNITIES HAVE BEEN THE KEY AREA OF FOCUS

I am pleased to introduce our Corporate governance report in which we describe our governance arrangements, the operation of the Board and its Committees and how the Board discharged its responsibilities during the year.

Strategic opportunities have been the key area of focus at each of our Board meetings during the year. In addition to this the Board and its Committees have undertaken a number of important governance-related projects, such as Board succession; an externally facilitated Board evaluation; a review of the Board's Diversity and Directors' Remuneration Policies, and also commenced the tender process for replacing PwC as the Company's external auditor.

> "As I have said before, the key to any successful company is the ability to innovate and to create the future."

More broadly FY2018 has been an important year for corporate governance and we welcome the publication of the new UK Corporate Governance Code by the UK Financial Reporting Council (FRC). The focus on the themes of culture, stakeholder engagement and sustainability are critical factors for us as we partner with our stakeholders to build an innovative enduring business.

We have begun to consider ways in which a stronger and more meaningful engagement can take place between the Board and the workforce and we look forward to updating you on these initiatives next year. I firmly believe that having a strong governance framework is vital to good decision-making and to the continued success of the Company.

We are committed to business integrity, high ethical values and professionalism across all our activities. Engagement with our workforce will, among other things, enable your Board to gauge how The Smiths Way, including the Group's values, are embedded within the organisation.

During the year, we announced that Anne Quinn and Sir Kevin Tebbit would step down from the Board after serving for nine and 12 years respectively. Both Anne and Sir Kevin have provided invaluable contributions to the Company and we are grateful for their hard work and wise counsel over the years. However, we also had the pleasure of welcoming Olivier Bohuon and Dame Ann Dowling to our Board. They are both highly respected leaders in their fields and I am confident they will further strengthen Board discussions and bring invaluable insight as we continue to lead Smiths on its growth journey. More details on our succession planning are set out in the Nomination Committee report.

I would like to thank all my colleagues who have served on the Board and for their contribution during the year and I hope that the following pages provide you with greater insight into our work on your behalf.

SIR GEORGE BUCKLEY
CHAIRMAN

CORPORATE GOVERNANCE CODE

In FY2018, and as at the date of this report, the Company has applied the main principles and complied with the relevant provisions of the 2016 UK Corporate Governance Code (the 'Code'). The ways in which the Code has been applied can be found on the following pages:

Leadership
Pages 71–75 provide details of the Board and the Board governance structure.

Effectiveness
Pages 76–81 describe the activities of the Board and its Committees, the induction of Directors and Board evaluation.

Accountability
The Audit Committee Report describes the role of the Board in this area (pages 83–89). Further detail on the Group's strategic objectives and the principal risks to the business can be found in the Strategic report.

Remuneration
The Directors' Remuneration Policy and Remuneration Committee report are found on pages 92–111.

Relations with shareholders
Pages 90–91 detail how we communicate with our shareholders.

A copy of the Code is available from the FRC's website at frc.org.uk.

As mentioned in my introduction, we welcome the recently published update of the Code and have started work on ensuring we comply with it as fully as possible by the time of its introduction in 2019.

BOARD GOVERNANCE

The Board is collectively responsible for the creation of sustainable value for our shareholders, and our Directors each have a duty to promote the long-term success of the Company. The Board has approved a governance framework of systems and controls in order to effectively discharge its responsibilities. This framework ensures that the Board takes appropriate account of the interests of our shareholders and our wider stakeholders, including our customers, employees, suppliers, regulators, the communities where we operate, and society as a whole.

Our Board is comprised of a majority of independent Directors whose diverse backgrounds and experience enable appropriate challenge at Board and Committee discussions. Biographies for each Director can be found on pages 72 to 75.

The Board has established the Nomination, Audit and Remuneration Committees, delegating specific authorities to each of them as set out in their Terms of Reference. Reports from each of the Committee Chairs on Committee activity during and in respect of FY2018 can be found in this Corporate governance report. The Terms of Reference were reviewed during the year and are available on our website.

The Chief Executive is responsible for the executive day-to-day management of the Company and leading the Executive Committee. Our Executive Committee membership and their biographies can be found on page 19. Executive management implement the Group's strategy and provide the Chief Executive, and the Board as a whole, with the information they need to make decisions.

GOVERNANCE MODEL

BOARD

CHAIRMAN

Responsible for:

- Ensuring the Board's continued effectiveness
- Leading the Board and setting the Board agenda
- Shaping boardroom culture and encouraging individual Director engagement
- Leading the annual Board evaluation

CHIEF EXECUTIVE

Responsible for:

- Developing and proposing strategy to the Board
- Setting and communicating the culture, values and behaviours for the Group
- Leading the Executive Committee
- Managing relationships with key stakeholders including the workforce, customers and shareholders

SENIOR INDEPENDENT DIRECTOR

Responsible for:

- Supporting the Chairman in the delivery of the Board's objectives
- Being available to shareholders if they wish to raise any concerns
- Acting as an intermediary between the other Directors if necessary

NON-EXECUTIVE DIRECTORS

Responsible for:

- Providing constructive challenge and strategic guidance to Board discussions
- Oversight of management and the business, including culture
- Offering specialist advice
- Assessing the effectiveness of systems of internal control and risk management

COMPANY SECRETARY

Responsible for:

- Advising the Board on governance matters
- Supporting the Chairman in the efficient and effective functioning of the Board and its Committees
- Ensuring the Board receives quality information in a timely manner

BOARD COMMITTEES

NOMINATION COMMITTEE

Reviews and makes recommendations to the Board on the structure, size and composition of the Board and its Committees, and leads the process for Director appointments and succession planning for Directors and senior management.

82

AUDIT COMMITTEE

Ensures the integrity of the financial reporting and audit processes, and the maintenance of sound internal control and risk management systems. Manages the relationship with the external auditor.

83

REMUNERATION COMMITTEE

Responsible for the Group's remuneration strategy and reviews and oversees the Group's Remuneration Policy for executive Directors, the Chairman and senior management.

92

EXECUTIVE MANAGEMENT COMMITTEES

EXECUTIVE COMMITTEE

Assists the Chief Executive in discharging his responsibilities. Develops and recommends strategy and budget, while management responsibilities are delegated to individual members.

INVESTMENT COMMITTEE

Assesses high-value and high-risk proposals, capital expenditure, asset disposal and special revenue expenditure projects which require Chief Executive or Board approval.

DISCLOSURE COMMITTEE

Advises the Chief Executive and the Board on the identification of inside information, and the timing and method of its disclosure.

ACQUISITIONS AND DIVESTMENTS COMMITTEE

Approves mergers, acquisitions, disposals and joint ventures within defined authority limits.

OUR BOARD

DIRECTOR BIOGRAPHIES

In order to operate effectively the Board and its Committees must be comprised of a diverse balance of skills, experience, knowledge, tenure and independence.

SIR GEORGE BUCKLEY

Chairman

Appointed: 1 August 2013

N R I on appointment

Sir George has had a successful career in engineering and innovation, holding the role of Chairman and CEO of 3M, a US-based global technology company and Dow Jones 30 component, prior to joining Smiths. His previous roles include Chairman and CEO of Brunswick Corporation and Chief Technology Officer for appliances, motors and controls at Emerson Electric Company. Sir George has a PhD in Electrical Engineering and his extensive experience of large, multi-industry businesses operating in global markets supports his effective Chairmanship of the Board.

Other significant appointments:

- Non-executive Chairman, Stanley Black & Decker, Inc.
- Non-executive Director, Hitachi Ltd.
- Non-executive Director, PepsiCo, Inc.

ANDY REYNOLDS SMITH

Chief Executive

Appointed: 25 September 2015

Andy spent over a decade at GKN plc, a complex global engineering group, before joining Smiths. Prior to leaving GKN he was Chief Executive of the Automotive division and a member of the GKN Board. Earlier in his career Andy held senior management roles at Ingersoll Rand, Siebe plc (now Schneider Electric) and Delphi Automotive Systems. His previous external appointments as Chairman of the CBI Manufacturing Council and as a member of the Government Ministerial Advisory Group for Manufacturing enhance the in-depth knowledge of the industry that Andy brings to the Board.

JOHN SHIPSEY

Chief Financial Officer

Appointed: 1 January 2018

John will stand for election by shareholders at the AGM.

Prior to joining Smiths John was Chief Financial Officer for Dyson, a diversified global technology company. He was part of the team leading Dyson's global growth, particularly in Asia. Before joining Dyson John spent 13 years at Diageo plc in a number of senior finance and strategy roles, including Finance Director for its Iberia region and Chief Financial Officer of Schieffelin & Somerset, a US joint venture between Diageo and LVMH. John is a Chartered Accountant and has valuable experience leading innovative companies with a global presence.

BRUNO ANGELICI

Non-executive Director

Appointed: 1 July 2010

A N R I

Bruno's career includes senior management roles in pharmaceutical and medical device companies. Bruno retired from AstraZeneca in 2010 as Executive Vice President, International, responsible for Europe, Asia Pacific, Latin America and MEA. Bruno's extensive experience brings a deeper understanding of the healthcare environment and industry to the Board. Bruno has an MBA from the Kellogg School of Management and a degree in Law from Reims University.

Other significant appointments:

- Non-executive Chairman, Vectura Group plc
- Supervisory Board member, Wolters Kluwer nv

OLIVIER BOHUON

Non-executive Director

Appointed: 1 July 2018

A N R I

Olivier will stand for election by shareholders at the AGM.

Olivier was Chief Executive at Smith & Nephew plc, a multinational medical equipment manufacturing company, until May 2018. He has significant global experience at pharmaceutical and MedTech companies, and his previous roles include CEO at Pierre Fabre Group and President of Abbott Pharmaceuticals. Olivier is a member of the French Academy of Pharmacy and the French Academy of Technologies, and has extensive business and leadership experience. He also has an MBA and a doctorate in Pharmacy.

Other significant appointments:

- Senior Independent Director, Shire plc
- Non-executive Director, Virbac SA
- Vice Chairman, LEO Pharma

DAME ANN DOWLING

Non-executive Director

Appointed: 19 September 2018

A N R I

Dame Ann will stand for election by shareholders at the AGM.

Dame Ann has had a distinguished academic career and is currently a Deputy Vice Chancellor and a professor of Mechanical Engineering at the University of Cambridge, where she served as Head of Engineering from 2009 to 2014. Dame Ann's contribution to engineering research is internationally recognised, and her knowledge and background will offer a different perspective to Board discussions.

Other significant appointments:

- Non-executive Director, BP plc
- President and Chairman of Trustees, Royal Academy of Engineering

Risk

A Audit Committee member

N Nomination Committee member

R Remuneration Committee member

Committee Chair

I Independent Director

DIRECTOR BIOGRAPHIES CONTINUED

TANYA FRATTO

Non-executive Director

Appointed: 1 July 2012

A N R I

Tanya has valuable experience in product innovation and sales and marketing across a range of sectors. Until 2010 she was CEO of Diamond Innovations Inc., a manufacturer of products for the material removal industry. Prior to this she held various senior positions during a successful 20-year career with GE, a multinational conglomerate. Tanya is a qualified electrical engineer with a BSc in Electrical Engineering.

Other significant appointments:

- Non-executive Director, Advanced Drainage Systems, Inc.
- Non-executive Director, Ashtead Group plc
- Non-executive Director, Mondi Group

BILL SEEGER

Non-executive Director

Appointed: 12 May 2014

N R I

Bill was appointed Chair of the Remuneration Committee on 1 July 2018, and subject to re-election by shareholders at the AGM will succeed Sir Kevin Tebbit as Senior Independent Director.

Bill was Group Finance Director at GKN plc, a global engineering group, until his retirement in 2014. Before joining GKN he held various senior finance positions at TRW, a US-based automotive and aerospace group, where he spent 28 years. Bill has had a long career in finance in the engineering sector, gaining an in-depth knowledge of global markets and has a BA in Economics and an MBA.

Other significant appointments:

- Non-executive Director, Spectris plc
- Visiting Professor, UCLA Anderson School of Management

MARK SELIGMAN

Non-executive Director

Appointed: 16 May 2016

A N R I

Mark brings a successful career in investment banking and extensive experience in corporate finance and capital markets to the Board. He was Chairman of UK Investment Banking for Credit Suisse and has served as chairman of several UK listed company audit committees. Mark is a Chartered Accountant, and has an MA in Philosophy, Politics and Economics.

Other significant appointments:

- Senior Independent Director, Kingfisher plc
- Senior Independent Director, The Royal Bank of Scotland Group plc
- Alternate member, Panel on Takeovers and Mergers for the Association for Financial Markets in Europe

NOEL TATA

Non-executive Director

Appointed: 1 January 2017

A N R I

Noel is the Managing Director of Tata International Limited, a global trading and distribution company and a trading arm of the Tata Group, a privately-owned multinational holding company. He is also a director of various Tata Group companies and has had a long and successful career in global business with extensive experience of high growth economies, including Asia and Africa which are key markets for Smiths' growth strategy. Noel has a BA in Economics.

Other significant appointments:

With the exception of Kansai Nerolac Paints Ltd, each of the following companies forms part of the Tata Group. All of the companies are listed on the Bombay and Indian National Stock Exchanges.

- Non-independent, Non-executive Chairman, Tata Investment Corporation
- Non-independent, Non-executive Chairman, Trent Ltd
- Non-independent, Non-executive Vice Chairman, Titan Company Ltd
- Non-independent, Non-executive Chairman, Voltas Ltd
- Non-executive Director, Kansai Nerolac Paints Ltd

SIR KEVIN TEBBIT KCB CMG

Senior Independent Director

Appointed: 14 June 2006

A N R I

Sir Kevin will step down from the Board at the conclusion of the 2018 AGM when Bill Seeger will be appointed the Senior Independent Director.

Sir Kevin held policy management and finance posts in the Ministry of Defence (MoD), Foreign and Commonwealth Office and NATO. These roles included Director of GCHQ and Permanent Under Secretary at the MoD between 1998 and 2005. Sir Kevin's career as a former senior British civil servant provides Smiths with considerable experience of government relations and the security and defence sectors.

Other significant appointments:

- Executive Vice President, AECOM UK (Government and Defence)
- Advisory board member, Imperial College Institute for Security, Science and Technology
- Chairman, Resilience Industry Suppliers Community

COMPANY SECRETARY BIOGRAPHY

JOHN MILLS

Company Secretary

Appointed: 1 June 2018

John has gained corporate governance and legal experience in a wide range of international businesses. He joined Smiths in 2018, having previously held senior roles in a variety of sectors, most recently at Anglo American plc, RSA Insurance Group plc and Cadbury plc. He has an LLB and is a Fellow of the ICSA: Governance Institute and a qualified solicitor.

Other Directors who served during FY2018

ANNE QUINN CBE

Non-executive Director

Anne retired from the Board and as Chair of the Remuneration Committee on 1 July 2018. Anne's biography can be found in our 2017 Annual Report.

Risk

- A Audit Committee member
- N Nomination Committee member
- R Remuneration Committee member
- Committee Chair
- I Independent Director

THE ROLE OF THE BOARD

COLLECTIVE RESPONSIBILITY FOR THE LONG-TERM SUCCESS OF SMITHS

The Directors are responsible for setting the tone from the top and ensuring that management actions are aligned with the interests of our shareholders. The Board is responsible for steering the Group's culture, and for our shared values of integrity, respect, ownership, customer focus and passion. The Board is also responsible for setting Group strategy and overseeing its implementation.

While monitoring the effective implementation of the Group's strategy our Directors ensure that risk is managed appropriately, and that management maintains an effective system of internal control. The Board also takes the interests of the Company's stakeholders into account, considering the impact that decisions taken have upon them.

There is a schedule of matters which are considered significant to Smiths and have therefore been reserved for the decision of the Board. This is due to their strategic, financial or reputational implications or consequences. The formal schedule can be found on our website and includes approval of:

- Group strategy, business plans and budgets
- Half yearly results and the Annual Report and Accounts
- Acquisition or divestment of significant companies or businesses
- Changes to the structure, size and composition of the Board

Board and Committee meetings

In order to operate effectively our Board meets at least six times a year. The Chairman is responsible for setting Board agendas and determines the style and tone of Board discussions. The meeting agendas are primarily focused on strategy, performance, value creation and accountability. More information about the Board's activity in FY2018 can be found on page 77.

All of our Directors allocate sufficient time to Smiths in order to remain effective. Individual Director attendance at Board and Board Committee meetings in FY2018 is detailed below. With the exception of Bill Seeger (see page 79 for more information) all of the non-executive Directors are members of the Nomination, Audit and Remuneration Committees.

Invitations to Board meetings are extended to divisional presidents, business managers and heads of functions to ensure that the Board is kept up to date with management priorities and challenges. External advisers are invited to attend as necessary. In addition to the formal meeting schedule our Directors attend informal meetings and visit divisional sites where they meet and hear from Smiths employees. Our Directors are able to gauge the culture embedded within the business through meeting employees both formally and informally.

To ensure the continued effectiveness of the Board, the Chairman meets the non-executive Directors without the executive Directors present after each Board meeting, and has separate meetings with the Senior Independent Director and the Chairs of the Audit and Remuneration Committees.
At least annually the Senior Independent Director consults with the other non-executive Directors, in respect of the Chairman's performance, without the Chairman present.

DIRECTOR ATTENDANCE

	Board[1]		Nomination Committee		Audit Committee		Remuneration Committee	
	Attended	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend
Chairman								
Sir George Buckley	6	6	6	6	–	–	6	6
Executive Directors								
Andy Reynolds Smith	6	6	–	–	–	–	–	–
John Shipsey[2]	4	4	–	–	–	–	–	–
Non-executive Directors								
Bruno Angelici[3]	6	6	5	6	3	4	5	6
Olivier Bohuon[2]	1	1	1	1	1	1	1	1
Tanya Fratto	6	6	6	6	4	4	6	6
Bill Seeger[4]	6	6	1	1	–	–	1	1
Mark Seligman	6	6	6	6	4	4	6	6
Noel Tata	6	6	6	6	4	4	6	6
Sir Kevin Tebbit	6	6	6	6	4	4	6	6
Former Directors								
Anne Quinn[5]	5	5	5	5	3	3	5	5

1 In addition to the six scheduled Board meetings there were three ad-hoc meetings called at short notice. Sir George Buckley, Mark Seligman and Anne Quinn had pre-existing commitments and were each unable to attend one of those meetings. All other Directors attended.

2 John Shipsey and Olivier Bohuon joined the Board part way through FY2018 so were not eligible to attend all meetings.

3 Bruno Angelici was unable to attend three Committee meetings held on the same day due to illness.

4 Bill Seeger was only eligible to attend one Nomination Committee and one Remuneration Committee meeting in FY2018 as he was not determined to be independent until May 2018. He was not a member of the Audit Committee in FY2018.

5 Anne Quinn retired from the Board on 1 July 2018.

FOCUSED ON OUR VISION AND STRATEGY

Board activity is focused on executing our strategy while ensuring our processes continue to deliver excellence.

STRATEGY

In May 2018, the Directors met for two days of strategy focused Board meetings. Senior leaders from each of the divisions, Asia Pacific, the Digital Forge and the i^3 team shared their strategic roadmaps out to FY2023, identifying the opportunities and challenges for how Smiths will continue to grow and achieve its ambition of being one of the world's leading technology companies.

The Board routinely reviews all options for the Group's portfolio of businesses to maximise value for our shareholders. During the year, the Board considered a number of strategic options for the Group.

M&A OVERSIGHT

The Board reviews the Group's M&A pipeline at each scheduled meeting and during the period approved M&A activity as the Group continues to review its portfolio. M&A activity over the year included:

November 2017
Flex-Tek's acquisition of the heating element division of Osram Sylvania Inc.

May 2018
The sale of John Crane's Bearings business

June 2018
John Crane's acquisition of Seebach GmbH, a high performance filtration business

PEOPLE AND CULTURE

The Group Human Resources Director presented the Directors with the People strategy in July 2018. A report on culture briefed the Board on The Smiths Way, the first annual Smiths Day, Diversity and Inclusion, the MySay engagement survey, the Smiths Excellence Awards finalists and the Smiths Now colleague smartphone app. In FY2018, the Board oversaw the launch of the Group's new Code of Business Ethics, and the Audit Committee has enhanced oversight of the programme of work to support the Code.

The Group Head of Health, Safety and the Environment presents regular reports to the Board. In FY2018 his reports covered safety performance and injuries at work, reduction of energy use, greenhouse gas emissions and water usage for the Group.

OPERATIONAL SITE VISITS

In May, the Board visited the 'digital accelerator' at Stanley Black and Decker in Atlanta, USA, and shared innovation ideas with other leaders in the field.

In July, the Directors were able to see the Smiths Excellence System in practice during their visit to the John Crane site in Chicago, USA. In addition to a tour of the site they received in-depth business updates on FY2019 plans, financial performance, operations, R&D and the people strategy. The Board were also briefed on the M&A pipeline for John Crane and the progress of the Seebach integration.

BOARD BRIEFINGS

The Board continues to focus on technology and innovation, and in FY2018 the Directors were briefed on Cyber risk and security by a security services professional, and received a presentation on innovative business models for potentially disruptive digital startup companies.

FINANCIAL PERFORMANCE

The Directors reviewed the Group's financial performance throughout the period, and particular focus was given to the half and full year results to ensure they were fair, balanced and understandable.

BOARD EFFECTIVENESS

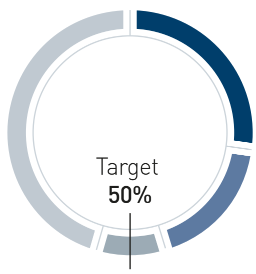
THE BOARD LOOKS TO MAINTAIN AND ENHANCE ITS EFFECTIVENESS TO CONTINUE TO DELIVER VALUE TO STAKEHOLDERS

Composition of the Board

A formal, rigorous and transparent process is in place for appointments to the Board. The Nomination Committee is responsible for recommending Director appointments following its regular assessment of the composition and skill set of the Board and its Committees. The Committee makes recommendations based on the merits of the individual candidates, having due regard for the benefits of diversity, and also the need to ensure the effective functioning of the Board at all times, especially as membership of the Board is refreshed. The breadth of experience on the Board was demonstrated when, at short notice, Bill Seeger was able to step into the role of CFO on an interim basis between May and December 2017. This also helped to facilitate John Shipsey's induction as Chief Financial Officer and as a member of the Board. More information can be found in the Nomination Committee report on page 82.

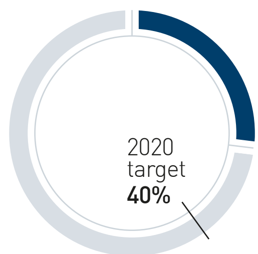
The rules regarding the appointment and replacement of Directors are determined by our Articles of Association and the Companies Act 2006 (the 'Act'). The Articles of Association can be found on our website and can only be amended by a special resolution of the shareholders.

BIRTHPLACE OR BACKGROUND



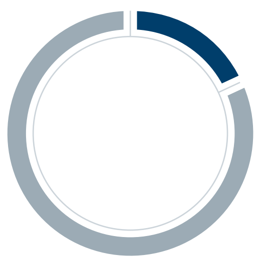
US	3
France	2
India	1
UK	5 (45%)

GENDER AND ETHNICITY



Current	27%

GENDER BALANCE



Female	2 (18%)
Male	9 (82%)

TENURE ON THE BOARD

0-2 years	4 (36%)
3-5 years	3 (28%)
Over 5 years	4 (36%)

* Correct as at 19 September 2018.

Diversity

Smiths supports the principles of the Hampton-Alexander and Parker reports on gender and ethnic diversity and will work to achieve a diverse Board and, just as importantly, diverse management teams. Members of the Board and senior management should collectively possess a diverse range of skills, expertise, national birthplace, domain knowledge and ethnic and societal backgrounds. These are important ingredients for the effective operation of the Board and oversight of the Group. As a multinational

Group with operations in more than 50 countries and over 95% of revenues originating outside the UK, diversity of thought and background is essential and will therefore remain one of the key criteria by which candidates are selected for the Board and the pipeline for senior leadership positions.

In recognition of the value of diversity, the Board seeks to ensure that at least 50% of its members have a birthplace or background outside the UK and that no less than 40% of the Board will be comprised of female plus historically under-represented ethnic groups by 2020. We are at 55% for birthplace or background and 27% combined gender and ethnic diversity as at the date of this report. This is expected to increase following the 2018 AGM, with 30% of the Board being gender and ethnically diverse. The Board will always seek to appoint the best qualified candidate, but between two candidates of equal merit the Board will, in recognition of the disproportionate under-representation of gender diversity on the Board, give preference to a female candidate when making its next appointment.

In order to help achieve these aspirations the Nomination Committee endeavours to only use the services of executive search firms who have signed up to the Voluntary Code of Conduct on Gender Diversity. Executive search firms will also be required to ensure non-UK nationals, women and candidates from historically under-represented ethnic groups are represented on the shortlist for all Board positions.

The Board will look to extend its work on diversity to senior leadership positions in the business and across the Group through oversight of the Smiths Diversity and Inclusion Plan, which is available on the Company's website. More information can be found on pages 62 and 63.

Independence

The Board keeps the independence of its members under continual review. Following his appointment as CFO on an interim basis during FY2017 Bill Seeger was no longer considered an independent non-executive Director. He resumed his non-executive Director responsibilities on 1 January 2018, and in May 2018 following careful consideration of agreed independence criteria, the Board determined Bill to be independent and he re-joined the Nomination and Remuneration Committees. With effect from 1 July 2018 he was appointed Remuneration Committee Chair. However, given his role as CFO on an interim basis during the period, the Board determined that Bill should not re-join the Audit Committee until after the publication of the FY2018 results.

In July 2018, the Nomination Committee assessed the performance and independence of each of the non-executive Directors, and the Committee concluded that each of them contributed effectively to the operation of the Board. As Sir Kevin Tebbit has served on the Board for 12 years a particularly rigorous review of his performance was undertaken. The Board concluded that he continues to demonstrate the qualities of objectivity and independence, and to contribute to constructive challenge and debate at meetings. It was therefore agreed that he should continue as Senior Independent Director until his retirement at the 2018 AGM, when Bill Seeger will replace him as the Senior Independent Director.

Time commitment

Our Directors must allocate sufficient time to their work as members of the Board. For non-executive Directors their expected time commitment is set out in their letter of appointment and includes time preparing for and attending Board and Committee meetings, meeting with shareholders as required, attending meetings as part of the Board evaluation process and making time to familiarise themselves with business priorities and challenges. Executive Directors will not be permitted to take on more than one non-executive directorship in a FTSE 100 company nor the chairmanship of such a company. The Directors' other significant commitments are detailed in their biographies on pages 72–75.

The Board considers the external appointments of each of the Directors twice a year, and in FY2018 the Board concluded that the Chairman and the non-executive Directors devoted sufficient time to fulfil their commitments to Smiths and discharge their responsibilities effectively.

In reaching this conclusion, particular consideration was given to Sir George Buckley's and Noel Tata's other commitments. Sir George has several other appointments, but following due consideration the other Directors confirmed that he continues to demonstrate commitment to his role as Chairman and as a member of the Board. Sir George attended and fully participated in every scheduled Board and Committee meeting and is always available for consultation with management when needed. Noel is Managing Director of Tata International Limited, a trading arm of the Tata Group (a privately-owned multinational group of companies) and, in order to fulfil his executive responsibilities for that group, is also director of various Tata Group companies. The Board believes that these appointments do not prevent him from committing sufficient time to his work as a Director, as evidenced by his full attendance and participation at all Board and Committee meetings in the year. As a current executive with contacts in higher-growth countries which are a strategic focus for Smiths, Noel brings valuable and distinct experience to discussions, and there was unanimous support from the Board to recommend his re-election to shareholders.

Information and training

All of our Directors undergo an induction programme on joining the Board in order to ensure that they are able to contribute effectively to discussion and decision-making. This is to provide them with the necessary knowledge and understanding of the Group, based on their personal experience and background. The table on page 80 describes the induction programmes for recent appointees.

The Board recognises the importance of ongoing training and our Directors are given the opportunity to update their skills and experience on a regular basis. Formal reports and updates from the divisions and external advisers ensure that the Directors remain aware of business priorities and external developments. The Board continues to focus on technology and innovation, and in FY2018 the Directors received briefings on cyber risk and security by a security services professional, and innovative business models for potentially disruptive digital startup companies. The Directors were also given training on regulatory developments, including Corporate Governance reform, EU General Data Protection Guidelines and Gender Pay Gap Reporting. Particular individual development needs are discussed with Directors as part of the annual performance evaluation.

BOARD EFFECTIVENESS CONTINUED

In order to operate effectively our Directors receive accurate, timely and high-quality information. This supports their ability to make sound decisions and provide appropriate advice and challenge. The Company Secretary and his team assist the Chairman and Chief Executive in ensuring effective information flows and that the Board is provided with all relevant information in a timely manner. There are procedures in place to ensure that information the Board receives is presented in an appropriate format and contains the level of detail required for Directors to fulfil their responsibilities effectively.

Conflicts of interest

Our Directors must avoid situations where they have a direct or indirect interest that conflicts, or may possibly conflict, with the best interests of Smiths. The Directors are required to declare such interests to the Board, and in accordance with our Articles of Association and the Act, our Board can authorise conflicts and potential conflicts.

The Company Secretary maintains a Register of Conflicts which forms the record of actual and potential conflicts that exist, and any Board authorisation granted. The Board reviews the Register in September and March each year, and retains the power to vary or terminate any authorisation.

Advice and insurance

All of our Directors have access to the advice and services of the Company Secretary, and are able to seek independent professional advice at Smiths' expense to enable them to fulfil their obligations as members of the Board. In addition, the Directors and Officers of Smiths and its subsidiaries have the benefit of a Directors' and Officers' liability insurance policy.

During FY2018, and at the date of this report, qualifying third-party indemnity provisions (as defined by section 234 of the Act) have remained in force for the Directors of the Company and certain other employees in respect of their directorships of some subsidiary companies in relation to certain losses and liabilities which they may incur (or may have incurred) to third parties in the course of their professional duties for the Company, or a subsidiary.

Director re-election

Each year our Directors are subject to election or re-election by shareholders at the AGM. Non-executive Directors are appointed for a specified term of three years, subject to annual re-election at the AGM. Reappointment for a second three-year term is not automatic, and any term for a non-executive Director beyond six years is subject to a particularly rigorous review.

Based on the performance evaluation undertaken in FY2018 our Chairman, on behalf of the Nomination Committee, has confirmed that each non-executive Director standing for re-election at this year's AGM continues to be an effective member of the Board, and has demonstrated the commitment required.

DIRECTOR INDUCTION

Following their appointments in FY2018, John Shipsey, Olivier Bohuon and Dame Ann Dowling received tailored induction programmes. In line with normal practice, meetings were arranged with the Chairman, the Company Secretary, non-executive Directors, Executive Committee members, including the divisional presidents, and other senior executives. Extensive information about the Group is made available to new Directors, including access to previous Board papers and minutes, to provide an insight into the Group's strategy, culture and values.

John Shipsey was appointed as Chief Financial Officer Designate in October 2017, creating time for a three-month handover with Bill Seeger who was still in post as CFO on an interim basis, before John was appointed to the Board on 1 January 2018. John's induction was tailored for his appointment as an executive Director, and in his handover period he learnt about the business while starting to collaborate with colleagues and developing relationships. He visited sites in China with the President, Asia, where time was dedicated to learning about the opportunities for growth in the region.

To support their understanding of the business, Roland Carter, President Detection, hosted Olivier and Dame Ann at Smiths Detection's Wiesbaden site. They were given a site tour, attended management meetings, and discussed business performance and technologies.

They also met the winners of divisional Excellence Awards and discussed their winning projects. Further meetings are being arranged for Olivier and Dame Ann to learn more about the business and its people.

BOARD EVALUATION

PRINCIPLES

Each year an evaluation of the Board, its Committees and each individual Director is conducted. The Board uses this evaluation to monitor its effectiveness and to continue to improve its performance. The Board conducts an externally facilitated evaluation at least every three years.

FY2017 BOARD EVALUATION ACTIONS

The Board has made progress on the actions following the FY2017 internally facilitated evaluation.

Evaluation theme	Actions	Progress in FY2018
Board composition	Review succession plans and introduce a Board Diversity Policy	Appointed two new non-executive Directors and considered ongoing succession planning Approved the new Board Diversity Policy
Culture, people and succession planning	Increase Board oversight of these areas and create opportunities to meet senior managers	Divisional operating reviews given more time on the Board agenda and invitations to Board events extended to senior managers Site visits for the Board held in Chicago, and incorporated into Director induction programmes Enhanced oversight of the new programme of work supporting the Code of Business Ethics
Strategic oversight and governance	Review Board Governance framework Redesign Board and Board Committee agendas	Commenced review of the role and responsibility of the Board and its Committees and updated the Committees' Terms of Reference Updated agendas to focus on strategic objectives New KPIs were agreed, see page 25
Board effectiveness	Improve length, focus and clarity of Board papers Identify Director briefing opportunities	Introduction of new software for the distribution of Board papers, and continued improvement to content and timeliness of papers Two Director briefings were held, see page 79

FY2018 BOARD EVALUATION

The FY2018 evaluation of the Board was externally facilitated by Independent Audit Limited, who have no other connection to the Company. The objective was to build on the FY2017 process and to enhance the Board's contribution to support the delivery of the Group's growth strategy.

The evaluation was focused on boardroom dynamics, strategic focus, people and culture and risk. Independent Audit held interviews with the Board and certain members of the Executive Committee, senior managers and external advisers. They presented their final report to the September 2018 Board meeting and the Directors will agree an action plan to address the key findings. These included processes around succession planning for the Board itself and for executive management, and ways to increase the Board's insight into and interactions with the Group and its culture, and we will report on progress in next year's Annual Report.

NOMINATION COMMITTEE

SIR GEORGE BUCKLEY
Chair of the Nomination Committee

> "Inclusive and diverse Boards are better able to understand the interests of all our stakeholders. This leads to stronger governance and better decision-making."

ROLE OF THE COMMITTEE

The Nomination Committee reviews and makes recommendations to the Board on the structure, size and composition of the Board and its Committees. In fulfilling this role, the Committee considers the balance of skills, knowledge, experience and diversity on the Board, and takes account of the Group's strategy, current and future challenges and opportunities.

The Committee leads the Director appointment process, and is responsible for considering Director and senior management succession planning.

The members of the Committee and their meeting attendance during the year is set out on page 76. The Chief Executive is normally invited to attend Committee meetings and has attended each of the meetings in FY2018. Other members of senior management are invited to attend as necessary.

IN ORDER TO FULFIL ITS ROLE THE COMMITTEE

- Takes account of the Group's strategy, business performance, current and future leadership needs, challenges and opportunities, and makes recommendations to the Board on its composition and that of its Committees
- Holds at least one meeting a year to review senior management succession plans and the quality of the talent pipeline across the Group
- Conducts an annual review of its performance and of its Terms of Reference, and recommends any changes to the Board

PERFORMANCE EVALUATION

In FY2018, the performance of the Committee was considered as part of the wider externally facilitated Board evaluation process. A number of minor recommendations were made to enhance the Committee's operation, and overall it was confirmed that the Committee continues to operate effectively.

NOMINATION COMMITTEE ACTIVITIES

Succession planning

When considering potential Board candidates the Committee reviews the Board succession plan. In FY2018, particular focus was given to the skills required for the Board to continue to deliver the Group's growth strategy, in anticipation of the retirement of Anne Quinn and Sir Kevin Tebbit. The Committee recommended the appointment of John Shipsey as Chief Financial Officer and Olivier Bohuon and Dame Ann Dowling as non-executive Directors. In FY2018, external search firm Buchanan Harvey & Co. was used for Director appointments; this is its only connection to Smiths. Buchanan Harvey & Co. is a member of the Voluntary Code of Conduct for executive search firms.

In July 2018, the Group Human Resources Director presented a report on executive Director and senior management leadership and succession, and the Committee undertook a detailed review of talent management.

The Committee considered the independence requirements set out in the UK Corporate Governance Code, and in May recommended to the Board that Bill Seeger be considered independent and rejoin the Nomination and Remuneration Committees, following his role as CFO on an interim basis in 2017. On the recommendation of the Committee, and subject to his re-election at the AGM, Bill will succeed Sir Kevin Tebbit as Senior Independent Director.

Diversity

In FY2018, the Board delegated an additional responsibility to the Committee to review and approve the Board Diversity Policy. The Board has published a new Board Diversity Policy, details of which can be found on page 78. The Committee considered how to express the Board's commitment to diversity in its broadest sense, and targets were agreed which are in line with the Group's strategy.

AUDIT COMMITTEE

MARK SELIGMAN
Chair of the Audit Committee

"With the Group's return to growth and the challenges and risks faced by the business, the Committee plays a key role in overseeing the integrity of the Company's financial statements."

ROLE OF THE COMMITTEE

The principal role of the Committee is to assist the Board in fulfilling its oversight responsibilities in relation to financial reporting, financial controls and audit, risk and internal controls. The Committee also manages the relationship with the external auditor, including making recommendations to the Board and our shareholders in relation to the reappointment of the external auditor.

The Committee also oversees the Group's ethics and compliance annual work programme and investigates any material ethics and compliance issues that may arise.

IN ORDER TO FULFIL ITS ROLE THE COMMITTEE

- Holds four scheduled meetings a year to coincide with key dates within the financial reporting and audit cycle. With effect from FY2019, the Committee has agreed to hold an additional fifth meeting each year to help accommodate its increasing risk agenda
- Receives presentations from divisional and functional heads to gain an understanding of the risks and culture present throughout the organisation
- Has access to information and advice from within Smiths and externally, including the opportunity to seek external professional advice
- Meets privately with internal and external audit after each Committee meeting
- Conducts an annual review of its performance and its Terms of Reference, and recommends any changes to the Board

I am pleased to present the Audit Committee's report for FY2018.
The Committee fulfils an important oversight role on behalf of the Board, monitoring the integrity of the Group's financial reporting and the effectiveness of both the Group's systems of internal control and its risk management framework.

A key stakeholder in supporting this oversight is the Group's external auditor, PwC, so in addition to fulfilling its normal programme of work the Committee has focused on the external audit tender we described in last year's Annual Report. The tender process is ongoing and we hope to be able to make a recommendation to the Board during the calendar year. During FY2018, to further support our oversight, we have also received independent third-party reports on important elements of our internal control environment. More details can be found in this report.

The Committee has also considered the way it operates. Previously, at each meeting the Committee received a report from the Chief Financial Officer and PwC. However, as an enhancement in FY2018 these reports were integrated such that the Committee now receives a single report on the Group's financial controls, approach to reporting and related audit matters. This allows the Committee to more easily identify and challenge the issues in hand with the views of both management and the external auditor in one place.

We have agreed to schedule another Committee meeting each year to allow greater opportunity to review the Group's risk framework and to discuss with senior employees the arrangements in place to mitigate principal risks.

Finally, I'd like to thank my colleagues on the Committee for their contribution during the year and I look forward to continuing our work in FY2019.

MARK SELIGMAN
CHAIR OF THE AUDIT COMMITTEE

AUDIT COMMITTEE CONTINUED

AUDIT COMMITTEE ACTIVITIES

Committee membership and meetings

The Committee met four times during FY2018, with three meetings timed to align with the financial reporting and audit cycles of the Group, namely: the approval of the Annual Report and Accounts in September; the approval of the half yearly results in March; and the presentation of the pre-year-end 'early warnings' report from the external auditor, PwC, in July. A meeting was also held in May 2018 at which the Committee undertook a deep-dive of the Group's arrangements in respect of cyber risk.

All members of the Committee who served during the year are, in the view of the Board, independent non-executive Directors and collectively have recent and relevant financial, accounting and sector experience gained from the Directors' respective international business activities. Individual Committee member biographies and attendance at meetings during the year can be found on pages 72–75 and 76 respectively. In particular, the Board considers that Mark Seligman who has a long history in corporate finance and experience of other listed company audit committees, as well as being a qualified accountant, has the recent and relevant financial experience required to Chair the Committee.

At the invitation of the Chair of the Committee and in order to maintain effective communications, the Chairman, Chief Executive and Chief Financial Officer attended all meetings. Other regular attendees who advised the Committee included: the Group Financial Controller, the Director of Internal Audit, the Group Director of Tax and Treasury, the Senior Vice-President & General Counsel – Ethics & Compliance, the Company Secretary and audit partners of PwC. Other members of senior management were also invited to attend as appropriate.

At the conclusion of meetings, PwC and the Director of Internal Audit were each given the opportunity to discuss matters with the Committee without executive management being present.

The Director of Internal Audit, the Senior Vice-President & General Counsel – Ethics & Compliance and PwC have direct access to the Committee should they wish to raise any concerns outside formal Committee meetings.

The Chair of the Audit Committee reports formally to the full Board on the activities of the Committee after each Committee meeting.

Financial and narrative reporting

The Committee is responsible for reviewing the half yearly results announcements and the Annual Report and Accounts before recommending them to the Board for approval.

During the year, the Group has had internal control and risk management arrangements in place to support the financial reporting process and provide reasonable assurance that the financial statements are prepared in accordance with applicable standards. These arrangements include seeking divisional confirmation that their reported information gives a true and fair view of the results for the period and ensuring that record keeping allows an accurate and fair reflection of transactions.

For the period under review the Committee has:

- considered information presented by management on significant matters of judgement, accounting estimates and the interpretation of reporting standards in the adoption of policies. The Committee is required to report to shareholders on the process it follows in its review of significant estimates and judgemental issues. These are set out on page 85;
- considered changes to accounting standards and agreed the appropriateness of accounting policies;
- discussed with PwC its audit reports and noted the key accounting matters and significant judgements highlighted by PwC in respect of each set of financial statements;
- examined key points of disclosure and presentation to ensure the adequacy, clarity and completeness of the 2018 Annual Report and Accounts and the half yearly results announcement;
- reviewed various materials to support the statements on risk management and internal control; going concern; and the assessment of the Group's long-term viability – see pages 50–59 and 68 for more details; and
- assessed the processes and activities undertaken by the Group in order to ensure that the Annual Report when taken as a whole, is 'fair, balanced and understandable' and concluded that the quality and range of information provided in the Annual Report was sufficient to enable shareholders to assess properly the Group's position, performance, business model and strategy.

In assessing the fairness, balance and understandability of the Annual Report, the Committee considered:

- the accuracy and integrity of the messages conveyed in the report; the appropriateness of the level of detail in the narrative reporting; the correlation between the judgements and issues and the disclosures and estimation of uncertainties;
- the consistency between the narrative reporting in the 'front half' and the financial reporting in the 'back half' of the report;
- the explanations of the differences between statutory and headline reported results; and
- the design and layout of information and data; the clarity of the reporting and messages conveyed; and the holistic nature and tone of the report.

Following its review the Committee agreed that the Annual Report is representative of the year and presents a fair, balanced and understandable overview, providing the necessary information for shareholders to assess the Group's position, performance, business model and strategy.

SIGNIFICANT JUDGEMENTS AND ISSUES

An important responsibility of the Committee is to review and agree the most significant management judgements and issues which impact the financial statements. The key areas of judgement in the year were as follows:

Revenue recognition

The Committee reviewed progress toward the adoption of IFRS 15 'Revenue from Contracts with Customers' including the interpretation judgements made in drafting the Group's revenue recognition policies. Attention was also given to the weighting of profits toward the final quarter of the year and in particular the timing of shipments to distributors and customers. The Committee oversaw the implementation of a new control process designed to ensure revenue was accounted for correctly. The treatment of one-off items generating non-recurring profit was also considered.

Impairment

The intangible assets and the assumptions used to justify their carrying values, including 'fair value less costs to sell' were reviewed. Following the integration of Morpho Detection and Smiths Detection, particular attention was given to the combined business being treated as a single cash generating unit (CGU). The Smiths Interconnect – Subsystems CGU was also considered, along with the proposal to consolidate Interconnect's Microwave Subsystems and Connectors & Components CGUs into a single CGU for impairment testing. The carrying value of capitalised development expenditure was reviewed and the treatment was considered reasonable due to the planned timing of new product launches and projected future cash-flows. The Committee agreed a change to the evaluation of the useful life used to amortise capitalised R&D which resulted in a change from a standard five years to between three and eight years, depending on whether the product is a new platform or derivative, and whether it is hardware or software. See note 11 of the financial statements.

Acquisitions and divestments

The Committee reviewed the final fair-value adjustments to the acquisition balance sheet for Morpho Detection and agreed the treatment for deferred consideration which has been recognised in the income statement. The accounting treatment of the disposal of John Crane's Bearings business included the judgement that, due to the immaterial scale of the transaction, the disposal did not meet the criteria to be classified as a discontinued operation. The acquisitions of the heating element division of Osram Sylvania Inc. and Seebach GmbH were also considered and particular attention was paid to the fair value of assets and liabilities acquired and the resulting goodwill. The Committee also considered the treatment of costs between headline and non-headline.

Working capital

Judgements within working capital, including the level of inventory and provisions and overdue receivables particularly in emerging markets were reviewed. The Committee reviewed progress toward adoption of IFRS 9 'Financial instruments' including the impact of adopting an expected credit loss model for receivables provisioning. See the Accounting Policies section of the financial statements.

Provisions for liabilities and charges

The Committee continued to monitor expert assessments on the Group's exposure to the John Crane, Inc. asbestos litigation and to the Titeflex Corporation CSST claims. In particular, the Committee considered the treatment of potential liabilities and the changes to the assumptions made in calculating the provisions, including the re-assessment of the time period for the Titeflex Corporation CSST provision and the continued appropriateness of the ten-year time period for John Crane, Inc. asbestos litigation. In the case of the John Crane, Inc. asbestos litigation, the Committee also agreed with the judgement that, whilst large numbers of claims are made against John Crane, Inc. and other defendants every year, trials are extremely rare such that a sufficiently reliable estimate cannot be made to cover the full period over which it is expected that costs will be incurred. In both these cases, it was determined that the assumptions fairly reflect the position. See note 22 of the financial statements.

Taxation

The assets and liabilities recognised in income and deferred tax, as well as the treatment of losses in the UK were assessed. Particular focus was given to the recognition of UK deferred tax assets which are judged to be recoverable; deferred tax assets relating to the John Crane, Inc. asbestos provision; and the Titeflex Corporation CSST provision. In reviewing projected profit streams the Committee was satisfied that, where appropriate, the relevant entities will generate sufficient future taxable profits to utilise the assets recognised. See note 6 of the financial statements.

Post-retirement benefits

The Committee reviewed and agreed the methods, assumptions and benchmarks used by the actuaries to calculate the position of the UK and US schemes at 31 July 2018, which have continued to show a net accounting surplus position. The Committee agreed the treatment and the corresponding disclosures on these matters. See note 8 of the financial statements.

The Committee, after receiving the reports on the significant issues and areas of judgement, was content that the judgements made were appropriate and are correctly reflected in the Annual Report.

AUDIT COMMITTEE CONTINUED

AUDIT COMMITTEE ACTIVITIES

External audit

The Committee places great importance on the quality, effectiveness and independence of the external audit process. In respect of the period, the Committee:

- considered PwC's audit report on its review of the FY2018 half yearly results announcements; and its 'early warnings' report on the FY2018 audit;
- approved and monitored PwC's execution of the audit plan;
- discussed any significant issues identified by PwC during the course of the audit, including the key accounting and audit judgements taken by management and management's responses to the audit findings;
- agreed materiality and de minimis levels with PwC; and
- considered the draft letter of representation from the Company to PwC in connection with the audit of the FY2018 financial statements.

The Committee confirms that the Company has complied with the provisions of the Competition and Markets Authority Order 2014 relating to the UK audit market for large companies throughout the year under review and as at the date of this report.

External auditor independence, effectiveness and reappointment

The Committee is responsible for the development, implementation and monitoring of the Group's policies on external audit, which are designed to maintain the objectivity and safeguard the independence of the external auditor. These policies, which are reviewed annually, include the engagement of PwC for non-audit work and regulate the appointment by the Group of former employees of PwC.

The non-audit services policy corresponds with the European Commission's recommendations on the auditor's independence and with the Revised Ethical Standards issued by the Audit Practices Board in the UK.

The Committee recognises that certain non-audit services can be completed more efficiently by, and be purchased more cost-effectively from, the incumbent auditor due to the audit firm's existing knowledge of the Group and its systems. Under the policy the Committee has delegated its responsibility for authorising non-audit services from PwC to the Chair of the Committee and the Chief Financial Officer, within set limits:

- the Chief Financial Officer may approve any service costing less than £10,000 if it complies with the objectivity and independence principles set out in the policy.
- any permitted service costing more than £10,000 in aggregate and less than £100,000 must be approved by the Chair of the Committee.
- where the estimated total cost is expected to exceed £100,000 then the service must be subject to a competitive tender unless agreed by the Chief Financial Officer and the Chair of the Audit Committee.

The Committee is satisfied that the non-audit work performed by PwC during the financial year had been properly assessed and authorised in accordance with the Group policy.

In addition to monitoring compliance with the Group's policies on the employment of former employees of PwC and the use of PwC for non-audit work, the Committee's review of PwC's independence included:

- examining written confirmation from PwC that they remained independent and objective within the context of applicable professional standards;
- considering the tenure of the audit engagement partner, who is required to rotate every five years in line with ethical standards; and
- monitoring the ratio between the fees for audit work and non-audit services.

Details of the fees paid to PwC for the year ended 31 July 2018 can be found in note 2 on page 138. Non-audit fees as a percentage of audit fees totalled 5% (FY2017: 8%). The Company would not expect in the ordinary course of business for non-audit fees to exceed 20% of the average of the previous three years' total Group audit fees unless exceptional circumstances existed.

Audit effectiveness is assessed continually throughout the year using a number of measures including: reviewing the quality and scope of the proposed audit plan and progress against the plan; responsiveness to changes in our businesses; and monitoring the independence and transparency of the audit.

The Committee also reviews the performance of PwC and the effectiveness of the external audit process by conducting a survey of the Board, senior management and divisional finance teams. The survey included questions on PwC's independence and objectivity, audit strategy and planning, conduct and communication, audit findings and feedback, and expertise and resourcing. The results were positive and confirmed that PwC and its audit process were appropriate and effective; and that the relationships between the audit teams and the Company's businesses continued to provide effective and objective challenge. Areas identified for improvement were agreed with PwC. The Committee also noted the findings in the FRC's June 2018 Audit Quality Inspection report on PwC.

Subsequent to its assessment of PwC's independence and performance, the Committee satisfied itself that the quality of the work exhibited by the firm and its commitment to improvements were of a high standard. The Committee therefore agreed that it was appropriate to recommend to the Board that the reappointment of PwC as the Company's auditor for a further year be proposed to shareholders at the 2018 AGM.

AUDIT TENDER

PwC or a predecessor firm has been the Company's external auditor since 1997, and there has been no previous external audit tender since their appointment. Smiths is required to replace PwC as its statutory auditor by 2023. However, as reported in the FY2017 Annual Report, the Committee concluded that it was in the best interests of the Company to tender for the rotation of the external auditor for the FY2020 audit. This coincides with the end of tenure for the current lead engagement partner Andrew Kemp who, having been the lead engagement partner for five years, in accordance with ethical standards, will be required to rotate off the Smiths account.

During FY2018, the Committee initiated a tender process designed to be transparent, effective and efficient and give each participating firm an equal opportunity to successfully tender. Prior to the tender, participating firms were provided opportunities to engage with Smiths through the placement of non-audit services. This enabled participating firms to develop their understanding of the business, and its systems and controls. Procedures for managing access to employees and Board members and potential conflicts of interest, including gifts and hospitality, were implemented.

Except for PwC, no other firms were prevented from participating in the tender. However, the Committee agreed that only Deloitte, EY and KPMG should be issued with the Request For Proposal (RFP) following consultation with several "second tier" firms who confirmed that due to their size they would be unable to respond effectively to an RFP. There are no contractual obligations restricting the Group's choice of external auditor.

To help support the Committee in developing and implementing its planned approach, the Committee approved the formation of a Steering Group, comprised of the Chair of the Committee Mark Seligman, Sir Kevin Tebbit, Bill Seeger and John Shipsey to oversee the work of management. The Chair of the Committee and the Steering Group each met with the tender project team and received and commented on the main materials prior to them being issued to the Committee and/or the participating firms.

In line with FRC guidance the evaluation criteria for the process was agreed as:

- Organisation and capability
- Audit approach and delivery
- Audit quality and value-add
- Resourcing and engagement team
- Fees and contracts.

In order to evaluate each of the firms against the criteria the Committee is in the process of overseeing a number of activities including:

- Analysis of RFP responses
- Presentations to Group and divisional finance teams and corporate functions
- Assessment of performance on non-audit services previously provided
- Due diligence including reviewing Audit Quality Review Team reports published by the FRC and references
- Presentations to the Steering Group and the Committee.

The tender process is ongoing and the Committee hopes to make a recommendation to the Board during the 2018 calendar year following which a detailed transition plan will be developed. The implementation of the transition plan will be overseen by the Committee through FY2019.

AUDIT COMMITTEE CONTINUED

AUDIT COMMITTEE ACTIVITIES

Risk management and internal control

During the year, the Committee, on behalf of the Board, carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency and liquidity. A description of the principal risks facing the Company and how these were reviewed to assess the Group's viability can be found on pages 50–59 and 68.

The Board is also responsible for ensuring that there are sound risk management and internal control systems in place to safeguard shareholders' investments and the Group's assets.

The internal control system is a framework to manage risks and monitor compliance with procedures. The Group's internal control systems are designed to meet Smiths' particular needs and the risks to which it is exposed. However, they can provide only reasonable, not absolute, assurance against material loss to the Group or material misstatement in the financial statements. The Executive Committee is responsible for designing the Enterprise Risk Management (ERM) system and ensuring it is effectively deployed throughout the Group. More detail can be found on pages 50 and 51.

In FY2018, the Committee, on behalf of the Board and with the assistance of the Internal Audit function, monitored, reviewed and assessed the effectiveness of the Group's risk management and internal control systems in the context of the Group's strategy and business model.

In fulfilling its responsibilities, the Committee:

- Received reports to enable an evaluation of the Group's control environment and risk assurance framework and embedded risk management processes. This included a report commissioned by the Committee from an independent third-party provider to complete a limited scope review of the Group's ERM framework. The report confirmed that the existing ERM process addressed all of the expected elements. In particular, stakeholders had reported that the risk process had proportionate focus and consistency across the business. Enhancement opportunities were identified based on stakeholder feedback and leading practice witnessed at other organisations. Although none of the opportunities were considered material, the Committee provided oversight of the enhancements adopted;
- Received reports from each of the divisions on the ERM process and an analysis of their own risk registers. This enabled the Committee to understand the risks and opportunities and assurance processes throughout the business and the potential impact on the Group. The Committee also considered two principal risk deep-dive reviews into enterprise and product cyber risk and the risk of a significant ethical breach with a focus on third-party agents and distributors; and
- Reviewed management's plans to enhance controls in the Group's internal financial and risk controls and monitored their effectiveness. The Committee did not view any of the issues identified as significant.

Internal Audit

Internal Audit is independent of the business, and as such has no responsibility for operational business management. This ensures the integrity and objectivity of its annual Audit Plan work, which is approved by the Committee. The authority of the Internal Audit function is derived from the Committee. The Director of Internal Audit is accountable to the Board through the Chair of the Committee. Administratively, the Director of Internal Audit reports to the Chief Financial Officer. In order to carry out the responsibilities, as set out in a charter approved by the Committee, the Internal Audit function has:

- full and unrestricted access to all Smiths records, property and personnel;
- independent access to the Chair and members of the Committee;
- the right to request meetings with the Committee; and
- the authority and obligation to report significant findings or other concerns to the Committee.

During the period the Committee:

- received progress reports on the execution of the 2018 Internal Audit Plan;
- discussed recommendations made by the internal auditors;
- considered the remit of Internal Audit, its budget and resources and the nature and extent of any outsourcing to specialist co-source providers; and
- approved the 2019 Internal Audit Plan, including the proposed audit scope, approach, coverage and allocation of resources.

The Committee oversees the performance of the Internal Audit function through the Director of Internal Audit's attendance at Committee meetings and a review of agreed KPIs which are reported to the Committee. In addition, the Committee oversaw the appointment of an independent third party to conduct an effectiveness review of the Internal Audit function. The review assessed the Internal Audit function's conformance with the International Standards for the Professional Practice of Internal Auditing (Standards) and benchmarked the function's operation against other functions in listed companies, as well as identifying any opportunities for improvement. The findings from the review, which were presented to the Committee, were positive. Internal Audit is seen as a valued assurance function throughout the Group, it is appropriately resourced and conforms with the Standards. There were some opportunities for improvement, including enhancements to audit documentation and agreeing the correct level of coverage for future internal audits.

Treasury and Tax

During the financial year, the Committee reviewed reports from the Treasury department on financial risk and treasury management, noting the Group's borrowing position and debt capacity and its impact on the Group's viability. The Committee also received status reports on tax risk from the Tax department, noting the assessments of compliance, tax audit risk, tax provisions and international tax rates. The Group's assessment of its appetite for tax risk was also reviewed. The Group's tax strategy is available on our website.

Ethics and Compliance

During the financial year, the Committee reviewed the work programme of the Smiths Ethics and Compliance Office, whose activities included the launch of a new Code of Business Ethics; investigations into allegations of non-compliance with the Code of Business Ethics and any matters raised through the Group's anonymous ethics reporting procedures. In respect of anonymous ethics reporting the Committee considered that the Group's processes and arrangements for employees to report concerns about any improprieties and any subsequent investigation as necessary, were both appropriate and effective. No issues were raised that required the Committee's action. More information can be found on page 63.

The Committee also commissioned an audit from a third party on the effectiveness of certain Group policies and processes supporting Ethics and Compliance. The review covered the ethics and compliance framework; distributors and agents; international trade compliance; gifts and entertainment and modern slavery (direct labour and supply chain). The report concluded that there has been significant progress in strengthening the overall compliance framework and compliance processes around the in-scope policy areas from its previous audit conducted in 2016. The report also identified some areas for further focus which will be overseen by the Committee. The third party has recently audited Smiths' antitrust and labour standards compliance programme. The audit report is due by the end of September and will be reviewed by the Committee.

The Committee also received regular reports on the Group's preparedness for the implementation of the General Data Protection Regulation (GDPR). The obligations under GDPR build on those in existing law already applicable to Smiths. Smiths has revised and updated its policies and procedures to reflect these obligations.

Performance evaluation

The annual evaluation of the performance of the Committee was conducted as part of the overall annual evaluation of the performance of the Board conducted by Independent Audit. The findings relating to the Committee were discussed with the Committee Chair. Overall, the Committee is considered to be performing well, and is rigorous and effective in discharging its responsibilities.

Committee's assessment of internal control and risk management arrangements

In light of its work, the Committee was content with the effectiveness of the Group's processes governing financial reporting and controls, its culture, ethical standards and its relationships with stakeholders. The Committee was also satisfied with the appropriateness and adequacy of the Group's risk management arrangements, internal control framework and three lines of defence model.

RELATIONS WITH SHAREHOLDERS

EFFECTIVE COMMUNICATION WITH OUR SHAREHOLDERS IS ESSENTIAL

A strong relationship with shareholders is essential for the success of the Company, and our Directors believe that this is supported and maintained by effective communication. The Board continually engages with institutional investors, private shareholders and other providers of capital.

INSTITUTIONAL INVESTORS

The Board is kept informed of investor views through the distribution of analyst and broker briefings, and after meetings with major or prospective shareholders the Chief Executive circulates written updates to the other Directors to ensure that all Directors are made aware of major shareholders' issues and concerns.

- In FY2018, our Chief Executive, Chief Financial Officer and Investor Relations Director led analyst briefings, including the bi-annual presentations of the Group's financial results, and carried out extensive investor roadshows in the UK, USA and Europe. This ongoing engagement ensures a two-way communication on business performance and our strategy
- Our Chairman and non-executive Directors were available to meet with investors to discuss issues as and when they arose
- In December 2017, our Chief Executive hosted a Capital Markets Day in London for analysts and investors, with presentations from members of the Executive Committee and senior managers. The event was an opportunity for institutional investors to gain a deeper understanding of the Group's strategy and the actions underway to drive sustainable growth. Details are available on our website.

In FY2018, senior management and the Investor Relations team had contact with over 150 investors and analysts.

INVESTOR AND ANALYST MEETINGS IN FY2018

United Kingdom	57%
US and Canada	28%
Rest of Europe	11%
Rest of World	4%

Investor relations timeline

Date	Event
September 2017	Annual results and investor roadshow
December 2017	Capital Markets Day
January 2018	US Investor Relations roadshow
March 2018	Interim results and investor roadshow
May 2018	UK private client broker roadshow
September 2018	Annual results and investor roadshow

PRIVATE SHAREHOLDERS

- Sir Kevin Tebbit, Senior Independent Director, hosted a meeting with members of the UK Shareholders Association in June 2018
- In FY2018 a number of initiatives were in place for the benefit of our private shareholders

Asset reunification programme – the programme to facilitate the payment of unclaimed dividends and to reunite shares with shareholders began in 2016. The programme finished in April 2018, having reunited shareholders with shares or dividends valued at £8.3m.

E-communications – letters promoting the benefits of e-communications were issued to shareholders who receive hard copy Company documents. E-communications allow timely, cost effective and environmentally friendly shareholder communication.

Dividend cheques – the Board approved the removal of dividend cheques with effect from November 2019 to ensure that all shareholders receive their dividend securely and on the payment date.

OTHER CAPITAL PROVIDERS

- The Chief Financial Officer and the Group Director, Tax and Treasury meet and communicate proactively with committed lending banks and bond holders and the rating agencies on a regular basis
- Committed banks are invited to the results presentations to enable them to keep informed of business strategy and to meet senior management
- Board members are kept informed of the current credit views of debt investors and the ratings agencies through regular commentary and financial metric reporting to Board meetings

Our AGM

The Directors consider our AGM an important opportunity to engage with shareholders. Shareholders are invited to ask questions during the meeting, and have the opportunity to meet Directors before and after the formal proceedings to discuss issues and priorities. It is also an opportunity for shareholders to vote on certain aspects of Group business in person after hearing from the Chairman, Chief Executive and Chief Financial Officer. All resolutions are voted on by way of a poll as this allows the Company to count all votes cast rather than just those of shareholders attending the meeting. All resolutions are voted on separately and the final voting results are published as soon as practicable after the meeting. At the 2017 AGM, all Directors were available to meet shareholders and answer their questions, and all resolutions were passed.

The 2018 AGM will be held at 11:00am on Wednesday, 14 November 2018 at Linklaters LLP, One Silk Street, London, EC2Y 8HQ. The Notice of AGM can be found in a separate document which is sent out at least 20 working days before the AGM and made available on our website. All Directors, including the Chairs of the Nomination, Audit and Remuneration Committees are expected to attend. Shareholders who are not able to attend the AGM in person are encouraged to vote by appointing a proxy and issuing voting instructions, which must be received by Equiniti, the Company's Registrar, not later than 48 hours before the AGM in order to be valid. Information about Equiniti and how to contact them can be found on page 199.

Major shareholders' interests

As at 31 July 2018, the Company had been notified under the Financial Conduct Authority's (FCA's) Disclosure Guidance & Transparency Rules, or had received disclosures pursuant to the Act, of the following holdings of voting rights in its shares:

Number of voting rights	% of total voting rights	Date of notification
BlackRock		
23.3m	5.9%	31 May 2018
Harris Associates LP		
19.8m	5.0%	23 February 2018
Ameriprise Financial		
19.7m	5.0%	27 April 2018
Dodge & Cox		
19.5m	4.9%	24 August 2017
Jupiter Asset Management		
14.8m	3.8%	22 September 2016

No further notifications were received between 1 August and 14 September 2018.

REMUNERATION REPORT

REMUNERATION COMMITTEE

BILL SEEGER
Chair of the Remuneration Committee

"Our objectives are to create clear alignment between remuneration and sustainable, long-term stakeholder interests, taking account of shareholder views and ensuring that performance measures support the delivery of business strategy through targeting our Key Performance Indicators (KPIs)."

ROLE OF THE COMMITTEE

The Committee is responsible for the Group's overall remuneration strategy and oversees the Group's remuneration policy for executive Directors and senior management. The Committee seeks to achieve a strategy that attracts, retains and motivates executive management of the quality required to run the Group successfully and that promotes the long-term success of Smiths, while reflecting the views of all stakeholders.

The Committee also approves the service contracts of all executive Directors and reviews any major changes in Group employee benefits structures, including the incentive arrangements that apply across the wider population.

IN ORDER TO FULFIL ITS ROLE THE COMMITTEE

- Meets at least three times a year and as otherwise required by the Chair of the Committee
- Utilises external expert advisers where appropriate to understand remuneration trends in the market insofar as they may inform our own remuneration strategy and policy
- Reviews business plans and performance to assess their potential impact on existing and future incentive arrangements
- Annually reviews the ongoing appropriateness and relevance of the remuneration policy
- Ensures that a remuneration report is prepared annually and included in the Annual Report and put to shareholders at the AGM
- Conducts an annual review of its performance and Terms of Reference, and recommends any changes to the Board
- Considers environmental, social and governance (ESG) risks when determining Director remuneration

KEY CONTENTS

I am pleased to present the remuneration report for the year to 31 July 2018. This is my first report as Chair of the Remuneration Committee having succeeded Anne Quinn in July 2018. On behalf of the Board I would like to thank Anne for her significant contribution to the Committee's work during her six years in the role. Anne's guidance and support to me has been invaluable and I would like to extend my personal gratitude to her.

We have invested significant time during the past year in reviewing how best to align our remuneration arrangements to the Smiths strategy. The review confirmed that the Remuneration Policy approved by shareholders in 2015 remains a good fit with no major changes required. Whilst maintaining the broad design we have nevertheless taken the opportunity to introduce a number of minor changes designed to reinforce the alignment between executive and shareholder interests and to ensure that performance measures remain closely aligned to business strategy. In making these changes we have taken account of feedback from major investors and shareholder bodies.

The new policy will be put to shareholders for approval at the AGM to be held on 14 November 2018. We look forward to your support for the proposals.

BILL SEEGER
CHAIR OF THE REMUNERATION COMMITTEE

REMUNERATION AT A GLANCE

REMUNERATION COMMITTEE ACTIVITIES

SALARY

Approved salary proposals for the Executive Directors and other Executive Committee members, and reviewed fees for the Chairman

ANNUAL INCENTIVE PLAN

Considered and approved annual incentive plan payouts and set targets for the new financial year

LONG-TERM INCENTIVE ARRANGEMENTS

Determined vesting levels for 2015 LTIP awards, and agreed performance measures for FY2019 LTIP awards

EXECUTIVE DIRECTOR CHANGES

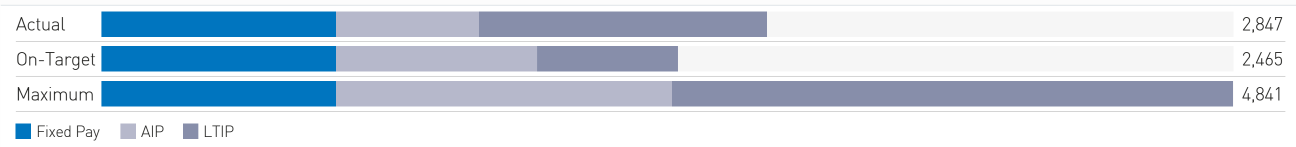
Agreed remuneration package for John Shipsey on appointment as Chief Financial Officer

POLICY REVIEW

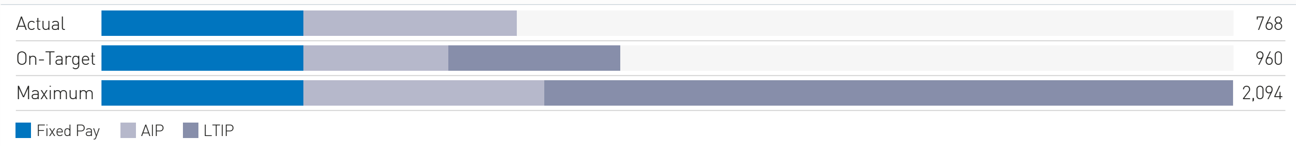
Considered the Remuneration Policy with a view to making changes for implementation in FY2019

REMUNERATION FOR THE YEAR ENDED 31 JULY 2018

ANDY REYNOLDS SMITH
TOTAL REMUNERATION vs OPPORTUNITY (£000)



JOHN SHIPSEY
TOTAL REMUNERATION vs OPPORTUNITY (£000)



Notes:

1 John Shipsey was appointed on 1 January 2018 and the chart relating to him is pro-rated to reflect this.

2 Bill Seeger served as CFO on an interim basis from 19 May 2017 to 31 December 2017. His remuneration comprised a fixed fee and is not shown here.

REMUNERATION REPORT CONTINUED

SUMMARY OF POLICY CHANGES AND FY2019 IMPLEMENTATION

The table below summarises the key components of the proposed framework of policy changes, illustrating how they differ from current policy and its application, and how we intend to operate the new policy in FY2019. Full details of the new policy are set out in the Remuneration Policy Report on pages 95 to 102. Subject to shareholder approval at the AGM on 14 November 2018, the policy will apply for three years from the AGM.

Current arrangements	FY2018	Proposed changes to policy	FY2019 implementation
FIXED PAY			
Salary			
Fixed remuneration which reflects required skills and expertise to deliver the Group's objectives	CEO: £800,000 CFO: £510,000	No change to policy Increases for FY2019 in line with average increase for UK employees of 2.9%	CEO: £820,000 CFO: £525,000
Pension			
Executive Directors receive an annual cash allowance of 25% of salary		No change	
Benefits			
Car allowance, healthcare and life assurance		No change	
VARIABLE PAY			
Annual Incentive Plan			
Maximum opportunity: 33% of bonus deferred into shares for three years	CEO: 180% of salary CFO: 150% of salary	No change to opportunities or deferral structure	
Measures and weightings:	50% EPS after tax 20% Operating cash conversion 30% Personal	Performance measures realigned with business strategy	40% EPS after tax 20% Operating cash conversion 30% Organic sales growth 10% Personal
Long-Term Incentive Plan (LTIP)			
LTIP awards	CEO: 300% of salary CFO: 250% of salary	No change to policy but award basis amended from multiple of salary to fixed number of shares (restricted if share price increases by more than 33% in three-year period)	CEO: shares equal in value to 300% of salary CFO: shares equal in value to 250% of salary
Vesting after three years		No change to policy but two year post-vesting holding period will apply for FY2019 and future LTIP awards	
Performance measures and weightings	35% EPS growth before tax 35% ROCE 30% Operating cash conversion	Performance measures realigned with business strategy	25% EPS growth after tax 20% ROCE 25% Operating cash conversion 30% Organic sales growth
OTHER			
Shareholding guidelines			
	CEO: 200% of salary CFO: 200% of salary	Increased for CEO	CEO: 250% of salary CFO: 200% of salary
NED fees			
Fees reflect responsibilities and time commitments for the role		Flexibility to introduce Committee membership fees	Non-executive Director fee arrangements will be reviewed in FY2019
Gifts for retiring non-executive Directors		Introduction of provision to allow modest retirement gifts for non-executive Directors in appropriate circumstances	

REMUNERATION POLICY REPORT

This section of the report sets out our remuneration policy for Directors, which shareholders will be asked to approve at the AGM to be held on 14 November 2018 and which will be effective for a period of up to three years from the date of the 2018 AGM. The amendments to this policy report from the version approved by shareholders in 2015 are set out on page 94.

Remuneration policy for the executive Directors

The remuneration policy for the executive Directors at Smiths is summarised in the table below:

Element and link to strategy	Operation	Opportunity	Performance measures
Base Salary			
To attract, motivate and retain executive Directors with the required skills and expertise to deliver the Group's objectives.	Salaries are reviewed (but not necessarily adjusted) annually and benchmarked against comparable roles at companies of similar market capitalisation, revenues and complexity. The review also takes into account individual performance and experience, the relative performance of the Company and the remuneration policy operated across the Company as a whole. Salary increases (if applicable) are typically effective 1 August.	Base salaries are adjusted according to the outcome of the annual review and will be disclosed in the Annual Report on Remuneration. Salary increases for the executive Directors will normally be in line with those awarded to Smiths wider employee population. Where increases are awarded in excess of this, for example if there is a material change in the responsibility, size or complexity of the role, or a significant change in the market competitiveness of salary, the Committee will provide the rationale in the relevant year's Annual Report on Remuneration.	Not applicable
Pensions			
Enables executive Directors to save for their retirement in a cost-efficient manner.	Executives may choose either to participate in the Company's defined contribution pension plan or to receive a pension allowance in lieu thereof (and thus arrange their own pension provision). Pension allowances are reviewed periodically to ensure market competitiveness. Salary is the only element of remuneration that is taken into account when determining pension contributions or allowances.	Pension contributions (or cash allowances in lieu thereof) are set at a level that the Committee considers appropriate having regard to prevailing market practice at other FTSE 100 companies of similar market capitalisation, revenues and complexity. Pension arrangements for current executive Directors are set out in the Annual Report on Remuneration. The maximum level of pension contribution (or allowance in lieu thereof) is 30% of annual base salary.	Not applicable

REMUNERATION POLICY REPORT CONTINUED

Element and link to strategy	Operation	Opportunity	Performance measures
Annual bonus			
Incentivises short-term priorities in line with the Group's business strategy.	Annual bonus payments are determined based upon performance against measures and targets set by the Committee at the start of each financial year. After the end of the financial year, to the extent that the performance criteria have been met, up to 67% of the earned annual bonus is paid in cash. The balance is deferred into shares and released after a further period of three years, subject to continued employment only. Dividends accrue and are payable in cash at the end of the deferral period. The Committee may use its discretion to adjust payout of the annual bonus to executive Directors, within the range of the minimum to maximum opportunity, including reducing it down to zero. Such discretion will only be used where the Committee believes that performance against the prescribed targets does not accurately reflect the Company's underlying performance. In addition, cash and deferred share bonuses awarded will be subject to malus and/or clawback for a period of three years from the end of the relevant performance year in case of misconduct or material misstatement in the published results of the Group.	The maximum annual bonus opportunity for executive Directors is up to 180% of salary. The annual bonus opportunities for the year under review and the coming year are disclosed in the Annual Report on Remuneration. Under the financial element of the annual bonus, threshold performance must be exceeded before any annual bonus becomes payable. The percentage payout then increases according to the level of achievement against targets. Payment of 25% of maximum opportunity occurs on achievement of threshold performance and 60% of maximum opportunity on achievement of on-target performance.	Based on a combination of financial and non-financial performance measures linked to short-term objectives. Financial performance will account for no less than 70% of the bonus opportunity and may include, but is not limited to, profit, organic sales growth and cash measures.

Element and link to strategy	Operation	Opportunity	Performance measures
Long-Term Incentive Plan (LTIP)			
Incentivises long-term value creation for shareholders, sustainable profit growth and effective management of the balance sheet.	Awards of conditional shares are granted annually and vest after a performance period of at least three years, subject to the achievement of performance targets set by the Committee at the start of each cycle. For awards made in FY2019 onwards, vested shares will be subject to a two year post vesting holding period. Details of such holding period will be disclosed in the Annual Report on Remuneration for the year in which the relevant award is made. To the extent that the performance targets are not met over the performance period, awards will lapse. No retesting of awards under any performance condition is permitted. Dividends accrue and are paid in cash at the end of the vesting period, on shares that vest. The Committee may use its discretion to adjust payout of the LTIP to executive Directors, within the limits of the Plan rules. Such discretion will only be used where the Committee believes that performance against the prescribed targets does not accurately reflect the Company's underlying performance. Awards are also subject to clawback for a period of five years from the date of grant in case of misconduct or material misstatement in the published results of the Group.	The maximum LTIP award opportunity for executive Directors is up to 400% of salary. For awards made in FY2019 onwards, the award will be a fixed number of shares. In FY2019 this fixed number of shares will be equivalent to 300% of salary for the CEO and 250% of salary for the CFO. In future years for which this policy applies it is intended that the executive Directors will each be awarded the same fixed number of shares as in FY2019. In the event that the Company share price increases by more than 33% during the three year policy period, the fixed number of shares awarded will be restricted so that the value of the award is no more than 33% greater than the value of the FY2019 award at the date of grant. This will ensure that the maximum LTIP award opportunity is not exceeded. LTIP award sizes for the year under review and the coming year are disclosed in the Annual Report on Remuneration. At threshold performance against each measure, up to 25% of the award subject to that measure vests, increasing on a straight-line basis to 100% for achieving stretch targets.	Based on measures of performance that are aligned with the Group's strategy. For awards made in FY2019 the performance measures are EPS growth after tax (25%), ROCE (20%), operating cash conversion (25%) and organic sales growth (30%). To ensure continued alignment with the Company's strategic priorities, the Committee may, at its discretion, vary the measures and their weightings from time to time (but will consult shareholders before making significant changes to the performance measures).

REMUNERATION POLICY REPORT CONTINUED

Element and link to strategy	Operation	Opportunity	Performance measures
Benefits			
To provide market-competitive benefits to executive Directors.	Benefits comprise car allowance, life assurance and private healthcare insurance, and other such benefits as the Committee may from time to time determine are appropriate. These include, but are not limited to, relocation allowances, as well as any other future benefits made available either to all employees globally or all employees in the region in which the executive Director is employed.	Benefits vary by role and individual circumstances. Benefits in respect of the year under review are disclosed in the Annual Report on Remuneration. It is not anticipated that the costs of benefits provided will increase significantly in the financial years over which this policy will apply, although the Committee retains discretion to approve a higher cost in exceptional circumstances (e.g. to facilitate recruitment, relocation, expatriation, etc.) or in circumstances where factors outside the Group's control have changed materially (e.g. market increases in insurance costs).	Not applicable
Sharesave			
Encourages ownership of shares in the Company and alignment with shareholder interests.	All UK employees (including executive Directors) may save up to a maximum monthly savings limit (as determined by UK legislation, or other such lower limit as the Committee may determine at its discretion) for three or five years. At the end of the savings period, participants may use their savings to exercise options to acquire shares, which may be granted at a discount of up to 20% to the market price on grant. The Company intends to look into introducing all-employee share schemes to some non-UK countries on a basis consistent with local laws and market practice.		Not applicable
Shareholding guidelines			
Encourages ownership of shares in the Company and alignment with shareholder interests.	Executive Directors must build a minimum shareholding of 200% (250% for the CEO from FY2019) of base salary within five years of appointment to the Board. 50% of any net vested share awards (after sales to meet tax liabilities) must be retained until the minimum shareholding requirements are met.		Not applicable

EXISTING GRANTS OR ENTITLEMENTS

It is the Company's intention to honour all pre-existing commitments at the date of this report and to honour all future obligations entered into, consistent with the approved remuneration Policy in force at that time. In the case of internal promotion to the Board, the Committee intends to honour any pre-existing commitments made prior to becoming a member of the Board, including where these differ from the approved remuneration Policy.

PERFORMANCE MEASURE SELECTION AND APPROACH TO TARGET SETTING

Annual bonus measures are selected to reflect the Company's short-term financial and non-financial priorities. At its discretion, the Committee may vary these measures at the start of each financial year to maintain close alignment between executive incentives and the annual business plan.

The measures used in the Long-Term Incentive Plan are selected to reflect Smiths' strategy and to reinforce the key drivers of value creation and growth highlighted elsewhere in this Annual Report: earnings per share, cash conversion, organic sales growth and delivering sustainable return on capital.

Annual bonus and LTIP targets are reviewed annually, and take into account the Company's strategic plan, analyst forecasts for Smiths and its sector comparators and external expectations for Smiths' key markets. The Committee sets targets that it considers to be challenging but attainable and aligned to the Company's business objectives over the short term, as reflected in the annual business plan, and longer term, consistent with the strategic plan. On top of aligning incentives with strategy, targets are designed to ensure that participants are aligned with the interests of shareholders.

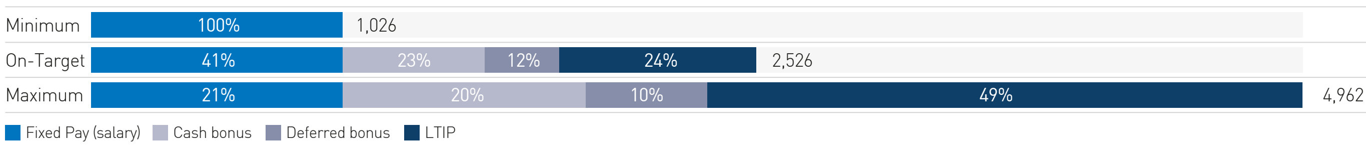
DIFFERENCE IN POLICY BETWEEN EXECUTIVE DIRECTORS AND OTHER EMPLOYEES

The reward policy for other senior employees is broadly consistent with that for executive Directors, and the Company does not currently operate any incentive plans in which only executive Directors participate. The Committee reviews each year the all-employee pay and incentive trends and takes these into account in setting executive Director pay levels. The principles of remuneration packages being market related, performance sensitive and driven by business needs are applied at all levels and geographies in the Group.

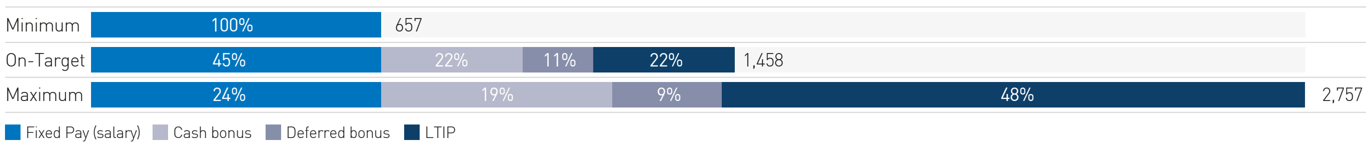
PAY SCENARIOS

The graphs below provide estimates of the potential future reward opportunity for the CEO, and the potential mix between the different elements of remuneration under three different performance scenarios; 'Minimum', 'On-Target' and 'Maximum'.

ANDY REYNOLDS SMITH (£000)



JOHN SHIPSEY (£000)



Potential opportunities illustrated above are based on the Policy, which will apply in FY2019, applied to the annualised base salaries in force from 1 August 2018. For the annual bonus, the amounts illustrated are those potentially receivable in respect of performance for FY2019. It should be noted that any awards granted under the LTIP in a year do not normally vest until at least the third anniversary of the date of grant. This illustration is intended to provide further information to shareholders on the relationship between executive pay and performance. Please note, however, that actual pay delivered will further be influenced by factors such as share price appreciation or depreciation and the value of dividends paid. The following assumptions have been made in compiling the above charts:

CEO	Minimum	On-Target	Maximum
Base salary		Annual base salary	
Pension		Company pension allowance	
Other benefits		Taxable value of annual benefits provided	
Cash bonus	0% of salary	72% (CEO), 60% (CFO) of salary	120% (CEO), 100% (CFO) of salary
Deferred bonus	0% of salary	36% (CEO), 30% (CFO) of salary	60% (CEO), 50% (CFO) of salary
LTIP	0% of salary	75% (CEO), 62.5% (CFO) of salary	300% (CEO), 250% CFO of salary

REMUNERATION POLICY REPORT CONTINUED

Remuneration policy for the Chairman and non-executive Directors

The policy for the remuneration of the Chairman and non-executive Directors at Smiths is summarised in the table below:

Element and link to strategy	Operation	Opportunity	Performance measures
Annual fee			
To attract, motivate and retain non-executive Directors with the required skills and expertise.	Fees may be paid in cash or a combination of cash and shares and are reviewed annually (but not necessarily increased) to ensure they compare appropriately to fees payable at companies of similar size and complexity to Smiths. Additional fees are paid to the Chairs of the Nomination, Audit and Remuneration Committees and to the Senior Independent Director to reflect the additional time commitment of these roles. Additional fees may also be paid to members of the Nomination, Audit and Remuneration Committees. The additional fee paid to the Chairman of the Board is determined by the Committee, absent the Chairman, while the fees for all non-executive Directors are agreed by the executive Directors.	Fees are adjusted according to the outcome of the annual reviews. The basic fee for non-executive Directors is subject to the maximum aggregate annual fee of £1,000,000, as approved by shareholders in 2017 in the Company's Articles of Association.	Not applicable.

Other

The Chairman and non-executive Directors are not eligible for benefits. The Chairman and the non-executive Directors are not eligible for bonuses or participation in share schemes or any pension provision. They may be paid an attendance allowance for each meeting attended outside their home continent in addition to the annual fee and are reimbursed for actual expenses incurred (transportation, hotels etc.). Modest retirement gifts may be provided for non-executive directors in appropriate circumstances.

Approach to remuneration on recruitment and leaving

EXTERNAL APPOINTMENTS

The Committee approves the remuneration of each executive Director on their appointment. In setting the remuneration during the recruitment of external appointments, the Committee will apply the following policy:

Pay element	Policy on recruitment
Salary	Salary on recruitment is determined based on the same principles as the annual salary review, as outlined in the policy table.
Pension	As described in the policy table.
Benefits	As described in the policy table.
Annual Bonus	As described in the policy table and typically pro-rated for the proportion of year served. Maximum annual award opportunity: 180% of salary with mandatory deferral of 33% into shares.
LTIP	May be considered for an award under the LTIP on similar terms to other executives. Maximum annual award opportunity: 400% of salary.
Other	The Committee may make an award in recognition of incentive arrangements forfeited on leaving a previous employer. Any such award will take account of relevant factors including the fair value of awards forfeited, any performance conditions attached, the likelihood of those conditions being met and the proportion of the vesting period remaining. For the purposes of making such awards, but for no other reason, the Committee may avail itself of Listing Rule 9.4.2R. The Committee may also make payments to cover reasonable expenses in recruitment and relocation, and any other miscellaneous expenses including but not limited to housing, tax and immigration support.

INTERNAL PROMOTIONS

In cases of appointing a new executive Director by way of internal promotion, the policy will be consistent with that for external appointees, as detailed above. Any commitments made prior to an individual's promotion will continue to be honoured even if they would not otherwise be consistent with the policy prevailing when the commitment is fulfilled, although the Company may, where appropriate, seek to revise an individual's existing service contract on promotion to ensure it aligns with other executive Directors and prevailing market best practice.

Disclosure on the remuneration structure of any new executive Director (external or internal), including details of any exceptional payments, will be disclosed in the RNS notification made at the time of appointment and in the Annual Report on Remuneration for the year in which the recruitment occurred.

Respecting diversity is woven into everything we do. We ensure that equal opportunities are practiced when interviewing, recruiting and promoting employees with decisions made based on skills and expertise first and foremost.

NON-EXECUTIVE DIRECTORS

In recruiting a new non-executive Director, the Committee will use the policy as set out in the table on page 100.

SERVICE CONTRACTS

The Company's policy is that executive Directors are normally employed on terms which include a one-year rolling period of notice from the Company and six months notice from the individual. The contract includes provision for the payment of a predetermined sum in the event of termination of employment in certain circumstances (but excluding circumstances where the Company is entitled to dismiss without compensation). In addition to payment of basic salary, pension allowance and benefits in respect of the unexpired portion of the one-year notice period, the predetermined sum would include annual bonus and share awards only in respect of the period they have served, payable following the end of the relevant performance period and subject to the normal performance conditions. Existing service contracts and letters of appointment for non-executive Directors or other applicable agreements are available for viewing at the Company's Registered Office.

EXECUTIVE DIRECTORS

Andy Reynolds Smith is employed under a service contract with the Company dated 6 July 2015 and effective from 25 September 2015. John Shipsey is employed under a service contract with the Company dated and effective from 18 October 2017. He became an executive Director on 1 January 2018.

The service contracts for both executive Directors may be terminated by 12 months' notice given by the Company or six months' notice given by the Director. The Company may elect to terminate the contract by making a payment in lieu of notice equal to the Director's base salary and benefits (including pension allowance) in respect of any unserved period of notice. The service contract contains specific provisions enabling a reduction in any phased payments in lieu of notice, in the event that the Director finds alternative employment during the notice period.

BILL SEEGER

Bill Seeger was employed under an extended letter of agreement with the Company dated 22 June 2017 and effective from 19 May 2017 in the role of Chief Financial Officer for an interim period until 31 December 2017. He returned to his non-executive Director role on 1 January 2018.

CHAIRMAN AND NON-EXECUTIVE DIRECTORS

The Chairman and the non-executive Directors serve the Company under letters of appointment and do not have contracts of service or contracts for services. Except where appointed at a general meeting, Directors stand for election by shareholders at the first AGM following appointment. Although the Articles of Association only require Directors to stand for re-election at every third AGM (or such earlier AGM as the Board may determine) thereafter (under Article 49), the Board has resolved that all Directors who are willing to continue in office will stand for re-election by the shareholders each year at the AGM. Either party can terminate the appointment on one month's written notice and no compensation is payable in the event of an appointment being terminated early.

Non-executive Director	Date of appointment
Sir George Buckley	1 August 2013
Bruno Angelici	1 July 2010
Olivier Bohuon	1 July 2018
Dame Anne Dowling	19 September 2018
Tanya Fratto	1 July 2012
Anne Quinn (until 1 July 2018)	1 August 2009
Bill Seeger	12 May 2014
Mark Seligman	16 May 2016
Noel Tata	1 January 2017
Sir Kevin Tebbit	14 June 2006

REMUNERATION POLICY REPORT CONTINUED

LEAVING AND CHANGE-OF-CONTROL PROVISIONS

For those individuals regarded as 'bad leavers' (e.g. voluntary resignation or dismissal for cause), annual bonus awards are forfeited, and outstanding awards under the LTIP automatically lapse. Deferred bonus awards are forfeited on dismissal for cause.

A 'good leaver' will typically remain eligible for a pro-rated annual bonus award to be paid after the end of the financial year and deferred bonus awards will be paid out at the normal vesting date. LTIP awards will typically vest at the normal vesting date to the extent that the associated performance conditions are met, but will normally be pro-rated on the basis of actual service within the performance period. In cases of death or disability, individuals are automatically deemed to be good leavers under the plan rules of the LTIP. All other good leavers will be defined at the discretion of the Committee on a case-by-case basis.

In the event of a change of control, LTIP awards will vest to the extent that each of the performance conditions is met based on the Committee's assessment of performance over the performance period to the date of change of control. For internal performance measures, the Committee may exercise its judgement in determining the outcome based on its assessment of whether or not the performance conditions would have been met to a greater or lesser extent at the end of the full performance period. Awards will also normally be pro-rated to reflect the time that has elapsed between the grant of the award and the date of change of control.

The Committee retains discretion to vary these provisions on a case-by-case basis.

In connection with the termination of an executive Director's contract, the Company may make a payment on account of accrued but untaken leave and may pay outplacement and legal fees for support provided to the individual.

EXTERNAL APPOINTMENTS

Subject to the overriding requirements of the Company, the Committee allows executive Directors to accept one external appointment where it considers that such appointment will contribute to the Director's breadth of knowledge and experience. Directors are permitted to retain fees associated with such appointments.

CONSIDERATION OF EMPLOYMENT CONDITIONS

The Committee always takes into account pay and employment conditions elsewhere in the Company. We do not consult directly with employees regarding executive Director pay. However the Committee is regularly, and at least annually, provided with information on pay trends and ratios of the wider employee population across the Group.

CONSIDERATION OF SHAREHOLDER VIEWS

The Committee has taken account of the views expressed by shareholders. The proposed changes to the remuneration policy are receptive to and respectful of shareholder views.

ANNUAL REPORT ON REMUNERATION

This section of the remuneration report details how our Policy was implemented in the year ended 31 July 2018.

COMMITTEE MEMBERS AND MEETING ATTENDANCE IN FY2018

The members of the Committee and their meeting attendance during the year is set out on page 76 of this report.

Sir George Buckley is absent when his own remuneration as Chairman of the Company is under consideration. The Chief Executive attends meetings of the Committee by invitation but he is not involved in the determination of his own remuneration.

ADVISERS TO THE COMMITTEE

During the year, the Committee received material assistance and advice from the Chief Executive, the Group HR Director, the Group Director of Reward, Mercer | Kepler (the Committee's appointed independent remuneration adviser) and Freshfields Bruckhaus Deringer LLP. The Company Secretary is secretary to the Committee.

The Company paid a total annual fee of £57,500 to Mercer | Kepler in relation to remuneration advice to the Committee during the year. Fees were determined on the basis of time and expenses.

During FY2018, Mercer | Kepler provided the Committee with benchmarking analysis of executive and non-executive Directors' pay, information on market trends, drafting support for this and last year's Directors' Remuneration Report, and other relevant assistance on determining Directors' remuneration. Kepler was reappointed by the Committee via competitive tender in 2013.

Mercer | Kepler is a founding member of the Remuneration Consultants Group and a signatory to its Code of Conduct. Kepler's parent company, Mercer, provides unrelated services to the Group in the areas of all-employee reward and retirement benefits. However, the Committee is satisfied that the advice provided by Mercer | Kepler is objective and independent and that they do not have connections with the Group that may impair their independence.

Freshfields Bruckhaus Deringer LLP was appointed by the Company to advise the Group on various legal matters during the year.

SUMMARY OF SHAREHOLDER BINDING VOTE ON DIRECTORS' REMUNERATION POLICY (FY2016)

The resulting voting outcome in 2015 for Directors' Remuneration Policy was as follows:

Votes for	% of votes cast for	Votes against	% of votes cast against	Total votes cast	Votes withheld (abstentions)
278,345,426	96.4%	10,397,058	3.6%	288,742,484	22,481,558

SUMMARY OF SHAREHOLDER ADVISORY VOTE ON DIRECTORS' REMUNERATION REPORT (FY2018)

The resulting voting outcome for last year's Directors' Remuneration Report was as follows:

Votes for	% of votes cast for	Votes against	% of votes cast against	Total votes cast	Votes withheld (abstentions)
277,476,524	98.1%	5,256,419	1.9%	282,732,943	12,054,822

DIRECTORS' SINGLE FIGURE OF ANNUAL REMUNERATION (AUDITABLE)

Executive Directors

	Salary/fees		Benefits[7]		Annual bonus[8]		Long-term incentives		Other[9]		Payments in lieu of pension contribution		Total	
	FY2018 £000	FY2017 £000	FY2018 £000	FY2017 £000	FY2018 £000	FY2017 £000	FY2018 £000	FY2017 £000	FY2018 £000	FY2017 £000	FY2018 £000	FY2017 £000	FY2018 £000	FY2017 £000
Andy Reynolds Smith	800	780	1	1	612	1,344	1,234	–	435	–	200	195	3,282	2,320
John Shipsey[1]	402	–	1	–	265	–	–	–			100	–	768	–
Bill Seeger[2]	498	205	112	63									610	268

ANNUAL REPORT ON REMUNERATION CONTINUED

Chairman and non-executive Directors

	Salary/fees		Benefits[7]		Annual bonus[8]		Long-term incentives		Other		Payments in lieu of pension contribution		Total	
	FY2018 £000	FY2017 £000	FY2018 £000	FY2017 £000	FY2018 £000	FY2017 £000	FY2018 £000	FY2017 £000	FY2018 £000	FY2017 £000	FY2018 £000	FY2017 £000	FY2018 £000	FY2017 £000
Sir George Buckley[3]	433	423	65	98									498	521
Bruno Angelici	76	69	9	13									85	82
Olivier Bohuon	6	–											6	–
Tanya Fratto	84	82	57	58									141	140
Anne Quinn[4]	96	89											96	89
Bill Seeger[2]	48	84	26	65									74	149
Mark Seligman[5]	96	73											96	73
Noel Tata	92	45	27	18									119	63
Sir Kevin Tebbit[6]	96	89											96	89

1 John Shipsey commenced employment on 18 October 2017 and was appointed as Chief Financial Officer from 1 January 2018.

2 Bill Seeger served as Chief Financial Officer on an interim basis from 19 May 2017 to 31 December 2017 for which he received a fixed fee, having served as a non-executive Director and chairing the Audit Committee prior to that date. He did not receive any further fees from Smiths during this period. He resumed his non-executive role from 1 January 2018. Throughout 2017 Bill Seeger was a non-executive Director of Spectris plc and during the period he served as Chief Financial Officer for Smiths in FY2018 he retained his non-executive Director fees from Spectris of £37,500.

3 Sir George Buckley's fee comprised his non-executive Director's fee; an additional fee for being Chairman and his additional fee for chairing the Nomination Committee.

4 Anne Quinn's fees comprised her non-executive Director's fee and her additional fee for chairing the Remuneration Committee.

5 Mark Seligman's fees comprised his non-executive Director's fee and his additional fee for chairing the Audit Committee.

6 Sir Kevin Tebbit's fees comprised his non-executive Director's fee and his additional fee as Senior Independent Director.

7 Benefits for executive Directors include life assurance and private healthcare insurance. For the Chairman and non-executive Directors, this value relates to reimbursed travel-related expenses, which is grossed-up for the UK income tax and National Insurance contributions paid by the Company on their behalf.

8 Andy Reynolds Smith deferred 33% of his 2018, 2017 and 2016 bonus earned into Smiths shares. The total bonus paid during the year, including deferral, is captured under 'annual bonus' above. The deferral is for a three-year period and is not subject to any further performance conditions.

9 Andy Reynolds Smith was awarded 79,806 Performance Shares in 2015 which vest in 2018 (the performance criteria for these shares is included in the key on page 110). The value shown is calculated using the vesting percentage of 32.1% and the average share price over the 3 months to 31 July 2018 of £16.98.

INCENTIVE OUTCOMES FOR FY2018 (AUDITABLE)

FY2018 annual bonus outcome for Andy Reynolds Smith and John Shipsey

The table below summarises the structure of the FY2018 annual bonus, our performance and the resulting annual bonus payout for each of the executive Directors.

					Earned bonus		
Director	Measure	Weighting	Maximum Opportunity (% of salary)	Performance Level	(% of max. bonus)	(% salary)	£000
Andy Reynolds Smith	EPS after tax	50%	90%	Between threshold and max	15.5%	27.9%	223
	Op. Cash Conversion	20%	36%	Just above threshold	3.0%	5.4%	43
	Personal Objectives	30%	54%	See below	24.0%	43.2%	346
Total		100%	180%		42.5%	76.5%	612
John Shipsey (pro-rated from 1 January 2018)	EPS after tax	50%	75%	Between threshold and max	15.5%	23.2%	93
	Op. Cash Conversion	20%	30%	Just above threshold	3.0%	4.5%	18
	Personal Objectives	30%	45%	See below	25.5%	38.3%	154
Total		100%	150%		44.0%	66.0%	265

In determining the earned bonus under the EPS measure, the Remuneration Committee has applied its discretion to make a downward adjustment, taking account of US tax changes which provided a beneficial impact on profit during the year. The bonus payments without application of this discretion would have been 57.5% of maximum for the CEO and 59.0% of maximum for the CFO.

As the annual bonus targets are commercially sensitive they will be disclosed in next year's report or at such later time as they are considered to be no longer commercially sensitive.

PERSONAL OBJECTIVES

Challenging personal objectives were set for each executive Director to reinforce the Company's annual and strategic priorities. For FY2018, these targets focussed on four categories of equal weighting; business growth, internal excellence, strategy development, and leadership and organisation.

Andy Reynolds Smith's performance in the business growth category was rated at 72%, reflecting the excellent progress in the second half measured against the stretching revenue targets set at the start of the financial year. He also scored 72% against the objectives set in the excellence category, based on the successful achievement of working capital targets, improved inventory performance and deployment of the Smiths Excellence System (SES). The strategy category was rated at 76% based on the Committee's assessment of the execution of Group tax strategy and the continued good progress in meeting milestones related to the development of the future Group structure.

The leadership and organisation measure was assessed as being achieved in full, reflecting the excellent progress in developing the capability of the Executive Committee. Overall the Committee determined that this resulted in 80% achievement of the personal objectives.

John Shipsey's performance in the business growth category was scored as 80% to reflect his contribution to driving the excellent progress in revenue growth in the second half of the year, and following his appointment as CFO. He achieved a score of 80% in the excellence category to reflect strong progress in the development of operational procedures aligned to SES. The strategy measure was assessed by the Committee as being achieved in full, as a result of his excellent contribution to, and performance in, developing and implementing the Group tax strategy to underpin delivery of the Group's strategic plan. He achieved a rating of 80% for the leadership and organisation objectives, reflecting the strong progress since his joining Smiths in reviewing and implementing changes to the Group and divisional finance structure and succession planning for key roles. The overall score determined by the Committee is 85% achievement of the personal objectives.

The bonus payments arising from personal objectives will be seen to form a significant proportion of the total bonus payment. This arises as a result of the Committee decision to apply downward discretion to the financial metrics as set out on page 104.

INCENTIVE OUTCOMES FOR FY2017 (AUDITABLE)

As disclosed last year, the Committee will disclose annual bonus targets at such time as these are considered to be no longer commercially sensitive. In line with this commitment, the table below summarises the financial targets and the Company's actual performance against these for the FY2017 annual bonus.

		Performance Targets and Actual Performance			
Measure		Threshold	Target	Maximum	Actual
EPS after tax		76.6.p	80.8p	86.8p	88.5p
Operating cash conversion[1]	Q1	–	83%	–	116%
	Q2	–	102%	–	144%
	Q3	–	88%	–	177%
	Q4	–	125%	–	183%
	H1	93%	–	111%	106%
	H2	107%	–	120%	134%

1 Payment was dependent on exceeding target cash conversion for relevant quarter and half year. Maximum payout required the meeting or exceeding of quarterly targets and half year maxima.

2015 LTIP OUTCOME

Awards granted under the LTIP in 2015 were subject to the following performance conditions:

			Vesting schedule		Actual performance	
Measure	Weighting	Performance period	Performance	% vesting	Outturn	% vesting
Group EPS growth before tax	30%	1 August 2015 to 31 July 2018	< 3% p.a.	0%	2% p.a.	0%
			3% p.a.	7.5%		
			≥12% p.a.	30.0%		
			Straight-line vesting between these points			
Average underlying revenue growth	30%	1 August 2015 to 31 July 2018	<2% p.a.	0%	0% p.a.	0%
			2% p.a.	7.5%		
			≥5% p.a.	30.0%		
			Straight-line vesting between these points			
Average ROCE	20%	1 August 2015 to 31 July 2018	<15% p.a.	0%	16.4% p.a.	12.1%
			15% p.a.	5.0%		
			≥18% p.a.	20.0%		
			Straight-line vesting between these points			
Average operating cash conversion	20%	1 August 2015 to 31 July 2018	<85%	0%	106%	20%
			85%	5.0%		
			≥100%	20.0%		
			Straight-line vesting between these points			
Total						32.1%

ANNUAL REPORT ON REMUNERATION CONTINUED

2015 LTIP OUTCOME FOR EXECUTIVE DIRECTORS

2015 LTIP	Interests held	Vesting %	Interests vesting	Date of vesting	Market price[1]	Value £000
Andy Reynolds Smith[1]	226,524	32.1%	72,668	Oct 2018	£16.98	£1,234

John Shipsey did not participate in the 2015 LTIP.

1 Based on the average share price over the 3 months to 31 July 2018 of £16.98.

2015 LTIP OUTCOME FOR PAST DIRECTORS

2015 LTIP	Interests held	Vesting %	Interests vesting	Date of vesting	Market price[1]	Value £000
Chris O'Shea[2]	89,847	32.1%	28,822	Oct 2018	£16.98	£489

1 Based on the average share price over the 3 months to 31 July 2018 of £16.98.

2 Chris O'Shea was formerly the Chief Financial Officer and an executive Director of the Company. He ceased to be an employee on 18 November 2017 and his original share award of 119,796 shares was pro-rated as per his termination agreement.

SCHEME INTERESTS AWARDED IN FY2018 (AUDITABLE)

2017 LTIP

During the year ended 31 July 2018, the executive Directors were awarded conditional share awards under the LTIP details of which are summarised in the table below:

				Face value			
Executive	Form of award	Date of grant	Number of shares awarded	Award price[1]	£'000	% of salary	Date of vesting
Andy Reynolds Smith	Conditional shares	27 Oct 2017	153,354	£15.65	2,400	300%	Oct 2020
John Shipsey	Conditional shares	27 Oct 2017	81,469	£15.65	1,275	250%	Oct 2020

1 The closing price on 26 October 2017.

The performance conditions attached to these 2017 LTIP awards are as follows:

			Vesting schedule	
Measure	Weighting	Performance period	Performance	% vesting
Group EPS growth before tax	35%	1 August 2017 to 31 July 2020	< 3% p.a.	0%
			3% p.a.	8.75%
			≥12% p.a.	35.0%
			Straight-line vesting between these points	
Average ROCE	35%	1 August 2017 to 31 July 2020	< 15% p.a.	0%
			15% p.a.	8.75%
			≥18% p.a.	35.0%
			Straight-line vesting between these points	
Average operating cash conversion	30%	1 August 2017 to 31 July 2020	< 85%	0%
			85%	7.5%
			≥100%	30.0%
			Straight-line vesting between these points	

2017 DEFERRED BONUS AWARD

During the year ended 31 July 2018, Andy Reynolds Smith was awarded conditional shares as deferred bonus awards, details of which are summarised in the table below. There are no further performance conditions for these awards.

				Face value		
Executive	Form of award	Date of grant	Number of shares awarded	Award price[1]	£'000	Date of vesting
Andy Reynolds Smith	Conditional shares	27 Oct 2017	28,618	£15.65	448	Oct 2020

1 The closing price on 26 October 2017.

2 Chris O'Shea, former Chief Financial Officer, was granted 12,251 deferred bonus shares on 27 October 2017 at an award price of £15.65. This award had a value of £191,737 and vests in October 2020.

SAYE

Andy Reynolds Smith became a participant in the Smiths Group Sharesave Scheme in the year ending in 31 July 2016 and as he chose to participate at the maximum level he did not participate in the scheme in the years ending 31 July 2017 and 31 July 2018. He has 2,078 share options under the scheme.

John Shipsey does not currently participate in the scheme.

BUYOUT AWARDS

As disclosed in last year's Annual Report on Remuneration, Andy Reynolds Smith was made certain buyout awards to replicate the structure and fair value of incentives forfeited as a consequence of joining Smiths Group.

He received an award of 86,893 restricted shares, the grant value of which was captured in the 2016 single figure. 30,412 shares vested on the 30 June 2016, with the remaining 56,481 restricted shares vesting on 30 June 2017 (at a share price of 1,597p). Andy Reynolds Smith also received awards of 79,806, 26,602 and 26,602 conditional shares which vest, subject to performance conditions, in October 2018, 2019 and 2020 respectively. The estimated value of the award vesting in October 2018 is included in this year's single figure of remuneration table for Andy Reynolds Smith. To the extent the other awards vest, their value will be reflected in the FY2019 and FY2020 single figures of remuneration.

PERCENTAGE CHANGE IN REMUNERATION FROM FY2017 TO FY2018

	Salary	Benefits	Bonus
CEO remuneration	2.6%	0.0%	–54%
Average of all employees	2.5%	0.0%	–27%

'All employees' is defined as the global senior management population of approximately 60 individuals who are eligible to participate in the same incentive arrangements as the Chief Executive.

RELATIVE IMPORTANCE OF SPEND ON PAY

The table below shows shareholder distributions (i.e. dividends and share buybacks) and total employee pay expenditure for the financial years ended 31 July 2017 and 31 July 2018, and the percentage change.

	FY2018 £m	FY2017 £m	Change
Shareholder distributions	172	167	3.0%
Employee costs	989	978	1.1%

PAYMENTS TO PAST DIRECTORS (AUDITABLE)

Other than the 2015 LTIP outcome and the 2017 deferred bonus award disclosed on page 106 in relation to Chris O'Shea, there were no other payments to past Directors.

PAYMENTS FOR LOSS OF OFFICE (AUDITABLE)

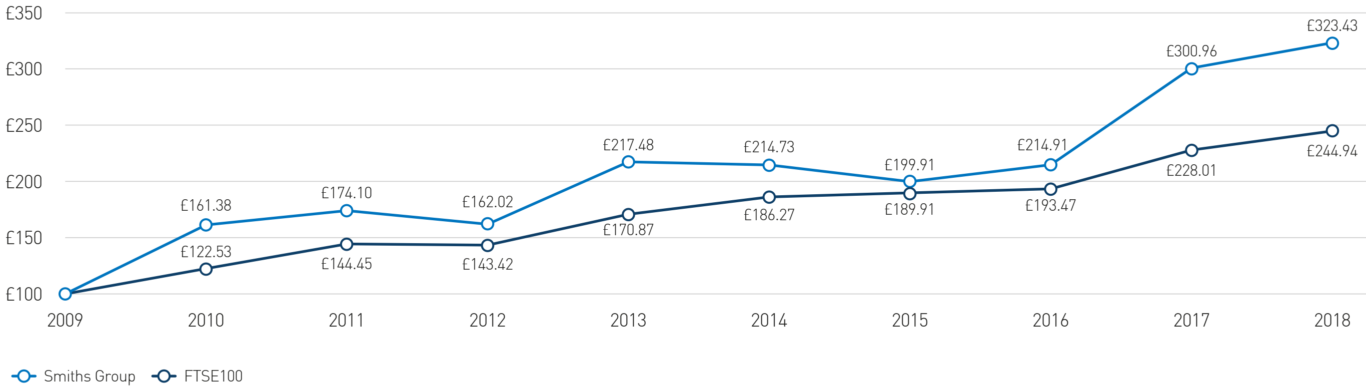
Chris O'Shea received a payment totalling £253,688 in respect of salary (plus associated benefits of £63,422) between 19 May 2017 and 18 November 2017 as reported last year plus a contribution of £10,000 to his legal fees as part of his stepping down arrangements.

TSR PERFORMANCE

The following graph shows the Company's total shareholder return (TSR) performance over the past nine years compared to the FTSE 100 Index. The FTSE 100 Index, of which the Company has been a member throughout the period, has been selected to reflect the TSR performance of other leading UK-listed companies. The values of hypothetical £100 investments in the FTSE 100 Index and Smiths Group plc shares at 31 July 2018 were £244.94 and £323.42 respectively.

TOTAL SHAREHOLDER RETURN

Value of £100 invested on 31 July 2009



ANNUAL REPORT ON REMUNERATION CONTINUED

CEO REMUNERATION FOR THE LAST NINE YEARS

CEO	FY2010 P Bowman	FY2011 P Bowman	FY2012 P Bowman	FY2013 P Bowman	FY2014 P Bowman	FY2015 P Bowman	FY2016 P Bowman	FY2016 A Reynolds Smith	FY2017 A Reynolds Smith	FY2018 A Reynolds Smith
CEO total remuneration £000	3,399	4,776	5,026	3,864	3,912	4,195	1,602	2,964	2,320	3,282
Annual bonus outcome (% max)	95%	64%	79%	39%	43%	80%	88%	89%	96%	42%
CIP outcome (% max)	n/a	100%	100%	100%	100%	100%	100%	n/a	n/a	n/a
2007 Performance Share Plan outcome (% max)	46%	33%	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
LTIP outcome (% max)					18%	17%	18%	n/a	n/a	32%

Statement of implementation of remuneration policy in FY2019

BASE SALARY

Salaries are reviewed (but not necessarily increased) annually and benchmarked against comparable roles at other FTSE 100 companies of similar market capitalisation, revenues and complexity. Having considered a number of important factors including individuals' performance and experience, the relative performance of the Company and the remuneration policy within the Company, the Committee has determined the following annualised salaries for executive Directors for FY2019, which are in line with the average increase for UK employees of 2.9%:

Executive director	FY2018	FY2019
Andy Reynolds Smith	£800,000	£820,000
John Shipsey	£510,000	£525,000

PENSION AND BENEFITS

Andy Reynolds Smith and John Shipsey will continue to receive a cash allowance in lieu of pension of 25% of base salary. The executive Directors do not have a prospective entitlement to a defined benefit pension.

ANNUAL BONUS

For FY2019, Andy Reynolds Smith will continue to have a maximum bonus opportunity of 180% of salary and John Shipsey 150%. Annual bonus measures (and their weightings) will be amended from FY2019 as set out in the proposed Policy Changes table on page 94. 33% of any bonus earned will be deferred into shares for three years. Specific targets cannot be disclosed at this time due to the commercially sensitive nature of these objectives, but they will be disclosed at such a time as the Committee deems them to no longer affect the commerciality of the Company, likely to be within two years of the end of the performance period.

LONG-TERM INCENTIVE PLAN

The LTIP is a conventional share plan under which an award over a capped number of shares will vest if demanding performance conditions are met. LTIP awards of conditional shares are granted to selected senior executives (including the executive Directors) with face values of up to 400% of salary. Under the LTIP, for the FY2019 award a fixed number of shares will be granted equivalent to 300% of salary for the Chief Executive and 250% of salary for the Chief Financial Officer.

The LTIP awards granted to Andy Reynolds Smith and John Shipsey in FY2019 will vest on the achievement of the following performance conditions:

Performance measure	Weighting	Threshold performance target	Maximum performance target (full vesting of element)
Three-year EPS growth after tax	25%	4% p.a.	11% p.a.
Three-year average return on capital employed	20%	15%	18% p.a.
Three-year average annual operating cash conversion	25%	90%	105%
Three-year average organic sales growth	30%	3%	6% p.a.

This represents a change to the LTIP performance measures and weightings from the 2017/18 cycle as set out in the proposed Policy Changes table set out on page 94. The Committee believes that the proposed structure provides an appropriate balance between earnings growth, returns, cash and sales growth. The Committee recognises that this balance of Group performance measures remains very important for many of our largest shareholders. As previously stated, the scorecard will be reviewed at the start of each future LTIP cycle to ensure it continues to reflect the Group's strategic priorities.

For performance between 'threshold' and 'maximum', awards vest on a straight-line sliding scale.

NON-EXECUTIVE DIRECTOR FEES

NED fees paid during FY2018 are shown below:

	FY2018
NED base fee	£67,850
Additional fee payable to the Chairman of the Board	£345,050
Additional fee payable to the Senior Independent Director	£20,000
Additional fees for Audit, Nomination and Remuneration Committee Chairs	£20,000
Attendance allowance for meetings outside the NED's home continent	£4,000 per meeting

If the new Directors' Remuneration Policy is approved at the 2018 Annual General Meeting, the fees payable to the non-executive Directors will be reviewed during FY2019.

SHARE OWNERSHIP GUIDELINES

Executive Directors are required, over time, to build up a shareholding with a value equal to at least 200% of base salary (250% for CEO from FY2019). Executive Directors are required to retain at least 50% of any net vested share awards (after sales to meet tax liabilities) until those guidelines are achieved. Shares under awards that are still subject to vesting conditions do not count towards the guidelines.

There is no shareholding policy for non-executive Directors.

CHANGE OF CONTROL

The Company's share plans (including the buy-out awards granted to the executive Directors on their appointments) contain clauses which may cause options and awards to vest on a change in control, in some cases subject to the satisfaction of performance conditions at that time. No Director or employee is contractually entitled to compensation for loss of office or employment as a result of a change in control, except as provided for under the Company's share schemes as noted above.

DIRECTORS' SHAREHOLDINGS (AUDITABLE)

The table below shows the shareholding of each Director (or past Director) and for executive Directors the shareholding against their respective shareholding requirement as at 31 July 2018.

	Shareholding requirement (% FY2018 salary)	Shares owned outright	Shares subject to performance	Performance tested but unvested shares	Shares arising from bonus deferral	Save As You Earn (SAYE)	Current shareholding (% FY2018 salary)	Guideline met[1]
Andy Reynolds Smith	200%	148,649	679,829	0	53,164	2,078	300%	Yes
John Shipsey	200%	25,000	81,469	0	0	0	79%	No
Sir George Buckley		13,106						
Bruno Angelici		2,000						
Olivier Bohuon		0						
Tanya Fratto		1,500						
Anne Quinn		1,024						
Bill Seeger		7,500						
Mark Seligman		5,000						
Noel Tata		0						
Sir Kevin Tebbit		1,000						

1 Executive Directors have five years from the date of appointment to meet the required personal shareholding.

In accordance with a binding commitment entered into on 19 July 2017, pursuant to which the Chairman purchases ordinary shares on a quarterly basis using a fixed proportion (20%) of the after-tax fees he receives from the Company, Sir George Buckley acquired 779 ordinary shares on 1 August 2018. There have been no other changes in the interests of the Directors and their connected persons between 31 July 2018 and the date of this report.

ANNUAL REPORT ON REMUNERATION CONTINUED

DIRECTORS' SHARE OPTIONS AND LONG-TERM SHARE PLANS (AUDITABLE)

Director and Plans	Options and awards held on 31 July 2018 Number	Options and awards held on 31 July 2017 Number	Option and award data: Performance test	Exercise price	Grant date	Vesting date*	Expiry date**	Exercise/ vesting date	Number	Exercise price	Awards vested FY2018: Market price at date of grant	Market price at date of exercise
Andy Reynolds Smith												
Performance Share Award	79,806	79,806	A	n/a	26/11/15	Oct 2018						
	26,202	26,602	B	n/a	26/11/15	Oct 2019						
	26,202	26,602	B	n/a	26/11/15	Oct 2020						
LTIP 2015	226,524	226,524	A	n/a	26/11/15	Oct 2018						
	167,741	167,741	B	n/a	08/11/16	Oct 2019						
	153,354	0	B	n/a	27/10/17	Oct 2020						
Deferred bonus award	24,546	24,546	–	n/a	08/11/16	08/11/19						
	28,618	0	–	n/a	27/10/17	27/10/20						
SAYE	2,078	2,078	–	866.00p	11/05/16	01/08/19	01/02/20					
John Shipsey												
LTIP 2015	81,469	0	B	n/a	27/10/17	Oct 2020						

Key

Performance Share Award	Under the terms of his contract of employment on joining the Company, Andy Reynolds Smith was granted a buy-out conditional award over 133,010 shares of which up to 60% are expected to vest in October 2018 (subject to the performance tests applicable to awards granted under LTIP 2015 in 2015); up to 20% are expected to vest in October 2019 (subject to performance tests applicable to awards granted under long-term incentive plans in 2016); and up to 20% are expected to vest in October 2020 (subject to the performance tests applicable to awards granted under long-term incentive plans in 2017). The terms of the award provide that additional shares are awarded on vesting to a value equivalent to the notional dividends that would have been earned on the number of shares that vest.
LTIP 2015	The Smiths Group Long-Term Incentive Plan 2015.
SAYE	The Smiths Group Sharesave Scheme.
*	The vesting dates shown above in respect of awards made under the LTIP are subject to the relevant performance test(s) being passed.
**	The expiry dates shown above apply in normal circumstances.

Performance tests

A LTIP 2015 awards – 30% subject to revenue growth; 30% subject to EPS element; 20% subject to cash conversion; 20% subject to return on capital employed

B LTIP 2016 and 2017 awards – 35% subject to EPS element; 35% subject to return on capital employed; 30% subject to cash conversion

– There are no performance criteria for the Deferred Bonus Shares awards or SAYE

Notes

- The high and low market prices of the ordinary shares during the period 1 August 2017 to 31 July 2018 were 1801p and 1444p respectively. The mid-market closing price on 31 July 2017 was 1535p and on 31 July 2018 was 1614p.
- The mid-market closing prices of a Smiths Group share on the dates of the awards made to Directors in the 2017/18 financial year was 1561p (27 October 2017).
- The options over 5,542 shares granted to and held by the CEO under SAYE at 31 July 2018 were granted at exercise prices below the market price of a Smiths Group share on 8 April 2016 (1082p).
- None of the options or awards listed above was subject to any payment on grant.
- No other Directors held any options over the Company's shares during the period 1 August 2017 to 31 July 2018.
- No options or awards have been granted to or exercised by Directors or have lapsed during the period 1 August to 20 September 2018.
- At 31 July 2018, the trustee of the Employee Share Trust held 766 shares (none of the Directors had an interest in these shares at 31 July 2018). The market value of the shares held by the trustee on 31 July 2018 was £12,363 and dividends of approximately £333 were waived in the year in respect of the shares held by the trustee during the year.
- Special provisions permit early exercise of options and vesting of awards in the event of retirement, redundancy, and death.

SHARE SCHEME DILUTION LIMITS

The Company complies with the guidelines laid down by the Investment Association. These restrict the issue of new shares under all the Company's share schemes in any ten year period to 10% of the issued ordinary share capital and under the Company's discretionary schemes to 5% in any ten year period. As at 31 July 2018, the headroom available under these limits was 7.9% and 3.4%, respectively.

PERFORMANCE EVALUATION

The annual evaluation of the performance of the Committee was conducted as part of the overall annual evaluation of the performance of the Board carried out by Independent Audit. The findings relating to the Committee were discussed with the Committee Chair. Overall, the Committee is regarded and performing well and is rigorous and effective in discharging its responsibilities.

AUDITABLE PART

The Directors' single figure of annual remuneration and accompanying notes on page 104-105; the incentive outcomes for 2017 and 2018 on pages 104 and 105; the scheme interests awarded in FY2018 and accompanying notes on page 106; the payments to past Directors and payments for loss of office on page 107; the Directors' shareholdings on page 109 and the Directors' share options and long-term plans table on page 110 have been audited.

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

BILL SEEGER

CHAIR OF THE REMUNERATION COMMITTEE

20 September 2018

DIRECTORS' REPORT

The Strategic report is a requirement of the Companies Act 2006 (the 'Act') and can be found on pages 06 to 68. The Company has chosen, in accordance with section 414 C(11) of the Act, to include certain matters in its Strategic report that would otherwise be disclosed in this Directors' Report.

Other information that is relevant to the Directors' Report, and is incorporated by reference, can be located as follows:

Disclosure	Location
Likely future developments	Strategic report pages 20–49
Directors' dividend recommendation	Strategic report page 28
Research and development activities	Strategic report pages 30–49
Employment of disabled persons and employee involvement	Resources and relationships pages 62–63
Political donations and expenditure	Resources and relationships page 63
Greenhouse gas emissions	Resources and relationships page 66
Corporate governance statement	Corporate governance report pages 70–112
Directors during FY2018	Corporate governance report pages 72–75
Director appointment and replacement	Corporate governance report page 78
Amendment of Articles of Association	Corporate governance report page 78
Indemnities	Corporate governance report page 80
Change of control	Remuneration report page 109 Borrowings and net debt note page 158
Directors' responsibility statement	Statement of Directors' responsibilities page 114
Disclosure of information to auditor	Directors' responsibility statement page 114
Financial instruments	Financial risk management note page 158
Share capital disclosures	Share capital note page 170
Powers of the Directors	Share capital note page 170
Post balance sheet events	Post balance sheet event note page 189
Overseas branches	Subsidiary undertakings note page 198

LISTING RULES DISCLOSURE

Information required by the Financial Conduct Authority's Listing Rules can be located as follows:

Listing Rule	Disclosure	Location
9.8.4(1)	Capitalised interest	Net Finance costs note page 140
9.8.4(12)(13)	Dividend waivers	Dividend note page 171
9.8.6(1)	Directors' interests	Remuneration report page 109
9.8.6(2)	Major shareholders' interests	Corporate governance report page 91
9.8.6(3)(a)(b)	Going concern and viability statements	Strategic report page 68
9.8.6(4)(a)	Purchase of own shares	Share capital note page 170
9.8.6(5)(6)	UK Corporate Governance Code compliance	Corporate governance report page 70
9.8.6(7)	Unexpired term of service contract	Remuneration report page 101

There are no further disclosures required in accordance with Listing Rule 9.8.

By order of the Board

JOHN MILLS
COMPANY SECRETARY

20 September 2018

A STRONG FINANCIAL FRAMEWORK

FINANCIALS

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for preparing the Annual Report and the Group and Parent Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare accounts for each financial year. Under company law the Directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for that period. In preparing these accounts, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether the consolidated accounts comply with International Financial Reporting Standards ('IFRS'), and the Parent Company accounts comply with applicable UK Accounting Standards, subject to any material departures disclosed and explained in the accounts; and
- prepare the accounts on the going concern basis unless it is inappropriate to presume that the Group and the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's and the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and the Company and enable them to ensure that the accounts and the Directors' remuneration report comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

DIRECTORS' RESPONSIBILITY STATEMENT

The Directors consider that the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

Each of the Directors (who are listed on pages 72 to 75) confirms that to the best of his or her knowledge:

- the Group's financial statements have been prepared in accordance with IFRS as adopted by the European Union and give a true and fair view of the Group's assets, liabilities and financial position as at 31 July 2018 and of its profit for the financial year then ended; and
- the Group Directors' report and Strategic report include a fair review of the development and performance of the business and the position and performance of the Group, together with a description of the principal risks and uncertainties that the Group faces.
- as at the date of this report there is no relevant audit information of which the Company's auditor is unaware. Each Director has taken all the steps he or she should have taken as a Director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Signed on behalf of the Board of Directors:

ANDY REYNOLDS SMITH
CHIEF EXECUTIVE

JOHN SHIPSEY
CHIEF FINANCIAL OFFICER

20 September 2018

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SMITHS GROUP PLC

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

OPINION

In our opinion:

- Smiths Group plc's Group financial statements and Company financial statements (the "financial statements") give a true and fair view of the state of the Group's and of the Company's affairs as at 31 July 2018 and of the Group's profit and cash flows for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the Company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 "Reduced Disclosure Framework", and applicable law); and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements, included within the Annual Report, which comprise: the consolidated balance sheet and Company balance sheet as at 31 July 2018; the consolidated income statement and consolidated statement of comprehensive income for the year then ended; the consolidated cash-flow statement for the year then ended; the consolidated statement of changes in equity and the Company statement of changes in equity for the year then ended; the accounting policies, and the notes to the financial statements.

Our opinion is consistent with our reporting to the Audit Committee.

BASIS FOR OPINION

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

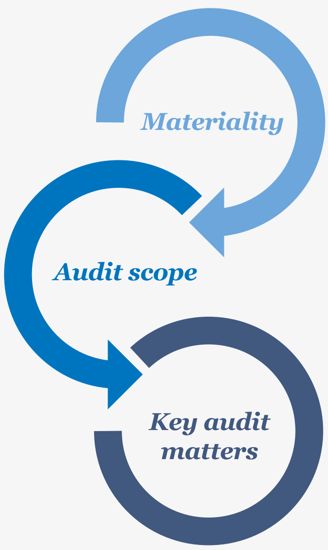
We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Company.

Other than those disclosed in note 2 to the financial statements, we have provided no non-audit services to the Group or the Company in the period from 1 August 2017 to 31 July 2018.

OUR AUDIT APPROACH

Overview



MATERIALITY

- Overall Group materiality: £20 million (FY2017: £20 million), based on approximately 3.5% of headline operating profit.
- Overall Company materiality: £18 million (FY2017: £18 million), based on 0.5% of total assets.

AUDIT SCOPE

- We conducted full scope audits at 19 reporting units across 8 countries.
- In addition, we performed the audit of specific balances and transactions at 16 reporting units across North America and Canada.
- During the year, the Group engagement team visited multiple reporting sites in North America and Europe and attended the year end clearance meetings for each division.

KEY AUDIT MATTERS

- Revenue recognition (occurrence), together with accounting for complex programmes and contract accounting in the Smiths Detection and Smiths Interconnect Divisions (Group).
- Product litigation provisions for asbestos in John Crane, Inc. and flexible gas piping product in Titeflex Corporation, a subsidiary of the Flex-Tek Division (Group).
- Working capital and associated provisions (Group).
- Taxation provisions and the recognition of deferred tax assets (Group).
- Goodwill and intangible asset impairment assessments (Group).
- Defined benefit pension plan net assets and liabilities (Group and Company).

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SMITHS GROUP PLC CONTINUED

THE SCOPE OF OUR AUDIT

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the Directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the Group and the industries in which it operates, and considered the risk of acts by the Group which were contrary to applicable laws and regulations, including fraud. We designed audit procedures at Group and significant component level to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

We focused on laws and regulations that could give rise to a material misstatement in the Group and Company financial statements, including, but not limited to, indirect and direct tax laws, product safety regulations and financial reporting regulations.

Our tests included, but were not limited to understanding management's approach to ensuring compliance with laws and regulations; enquiries with local, divisional and Group management; meeting with Group legal counsel to discuss legal matters; meeting with internal audit; obtaining legal confirmations where relevant; and focussing testing of balances and transactions, in addition to those listed as key audit matters below, that are subject to estimation, such as litigation provisions.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the Directors that represented a risk of material misstatement due to fraud.

KEY AUDIT MATTERS

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter	How our audit addressed the key audit matter
Revenue recognition (occurrence), together with accounting for complex programmes and contract accounting in the Smiths Detection and Smiths Interconnect Divisions (Group)	
We focused on revenue recognition for all divisions in the Group to check that revenue has been appropriately recognised upon fulfilment of contractual obligations. In the Smiths Detection and Smiths Interconnect divisions we focused on the accounting for complex programmes and contract accounting. The recognition of revenue is largely dependent on the terms of the underlying contract with the customer, including the nature of separate deliverables within the contract, achieving milestones within those contracts and the mechanisms in the contract by which risks and rewards of goods and services are transferred to the customer. These contracts are usually long term in nature, sometimes spanning a number of reporting periods. This means that the final profitability of a contract, which will be based upon forecast revenues and costs to complete, can be uncertain during the earlier phases. Judgement must therefore be applied in order to estimate the profit margins to recognise the revenue that is recorded. Changes in conditions and circumstances over time can result in variations to the original contract terms or to the overall profitability of the contract. This can include cost overruns which require further negotiation and settlements resulting in the need for provisions. Refer also to Accounting Policies.	For all the divisions we assessed whether the Group's revenue recognition policies complied with IFRSs as adopted by the EU and tested the implementation of those policies. Specifically we considered whether revenue was recognised based on the transfer of the risks and rewards of ownership of goods to the customer or the accounting period in which services were rendered by testing a sample of revenue items to contract and shipping documents, with a specific focus on major programmes where revenue was recorded close to the year-end. Where appropriate we evaluated the relevant IT systems and tested the operating effectiveness of the internal controls over the recording of revenue in the correct period. We also tested journal entries posted to revenue accounts to identify any unusual or irregular items, and the reconciliations between the systems used by the Group. In the case of the Smiths Detection and Smiths Interconnect divisions, for a sample of contracts, we read the relevant customer agreements and tested the accounting for separate deliverables and contractual milestones. This testing included evaluating customer acceptance of the work done to establish whether contractual milestones had been achieved, assessing the impact of any ongoing disputes, and assessing the reasonableness of the management's estimates of costs to complete the contract by comparing them to actual historical costs incurred on comparable contracts. We did not identify any material exceptions from the audit work performed and we found estimates to be in line with our expectations.

Key audit matter	How our audit addressed the key audit matter
Product litigation provisions for asbestos in John Crane, Inc. and flexible gas piping product in Titeflex Corporation, a subsidiary of the Flex-Tek Division (Group)	
John Crane, Inc., a US based subsidiary of the Group, is currently one of many co-defendants in litigation relating to products previously manufactured which contained asbestos. A provision of £223 million 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. Titeflex Corporation, another US based subsidiary of the Group, 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. A provision of £78 million has been made for the costs which the Group is expected to incur in respect of these claims. We focused on these areas because there is significant judgement involved in the assumptions used to estimate the provisions, in particular those relating to the US litigation environment such as the future level of claims and the cost of defence. As a result the provision may be subject to potentially material revisions from time to time. Refer also to note 22.	In John Crane, Inc. we used our own internal experts to challenge management's assumptions underlying the adverse judgment and defence cost provisions. This included an examination of the model maintained by management's valuation expert and evaluation of the work of the expert, by considering the appropriateness of the methodology used, the reasonableness of assumptions (including the use of a rolling 10 year horizon) and considering alternative outcomes, particularly the sensitivity calculations performed. In addition we tested the mathematical accuracy of the underlying calculations and agreed input data to source documents. We challenged management's underlying assumptions supporting its Titeflex provision. This included an evaluation of the valuation model, by testing the mathematical accuracy of the underlying calculations and the input data such as the average amount of settlements, the number of future settlements and the period over which expenditure can be reasonably estimated by testing them to historic claims. We also discussed these matters with the Company's internal legal counsel, obtained letters from external counsel and evaluated the appropriateness of the disclosures made in the Group financial statements. We found the assumptions to be consistent and in line with historical claims. We read the disclosures and found them to be consistent with the information we have obtained during the course of our audit.
Working capital and associated provisions (Group)	
We focused on this area because inventory provisions include subjective estimates and are influenced by assumptions concerning future selling prices and the level of sales activity, and the Group also has material levels of trade receivables that are overdue and not impaired (as disclosed in note 14 to the financial statements). We focused in particular on inventory levels in those parts of the business experiencing challenging trading environments. We also focused on divisions with inherent judgements associated with large programmes and complex contractual terms. The key associated risks were recoverability of billed and unbilled trade receivables and the valuation of inventory. Refer also to notes 13 and 14.	Where appropriate, we evaluated the management's forecasted sales for each significant category of slow moving inventory by comparing them to historical sales and orders for future sales. We compared the historical provision for bad debts to the actual amounts written off, to determine whether the management's estimation techniques were reasonable and considered the adequacy of provisions for bad debts for significant customers at reporting unit level, taking into account specific credit risk assessments. We did not identify any material exceptions from our audit work.
Taxation provisions and the recognition of deferred tax assets (Group)	
The Group has recognised £180 million deferred tax assets on the balance sheet, the recognition of which involves judgement by management as to the likelihood of the realisation of these deferred tax assets. The expectation that the benefit of these assets will be realised is dependent on a number of factors, including appropriate taxable temporary timing differences, and whether there will be sufficient taxable profits in future periods to support recognition. The Group has recognised provisions against uncertain tax positions, the valuation of which is an inherently judgemental area. The Group has a wide geographic footprint and is subject to tax laws in a number of jurisdictions. Refer also to note 6.	We evaluated the management's assessment as to whether there will be sufficient taxable profits in future periods to support the recognition of deferred tax assets by evaluating the management's future cash flow forecasts, and the process by which they were drawn up, including testing the underlying calculations and comparing the forecasts to historical performance. We also used our tax specialists to assess management's assumptions underlying the provisions for uncertain tax positions. We discussed with management the known uncertain tax positions and read communications from taxation authorities to identify uncertain tax positions. We did not identify any material exceptions from our audit work.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SMITHS GROUP PLC CONTINUED

Key audit matter	How our audit addressed the key audit matter
Goodwill and intangible asset impairment assessments (Group)	
The Group holds significant amounts of goodwill and intangible assets on the balance sheet, as detailed in note 10 to the financial statements. The risk is that these balances are overstated. Goodwill (£1,616 million) must be tested for impairment on at least an annual basis. The determination of recoverable amount, being the higher of value-in-use and fair value less costs to sell, requires judgement in both identifying and then valuing the relevant cash generating units (CGUs). The impairment assessment for these assets involves subjective judgements about future business performance, with key assumptions including cash flows, the overall long-term growth rates, discount rates used and to the extent relevant, the fair value less costs to dispose. The Group also holds capitalised development costs (£155 million), where the risk of inappropriate capitalisation or impairment may arise. The key judgements relate to the technical feasibility and regulatory and commercial viability of the products under development; and the related assumptions used within the related impairment assessments. Refer also to notes 10 and 11.	We evaluated the Directors' future cash flow forecasts, and the process by which they were drawn up, including testing the underlying calculations and comparing them to the latest Board approved divisional budgets. We challenged: – the Directors' key assumptions for long-term growth rates in the forecasts by comparing them to historical results, and economic and industry forecasts; and – the discount rate by assessing the cost of capital for the Group. We evaluated the reasonableness of the Directors' forecast performance by performing a sensitivity analysis around the key drivers of the cash flow forecasts. We found the assumptions to be consistent and in line with our expectations. We evaluated the appropriateness of the related disclosures in note 11 of the financial statements, including sensitivities provided with respect to the Interconnect Subsystems Detection CGU. To address the risks around capitalised development costs we assessed the business cases supporting commercial viability, discussed technical feasibility with the product development team (where applicable), tested key assumptions within the impairment assessments, and performed sensitivity analysis. We did not identify any material exceptions from our audit work.
Defined benefit pension plan net assets and liabilities (Group and Company)	
The Group has defined benefit pension plans with net post-retirement assets of £526 million and net post-retirement liabilities of £145 million, which are significant in the context of the overall balance sheet of the Group and Company. The valuation of the pension liabilities requires some judgement and technical expertise in choosing appropriate assumptions. A number of the key assumptions (including salary increases, inflation, discount rates and mortality) can have a material impact on the calculation of the liability. The pension assets include significant pension asset investments and the fair value measurement of which includes judgement. The recognition of post-retirement plan net assets for accounting purposes is dependent on the rights of the employers to recover the surplus at the end of the life of the scheme. Refer also to note 8.	We evaluated the Directors' assessment of the assumptions made in relation to the valuations of the liabilities and assets in the pension plans and the assumptions around salary increases and mortality rates by comparing them to national and industry averages. We also focussed on the valuation of pension plan liabilities and the pension assets as follows: – We agreed the discount and inflation rates used in the valuation of the pension liability to our internally developed benchmarks. – We obtained third party confirmations on ownership and valuation of pension assets. – We checked that the recognition of post retirement plan net assets complies with the Group's investment principles. – Where there was no new census data in the year we assessed the assumptions used by the actuaries. – We tested the basis of recognition of the UK pension surplus through the reading of scheme rules. We did not identify any material exceptions from our audit work.

HOW WE TAILORED THE AUDIT SCOPE

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the Group and the Company, the accounting processes and controls, and the industry in which they operate.

The Group is organised into five divisions: John Crane, Smiths Medical, Smiths Detection, Smiths Interconnect and Flex-Tek and is a consolidation of over 250 units.

In establishing the overall approach to the Group audit, we determined the type of work that needed to be performed at the reporting units by us, as the Group Engagement team, or component auditors within PwC UK and from other PwC network firms operating under our instruction. Where the work was performed by component auditors, we determined the level of involvement we needed to have in the audit work at those reporting units to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the financial statements as a whole.

The Group's operating reporting units vary significantly in size and we identified 19 reporting units that, in our view, required an audit of their complete financial information, due to their size or risk characteristics. Specific audit procedures over certain balances and transactions were performed at a further 16 reporting units, to give appropriate coverage of material balances at both divisional and Group levels. Of these, one reporting unit has been determined to be financially significant based on its contribution to Group revenue and headline operating profit. We conducted work in 11 countries and the Group engagement team visited reporting sites in North America and Europe, and participated in each of the divisional audit clearance meetings. Together, the reporting units subject to audit procedures accounted for 74% (FY2017: 75%) of the Group's revenues and 79% (FY2017: 78%) of the Group's headline operating profit.

Further specific audit procedures over IT controls, central functions such as treasury and areas of judgement, including the accounting for acquisitions and disposals, taxation, goodwill, post-retirement benefits and material litigation, were performed at the local headquarters of each of the divisions and at the Group's Head Office.

MATERIALITY

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Company financial statements
Overall materiality	£20 million (FY2017: £20 million).	£18 million (FY2017: £18 million).
How we determined it	Based on approximately 3.5% of headline operating profit.	0.5% of total assets.
Rationale for benchmark applied	Consistent with last year, we applied this benchmark because, in our view, this is the metric against which the performance of the Group is most commonly measured.	Consistent with last year, we applied this benchmark because, in our view, the Company is a holding company and the parent company of the Group, which is not a profit oriented entity.

For each component in the scope of our Group audit, we allocated a materiality that is less than our overall Group materiality. The range of materiality allocated across components was between £1 million and £10 million. Certain components were audited to a local statutory audit materiality that was also less than our overall Group materiality.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £1 million (Group audit) (FY2017: £1 million) and £1 million (Company audit) (FY2017: £1 million) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

GOING CONCERN

In accordance with ISAs (UK) we report as follows:

Reporting obligation	Outcome
We are required to report if we have anything material to add or draw attention to in respect of the Directors' statement in the financial statements about whether the Directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the Directors' identification of any material uncertainties to the Group's and the Company's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements.	We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and Company's ability to continue as a going concern.
We are required to report if the Directors' statement relating to Going Concern in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.	We have nothing to report.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SMITHS GROUP PLC CONTINUED

REPORTING ON OTHER INFORMATION

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The Directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, the Companies Act 2006 (CA06), ISAs (UK) and the Listing Rules of the Financial Conduct Authority (FCA) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 July 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements. (CA06)

In light of the knowledge and understanding of the Group and Company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report. (CA06)

The Directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group

We have nothing material to add or draw attention to regarding:

- The Directors' confirmation on page 88 of the Annual Report that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.
- The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.
- The Directors' explanation on page 68 of the Annual Report as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We have nothing to report having performed a review of the Directors' statement that they have carried out a robust assessment of the principal risks facing the Group and statement in relation to the longer-term viability of the Group. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the Directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the UK Corporate Governance Code (the "Code"); and considering whether the statements are consistent with the knowledge and understanding of the Group and Company and their environment obtained in the course of the audit. (Listing Rules)

Other Code Provisions

We have nothing to report in respect of our responsibility to report when:

- The statement given by the Directors, on page 84, that they consider the Annual Report taken as a whole to be fair, balanced and understandable, and provides the information necessary for the members to assess the Group's and Company's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and Company obtained in the course of performing our audit.
- The section of the Annual Report on pages 83–89 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.
- The Directors' statement relating to the Company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified, under the Listing Rules, for review by the auditors.

Directors' Remuneration

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006. (CA06)

RESPONSIBILITIES FOR THE FINANCIAL STATEMENTS AND THE AUDIT

Responsibilities of the Directors for the financial statements

As explained more fully in the Statement of Directors' Responsibilities set out on page 114, the Directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Group's and the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or the Company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

OTHER REQUIRED REPORTING

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- the Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the Audit Committee, we were appointed by the members on 19 November 1996 to audit the financial statements for the year ended 31 July 1997 and subsequent financial periods. The period of total uninterrupted engagement is 22 years, covering the years ended 31 July 1997 to 31 July 2018.

Andrew Kemp (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors
London
20 September 2018

CONSOLIDATED INCOME STATEMENT

	Notes	Year ended 31 July 2018 Headline £m	Year ended 31 July 2018 Non-headline (note 3) £m	Year ended 31 July 2018 Total £m	Year ended 31 July 2017 Headline £m	Year ended 31 July 2017 Non-headline (note 3) £m	Year ended 31 July 2017 Total £m
CONTINUING OPERATIONS							
Revenue	1	3,213		3,213	3,280		3,280
Cost of sales		(1,749)		(1,749)	(1,755)		(1,755)
Gross profit		1,464		1,464	1,525		1,525
Sales and distribution costs		(435)		(435)	(449)		(449)
Administrative expenses		(485)	(57)	(542)	(487)	(90)	(577)
Profit on business disposal	28		7	7		175	175
OPERATING PROFIT	2	**544**	**(50)**	**494**	**589**	**85**	**674**
Interest receivable		7		7	5		5
Interest payable		(64)		(64)	(66)		(66)
Other financing losses			(9)	(9)		(14)	(14)
Other finance income – retirement benefits	8		7	7		2	2
Finance costs	4	(57)	(2)	(59)	(61)	(12)	(73)
Continuing operations – Profit before taxation		**487**	**(52)**	**435**	**528**	**73**	**601**
Taxation	6	(126)	(30)	(156)	(140)	111	(29)
Continuing operations – Profit for the year		**361**	**(82)**	**279**	**388**	**184**	**572**
Discontinued operations							
Loss on discontinued operations	27					(8)	(8)
PROFIT FOR THE YEAR		**361**	**(82)**	**279**	**388**	**176**	**564**
Profit for the year attributable to:							
Smiths Group shareholders – continuing operations		359	(82)	277	386	184	570
Smiths Group shareholders – discontinued operations						(8)	(8)
Non-controlling interests in respect of continuing operations		2		2	2		2
		361	**(82)**	**279**	**388**	**176**	**564**
EARNINGS PER SHARE	5						
Basic				70.0p			142.1p
Basic – continuing				70.0p			144.1p
Diluted				69.1p			140.3p
Diluted – continuing				69.1p			142.3p

References in the consolidated income statement, consolidated statement of comprehensive income, consolidated balance sheet, consolidated statement of changes in equity and consolidated cash-flow statement relate to notes on pages 127 to 174, which form an integral part of the consolidated accounts.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Notes	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
PROFIT FOR THE YEAR		**279**	**564**
Other comprehensive income:			
Actuarial gains on retirement benefits	8	104	55
Taxation recognised on actuarial movements	6	(18)	(13)
Other comprehensive income and expenditure which will not be reclassified to the consolidated income statement		86	42
Other comprehensive income which will be reclassified and reclassifications:			
Exchange gains		6	25
Cumulative exchange gains recycled on business disposals		(5)	(41)
Fair value gains/(losses) and reclassification adjustments:			
– deferred on available for sale financial assets		1	1
– deferred in the period on cash-flow and net investment hedges		(6)	(14)
– reclassified to income statement on cash-flow and net investment hedges		(6)	25
Taxation recognised on fair value gains	6		(1)
Total other comprehensive income		**76**	**37**
Total comprehensive income		**355**	**601**
Attributable to:			
Smiths Group shareholders		353	600
Non-controlling interests		2	1
		355	**601**

CONSOLIDATED BALANCE SHEET

	Notes	31 July 2018 £m	31 July 2017 £m
NON-CURRENT ASSETS			
Intangible assets	10	2,061	2,015
Property, plant and equipment	12	320	315
Financial assets – other investments	16	18	21
Retirement benefit assets	8	526	390
Deferred tax assets	6	180	272
Trade and other receivables	14	57	57
Financial derivatives	19	50	56
		3,212	**3,126**
CURRENT ASSETS			
Inventories	13	466	452
Current tax receivable	6	38	62
Trade and other receivables	14	733	722
Cash and cash equivalents	17	717	782
Financial derivatives	19	7	13
		1,961	**2,031**
TOTAL ASSETS		**5,173**	**5,157**
NON-CURRENT LIABILITIES			
Financial liabilities			
– borrowings	17	(1,407)	(1,598)
– financial derivatives	19	(6)	(2)
Provisions for liabilities and charges	22	(262)	(283)
Retirement benefit obligations	8	(145)	(166)
Deferred tax liabilities	6	(77)	(111)
Trade and other payables	15	(27)	(26)
		(1,924)	**(2,186)**
CURRENT LIABILITIES			
Financial liabilities			
– borrowings	17	(203)	(151)
– financial derivatives	19	(4)	(10)
Provisions for liabilities and charges	22	(76)	(85)
Trade and other payables	15	(606)	(576)
Current tax payable	6	(72)	(45)
		(961)	**(867)**
TOTAL LIABILITIES		**(2,885)**	**(3,053)**
NET ASSETS		**2,288**	**2,104**
SHAREHOLDERS' EQUITY			
Share capital	23	148	148
Share premium account		358	355
Capital redemption reserve	25	6	6
Revaluation reserve	25	1	1
Merger reserve	25	235	235
Retained earnings		1,826	1,634
Hedge reserve	25	(302)	(290)
Total shareholders' equity		**2,272**	**2,089**
Non-controlling interest equity		16	15
TOTAL EQUITY		**2,288**	**2,104**

The accounts on pages 122 to 174 were approved by the Board of Directors on 20 September 2018 and were signed on its behalf by:

ANDY REYNOLDS SMITH
CHIEF EXECUTIVE

JOHN SHIPSEY
CHIEF FINANCIAL OFFICER

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 2017		503	242	1,634	(290)	2,089	15	2,104
Profit for the year				277		277	2	279
Other comprehensive income:								
Actuarial gains on retirement benefits and related tax				86		86		86
Exchange gains				1		1		1
Fair value gains/(losses) and related tax				1	(12)	(11)		(11)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR				**365**	**(12)**	**353**	**2**	**355**
Transactions relating to ownership interests:								
Exercises of share options	23	3				3		3
Purchase of own shares	25			(15)		(15)		(15)
Dividends:								
– equity shareholders	24			(172)		(172)		(172)
– non-controlling interest							(1)	(1)
Share-based payment	9			14		14		14
At 31 July 2018		**506**	**242**	**1,826**	**(302)**	**2,272**	**16**	**2,288**

	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 2016		500	242	1,205	(301)	1,646	14	1,660
Profit for the year				562		562	2	564
Other comprehensive income:								
Actuarial gains on retirement benefits and related tax				42		42		42
Exchange losses				(15)		(15)	(1)	(16)
Fair value gains and related tax					11	11		11
TOTAL COMPREHENSIVE INCOME FOR THE YEAR				**589**	**11**	**600**	**1**	**601**
Transactions relating to ownership interests:								
Exercises of share options	23	3				3		3
Taxation recognised on share options	6			3		3		3
Purchase of own shares	25			(10)		(10)		(10)
Dividends:								
– equity shareholders	24			(167)		(167)		(167)
Share-based payment	9			14		14		14
At 31 July 2017		**503**	**242**	**1,634**	**(290)**	**2,089**	**15**	**2,104**

CONSOLIDATED CASH-FLOW STATEMENT

	Notes	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
Net cash inflow from operating activities	29	**405**	**479**
Cash-flows from investing activities			
Expenditure on capitalised development		(26)	(37)
Expenditure on other intangible assets	10	(12)	(8)
Purchases of property, plant and equipment	12	(68)	(62)
Disposals of property, plant and equipment		4	9
Investment in financial assets	16	(1)	(18)
Acquisition of businesses	26	(71)	(580)
Disposals of businesses – continuing operations	28	29	399
Disposals of businesses – discontinued operations	27		63
Net cash-flow used in investing activities		**(145)**	**(234)**
Cash-flows from financing activities			
Proceeds from exercise of share options	23	3	3
Purchase of own shares	25	(15)	(10)
Settlement of cash settled options		(1)	
Dividends paid to equity shareholders	24	(172)	(167)
Cash inflow from matured derivative financial instruments		4	
Increase in new borrowings	17		546
Reduction and repayment of borrowings	17	(135)	(256)
Net cash-flow used in financing activities		**(316)**	**116**
Net (decrease)/increase in cash and cash equivalents		(56)	**361**
Cash and cash equivalents at beginning of year		781	430
Exchange differences		(8)	(10)
Cash and cash equivalents at end of year	17	**717**	**781**
Cash and cash equivalents at end of year comprise:			
– cash at bank and in hand		287	226
– short-term deposits		430	556
– bank overdrafts			(1)
		717	**781**
Included in cash and cash equivalents per the balance sheet		717	782
Included in overdrafts per the balance sheet			(1)
		717	**781**

Reconciliation of net cash-flow to movement in net debt

	Notes	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
Net debt at start of year	17	**(967)**	**(978)**
Net (decrease)/increase in cash and cash equivalents		(56)	361
Increase in borrowings			(546)
Reduction and repayment of borrowings		135	256
Movement in net debt resulting from cash-flows		**79**	**71**
Capitalisation, interest accruals and unwind of capitalisation fees		2	(4)
Movement from fair value hedging		1	5
Exchange differences		(8)	(61)
Movement in net debt in the year		**74**	**11**
Net debt at end of year	17	**(893)**	**(967)**

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 judgements, 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 £24m (FY2017: £24m) has been recognised in the period in respect of contracts in progress at the period end with a total expected value of £63m (FY2017: £48m) and cumulative revenue recognised to date of £44m (FY2017: £36m). 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 (FY2017: less than £1m).

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

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 2018 was £32m (FY2017: £27m).

Contract profitability

Smiths Detection has multi-year 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.

At 31 July 2018 and 2017 no other contracts had been assessed as at significant risk of becoming onerous and no provision was held against onerous contracts.

Taxation

The Group has recognised deferred tax assets of £121m (FY2017: £129m) relating to losses and £67m (FY2017: £112m) 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. This is based on a number of factors, which seek to assess the expectation that the benefit of these assets will be realised, including expected future levels of operating profit, expenditure on litigation, pension contributions and the timing of the unwind of other tax positions. It has been concluded that there are sufficient taxable profits in future periods to support recognition. A 5% reduction in expected future operating profits would reduce the level of deferred tax recognised by £1m (FY2017: £8m), and a 5% increase in expected future operating profits would increase the level of deferred tax recognised by £7m (FY2017: £11m). Further detail on the Group's deferred taxation position is included in note 6.

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 8.

At 31 July 2018 there is a retirement benefit asset of £526m (FY2017: £390m), principally relating to UK schemes, which arises from the rights of the employers to recover the surplus at the end of the life of the scheme. 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.

Receivables provisions

If the carrying value of any receivable is higher than the fair value, the Group makes provisions writing down the balance to its fair value. The fair value of receivables is considered individually for each customer and incorporates past experience and progress with collecting receivables.

At 31 July 2018 the gross value of receivables partly provided for or more than three months overdue was £70m (FY2017: £73m) and there were provisions of £32m (FY2017: £33m) against these receivables. Consequently, these receivables were carried at a net value of £38m (FY2017: £40m). See note 14 for disclosures on credit risk and ageing of trade receivables.

Inventory provisions

The calculation of inventory provisions requires judgement by management of the expected value of future sales. If the carrying value of inventory is higher than the expected recoverable value, the Group makes provisions writing inventory down to its net recoverable value. Inventory is initially assessed for impairment by comparing inventory levels to recent utilisation rates and carrying values to historical selling prices. A detailed review is completed for inventory lines identified in the initial assessment considering sales activity, order flow, customer contracts and current selling prices.

At 31 July 2018, there were provisions of £54m (FY2017: £55m) against gross inventory of £520m (FY2017: £507m). See note 13 for a breakdown of inventory.

ACCOUNTING POLICIES CONTINUED

A 10% increase in the proportion of raw materials provided for would increase the provision by £17m (FY2017: £17m) and a 10% increase in the proportion of finished goods provided for would increase the provision by £23m (FY2017: £22m).

Capitalisation of development costs

Expenditure incurred in the development of major new products is capitalised as internally generated intangible assets only when strict criteria are met, specifically in relation to the products' technical feasibility and probable future economic benefits. The carrying value of intangible assets are amortised over their expected useful lives, commencing in the year that sales are first made.

The assessment of the future viability and technical feasibility of development projects and the determination of the underlying products' useful economic life and amortisation basis require significant judgement and the use of assumptions and estimates.

Impairment

Goodwill is tested at least annually for impairment and other assets, including capitalised development costs 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 assets are determined based on value in use calculations unless future trading projections cannot be adjusted to eliminate the impact of a major restructuring. The value in use calculations require the use of assumptions and estimates including projected future cash-flows and other future events.

Provisions for liabilities and charges

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

Non-headline and legacy provisions

John Crane, Inc. (JCI), a subsidiary of the Group, is one of many co-defendants in litigation relating to products previously manufactured which contained asbestos. Provision of £223m (FY2017: £237m) has been made for the future defence costs which the Group is expected to incur and the expected costs of future adverse judgments against JCI. Whilst well-established incidence curves can be used to estimate the likely future pattern of asbestos-related disease, JCI's claims experience is significantly impacted by other factors which influence the US litigation environment. These can include: changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels; and legislative and procedural changes in both the state and federal court systems. 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.

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

- the period over which the expenditure can be reliably estimated is judged to be ten years, based on past experience regarding significant changes in the litigation environment that have occurred every few years and on the amount of time taken in the past for some of those changes to impact the broader asbestos litigation environment. See note 22 for a sensitivity showing the impact on the provision of reducing or increasing this time horizon;
- the future trend of legal costs; the rate of future claims filed; the rate of successful resolution of claims; and the average amount of judgments awarded have been projected based on the past history of JCI claims and well-established tables of asbestos incidence projections, since this is the best available evidence. Claims history from other defendants is not used to calculate the provision because JCI's defence strategy generates a significantly different pattern of legal costs and settlement expenses. See note 22 for a sensitivity showing the range of expected future spend.

Titeflex Corporation, a subsidiary of the Group in the Flex-Tek division, has received a number of claims from insurance companies seeking recompense on a subrogated basis for the effects of damage allegedly caused by lightning strikes in relation to its flexible gas piping product. It has also received a number of product liability claims regarding this product, some in the form of purported class actions. Titeflex Corporation believes that its products are a safe and effective means of delivering gas when installed in accordance with the manufacturer's instructions and local and national codes; however some claims have been settled on an individual basis without admission of liability. Provision of £78m (FY2017: £84m) has been made for the costs which the Group is expected to incur in respect of these claims. In preparing the provision calculation, judgements were made about the impact of safe installation initiatives on the level of future claims. See note 22 for a sensitivity showing the impact on the provision of reducing or increasing the expected impact. However, because of the significant uncertainty associated with the future level of claims, there can be no guarantee that the assumptions used to estimate the provision will result in an accurate prediction of the actual costs that may be incurred.

Trading provisions

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.

Presentation of results

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

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

Performance measures for the Group's ongoing trading activity are described as 'headline' and used by management to measure and monitor performance. See note 1 for disclosures of headline operating profit and note 30 for more information about the calculation of return on capital employed and credit metrics.

In addition, the Group reports underlying growth rates for sales and profit measures and determining which items should be adjusted for involves judgement. Underlying growth excludes the impact of acquisitions, divestments, presentational changes and the effects of foreign exchange translation, by making the following adjustments:

- Exclude acquisitions from the current period for the first 12 months of ownership;
- Exclude the performance of divested businesses after the date of disposal from comparative period;
- Include restructuring and pension administration costs as headline items for both the current and comparative periods; and
- Retranslate the comparative to current year exchange rates before calculating growth measures.

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. A list of the subsidiaries of Smiths Group plc is provided on pages 190 to 198.

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 which the Group has significant influence over 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 financial position of all subsidiaries and associates that have a functional currency different from sterling are translated into sterling at the rate of exchange at the date of that balance sheet, and the income and expenses are translated at average exchange rates for the period. All resulting exchange differences are recognised as a separate component of equity.

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

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

Revenue

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

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

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.

ACCOUNTING POLICIES CONTINUED

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.

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.

Taxation

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

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

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

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

Deferred tax liabilities and assets are not discounted.

Employee benefits

Share-based compensation

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

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

Pension obligations and post-retirement benefits

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

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

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

Intangible assets

Goodwill

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

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 over the estimated period of sale for each product, commencing in the year that sales of the product are first made. Amortisation is charged straight line or based on the units produced, depending on the nature of the product and the availability of reliable estimates of production volumes.

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

Intangible assets acquired in business combinations

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

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

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

Software, patents and intellectual property

The estimated useful lives are as follows:

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

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

Property, plant and equipment

Property, plant and equipment 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 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. 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.

Discontinued operations

A discontinued operation is either:

- a component of the Group's business that represents a separate major line of business or geographical area of operations that has been disposed of, has been abandoned or meets the criteria to be classified as held for sale; or
- a business acquired solely for the purpose of selling it.

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

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.

ACCOUNTING POLICIES CONTINUED

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.

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.

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.

Fair value of financial assets and liabilities

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

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

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

See note 20 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

A number of new standards and amendments to standards and interpretations have been issued but are not yet effective for the current accounting period. Certain standards which could be expected to have an impact on the consolidated financial statements are discussed in further detail below.

The Group conducted an impact assessment of the new standards which are effective next year based on the Group's current activities and have quantified the impact. The results of the impact assessment confirm that the new standards will lead to limited changes to presentation and disclosure.

IFRS 9: Financial instruments (effective year ending 31 July 2019)

The new standard addresses the classification and measurement of financial assets.

The alignment of the classification and measurement model under IFRS 9 will result in changes in the classification of all financial assets excluding derivatives. These changes will not have a quantitative impact on the financial statements.

IFRS 9 introduces an expected credit loss model, requiring an expected credit loss to be recognised on all financial assets held at amortised cost. The Group has previously provided against bad and doubtful debts within trade and other receivables based on specific risk assessments and reference to past default experience. The resulting reassessment of existing provisions is not expected to have a material impact on the net assets of the Group.

IFRS 9 also introduces changes to the qualifying criteria for hedge accounting and expands the financial and non-financial instruments which may be designated as hedged items and hedging instruments in order to align hedge accounting with business strategy. The changes to hedge accounting under IFRS 9 will result in qualitative enhancements to the interest rate and foreign currency risk management disclosures but will not have a quantitative impact on the consolidated financial statements of the Group.

IFRS 15: Revenue from contracts with customers (effective year ending 31 July 2019)

IFRS 15 replaces IAS 18: Revenue and IAS 11: Construction contracts. The new standard combines a number of previous standards, sets out a five step model for the recognition of revenue and establishes principles for reporting useful information to users of financial statements about the nature, timing and uncertainty of revenue and cash-flows arising from an entity's contracts with customers.

A detailed assessment has been undertaken for the expected impact of IFRS 15 on how the Group currently recognises revenue and a summary of the results of this assessment is shown below. The Group will utilise the full retrospective application with practical expedients option for the adoption of IFRS 15.

The assessment summary represents a reasonable estimate of the expected impact on the reported results for the year ended 31 July 2018 and on the net assets at that date but is subject to revision during the coming half year as the Group completes its analysis, particularly for those contracts on which revenue was recognised in the latter part of the financial year under current IFRS.

The principal areas of impact for the Group's revenue recognition include:

- Customer specific products – rephasing of revenue recognition for certain customer specific products that have no alternative use and for which the Group has the right to receive payment;
- Customer specific rights – rephasing of revenue recognition for contractual Customer specific rights;
- Variable selling costs – certain expenses currently classified as variable selling costs will be reclassified as offsets to revenue. This classification change reduces revenue and cost of sales but has no impact on profit; and
- Contract assets and liabilities – certain assets and liabilities current included within trade receivables, accrued income and deferred revenue will be reclassified as contract assets and liabilities.

Revenue

	£m
As reported	3,213
Expected impacts	(16)
IFRS 15 revenue for the year ended 31 July 2018	**3,197**

Headline operating profit

	£m
As reported	544
Expected impacts	nil
IFRS 15 headline operating profit for the year ended 31 July 2018	**544**

Net Assets

	£m
As reported	2,288
Expected impacts	(1)
IFRS 15 net assets as at 31 July 2018	**2,287**

IFRS 16: Leases (effective year ending 31 July 2020)

The standard fundamentally changes the accounting treatment of leased assets, requiring all material lease liabilities and corresponding 'right of use' assets to be recognised on the balance sheet. The operating lease rental expense currently charged to operating profit in the income statement will be replaced by a depreciation charge for the 'right of use' assets recognised in operating profit and an interest charge on the lease liabilities recognised in finance costs.

The Group is mid-way through an IFRS 16 adoption project and the preliminary assessment indicates the impact of adoption will not have a material impact on net assets. The total value of operating lease commitments at 31 July 2018 was £155m (FY2017: £140m).

PARENT COMPANY

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.

The accounts of the Parent Company, Smiths Group plc, have been prepared in accordance with UK GAAP, applying Financial Reporting Standard 101, "Reduced Disclosure Framework". The Company accounts are presented in separate financial statements on pages 182 to 189. The principal subsidiaries of the Parent Company are listed in the above accounts.

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, manufacture and support the following products:

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

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.

Segment trading performance

Year ended 31 July 2018	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £m
Revenue	881	885	793	300	354		3,213
Divisional headline operating profit	202	156	134	42	67		601
Corporate headline operating costs						(57)	(57)
Headline operating profit/(loss)	**202**	**156**	**134**	**42**	**67**	**(57)**	**544**
Items excluded from headline measures (note 3)	(12)	(4)	(40)	(4)	1	2	(57)
Profit/(loss) on disposal of businesses	9		(1)	(1)			7
Operating profit/(loss)	**199**	**152**	**93**	**37**	**68**	**(55)**	**494**

Year ended 31 July 2017	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate costs £m	Total £m
Revenue	885	951	687	419	338		3,280
Divisional headline operating profit	204	209	103	56	65		637
Corporate headline operating costs						(48)	(48)
Headline operating profit/(loss)	**204**	**209**	**103**	**56**	**65**	**(48)**	**589**
Items excluded from headline measures (note 3)	(17)	(23)	(33)	(4)	3	(16)	(90)
Profit on disposal of businesses	3	100		72			175
Operating profit/(loss)	**190**	**286**	**70**	**124**	**68**	**(64)**	**674**

Divisional headline operating profit is stated after charging the following items:

Year ended 31 July 2018	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate and non-headline £m	Total £m
Depreciation	13	20	10	7	4	1	55
Amortisation of capitalised development		14	10				24
Amortisation of software, patents and intellectual property	3	4	5	2		4	18
Amortisation of acquired intangibles						29	29
Share-based payment	3	2	1	1	1	6	14

Year ended 31 July 2017	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate and non-headline £m	Total £m
Depreciation	15	21	8	8	4	1	57
Amortisation of capitalised development		14	13				27
Amortisation of software, patents and intellectual property	2	5	4	2		5	18
Amortisation of acquired intangibles						17	17
Share-based payment	3	2	1	1	1	7	15

Corporate and non-headline items are central costs and charges that are treated as non-headline (see note 3).

Segment assets and liabilities

Segment assets

31 July 2018	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate and non-headline £m	Total £m
Property, plant, equipment, development projects, other intangibles and investments	94	242	101	35	37	21	530
Inventory, trade and other receivables	361	266	372	120	117	22	1,258
Segment assets	**455**	**508**	**473**	**155**	**154**	**43**	**1,788**

31 July 2017	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate and non-headline £m	Total £m
Property, plant, equipment, development projects, other intangibles and investments	96	233	107	40	35	20	531
Inventory, trade and other receivables	337	256	389	118	104	27	1,231
Segment assets	**433**	**489**	**496**	**158**	**139**	**47**	**1,762**

Non-headline assets comprise receivables relating to non-headline items, acquisitions and disposals.

NOTES TO THE ACCOUNTS CONTINUED

1 SEGMENT INFORMATION CONTINUED

ANALYSIS BY OPERATING SEGMENT CONTINUED

Segment assets and liabilities continued

Segment liabilities

	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate and non-headline £m	Total £m
							31 July 2018
Divisional liabilities	(138)	(116)	(257)	(43)	(46)		(600)
Corporate and non-headline liabilities						(370)	(370)
Segment liabilities	**(138)**	**(116)**	**(257)**	**(43)**	**(46)**	**(370)**	**(970)**

	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate and non-headline £m	Total £m
							31 July 2017
Divisional liabilities	(124)	(120)	(246)	(48)	(39)		(577)
Corporate and non-headline liabilities						(393)	(393)
Segment liabilities	**(124)**	**(120)**	**(246)**	**(48)**	**(39)**	**(393)**	**(970)**

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

Reconciliation of segment assets and liabilities to statutory assets and liabilities

	Assets		Liabilities	
	31 July 2018 £m	31 July 2017 £m	31 July 2018 £m	31 July 2017 £m
Segment assets and liabilities	**1,788**	**1,762**	**(970)**	**(970)**
Goodwill and acquired intangibles	1,867	1,820		
Derivatives	57	69	(11)	(12)
Current and deferred tax	218	334	(149)	(156)
Retirement benefit assets and obligations	526	390	(145)	(166)
Cash and borrowings	717	782	(1,610)	(1,749)
Statutory assets and liabilities	**5,173**	**5,157**	**(2,885)**	**(3,053)**

Segment capital expenditure

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

	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Corporate and non-headline £m	Total £m
Capital expenditure year ended 31 July 2018	17	48	22	10	7	4	**108**
Capital expenditure year ended 31 July 2017	12	58	22	10	6	1	**109**

Corporate and non-headline items include corporate capital expenditure through Smiths Business Information Services on IT equipment and software.

Segment capital employed

Capital employed is a non-statutory measure of invested resources. It comprises statutory net assets adjusted to add goodwill recognised directly in reserves in respect of subsidiaries acquired before 1 August 1998 of £787m (31 July 2017: £787m) and eliminate post-retirement benefit assets and liabilities and litigation provisions relating to non-headline items, both net of related tax, and net debt. See note 30 for a reconciliation of net assets to capital employed.

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

31 July 2018	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Average divisional capital employed	881	1,195	1,108	356	191	3,731
Average corporate capital employed						4
Average total capital employed						**3,735**

31 July 2017	John Crane £m	Smiths Medical £m	Smiths Detection £m	Smiths Interconnect £m	Flex-Tek £m	Total £m
Average divisional capital employed	890	1,257	820	492	182	3,641
Average corporate capital employed						(2)
Average total capital employed						**3,639**

ANALYSIS OF REVENUE

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

John Crane	Original equipment £m	Aftermarket £m	Total £m
Revenue year ended 31 July 2018	292	589	**881**
Revenue year ended 31 July 2017	314	571	**885**

Smiths Medical	Infusion systems £m	Vascular access £m	Vital care £m	Specialty products £m	Total £m
Revenue year ended 31 July 2018	302	294	248	41	**885**
Revenue year ended 31 July 2017	302	318	273	58	**951**

Smiths Detection	Air transportation £m	Ports and borders £m	Defence £m	Urban security £m	Total £m
Revenue year ended 31 July 2018	540	56	33	164	**793**
Revenue year ended 31 July 2017	355	100	65	167	**687**

Smiths Interconnect	Connectors £m	Microwave £m	Power £m	Total £m
Revenue year ended 31 July 2018	215	85		**300**
Revenue year ended 31 July 2017	177	195	47	**419**

Flex-Tek	Fluid Management £m	Flexible Solutions £m	Heat Solutions £m	Construction Products £m	Total £m
Revenue year ended 31 July 2018	87	66	93	108	**354**
Revenue year ended 31 July 2017	81	64	84	109	**338**

NOTES TO THE ACCOUNTS CONTINUED

1 SEGMENT INFORMATION CONTINUED

ANALYSIS OF REVENUE CONTINUED

The Group's statutory revenue is analysed as follows:

	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
Sale of goods	2,734	2,865
Services	462	394
Contracts qualifying as construction contracts	17	21
	3,213	**3,280**

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 2018 £m	Year ended 31 July 2017 £m	31 July 2018 £m	31 July 2017 £m
United Kingdom	142	118	92	92
Germany	170	160	410	363
France	96	96	16	16
Other European	362	355	70	72
Total European	**770**	**729**	**588**	**543**
United States of America	1,414	1,531	1,633	1,627
Canada	132	114	11	13
Other North American	35	33	13	12
Total North American	**1,581**	**1,678**	**1,657**	**1,652**
Japan	122	119	19	19
China (excluding Hong Kong)	122	93	51	49
Rest of the World	618	661	66	67
	3,213	**3,280**	**2,381**	**2,330**

2 OPERATING PROFIT IS STATED AFTER CHARGING

	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
Research and development expense	107	98
Depreciation of property, plant and equipment	55	57
Amortisation of intangible assets	71	62
Operating leases:		
– land and buildings	33	34
– other	9	8

	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
Audit services		
Fees payable to the Company's auditors for the audit of the Company's annual financial statements	4	4
Fees payable to the Company's auditors and its associates for other services:		
– the audit of the Company's subsidiaries	2	2
	6	**6**
All other services		1

Other services comprise audit-related assurance services £0.2m (FY2017: £0.2m), other services £0.1m (FY2017: £0.1m), tax advisory services £nil (FY2017: £0.1m) and one-off IT and consulting projects £nil (FY2017: £0.2m). Total fees for non-audit services comprise 5% (FY2017: 8%) of audit fees. Audit-related assurance services include the review of the Interim Report.

3 NON-STATUTORY PROFIT MEASURES

Headline profit measures

The Company seeks to present a measure of performance which is not impacted by material non-recurring 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. See the disclosures on presentation of results in accounting policies for an explanation of the adjustments. The items excluded from 'headline' are referred to as 'non-headline' items.

Non-headline operating profit items

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

	Notes	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
Morpho Detection – integration and fair value adjustment unwind			
Integration programme costs		(19)	(4)
Unwind of fair value uplift of inventory on the acquisition balance sheet		(2)	(3)
Non-headline litigation provision movements			
Net release of provision held against Titeflex Corporation subrogation claims	22	2	4
Provision for John Crane, Inc. asbestos litigation	22	(10)	(15)
Cost recovery for John Crane, Inc. asbestos litigation			6
Legacy pension scheme arrangements			
Administration costs for post-retirement benefit schemes	8		(7)
Settlement gain/(losses) on post-retirement benefit schemes	8	4	(2)
Other items			
Restructuring programmes			(33)
Amortisation of acquisition related intangible assets	10	(29)	(17)
Acquisition costs and provision releases		(3)	(19)
Profit on disposal of businesses	28	7	175
Non-headline items in operating profit		**(50)**	**85**

Morpho Detection – integration and fair value adjustment unwind

Integration programmes comprise £19m (FY2017: £4m) in respect of the integration of the Morpho Detection acquisition into the existing Smiths Detection business. This item includes site rationalisation costs, IT system harmonisation expenses, organisational change and severance costs. This integration programme has been included as a non-headline item as it is non-operational in nature and non-recurring.

The impact of unwinding the business combination fair value adjustment on the inventory held on Morpho Detection's acquisition balance sheet is included in non-headline items as this charge is a result of acquisition accounting and does not relate to current trading activity.

Non-headline litigation provision movements

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

- A provision release of £2m (FY2017: £4m) has been recognised by Titeflex Corporation in respect of changes to the estimated cost of future claims. The release is principally related to a decrease in the expected number of claims. See note 22 for further details; and
- The £10m (FY2017: £15m) charge in respect of John Crane, Inc. asbestos litigation is principally due to an increased provision for legal defence costs. The costs recovered via insurer settlements in the current year were £nil (FY2017: £6m). See note 22 for further details.

Legacy pension scheme arrangement

A £4m settlement gain (FY2017: £2m loss) was recognised in the current year when US funded plan members opted to take lump sums in lieu of annuities. This is included in non-headline as it relates to legacy pension liabilities. See note 8 for further details.

Pension administration costs are included as headline items in the current year. In the prior year £7m of pension administration costs were treated as non-headline.

Other items

In the prior year £33m of costs for the Fuel for Growth restructuring programme were recognised as non-headline items. No costs have been recognised in respect of this programme in the current year.

Acquisition related intangible asset amortisation costs of £29m (FY2017: £17m) were recognised in the current year. This is considered to be a non-headline item on the basis that these charges result from acquisition accounting and do not relate to current trading activity.

Acquisition costs and provision releases comprise £3m (FY2017: £19m) of directly linked incremental transaction costs. These costs do not include the cost of employees working on transactions and are reported as non-headline because they are dependent on the level of acquisition activity in the year.

The profit on disposal of businesses of £7m (FY2017: £175m) principally relates to the sale of John Crane Bearings. See note 28 for further details. It is considered to be a non-headline item since the proceeds and cash impact are material and non-recurring.

NOTES TO THE ACCOUNTS CONTINUED

3 NON-STATUTORY PROFIT MEASURES CONTINUED

Headline profit measures continued

Non-headline finance costs items

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

	Notes	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
Unwind of discount on provisions	22	(7)	(6)
Other financing losses		(2)	(8)
Other finance income – retirement benefits	8	7	2
Non-headline items in finance costs		**(2)**	**(12)**
Non-headline (loss)/profit before taxation		**(52)**	**73**

The unwind of discount on provisions has been excluded from headline finance costs because these provisions were originally recognised as non-headline and this treatment has been maintained for ongoing costs and credits.

Other financing gains and losses represent the potentially volatile gains and losses on derivatives, loans inside the group and other financial instruments which are not hedge accounted under IAS 39. They have been excluded from headline finance costs because they do not accurately reflect the aggregate risks of the group, since offsetting gains have been recognised in reserves or deferred in assets and liabilities which are not held at fair value.

Other finance income comprises financing credits relating to retirement benefits. These are excluded from headline finance costs because the ongoing costs and credits are a legacy of previous employee pension arrangements.

Non-headline taxation items

A non-headline tax charge of £30m (FY2017: £111m credit) has been taken in the year. See note 6 for further details.

4 NET FINANCE COSTS

	Notes	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
Interest receivable		7	5
Interest payable:			
– bank loans and overdrafts, including associated fees		(8)	(9)
– other loans		(56)	(57)
Interest payable		**(64)**	**(66)**
Other financing gains/(losses):			
– fair value gains on hedged debt		3	6
– losses on fair value hedges		(3)	(6)
– net foreign exchange losses		(3)	(8)
– adjustment to discounted provisions		(6)	(6)
Other financing gains/(losses)		**(9)**	**(14)**
Net interest income on retirement benefit obligations	8	**7**	**2**
Net finance costs		**(59)**	**(73)**

£2.8m (FY2017: £2.4m) interest was capitalised as part of the costs of development projects. £0.8m (FY2017: £0.6m) of tax relief has been recognised as current tax relief in the period.

5 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 2018 £m	Year ended 31 July 2017 £m
Profit attributable to equity shareholders for the year:		
– continuing	277	570
– total	277	562
Average number of shares in issue during the year	395,723,069	395,422,421

Diluted earnings per share are calculated by dividing the profit attributable to ordinary shareholders by 400,999,220 (FY2017: 400,518,049) 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 2018, zero options (FY2017: zero) were excluded from this calculation because their effect was anti-dilutive for continuing operations.

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

	Year ended 31 July 2018		Year ended 31 July 2017	
	£m	EPS (p)	£m	EPS (p)
Profit attributable to equity shareholders of the Parent Company	277	70.0	570	144.1
Exclude:				
Non-headline items and related tax (note 3)	82	20.7	(184)	(46.5)
Headline profit attributable to equity shareholders for the year	359	90.7	386	97.6
Statutory earnings per share – diluted (p)		69.1		142.3
Headline earnings per share – diluted (p)		89.5		96.3

6 TAXATION

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

	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
The taxation charge in the consolidated income statement for the year comprises:		
Continuing operations		
– current income tax charge	109	58
– current tax adjustments in respect of prior periods	6	3
Current taxation	**115**	**61**
– deferred taxation	41	(32)
Total taxation expense – continuing operations	**156**	**29**
Discontinued operations		
– current income tax credit		(9)
– deferred taxation		6
Total taxation expense in the consolidated income statement	**156**	**26**

	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
Tax on items charged/(credited) to equity		
Deferred tax charge/(credit):		
– retirement benefit schemes	18	13
– cash-flow hedge accounting	(1)	1
– share options	1	(3)
	18	**11**

Of the £18m charge to equity for retirement benefits, a £17m charge relates to UK retirement schemes and £1m to US pension schemes.

NOTES TO THE ACCOUNTS CONTINUED

6 TAXATION CONTINUED

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 19.0% (FY2017: 19.7%). The difference is reconciled as follows:

	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
Profit before taxation	**435**	**602**
Notional taxation expense at UK rate of 19.0% (FY2017: 19.7%)	83	118
Different tax rates on non-UK profits and losses	33	55
Non-deductible expenses	9	14
Tax credits and non-taxable income	(13)	(15)
Non-headline recognition of UK deferred tax		(69)
Other adjustments to unrecognised deferred tax	(1)	(23)
Non-headline impact of US tax reform – deferred tax revaluation	34	
Non-headline impact of US tax reform – deemed repatriation tax	18	
Current and deferred benefits from closed financing arrangement		(19)
Effect of non-taxable profits on business disposals	(1)	(35)
Prior year true-up	(6)	3
Tax on discontinued activities		(3)
	156	**26**
Comprising:		
– taxation on headline profit	126	140
– tax on non-headline loss	(22)	(27)
– non-headline impact of US tax reform	52	
– change in deferred tax recognition treated as non-headline		(84)
– taxation on discontinued operation		(3)
Taxation expense in the consolidated income statement	**156**	**26**

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

US Tax Reform

The Tax Cuts and Jobs Act (the Act) enacted on 22 December 2017 reduced the US Federal tax rate from 35% to 21% from 1 January 2018. This revised rate has been used to revalue net deferred tax assets in the United States, leading to a charge to the income statement of £34m. In addition there is a one-time deemed repatriation tax charge of £18m related to unremitted foreign earnings.

Current taxation

	Current tax £m
At 31 July 2016	(10)
Foreign exchange gains and losses	2
Charge to income statement – continuing	(61)
Credit to income statement – discontinued	9
Business combinations	(1)
Business disposals	(4)
Tax paid	82
At 31 July 2017	**17**
Foreign exchange gains and losses	(1)
Charge to income statement	(115)
Tax paid	65
At 31 July 2018	**(34)**
Current tax receivable	38
Current tax payable	(72)
At 31 July 2018	**(34)**

Provisions included in current tax liabilities are established based on reasonable estimates of the possible consequences of tax authority audits in the various countries in which the Group operates. Management judgement is used to determine the amount of such provisions based on an understanding of the relevant local tax law, taking into account the differences of interpretation that can arise on a wide variety of issues, depending on the prevailing circumstances, including the nature of current tax audits and the experience of previous enquiries.

Deferred taxation

	Property, plant and equipment and intangible assets £m	Employment benefits £m	Losses carried forward £m	Provisions £m	Other £m	Total £m
At 31 July 2016	(145)	8	87	140	61	151
Reallocation				4	(4)	
(Charge)/credit to income statement – continuing	11	(9)	43	(7)	(6)	32
(Charge)/credit to income statement – discontinued	(6)					(6)
(Charge) to equity		(10)			(1)	(11)
Business combinations	(6)				2	(4)
Business disposals	(3)					(3)
Exchange adjustments	1	1	(1)	1		2
At 31 July 2017	**(148)**	**(10)**	**129**	**138**	**52**	**161**
Deferred tax assets	(4)	(10)	127	133	26	272
Deferred tax liabilities	(144)		2	5	26	(111)
At 31 July 2017	**(148)**	**(10)**	**129**	**138**	**52**	**161**
Reallocation				2	(2)	
(Charge)/credit to income statement – continuing	60	(21)	(7)	(55)	(18)	(41)
(Charge)/credit to income statement – discontinued	2		(1)		(1)	
(Charge) to equity		(18)				(18)
Business combinations	1					1
Exchange adjustments	1	(1)		(1)	1	
At 31 July 2018	**(84)**	**(50)**	**121**	**84**	**32**	**103**
Deferred tax assets	3	(56)	120	80	33	180
Deferred tax liabilities	(87)	6	1	4	(1)	(77)
At 31 July 2018	**(84)**	**(50)**	**121**	**84**	**32**	**103**

The deferred tax asset relating to losses has been recognised on the basis that evidence demonstrates 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.

The closing net deferred tax asset balance related to UK activities and included in the balance at 31 July 2018 amounted to £41m.

The net deferred tax asset has reduced significantly from previous year. This is mainly due to the two following items:

- US Tax reform, resulting in a £34m reduction in net US deferred tax assets
- Increase in the deferred tax liability of £30m related to an increase in the UK retirement benefits surplus

Deferred tax on provisions includes £48m (FY2017:£79m) relating to John Crane, Inc. litigation provision, and £19m (FY2017: £33m) relating to Titeflex Corporation. See note 22 for additional information on provisions.

Included in other deferred tax balances above are deferred tax assets related to inventory of £8m (FY2017: £14m), deferred revenue of £9m (FY2017: £14m) and rebate reserve of £6m (FY2017: £9m).

Unrecognised Deferred Tax

The Group has unrecognised deferred tax relating to non-UK losses amounting to £73m (FY2017:£67m).

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:

	2018 £m	Expiry of losses	2017 £m	Expiry of losses
Restricted losses – Asia	16	2019-2025	12	2018-2024
Unrestricted losses – operating losses	57	No expiry	55	No expiry
Total losses	**73**		**67**	

NOTES TO THE ACCOUNTS CONTINUED

6 TAXATION CONTINUED

Franked Investment Income Group Litigation Order (FII GLO)

Smiths Group is one of the companies enrolled in the FII GLO litigation against HMRC. The court actions first filed in 2003 are nearing an end and some claimants with different fact patterns have received payments. There are further relevant legal actions that could impact Smiths' recoveries that amount to around £22m (computed on a simple interest basis and after deducting 45% withholding tax).

Claims related to the impact of the Foreign Income Dividends (FID) regime are included in the FII GLO litigation claims Smiths issued in 2009. Under the final relevant ECJ decision, FID claims are now conclusively successful and accordingly Smiths Group made its claim in respect of FIDs and received £2.1m in August 2017. This amount was calculated using simple interest and has been paid under deduction of withholding tax.

The Group has not recognised any impact to the financial statements in the current period or the prior year, due to the uncertainty of the eventual outcome, except for the amount received in the period in respect of FID.

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

The European Commission has opened a state aid investigation into the Group Financing Exemption in the UK controlled foreign company (CFC) rules. The Group Financing Exemption was introduced in legislation by the UK government in 2013. In common with other UK-based international companies whose arrangements were in line with current UK CFC legislation, Smiths Group may be affected by this investigation and is monitoring developments. If the European Commission's investigation is upheld, the estimated maximum potential liability is approximately £14m. Based on our current assessment, no provision is being made in respect of this issue.

7 EMPLOYEES

	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
Staff costs during the period		
Wages and salaries	839	833
Social security	97	94
Share-based payment (note 9)	16	15
Pension costs (including defined contribution schemes) (note 8)	37	36
	989	**978**

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

	Year ended 31 July 2018	Year ended 31 July 2017
John Crane	6,100	6,050
Smiths Medical	8,050	7,700
Smiths Detection	2,750	2,450
Smiths Interconnect	2,300	3,250
Flex-Tek	2,150	2,100
Corporate	350	350
	21,700	**21,900**

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 on pages 92 to 111.

	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
Key management compensation		
Salaries and short-term employee benefits	11.4	13.2
Cost of post-retirement benefits	0.1	0.1
Cost of share-based incentive plans	5.4	5.3

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 2018		Year ended 31 July 2017	
	Number of instruments '000	Weighted average exercise price	Number of instruments '000	Weighted average exercise price
CIP / SMP	88		204	
SEP	309		134	
LTIP	1,455		1,041	
Restricted stock	296		254	
SAYE	9	£10.48	7	£10.87

Related party transactions

The only related party transactions in the year ended 31 July 2018 were key management compensation (31 July 2017: key management compensation).

8 POST-RETIREMENT BENEFITS

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

Defined contribution plans

The Group operates 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 401(k) defined contribution plan operates. The total expense recognised in the consolidated income statement in respect of all these plans was £34m (FY2017: £33m).

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 2018. Scheme assets are stated at their market values. Contributions to the schemes are made on the advice of the actuaries, in accordance with local funding requirements.

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

	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
At beginning of period	224	80
Exchange adjustment		(6)
Current service cost	(3)	(4)
Scheme administration costs	(5)	(7)
Past service cost, curtailments, settlements	5	(1)
Finance income – retirement benefits	7	2
Contributions by employer	49	105
Actuarial gain	104	55
Net retirement benefit asset	**381**	**224**

UK pension schemes

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

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

Smiths Industries Pension Scheme ("SIPS")

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

The most recent actuarial valuation of this scheme has been performed using the Projected Unit Method as at 31 March 2017, and experience gains and losses identified during this valuation have been incorporated into the IAS 19 valuation. Under the funding plan for SIPS agreed in

NOTES TO THE ACCOUNTS CONTINUED

8 POST-RETIREMENT BENEFITS CONTINUED

UK pension schemes continued

June 2018 Smiths pays cash contributions of £1m a month until the Scheme reaches full funding on a 'gilts + 0%' basis. Under the governing documentation of the SIPS, any future surplus would be returnable to Smiths Group plc by refund, assuming gradual settlement of the liabilities over the lifetime of the scheme.

Subject to clarification of the legal position, SIPS expects to 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 SIPS liabilities is around 23 years (FY2017: 23 years) for active deferred members, 22 years (FY2017: 22 years) for deferred members and 11 years (FY2017: 11 years) for pensioners and dependants.

On 31 August 2017, SIPS bought in a tranche of the scheme's pension population with Canada Life for a premium of £207m. An actuarial loss of £26m was recognised as a result of this buy-in agreement.

TI Group Pension Scheme ("TIGPS")

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

The most recent actuarial valuation of this scheme has been performed using the Projected Unit Method as at 5 April 2017. Under the funding plan for TIGPS agreed in June 2018, Smiths pays cash contributions of £1m a month until the Scheme is fully funded on a solvency basis. 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.

Subject to clarification of the legal position, 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 24 years (FY2017: 24 years) for active deferred members, 22 years (FY2017: 22 years) for deferred members and ten years (FY2017: 11 years) for pensioners and dependants.

US pension plans

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

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

The duration of the liabilities for the largest US plan is around 19 years (FY2017: 19 years) for active deferred members, 19 years (FY2017: 19 years) for deferred members and 12 years (FY2017: 12 years) for pensioners and dependants.

On 26 December 2017, the US funded plans paid $36m to members who opted to take lump sums in lieu of annuities. A settlement gain of £4m was recognised on this transaction (see note 3).

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, causing amounts payable under index-linked pensions to be 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 aim to match assets to future obligations, after allowing for the funding position of the scheme.

TI Group Pension Scheme ("TIGPS")

TIGPS with a mature member profile, and a strong funding position, has been able to progress its matching strategy to the point where roughly 50% of liabilities are covered by matching annuities, eliminating investment return, longevity, inflation and funding risks.

Smiths Industries Pension Scheme ("SIPS")

The trustees of SIPS have adopted a leveraged liability matching strategy. The scheme uses repurchase arrangements, total return swaps, inflation swaps and interest rate swaps to hedge the interest and inflation risks of the scheme liabilities. Repurchase agreements exchange government bonds held by the scheme for cash with an obligation to buy back the asset at a fixed future date and price. The cash is invested in liability matching assets, reducing funding risk. A total return swap exchanges the return on a specified asset (for example an index-linked bond) and an interest payment (fixed or floating). Contracts are spread across a panel of banks. To minimise the risk that counterparties fail to settle obligations, positions are collateralised.

At 31 July 2018, SIPS assets were net of £866m (FY2017: £773m) repurchase obligations, and included £12m gains (FY2017: £4m gains) on interest rate swaps, £3m gains (FY2017: £8m gains) on inflation swaps and £2m gain (FY2017: £1m gain) on total return assets. The scheme was holding £67m (FY2017: £1m) in liquidity funds to meet potential future obligations to collateralise repurchase arrangements or swap agreements.

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

	2018 UK	2018 US	2018 Other	2017 UK	2017 US	2017 Other
Rate of increase in salaries	n/a	n/a	3.1%	n/a	n/a	2.8%
Rate of increase for active deferred members	4.1%	n/a	n/a	4.1%	n/a	n/a
Rate of increase in pensions in payment	3.2%	n/a	2.5%	3.2%	n/a	1.5%
Rate of increase in deferred pensions	3.2%	n/a	n/a	3.2%	n/a	0.1%
Discount rate	2.8%	4.15%	3.4%	2.6%	3.85%	2.6%
Inflation rate	3.2%	n/a	3.3%	3.2%	n/a	2.2%
Healthcare cost increases	4.7%	n/a	n/a	4.2%	n/a	1.8%

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 is based on the Towers Watson cash-flow matching models and set with reference to Moody's Aa annualised yield, the Citigroup High Grade Index and the Merrill Lynch 15+ years High Quality Index.

Mortality assumptions

The mortality assumptions used in the principal UK schemes are based on the "SAPS S2" All Birth year tables with relevant scaling factors based on the recent experience of the schemes. The assumption allows for future improvements in life expectancy in line with the 2017 CMI projections, with a smoothing factor of 7.5, 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 adjusted backward to 2006 with MP-2014 and projected forward using MP-2017 as of 31 July 2017. The table selected allows for future mortality improvements and applies an adjustment for job classification (blue collar versus white collar).

	UK schemes				US schemes			
Expected further years of life	Male 31 July 2018	Female 31 July 2018	Male 31 July 2017	Female 31 July 2017	Male 31 July 2018	Female 31 July 2018	Male 31 July 2017	Female 31 July 2017
Member who retires next year at age 65	22	24	23	24	21	23	21	23
Member, currently 45, when they retire in 20 years' time	24	25	24	25	22	24	23	24

Sensitivity

Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 July 2018 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions. In practice, such assumptions rarely change in isolation.

	Profit before tax for year ended 31 July 2018 £m	Increase/ (decrease) in scheme assets 31 July 2018 £m	(Increase)/ decrease in scheme liabilities 31 July 2018 £m	Profit before tax for year ended 31 July 2017 £m	Increase/ (decrease) in scheme assets 31 July 2017 £m	(Increase)/ decrease in scheme liabilities 31 July 2017 £m
Rate of mortality – 1 year increase in life expectancy	(3)	70	(166)	(3)	67	(177)
Rate of mortality – 1 year decrease in life expectancy	3	(71)	166	3	(66)	177
Rate of inflation – 0.25% increase	(2)	22	(94)	(2)	20	(97)
Discount rate – 0.25% increase	5	(28)	135	4	(27)	151
Market value of scheme assets – 2.5% increase	2	74		2	79	

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

Asset valuation

Liquidity funds, equities and bonds are valued using quoted market prices in active markets. Exchange traded equity index futures are valued at market prices.

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

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.

NOTES TO THE ACCOUNTS CONTINUED

8 POST-RETIREMENT BENEFITS CONTINUED

Retirement-benefit plan assets

	31 July 2018 £m				31 July 2017 £m			
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
Cash and cash equivalents:								
– cash	26	1	1	28	33	1	1	35
– liquidity funds	32			32	271			271
– cash collateral and liquidity funds held to support exchange traded futures					4			4
Equities:								
– UK funds	1		1	2	1		3	4
– North American funds								
– other regions and global funds	79		3	82	94		1	95
Government bonds:								
– index-linked bonds	1,679	72	4	1,755	1,298			1,298
– fixed-interest bonds					393	81	3	477
Corporate bonds	1,097	166		1,263	1,048	184		1,232
Insured liabilities	1,154		1	1,155	1,050		1	1,051
Property	121			121	133		1	134
Other:								
– diversified growth funds and scheme receivables	544		23	567	407		24	431
– repurchase obligations	(866)			(866)	(773)			(773)
Total market value	**3,867**	**239**	**33**	**4,139**	**3,959**	**266**	**34**	**4,259**

UK other investments at 31 July 2018 included £192m (FY2017: £184m) of investments in leveraged index linked UK government bond funds held by TIGPS and £19m (FY2017: £12m) of interest and inflation swaps held by SIPS. At 31 July 2017 SIPS also held £70m of investments in diversified growth funds.

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

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

	31 July 2018 £m			31 July 2017 £m		
	SIPS	TIGPS	US schemes	SIPS	TIGPS	US schemes
Present value of funded scheme liabilities:						
– Active deferred members	(57)	(56)	(88)	(81)	(92)	(101)
– Deferred members	(784)	(550)	(115)	(891)	(625)	(160)
– Pensioners	(1,070)	(804)	(47)	(1,053)	(809)	(31)
Present value of funded scheme liabilities	**(1,911)**	**(1,410)**	**(250)**	**(2,025)**	**(1,526)**	**(292)**
Market value of scheme assets	2,214	1,633	239	2,238	1,703	266
Surplus/(deficit)	**303**	**223**	**(11)**	**213**	**177**	**(26)**

Net retirement benefit obligations

	31 July 2018 £m				31 July 2017 £m			
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
Market value of scheme assets	3,867	239	33	4,139	3,959	266	34	4,259
Present value of funded scheme liabilities	(3,342)	(250)	(41)	(3,633)	(3,571)	(292)	(42)	(3,905)
Surplus/(deficit)	**525**	**(11)**	**(8)**	**506**	**388**	**(26)**	**(8)**	**354**
Unfunded pension plans	(53)	(7)	(49)	(109)	(55)	(8)	(48)	(111)
Post-retirement healthcare	(5)	(9)	(2)	(16)	(6)	(11)	(2)	(19)
Present value of unfunded obligations	**(58)**	**(16)**	**(51)**	**(125)**	**(61)**	**(19)**	**(50)**	**(130)**
Unrecognised asset due to surplus restriction								
Net pension asset/(liability)	**467**	**(27)**	**(59)**	**381**	**327**	**(45)**	**(58)**	**224**
Post-retirement assets	526			526	390			390
Post-retirement liabilities	(59)	(27)	(59)	(145)	(63)	(45)	(58)	(166)
Net pension asset/(liability)	**467**	**(27)**	**(59)**	**381**	**327**	**(45)**	**(58)**	**224**

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 2018 £m	Year ended 31 July 2017 £m
Amounts charged to operating profit		
Current service cost	3	4
Settlement (gain) / loss	(4)	1
Scheme administration costs	5	7
	4	**12**
The operating cost is charged as follows:		
Cost of sales	1	1
Sales and distribution costs	1	1
Headline administrative expenses	6	2
Non-headline settlement gains	(4)	1
Non-headline administrative expenses		7
	4	**12**
Amounts credited to finance costs		
Net interest income	**(7)**	**(2)**

Amounts recognised directly in the consolidated statement of comprehensive income

	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
Actuarial gains/(losses)		
Difference between interest credit and return on assets	(18)	(31)
Experience (losses)/gains on scheme liabilities	(10)	22
Actuarial gains arising from changes in demographic assumptions	5	69
Actuarial gains/(losses) arising from changes in financial assumptions	127	(6)
Movements in surplus restriction		1
	104	**55**

NOTES TO THE ACCOUNTS CONTINUED

8 POST-RETIREMENT BENEFITS CONTINUED

Changes in present value of funded scheme assets

	31 July 2018 £m				31 July 2017 £m			
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
At beginning of period	3,959	266	34	4,259	4,034	216	62	4,312
Interest on assets	101	9	1	111	91	9	2	102
Actuarial movement on scheme assets	(6)	(12)	(1)	(19)	(15)	(14)	(2)	(31)
Employer contributions	28	12	1	41	27	67	5	99
Assets distributed on settlement		(27)		(27)			(32)	(32)
Scheme administration costs	(3)	(1)		(4)	(5)	(2)		(7)
Exchange adjustments		1		1		(1)	2	1
Benefits paid	(212)	(9)	(2)	(223)	(173)	(9)	(3)	(185)
At end of period	**3,867**	**239**	**33**	**4,139**	**3,959**	**266**	**34**	**4,259**

Changes in present value of funded defined benefit obligations

	31 July 2018 £m				31 July 2017 £m			
	UK schemes	US schemes	Other countries	Total	UK schemes	US schemes	Other countries	Total
At beginning of period	(3,571)	(292)	(42)	(3,905)	(3,709)	(315)	(70)	(4,094)
Current service cost			(1)	(1)			(2)	(2)
Interest on obligations	(90)	(10)	(2)	(102)	(83)	(11)	(3)	(97)
Actuarial movement on liabilities	107	13	1	121	48	27	1	76
Liabilities extinguished on settlement		31		31			31	31
Exchange adjustments						(2)	(2)	(4)
Benefits paid	212	9	2	223	173	9	3	185
At end of period	**(3,342)**	**(249)**	**(42)**	**(3,633)**	**(3,571)**	**(292)**	**(42)**	**(3,905)**

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

	Assets		Obligations	
	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
At beginning of period			(130)	(137)
Reclassification of small unfunded obligations				
Liabilities transferred on disposals			1	
Current service cost			(2)	(2)
Interest on obligations			(3)	(3)
Actuarial movement			2	9
Employer contributions	7	6		
Exchange adjustments				(3)
Benefits paid	(7)	(6)	7	6
At end of period			**(125)**	**(130)**

Cash contributions

Company contributions to the defined benefit pension plans and post-retirement healthcare plans for 2018 totalled £49m (FY2017: £105m). This comprised regular contributions to funded schemes of £24m (FY2017: £24m) to SIPS, £5m (FY2017: £3m) to TIGPS, a one-off £12m contribution (FY2017: £67m) to funded US Schemes and contributions to other schemes of £2m (FY2017: £5m, of which £3m of additional contributions were made to fund the closure of a scheme in Canada). In addition, £7m (FY2017: £6m) was spent on providing benefits under unfunded defined benefit pension and post-retirement healthcare plans.

In 2019 the cash contributions to the Group's schemes are expected to total about £45m, including £12m to SIPS and £12m to TIGPS, with the balance relating mainly to the US scheme. Group contributions in respect of the unfunded schemes and post-retirement healthcare are expected to be in line with 2018.

9 EMPLOYEE SHARE SCHEMES

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

Long-Term Incentive Plan (LTIP)

The LTIP is a share plan under which an award over a capped number of shares will vest after the end of the three-year performance period if performance conditions are met. LTIP awards are made to selected senior executives, including the executive directors. Awards made prior to 2016 were made with different targets for corporate executives and divisional executives. Since 2016 all LTIP awards have had one set of targets.

LTIP performance conditions

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

Both Group and Divisional LTIP awards have performance conditions relating to underlying revenue growth, growth in headline EPS adjusted to exclude tax, ROCE and cash conversion.

Smiths Share Matching Plan (SMP)

Under the scheme participants are required to invest between 25% and 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 depending on the performance of the Group LTIP issued for the same performance period. The first matching share is awarded if the Group LTIP vests under any performance condition.

No future awards will be made under the SMP.

Smiths Excellence Plan (SEP)

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

Directors are not eligible to participate in the SEP.

Restricted stock

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

	SEP	SMP	Long-term incentive plans	Restricted stock	Other share schemes	Total	Weighted average exercise price £
Ordinary shares under option ('000)							
31 July 2016		1,439	3,354	273	1,221	6,287	£1.83
Granted	817		1,581	58	218	2,674	£1.06
Exercised		(339)	(198)	(119)	(259)	(915)	£2.77
Lapsed	(69)	(174)	(939)	(7)	(70)	(1,259)	£0.51
31 July 2017	748	926	3,798	205	1,110	6,787	£1.64
Granted	857		1,600	283	268	3,008	£1.07
Exercised	(55)	(424)	(444)	(178)	(298)	(1,399)	£2.12
Lapsed	(191)	(89)	(1,043)	(6)	(118)	(1,447)	£0.86
31 July 2018	**1,359**	**413**	**3,911**	**304**	**962**	**6,949**	**£1.46**

NOTES TO THE ACCOUNTS CONTINUED

9 EMPLOYEE SHARE SCHEMES CONTINUED

Options were exercised on an irregular basis during the period. The average closing share price over the financial year was 1,589.60p (FY2017: 1,499.95p). 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 July 2018 ('000)	Weighted average remaining contractual life at 31 July 2018 (months)	Total shares under option at 31 July 2017 ('000)	Weighted average remaining contractual life at 31 July 2017 (months)	Options exercisable at 31 July 2018 ('000)	Exercisable weighted average exercise price for options exercisable at 31 July 2018	Options exercisable at 31 July 2017 ('000)	Exercisable weighted average exercise price for options exercisable at 31 July 2017
£0.00 – £2.00	5,986	13	5,677	17				
£2.01 – £6.00								
£6.01 – £10.00	504	17	791	24			42	£9.20
£10.01 – £14.00	459	40	319	32			90	£10.96

For the purposes of valuing options to arrive at the share-based payment charge, the Binomial option-pricing model has been used. The key assumptions used in the models for 2018 and 2017 are volatility of 25% to 20% (FY2017: 25% to 20%) and dividend yield of 3% (FY2017: 3.50%), based on historical data, for the period corresponding with the vesting period of the option. These generated a weighted average fair value for SEP of £14.87 (FY2017: £12.86), LTIP of £13.48 (FY2017: £12.68), and restricted stock of £12.73 (FY2017: £12.59).

Included within staff costs is an expense arising from share-based payment transactions of £16m (FY2017: £15m), of which £14m (FY2017: £14m) relates to equity-settled share-based payment.

10 INTANGIBLE ASSETS

	Goodwill £m	Development costs £m	Acquired intangibles (see table below) £m	Software, patents and intellectual property £m	Total £m
Cost					
At 31 July 2016	1,679	302	477	199	2,657
Exchange adjustments	23	4	(2)	1	26
Business combinations	210		240	6	456
Additions		39		8	47
Disposals		(15)		(5)	(20)
Business disposals	(254)		(141)	(3)	(398)
At 31 July 2017	**1,658**	**330**	**574**	**206**	**2,768**
Exchange adjustments	1	1	1	1	4
Business combinations (note 26)	46		29	1	76
Additions		29		11	40
Disposals				(11)	(11)
Business disposals (note 28)	(1)		(22)	(1)	(24)
At 31 July 2018	**1,704**	**360**	**582**	**207**	**2,853**
Amortisation					
At 31 July 2016	162	166	438	149	915
Exchange adjustments	5	2	9	1	17
Charge for the year		27	17	18	62
Disposals		(15)		(5)	(20)
Business disposals	(79)		(140)	(2)	(221)
At 31 July 2017	**88**	**180**	**324**	**161**	**753**
Exchange adjustments		1		1	2
Charge for the year		24	29	18	71
Disposals				(11)	(11)
Business disposals (note 28)			(22)	(1)	(23)
At 31 July 2018	**88**	**205**	**331**	**168**	**792**
Net book value at 31 July 2018	**1,616**	**155**	**251**	**39**	**2,061**
Net book value at 31 July 2017	1,570	150	250	45	2,015
Net book value at 31 July 2016	1,517	136	39	50	1,742

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 31 July 2016	85	160	232	477
Exchange adjustments	2	(3)	(1)	(2)
Business combinations		103	137	240
Business disposals	(30)	(49)	(62)	(141)
At 31 July 2017	**57**	**211**	**306**	**574**
Exchange adjustments		1		1
Business combinations (note 26)		2	27	29
Business disposals (note 28)			(22)	(22)
At 31 July 2018	**57**	**214**	**311**	**582**
Amortisation				
At 31 July 2016	61	149	228	438
Exchange adjustments	1	2	6	9
Charge for the year	3	8	6	17
Business disposals	(29)	(49)	(62)	(140)
At 31 July 2017	**36**	**110**	**178**	**324**
Charge for the year	3	11	15	29
Business disposals (note 28)			(22)	(22)
At 31 July 2018	**39**	**121**	**171**	**331**
Net book value at 31 July 2018	**18**	**93**	**140**	**251**
Net book value at 31 July 2017	21	101	128	250
Net book value at 31 July 2016	24	11	4	39

11 IMPAIRMENT TESTING

Goodwill

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

Recoverable amount is determined by value in use or fair value less cost to sell calculations for each group of cash generating units (CGU) that goodwill is allocated to.

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 2018 budget, the five-year strategic plan approved by the Board and detailed divisional strategic projections, where these have been prepared and approved by the Board.

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

Goodwill is allocated by division as follows:

	2018 £m	**2018 Number of CGUs**	2017 £m	2017 Number of CGUs
John Crane	133	1	111	1
Smiths Medical	563	1	561	1
Smiths Detection	642	1	629	2
Smiths Interconnect	243	2	242	2
Flex-Tek	35	2	27	2
	1,616	**7**	**1,570**	**8**

Smiths Detections acquired Morpho Detection in April 2017 and a single management team was in place covering Smiths Detection and Morpho Detection. As discussed and anticipated in the 2017 Annual Report, the integration of the two businesses during the current year has been such that they are now considered to be a single CGU for impairment testing.

NOTES TO THE ACCOUNTS CONTINUED

11 IMPAIRMENT TESTING CONTINUED

Goodwill continued

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 12.0% to 14.9% (FY2017: 12.2% to 16.9%) have been used for the impairment testing; and
- 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 2.0% (FY2017: 2.1%). These rates do not reflect the long-term assumptions used by the Group for investment planning.

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

Year ended 31 July 2018	John Crane	Smiths Medical	Smiths Detection	Smiths Interconnect	
				Microwave Subsystems	Connectors and Components
Net book value of goodwill (£m)	133	563	642	75	168
Basis of valuation	Value in use	Value in use	Value in use	Value in use	Value in use
Discount rate	14.0%	12.0%	13.5%	12.4%	14.9%
Period covered by management projections	5 years	5 years	5 years	5 years	5 years
Long-term growth rates	2.2%	1.9%	1.8%	2.0%	2.0%

The discount rate for Smiths Interconnect Connectors and Components includes a risk adjustment. The remaining balance of the goodwill represents smaller individual amounts which have been allocated to smaller CGUs.

Year ended 31 July 2017	John Crane	Smith Medical	Smiths Detection		Smiths Interconnect	
			Original Smiths Detection	Morpho Detection	Microwave Subsystems	Connectors and Components
Net book value of goodwill (£m)	111	561	429	200	75	167
Basis of valuation	Value in use	Value in use	Value in use	Fair value less costs to sell	Value in use	Value in use
Discount rate	14.9%	12.2%	14.1%	n/a	12.2%	16.9%
Period covered by management projections	5 years	5 years	5 years	1 year	5 years	5 years
Long-term growth rates	2.2%	2.1%	2.0%	n/a	2.2%	2.1%

Sensitivity analysis

Smiths Interconnect – Microwave Subsystems business

Microwave Subsystems' value in use exceeds its carrying value by £11m. Sensitivity analysis performed around the base case assumptions has indicated that for Microwave Subsystems, the following changes in assumptions (in isolation), would cause the value in use to fall below the carrying value:

	Year ended 31 July 2018 Change required to trigger impairment	Year ended 31 July 2017 Change required to trigger impairment
Forecast earnings before interest, tax, depreciation and amortisation	-11.3%	-33.3%
Discount rate	+8.2%	+26.5%

Forecast earnings before interest, tax, depreciation and amortisation have been projected using:

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

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.

Goodwill impairment

No impairment charges have been incurred (FY2017: £nil).

Revised CGU structure for year ended 31 July 2019 – Impairment testing

Following a re-organisation and rationalisation of management and reporting structures within the Interconnect and Flex-Tek divisions, the CGU structures used for the testing of goodwill has been reassessed. Given the commonality of reporting, policies, leadership and intra-divisional trading relationships, it is considered that the Interconnect and Flex-Tek divisions are now single CGUs for impairment testing.

Impairment testing and sensitivity analysis has been undertaken for the revised Interconnect CGU and Flex-Tek CGU structures, which have indicated that no reasonable change in key assumptions would cause an impairment of goodwill in either CGU. The assumptions used in this impairment testing were as follows:

- Interconnect: Discount rate: 14.9%; Period covered by management projections 5 years; Long-term growth rates 2.0%
- Flex-Tek: Discount rate: 12.1%; Period covered by management projections 5 years; Long-term growth rates 2.2%

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 (FY2017: £nil).

12 PROPERTY, PLANT AND EQUIPMENT

	Land and buildings £m	Plant and machinery £m	Fixtures, fittings, tools and equipment £m	Total £m
Cost or valuation				
At 31 July 2016	223	631	220	1,074
Exchange adjustments	5	10	5	20
Business combinations		7	1	8
Additions	6	44	12	62
Disposals	(24)	(42)	(24)	(90)
Business disposals	(6)	(15)	(5)	(26)
At 31 July 2017	**204**	**635**	**209**	**1,048**
Exchange adjustments		1	(1)	
Business combinations (note 26)	2	1		3
Additions	8	47	13	68
Disposals	(6)	(28)	(24)	(58)
Business disposals (note 28)	(1)	(19)	(3)	(23)
At 31 July 2018	**207**	**637**	**194**	**1,038**
Depreciation				
At 31 July 2016	119	466	174	759
Exchange adjustments	2	8	4	14
Charge for the year	9	34	14	57
Disposals	(18)	(36)	(23)	(77)
Business disposals	(5)	(11)	(4)	(20)
At 31 July 2017	**107**	**461**	**165**	**733**
Exchange adjustments		1	(1)	
Charge for the year	7	35	13	55
Disposals	(6)	(24)	(23)	(53)
Business disposals (note 28)	(1)	(14)	(2)	(17)
At 31 July 2018	**107**	**459**	**152**	**718**
Net book value at 31 July 2018	**100**	**178**	**42**	**320**
Net book value at 31 July 2017	97	174	44	315
Net book value at 31 July 2016	104	165	46	315

NOTES TO THE ACCOUNTS CONTINUED

13 INVENTORIES

	31 July 2018 £m	31 July 2017 £m
Inventories comprise		
Raw materials and consumables	149	148
Work in progress	94	86
Finished goods	223	218
	466	**452**

The Group consumed £1,424m (FY2017: £1,470m) of inventories during the period. In the year to 31 July 2018, £13m (FY2017: £17m) was charged for the write-down of inventory and £7m (FY2017: £6m) was released from inventory provisions no longer required.

Inventory provisioning

	31 July 2018 £m	31 July 2017 £m
Gross inventory carried at full value	**391**	**414**
Gross value of inventory partly or fully provided for	129	93
	520	**507**
Inventory provision	(54)	(55)
Inventory after provisions	**466**	**452**

14 TRADE AND OTHER RECEIVABLES

	31 July 2018 £m	31 July 2017 £m
Non-current		
Trade receivables	45	41
Accrued income	1	2
Other receivables	11	14
	57	**57**
Current		
Trade receivables	656	642
Accrued income	11	11
Prepayments	31	28
Other receivables	35	41
	733	**722**

Trade receivables include balances not yet due of £84m (FY2017: £75m) relating to multi-year Smiths Detection contracts, where revenue recognition does not align with the agreed payment schedule. The Group also has cash received of £87m (FY2017: £78m) deferred in trade and other payables relating to Smiths Detection contracts.

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 £688m (FY2017: £720m).

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% (FY2017: less than 5%) of Group revenue.

Ageing of trade receivables

	31 July 2018 £m	31 July 2017 £m
Trade receivables which are not impaired and not yet due	566	539
Trade receivables which are not impaired and less than three months overdue	97	104
Trade receivables which are not impaired and more than three months overdue	27	30
Gross value of partially and fully provided receivables	43	43
	733	**716**
Provision for bad and doubtful debts	(32)	(33)
Trade receivables	**701**	**683**

15 TRADE AND OTHER PAYABLES

	31 July 2018 £m	31 July 2017 £m
Non-current		
Other payables	**27**	**26**
Current		
Trade payables	244	202
Other payables	23	17
Other taxation and social security costs	22	27
Accruals	225	247
Deferred income	92	83
	606	**576**

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.

16 FINANCIAL ASSETS

At 31 July 2018 £13m (FY2017: £11m) was held on deposit with banks as security for liabilities or letters of credit.

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

17 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 2018 £m	31 July 2017 £m
Cash and cash equivalents		
Net cash and deposits	**717**	**782**
Short-term borrowings		
Bank overdrafts		(1)
$175m 7.37% US$ Private placement 2018		(133)
$250m 7.20% US$ Guaranteed notes 2019	(190)	
Bank and other loans	(1)	(1)
Interest accrual	(12)	(16)
	(203)	**(151)**
Long-term borrowings		
$250m 7.20% US$ Guaranteed notes 2019		(189)
$400m 3.625% US$ Guaranteed notes 2022	(298)	(301)
€600m 1.25% Eurobond 2023	(533)	(533)
€650m 2.00% Eurobond 2027	(575)	(574)
Bank and other loans	(1)	(1)
	(1,407)	**(1,598)**
Borrowings	**(1,610)**	**(1,749)**
Net debt	**(893)**	**(967)**

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

Borrowings are accounted for at amortised cost and are categorised as other financial liabilities. See note 18 for a maturity analysis of borrowings.

Interest of £42m (FY2017: £45m) was charged to the consolidated income statement in this period in respect of public bonds.

Secured loans

Loans amounting to £2m (FY2017: £2m) were secured on plant and equipment with a book value of £3m (FY2017: £3m).

NOTES TO THE ACCOUNTS CONTINUED

17 BORROWINGS AND NET DEBT CONTINUED

Net cash and cash equivalents

	31 July 2018 £m	31 July 2017 £m
Cash at bank and in hand	287	226
Short-term deposits	430	556
Cash and cash equivalents	**717**	**782**
Bank overdrafts		(1)
Net cash and cash equivalents	**717**	**781**

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, as there is no intention to settle the balances net, these arrangements do not qualify for net presentation. At 31 July 2018 the total value of overdrafts on accounts in interest compensation cash pooling systems was £nil (FY2017: £nil). The balances held in zero balancing cash pooling arrangements have daily settlement of balances, therefore netting is not relevant.

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 2017	781	(150)	(1,598)	(967)
Foreign exchange gains and losses	(8)	(2)	3	(7)
Net cash outflow	(56)		(1)	(57)
Repayment of borrowings		135		135
Capitalisation, interest accruals and unwind of capitalised fees		4	(2)	2
Fair value movement from interest rate hedging			1	1
Change in maturity analysis		(190)	190	
At 31 July 2018	**717**	**(203)**	**(1,407)**	**(893)**

Change of control

The Company has in place credit facility agreements under which a change in control would trigger prepayment clauses. The Company also has bonds in issue, the terms of which would allow bondholders to exercise put options and require the Company to buy back the bonds at their principal amount plus interest if a rating downgrade occurs at the same time as a change of control takes effect.

18 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. The management of operational credit risk is discussed in note 14.

Treasury Risk Management Policy

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

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

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

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

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

Credit quality

The Group's strategy is to maintain a solid investment-grade rating to ensure access to the widest possible sources of financing at the right time and to minimise the resulting cost of debt capital. The credit ratings at the end of July 2018 were BBB+ / Baa2 (both stable) from Standard & Poor's and Moody's respectively. An essential element of an investment-grade rating is consistent and robust cash-flow metrics. The Group's objective is to maintain a net debt/headline EBITDA ratio at two times or lower over the medium term. Capital management is discussed in more detail in note 25.

Debt and interest rate

The Group's risk management objectives are to ensure that over time funding drawn from the bank market is less than 30% of net debt, the average maturity profile of gross debt is at or greater than four years and over 55% of gross debt is at fixed rates. At 31 July 2018, these measures were 0.1% (FY2017: 0%); 5.5 years (FY2017: 5.9 years) and 55% (FY2017: 57%).

The Group remains in full compliance with all covenants within its external debt agreements. Interest rate risk management is discussed in note 18(b).

Liquidity management

The Group's objective is to ensure that at any time undrawn committed facilities, net of short-term overdraft financing, are greater than £200m and that committed facilities have at least 18 months to run until maturity. At 31 July 2018, these measures were £609m (FY2017: £607m) and 51 months (FY2017: 43 months). At 31 July 2018, cash resources were £717m (FY2017: £782m). Liquidity risk management is discussed in note 18(d).

The Group aims to ensure that cash resources are placed on deposit with highly-rated relationship bank counterparties at short-notice availability. Financial credit risk management is discussed in note 18(c).

Currency management

The Group is an international business with the majority of its net assets denominated in foreign currency. We protect our balance sheet and reserves from adverse foreign exchange movements by financing our foreign currency assets where appropriate in the same currency and targets that, where the value of net asset exposure is over £30m equivalent, over 50% of those assets are matched with the same currency liability. The Group's objective for managing transaction currency exposure is to reduce medium-term volatility to cash-flow, margins and earnings. Foreign exchange risk management is discussed in note 18(a) below.

(a) Foreign exchange risk

Transactional currency exposure

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

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

					At 31 July 2018
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Financial assets and liabilities					
Financial instruments included in trade and other receivables	42	375	106	165	688
Financial instruments included in trade and other payables	(49)	(237)	(77)	(78)	(441)
Cash and cash equivalents	53	444	58	162	717
Cross currency swaps (not hedge accounted)		(242)	267		25
Borrowings not designated as net investment hedges	(1)	(2)	(271)	(2)	(276)
	45	338	83	247	713
Exclude balances held in operations with the same functional currency	(40)	(195)	(63)	(227)	(525)
Exposure arising from intra-group loans		(307)	(65)	(38)	(410)
Forward foreign exchange contracts	(100)	(6)	41	65	
	(95)	**(170)**	**(4)**	**47**	**(222)**

NOTES TO THE ACCOUNTS CONTINUED

18 FINANCIAL RISK MANAGEMENT CONTINUED

(a) Foreign exchange risk continued

					At 31 July 2017
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Financial assets and liabilities					
Financial instruments included in trade and other receivables	55	351	143	171	720
Financial instruments included in trade and other payables	(57)	(214)	(69)	(72)	(412)
Cash and cash equivalents	5	512	80	184	781
Borrowings not designated as net investment hedges	1	(12)	(275)	(2)	(288)
	4	637	(121)	281	801
Exclude balances held in operations with the same functional currency	(5)	(220)	(102)	(195)	(522)
Exposure arising from intra-group loans		(352)	(85)	(83)	(520)
Impact of fair value hedging of exchange exposure	(269)		269		
Forward foreign exchange contracts	(88)	19	50	19	
	(358)	**84**	**11**	**22**	**(241)**

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

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

	Impact on profit for the year 31 July 2018 £m	Gain/(loss) recognised in reserves 31 July 2018 £m	Impact on profit for the year 31 July 2017 £m	Gain/(loss) recognised in reserves 31 July 2017 £m
US dollar	19	(4)	(5)	(5)
Euro	(1)	2	(3)	2
Sterling	(32)	(6)	1	(1)

These sensitivities were calculated before adjusting for tax and exclude the effect of quasi-equity intra-group loans. During the current year cross-currency swaps related to the 2027 Eurobond were de-designated from net investment hedge relationships, increasing the notional US Dollar exposure at 31 July 2018 by $318m. This additional notional US Dollar exposure is the driver of £24m of the US dollar and Sterling profit sensitivity in the table above. These swaps have since been re-designated as net investment hedges.

Cash-flow hedging

The Group uses foreign currency contracts to hedge future foreign currency sales and purchases. At 31 July 2018 contracts with a nominal value of £385m (FY2017: £407m) were designated as hedging instruments. In addition, the Group had outstanding foreign currency contracts with a nominal value of £275m (FY2017: £243m) 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 19.

The majority of hedged transactions will be recognised in the consolidated income statement in the same period that the cash flows are expected to occur, with the only differences arising because of normal commercial credit terms on sales and purchases. Of the foreign exchange contracts designated as hedging instruments 81% are for periods of 12 months or less (FY2017: 86%).

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

	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
Brought forward cash-flow hedge reserve at start of year	1	(7)
Gains on effective cash-flow hedges recognised in equity	2	3
Amounts removed from the hedge reserve and recognised in the following lines on the income statement:		
– revenue	1	9
– cost of sales	(2)	(4)
Carried forward cash-flow hedge reserve at end of year	**2**	**1**

Translational currency exposure

The Group has significant investments in overseas operations, particularly in the United States and Europe. As a result, the sterling value of the Group's balance sheet can be significantly affected by movements in exchange rates. The Group seeks to mitigate the effect of these translational currency exposures by matching the net investment in overseas operations with borrowings denominated in their functional currencies, except where significant adverse interest differentials or other factors would render the cost of such hedging activity uneconomic. This is achieved by borrowing primarily in the relevant currency or in some cases indirectly using 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 2018				
	Sterling £m	**US$ £m**	**Euro £m**	**Other £m**	**Total £m**
Loans designated as net investment hedges		(491)	(836)		(1,327)
Cross-currency swap contracts		(329)	357		28
Currency swap contracts	110			(110)	
	110	**(820)**	**(479)**	**(110)**	**(1,299)**

	At 31 July 2017				
	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Loans designated as net investment hedges		(621)	(840)		(1,461)
Cross-currency swap contracts	254	(568)	359		45
Currency swap contracts	109			(109)	
	363	**(1,189)**	**(481)**	**(109)**	**(1,416)**

At 31 July 2018 swap contracts hedged the Group's exposure to Canadian dollars, Japanese yen and Chinese renminbi (31 July 2017: Canadian dollars, Japanese yen and Chinese renminbi). All the currency swap contracts designated as net investment hedges are current (FY2017: current). The cross-currency swap contracts are non-current.

Swaps generating £329m of the US dollar exposure (FY2017: £327m) will mature in April 2023 and swaps generating £241m of the US dollar exposure during 2017, maturing in February 2027, have been de-designated during the current year.

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

	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
Brought forward net investment hedge reserve at start of year	(291)	(294)
Amounts removed from the hedge reserve and recognised in the income statement	(5)	20
Amounts deferred in the period on effective net investment hedges	(8)	(17)
Carried forward net investment hedge reserve at end of year	**(304)**	**(291)**

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 2018 £m	Loss recognised in hedge reserve 31 July 2017 £m
US dollar	91	132
Euro	53	53

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 55% of the level of gross debt. This is achieved through fixed rate borrowings and interest rate swaps. At 31 July 2018 55% (FY2017: 57%) 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 2018, after interest rate swaps, is 3.69% (FY2017: 3.52%).

NOTES TO THE ACCOUNTS CONTINUED

18 FINANCIAL RISK MANAGEMENT CONTINUED

(b) Interest rate risk 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 2018 £m	Cash and cash equivalents 31 July 2018 £m	Borrowings 31 July 2018 £m	Fair value of borrowings 31 July 2018 £m	Available for sale investments 31 July 2017 £m	Cash and cash equivalents 31 July 2017 £m	Borrowings 31 July 2017 £m	Fair value of borrowings 31 July 2017 £m
Fixed interest								
Less than one year			(190)	(196)			(134)	(140)
Between one and five years			(365)	(368)			(190)	(206)
Greater than five years			(307)	(314)			(672)	(693)
Total fixed interest financial liabilities			**(862)**	**(878)**			**(996)**	**(1,039)**
Floating rate interest financial assets/(liabilities)	4	657	(748)	(758)	6	711	(753)	(753)
Total interest-bearing financial assets/(liabilities)	**4**	**657**	**(1,610)**	**(1,636)**	**6**	**711**	**(1,749)**	**(1,792)**
Non-interest-bearing assets in the same category	14	60			15	71		
Total	**18**	**717**	**(1,610)**	**(1,636)**	**21**	**782**	**(1,749)**	**(1,792)**

Interest rate hedging

At 31 July 2018 and 31 July 2017 the Group had designated the following hedges against variability in the fair value of borrowings arising from fluctuations in base rates:

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

At 31 July 2017 the Group had designated the following hedge against variability in the fair value of borrowings arising from fluctuations in base rates and exchange rates:

- the fixed/floating and € exchange exposure of €300m of €/US$ interest rate swaps which mature on 23 February 2027 partially hedging the € 2027 Eurobond.

The above hedge was de-designated in the year to 31 July 2018.

The fair values of the hedging instruments are disclosed in note 19. The effect of the swaps is to convert £471m (FY2017: £741m) 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 investments at 31 July 2018, and taking into consideration all fixed rate borrowings and interest rate swaps in place, a one percentage point (100 basis points) change in average floating interest rates for all three currencies would have less than £3m impact (FY2017: £1m impact) on the Group's profit before tax.

(c) Financial credit risk

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

The maximum credit risk exposure in the event of other parties failing to perform their obligations under financial assets, excluding trade and other receivables and derivatives, totals £735m at 31 July 2018 (FY2017: £803m).

	31 July 2018 £m	31 July 2017 £m
Cash in AAA liquidity funds	200	376
Cash at banks with at least a AA- credit rating	306	226
Cash at banks with a A+ credit rating	74	98
Cash at other banks	137	82
Investments in bank deposits	13	11
Other investments	5	10
	735	**803**

At 31 July 2018 the maximum exposure with a single bank for deposits and cash is £127m (FY2017: £126m), whilst the maximum mark to market exposure with a single bank for derivatives is £17m (FY2017: £20m). Both these banks have AA- credit ratings (FY2017: Both AA-).

(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.

Smiths has a $800m Revolving Credit Facility that matures on 1 November 2022. At the balance sheet date, the Group had the following undrawn credit facilities:

	31 July 2018 £m	31 July 2017 £m
Expiring within one year		
Expiring between one and two years		
Expiring after more than two years	609	607
	609	**607**

Cash deposits

As at 31 July 2018, £430m (FY2017: £556m) of cash and cash equivalents was on deposit with various banks of which £71m (FY2017: £83m) was on deposit with UK banks, £200m (FY2017: £375m) was in liquidity funds and £13m (FY2017: £11m) of investments comprised bank deposits held to secure liabilities and letters of credit.

Gross contractual cash-flows for borrowings

	Borrowings (Note 17) 31 July 2018 £m	Fair value adjustments 31 July 2018 £m	Contractual interest payments 31 July 2018 £m	Total contractual cash-flows 31 July 2018 £m	Borrowings (Note 17) 31 July 2017 £m	Fair value adjustments 31 July 2017 £m	Contractual interest payments 31 July 2017 £m	Total contractual cash-flows 31 July 2017 £m
Less than one year	(203)		(43)	(246)	(151)	1	(38)	(188)
Between one and two years			(29)	(29)	(190)		(43)	(233)
Between two and three years			(29)	(29)			(29)	(29)
Between three and four years			(29)	(29)			(29)	(29)
Between four and five years	(832)	(5)	(24)	(861)			(29)	(29)
Greater than five years	(575)		(46)	(621)	(1,408)	(1)	(71)	(1,480)
Total	**(1,610)**	**(5)**	**(200)**	**(1,815)**	**(1,749)**		**(239)**	**(1,988)**

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 2018 £m	Payments 31 July 2018 £m	Net cash-flow 31 July 2018 £m	Receipts 31 July 2017 £m	Payments 31 July 2017 £m	Net cash-flow 31 July 2017 £m
Assets						
Less than one year	379	(386)	(7)	315	(310)	5
Greater than one year	726	(657)	69	710	(642)	68
Liabilities						
Less than one year	319	(324)	(5)	279	(287)	(8)
Greater than one year	36	(42)	(6)	51	(54)	(3)
Total	**1,460**	**(1,409)**	**51**	**1,355**	**(1,293)**	**62**

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: £432m (FY2017: £400m) due in less than one year, £6m (FY2017: £8m) due between one and five years and £3m (FY2017: £4m) due after more than five years.

NOTES TO THE ACCOUNTS CONTINUED

19 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 2018
	Contract or underlying nominal amount £m	Fair value Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	385	6	(4)	2
Foreign exchange contracts (not hedge accounted)	275	2		2
Total foreign exchange contracts	**660**	**8**	**(4)**	**4**
Currency swaps (net investment hedges)	**110**			
Cross currency swaps (fair value and net investment hedges)	328	28		28
Cross currency swaps (not hedge accounted)	242	21		21
Interest rate swaps (fair value hedges)	114		(6)	(6)
Total financial derivatives	**1,454**	**57**	**(10)**	**47**
Balance sheet entries				
Non-current	760	50	(6)	44
Current	694	7	(4)	3
Total financial derivatives	**1,454**	**57**	**(10)**	**47**

				At 31 July 2017
	Contract or underlying nominal amount £m	Fair value Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (cash-flow hedges)	407	11	(10)	1
Foreign exchange contracts (not hedge accounted)	243	2	(1)	1
Total foreign exchange contracts	**650**	**13**	**(11)**	**2**
Currency swaps (net investment hedges)	**109**			
Cross currency swaps (fair value and net investment hedges)	569	56		56
Interest rate swaps (fair value hedges)	113		(1)	(1)
Total financial derivatives	**1,441**	**69**	**(12)**	**57**
Balance sheet entries				
Non-current	745	56	(2)	54
Current	696	13	(10)	3
Total financial derivatives	**1,441**	**69**	**(12)**	**57**

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 2018 £m	Liabilities 31 July 2018 £m	Assets 31 July 2017 £m	Liabilities 31 July 2017 £m
Gross value of assets and liabilities	57	(10)	69	(12)
Related assets and liabilities subject to master netting agreements	(1)		(1)	1
Net exposure	**56**	**(10)**	**68**	**(11)**

20 FAIR VALUE OF FINANCIAL INSTRUMENTS

	Notes	Carrying value 31 July 2018 £m	Fair value 31 July 2018 £m	Carrying value 31 July 2017 £m	Fair value 31 July 2017 £m
Level 2 valuations					
Financial assets – other investments	16	13	13	11	11
Financial derivatives – assets	19	57	57	69	69
Borrowings	17	(1,610)	(1,636)	(1,749)	(1,792)
Financial derivatives – liabilities	19	(10)	(10)	(12)	(12)
Level 3 valuations					
Financial assets – other investments	16	4	4	10	10

Investments in bank deposits are valued at the bank balance, adjusted for accrued interest.

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.

21 COMMITMENTS

Operating lease commitments – minimum lease payments

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

	31 July 2018		31 July 2017	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Payments due:				
– not later than one year	34	7	34	7
– later than one year and not later than five years	83	8	68	7
– later than five years	23		24	
	140	**15**	**126**	**14**

Other commitments

At 31 July 2018, commitments, comprising bonds and guarantees arising in the normal course of business, amounted to £184m (FY2017: £186m), including pension commitments of £54m (FY2017: £54m).

NOTES TO THE ACCOUNTS CONTINUED

22 PROVISIONS AND CONTINGENT LIABILITIES

	Trading	Non-headline and legacy			Total
	£m	John Crane, Inc. litigation £m	Titeflex Corporation litigation £m	Other £m	£m
Current liabilities	25	30	21	9	85
Non-current liabilities	6	207	63	7	283
At 31 July 2017	**31**	**237**	**84**	**16**	**368**
Exchange adjustments	(1)	1			
Provision charged	19	7	6	9	41
Provision released	(11)		(8)	(3)	(22)
Unwind of provision discount		5	2		7
Utilisation	(15)	(27)	(6)	(8)	(56)
At 31 July 2018	**23**	**223**	**78**	**14**	**338**
Current liabilities	21	29	20	6	76
Non-current liabilities	2	194	58	8	262
At 31 July 2018	**23**	**223**	**78**	**14**	**338**

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 2018 there are warranty and product liability provisions of £22m (FY2017: £28m). Warranties over the Group's products typically cover periods of between one and three years. Provision is made for the likely cost of after-sales support based on the recent past experience of individual businesses.

Commercial disputes and litigation in respect of ongoing business activities

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

Contingent liabilities

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

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

Non-headline and legacy

John Crane, Inc.

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

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

JCI continues to actively monitor the conduct and effect of its current and expected asbestos litigation, including the most efficacious presentation of its 'safe product' defence, and intends to continue to resist these asbestos claims based upon this defence. The table below summarises the JCI claims experience over the last 39 years since the start of this litigation:

	Year ended 31 July 2018	Year ended 31 July 2017	Year ended 31 July 2016	Year ended 31 July 2015	Year ended 31 July 2014
JCI claims experience					
Claims against JCI that have been dismissed	277,000	273,000	247,000	242,000	235,000
Claims JCI is currently a defendant in	43,000	50,000	74,000	76,000	80,000
Cumulative final judgments, after appeals, against JCI since 1979	140	138	137	133	131
Cumulative value of awards ($'m) since 1979	164	160	158	153	149

The number of claims outstanding at 31 July 2018 reflects the benefit of 4,000 claims being dismissed in the year.

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

John Crane, Inc. litigation provision

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

Established incidence curves can be used to estimate the likely future pattern of asbestos related disease. However, JCI's claims experience is also significantly impacted by other factors which influence the US litigation environment. These can include: changing approaches on the part of the plaintiffs' bar; changing attitudes amongst the judiciary at both trial and appellate levels in specific jurisdictions which move the balance of risk and opportunity for claimants; and legislative and procedural changes in both the state and federal court systems. The build-up of assets in trusts established by asbestos defendants in Chapter 11 restructuring ("524(g) trusts") will increase the influence of these trusts on the behaviour of claimants. Developments in the Garlock Sealing Technologies LLC Chapter 11 proceedings have provided additional data on plaintiff claims to 524 (g) trusts. Given the evidence that emerged of inconsistent duplicate claims, there is a significant likelihood that this will lead to changes in the pattern of claims made in the future, and the costs arising from claims.

The projections use a limited time horizon on the basis that Bates White LLC consider that there is substantial uncertainty in the asbestos litigation environment so probable expenditures are not reasonably estimable beyond this time horizon. Asbestos is the longest running mass tort litigation in American history which is constantly evolving in ways that cannot be anticipated. JCIs defence strategy also generates a significantly different pattern of legal costs and settlement expenses from other defendants, thus JCI is in an extremely rare position, and evidence from other litigation cannot be used to improve the reliability of the projections. A ten year (FY2017: ten year) time horizon has been used based on past experience regarding significant changes in the litigation environment that have occurred every few years and on the amount of time taken in the past for some of those changes to impact the broader asbestos litigation environment, and recent events, like the Garlock Sealing Technologies LLC Chapter 11 proceedings, which may lead to further major changes.

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

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

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

John Crane, Inc. litigation insurance recoveries

While JCI has 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. The calculation of the provision does not take account of any potential recoveries from insurers.

NOTES TO THE ACCOUNTS CONTINUED

22 PROVISIONS AND CONTINGENT LIABILITIES CONTINUED

Non-headline and legacy continued

John Crane, Inc. continued

John Crane, Inc. litigation provision history

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

	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
John Crane, Inc. litigation provision					
Gross provision	251	260	267	236	227
Discount	(28)	(23)	(15)	(20)	(23)
Discounted provision	**223**	**237**	**252**	**216**	**204**
Operating profit charge/(credit)					
Increased provisions for adverse judgments and legal defence costs	13	17	8	14	49
Change in US risk free rates	(6)	(13)	7	1	(2)
Litigation management, legal fees in connection with litigation against insurers and defence strategy	3	11	8	4	1
Recoveries from insurers		(6)	(16)		
Operating profit charge	10	9	7	19	48
Cash-flow					
Provision utilisation	(27)	(24)	(22)	(24)	(36)
John Crane, Inc. litigation spend	30	32	32	27	25

The reduction in 2018 is due to increasing US dollar discount rates, with no material movement in the gross provision.

The operating charge for John Crane, Inc. litigation comprises:

- a charge of £13m (FY2017: £17m) in respect of the net increased provision for adverse judgments and legal defence costs;
- a credit of £6m arising from an increase in US risk free rates (FY2017: credit of £13m); and
- £3m (FY2017: £11m) costs for litigation management, defence strategy and legal fees in connection with litigation against insurers.

In the year ended 31 July 2017 JCI recognised the recovery of £6m through a settlement with an insurer. This agreement does not provide any cover for future costs so there is no material impact on the closing litigation provision.

John Crane, Inc. litigation provision sensitivities

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

Statistical reliability of projections over the ten year time horizon

In order to evaluate the statistical reliability of the projections, a population of outcomes is modelled using randomised verdict outcomes. This generated a distribution of outcomes with future spend at the 5th percentile of £230m and future spend at the 95th percentile of £290m (FY2017: £231m and £304m, respectively). Statistical analysis of the distribution of these outcomes indicates that there is a 50% probability that the total future spend will fall between £238m and £263m (FY2017: between £243m and £272m), compared to the gross provision value of £251m (FY2017: £260m).

Sensitivity of the projections to changes in the time horizon used

If the asbestos litigation environment becomes more volatile and uncertain, for example if defendants are successful in legal cases against plaintiff law firms and this impacts the nature of claims filed, the time horizon over which the provision can be calculated may reduce. Conversely, if the environment became more stable, or JCI changed approach and committed to long-term settlement arrangements, the time period covered by the provision might be extended.

The projections use a 10 year time horizon. Reducing the time horizon by one year would reduce the provision by £15m (FY2017: £17m) and reducing it by five years would reduce the provision by £91m (FY2017: £98m).

We consider, after obtaining advice from Bates White LLC, that to forecast beyond ten years requires that the litigation environment remains largely unchanged with respect to the historical experience used for estimating future asbestos expenditures. Historically, the asbestos litigation environment has undergone significant changes more often than every ten years. If one assumed that the asbestos litigation environment would remain unchanged for longer and extended the time horizon by one year it would increase the provision by £13m (FY2017: £14m) and extending it by five years would increase the provision by £52m (FY2017: £58m). However, there are also reasonable scenarios that, given certain recent events in the US asbestos litigation environment, would result in no additional asbestos litigation for JCI beyond ten years. At this time, how the asbestos litigation environment may evolve beyond 10 years is not reasonably estimable.

John Crane, Inc. contingent liabilities

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

Although the methodology used to calculate the JCI litigation provision can in theory be applied to show claims and costs for longer periods, the Directors consider, based on advice from Bates White LLC, that the level of uncertainty regarding the factors used in estimating future costs is too great to provide for reasonable estimation of the numbers of future claims, the nature of such claims or the cost to resolve them for years beyond the 10 year time horizon.

Titeflex Corporation

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.

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; and the impact of statutes of repose and safe installation initiatives on the expected number of future claims.

The provision of £78m (FY2017: £84m) is a discounted pre-tax provision using discount rates, being the risk-free rate on US debt instruments for the appropriate period. The deferred tax asset related to this provision is shown within the deferred tax balance (note 6).

	31 July 2018 £m	31 July 2017 £m
Gross provision	129	136
Discount	(51)	(52)
Discounted pre-tax provision	**78**	**84**
Deferred tax	(19)	(33)
Discounted post-tax provision	**59**	**51**

Titeflex Corporation litigation provision history

An additional provision of £6m (FY2017: £8m) has been recognised by Titeflex Corporation in respect of changes to the estimated cost of future claims from insurance companies seeking recompense for damage allegedly caused by lightning strikes. An offsetting provision release of £8m is principally driven by a reduction in subrogation payments.

Titeflex Corporation litigation provision sensitivities

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

The projections incorporate a long-term assumption regarding the impact of safe installation initiatives on the level of future claims. If the assumed annual benefit of bonding and grounding initiatives were 0.5% higher, the provision would be £4m (FY2017: £5m) lower, and if the benefit were 0.5% lower, the provision would increase by £5m (FY2017: £5m).

NOTES TO THE ACCOUNTS CONTINUED

22 PROVISIONS AND CONTINGENT LIABILITIES CONTINUED

Non-headline and legacy continued

Other non-headline and legacy

Legacy provisions comprise provisions relating to former business activities and properties no longer used by Smiths. Non-headline provisions comprise all provisions that were disclosed as non-headline items when they were charged to the consolidated income statement.

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

Reorganisation and property

At 31 July 2018 there were reorganisation provisions of £7m relating to the integration of the Morpho business into the Detection division (FY2017: £8m related to Fuel for Growth), £2m (FY2017: £3m) related to onerous leases and dilapidations provisions, and £2m (FY2017: £2m) related to actual and potential environmental issues for sites which were no longer occupied by Smiths operations. The Morpho integration provision is expected to be utilised in the next 1 – 2 years.

Disposal

Other provisions include disposal provisions of £3m (FY2017: £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 five years.

23 SHARE CAPITAL

	Number of shares	Issued capital £m	Consideration £m
Ordinary shares of 37.5p each			
Total share capital at 31 July 2016	395,223,072	148	
Exercise of share options	253,590		3
Total share capital at 31 July 2017	**395,476,662**	**148**	
Exercise of share options	284,565		3
Total share capital at 31 July 2018	**395,761,227**	**148**	

Share capital structure

As at 31 July 2018 the Company's issued share capital was 395,761,227 ordinary shares with a nominal value of 37.5p per share, all of the issued share capital was in free issue and all issued shares are fully paid.

The Company's ordinary shares are listed and admitted to trading on the Main Market of the London Stock Exchange. The Company has an American Depositary Receipt (ADR) programme and one ADR equates to one ordinary share. As at 31 July 2018, 10,125,054 ordinary shares were held by the nominee of the programme in respect of the same number of ADRs in issue.

The holders of ordinary shares are entitled to receive the Company's Reports and Accounts, to attend and speak at general meetings of the Company, to appoint proxies and to exercise voting rights. None of the ordinary shares carry any special rights with regards to control of the Company.

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

Powers of Directors

The Directors are authorised to issue and allot shares and to buy back shares subject to annual shareholder approval at the AGM. Such authorities were granted by shareholders at the 2017 AGM, and at the 2018 AGM it will be proposed that the Directors be granted new authorities to allot and buy back shares.

Repurchase of shares

The Company did not purchase any of its own shares during the financial year ended 31 July 2018. As at 14 September 2018 (the latest practicable date for inclusion in this report) the Company had an unexpired authority to repurchase ordinary shares up to a maximum of £40m ordinary shares. As at 14 September 2018, the Company did not hold any shares in treasury. Any ordinary shares purchased may be cancelled or held in treasury.

Employment share schemes

Shares acquired through Company share schemes and plans rank pari passu with the shares in issue and have no special rights. The Company operates an Employee Benefit Trust, with an independent trustee, to hold shares pending employees becoming entitled to them under the Company's share schemes and plans. On 31 July 2018 the trust held 766 ordinary shares in the Company. The trust waived its dividend entitlement on its holding during the year, and the trust abstains from voting the shares at general meetings.

24 DIVIDENDS

The following dividends were declared and paid in the period:

	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
Ordinary final dividend of 29.70p for FY2017 (FY2016: 28.75p) paid 17 November 2017	117	114
Ordinary interim dividend of 13.80p for FY2018 (FY2017: 13.55p) paid 23 April 2018	55	53
	172	**167**

The final dividend for the year ended 31 July 2018 of 30.75p per share was recommended by the Board on 20 September 2018 and will be paid to shareholders on 16 November 2018, 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 19 October 2018.

Waiver of dividends

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

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

25 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 (FY2017: nil) shares to the Trust, and the Trust purchased 952,111 shares (FY2017: 658,217 shares) in the market for a consideration of £15m (FY2017: £10m). At 31 July 2018 the Trust held 766 (FY2017: 766) ordinary shares.

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

Capital management

Capital employed comprises total equity adjusted for goodwill recognised directly in reserves, net post-retirement benefit related assets and liabilities, net litigation provisions relating to non-headline items and net debt. The efficiency of the allocation of the capital to the divisions is monitored through the return on capital employed (ROCE). This ratio is calculated over a rolling 12-month period and is the percentage that headline operating profit comprises of monthly average capital employed. The ROCE was 14.6% (FY2017: 16.2%), see note 30.

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

The ratio of net debt to headline EBITDA of 1.4 (FY2017: 1.4) is within the Group's stated policy of 2.0 or less over the medium term. The Group's robust balance sheet and record of strong cash generation is more than able to fund the immediate investment needs and other legacy obligations. See note 30 for the definition of headline EBITDA and the calculation of this ratio.

As part of its capital management the Group strategy is to maintain a solid investment grade credit rating to ensure access to the widest possible sources of financing and to minimise the resulting cost of capital. At 31 July 2018 the Group had a credit rating of BBB+/Baa2 (FY2017: BBB+/Baa2) with Standard & Poor's and Moody's respectively.

The Board has a progressive dividend policy for future payouts, with the aim of increasing dividends in line with the long-term underlying growth in earnings. In setting the level of dividend payments, the Board will take into account prevailing economic conditions and future investment plans, along with the objective to maintain minimum dividend cover of around 2.0.

Hedge reserve

	31 July 2018 £m	31 July 2017 £m
The hedge reserve on the balance sheet comprises:		
– cash-flow hedge reserve	2	1
– net investment hedge reserve	(304)	(291)
	(302)	**(290)**

See transactional currency exposure risk management disclosures in note 18 for additional details of cash-flow hedges, and translational currency exposure risk management disclosure also in note 18 for additional details of net investment hedges.

26 ACQUISITIONS

On 1 November 2017, Tutco LLC, part of the Group's Flex-Tek Heat Solutions business, completed the acquisition of the heating element division of Osram Sylvania Inc. This acquisition has been rebranded as Tutco Sureheat. The intangible assets recognised on this acquisition comprise technology and customer relationships. Goodwill represents synergies and the value of the expertise in the assembled workforce. The goodwill recognised is expected to be deductible for tax purposes.

From the date of acquisition to 31 July 2018, Tutco Sureheat contributed £4m to revenue and £1m to profit before taxation. If the Group had acquired this business at the beginning of the financial year, the acquisition would have contributed £6m to revenue and £2m to profit before taxation.

NOTES TO THE ACCOUNTS CONTINUED

26 ACQUISITIONS CONTINUED

On 13 June 2018, the Group's John Crane division completed the acquisition of Seebach GmbH, a provider of highly-engineered filtration solutions, from Avedon Capital Partners. The intangible assets recognised on this acquisition comprise technology, customer relationships and branding. Goodwill represents the expected synergies from the strategic fit of the acquisition and the value of the expertise in the assembled workforce. The goodwill recognised is expected to be deductible for tax purposes.

From the date of acquisition to 31 July 2018, Seebach GmbH contributed £2m to revenue and less than £1m to profit before taxation. If the Group had acquired this business at the beginning of the financial year, the acquisition would have contributed £17m to revenue and £2m to profit before taxation.

The provisional balance sheets at the date of acquisition are:

	Tutco Sureheat £m	Seebach GmbH £m	Total £m
Non-current assets			
– acquired intangible assets	6	23	29
– land and buildings		2	2
– plant and equipment		1	1
– deferred tax asset		1	1
Current assets			
– inventory	1	6	7
– trade and other receivables	1	4	5
Current liabilities			
– net debt		(1)	(1)
– trade and other payables		(4)	(4)
Net assets acquired	**8**	**32**	**40**
Goodwill on current year acquisitions	7	24	31
Total consideration – cash paid during the year	**15**	**56**	**71**

Acquisitions in previous years

The Group acquired the Morpho Detection business from Safran S.A. in the prior year. Since the acquisition the Group has undertaken a thorough review of the business and has adjusted the fair value of assets and liabilities on the acquisition balance sheet, resulting in a £15m increase in the Goodwill associated to this acquisition in the current year.

27 DISCONTINUED OPERATIONS

There were no discontinued operations in the current year. In the prior year, the Group acquired the Morpho Detection explosive trace detection business after making commitments to the European Commission and the US Department of Justice to sell this business to an approved purchaser. The Group began marketing this business for sale once the terms of the competition clearance were known.

The sale was completed on 7 July 2017 for a cash consideration of £63m. In the year ended 31 July 2017 a loss after tax of £8m was generated by discontinued operations, giving a loss per share from discontinued operations, basic and diluted, of 2.0p.

28 DISPOSALS

During the year the Group received £29m consideration for business disposals, including the sale of the John Crane Bearings business for an enterprise value of $35m, the John Crane Bearings sale completed on 31 May 2018.

John Crane Bearings	Total £m
Consideration	26
Less: transaction costs	(1)
Net consideration received	25
Net assets disposed of:	
– Intangible assets	1
– Non-current tangible assets	6
– Inventories	9
– Trade and other receivables	7
– Trade and other payables	(2)
Net assets	21
Recycling of foreign exchange	5
Profit on John Crane Bearings disposals	**9**
Loss on other disposals	(2)
Total	**7**

29 CASH-FLOW

Cash-flow from operating activities

	Year ended 31 July 2018			Year ended 31 July 2017		
	Headline £m	Non-headline £m	Total £m	Headline £m	Non-headline £m	Total £m
Operating profit	544	(50)	494	589	85	674
Amortisation of intangible assets	39	32	71	44	18	62
Depreciation of property, plant and equipment	55		55	57		57
(Profit)/loss on disposal of property, plant and equipment	(1)		(1)	4		4
Profit on disposal of business		(7)	(7)		(175)	(175)
Share-based payment expense	14	2	16	13	1	14
Retirement benefits	5	(49)	(44)	1	(94)	(93)
Decrease/(increase) in inventories	(19)	2	(17)	52		52
Decrease/(increase) in trade and other receivables	(17)		(17)	31	8	39
Increase/(decrease) in trade and other payables	26	(5)	21	8	8	16
Decrease in provisions	(6)	(30)	(36)	(6)	(34)	(40)
Cash generated from operations	**640**	**(105)**	**535**	**793**	**(183)**	**610**
Interest paid	(71)	(1)	(72)	(65)		(65)
Interest received	7		7	5	11	16
Tax paid	(65)		(65)	(82)		(82)
Net cash inflow from operating activities	**511**	**(106)**	**405**	**651**	**(172)**	**479**

Interest paid includes £1m of cash outflows from foreign exchange hedging of intra-group loan exposures (FY2017: interest received included £6m cash inflows from hedging of intra-group loans exposures and £5m exchange gains realised on internal interest).

The split of tax payments between headline and non-headline only considers the nature of payments made. No adjustment has been made for reductions in tax payments due to tax relief received on non-headline items.

Headline cash measures

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

	Year ended 31 July 2018			Year ended 31 July 2017		
	Headline £m	Non-headline £m	Total £m	Headline £m	Non-headline £m	Total £m
Net cash inflow from operating activities	**511**	**(106)**	**405**	**651**	**(172)**	**479**
Include:						
Expenditure on capitalised development, other intangible assets and property, plant and equipment	(106)		(106)	(107)		(107)
Disposals of property, plant and equipment	4		4	9		9
Investment in financial assets relating to operating activities and pensions financing	(1)		(1)	(5)	(6)	(11)
Free cash-flow			**302**			**370**
Exclude:						
Investment in financial assets relating to operating activities and pensions financing outstanding at the balance sheet	1		1	5	6	11
Interest paid	71	1	72	65		65
Interest received	(7)		(7)	(5)	(11)	(16)
Tax paid	65		65	82		82
Headline operating cash-flow	**538**	**(105)**	**433**	**695**	**(183)**	**512**

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

	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
Free cash-flow	**302**	**370**
Investment in other financial assets		(7)
Acquisition of businesses	(71)	(580)
Disposal of businesses and discontinued operations	29	462
Net cash-flow used in financing activities	(316)	116
Net (decrease)/increase cash and cash equivalents	**(56)**	**361**

NOTES TO THE ACCOUNTS CONTINUED

30 NON-STATUTORY CAPITAL AND CREDIT METRICS

In addition to the non-statutory profit measures explained in note 3, the Group calculates credit metrics and return on capital employed incorporating the same adjustments. See the disclosures on presentation of results in accounting policies for an explanation of the excluded items.

Return on capital employed (ROCE)

Smiths ROCE is calculated over a rolling 12-month period and is the percentage that headline operating profit comprises of monthly average capital employed.

See note 1 for the divisional headline operating profit and average divisional capital employed used to calculate divisional ROCE.

Capital employed

Capital employed is a non-statutory measure of invested resources. It comprises statutory net assets adjusted to add goodwill recognised directly in reserves in respect of subsidiaries acquired before 1 August 1998 of £787m (31 July 2017: £787m) and eliminate post-retirement benefit assets and liabilities and litigation provisions relating to non-headline items, both net of related tax, and net debt.

	Notes	31 July 2018 £m	31 July 2017 £m
Net assets		**2,288**	**2,104**
Adjust for:			
Goodwill recognised directly in reserves		787	787
Post-retirement benefit assets and liabilities	8	(381)	(224)
Tax related to post retirement benefit assets and liabilities		62	22
John Crane, Inc. litigation provisions and related tax	22	175	158
Titeflex Corporation litigation provisions and related tax	22	59	51
Net debt	17	893	967
Capital employed		**3,883**	**3,865**

Return on capital employed

	Notes	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
Headline operating profit for previous twelve months		544	589
Average capital employed	1	3,735	3,639
ROCE		**14.6%**	**16.2%**

Credit metrics

Smiths Group monitors the ratio of net debt to Headline EBITDA as part of its management of credit ratings, see note 25 for details. This ratio is calculated as follows.

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

	Notes	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
Headline operating profit		**544**	**589**
Exclude:			
– depreciation	12	55	57
– amortisation of development costs	10	24	27
– amortisation of software, patents and intellectual property	10	18	17
Headline EBITDA		**641**	**690**

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

Ratio of net debt to headline EBITDA

	Notes	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m
Headline EBITDA		641	690
Net debt	17	893	967
Ratio of net debt to headline EBITDA		**1.4**	**1.4**

UNAUDITED GROUP FINANCIAL RECORD 2014-2018

	Year ended 31 July 2018 £m	Year ended 31 July 2017 £m	Year ended 31 July 2016 £m	Year ended 31 July 2015 £m	Year ended 31 July 2014 £m
Income statement metrics – headline					
Revenue	3,213	3,280	2,949	2,897	2,952
Headline operating profit	544	589	510	511	504
Headline profit before tax	487	528	451	459	445
Income statement metrics – statutory					
Operating profit	494	674	387	394	378
Profit before taxation	435	601	346	325	302
Profit for the year	279	572	261	248	235
Balance sheet metrics					
Net debt	(893)	(967)	(978)	(818)	(804)
Shareholders' equity	2,272	2,089	1,646	1,419	1,237
Average capital employed	3,735	3,639	3,324	3,197	3,218
Ratios					
Headline operating profit: revenue (%)	16.9	18.0	17.3	17.6	17.1
Headline effective tax rate (%)	25.8	26.5	25.0	25.5	27.0
Return on capital employed (%)	14.6	16.2	15.3	16.0	15.7
Return on shareholders' funds (%)	12.1	14.5	14.3	15.8	14.9
Cash-flow					
Headline operating cash	538	695	520	484	490
Headline operating cash conversion (%)	99	118	102	95	97
Statutory free cash-flow	302	370	243	158	143
Statutory free cash-flow per share (p)	76.3	93.6	61.1	40.1	36.2
Earnings per share					
Headline earnings per share (p)	90.7	97.6	85.2	86.1	81.8
Dividends					
Pence per share	44.55	43.25	42.00	41.00	40.25
Headline dividend cover	2.0	2.3	2.0	2.1	2.0
Number of employees (000s)					
United Kingdom	1.5	1.5	1.5	1.7	1.8
Overseas	20.2	20.4	20.5	21.6	21.4
	21.7	21.9	22.0	23.3	23.2

UNAUDITED SUPPLEMENTARY CONSOLIDATED INCOME STATEMENT – US DOLLAR TRANSLATION

	Notes	Year ended 31 July 2018 Headline $m	Year ended 31 July 2018 Non-headline (note 3) $m	Year ended 31 July 2018 Total $m	Year ended 31 July 2017 Headline $m	Year ended 31 July 2017 Non-headline (note 3) $m	Year ended 31 July 2017 Total $m
Continuing operations							
Revenue	1	4,332		4,332	4,158		4,158
Cost of sales		(2,358)		(2,358)	(2,225)		(2,225)
Gross profit		1,974		1,974	1,933		1,933
Sales and distribution costs		(586)		(586)	(570)		(570)
Administrative expenses		(654)	(77)	(731)	(616)	(115)	(731)
Profit on business disposal	28		9	9		223	223
Operating profit/(loss)	2	**734**	**(68)**	**666**	**747**	**108**	**855**
Interest receivable		9		9	6		6
Interest payable		(87)		(87)	(84)		(84)
Other financing losses			(12)	(12)		(18)	(18)
Other finance charges – retirement benefits	8		9	9		3	3
Finance costs	4	(78)	(3)	(81)	(78)	(15)	(93)
Continuing operations – Profit before taxation		**656**	**(71)**	**585**	**669**	**93**	**762**
Taxation	6	(169)	(41)	(210)	(178)	141	(37)
Continuing operations – Profit for the year		**487**	**(112)**	**375**	**491**	**234**	**725**
Discontinued operations							
Loss on discontinued operations	27					(10)	(10)
Profit for the year		**487**	**(112)**	**375**	**491**	**224**	**715**
Attributable to							
Smiths Group shareholders – continuing operations		484	(112)	372	488	234	722
Smiths Group shareholders – discontinued operations						(10)	(10)
Non-controlling interests in respect of continuing operations		3		3	3		3
		487	**(112)**	**375**	**491**	**224**	**715**
Earnings per share	5						
Basic				94.4c			180.1c
Basic – continuing				94.4c			182.7c
Diluted				93.1c			177.8c
Diluted – continuing				93.1c			180.3c

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. This reflects the accounting approach that Smiths Group plc would use if the Group moved to reporting in US dollars without making any changes to its Group structure or financing arrangements.

UNAUDITED SUPPLEMENTARY CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME – US DOLLAR TRANSLATION

	Notes	Year ended 31 July 2018 $m	Year ended 31 July 2017 $m
Profit for the year		**375**	**715**
Other comprehensive income:			
Actuarial gains on retirement benefits	8	140	70
Taxation recognised on actuarial movements	6	(24)	(16)
Other comprehensive income and expenditure which will not be reclassified to the consolidated income statement		**116**	**54**
Other comprehensive income which will be reclassified and reclassifications:			
Exchange (losses)/gains		(11)	49
Cumulative exchange gains recycled on disposal		(7)	(52)
Fair value gains/(losses) and reclassification adjustments:			
– deferred on available for sale financial assets		1	1
– reclassified to income statement on available for sale financial assets	4		
– deferred in the period on cash-flow and net investment hedges		(8)	(18)
– reclassified to income statement on cash-flow and net investment hedges		(8)	31
Taxation recognised on fair value gains	6		(1)
Total other comprehensive income		**83**	**64**
Total comprehensive income		**458**	**779**
Attributable to			
Smiths Group shareholders		456	778
Non-controlling interests		2	1
		458	**779**

UNAUDITED SUPPLEMENTARY CONSOLIDATED BALANCE SHEET – US DOLLAR TRANSLATION

	Notes	31 July 2018 $m	31 July 2017 $m
Non-current assets			
Intangible assets	10	2,705	2,657
Property, plant and equipment	12	420	415
Financial assets – other investments	16	23	28
Retirement benefit assets	8	690	514
Deferred tax assets	6	237	359
Trade and other receivables	14	75	74
Financial derivatives	19	65	75
		4,215	**4,122**
Current assets			
Inventories	13	612	597
Current tax receivable	6	49	82
Trade and other receivables	14	963	952
Cash and cash equivalents	17	941	1,032
Financial derivatives	19	9	17
		2,574	**2,680**
Total assets		**6,789**	**6,802**
Non-current liabilities			
Financial liabilities			
– borrowings	17	(1,847)	(2,108)
– financial derivatives	19	(8)	(3)
Provisions for liabilities and charges	22	(344)	(374)
Retirement benefit obligations	8	(190)	(219)
Deferred tax liabilities	6	(101)	(146)
Trade and other payables	15	(35)	(35)
		(2,525)	**(2,885)**
Current liabilities			
Financial liabilities			
– borrowings	17	(266)	(199)
– financial derivatives	19	(6)	(12)
Provisions for liabilities and charges	22	(100)	(111)
Trade and other payables	15	(795)	(760)
Current tax payable	6	(94)	(60)
		(1,261)	**(1,142)**
Total liabilities		**(3,786)**	**(4,027)**
Net assets		**3,003**	**2,775**
Shareholders' equity			
Share capital	23	194	196
Share premium account		469	468
Capital redemption reserve	25	8	7
Revaluation reserve	25	2	2
Merger reserve	25	308	311
Retained earnings		2,398	2,155
Hedge reserve	25	(397)	(383)
Total shareholders' equity		**2,982**	**2,756**
Non-controlling interest equity		21	19
Total equity		**3,003**	**2,775**

UNAUDITED SUPPLEMENTARY CONSOLIDATED STATEMENT OF CHANGES IN EQUITY – US DOLLAR TRANSLATION

	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 2017		664	320	2,155	(383)	2,756	19	2,775
Profit for the year				372		372	3	375
Other comprehensive income:								
Exchange (losses)/gains		(5)	(2)	(13)	2	(18)		(18)
Actuarial gains on retirement benefits and tax				116		116		116
Fair value gains/(losses) and related tax				1	(16)	(15)		(15)
Total comprehensive income for the year		**(5)**	**(2)**	**476**	**(14)**	**455**	**3**	**458**
Transactions relating to ownership interests:								
Exercises of share options	23	4				4		4
Purchase of own shares	25			(20)		(20)		(20)
Dividends:								
– equity shareholders	24			(232)		(232)		(232)
– non-controlling interests							(1)	(1)
Share-based payment	9			19		19		19
At 31 July 2018		**663**	**318**	**2,398**	**(397)**	**2,982**	**21**	**3,003**

	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 2016		662	320	1,594	(398)	2,178	19	2,197
Profit for the year				712		712	3	715
Other comprehensive income:								
Exchange (losses)/gains		(1)		(2)	2	(1)	(2)	(3)
Actuarial gains on retirement benefits and related tax				54		54		54
Fair value gains and related tax					13	13		13
Total comprehensive income for the year		**(1)**		**764**	**15**	**778**	**1**	**779**
Transactions relating to ownership interests:								
Exercises of share options	23	3				3		3
Taxation recognised on share options	6			3		3		3
Purchase of own shares	25			(13)		(13)		(13)
Dividends:								
– equity shareholders	24			(212)		(212)		(212)
– non-controlling interest							(1)	(1)
Share-based payment	9			19		19		19
At 31 July 2017		**664**	**320**	**2,155**	**(383)**	**2,756**	**19**	**2,775**

UNAUDITED SUPPLEMENTARY CONSOLIDATED CASH-FLOW STATEMENT – US DOLLAR TRANSLATION

	Notes	Year ended 31 July 2018 $m	Year ended 31 July 2017 $m
Net cash inflow from operating activities	29	546	**607**
Cash-flows from investing activities			
Expenditure on capitalised development		(35)	(47)
Expenditure on other intangible assets	10	(16)	(10)
Purchases of property, plant and equipment	12	(92)	(79)
Disposals of property, plant and equipment		5	11
Investment in financial assets	16	(1)	(23)
Acquisition of businesses	26	(96)	(735)
Disposals of businesses – continuing operations	28	39	506
Disposals of businesses – discontinued operations	27		80
Net cash-flow used in investing activities		**(196)**	**(297)**
Cash-flows from financing activities			
Proceeds from exercise of share options	23	4	5
Purchase of own shares	25	(21)	(13)
Settlement of cash settled options		(1)	
Dividends paid to equity shareholders	24	(232)	(212)
Dividends paid to non-controlling interests			(1)
Cash inflow from matured derivative financial instruments		5	
Increase in new borrowings	17		692
Reduction and repayment of borrowings	17	(182)	(324)
Net cash-flow used in financing activities		**(427)**	**147**
Net (decrease)/increase in cash and cash equivalents		**(77)**	**457**
Cash and cash equivalents at beginning of year		1,030	569
Exchange differences		(12)	4
Cash and cash equivalents at end of year	17	**941**	**1,030**
Cash and cash equivalents at end of year comprise			
– cash at bank and in hand		377	298
– short-term deposits		564	733
– bank overdrafts			(1)
		941	**1,030**
Included in cash and cash equivalents per the balance sheet		941	1,031
Included in overdrafts per the balance sheet			(1)
		941	**1,030**

Reconciliation of net cash-flow to movement in net debt

	Notes	Year ended 31 July 2018 $m	Year ended 31 July 2017 $m
Net debt at start of year	17	**(1,275)**	**(1,294)**
Net (decrease)/increase in cash and cash equivalents		(77)	457
Increase in borrowings			(692)
Reduction and repayment of borrowings		182	324
Movement in net debt resulting from cash-flows		**105**	**89**
Capitalisation, interest accruals and unwind of capitalisation fees		3	(4)
Movement from fair value hedging		1	6
Exchange differences		(12)	(72)
Movement in net debt in the year		**97**	**19**
Net debt at end of year	17	**(1,178)**	**(1,275)**

UNAUDITED GROUP US DOLLAR FINANCIAL RECORD 2014-2018

	Year ended 31 July 2018 $m	Year ended 31 July 2017 $m	Year ended 31 July 2016 $m	Year ended 31 July 2015 $m	Year ended 31 July 2014 $m
Income statement metrics – headline					
Revenue	4,332	4,158	4,315	4,525	4,849
Headline operating profit	734	747	747	798	828
Headline profit before tax	656	669	661	717	730
Income statement metrics – statutory					
Operating profit	666	855	567	616	620
Profit before taxation	585	762	506	509	496
Profit for the year	375	715	382	388	385
Balance sheet metrics					
Net debt	(1,172)	(1,275)	(1,294)	(1,278)	(1,358)
Shareholders' equity	2,982	2,756	2,178	2,219	2,090
Average capital employed	4,903	4,800	4,864	4,994	5,287
Ratios					
Headline operating profit: revenue (%)	16.9	18.0	17.3	17.6	17.1
Headline effective tax rate (%)	25.8	26.5	25.0	25.5	27.0
Return on capital employed (%)	14.6	16.2	15.3	15.9	15.8
Return on shareholders' funds (%)	12.5	14.2	14.6	15.3	15.1
Cash-flow					
Headline operating cash	725	881	760	756	804
Headline operating cash conversion (%)	99	118	102	95	97
Statutory free cash-flow	406	469	356	247	235
Statutory free cash-flow per share (c)	102.9	118.6	89.4	62.6	59.5
Earnings per share					
Headline earnings per share (c)	122.3	123.6	124.6	134.5	134.4
Dividends					
Cents per share (c)	60.1	54.8	61.5	64.0	66.1
Headline dividend cover	2.0	2.3	2.0	2.1	2.0
Number of employees (000s)					
United States of America	7.1	7.7	7.9	8.4	8.3
Rest of World	14.6	14.2	14.1	14.9	14.9
	21.7	21.9	22.0	23.3	23.2

COMPANY BALANCE SHEET

	Notes	31 July 2018 £m	31 July 2017 represented £m
Non-current assets			
Tangible assets	2	1	1
Investments and advances	3	3,247	3,573
Financial assets	4	6	7
Retirement benefit assets	11	526	390
Deferred tax assets	5		17
Debtors	6	1	
Financial derivatives	9	49	56
Total non-current assets		**3,830**	**4,044**
Current assets			
Debtors	6	63	69
Cash at bank and on deposit	8	347	468
Financial derivatives	9	2	1
Total current assets		**412**	**538**
Current liabilities			
Creditors	7	(331)	(411)
Financial derivatives	9		(1)
Net current assets		**81**	**126**
Total assets less current liabilities		**3,911**	**4,170**
Non-current liabilities			
Borrowings	8	(1,405)	(1,597)
Provisions for liabilities and charges	10	(2)	(2)
Retirement benefit liabilities	11	(59)	(62)
Deferred tax liabilities	5	(8)	
Financial derivatives	9	(6)	(1)
Total non-current liabilities		**(1,480)**	**(1,663)**
Net assets		**2,431**	**2,508**
Capital and reserves			
Called up share capital	12	148	148
Share premium account	12	358	355
Capital redemption reserve	12	6	6
Other reserves	12	181	181
Profit and loss account	12	1,738	1,818
Shareholders' equity		**2,431**	**2,508**

Note: the comparative column has been represented to include non-current retirement benefit and financial derivative assets within total non-current assets.

The accounts on pages 182 to 189 were approved by the Board of Directors on 20 September 2018 and were signed on its behalf by:

ANDY REYNOLDS SMITH
CHIEF EXECUTIVE

JOHN SHIPSEY
CHIEF FINANCIAL OFFICER

Smiths Group plc – registered number 137013

COMPANY STATEMENT OF CHANGES IN EQUITY

	Share capital £m	Share premium £m	Capital redemption reserve £m	Other reserves £m	Retained profit £m	Shareholders' equity £m
At 31 July 2017	148	355	6	181	1,818	2,508
Profit for the year					7	7
Other comprehensive income:						
Actuarial gain on retirement benefits					103	103
Taxation recognised on retirement benefits					(17)	(17)
Total comprehensive income					**93**	**93**
Transactions with owners:						
Exercise of share options		3				3
Purchase of own shares					(15)	(15)
Dividends paid to equity shareholders					(172)	(172)
Share-based payment					14	14
Total transactions with owners recognised in equity		**3**			**(173)**	**(170)**
At 31 July 2018	**148**	**358**	**6**	**181**	**1,738**	**2,431**

	Share capital £m	Share premium £m	Capital redemption reserve £m	Other reserves £m	Retained profit £m	Shareholders' equity £m
At 31 July 2016	148	352	6	181	1,857	2,544
Profit for the year					96	96
Other comprehensive income:						
Actuarial gain on retirement benefits					34	34
Taxation recognised on retirement benefits					(6)	(6)
Total comprehensive income					**124**	**124**
Transactions with owners:						
Exercise of share options		3				3
Purchase of own shares					(10)	(10)
Dividends paid to equity shareholders					(167)	(167)
Share-based payment					14	14
Total transactions with owners recognised in equity		**3**			**(163)**	**(160)**
At 31 July 2017	**148**	**355**	**6**	**181**	**1,818**	**2,508**

COMPANY ACCOUNTING POLICIES

Basis of preparation

The accounts have been prepared in accordance with the Companies Act 2006 and Financial Reporting Standard 101, "Reduced Disclosure Framework" (FRS 101).

These accounts have been prepared on a going concern basis and under the historical cost convention modified to include revaluation of certain financial instruments, share options and pension assets and liabilities held at fair value.

As permitted by Section 408(3) of the Companies Act 2006, the Company's income statement and statement of comprehensive income have not been presented. As permitted by Section 408(2), information about the Company's employee numbers and costs is not presented.

Exemptions from the requirements of IFRS applied in accordance with FRS 101

The following exemptions from the requirements of IFRS have been applied in the preparation of these financial statements, in accordance with FRS 101:

- Paragraphs 45(b) and 46 to 52 of IFRS 2, 'Share-based payment' (details of the number and weighted-average exercise prices of share options, and how the fair value of goods or services received was determined)
- IFRS 7, 'Financial Instruments: Disclosures'
- Paragraphs 91 to 99 of IFRS 13, 'Fair value measurement' (disclosure of valuation techniques and inputs used for fair value measurement of assets and liabilities).
- Paragraph 38 of IAS 1, 'Presentation of financial statements' comparative information requirements in respect of:
  - paragraph 79(a)(iv) of IAS 1;
  - paragraph 73(e) of IAS 16 'Property, plant and equipment';
- The following paragraphs of IAS 1, 'Presentation of financial statements':
  - 10(d) (statement of cash flows),
  - 16 (statement of compliance with all IFRS),
  - 38A (requirement for minimum of two primary statements, including cash flow statements),
  - 38B-D (additional comparative information),
  - 111 (cash flow statement information), and
  - 134-136 (capital management disclosures)
- IAS 7, 'Statement of cash flows'
- Paragraph 30 and 31 of IAS 8 'Accounting policies, changes in accounting estimates and errors' (requirement for the disclosure of information when an entity has not applied a new IFRS that has been issued but is not yet effective)
- Paragraph 17 of IAS 24, 'Related party disclosures' (key management compensation)
- The requirements in IAS 24, 'Related party disclosures' to disclose related party transactions entered into between two or more members of a group.

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 parent company financial statements are set out below.

Taxation

The Company has recognised deferred tax assets of £63m (FY2017: £55m) relating to revenue losses brought forward. The recognition of these assets is dependent on the ability to recover them against the unwind of other tax positions and forecast UK taxable profits of the tax group. The treatment of these assets is reviewed regularly. Further detail on the Company's deferred taxation position is included in note 5.

Retirement benefits

The 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 Company 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 8 to the consolidated accounts.

At 31 July 2018 there is a retirement benefit asset of £525m (FY2017: £390m) 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.

Investment carrying value

Investments in subsidiary undertakings and loans due from subsidiaries are reviewed regularly, and tested if there are any indications of impairment, or problems with recoverability. The recoverable amounts of investments are determined based on valuations of the underlying trading operations. The recoverability of loans is assessed by looking at the credit quality of the subsidiary and any support available to the subsidiary. These calculations require the use of estimates including projected future cash-flows and other future events.

Foreign currencies

Foreign currency transactions are recorded at the exchange rate ruling on the date of transaction. Foreign exchange gains and losses resulting from the settlement of such transactions, and from the retranslation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies, are recognised in the profit and loss account.

Operating leases

Payments made under operating leases are charged to the profit and loss account as incurred over the term of the lease.

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

Property, plant and equipment

Depreciation is provided at rates estimated to write off the relevant assets by equal annual amounts over their expected useful lives. In general, the rates used are: Freehold and long leasehold property – 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%.

Investments in shares in Group companies

The Company's investments in shares in Group companies are stated at cost less provision for impairment. Any impairment is charged to the profit and loss account as it arises.

Financial instruments

The policies disclosed in the Group accounting policies on pages 129 to 133 for recognition, measurement and presentation of financial instruments are applied in the Company accounts.

Taxation

Deferred tax is provided 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.

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

Provisions

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

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

Post-retirement benefits

The Company has both defined benefit and defined contribution plans.

For defined benefit plans the liability for each scheme recognised in the balance sheet is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of AA corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised in full when they occur and presented in the statement of other comprehensive income.

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

The Company also has post-retirement healthcare schemes that are accounted for on a similar basis to the defined benefit plans.

Share-based payment

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

The fair value of the shares or share options granted is recognised over the vesting period to reflect the value of the employee services received. The charge relating to grants to employees of the Company is recognised as an expense in the profit and loss account and the charge for grants to employees of other group companies is recognised as an investment in the relevant subsidiary.

The fair value of options granted, excluding the impact of any non-market vesting conditions, is calculated using established option pricing models, principally binomial models. The probability of meeting non-market vesting conditions, which include profitability targets, is used to estimate the number of share options that are likely to vest.

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

Dividends

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

NOTES TO THE COMPANY ACCOUNTS

1 AUDIT FEE

The audit fee for the Parent Company was £0.1m (FY2017: £0.1m).

2 TANGIBLE ASSETS

	Plant and equipment £m
Cost or valuation	
At 31 July 2017 and 31 July 2018	**3**
Depreciation	
At 31 July 2017 and 31 July 2018	**2**
Net book value at 31 July 2018	**1**
Net book value at 31 July 2017	1

Plant and equipment comprises plant, machinery, fixtures, fittings, tools and equipment, including computer hardware.

3 INVESTMENTS AND ADVANCES

	Shares in subsidiary undertakings £m	Loans due from subsidiaries £m	Total £m
Cost or valuation			
At 31 July 2017	2,404	1,180	3,584
Exchange adjustments		(2)	(2)
Contribution through share options	10		10
Decrease in advances due from subsidiaries		(334)	(334)
At 31 July 2018	**2,414**	**844**	**3,258**
Provision for impairment			
At 31 July 2017 and 31 July 2018	**10**	**1**	**11**
Net book value at 31 July 2018	**2,404**	**843**	**3,247**
Net book value at 31 July 2017	2,394	1,179	3,573

Loans due to subsidiaries are offset against loans due from subsidiaries to the extent that there is a legal right of set off and an intention to settle the balances net. At 31 July 2018 £2,323m of loans payable are offset against loans receivable (FY2017: £2,088m). The Company has large offsetting loan balances because it uses loans to reduce its foreign currency exposures and separately monitor net cash generated from trading activities.

The Company's subsidiaries are largely held according to business lines by the following holding companies, which are incorporated in England:

Smiths Group International Holdings Limited
Smiths Detection Group Limited
John Crane Group Limited
Smiths Medical Group Limited
Smiths Interconnect Group Limited

The principal subsidiaries and their countries of incorporation are:

England

Smiths Detection – Watford Ltd
Smiths Medical International Limited
John Crane UK Limited

United States

Smiths Detection, Inc.
Smiths Medical ASD, Inc.
John Crane, Inc.
Titeflex Corporation
Flexible Technologies, Inc.
Tutco, LLC.
Smiths Interconnect Americas, Inc.

Europe

Smiths Heimann SAS (France)
Smiths Heimann GmbH (Germany)
Smiths Medical France SAS (France)
Smiths Medical Deutschland GmbH (Germany)
John Crane Italia SpA (Italy)

Other

Smiths Detection (Asia-Pacific) Pte Ltd (Singapore)
Smiths Medical Japan Limited (Japan)
John Crane Middle East FZE (UAE)

Of the companies above, Smiths Group International Holdings Limited is 100% owned directly by the Company. The others are 100% owned through intermediate holding companies. Shareholdings are of ordinary shares or common stock. All of the above subsidiaries operate in their country of incorporation.

See pages 190 to 198 for a complete list of subsidiary undertakings.

4 FINANCIAL ASSETS

At 31 July 2018 £6m (FY2017: £7m) was held on deposit with banks as security for liabilities or letters of credit.

5 DEFERRED TAX ASSETS AND LIABILITIES

The Company has recognised the following deferred tax assets and liabilities:

	Share-based payment £m	Retirement benefit obligations £m	Losses carried forward £m	Other £m	Total £m
At 31 July 2017	4	(43)	55	1	17
(Charge)/credit to income statement	(1)	(15)	8		(8)
Charge to equity		(17)			(17)
At 31 July 2018	**3**	**(75)**	**63**	**1**	**(8)**

The Company is part of a UK tax group including all its UK-based subsidiaries. The Company has recognised deferred tax assets of £63m (FY2017: £55m) relating to revenue losses brought forward. The recognition of these assets is dependent on the ability to recover them against the unwind of other tax positions and forecast UK taxable profits of the tax group. The timing of the unwind of other tax positions depends on the impact of pension contributions on the UK tax base. The treatment of these assets is reviewed regularly.

6 DEBTORS

	31 July 2018 £m	31 July 2017 £m
Amounts falling due after one year		
Other receivables	1	
Amounts falling due within one year		
Amounts owed by subsidiaries	56	59
Other receivables	7	10
Debtors falling due within one year	**63**	**69**

7 CREDITORS

	31 July 2018 £m	31 July 2017 £m
Amounts falling due within one year		
Term loans due within one year (note 8)	190	133
Amounts owed to subsidiaries	113	231
Other creditors	18	30
Accruals and deferred income	10	17
	331	**411**

8 BORROWINGS AND NET DEBT

	31 July 2018 £m	31 July 2017 £m
Cash at bank	12	8
Short-term deposits	335	460
Cash and cash equivalents	**347**	**468**
Term loans due within one year (note 7)	(190)	(133)
Term loans due after more than one year	(1,405)	(1,597)
Borrowings	**(1,595)**	**(1,730)**
Net debt	**(1,248)**	**(1,262)**

Term loans

The currency and coupons for the term loans are disclosed in note 17 of the Group accounts.

	31 July 2018 £m	31 July 2017 £m
Less than one year	190	133
Between one and two years		189
Between two and three years		
Between three and four years		
Between four and five years	831	
Greater than five years	574	1,408
Smiths Group plc term loans	**1,595**	**1,730**

See the liquidity risk disclosures in note 18 in the Group accounts for information on the cash and borrowing facilities available to the Group. The Company can borrow an additional $800m under the US$800m multi-currency revolving credit facility, which matures in February 2021.

NOTES TO THE COMPANY ACCOUNTS CONTINUED

9 DERIVATIVES

The tables below set out the nominal amount and fair value of derivative contracts held by the Company:

	At 31 July 2018			
		Fair value		
	Contract or underlying nominal amount £m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (not hedge accounted)	179	2		2
Currency swaps (net investment hedges)	110			
Cross currency swaps (fair value and net investment hedges)	570	49		49
Interest rate swaps (fair value hedges)	114		(6)	(6)
Total financial derivatives	**973**	**51**	**(6)**	**45**
Balance sheet entries				
Non-current		49	(6)	43
Current		2		2
Total financial derivatives		**51**	**(6)**	**45**

	At 31 July 2017			
		Fair value		
	Contract or underlying nominal amount £m	Assets £m	Liabilities £m	Net £m
Foreign exchange contracts (not hedge accounted)	165	1	(1)	
Currency swaps (net investment hedges)	109			
Cross currency swaps (fair value and net investment hedges)	569	56		56
Interest rate swaps (fair value hedges)	113		(1)	(1)
Total financial derivatives	**956**	**57**	**(2)**	**55**
Balance sheet entries				
Non-current		56	(1)	55
Current		1	(1)	
Total financial derivatives		**57**	**(2)**	**55**

10 PROVISIONS FOR LIABILITIES AND CHARGES

	At 31 July 2017 £m	Charged against profit £m	Utilisation £m	At 31 July 2018 £m
Disposals	2			2
	2			**2**

The closing disposal provision relates to warranties and other obligations in respect of a past disposal and is expected to be utilised within the next five years.

11 POST-RETIREMENT BENEFITS

The Company is the principal employer for the two major defined benefit plans in the UK. The Company is accounting for all the UK defined benefit schemes (funded and unfunded) and virtually all of the post-retirement healthcare schemes.

The retirement benefit assets and liabilities comprise:

	31 July 2018 £m	31 July 2017 £m
Market value of scheme assets	3,867	3,959
Present value of funded scheme liabilities	(3,342)	(3,571)
Surplus	525	388
Unfunded pension plans	(53)	(55)
Post-retirement healthcare	(5)	(5)
Present value of unfunded obligations	(58)	(60)
Net pension asset	**467**	**328**
Retirement benefit assets	526	390
Retirement benefit liabilities	(59)	(62)
Net pension asset	**467**	**328**

See the disclosures for UK schemes in note 8 to the consolidated accounts for the circumstances of the major schemes, risk management, principal assumptions, assets and liabilities and the funding position of the two major schemes.

12 SHARE CAPITAL AND RESERVES

Share capital

	Number of shares	Issued capital £m	Consideration £m
Ordinary shares of 37.5p each			
At 31 July 2017	395,476,662	148	
Exercise of share options	284,565		3
Total share capital at 31 July 2018	**395,761,227**	**148**	

At 31 July 2018, all of the issued share capital was in free issue. All issued shares are fully paid.

See note 9 to the consolidated accounts for information about share schemes, including total shares under options and options exercisable at the balance sheet date.

During the year, the Company received £3m (FY2017: £3m) on the issue of shares in respect of the exercise of options awarded under various share option schemes.

Smiths Industries Employee Benefit Trust

The retained earnings include the purchase of Smiths Group plc shares by the Smiths Industries Employee Benefit Trust, and the issue of these shares upon the exercise of share options. The consideration paid was £15m (FY2017: £10m) and £nil (FY2017: £nil) was received as a result of the issue of shares. At 31 July 2018 the Trust held 766 (FY2017: 766) ordinary shares.

Distributable profits

The Company's profit and loss reserve of £1,738m (FY2017: £1,818m) includes £838m (FY2017: £924m) of distributable profits. See note 25 in the Group accounts for a discussion of capital management and the factors the Board consider when proposing dividends.

Other reserves

Other reserves arose from the cancellation of the share premium arising from an equity-funded acquisition in the year ended 30 July 1988.

13 CONTINGENT LIABILITIES

The Company has provided guarantees and arranged letter of credit facilities to support the Group's pension plans. The current amount outstanding under letters of credit is £54m (FY2017: £54m).

The Company has guaranteed the US$800m revolving credit facility available to a subsidiary.

14 POST BALANCE SHEET EVENT

The directors propose a final dividend of 30.75p per share (totalling approximately £122m) for the year ended 31 July 2018. The dividend will be submitted for formal approval at the Annual General Meeting to be held on 14 November 2018.

These financial statements do not reflect this dividend payable, which will be accounted for in shareholders' equity as an appropriation of retained earnings in the year ending 31 July 2019. During the year ended 31 July 2018, a final dividend of 29.7p per share (totalling £117m) was paid in respect of the dividends declared for the year ended 31 July 2017.

SUBSIDIARY UNDERTAKINGS

A full list of the Group's related undertakings as at 31 July 2018 is provided below. The entities are grouped by the country in which they are incorporated and details of their registered office address, classes(es) of shares and ownership is disclosed. Related undertakings includes subsidiaries, associated undertakings, joint ventures and associates.

Name	Security	Direct (%)	Total (%)
UNITED KINGDOM			
1 Sheldon Square, Paddington, London, W2 6TT			
Smiths Detection Group Limited	Ordinary £1		100
Smiths Detection Investments Limited	Ordinary £1		100
Smiths Detection Limited	Ordinary £1	100	100
Smiths Detection United Kingdom Limited	Ordinary £1		100
Smiths Group Finance EU Limited	Ordinary €1		100
Smiths Group Finance US Limited	Ordinary US$1		100
Smiths Heimann Limited	Ordinary £1	100	100
3 Melville Street, Edinburgh, EH3 7PE			
George Maclellan Holdings Limited	Ordinary 5p; Def Ordinary 25p	100	100
11-12 St James's Square, London, SW1Y 4LB			
Air Log Limited	Ordinary 1p		100
EIS Group Plc	Ordinary 25p	100	100
Flagtown Limited	Ordinary £1	100	100
Flightspares Limited	Ordinary £1; Ordinary 10p	100	100
Francis Shaw And Company (Manchester) Limited	Ordinary £1		100
Francis Shaw P L C	37% 2nd Pref Ordinary 10p; 5.25% Cum Pref £1; Dif 20p; Ordinary 10p		100
Gastite Systems Limited	Ordinary £1		100
Graseby Limited	Ordinary 25p	100	100
Kontak Manufacturing Company Limited	Ordinary £1		100
Pyzotec Limited	Ordinary £1	75	75
Roof Units (Group) Limited	Ordinary 10p	100	100
Sedding (No.3) Limited	Ordinary £1		100
S.I. Pension Trustees Limited	Ordinary £1	100	100
SI Properties Limited	Ordinary 25p	100	100
SITI 1 Limited	Common US$1		100
Smiths Aerospace Components-Burnley Limited	Ordinary £1		100
Smiths Aerospace Components Tyseley Limited	Ordinary £1	100	100
Smiths Aerospace Gloucester Limited	Ordinary 25p; Ordinary A 25p		100
Smiths Finance Limited	Ordinary £1; Red US$1		100
Smiths Group Innovation Limited	Ordinary £1		100
Smiths Group International Holdings Limited	Ordinary £1	100	100
Smiths Healthcare Limited	Ordinary 1p; Def 10p	100	100
Smiths Industries Limited	7% Non Cum Pref; Ordinary £1	100	100
Smiths Medical Distribution Limited	Ordinary £1	100	100
Smiths Medical Limited	Ordinary £1		99
Smiths Nominees Limited	Ordinary £1	100	100
Smiths Wolverhampton Limited	Ordinary 25p		100
TI Group Limited	Ordinary 25p	100	100
TI Guarantee Company Limited	Limited By Guarantee		100
TI Interest Limited	Ordinary A £1; Ordinary B £1; Floating Rate Cum Red Pref C £1		100
Tigrup No. 7 Limited	Ordinary £1	100	100
Tigrup No. 14 Limited	Ordinary 20p		100
XD Communications Limited	Ordinary £1		100
XDG Limited	Ordinary 50p	100	100
29 Dunsinane Avenue, Dundee, DD2 3QF			
Flexible Ducting Limited	Ordinary £1		100
Trak Microwave Limited	Ordinary £1		100
52 Grayshill Road, Westfield Industrial Area, Cumbernauld, G68 9HG			
Ashfield Medical Systems Limited	Ordinary £1		100
54 Hagley Road, Edgbaston, Birmingham, B16 8PE			
CVE Trustee Limited	Ordinary £1	100	100
Smiths Pensions Limited	Ordinary £1	99	100

Name	Security	Direct (%)	Total (%)
1500 Eureka Park, Lower Pemberton, Ashford, Kent, TN25 4BF			
Graseby Medical Limited	Ordinary £1		100
Medex Medical Limited	Ordinary £1		100
Pneupac Limited	Ordinary 50p		100
SI Overseas Holdings Limited	Ordinary £1		100
Smiths Medical Group Limited	Ordinary A £1; Ordinary B £1; Ordinary C £1		100
Smiths Medical International Limited	Ordinary £1; Pref €2		100
Smiths Medical UK	Ordinary US$1		100
Buckingham House, 361-366 Buckingham Avenue, Slough, Berkshire, SL1 4LU			
Flexibox International Limited	Ordinary £1		100
Flexibox Limited	Ordinary £1		100
Global TI Limited	Ordinary £1		100
John Crane Group Limited	Ordinary £1		100
John Crane Investments Limited	Ordinary £1		100
John Crane UK Limited	Ordinary £1		100
OIE Services Limited	Ordinary £1		100
Project Sugar Limited	Ordinary £1		100
Building 7, Croxley Business Park, Hatters Lane, Watford, WD18 8PA			
Smiths Business Information Services Limited	Ordinary £10		100
Centurion Court, North Esplanade, West Aberdeen, AB11 5QH			
XPD8 Solutions Limited	Ordinary £1		100
Century House, Maylands Avenue, Hemel Hempstead, Hertfordshire, HP2 7DE			
Smiths Detection-Watford Limited	Ordinary £1		100
KPMG LLP, 8 Salisbury Square, London, EC4Y 8BB			
Lighthome Limited (in liquidation)	Ordinary £1	99	100
Unit 130 Centennial Park, Elstree, Hertfordshire, WD6 3TJ			
Hypertac Limited	Ordinary £1		100
Smiths Industries Industrial Group Limited	Ordinary £1		100
Smiths Interconnect Connectors UK	Ordinary £1		100
Smiths Interconnect Group Limited	Ordinary £1		100
ANGOLA			
Rue Kwamme Nkrumah, Torres Impor-Africa, 3 Andar, Apt A, Luanda			
John Crane (Angola) Prestacao De Services Ltd	Ordinary AOA 1		100
ARGENTINA			
Av. Leandro N. Alem 1110, 13 Floor, Baker Mackenzie Office, Buenos Aires			
John Crane Argentina SA	Common $1 ARS		100
TI Group Automotive Systems (Argentina) SA	Ordinary $1 ARS		100
AUSTRALIA			
549 – 551, Somerville Road, Sunshine, Melbourne, VIC 3020			
Flexibox Pty Limited	Ordinary AUS$		100
John Crane Australia Pty Limited	Ordinary AUS$1		100
Botany Grove Estate Unit 5, 14A Baker Street, Botany, NSW 2019			
Smiths Detection (Australia) Pty Ltd	Ordinary AUD$ 1		100
Suite 2.03, 97 Waterloo Road, Macquarie Park, NSW 2113			
Smiths Medical Australasia Pty Ltd	Ordinary		100
AUSTRIA			
Campus 21, Europaring, A 03 5 02, Brunn Am Gebirge, A-2345			
Smiths Medical Osterreich GmbH	Ordinary €1		100
AZERBAIJAN REPUBLIC			
House No 20, Ismayilbey Qutqasinli Street, Baku AZ, 1006			
John Crane Baku LLC	Ordinary US$10		100
BELGIUM			
Pegasuslaan 5, Diegem, 1831			
Smiths Medical Belgium NV	Registered Shares		100
Square De Meeus 18, Brussels, 1050			
John Crane Belgium NV	Ordinary		100

SUBSIDIARY UNDERTAKINGS CONTINUED

Name	Security	Direct (%)	Total (%)
BRAZIL			
Rua George OHM, 205-5 Andar-Conj. 51 E 52 Torre B, Cidade Moncoes – CEP 04576-020, Sao Paulo			
Smiths Medical Do Brasil Produtos Hospitalares LTDA	Ordinary R$1		100
FCR Law, Rua do Rocio, 350-10. Andar, Condominio Edificio Atrium IX, Vila Olimpia, CEP 04552-000, Sao Paulo			
Smiths Detection Brasil Comérico De Equipamentos LTDA	Common R$1		100
Industrial District of The City of Rio Claro, State of Sao Paulo, AV. Brasil Number 4.700, CEP 13505-600			
Smiths Brasil LTDA	Ordinary R$1		100
CANADA			
301, Gough Road, Markham, Ontario, L3R 4Y8			
Smiths Medical Canada Ltd	Common		100
423, Green North Road, Stoney Creek, Ontario, L8E 3A1			
John Crane Canada Inc	Common CAD$1		100
3700, Stock Exchange Tower, P.O. Box 242, 800 Place Victoria, Montreal, PQ, H4Z 1E9			
Smiths Detection Montreal Inc.	Class A Shares; Class B Shares		100
4610, Eastgate Parkway, Unit 3, Mississauga, Ontario, L4W 3W6			
Flexible Technologies (Canada) Inc.	Ordinary $1		100
Suite 3002, 6865 Century Ave, Mississauga, Ontario, L5N 7K2			
Smiths Detection – Toronto Ltd.	Common Shares; Preference Shares		100
CHILE			
Americo Vespucio 2542, Complejo Empresarial El Cortijo, Conchali, Santiago			
John Crane Chile SA	Ordinary 1 Peso		100
CHINA			
No. 7, Factory Building, Maqiao Industrial Square, Changshu Economic Development Zone, Changshu, Jiangsu			
Changshu Flex-Tek Thermal Fluid Systems Manufacturer Co. Ltd	US$520,800 (Registered Capital)		100
No.9, No. 1, Haitai Huake Road, Huayuan Industrial District (Outside The Ring), Binhai Hi-Tech, Industrial Park, Tianjin			
John Crane Technology (Tianjin) Co Limited	Ordinary US$1		100
No. 14 Unit, No. 78, XingLin Road, Suzhou Industrial Park, Suzhou 215026			
Antares Advanced Test Technologies (Suzhou) Co. Ltd	Ordinary $1		100
No. 26, The 3rd Avenue, Economic & Technological Development Area, Hangzhou			
Smiths Medical Instrument (Zhejiang) Co. Ltd	Ordinary CNY1		100
333 Zhujian Road, Building 10, Eureka Industrial Park, MinHang District, Shanghai, 201107			
Kaelus Interconnect (Shanghai) Co. Ltd.	Ordinary $1		100
Room 923B, No 55, Xili Road, Shanghai, (China) Pilot Free Trade Zone			
SMO Detection Equipment (Shanghai) Co., Ltd	Ordinary US$1		100
Room 1668, No. 14F Floor 3 Datong Building, Huanghe Avenue, Nankai District, Tianjin			
John Crane China Co Limited	Ordinary CNY1		100
Unit 2805-2807, Tower 3, Jing An Kerry Centre, 1228 Middle Yan An Road, Shanghai, 200040			
Smiths Medical (Shanghai) Co., Ltd.	Ordinary US$		100
Unit 3018, South Tower, Beijing Kerry Centre, 1, Guanghua Road, Chaoyang District, Beijing			
Smiths Medical (Beijing) Co. Ltd	Ordinary US$1		100
COLOMBIA			
Calle 46A No 82-54 Int 14, Parque Empresarial San Cayetano, Bogota			
John Crane Colombia SA	Ordinary COP $1		100
COSTA RICA			
33rd St. Number 777 Barrio Francisco Peralta, Central Avenue & 8th, San Jose			
Smiths Interconnect Sociedad Anonima	Ordinary US$1		100

Name	Security	Direct (%)	Total (%)
CZECH REPUBLIC			
Jana Sigmunda 78, Lutin, 78349			
John Crane A.S.	Ordinary CZK 1M		100
Olomoucka 306, Hranice I-Mesto, Hranice, 75301			
Smiths Medical Czech Republic A.S	Ordinary CZK 100,000		100
DENMARK			
Orestads Boulevard 73, 2300 Kobenhavn S			
Smiths Medical Danmark ApS	DKK 100 Shares		100
DOMINICAN REPUBLIC			
Calle El Recodo, #2 Bella Vista, Santa Domingo			
John Crane Dominicana SA	Ordinary DP$1		100
EGYPT			
139, Mogamaa El Masanea Street, El Amireya, Cairo			
John Crane Egypt LLC	Ordinary EGP 1		100
John Crane Egypt Sealing Systems LLC	Ordinary EGP 100		99
Nile City Towers, North Tower, 22nd Floor, Ramlet Boulaq, Nile Cournich, Cairo			
Detection Technologies Egypt	Quotas		100
FINLAND			
PO Box 10, Punasillantie 15, Muurame, 40950			
John Crane Safematic Oy	Ordinary €16.82		100
FRANCE			
3/5 Rue Du Pont Des Halles, Batiment A, Rungis, 94150			
Smiths Medical France S.A.S.	€7.7 Shares		100
22, Avenue Maurice Chevalier, 77833 Ozoir-La-Ferriere, Paris			
Titeflex Europe S.A.S.	Ordinary $1		100
31 Rue Isidore Maille, Saint-Aubin-Les-Elbeuf, 76410			
Hypertac S.A.	Ordinary €76		100
36 Rue Charles Heller, Vitry Sur Seine, F-94400			
Smiths Heimann S.A.S.	€1 Shares		100
114, Rue Jules Ferry, B.p.35, Deville-Les-Rouen, 76250			
John Crane France S.A.S.	Ordinary €286		100
T I S A (France)	Ordinary €4.9		100
GERMANY			
Am Zirkus 2, Berlin, 10117			
Heptus 288. GmbH	Ordinary €1		100
Bretonischer Ring 3, Grasbrunn, 85630			
Smiths Group Deutschland GmbH	€1,491,400 Shares; €3,478,400 Shares; €995,500 Shares		100
Smiths Medical Deutschland GmbH	€1,000 Shares; €27,000 Shares; €5,000 Shares; €500 Shares		100
Heselstucken 3, Hamburg, 22453			
Smiths Detection Germany GmbH	Ordinary €25,000		100
Im Herzen 4, Wiesbaden, 65205			
Smiths Detection GmbH	€ 25,000 Share; €183,100 Share; €791,900 Share		100
Smiths Heimann GmbH	Ordinary		100
Neckarweg 3, Vellmar, 34246			
Herkules Holding GmbH	Ordinary €1		100
Seebach GmbH	Ordinary €1		100
Reepschlager Str., 10B, Lubeck, 23556			
Flexschlauch Producktions GmbH	Ordinary €1		100
Tolzer Strasse, 15 82031, Grunwald			
Zamor KG	Ordinary shares €1		49
Ulrichsberger Strasse 17, Deggendorf, 94469			
Hypertac GmbH	Ordinary €1		100
Werner–Von–Siemens – Str.6, Fulda, 36041			
John Crane GmbH	Ordinary €1		100

SUBSIDIARY UNDERTAKINGS CONTINUED

Name	Security	Direct (%)	Total (%)
GREECE			
3 Stratigou Tobre Street, Municipality Of Agia Paraskevi, Athens, 153 42			
John Crane Hellas – Engineered Sealing Systems Monoprosopi EPE	Ordinary €1		100
GUERNSEY			
Level 5, Mill Court, La Charroterie, St Peter Port, GY1 1EJ			
Smiths Group Insurance Limited	Ordinary £1		100
HONG KONG			
Suite 1106-8, 11/F Tai Yau Building, No 181 Johnston Road, Wanchai			
Smiths Detection Hong Kong Limited	Ordinary 1 HKD		100
Smiths Interconnect Group (HK) Limited	Ordinary US$1		100
Smiths Interconnect Hong Kong Co Limited	Ordinary US$1		100
Smiths Medical (Hong Kong) Limited	Ordinary 1 HKD		100
HUNGARY			
2040 Budaors, Gyar U. 2			
John Crane Hungary Kft	Ordinary €1		100
INDIA			
508/509, 5th Floor, Western Edge Ii, Western Express Highway, Borivali East, Mumbai, 400066			
Smiths Medical India Private Limited	Ordinary INR 1		100
D-196 Okhla Industrial Area, Phase-1, New Dehli, 110020			
Plenty India Limited	Ordinary Shares		100
No 10 B, 1st Phase, Peenya Industrial Area, Bangalore, 560058			
John Crane Flexibox India Private Limited	Ordinary INR 10		100
No 11, 1st Phase, Peenya, Industrial Area, Bangalore, 560058			
John Crane Sealing Systems India Private Limited	Ordinary INR 10		100
No 38, Kiadb Industrial Area, Bangalor, 561203			
STS Titeflex India Pvt Ltd	Ordinary INR 100		100
Shirwal, Maharashtra 412891			
Seebach Filter Solutions India Pvt Ltd	Ordinary INR 10		90
Vardhman Crown Mall, Unit No. 300 3rd Floor, Sector 19 Dwarka, New Delhi 110075			
Smiths Detection Veecon Systems Private Limited	Class A Equity Shares INR 10; Class B Equity Shares INR 10		100
INDONESIA			
Cilandak Commercial Estate Bldg 401A, Ji. Kko Cilandak, Jakarta, 12560			
PT John Crane Indonesia	Ordinary IDR 1,000		99
IRELAND			
Suite 3, One Earlsfort Centre, Earlsfort Terrace, Dublin 2			
Graseby Medical Ireland Limited	Ordinary €1.269738		100
Smiths Detection Ireland Limited	Ordinary €1.25; Ordinary B €1.269738; Ordinary D €1.25; Series C €1.25		100
T53/54, Shannon Industrial Estate, Shannon, Co. Clare			
John Crane (Ireland) Limited	Ordinary €1		100
ITALY			
Via Da Bissone 7A, Genova, 16153			
Hypertac SpA	Ordinary €5		100
Via Della Stazione, 2, 04013 Latina Scalo, Latina			
Smiths Medical Italia srl	Ordinary €1		100
Via Giotto 3, Muggio, 20835			
John Crane Italia SpA	Ordinary €5.16		100
Smiths Detection Italia srl	Quota Value of Shares		100
Smiths Group Italia Srl	Ordinary €1		100
JAPAN			
7-1-1, Akasaka, Minato-Ku, Tokyo			
Smiths Medical Japan Ltd	Common Stock		100
2222, Kamitoyama Ritto City, Ritto-Shi, Shiga-Ken			
John Crane Japan Inc	Ordinary JYP 1,000		70
2504, Kioicho Garden Tower, 3-10 Kioicho, Chiyoda-Ku, Tokyo			
Smiths Detection Japan Gk	Cash Contribution		100

Name	Security	Direct (%)	Total (%)
KAZAKHSTAN			
Atyrau Region, Gatyrau, Station K Arabathan, House Production Site 14, 060000			
John Crane Kazakhstan	Ordinary KZT		100
KOREA, REPUBLIC OF			
Migeundong, Westgatetower 15F, 70 Chungjeong-Ro, Seodaemun-Gu, Seoul			
John Crane Korea Co Ltd	Ordinary Kwon 5,000		100
MALAYSIA			
207, Jalan Tun Razak, Suite 13.03, 13th Floor, Menara Tan & Tan, Kuala Lumpur, 50400			
John Crane Malaysia Sdn Bhd	Ordinary MYR1		100
Level 21, Suite 21.01, The Gardens South Tower, Mid Valley Centre, Lingkaran Syed Putra, 59200, Kuala Lumpur			
Flexible Ducting Malaysia Sdn Bhd	Ordinary $1		100
Suite 13.03, 13th Floor, Menara Tan & Tan, 207 Jalan Tun Razak, 50400, Kuala Lumpur			
Smiths Detection Malaysia Sdn Bhd	MYR1 Share		100
MEXICO			
679, Poniente 152, Vallejo Delegacion Azcapotzalco, Mexico City, 2300			
Industrias John Crane Mexico S.A. de C.V.	Series A MXN 1; Series B MXN 1		100
Av. Primero De Mayo Lote 3 Edificio 1B, Prologis Park, Reynosa, 88780			
Tutco De Mexico S de RL de CV	Ordinary $1.00		100
Ave Calidad No. 4, Parque Industrial, Internacional Tijuana, Tijuana, B.C., 22425			
Smiths Healthcare Manufacturing, S.A. de C.V.	Series B 10 Pesos; Series B-1 Pesos 10		100
Carretera Ciudad Victoria Matamoros, Km.173+600, Solonia San Fernando Centro, Tamaulipas, San Fernando, CP 87600			
John Crane Sociedad De Responsibilidad Limitada De Capital Variable	Ordinary MXN $1		100
Paseo De La Reforma 505, Col, Cuauhtemoc, 6500, Ciudad De Mexico			
Smiths Detection Mexico S. de Rl de C.v.	PS US$1; PS US$2,999		100
NETHERLANDS			
Bergen 9 – 17, Barendrecht, Zuid, 2993LR			
John Crane Holland BV	Ordinary €1		100
Smiths Detection Netherlands BV	Ordinary €1		100
Buckingham House, 361-366 Buckingham Avenue, Slough, Berkshire, SL1 4LU, England			
Smiths Group Holdings Netherlands BV	Ordinary €1		100
Hydrograaf 25, PO Box 442, 6900 Ak Zevenaar, Duiven, 6921 RS			
Indufil BV	Ordinary €1		100
Jagersbosstraat 28, 5241JT Rosmalen			
Smiths Medical Nederland B.V.	Shares NLG 100		100
Simon Stevinweg 27, Arnhem, 6827 BS			
Seebach Nederland BV	Ordinary €0.01		100
NEW ZEALAND			
Quigg Partners, Level 7, 36 Brandon Street, Wellington, 6011			
Smiths Detection New Zealand Limited	Ordinary		100
PERU			
Av. Guillermo Dansey 2124, Urbanizacion Industrial Conde, Lima			
John Crane Peru SAC	Common Shares PEN 1		100
POLAND			
Warszawska 153, Bielsko – Biala, 43 – 300			
John Crane Poland Sp Z O.O.	Ordinary 50 PLN		100
PORTUGAL			
Avenida Engenheiro Duarte Pacheco, Amoreiras, Torre 2, 15º A, Campo De Ourique, Lisboa, 1070-102			
Smiths Medical (Portugal), Unipessoal Lda	€505,000 Share		100
PUERTO RICO			
654 Plaza, Suite #933, 654 Munoz Rivera Ave, San Juan			
John Crane Caribe Ltd	Common Share US$1		100

SUBSIDIARY UNDERTAKINGS CONTINUED

Name	Security	Direct (%)	Total (%)
RUSSIAN FEDERATION			
104 Oktyabrskayanab., Building 25, Litera AJ, Premises 4-H, Saint-Petersburg, 193079			
Smiths Heimann Rus LLC	Ordinary RUB 1		100
B.savvinsky Per, D.11, Moscow, 119435			
LLC John Crane Rus	Ordinary RUR 1		100
SAUDI ARABIA			
Dammam Industrial City, Dammam, 3243			
John Crane Saudi Arabia Ltd	Ordinary ZAR 1		100
PO Box 59490 Postal Code 11525, Riyadh			
Smiths Detection Saudi Arabia Ltd	1,000 Saudi Riyals Shares		100
SINGAPORE			
80 Raffles Place, Uob Plaza 1, #32-01, 048624			
John Crane Singapore Pte Limited	Ordinary S$1		100
Smiths Medical Singapore Pte. Limited	Ordinary US$1		100
100 Beach Road #15-09 Shaw Towers, 189702			
Smiths Connectors Asia Pte. Ltd.	Ordinary S$1		100
100 Beach Road #20-06 Shaw Towers, 189702			
Smiths Detection (Asia Pacific) Pte. Ltd	Ordinary S$1		100
SLOVAKIA			
Dvorakovo nabrezie 10, Bratislava-mestska cast Stare Mesto, 811 02			
John Crane Slovakia SRO	Ordinary €1		100
SOUTH AFRICA			
2, Jansen Road, Nuffield Industrial Sites, Springs Gauteng, 1559			
Flexibox (Pty) Limited	Ordinary SAR 1		100
John Crane Pty Ltd	Ordinary ZAR 1		100
3rd Floor, 54 Melrose Boulevard, Melrose Arch, 2196			
Smiths Medical (South Africa) (Pty) Ltd	R1 Shares		100
SPAIN			
Av Diagonal, Num.635 P.1, Barcelona, 08028,			
Smiths Medical Espana S.L.	Shares €1		100
Cemento 1, Torrejon De Ardoz, Madrid			
John Crane Iberica SA	Ordinary €6.010121		100
SWEDEN			
Box 1143, 164 22 Kista			
Smiths Medical Sverige AB	SEK100 Shares		100
Faltspatsgatan 4, Se-421 30 Vastra Frolunda			
John Crane Sverige AB	Ordinary SEK 100		100
SWITZERLAND			
Freulerstrasse 4, Birsfelden, 4127			
John Crane (Switzerland) AG	Ordinary 1 CHF		100
Zurichstrasse 33, Adliswil, 8134			
Smiths Medical Schweiz AG	Shares of CHF 10.00		100
TAIWAN			
324-4, Fong-Jen Road, Renwu District, Kaohsiung City 814			
John Crane Taiwan Co Ltd.	Ordinary T$1		100
THAILAND			
9/311, 31st Floor, Um Tower, Ramkhamhaeng Road, Suanluang District, Bangkok			
John Crane (Thailand) Limited	Ordinary THB 1; Pref THB 25		100
99/3 Moo 5, Kingkaew Road, Tambol Rajatheva, Amphoe Bangplee, Samutprakarn Province, 10540			
Smiths Detection (Thailand) Limited	Pref THB 100; Ordinary THB 100		100
TUNISIA			
Zone Industrielle Route De Khniss, Monastir, 5000			
Smiths Connectors Tunisia SARL	Ordinary 100 DT		100

Name	Security	Direct (%)	Total (%)
TURKEY			
Istanbul Sariyer, Huzur Mahallesi, Ahmet Bayman Caddessi, Dis, Reklamcilik Apt No:17-19/1			
John Crane Endustriyel Sizdirmazlik Sistemleri Ltd	Ordinary TRY 25		100
UNITED ARAB EMIRATES			
Building B07, Industrial Mussaffah, M44, Sector 15, Abu Dhabi			
Smiths Detection Security Systems LLC	AED 1,500		49
Dubai Airport Free Zone, PO Box 48225, Dubai			
Smiths Detection Middle East FZE	AED 1,000,000 Share		100
S20113, Jebel Ali Free Zone, 61040			
John Crane Middle East FZE	Ordinary AED 1		100
UNITED STATES			
116, Pine Street, 3rd Floor, Suite 320, Harrisburg, PA 17101			
Tutco, LLC	Ordinary US$1		100
208 S. Lasalle Street, Suite 814, Chicago, IL, 60604			
John Crane International Inc.	Common Shares		100
330, Corporate Woods Parkway, Vernon Hills, IL, 60061			
Medex Cardio-Pulmonary, Inc	Common Stock of US$0.01		100
1219 Stewart Plaza, Dunbar, WV, 25064			
Seebach Filtration USA, Inc.	Ordinary US$25		100
Corporation Service Company, 251 Little Falls Drive, Wilmington, DE, 19808			
MDII Investments LLC	Ordinary		100
Smiths Detection US Holdings, LLC	Ordinary US$1		100
Smiths Detection LLC	Equity Interests		100
The Corporation Trust Company, 1209 Orange Street, Wilmington, DE, 19801			
Antares China Holdings, Inc	Common Stock US$0.01		100
Flexible Technologies, Inc	Ordinary Shares US$0.01		100
John Crane Inc	Common US$0.01; Preferred US$0.10		100
John Crane Group, LLC	Ordinary US$0.01		100
John Crane Production Solutions Inc	Ordinary US$0.01		100
Powercam-Houdaille, Inc.	Common Shares US$1		100
Smiths Business Information Services, Inc.	Ordinary US$0.01		100
Smiths Detection International LLC	Equity Interests		100
Smiths Detection US, LLC	Ordinary US$1		100
Smiths Group Services Corp.	Common Stock US$0.01		100
Smiths Interconnect Americas, Inc.	Common Stock US$0.01		100
Smiths Interconnect, Inc.	Common Stock US$0.01		100
Smiths US Innovation LLC	Ordinary		100
Trak Microwave Corporation	Common Stock US$10.00		100
CT Corporation System, 9 Capitol Street, Concord, NH 03301			
Smiths Tubular Systems-Laconia, Inc	Ordinary Shares US$1		100
CT Corporation System, 155 Federal Street, Suite 700, Boston, MA 02110			
Millitech, Inc.	Common Stock		100
Titeflex Commercial, Inc.	Ordinary US$0.01		100
One Corporate Center, Hartord, CT 06103-3220			
Titeflex Corporation	Ordinary US$1		100
Registered Agent Solutions, Inc., 1679 Dupont Highway, Suite 100, Dover DE, 19901			
Smiths Medical ASD Inc.	Common Stock $1		100
The Corporation Trust Company of Nevada, 6100 Neil Road, Suite 150, Reno NV, 89511			
Smiths Detection Inc	Common Stock of $0.0001		100

SUBSIDIARY UNDERTAKINGS CONTINUED

Name	Security	Direct (%)	Total (%)
VENEZUELA			
Carretera Vía A Perijá, Km 8 ½, Avenida 50, Local N° 185-72, Zona Industrial El Silencio, Maracaibo, 4001			
John Crane Venezuela CA	Class A BSF1; Class B BSF1; Common BSF1		100
ASSOCIATES			
GERMANY			
Borsigstrasse, 15 65205 Wiesbaden			
STI Security Training International GmbH	Ordinary Shares		34
RUSSIAN FEDERATION			
28, Academica Vedeneeva Street, Perm, Permskiy Region, 614038			
LLC John Crane Iskra	Ordinary RUB 1		50

Between 1 August and 14 September 2018 the following companies were incorporated:

- Huafeng Smiths Interconnect (Sichuan) Co., Ltd. was incorporated in China on 3 August 2018 as a joint venture between Smiths Group companies and Sichuan Huafeng Enterprise Group Co., Ltd. The effective percentage of equity indirectly owned by Smiths Group plc is 60%.
- Flex-Tek Group (UK) Limited was incorporated in the United Kingdom on 31 August 2018. Smiths Group plc indirectly owns the entire issued share capital and the new company will be consolidated as a subsidiary from the date of incorporation.
- Flex-Tek Group (US) LLC was incorporated in the United States on 31 August 2018. Smiths Group plc indirectly owns the entire issued share capital and the new company will be consolidated as a subsidiary from the date of incorporation.

Overseas branches

The Company does not operate through any branches. Some Group subsidiary companies have established branch operations outside the UK.

SHAREHOLDER INFORMATION

FINANCIAL CALENDAR

	2018	2019 (provisional)
Announcement of FY2018 Results	21 September	
Final dividend ex-dividend date	18 October	
Final dividend record date	19 October	
Annual General Meeting	14 November	
Final dividend payment date	16 November	
Announcement of FY2019 Interim Results		22 March
Interim dividend ex-dividend date		4 April
Interim dividend record date		5 April
Interim dividend payment date		26 April
FY2019 financial year end		31 July
Announcement of FY2019 Results		20 September

The market value of an ordinary share of the Company on 31 March 1982 for the purposes of capital gains tax was 136.875p (taking into account the sub-division of 50p shares into 25p shares on 14 January 1985 and the subdivision and consolidation of 25p shares into 37.5p shares on 18 June 2007).

Registered Office
Smiths Group plc
4th Floor
11-12 St James's Square
London SW1Y 4LB, UK
020 7004 1600
www.smiths.com

Incorporated in England
Company No. 137013

Auditor
PricewaterhouseCoopers LLP

Registrars
Our share register is maintained by Equiniti. If you have any questions about your Smiths shares, please contact Equiniti by:

– Visiting: www.shareview.co.uk.

– Telephoning:
T: 0371 384 2943 (in the UK)
T: +44 (0)121 415 7047 (outside the UK)
Textel: 0870 384 2255
Lines open 8:30am to 5:30pm (UK time), Monday to Friday (excluding public holidays in England and Wales)

– Writing to:
Equiniti Limited
Aspect House
Spencer Road
Lancing
West Sussex BN99 6DA

Equiniti offer the Shareview portfolio service to investors, visit www.shareview.co.uk to register for an account. Through Shareview you can access information about your investments, including balance movements and indicative share prices, as well as practical help about transferring your shares or updating your personal details.

From November 2019 Smiths will no longer be issuing dividend cheques. In order to have future dividends paid directly to your bank or building society account please contact Equiniti for a copy of the Bank Mandate Form or register your nominated bank or building society account by visiting www.shareview.co.uk. By registering your account all future dividends will be paid securely by direct credit on the dividend payment date.

ANNUAL GENERAL MEETING (AGM)

The 2018 Smiths Group plc AGM will be held at 11:00am on Wednesday, 14 November 2018 at Linklaters LLP, One Silk Street, London, EC2Y 8HQ.

The Notice of AGM can be found in a separate document which is sent out at least 20 working days before the AGM and made available on our website.

If you are in any doubt as to what action you should take in relation to the resolutions being proposed at the AGM, you are recommended to consult your stockbroker, bank manager, solicitor, accountant or other independent professional adviser authorised under the Financial Services and Markets Act 2000.

VOTING AT THE AGM

The Company provides electronic proxy voting for the AGM. Shareholders who are unable to attend the AGM in person are encouraged to vote their shares by appointing a proxy and issuing voting instructions. Electronic and paper proxy appointments and voting instructions must be received by the Company's Registrar not later than 48 hours before the AGM is held in order to be valid. Shareholders who are not Crest members can appoint a proxy and vote online by visiting the website www.sharevote.co.uk. Crest members, Crest personal members and other Crest-sponsored members should consult the Crest Manual or their sponsor or voting service provider for instructions on electronic proxy appointment and voting.

NOTES

Designed and Produced by Radley Yeldar.

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ADR: SMGZY

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go to www.smiths.com/investors

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